Coming to Market

A Growing Reliance on Student-Supplied Revenue

The questions persist. Why do so many conversations within higher education end up as arguments about markets and market forces? Aren't colleges and universities academic institutions and not mere vendors? Isn't what they provide not so much a product as an experience that uniquely mixes formal learning and self-exploration?

Perhaps so, but the dominant fact of postsecondary finance today is that colleges and universities of every stripe are increasingly on their own; even public institutions must now rely on the market to fund their aspirations and operate their educational programs. What higher education has become is a remarkably robust industry in which student-supplied funds have successfully insulated a majority of campuses from the forces that have reshaped most other public institutions.

It has been a quiet revolution in postsecondary finance, this 25-year reshuffling of the mix of revenues that allowed the core budgets of all but a handful of institutions to outpace inflation each fiscal year. Granted, the budgets of most institutions seldom prove sufficient to fund all of their ambitions, but for a quarter-century—year in and year out—most colleges and universities have enjoyed real and substantial revenue growth. And while dollars derived from research and service activities have also risen substantially over this period, the real story is that students and their families in increasing numbers have shouldered an ever larger share of the costs of operating the nation's colleges and universities.

This issue of *The Landscape* presents a new analysis that indicates how, in the revenue game, most institutions have benefited—though clearly some classes of campuses more than others.

Tracking the Market

As part of its work with the National Center for Postsecondary Improvement (NCPI), the Institute for Research on Higher Education (IRHE) has continued to focus on the changing nature and shape of the American market for postsecondary education. Increasingly, as well, tertiary education systems outside of the United States have asked IRHE to update them on the shifting mix of postsecondary revenues in this country. The analysis presented here derives from a series of presentations made by NCPI researcher Robert Zemsky of IRHE to these international audiences.

The financial data were drawn from the Computer-Aided Science Policy Analysis and Research (CASPAR) Web site, a database housing information on academic, science, and engineering resources that is hosted by the National Science Foundation (NSF). The first step in the analysis was to define four groups of baccalaureate institutions: a set of highly selective, high-priced private research universities; their competitive peers among the nation's private liberal arts colleges; a set of major public research universities; and a set of public comprehensive institutions.

The two groups of private institutions included in the analysis comprise the Consortium on Financing Higher Education (COFHE), and the public research universities belong to the Association of American Universities (AAU). The comprehensive institutions represent all public doctoral and comprehensive colleges and universities that had

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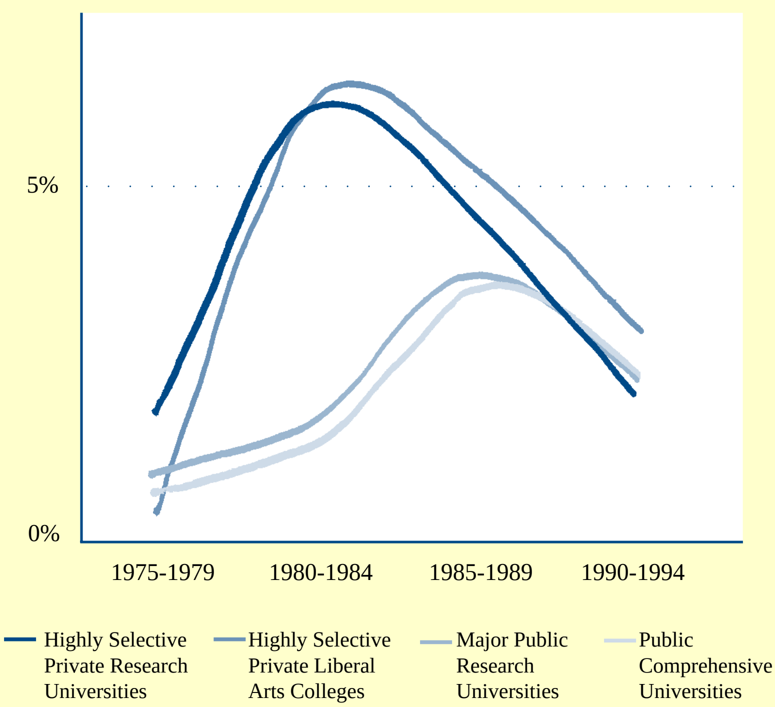
Table 1
Annualized Real Growth Rates in Core Revenues, 1975 to 1995

	Average Annual Increase in Core Revenues
Major Public Research Universities	2.7%
Public Comprehensive Universities	2.5%
Highly Selective Private Research Universities	3.9%
Highly Selective Private Liberal Arts Colleges	4.0%

Chart 1
Annualized Real Growth Rates in Core Revenues from 1975 to 1994, by Five-Year Intervals



consistently reported data first to the Higher Education General Information Survey (HEGIS) and subsequently to the Integrated Postsecondary Education Data Systems (IPEDS). Missing from the analysis are the nation's more moderately priced liberal arts colleges. It was not until the 1990s that IPEDS sufficiently isolated institutionally supplied financial aid funds to allow a realistic calculation of net tuition income for these fee-dependent institutions.

