



AMERICAN ENTERPRISE INSTITUTE
FOR PUBLIC POLICY RESEARCH

Postsecondary Post-“Access”

Burck Smith
StraighterLine

bsmith@straighterline.com

Draft: Please do not cite without permission from the author.

Prepared for the American Enterprise Institute Conference,
“Stretching the Higher Education Dollar”

August 2, 2012

The collected papers for this conference can be found at
<http://www.aei.org/events/2012/08/02/stretching-the-higher-education-dollar/>.

Author's Note¹

“Where you stand is where you sit” is an old saying that means that a person’s public opinions reflect their economic self-interest. Of course, the converse is “where you sit is where you stand,” which implies that a person’s choices that led to their economic self-interest are driven by their private beliefs. I am the CEO and founder of StraighterLine, a non-accredited provider of extremely affordable online college courses. I founded StraighterLine (and online tutoring company SMARTHINKING before it) based on my graduate work in public policy related to the internet’s implications on higher education policy, finance, and learning.

Public Mandates, Private Markets, and “Stranded” Public Investment

Dating back to the American Revolution, the United States Postal Service (USPS) has been a trusted and cherished American institution. Who doesn’t associate the Pony Express with the opening of the American West or the slogan of “neither rain, nor sleet, nor snow...” with American perseverance? With a mandate to provide access to mail service to anyone, anywhere, the USPS let a polyglot citizenry communicate across a sprawling country. It was a nation-building need that the private sector would not fill. In the nearly 250 years since Ben Franklin served as the first Postmaster General, the U.S. population has grown from under 3 million to over 300 million and the need for communication has grown exponentially.

Key Points

- The market and product characteristics of higher education are fundamentally different than they were sixty years ago due to demographic and technological changes.
- Today’s taxpayer subsidies for higher education accessed through accreditation are based on a legacy regulatory model.
- The application of a legacy regulatory model to the new market results in significant “profiteering” for many accredited colleges.
- The legacy regulatory model cannot be adapted to the new market because the changes would undermine the revenue structure of those that control it.
- Because of the mismatch between the legacy regulatory model and the characteristics of the new market, none of higher education cost reduction strategies currently discussed are likely to succeed.
- Principles of new regulatory models should focus on outcomes, student choice, and model innovation.
- Possible models range from consolidating all post secondary subsidies into a consumer Lifetime Learning Account to “Do No Harm” where existing structural tensions lead to stranded public investment.

¹ Special thanks to KC Deane, research associate in education policy studies at AEI, for research support on this paper.

Draft: Please do not cite without permission from the author.

The USPS experienced nearly constant growth until its peak of 208 billion pieces of mail delivered in 2001.¹ However, by 2010, the number of items delivered dropped to 171 billion, an 18 percent reduction, and the number of higher-profit first class letters dropped by 25 percent.² The loss of mail volume resulted in a \$10 billion loss in 2011. The response to such losses has been to increase stamp prices and cut services (and appeal to Congress). However, raising prices and reducing services only drives more customers away which results in even higher prices and greater service reductions—a business model death spiral.

With an insatiable demand for communication in an exponentially growing marketplace, what happened to the USPS? First, e-mail, cheap long distance calls, and online billing made personal communication essentially free. Second, the percentage of the United States population that can't be reached by either new technologies or private delivery services is extremely small. Put simply, the market for personal communication—previously unprofitable and requiring public support—became profitable and diversified, just not for USPS. Today, messaging options that are free—like e-mail and long-distance phone service—are bundled with other services that customers will pay for—like internet access, cell phone access, and search engines (for search engines, customers “pay” by being advertised to). Messaging options that are expensive—like overnight delivery—are now offered by providers who are able and willing to absorb losses from a small percentage of deliveries by profiting on the much larger number of deliveries. The evolution of the personal communications market from monolithic, unprofitable, and publicly supported to competitive, profitable, and privatized has brought massive innovation and savings to consumers, but it also erodes the economic justification for a publicly subsidized communication system.

Draft: Please do not cite without permission from the author.

