



Financializing Public Universities

Robert Meister

What is the crisis in U.S. public universities? They now expect most future revenue growth to come from tuition rather than taxation. But they don't expect tuition to cover the decline in per student spending on instruction as enrollments rise to fulfill their state mission. Their financial plan is to increase total revenues from enrollments by getting their median student to borrow more even though median family income, and hence ability to pay, has not increased.

In effect, public universities are selling debt (and other financial products) to prospective students on the assumption that the income gap between college graduates and non-graduates will continue to increase as it did in the 1990s. Public higher education faces a financial crisis because this gap has not increased over the past decade and because an even greater income gap has recently appeared among recent college graduates. Now that income growth is concentrated in the top 1%, the plan to finance public universities through greater borrowing by those expecting to be in the top 20% seems to reflect a transitional era (1978-1998) when all income growth occurred in the top quintile.

The moral crisis occurs as public universities lose their way now that this moment has passed. They still plan to increase revenue by, in effect, claiming to be principal drivers of growing income inequality, even though an ever-smaller percentage of graduates are beneficiaries of the income gap. Obviously, this is a different mission than the taxpayer-financed system that claimed to be the principal engine for greater income equality between 1950 and 1970.

I want to defend the specific virtues of a mid-twentieth century model of taxpayer-funded higher education that is best exemplified by the 1960 California Master Plan for Higher Education, which tied the growth and quality of public universities, especially the University of California (UC), to a rising prosperity in

which all Californians expected to share in different degrees. It was a successful compromise between class reproduction and class mobility that even Governor Ronald Reagan could support at a moment, the early 1970s, when California reached its demographic peak in the percentage of its population attending public schools (K-16).

The present model eclipses the Master Plan by treating public university tuition as partly a financial product that allows students to hedge against falling too low, and to speculate on rising to the top, as income gaps increase. This hedge, embedded in tuition, would be a private good that public university students can be expected to purchase outright or to add to the educational debt for which all students are eligible because of federal guarantees.

Debt financing of higher education is not a coherent alternative to the Master Plan vision in an era when the median income of college graduates is stagnant or declining. The median student does not in fact borrow more to attend four-year public universities during a decade in which tuition has doubled: he/she “transfers down” within the public system causing a downward cascade of enrollments that impacts community colleges in ways that ultimately benefit for-profit institutions where low-income students take on enormous debt.

But unmanageable debt burdens are now a principal reason many families are unwilling to assume greater tax burdens to pay for basic needs like healthcare and education that drive them into debt. The answer to the taxpayer revolt against the public sector must include a debt revolt against the financial sector. This is an issue on which defenders of public higher education can take the lead.

My forthcoming article in the fall issue of *Representations* develops a critique of the debt-financed model of public higher education in the context of the University of California (UC). Here I omit most of the historical detail that will appear there and summarize three of my five main arguments.

I. A Privatizing Public University is not En Route to Becoming Private

The State of California is not selling off its most valuable universities to the private sector or to foreign governments. This is one form of privatizing higher education but not the only one. Another form of privatization is for still-public universities to finance their growth through increased reliance on the same private credit markets that have financed the growth of for-profit higher education. UC has had such a plan since 1999. It increased in-state enrollment by 40 per cent between 1999 and

2004. Then, between 2004 and 2010, it doubled the tuition it charged those in-state students. Because one third of this tuition increase was “returned to aid” the lowest income students (who in effect didn’t pay it), the net effect of UC’s enrollment growth combined with tuition increases was to increase the “unrestricted” (non-state) income generated from higher enrollments by 84%. UC now receives more of its total revenue from students than from the state.

UC’s business plan was simply to maximize the total revenue generated by enrollment growth. It never had a plan to restore per student funding to the pre-growth level of 1999-2000. By now, that would require in-state tuition of \$23,000 which is more than twice the \$11,500 that UC presently charges, and much more than UC has ever believed Californians would pay to attend the campuses that absorbed the enrollment growth. Its real plan was to cut instructional spending—especially on those campuses—and then try to justify higher tuition as a defense against even greater cuts. There was thus no claim that higher tuition would be used to restore educational quality—instruction is the only area where university costs continue to go down. The assumption was that UC students are underpaying for the private good of public higher education—the income gap it produces—independently of the classroom experience.

Today, UC plans to remain a public university by charging less than privates for its contribution to rising income inequality. But as a public university it also plans to increase enrollments as tuition goes up—and to do this without using endowment funds to reduce or eliminate student debt as 55 private universities with stable enrollments have been able to do.

II. Privatization is Not Simply Commodification

One frequent criticism of privatizing public universities is that it turns public higher education into a mere commodity rather than a public good. This is indeed objectionable to the extent that it occurs.

A further objection is that public research universities, like UC, cannot commodify the educational component of their public mission and still get the revenue growth they expect from higher enrollment. Commodification on its own might be expected to drive the tuition of public higher education down through cheaper delivery and a glut of graduates on the job market. But the plan of very large public university systems, such as UC, is to increase enrollments while charg-

ing more per student—and to leverage its ability to do so on capital markets that will finance its growth plans independently of the state.

UC's ability to borrow on bond markets much more cheaply than the State of California depends upon the access it provides to student loans and its ability to charge a higher access fee (tuition) as income disparities increase. Without reliance on student loans it would not have been possible for public colleges and universities, where 76 per cent of U.S. students enroll, to raise tuition by 59 per cent in a decade when median family income rose by only 2 per cent. Funding the growth of public higher education through capital markets rather than taxation does not assume a broad rise in incomes as the California Master Plan did. Whether mean income rises or falls, UC now wants to charge a premium, over and above what the state will pay to subsidize enrollments, for the growing variance in income attributable to higher education.