The logic for selecting these particular sets of institutions was straightforward. Public research universities are often the flagship institutions that set the pace for other campuses in their state systems, and the public comprehensives (along with community colleges) satisfy the bulk of the market for postsecondary education in the United States. The two groups of private institutions receive most of the press heralding increasing tuition. And, indeed, these medallion institutions frequently serve as the industry's price-setters.

The Rollercoasters of Revenue Growth

The 20 years between 1975 and 1995 are often portrayed as a tough era for American postsecondary education—a time of rising costs, shrinking public appropriations, and increased hostility to the necessary tuition hikes that inevitably followed. In actuality, during this same period postsecondary education enjoyed real and steady growth in its core revenues, defined as student tuition and fees (not including room, board, and other auxiliaries); federal funds (principally research grants and contracts, but also federally supplied, institutionally based student aid funds); state and local grants, contracts, and appropriations; private gifts and grants; and income earned by the institution's endowment.

As shown in Table 1, highly selective private liberal arts colleges and research universities led the way, with annual average increases in core revenues of roughly 4 percent per year (in constant dollars). Chart 1 presents those mean growth rates by institutional type at five-year intervals, thus highlighting the financial advantage that highly selective private institutions came to enjoy during the 1980s. Starting in the 1990s, public institutions began to catch up—although if the more recent, roughly equivalent growth rates persist, so will the competitive advantage enjoyed by private medallion institutions. The other important fact to note in Chart 1 is that all mean growth rates are positive: even in years when the public institutions lagged behind their private counterparts, on average they too enjoyed real increases in core revenues.

Who or what was responsible for higher education's good fortunes? The answer is students and their families. Chart 2 demonstrates that the real economic driver over these two decades was student-supplied tuition revenue. Among the nation's most selective private institutions, tuition's share of core revenue grew at a steady pace: for medallion research universities, it increased from an average of 27.2 percent of core revenues in 1975 to 34.9 percent in 1995; and for medallion liberal arts colleges, it increased from 52.3 percent in 1975 to 60.6 percent in 1995.

Though, for public institutions, their initial percentages are relatively smaller, the rate of mean growth in tuition's share of core revenues is equally substantial. In 1975, major public research universities were deriving an average of 15.7 percent of their core revenues from tuition, and public comprehensive institutions were drawing an average of 19.8 percent. Twenty years later, the average figures rose to 24.6 percent and 33.4 percent, respectively—which translate into a nearly 9-percentage-point shift for the AAU public universities and a more than 13-percentage-point increase for the public comprehensives.

Charts 3 and 4 compare mean tuition and other major revenue sources by institutional groupings, further demonstrating the escalating importance of tuition's slice of the postsecondary revenue pie. For public institutions, the key ratio compares tuition revenues with state and local appropriations. For private institutions, the key ratio compares tuition revenue with endowment income.

Chart 3 displays the ratio of mean appropriations to mean tuition revenue—of public money to market money—for both public comprehensive and public research universities. At the high-water marks of public support during the close of the 1970s, both types of public institutions were receiving more than three dollars in state and local appropriations for every dollar of tuition revenue. Twenty years later, that ratio would be halved: for every three dollars in state appropriations, public institutions were earning an additional two dollars from student tuition and fees.

A comparison of the share of core revenues from tuition versus endowment income is a more appropriate—but analogous—analysis for private institutions. Chart 4 displays the ratio of mean tuition revenue to mean endowment income over the same period for the set of highly selective private liberal arts colleges and research universities. In 1975, highly selective liberal arts colleges received 1.8 tuition dollars for every dollar of endowment income, while research universities received two tuition

Chart 2
Growth in Tuition as a Percentage of Core Revenues, by Five-Year Intervals

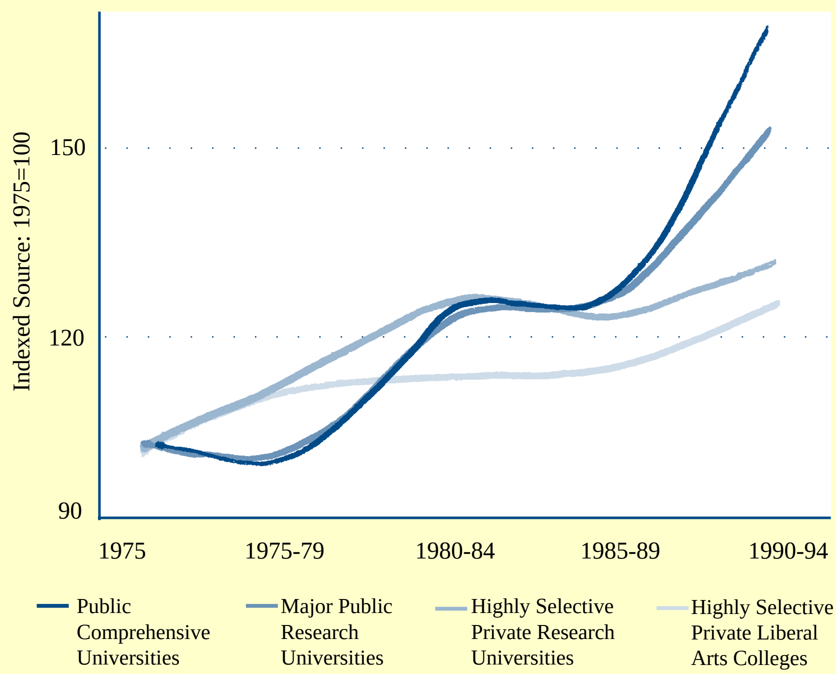


Chart 3
Ratio of State/Local Appropriations to Tuition Revenues, by Five-Year Intervals

