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### Authors

Ward, David  
Douglass, John Aubrey

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## THE DYNAMICS OF VARIABLE FEES: EXPLORING INSTITUTIONAL AND PUBLIC POLICY RESPONSES

May 2005

**David Ward**

President, American Council on Education

**John Aubrey Douglass**

Senior Research Fellow—Public Policy and Higher Education  
Center for Studies in Higher Education, UC Berkeley

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### ABSTRACT

Variable fees at the graduate and undergraduate levels are a topic of discussion in the US and in the EU as part of a larger movement towards increasing the role of fees in the funding of public universities. This essay describes this relatively new shift and its causes, outlines various funding models related to fee levels, and discusses the possible policy implications of variable fee structures. Here we argue that much of the movement toward increased fees in places such as the US and the UK is being pursued incrementally, without an adequate discussion of the long-term implications either for students or for how universities fund academic programs.

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On both sides of the Atlantic, public higher education faces similar challenges in how to maintain and expand access to high quality tertiary education at an affordable cost to students and their families. These challenges undermine assumptions about the cost of higher education that were based upon conditions prevalent during the generation following the end of the Second World War, when access to higher education could be made available at little or no cost. The costs and implications of mass access to higher education were rarely considered, whereas today the issues of cost, quality, and access drive public policies.

While there is a continued recognition of the need to expand access to higher education as a means to bolster socioeconomic mobility and egalitarian values of democratic nations, and as an essential ingredient for economic competitiveness in the global community, the old paradigm of universal low tuition is a matter of debate for four reasons.

- One: at current tax levels, governments can no longer afford to be the primary or nearly sole source of revenues for public higher education, and market related solutions to funding seem inevitable. These solutions are assumed to create efficiencies and other advantages in more fully integrating higher education institutions (HEIs) into local and national economies.
- Two: fee income will need to be an increasingly large component of the funding of higher education to replace declining government/taxpayer subsidization.
- Three: the expanded responsibility of private/individual funding of public higher education assumes that there are both private and social benefits of higher education.
- And four: more robust need-based financial aid programs and tax policies will mitigate economic barriers to a college or university education and avoid the current benefit transfer from low- to high-income families created by universal low tuition.

For those in public higher education, there is a sense of irony and loss in this contemporary paradigm shift in the funding of universities. It is generally recognized in the halls of government and in rich and poor communities that access to higher education of high quality is an absolutely essential building block for the egalitarian ideals of Western democracies. Access to and the products of HEIs are widely acknowledged as vital to national prosperity. But for the past two decades, institutions once chartered by government and funded and built to serve local and national purposes are now the subject of dis-investment by those same governments.

The era of robust public funding for HEIs, in large part to keep the cost to students extremely low, is over. The causes of this dis-investment include increased competition for tax revenues, rising operating costs, the sheer weight of funding expanding enrollment, and, to some extent, decreased confidence in the contemporary organization and leadership of HEIs. Market incentives are politically attractive simply because they are a means to address these other concerns.

It is difficult determine whether the new paradigm of high fees and high financial aid will permanently replace one of low or no fees, although it seems likely. In the long-term, there is at least the possibility of a return to a political culture that supports large-scale public investment in higher education. There may also be significant differences among nations in the magnitude of their public investments in higher education, and the competitive outcomes could stimulate a reversal of current trends. In the near term (a decade or more), however, there seems little chance of an immediate reversal.

Given these circumstances, we will explore the inevitable and potential roles of fees in funding higher education in the near and long-term from a national or state perspective, as well as from an institutional perspective. One goal is to provide a sense of the current American market and the array of pricing at the institutional level. Another is to discuss a framework for rationalizing the respective roles of fees, government subsidies, and other sources of funding in providing the costs of instruction.

Public higher education is in essence adopting *aspects* of the independent (private) higher education funding model long practiced in the United States—the high fee and high financial aid paradigm. However, it must also adapt this model to reflect the broader responsibilities of public HEIs. Fees are likely to be *moderate rather than high, financial aid will be exclusively need-based*, and it is likely that the growing array of differential fees (between campuses, between professional programs, and between different degrees) will be more restrained than in the independent model.

Comparisons of higher education arrangements in the UK and the EU with those in the US are fraught with difficulties. US higher education comprises fifty different systems in the public sector alone, each with substantial variations. There is also a greater diversity of institutional types and missions. Perhaps most notable is the co-habitation of a robust mix of public *and* independent (private) colleges and universities, as well as large and varied community and vocational college systems funded at the local level.

Independent (private) institutions have striking differences in their geographical representation. In New England and Pennsylvania, they enroll more students than does the public sector, while in the American West (which has the most significant projected increases in population), some 85 to 90 percent of all students are enrolled in public HEIs.

In the US, multi-campus public systems of higher education dominate enrollment and serve as the primary access point for lower-income students. In many states public universities and colleges (four-year and two-year) have been placed under a single governing board to enhance coordination and facilitate transfer. There are often formal matriculation links between institutions, particularly between community colleges and state universities. In California, these agreements have existed since 1910; more commonly, these types of agreements were part of states' efforts to reorganize HE in the post-World War II era.

In contrast, few tertiary institutions within the UK and Europe, whether the university or technical schools and further education, are linked in any coherent way—e.g., in governance or in matriculation agreements. They function largely as independent entities, linked only by shared funding mechanisms and mandates from ministries.

These constitutional and organizational differences will result in different responses to public policies on higher education. Because there is a convergence in overall national goals for higher education, however, some striking similarities are also likely. These similarities are linked to the following issues:

- *Expanding Access*  
In both the US and in the UK, there are similar goals to expand access to “underserved” or, in the American lexicon, “underrepresented” groups. Both terms express the idea that all segments of society should participate in higher education in some general proportion to their numbers in society. In the UK, the focus is largely on economic class and only marginally on race and ethnicity; in the US the focus is largely on race and ethnicity.<sup>1</sup>
- *Continued Reliance on Public Institutions*  
On both sides of the Atlantic, publicly funded and chartered institutions are, and will be for some time, the primary vehicles for expanding access. America has a wide

variety of institutional types, public and private, not-for-profit and for-profit. But the public still account for approximately 76 percent of current enrollments, with 40 percent of students enrolled in a four-year public university.