Another publicly subsidized market where customers can choose their provider and whose foundation is built upon information sharing and communication is higher education. In the name of access to higher education, a scarce resource in the twentieth century and all centuries before it, new colleges were built and operated with public money. To continue to spur demand for college education, publicly sanctioned financial instruments were created to purchase “college” at already subsidized prices. Due to greater supply and an even greater demand for skilled workers, annual college enrollment has grown ten-fold over the last 60 years to over 21 million students.³ Starting in 2001, some students began learning online. The growth in online learning coincided with increases in the number of transfer students, non-traditional students, certificate programs, and, increasingly, unaccredited alternatives to the traditional notion of college. Like with postal service, the arrival of new and cheaper options allows students/customers to differentiate themselves by type and by need. Institutions negatively affected by such differentiation are raising prices while reducing services—the business model death spiral. Lastly, “access”—the original justification for public mandates and taxpayer subsidies—is no longer limited by geography or by a scarcity of providers. It is limited by price and technological infrastructure. The mechanisms used to subsidize higher education, and possibly the subsidies themselves, no longer fit the market that they serve.

Some will argue that the USPS and public higher education are too dissimilar to draw meaningful conclusions; that e-mail is qualitatively better than snail-mail while online learning is only better than traditional higher education in certain circumstances. Admittedly, the “product” of higher education is far more complicated than the delivery of a simple message. However, it should be remembered that e-mail was not qualitatively better than the postal system when e-mail first became widely available in the mid-1990s (almost a decade prior to the precipitous

Draft: Please do not cite without permission from the author.

decline in first class delivery). Too few people had e-mail addresses, computing devices were scarcer and deskbound, bandwidth was limited, and file format incompatibility made attachments an adventure. However, as more users signed on, the technical limitations were solved and the necessary infrastructure expanded such that now, in 2012, e-mail seems qualitatively better than snail mail. Further, snail mail remains a preferred method of delivery, but for a small subset of uses. For instance, messages for which more emotional weight is desired—like birthday cards from relatives, letters from lovers, and advertisements for products—are best sent by post. Further, official documents that can be sent in print, but aren't time sensitive, also remain best sent by post. A better question for postal and higher education regulators is: “Is the relative value of physical mail delivery and place based education sufficient to justify the taxpayer investment in it? If so, in what parts and by how much?”

Unlike the postal service, the higher education regulatory and financing model creates barriers to competition that have slowed the ability of customers to self-differentiate. These barriers prevent new providers and new models from emerging, which keeps prices high. To extend the analogy, if the postal service acted like higher education, it would have asserted its exclusive authority to offer e-mail and charged first class rates for the messages. However, the recent growth of alternatives to traditional credentialing—like StraighterLine, Edx, and Udacity—and service delivery—like SMARTHINKING, InsideTrack, Piazza, and OpenStudy—and content creation—like Flatworld Knowledge, Carnegie Mellon's Open Learning Initiative (OLI), and the Saylor Foundation's open courseware—point to an accelerating fragmentation of our historical definition of “college.” Simultaneously, and not coincidentally, the issues of ever-rising college prices, student debt, and diminishing return on investment (ROI) to an undergraduate degree are becoming mainstays of media and public policy.

Draft: Please do not cite without permission from the author.

The explosion of more course-level and component-level choices for students is crashing headlong into the self-interest of providers of “college”—threatening the business models of incumbent providers. The problems of price, debt, and ROI will not be solved until we confront the realities of a higher education market where the founding assumptions embedded in our regulatory and financial structures are no longer valid. In this chapter, I explore how these founding assumptions will stunt the current effort to lower prices and suggest some new approaches to reform that can encourage low-cost providers to emerge and flourish.

Why Are Markets Subsidized?

Governments intervene in private markets to protect consumers, fix market failures, protect local industries, redistribute wealth, or provide for the common good. For instance, without the FDA, dangerous drugs and foods would be easier to purchase, thereby harming consumers. Without public utilities commissions, electricity providers would evolve into monopolies with too much pricing power, thereby distorting the market for electricity. Without agricultural subsidies, our (arguably) critical agricultural industries would be at risk to foreign competition. Without a progressive tax code, those that benefit the most from society’s rules and mores would contribute the least. Without the Department of Defense, our nation’s protection would be in other people’s hands who might not have the same interests as the country.