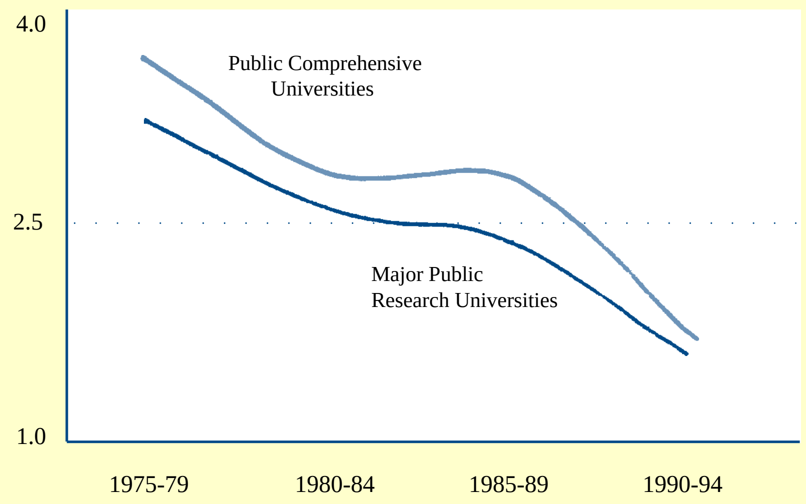
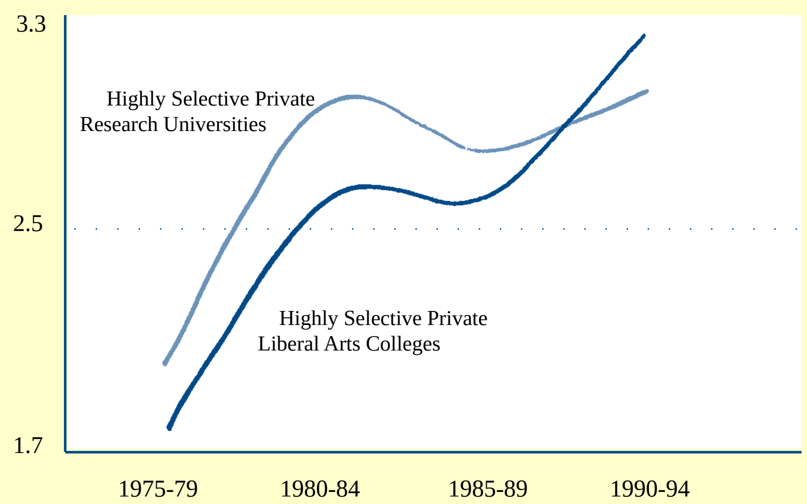


Chart 4
Ratio of Tuition Revenues to Endowment Income, by Five-Year Intervals



dollars for every endowment dollar. Twenty years later, the ratio of mean tuition to endowment income would nearly double for liberal arts colleges and increase by 50 percent for research universities.

Global Perspective

What has changed most in American postsecondary education is that the pursuit of student-generated revenues now plays the dominant financial role in shaping both the mission and operation of most institutions. Colleges and universities—even the great public institutions on which the reputation of American postsecondary education often rests—are expected to earn their own way. It is the key development that has helped to make the market.

Some think of these market trends as being distinctly American. Yet, as with other vicissitudes that first emerge in the United States, what has happened to postsecondary education here is becoming a reality in other parts of the globe as well. A recent story appearing in *The Chronicle of Higher Education* on tuition increases in a number of developed and developing nations tells a strikingly familiar story:

The root cause of the pressure on the cost of college is the surge in demand for higher education worldwide. Over the past two decades, as national populations have risen, so has the proportion that completes secondary schools. That trend, coupled with a job market that keeps raising the bar in education, has created an enormous increase in the need for college-level training. But in most countries, public financing of higher education hasn't kept pace with that need, because of declining budgets and competing national goals (May 5, 2000).

What the rest of the world is discovering—and what American institutions have known for nearly 25 years—is that when money matters, so do markets. □

Correction: *Due to a printing error, the titles of Charts 2 and 3 in the May/June 2000 issue of The Landscape were transposed, and a typo was introduced. The proper title for Chart 2 should read: "Overall Accountability According to Institutional Type." For Chart 3, it should read: "Overall Accountability According to Institutions' Graduation Rates and Net Revenue per FTE."*