Independent institutions—for instance Harvard, Stanford, and MIT, but more ubiquitously small colleges with less visibility—enroll approximately 20 percent of all students. While for-profit institutions account for 4 percent of all tertiary enrollment, and they may well expand their market share, the public sector will continue to be the focus of efforts to expand access. To an even greater degree in the UK and continental Europe, the public sector will necessarily be the main locus of new capacity.

In both the UK and in the US, demand for tertiary education will continue to expand. In the UK, growth is a result of rising demand within the population and of government mandates to increase access. In the US, growth is based on these same factors, but in addition demographic factors, fueled by immigration, will create a projected increase in high school graduates of 30 percent by 2010. Moreover, these demographic pressures are concentrated in a few regions, such as California, Texas, Florida, and parts of the East Coast metropolitan corridor; at the same time, other regions, such as the northern Midwest and the Great Plains, will encounter population declines.

- *A New Funding Paradigm*

While being held accountable for expanding access in general, as well as for meeting the special needs of under-represented groups, public institutions have also faced a serious decline in per capita student support and have begun to imagine and to seek funding alternatives. Thus far, one might argue that higher education institutions and their leaders have been relatively cautious in confronting this new reality, for three reasons.

One, government has initiated this paradigm shift, and continues to set the general parameters for such alternative income sources as tuition and fees. In the US, private donations contribute significantly to the capital budget and to specific programs, but frequently these contributions result in a proportionate reduction in state support.

Two, while the public is generally ambivalent about government decreasing its investment in tertiary education, increases in fees have provoked public resentment. There are legitimate and important concerns about how the fees will decrease access for the economically disadvantaged, but most popular concerns seem to be based upon the assumption that low tuition is a general entitlement. Much of the public criticism is directed at the higher education community, with an increasing focus on the need to lower costs and to make the kinds of innovations that have radically altered the cost structures of other services.

And three, any aggressive advocacy for higher fees may, in turn, further erode government's commitment to subsidize higher education. It is hard to imagine how an alternative system would work, and if it could ever be preferable to the model of high state subsidization that gave rise to mass higher education. There will need to be a more careful and specific discussion of the appropriate relative contributions to the cost of higher education of individuals and their families, on the one hand, and of

the state, on the other, and, accordingly, a more compelling consensus on the balance between the individual private gains and the broader social advantages of mass higher education.

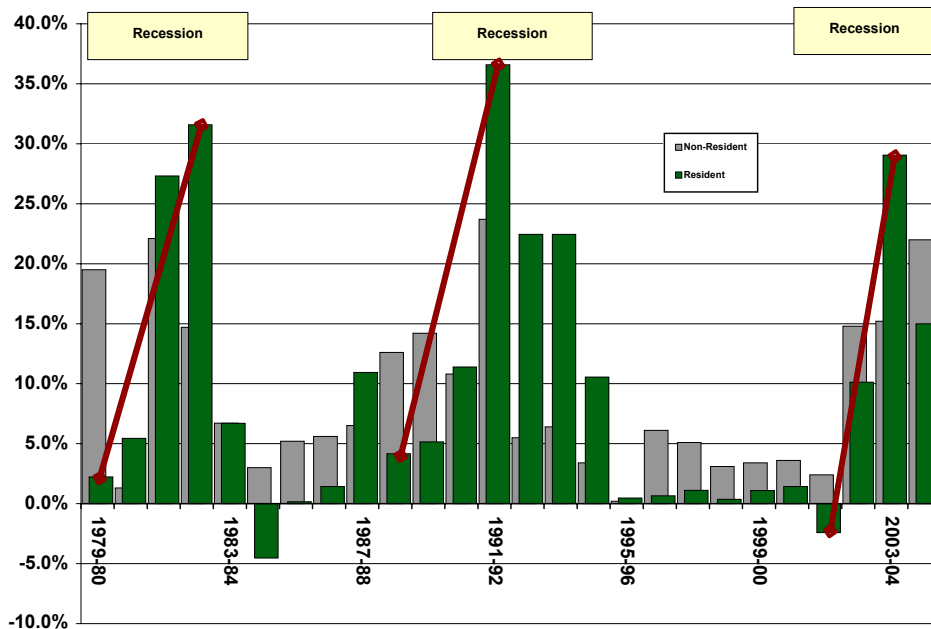
These issues are being addressed both at the institutional level, from a micro-economic point of view, and, at the state or national level, as matters of macro-economic public policy.

**Institutional Considerations**

Public universities clearly face a set of new questions: what should be the relative role of tuition and fees in funding the higher education enterprise? What is the elasticity in pricing when *combined* with a financial aid program that can maintain or possibly enhance affordability for lower and lower middle-class students? What would a socially responsible moderate fee and high financial aid model look like?

In the US, state governments and higher education institutions are backing into a higher tuition policy in an incremental fashion, but over the past decade the magnitude of these changes has amounted to a structural shift in responsibility for higher education. There is a clear pattern of declining state investment in HE during economic recessions, accompanied by sharp increases in fees, approved by lawmakers and ultimately supported by higher education institutions. In California and several other states, increases in tuition have not fully made up for the overall decline in state resources (see Figure 1).

Figure 1  
Undergraduate Resident and Non-Resident Fee Increases:  
University of California System, 1979-2005



Source: University of California, Office of the President

In the UK, this shift is more explicit and abrupt. The decision to establish tuition (or, really, to re-establish it as it existed in the pre-World War II era) in 1997, and now to raise it to a cap of £3,000 until 2010, is rationalized as a stopgap for declining state funding on a per-student basis. Why £3,000? One might venture that the figure has more to do with a sense of what might be politically acceptable than, for instance, a long term finance model carefully calibrated to ensure affordability while increasing enrollment capacity and maintaining quality over the long haul.