The primary justification for government intervention in higher education has been that students, particularly rural students, could neither access nor afford “college”—a personally uplifting and publicly democratizing institution. Therefore, public colleges were built in rural locations and student aid and other financial instruments were created to subsidize both the supply and demand for college. Frequent secondary justifications for public investment in higher

Draft: Please do not cite without permission from the author.

education include income redistribution through grants and subsidized loans, the provision of spillover social benefits above and beyond those that accrue to individuals, and consumer protection through the federal accreditation and state licensing system.

However, like the role of the postal system in the personal communication market, the public role of higher education needs to be rethought in a market whose characteristics have fundamentally changed. Today, the price of college courses taken online should be much lower than those taken in a face-to-face environment. Further, the number of students desiring a college degree has exploded due to population growth and the increased demand for postsecondary training. Lastly, the education options available to any single student have multiplied due to the ability to learn online. Access, the principle justification for public higher education, is not limited by providers but by price and high-speed bandwidth.

Other justifications are increasingly debatable. The ability of the current postsecondary regulatory apparatus to protect consumers is dubious. College tuition has risen four times faster than inflation, grade inflation is rampant though students are studying much less than they used to, studies indicate that students are learning very little, per-student debt is skyrocketing, profit margins for online courses are substantial, and the federal government felt it necessary to re-regulate already accredited for-profit institutions.

If access and consumer protection are not being served by the existing regulatory and financial structure, the lone remaining justification for public investment is simply investment in an enterprise whose social benefits accrue to more than just the individual. These benefits would be threefold: 1) the creation of an educated citizenry benefits the civic infrastructure and is the lifeblood of a democracy; 2) college subsidies generate research and knowledge creation that

Draft: Please do not cite without permission from the author.

would not be generated by the private sector; and 3) colleges create local cultural and employment centers.

Though it can be argued that the public benefits of higher education warrant market intervention, markets with surplus public benefits are not, by default, worthy of public investment. For instance, bicycle use (health improvement, pollution reduction, road use reduction) and newspaper publishing (education, community building, and more) create significant public benefits but are not subsidized markets. Also, some activities with public benefits are paid for by usage fees rather than broad-based taxpayer subsidies. For instance, airport security and 911 telephone service are paid for by user surcharges. To the extent that the public benefits of private education deserve subsidies, these should be negotiated and delivered on their merits. For instance, direct student subsidies might make sense to increase the percentage of the population that takes advantage of higher education, thereby increasing the public value, but institutional subsidies do not serve the same purpose. Much of the research function in higher education is already funded by non-tuition revenues like grants and contracts and there is a spirited debate about the value of much of the research that is generated by academia. So, the research function of education is already well-equipped to argue for its own subsidies. Lastly, the cultural and community benefit offered by colleges are questions of public resource allocation rather than student learning. Public subsidies for these functions should be justified accordingly.

Nevertheless, the public belief in the social benefits of higher education is sufficiently widespread to assume that some kind of public support of higher education is warranted. However, what is the right instrument for public support? Today's chaotic mix of customer and provider subsidies through direct payments and tax code adjustments has created a regulatory

Draft: Please do not cite without permission from the author.

Frankenstein monster whose perverse consequences are profoundly distorting a higher education market that should be much more affordable than it currently is.

Higher Education’s Current Subsidization, and Regulatory Structure

“Access,” the other side of the coin to “scarcity,” is the single most common justification for public funding of higher education. In a recent testimony to Congress, *Inside Higher Ed* reports that “the idea of access dominated much of [Secretary of Education Arne] Duncan’s testimony, which included frequent allusions to the fact that having at least some postsecondary learning is increasingly necessary to land a good job.”⁴ Indeed, throughout history access to the individuals and materials necessary to learn has been limited and precious. As eloquently described by Peter Smith, current vice president at Kaplan University, former president of Cal State University-Monterey Bay, and former Congressperson:

“Our system of higher education is based on and organized around the principle of scarcity, that the resources needed to provide an education must be collected in one place—a campus—because there is an insufficient supply of those resources in the general community. Not enough faculty members. Not enough classrooms. Not enough laboratories. Not enough library books. There was no other way to “do” higher education.... Scarcity was a reality in the world of information, teaching and learning until the early 1990’s when the web was born. Essentially, the principle of scarcity says that for an institution to be valuable to the community around it, it must offer a service that community members can’t get more cheaply or with higher quality somewhere else. The scarcity, based on an inability to duplicate the resource, controls the market.”⁵

“Scarcity” has been the underpinning of the organizational and business model of “college” since “college” first started in the Middle Ages. Because subject-matter experts were scarce and real-time communication options were limited, it made sense to build impressive campuses to attract professors and enable teaching. With such large fixed costs, adding a few more professors was relatively cheap. A critical mass of professors attracted a critical mass of students, who attracted more professors, and so on. This model—substantial fixed costs with low marginal

Draft: Please do not cite without permission from the author.

costs (the cost to offer one more class)—became the only and preferred economic model when it was “hardwired” by tying a college’s accreditation status to substantial direct and indirect public subsidies. By awarding significant taxpayer subsidies to course providers that adhere to a high fixed, low marginal cost economic model that is enshrined by accreditation, these providers have a preferred position in the marketplace. Such position makes it difficult for alternatives to emerge.

Students get a wide variety of taxpayer support to go to college. Taxpayer subsidies flow to public, private, and for-profit colleges through both state and federal channels:

Table 1: Higher Education Subsidies

Annual	Direct Subsidies	Indirect Subsidies
Demand Side (Student Subsidies)	<ul style="list-style-type: none"> ▪ \$8.5 billion (Student state and local aid, FY2011)⁶ ▪ \$41.5 billion (Federal Pell Grants, FY2012)⁷ ▪ \$2.07 billion (Lost revenue from subsidized Stafford loans at 3.4 percent interest rate, FY2012)⁸ ▪ <i>TOTAL: \$52.07 billion</i> 	<ul style="list-style-type: none"> ▪ \$25 billion (Government revenue losses from higher education tax provisions, FY2010)⁹ ▪ \$9.6 billion (Student loan defaults, FY2010)¹⁰ ▪ \$6.7 million (Perkins Loan Cancellations, FY2010)¹¹ ▪ <i>TOTAL: \$34.6 billion</i>
Supply Side (Institutional Subsidies)	<ul style="list-style-type: none"> ▪ \$73 billion (State and Local appropriations to colleges and universities, FY2011)¹² 	<ul style="list-style-type: none"> ▪ Property Tax Exemption for Non-profits, \$2.8 billion (1997) ¹³ ▪ Federal Tax Exemption for Non-profits. ▪ Land grants. ▪ de facto student loan guarantees

Note: This table is not intended to provide an authoritative value on the total higher education subsidy. There are undoubtedly a wide variety of subsidies and credits that are not included. It is an attempt to list the multiple sources and an order of magnitude for taxpayer support for higher education.

Draft: Please do not cite without permission from the author.