III. Privatization is also Financialization

The desire of public universities to reap a premium from growing income variance brings us into the realm of options pricing theory. Modern options theory, which developed in the 1970s, allows us to price changes in the variance of any number (in technical terms its “volatility”), which in the context of university tuition is a measure of present uncertainty and how high the highest incomes will rise, how low the lowest incomes will fall and how likely the average income will be.

Privatization, as a scheme for funding the growth of public universities, thus means more than simply commodifying the educational experience: it also means financializing the effect of growing income gaps. The core assumption of privatization-as-financialization is that rising income inequality increases the fear of falling behind and thus the willingness of middle-income students to borrow more. If this reasoning is correct, UC students should be indifferent to the choice between paying for the education premium up front (as equity) or taking on debt—higher tuition would simply move some students further up what financial economists call the “debt-equity frontier.” This argument opens the door to greater convergence in the prices charged by publics and comparably ranked privates.

Considering higher education as partly a financial asset is the abstract model under which both public and private providers can expect its price to rise even as the cost of delivering it continues to fall. By following this logic, UC kept growing through enrollment-generated revenue while lowering the quality of instruction

both according to the budget and in actual practice. Getting worse was actually part of its strategy for raising tuition. Ever-privatizing, but never private, UC could theoretically raise revenues from enrollment growth, and gain greater access to financial markets, for as long as Californians were more willing to pile on debt than to pay higher taxes. They would do this because borrowing makes them feel richer (at first) and taxation always makes them feel poorer, and because debt for higher education can be considered an “investment” in their own human capital—or, at least, a hedge against the fear of proletarianization or worse.

But what is the value of the embedded option (or “education premium”) on which UC and other public universities hope to capitalize? In post-Master Plan California it would be an option on the possibility that in California the spread between the top 20 per cent and the rest (the 20/80 spread) will increase as the economy grows. Suppose one could actually buy an option, tradable on public markets, that would protect against a rapid increase in the 20/80 spread. The price of such an option would probably be low in times like these when the 20/80 spread may not be growing; but the option could be worth a lot during another period, such as California’s transition to high tech, when broadly educated people could get jobs for which no prior training was available. My theoretical point is that the “education premium” is essentially a purely financial idea (based on changing income dispersion) that has no necessary relation to the price public universities should be able to charge. One should thus be able to buy cheaper and more effective income insurance directly from financial markets without having to become a student, thereby cutting out UC (and every other public university) as the middleman. If such income protection insurance were available to everyone, not just the educated, then there should be no willingness to pay a premium for public higher education.

But we do not need this kind of abstract argument to show the flaw in a funding model for public higher education that focuses on an 20/80 income gap that just happens to approximate the participation rate in California’s public universities. In California between 1998 and 2008 the 20/80 gap in incomes (aka the “education premium”) did not significantly grow: there would have been no growth in the incomes of the top 20 per cent if we were to subtract the income growth of the top 1 per cent. California’s economy grew between 1998 and 2008, but the price of an option on the relative income growth of the top 20 per cent minus the top 1 percent would have fallen to nearly nothing. Financializing the growing risk of being in the bottom 99% is no way to pay for a system of higher education for which 33% of Californians qualify and in which 20% participate,

especially now that many students are increasingly debt-averse and many parents are trying to pay down their total borrowing.

To understand the role that capital markets play in the democratic politics of states like California we have to compare how much in taxes people could afford to pay if they had no debt service and how much more debt they could take on if they paid no taxes. This question is the kernel of the struggle over privatization and its relation to public values.

Many students who borrow for higher education will end up paying more in debt service on those loans than they pay in state taxes. In aggregate the amount they owe is approaching \$1 Trillion on which they pay compound interest to the financial industry of 6-12% plus massive penalties and collection charges in the event of missed payments. To put this in perspective, \$1 Trillion is roughly the amount the U.S. government has borrowed to finance its wars in Iraq and Afghanistan; it is also roughly the amount of U.S. Treasury obligations owned by China. The total debt of all U.S. cities and states is only \$2 Trillion. It is clear that capital markets benefit much more from the expansion of student debt than public universities, which collect only a small portion of what is owed in the form of tuition and other fees.

But it is also clear that public universities have used private capital markets to cost as much as they can. Since the 1980s the cost of instruction has not risen—instructional salaries are now more unequal, but have remained on average the same and cost per credit hour has declined. Yet what students pay for public higher education in the U.S. has grown at twice the rate of the economy, three times as fast as consumer prices, and at more than double the cost of health insurance. The inflation-adjusted price of higher education has risen by 200 per cent since the 1980s despite the fact that inflation adjusted median income has risen by less than 10 per cent. And the most rapid rise in public higher education has occurred since the late 1990s, a period in which median family income fell.

Note: The longer version of this paper goes on to make two further arguments: 1) Public higher education as a whole is not benefitting from the federal support for student borrowing and 2) To defend public higher education we must articulate the links between debt burdens and tax burdens. I conclude on an optimistic note: Because California is a relative latecomer to financialization and because California's strong tradition of free tuition has given rise to significant early political protest and push-back, it is not too much to hope that California may be the place where public universities stop capitalizing on the growth of income inequality and become, once again, a vehicle for reversing it.