### **Pricing, Affordability, and Access – What We Think We Know**

There is a great need for research on the relationship between tuition levels and affordability and access. There are very few studies focused on micro-economic questions related to pricing and student (consumer) choices in higher education, though we can make a few generalizations about patterns of behavior in the US.

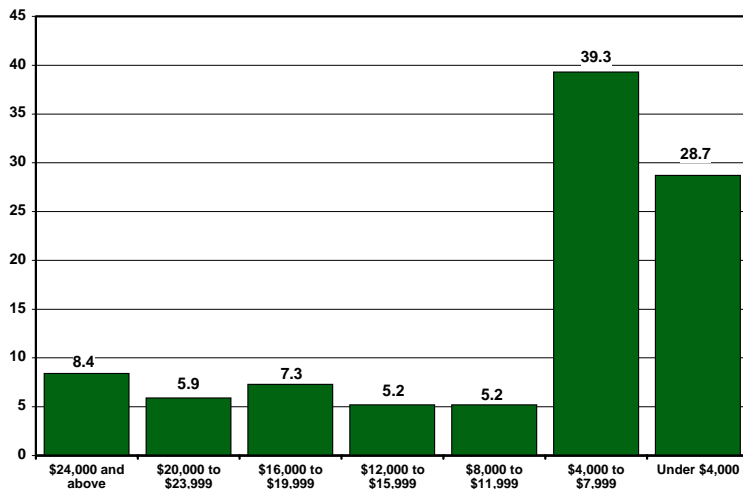
While fees have risen for both public and private higher education, demand and enrollment have also increased. For example, in Texas, the fees for in-state residents increased by 60.1 percent in the ten-year period from 1987 to 1997, while enrollment grew by 15.7 percent. Fees increased 57.2 percent over the same decade in North Carolina, and 44 percent in Illinois; enrollment increased in those states by 18 and 20.6 percent, respectively. Nationally, the number of students attending a public four-year institution increased by 47.6 while enrollment grew by 11 percent.<sup>2</sup>

Among all ethnic and socioeconomic classes, college-going rates have increased at approximately the same pace.<sup>3</sup> At the same time, student debt has increased. The net cost of attending a college or university is also taking a larger share of family income and at a disproportionate rate. One estimate indicates that the net cost of attending HEIs (fees minus financial aid) absorbs some 38 and 45 percent, respectively, of the total income of families and individuals in the lowest and second-lowest income quintiles. Families in middle, fourth, and highest income quintiles devote only 30, 20, and 14 percent of their family income, respectively, to college costs.<sup>4</sup>

In short, higher education in the US has become less affordable, but not unaffordable, for most Americans. Figure 2 provides data of what students actually pay, after discounts from financial aid. Need-based grants from federal, state, and institutional sources have helped to mitigate the impact of higher tuition, despite a real decline in the federal need-based grants relative to the increase in HE fees. The growth of a substantial information industry designed to assist families and individuals in their decision to attend a university, and indeed to choose from among several options within higher education, suggests that selecting a college is an active, informed, and competitive process.

Certainly, there is a wide public consensus that the current cost of going to college outweighs the price of *not* going to college. In the UK and in the US, the wage differential between college graduates and secondary school finishers continues to grow. Interestingly, however, in the US, where wage growth has been anemic in the last decade, graduates with a bachelor's degree are not making more money (after adjusting for inflation); meanwhile, the wages of those with only a secondary or lower qualification are declining.

Figure 2  
Percentage Breakdown of US Average Fees Paid: Full-Time Undergraduates at 4-Year HEIs, 2003-04



Source: American Council on Education, *College Costs*, 2004

Rising fees are also accentuating the tendency for students from more affluent families to congregate at the higher-priced and most prestigious colleges and universities, both publics and independents.<sup>5</sup> Recent trends in the US indicate that college-going rates, while not declining, are stagnating. Sharp and recent increases in public HE fees might be part of the story, but there are also more serious underlying causes. These may include a dramatic rise in the nation's immigrant population, increased poverty rates, and, for the first time in over fifty years, actual declines in high school graduation rates.

It is perhaps not an overstatement to say that we are entering a new era of moderate or high fees without a strong sense of what may transpire. Thus far, fee increases in the public sector in the US have been relatively small when adjusted for inflation. Much Congressional criticism of increased tuition has stressed the impact on middle-income families of a reduced entitlement. But what happens if fees jump sharply?

### Authority and Trends in Differential Fees

This shift toward the greater role of fees as a source of institutional revenue has also raised important issues of authority and autonomy. In England and in most states in the US, public institutions are acquiring greater responsibility for setting fees within certain limits. Governments continue to set politically determined maximums,<sup>6</sup> and most or all fees are retained by the institution. There remains, however, great variability in the US in the authority to set and retain tuition. There are differences between states, and differences between the institutions in a state—for example, between a state's flagship campus and its community colleges. Thus far, no state in the US has seriously considered incorporating a graduation tax in the form established first in Australia and now planned for England in 2006.

Prior to the current shift in tuition policy and authority, most public institutions charged either nothing or a relatively modest flat fee for all students, whether undergraduates,



graduate students, or professional degree candidates. Low tuition was viewed as the most effective means to lower economic barriers to attending a university. A flat fee (or the lack of differential fees) also ensured or reduced potential biases in a student's choice of subject and degree preference. A student's academic abilities and interests were expected to guide their choice of subject at a time when, at least in the US, salary differentials between different professions were relatively small. Since low tuition was made possible by tax-based subsidies, differential rates were established for non-citizens, i.e., out-of-state students and foreign nationals.