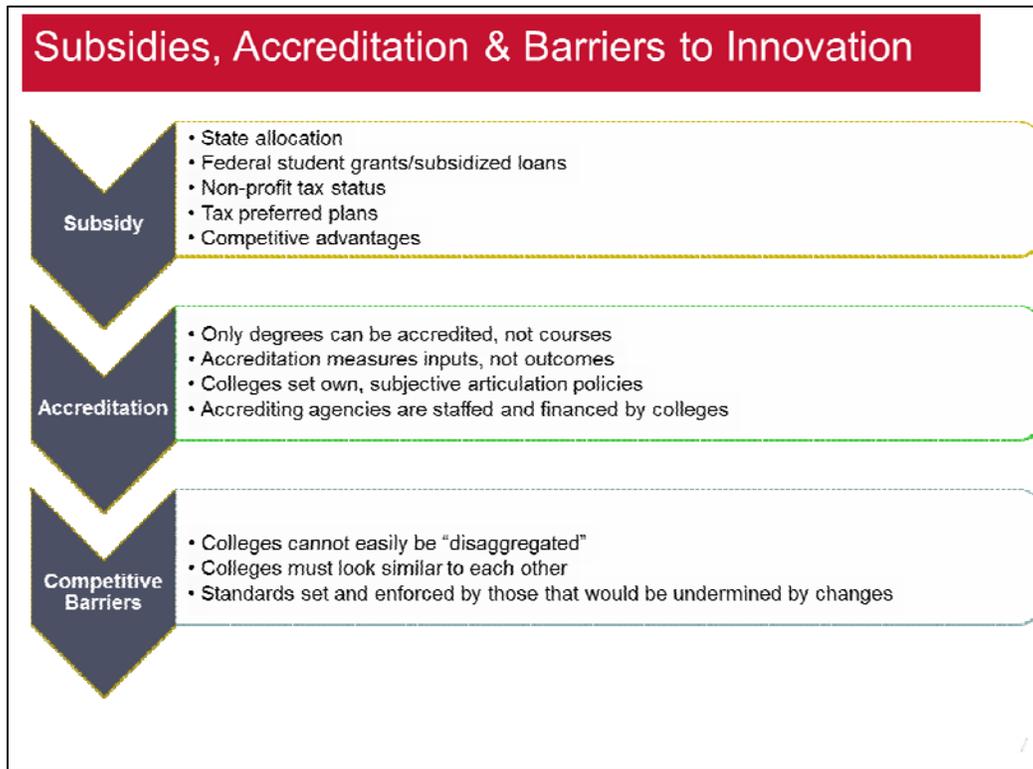
These subsidies include federal grants, federal loan subsidies, federal loan guarantees, federal tax-favored savings plans, federal tax credits, state grants and subsidized loans, state subsidies of colleges, and the non-profit tax status of colleges. Though impossible to fully calculate, a partial calculation yields \$163 billion annually, not including the value of federal tax-exemption and government endorsement. Divided by 21 million students (full and part-time), this yields a taxpayer subsidy of over \$7,750 per student per year.

To be accredited, a college must meet a variety of criteria, but most of these deal with a college's inputs rather than its outcomes. Furthermore, only providers of entire degree programs (rather than individual courses) can be accredited. And even though they are accredited by the same organizations, colleges have complete discretion over their "articulation" policies—the agreements that stipulate the credits that they will honor or deny when transferred from somewhere else. To better make the point, if a student wanted to take a course from the world's best and cheapest provider of any given course, the student would not be able to pay for the course with any of the taxpayer subsidies available to purchase courses from accredited colleges. Then, if the student purchased anyway, the student would have to persuade the college where the student attends to award credit for the course even though the college has a strong financial disincentive to do so. Lastly, to further tip the scales toward incumbent providers, accreditation bodies are funded by member colleges, and accreditation reviews are conducted by representatives from the colleges themselves. The "iron triangle" of input-focused accreditation, taxpayer subsidies tied to accreditation, and subjective course articulation ensures that almost all of the taxpayer funds set aside for higher education flow to providers that look the same. And by giving these models such a preferred position in the market for higher education and making it

Draft: Please do not cite without permission from the author.

difficult to alter the form of higher education, the legacy regulatory structure prevents the kind of innovation necessary when market conditions change.

Figure 1: Subsidies, Accreditation, and Barriers to Innovation



Legacy Regulatory Structures, New Market Conditions, and “Profiteering”

And the market has changed—dramatically. Between 1950 and today, the number of enrolled postsecondary students per year has grown ten-fold to over 21 million students¹⁴ while the overall population has doubled to over 300 million.¹⁵ Also, starting in the mid-1990s, and accelerating exponentially, is the revolution in the technologies of information transmission and communication – the underpinnings of education. With information and communication changing from scarce to free, the need to build a physical location to share information, ideas, and discussion has diminished. In fact, as the cost of content, learning management software, and

Draft: Please do not cite without permission from the author.

telecommunications plummets toward zero, the only remaining direct cost for online courses is the cost of a professor's time. With this kind of cost reduction, some of the elements of the college business model are now vastly cheaper to deliver. By combining newly viable customer segments with new technologies, some student segments and some segments of the college experience should be *much* cheaper to serve. But which segments?