Figure 3  
Differential Fees Among A Sample Group of Public and Private Universities, 2003-04

	UG	Graduate	Dentistry	Medicine	Optometry	Pharmacy	Veterinary Medicine	Law	MBA	Masters Nursing	Theatre & Film*
<b>PUBLIC Sample</b>											
CORNELL-NY STATE STATUTORY COLLEGES	16,037	17,970									
MICHIGAN STATE UNIVERSITY	7,044	7,762		21,836			14,000	24,810	15,100	297/cred.hr	6,962
OHIO STATE UNIVERSITY-MAIN CAMPUS	6,651	7,278	16,092	19,323	12,441	9,663	14,661	13,095	13,995	2,256	8,250
PENNSYLVANIA STATE UNIVERSITY-MAIN CAMPUS	9,206	10,420		26,422				25,650	10,304	10,420	8,962
SUNY AT ALBANY	5,770	7,890							7,890		7,934
THE UNIVERSITY OF TEXAS AT AUSTIN	4,188	4,554				6,924		9,358	11,923	2,842	5,394
UNIVERSITY OF ALABAMA	4,134	4,134		12,852				7,252	3,556	2,067	4,630
UNIVERSITY OF CALIFORNIA-BERKELEY	5,858	6,169			11,289			16,293	21,512		7,457
UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN	7,010	7,756		22,774			13,488	14,566	13,604		7,146
UNIVERSITY OF MICHIGAN-ANN ARBOR	7,975	12,933	19,865	20,525		16,619		27,863	27,500	3,976	6,925
UNIVERSITY OF MINNESOTA-TWIN CITIES	7,116	8,517	16,428	17,870		13,402	15,911	15,385	17,850	3,681	10,196
UNIVERSITY OF MISSOURI-COLUMBIA	6,558	6,339		19,572			13,309	11,922	236/cred.hr**	7,098	
UNIVERSITY OF WISCONSIN-MADISON	5,136	7,590		21,755		10,128	15,853	9,554	9,048	7,592	8,932
UNIVERSITY OF VIRGINIA-MAIN CAMPUS	6,149	7,856		22,486				23,798	26,228	4,577	9,210
<i>Public Sample Average</i>	<i>\$7,059</i>	<i>\$8,369</i>	<i>\$17,462</i>	<i>\$20,542</i>	<i>\$11,865</i>	<i>\$11,347</i>	<i>\$14,537</i>	<i>\$16,629</i>	<i>\$14,876</i>	<i>\$4,945</i>	<i>\$7,666</i>
<b>PRIVATE Sample</b>											
CORNELL-ENDOWED COLLEGES	28,754	28,680		31,085			19,150	33,020	32,800		30,062
BAYLOR UNIVERSITY	18,430	14,244		9,558				20,728	17,900	16,750	
BROWN UNIVERSITY	29,846	29,710		34,010							34,910
HARVARD UNIVERSITY	29,060	27,208	33,142	34,776				32,392	30,050		
MASSACHUSETTS INSTITUTE OF TECHNOLOGY	31,040	31,040							32,470		
NEW YORK UNIVERSITY	28,496	25,384	44,000	33,500				34,908	32,400	900/cred.hr	31,270
STANFORD UNIVERSITY	28,832	28,664		36,173				32,525	33,300		28,563
UNIVERSITY OF CHICAGO	29,238	30,672		29,550				32,754	36,520	***	32,235
UNIVERSITY OF PENNSYLVANIA	29,318	29,790	44,104	37,888			27,156	32,452	39,835	25,738	
UNIVERSITY OF SOUTHERN CALIFORNIA	28,692	23,244	49,587	37,076		29,420		33,252	33,800		30,524
YALE UNIVERSITY	28,400	25,600		34,175				33,850	31,500	24,788	19,712
<i>Private Sample Average</i>	<i>\$28,191</i>	<i>\$28,224</i>	<i>\$42,708</i>	<i>\$31,779</i>	<i>\$0</i>	<i>\$29,420</i>	<i>\$23,153</i>	<i>\$31,765</i>	<i>\$32,058</i>	<i>\$22,425</i>	<i>\$51,819</i>
<i>Public/Private Differential</i>	<i>-\$21,132</i>	<i>-\$19,855</i>	<i>-\$25,247</i>	<i>-\$11,238</i>	<i>\$11,865</i>	<i>-\$18,073</i>	<i>-\$8,616</i>	<i>-\$15,136</i>	<i>-\$17,182</i>	<i>-\$17,480</i>	<i>-\$44,153</i>

\* Tuition only found for 2004-05 year; Significant additional costs often apply to film students

\*\* MBA program length varies from 32-59 credit hours depending on business background.

\*\*\* Uses partner institutions that bring nursing degree programs to campus, mainly for their staff (RN/BSN)

NP No such program offered at the institution.

The first major break in this across-the-board low fee policy came with the introduction of specific and higher tuition levels for professional degrees following the lead of many independent institutions (see Figure 3). Four factors have influenced this shift. First and foremost is the increased private benefit afforded to the student with a professional qualification. It is assumed that a graduate of these programs will make a sizable income over the course their professional career and can therefore afford the higher initial cost (investment) in their university education. The second is the higher costs of maintaining the program, including rising costs in some professions for recruiting and retaining faculty. The third is the opportunity costs for the institution in lucrative fields in which fees more than cover costs. Fourth is the greater self-sufficiency of professional programs,

which may permit cross-subsidies of public funds to go to programs for which alternative revenues are unlikely.

In the US, we can compare the differential fee structures previously established by private institutions to the emerging variability in the public sector. From a sample set of public and independent research universities with highly selective admissions, it is possible to draw some conclusions about differences in tuition policies.

- *Independents – High Fees Across the Board*

Independent institutions have long charged extremely high fees when compared with their public competitors, but in the private sector there are only small differentials between undergraduate students and graduate students in liberal arts and science fields, and fees are only marginally higher for professional degrees. Differential tuition among independent institutions is also much less than that among similar public universities. The most prestigious independent colleges have long sought a national pool of applicants and see themselves in competition with each other for that pool, whereas most public institutions regulate the proportions of undergraduate students admitted from out of state.

- *Growing Differential Rates at Public Institutions*

Public universities have established marginal differentials in tuition between undergraduate and graduate students, but much higher rates for professional programs. It is clearly more politically acceptable to raise fees in professional schools because of the perceived private benefit to the student. Concerns about the effects of tuition levels on access do seem to focus almost exclusively on undergraduate fees.

Fee differential between states, particularly at the professional degree level, is also significant and in sharp contrast to that in our sample group of private universities. Most public universities still enroll the majority of their undergraduate students from the state that established and funds them, but at the graduate level, they seek a national and international pool. While there is increasing interest in looking at the comparative fees both in other states and at private institutions, the political dynamics of setting tuition remains a matter of state policy. Consequently, there are great differences in professional school tuitions, particularly in business.

- *Profit Versus Loss Centers*

Public universities on average have also established a greater array of professional programs. Many of these programs are linked to local social and economic needs that are valued highly by key political constituencies. Many, like nursing and library science, have high costs but relatively low private benefits.

Since for-profit institutions also strategically avoid degree programs that will not generate significant profits, this dilemma is compounded. The public sector has a responsibility to provide these programs and evolving fee schedules must confront issues of cross-subsidy. Of course, potential profit centers within public universities, such as business programs, seek to control their own fees and the resulting revenue.

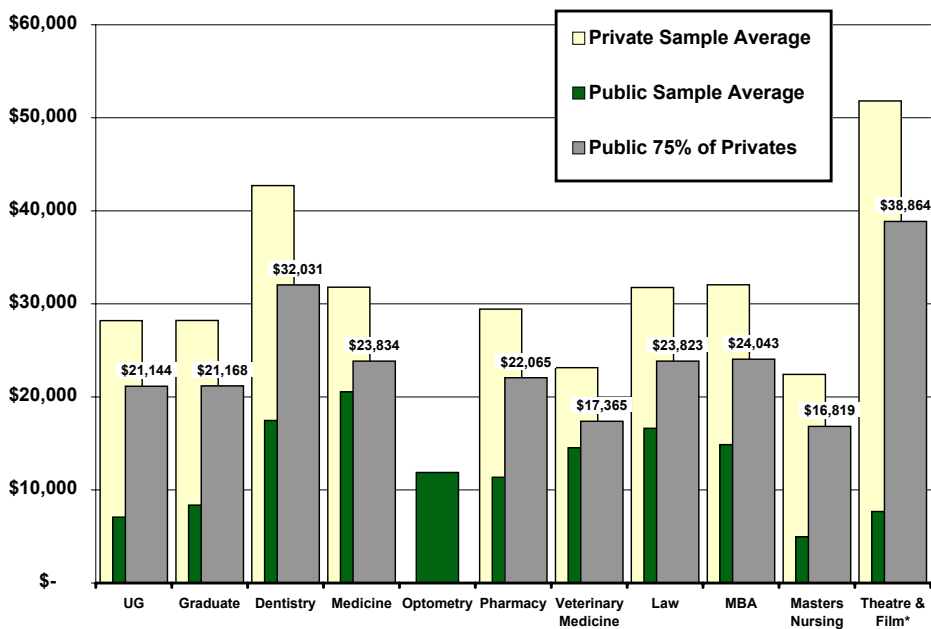
Under the policies currently being debated in the US, in the UK, and elsewhere, there is the prospect of fee differentials between undergraduate and non-professional graduate degree programs and, in the US, even between levels of

instruction. A number of states require higher fees for students who take more courses than are required to graduate, and there are a growing number of proposals to charge higher fees for students who take longer than the normal time required to complete their degree.

These emerging tuition policies must also be viewed in relation to the changing role of financial aid in private and, increasingly, in public institutions. Only a percentage of students actually pay the full fee rate—the so-called sticker price. Financial aid, in the form of need and merit-based grants and loans, as well as the more recent advent of tax tuition credits, alters the actual price of higher education. Both private and public universities redistribute fee income as institutional financial aid. On average, public four-year institutions route approximately 20 percent of all fees into financial aid; some devote as much as 33 percent to financial aid. A class of students may resemble the passengers of an airliner in the variability of payments they have made for the same service.

The privatization movement and the relatively new market thrust of public universities means that the differential fees between public and private institutions, and between the undergraduate and graduate and professional levels, will likely decrease in coming decades. The push by institutions to increase revenue via tuition will be significant.

Figure 4  
 US Public as a Percentage of Private Variable Fees: Sample Group of Public and Private Universities, 2003-04



If the average tuition fee of the sample group shown in Figure 4 were to increase to approximately 75% of the private sample group, the undergraduate sticker price (not counting financial aid offsets) would be just over \$21,100—an increase of over \$14,000. At the graduate level in non-professional fields, the increase would be similar, just over \$13,000. And in a professional program like pharmacy, the tuition rate at a public

university would be \$17,200, an increase of over \$5,800; in nursing, the fee level would be \$16,800, an increase of \$11,800; in medicine, \$23,000, an increase of only \$3,000, reflecting the one field where public and private fees are converging; and law would be nearly \$24,000, an increase of approximately \$8,000. Among our sample group of private institutions, none offers optometry, one of many fields in which the comprehensive public universities offer programs that are required by society but that are generally not lucrative for an institution.

If this is the future route of public higher education, an important question is how this will affect the market—specifically, access and opportunities for students and their families from lower and middle-class and disadvantaged backgrounds. There is evidence that robust financial aid programs can offset the potential negative effect of higher fees at the undergraduate level. For example, the University of California's experience with raising fees in the early 1990s did not result in a reduction in demand or in a discernable decline in access by lower-income groups, in part because for each dollar raised through fees, 35¢ was placed into an expanded financial-aid program. (The average among US universities is about 25¢ for each dollar raised via fees and tuition.)