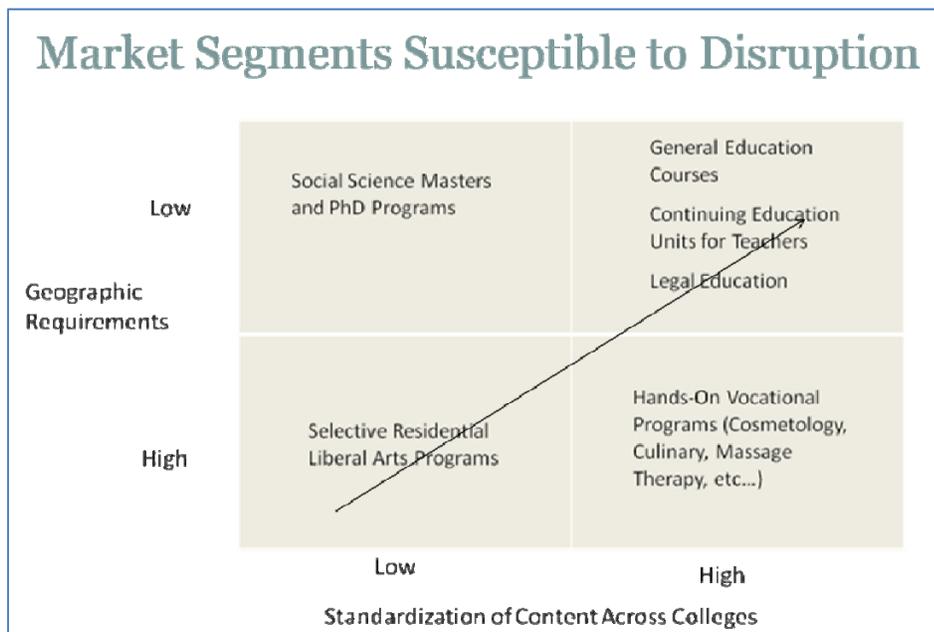
A famous quote by John Wannamaker, a successful American businessman, is “half the money I spend on advertising is wasted; the trouble is I don't know which half.” With the advent of targeted advertising through Google and data-intensive channels, John Wannamaker can now target his advertising much more precisely. Similarly, the growth of online learning allows students to more precisely choose how they want to learn. Students and colleges suffer from a comparable problem today. For any student (and taxpayer), a substantial portion of the money spent on higher education and services offered by higher education is wasted by purchasing services and functions that aren't desired. The problem is that accreditors—and by extension colleges and the Department of Education (ED)—refuse to define what “college” is. The ineffable concept of “college” was plausible when all “college” happened on the same campus. Teasing out the different functions of college was extremely difficult.

However, when colleges began offering online courses and programs as academically equivalent to face-to-face offerings, they created course-level economic substitutes with much lower cost structures. With courses and credits already interchangeable among many accredited colleges, online learning creates a global market for courses (instead of a geographic monopoly). The availability of cheaper substitutes within a global marketplace gives students a level of purchasing power and consumer choice that was previously unavailable. Under these conditions, a less regulated market would see prices plummet for those elements of college that are affected

Draft: Please do not cite without permission from the author.

by lower cost structures (see below) and revenue would migrate to new providers. However, such pricing would dramatically undermine the revenue models of many existing colleges who rely on the subsidies generated by higher priced face-to-face courses. Instead, colleges, with the protection of the accreditation and financial aid system, have kept course prices constant across all methods of delivery. By keeping pricing constant, colleges avoid a migration of students from a high revenue course option to a low revenue course option that might undermine the college's business model (on a side note, this is why the cable television industry fights so hard to prevent channel-specific purchases). Going one step further, some colleges have realized that, not only can constant pricing prevent revenue erosion, it can be a big money-maker. By developing online programs, the savings that are possible from online learning are captured by the college rather than delivered to the student. Indeed, 93 percent of colleges price online courses the same or higher than face-to-face courses.¹⁶

Figure 2: College Components Where Prices Should Fall



Draft: Please do not cite without permission from the author.