### **Institutional Autonomy and Public Policies**

Setting tuition rates is not simply a matter of balancing the revenue sources of HE. Tuition is viewed as a key indicator of the affordability of HE and remains a major focus of public policy. The drift to a new fee regime for public higher education also raises questions about the appropriate autonomy of HE institutions, e.g., who should set tuition levels and determine the use of those revenues. In the US, largely because of the highly decentralized structure of HE, these shifts to a new fee regime have largely come about as a contingent stopgap response to declining proportionate government subsidization and to the rising operating costs of increased enrollments. The debate at the national level is largely framed by the increasing demands for student financial aid.

In the UK, the Labour Government's current proposal offers an alternative to this drift. It frames the problem facing higher education in England, sets out new levels of autonomy for institutions to set tuition, and promises additional funds to increase overall funding on a per-student basis. But this ambitious proposal is still an incomplete solution and the details and possible effects have yet to be fully assessed and determined. Nevertheless, in the UK the national government has, in effect, taken a bold step: recognizing a critical need, offering a long-term scheme, engaging in a public debate, and placing higher education finance front and centre as a major national agenda item.<sup>7</sup> Of course, many in the US believe that the lack of a well-defined national policy limits the negative impacts of government policies and allows a varied rather than a standardized solution to the problem.

What then are the overall strategic goals of a national/state system of higher education *and* what funding models are available to policymakers?

- ***Model 1 - Public vs. Private Benefits***

Contemporary fee increases in the UK and the US are based, in part, on a simple proposition. Since the private benefits of higher education will continue to grow, students and their families should bear a larger burden of the educational costs. As early as 1973 the Carnegie Commission on Higher Education, led by Clark Kerr,

offered a structural approach to the funding of public HEIs. By estimating the proportionate public and private benefits of public higher education, the Commission proposed a threefold division of costs: students and their families; state government; and institutional sources, including federal financial aid support.<sup>8</sup>

At that time, around 15 percent of all operating expenses at four-year public institutions came from fees. Today it is around 20 percent. The actual public and private benefits of higher education are of course difficult to determine, but this model provides an equitable and negotiable solution to setting fee rates.

- *Model 2 - What the Market Will Bear*

An alternative model for public institutions is to charge what the market will bear, while mindful of the need to generate funds sufficient for a robust financial aid program that also draws on institutional, state, and national sources. Proposed HE finance reforms in England essentially follow this model, but have placed an artificial ceiling on tuition: up to £3,000 beginning in 2006. Generally, the increased acceptance of the market model among public institutions, including differential fees, has prompted government policies that limit the total amount that can be charged—either as a ceiling as in England, or as a percentage change per year.

A true market model, of course, would set no limits. There are many variables influencing the systems to which both the UK and the US are apparently drifting. Fees (sticker price) are set at the state system or multi-campus level, but usually with campus variability, while in England they are to be set at the institutional level. Differential fees have also crept into graduate and professional degree programs. The market model tends to focus on institutional revenue generation, but with little understanding of its influence on student choices or affordability.

- *Model 3 - National/International Comparative Norms*

Another model would be to calibrate tuition and fees based on what a comparable group of institutions (within a state, within a nation, and perhaps internationally) charges. This is a competitive model devoid of any larger sense of the relationship of revenue generation to the specific financial needs of an institution, or to its influence on affordability and access.

Yet in the US, fee policies currently in place at public and private institutions reflect the influence of this model. In the public sector, as state subsidies have declined, decisions on corresponding fee increases are sensitive to the overall percentage increase in fees and the overall decline in total resources generated on a per student basis. They also actively look at the price charged at other institutions outside of their state—particularly in the New England and Mid-Atlantic States, where there is greater student mobility.

This sensitivity explains the limited variability of fees charged by similar public institutions. Institutions with tuition levels outlying this average often argue that their fees should be closer to the norm. This argument is not based on an actual analysis of revenue needs, affordability, and access suitable for their mission, but rather it is simply one of the few political tools that have some saliency with lawmakers.

- *Model 4 - Fees Pegged to Economic Indicators or a Percentage Limit*  
Another model widely discussed, but rarely applied, is to set fees in relation to economic indicators, primarily the cost of living. Fees would rise only in relation to what people could afford.

Many lawmakers and critics of higher education in the US are partial to this model. They sense that university operating costs and fees at public and private HEIs have been rising too fast, but they also ignore the effects of significant declines in state subsidies for the public sector.

Percentage limits of course ignore the realities of the actual revenue needs of higher education and make large assumptions regarding affordability. The tendency is to start with a base fee range that, as we have seen, already bears the marks of instrumentalism. The rationality of the model requires at least an initial fee level based on institutional mission, revenue needs, and affordability. Percentage limits also have another disadvantage: a percentage increase in the relatively small fees of community colleges would generate very little additional revenue, while the same percentage increase in the relatively high fees of an elite private institution would generate large sums.

The political saliency of this model recently gained the favor of a number of congresspersons in Washington who forwarded a bill that would invoke penalties for any institution receiving federal funds, whether public or private, which raised fees faster than the rate of inflation.<sup>9</sup> Virtually all US HEIs receive federal funds for financial aid or for research (through agencies such as the National Science Foundation and the Department of Defense). On average, public universities receive approximately 11 percent of their revenue from the national government; independents (privates) receive around 8.5 percent.

None of these models are necessarily mutually exclusive, but they all raise serious questions about the inter-connectedness of HEIs and the need for some simple systematic relationships of tuition between and among both similar and different kinds of HE institutions. Should new fee regimes focus simply on improving the competitive financial position of individual institutions or, in the case of the US, multi-campus systems (such as the University of California and SUNY)? Or should they also have as an objective some level of revenue-sharing among all or some public higher education sectors in order to subsidize less affluent institutions, or to help fund national and state financial aid programs?