Every entity—for-profit or non-profit—has a business model comprised of a value proposition, resources, processes, and a profit formula.¹⁷ According to Clay Christensen and his seminal work on market disruption,¹⁸ there are three generic business models: solution shops, value-adding process businesses, and facilitated user networks. Solution shops solve unstructured problems. Examples include consulting firms or advertising agencies. They typically charge on a fee-for-service basis. Value adding process businesses bring in items that are incomplete and add value. Examples include manufacturing and restaurants. They typically charge on a per-unit basis for the output of their work. Facilitated user networks are enterprises in which the participants exchange things with each other. Examples include insurance companies or telecommunication companies. They usually charge a fee for membership or a fee for use. Due to the economic logic of scarcity, colleges perform all three functions. For instance, imparting critical thinking skills and civic responsibility are “unstructured problems” that universities profess to be good at solving. Workforce preparation and content delivery are “value added” solutions for students. Membership in an alumni community and access to the physical campus itself are facilitated user networks. Colleges perform all of these functions—sometimes together and sometimes in isolation. More importantly, due to accreditation, a college must perform all of these functions. Due to colleges’ incentive to avoid customer segmentation, they offer constant prices across all delivery models.

Though the stereotypical 18-22 year old student likely benefits from the conflation of these three business models, many do not. Due to increased demand for skilled workers, the largest segment of today’s college students are adult, working or attending college part-time.¹⁹ These students may have already developed critical thinking skills, civic responsibility, and effective work habits, therefore they do not need the “solution shop” element of higher

Draft: Please do not cite without permission from the author.

education. Similarly, they may have gained the skills that would be taught in a “value adding” process, but simply need proof to take elsewhere. Lastly, their work participation or obligations to other “facilitated user networks” may limit their desire to participate in the “facilitated user network” of a campus experience. Any given student may only need one of these permutations. More importantly, some of these are more appropriate for different parts of a degree program. The consumer demand possibilities not only vary by business model, but by elements within a degree program.

In a better functioning market, students would be able to choose by business model, by level of granularity, and by service offering at a wide variety of price points from a wide variety of providers. However, such choice is constrained by the distorting effects of market subsidies and the lack of an objective definition of college used by accreditors. In most industries, new technologies yield productivity improvements and price reductions because consumers vote with their dollars and providers that don’t adopt new technologies ultimately go out of business. However, in higher education, colleges use their preferred market position and existing subsidies to “capture” the price reductions that should flow to students. It’s not an accident that most colleges are looking to online learning as a way deal with budget woes.

Many colleges’ distance education programs are cash cows whose profits are maintained by the ability to keep prices high, allow students to access federal debt, and exert selective credentialing authority. For instance, Arizona State University Online, a revenue sharing relationship between Pearson and Arizona State University, yielded \$6 million in profit in 2011. Projections are that it will yield \$200 million in profit by 2020.²⁰ Similarly, Southern New Hampshire University, a private non-profit college, is justifiably proud of the 7,000 students (up from 1,700 in four years), \$73 million in annual revenue, and 42 percent profit margins

Draft: Please do not cite without permission from the author.

generated by its online program.²¹ However, back-of-the-envelope math shows that each student generates over \$4,000 in profit per year for this non-profit. By definition, online students are being overcharged to subsidize face-to-face students. A better functioning market would generate competition to reduce the price, but course-level competition is hard because new entrants don't benefit from the subsidies and articulation policies reflect college's reluctance to recognize courses from other colleges.

At most universities these profits, whether derived from online learning, big-time sports or outsourced services, are heavily invested in university facilities and personnel, rather than the students themselves. For instance, "between 1993 and 2007, the number of full-time administrators per 100 students at America's leading universities grew by 39 percent, while the number of employees engaged in teaching, research or service only grew by 18 percent. Inflation-adjusted spending on administration per student increased by 61 percent during the same period, while instructional spending per student rose 39 percent."²² Colleges have also committed to significant facilities construction, reflecting a belief in the continued and escalating flow of revenue. Says Jeff Selingo, editor of the *Chronicle of Higher Education* in a 2012 *New York Times* op/ed, "Students were not the only ones to go deeper into debt. So did schools, building lavish residence halls, recreational facilities and other amenities that contributed little to actual learning. The debt taken on by colleges has risen 88 percent since 2001, to \$307 billion." As the market begins to adjust to price points that more accurately represent the cost of delivery for courses that are academic equivalents, many colleges' budgets will no longer be supportable and they will have stranded fixed and personnel expenses.