In England, the current proposal approximates most closely the market model. Each institution will retain all the revenue from what they believe they can charge. We do know that there is elasticity in pricing higher education and greater flexibility than is generally recognized. We also know that strategic policies will be required to reduce the negative impact of rising fees on less affluent income groups. Among these policies are:

- *Robust financial aid programs that are adequately funded at a level that reduces the net cost to targeted populations*  
Financial aid programs function best when they are based on transparent policies, administered with direct and simple processes, and based on national standards. Institutional aid is also critical as a supplement to public support, though it is generally offered as part of an acceptance process based on individual student

attributes. A national- or state-based financial aid system offers more predictable expectations of aid and makes it more likely that economically disadvantaged students will apply to and attend a university.

- *Gradual increases in tuition in relation to a schedule of long-term financing of public higher education*

Abrupt and often last minute increases in fees create not only “sticker shock,” but also make it impossible for prospective students and families to make financial plans for the cost of their higher education. Some states and several independent colleges have already agreed to set tuition at the same level for the duration of a degree program and restrict increases to each entering class. In recent decades in the US, the under-representation of the lowest income quartile of the population combined with the selective racial and ethnic impacts of these trends have been linked to rapid increases in tuition; however, a host of other factors also influence college attendance, including difficulties in understanding increasingly complex financial aid benefits.

A recent survey sponsored by the National Center for Educational Statistics in Washington found that students from all income brackets overestimate the net cost of attending private and public tertiary institutions. However, the problems are particularly acute for students from lower-income families.<sup>10</sup>

### **Student Choices, Financial Aid, and the Concept of Revenue Sharing**

Dealing with the politics of increasing fee revenue and incorporating differential fees is a relatively new phenomenon for public institutions. Much of the discourse concerning fee policy has focused on the need to generate income. Yet an equally important consideration is how various models of differential fees will influence student choices *and* how fee revenue will be used.

Institutions have tended to engage in internal debates about the overall need to generate new fee income without a broad conceptual idea of the long-term implications or influence on institutional mission.

- *Student Choice - Undergraduate and Graduate Levels*

We know relatively little regarding how changing fee patterns among and within public universities will affect student choices. At the graduate level, the initial movement toward differential fees appears to have a minimal impact on demand—largely because the fields that have incorporated higher fees tend to be in professional areas leading to highly compensated employment and social prestige. Also, within the American market, tuition at publics remains well below the sticker price of most independents (privates). Within our sample group of public and private universities, the differential in law is \$15,136; in business administration, \$17,182; and in medicine, \$11,238.

The availability of financial aid for low-income and underrepresented groups mitigates the influence of fee differentiation on student choices, but there are greater concentrations of students from lower income backgrounds in public universities, at both the graduate and undergraduate level. Assuming that the differential between fee levels between public and private institutions narrows in future years, the

opportunity costs could change and influence student choices and opportunities. This response will also depend on the robustness of financial aid to reduce substantially the sticker price *and* on the transparency of these options to potential applicants.

One might argue that differential fee policies work within the sphere of graduate programs, and specifically in professional degree programs, but that they are not appropriate at the undergraduate level. At the graduate level, and particularly in the US, students are making an informed choice for a narrowly-tailored program leading to employment. They are usually adults who have already entered the job market and are returning to school.

At the undergraduate level, students are generally developing their interests and testing and proving their academic abilities. The US model of undergraduate education has long focused on providing new students with a “general education” during the first two years of a four-year program before they specialize in a single subject. Within this structure, differential pricing could have a huge impact on student choices. In the UK and the EU, students enter the university focused on a single subject. But they too are making their decision on which field to enter at an extremely young age. Differential pricing would skew student choices, creating market forces that would be heavily influenced by a student’s economic background.

- *Financial Aid and Inter-Institutional Revenue Sharing*

In order to facilitate the recruitment of under-represented ethnic and income groups, many institutions in the US have entered into bi-lateral partnerships with high schools, community colleges, and historically or predominantly Black, Latino, or Native American institutions. This process is a kind of revenue sharing of the resources by well-funded universities. Many prestigious independent institutions have used their institutional financial aid as a means to compete for the most academically prepared of under-represented groups. However, the national impact of these measures is decidedly modest because of the relatively low contribution of these institutions to overall national student enrollment in HE.

Eligibility rules for student financial aid, increasingly questioned on constitutional grounds, have also directed resources to specific sectors of HE. Clearly, in an environment in which fees will contribute an increasing proportion of the revenues of HE, it will be necessary to develop some redistributive mechanisms based on not just public but also institutional resources.

Since the late 1980s many multi-campus university and college systems in the US have designated at least a portion of each *additional* dollar in fees for financial aid. The current average is just above 20 percent. As a result, public institutions are now developing significant revenue streams for institutional-based aid—a model long practiced by private institutions.

Within state public HE systems (in the US) and national systems (in the UK), a natural question is how new fee-generated revenue might work into a general scheme of revenue sharing specifically for financial aid. Thus far in the US, increased fee revenue generally benefits only individual campuses or multi-campus systems. A stated goal of allocating x amount to financial aid for each new dollar charged provides a model for both raising revenues and maintaining affordability by means of a robust need-based financial aid program. It would help to mitigate the



inevitable political opposition to any and all fee increases, both by student groups and by those who legitimately worry over affordability and access.

- *Campus Revenue Sharing, or, Will the Rich Get Richer?*

Differential fees at the graduate level within public universities are justified by the fact that students should receive decreased or less subsidization for the real costs of their education in fields that promise to provide lucrative compensation for the student. Another motivation for differential fees is the entrepreneurial drive of some academic programs. In areas such as business, academic leaders have clearly set out to generate income above real costs that is then invested to further academic quality and prestige.

In regards to the quest for quality and its direct correlate, prestige, the economist Howard R. Bowen famously observed in 1980 that HEIs would always spend whatever resources they could garner on this quest.<sup>11</sup> In an age of relatively uniform fee levels, fund generation (whether by state subsidies or fees) and expenditures were highly centralized within a campus administration. The new differentiated fee schemes stress generating and retaining revenue in specific academic departments or schools. This process is not entirely new, as research grants and philanthropic gifts as well as institutional funds are increasingly concentrated in scientific fields and some professional schools.

Depending on how an institution approaches the use of differential fees, this uneven distribution of wealth may be significantly accelerated. The natural inclination of units that can charge differential rates is to claim all their revenue as their own. Certainly this is not all bad. As one president of a US university noted recently, “academic empires”, so long as they fit within an institution's overall mission and direction, characterize the strongest universities: “It's the innovators and empire builders who create institutional reputation, ensuring their students' success and their institution's survival.”<sup>12</sup>

Yet an important question remains: what forces exist to create a stronger sense of academic community? Historically, revenue sharing (the idea that resources are centrally controlled within a campus administration or multi-campus system) has allowed for greater strategic placement of resources in academic units—sometimes in units with well-recognized quality or a growing workload, sometimes in areas with potential. This institutional mechanism will remain important to HEIs in the future. The question is, what is the appropriate role of differential fees in this process?

Again, public universities have only recently adopted differential fees. They are often making choices without clear norms or well-scrutinized goals beyond the search for new revenues. Nevertheless, the nature of large and complex organizations, academic or otherwise, is to make choices and create precedents incrementally. With the increasing emphasis on revenue generation to compensate for declining per capita government support, precedent will certainly influence future policies on differential fees. Without a strong commitment to revenue sharing from the outset, powerful academic units will increasingly resist allocations based on shared revenues in their own individual quest for quality and prestige.

## Conclusion – Passive to Active

At present we have the benefit of good economic models to guide us on issues such as price sensitivity. If public higher education institutions are to move from a reactive to a creative role in the development of new tuition policies, there will need to be a broad public consensus on the appropriate proportionate contributions of individuals and the state to the cost of public HE. A long tradition and experience of low tuition has created a strong sense of entitlement to low cost HE even amongst the most affluent. Another critical issue is also central to this discussion. What is the level of funding necessary to sustain high quality academic enterprise? Should funding and fee policy be different among institutions with different missions or strengths? Does HE have the capacity to address allegations of excessively high costs of operation and a reluctance to innovate and experiment with different modes of learning and delivery? We have not attempted to discuss this side of the equation.

One might argue that the decisions governments and higher education institutions come to in this period of fiscal difficulties might very well shape, indeed lock in, a market approach that:

- Further divides the wealthy from financially poor public institutions, and similarly accentuates the divide in the socioeconomic background of students;
- Creates new market biases in the academic degree programs pursued by students—perhaps accentuating careerism and, for example, a declining demand for the humanities;
- May significantly influence the type of student an institution attempts to recruit—e.g., as is the case already, foreign nationals;
- Enhances institutional autonomy, but also may significantly hinder the ability of government to pursue national priorities. National versus institutional goals are, obviously, not always one and the same.

Each of these outcomes can be mitigated if there is a systematic effort to shape and justify a moderate fee and high financial aid model. One might speculate that as differential fee systems develop and mature, they will permanently foreclose on the interest or ability of governments to return to a high public subsidization model. The same pressures and the same debates are likely to become parts of HE policies for the rest of the EU, and for other nations in the OECD.

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## Notes

<sup>1</sup> See John Aubrey Douglass, “A Transatlantic Persuasion: A Comparative Look at America’s Path Toward Access and Equity in Higher Education,” in *Understanding Mass HE: Comparative Perspectives on Access*, ed. T. Tapper and D. Palfreyman (RoutledgeFalmer, 2005).

<sup>2</sup> T. Snyder, C. Hoffman, and C. Geddes, *State Comparisons of Education Statistics 1969-70 to 1996-97* (US Department of Education, National Center for Educational Statistics, 1998).

<sup>3</sup> Donald E. Heller, "Trends in Public Colleges and Universities," in *The States and Public Higher Education Policy*, ed. Donald E. Heller (Baltimore: Johns Hopkins University Press, 2001), 11-38.

<sup>4</sup> *Ibid.*

<sup>5</sup> See Alexander W. Astin and Leticia Oseguera, "The Declining 'Equity' of American Higher Education," *The Review of Higher Education* 27, no. 3 (Spring 2004): 321-341.

<sup>6</sup> See Arthur M. Hauptman, "Reforming the Ways in Which States Finance Higher Education," in *The States and Public Higher Education Policy*, ed. Donald E. Heller (Baltimore: Johns Hopkins University Press, 2001), 64-80.

<sup>7</sup> David Ward, "That Old Familiar Feeling: What an Important Difference," *The Presidency* (Winter 2004).

<sup>8</sup> Carnegie Commission on Higher Education, *Higher Education: Who Pays? Who Benefits? Who Should Pay?* (New York: McGraw-Hill, 1973).

<sup>9</sup> A provision in the Affordability in Higher Education Act offered in October 2003 by Rep. Howard P. "Buck" McKeon, chairman of the U.S. House Subcommittee on 21st Century Competitiveness, would have allowed colleges and universities, public and private, to set tuition at rates of their choosing. But beginning in the year 2011, the federal government would have the option of removing direct subsidies to institutions that "repeatedly engage in exorbitant tuition hikes that hurt students and parents, reflecting McKeon's belief that the federal government should not be required to endlessly subsidize hyperinflation in college costs."

<sup>10</sup> Laura J. Horn and Chris Chapman, *Getting Ready to Pay for College: What Students and Their Parents Know About the Cost of College Tuition and What They are Doing to Find Out* (U.S. Department of Education, National Center for Educational Statistics, September 2003).

<sup>11</sup> Howard R. Bowen, *The Costs of Higher Education*, Carnegie Council for Policy Studies in Higher Education (San Francisco: Jossey-Bass Publishers, 1980).

<sup>12</sup> J. Michael Adams, "Foundations for Innovation: Encouraging Academic Empire Building," *The Presidency* (Spring 2004).