Some will argue that the reduction of course delivery costs does not translate to a reduction of college expenses because the college experience is greater than the sum of its

Draft: Please do not cite without permission from the author.

constituent courses. While this is true at some colleges, student behavior at most others proves that students see at least a significant portion of “college” as interchangeable. Over one-third of all students transfer and nearly half have taken at least one online course. This does not include courses and credits earned from alternative sources like dual enrollment, AP, CLEP, ACE Credit recommended courses, prior learning assessment, and credit imported from other colleges.

Legacy Regulation Protects Colleges Rather Than Controlling Price

Because of the market distortions caused by an outdated regulatory and subsidy structure and the limitations on product innovation created and maintained by accreditation, there is no effective price setting mechanism in higher education. Without effective price setting in a market with thousands, rather than a few, providers for any given student, cost control will never be realized. Accordingly, almost all current cost control policy suggestions that protect existing colleges are likely to be unsuccessful.

When working properly, the benefit of markets is that they set prices efficiently. To work properly, markets need sufficient buyers, sellers, and available information about the product to be purchased. In the past, there weren't sufficient buyers (students) or sellers (colleges), and the only way to organize and deliver “college” was a time-delimited stint in a physical place with other buyers. “College” was well-defined, but the market wasn't. Accordingly, the public stepped in to subsidize the market. Today, the market is well-defined, but “college” isn't. There are plenty of buyers and sellers, but “college” could be delivered in all sorts of ways. Yet, the price is either set by government mandate (public colleges), varies depending on the buyer characteristics (net tuition), or both. The product—a college degree—is defined by the college and accreditors, and information about its value for any given provider is not only not available,

Draft: Please do not cite without permission from the author.

but not tracked and certainly not communicated. In short, despite having sufficient buyers and sellers, market pricing cannot flourish because the product (“college”) is defined by the providers of it, preserved by the government’s financial backing, and difficult to measure because of the paucity of inter-provider information. The result is little innovation in the elements of the product coupled with continued price growth despite lower cost means of delivery. When providers can combine strong demand with strong pricing power emanating from limited competition, the result is rapid price growth. It is also the textbook definition of a cartel. Like all profit maximizing entities, colleges want to maintain this preferential market positioning. However, because they are being funded and protected by government dollars and policies, they must respond to criticism about rising prices.

When asked about ways to reduce the high price of college, colleges almost always point to cost reduction—rather than price reduction—strategies. Examples include Course Redesign²³—a proven way to reduce the cost of delivery of high enrollment classes while improving student outcomes—the promotion of free content through open courseware initiatives, and greater use of online learning. Unfortunately, even if every college in the country adopted Course Redesign principles for all of their general education courses (it’s a crime that more haven’t done so already), used all available open courseware, and offered a full list of online courses, higher education tuition would continue to rise unabated.

To understand why the cost of course delivery can fall but price can continue to rise, it’s helpful to look at a college’s course-level revenue and cost structure. For instance, in Massachusetts (other states have comparable cost structures), the average tuition and fees charged by the two- and four-year systems (not including the University of Massachusetts) are roughly \$540 and \$872 respectively (these are derived by dividing the tuition and fees for a full-

Draft: Please do not cite without permission from the author.

time student by ten courses). The portion of two- and four-year systems' budgets that are subsidized by the state is roughly 32 percent and 21 percent respectively.²⁴ This means that the average all-in revenue for a course delivered to an in-state student at a two-year college is \$792 and \$1,108 at a four-year college. Depending on the college and course, the direct instructional costs (not overhead and fixed costs) of an introductory level course is somewhere around \$100 per student (for back of the envelope calculations, assume that an adjunct makes \$3,000 per course²⁵ with thirty students. There are few other direct instructional costs). Courses redesigned using Course Redesign principles have demonstrated an average 37 percent reduction in the cost of delivery. From a \$100 per-student per-course, this represents a \$37 savings. Though this cost reduction adds up to real dollars, it represents only a 5 percent potential price reduction for that course at a community college and a 3 percent potential price reduction at a four-year college for that particular course. The most likely candidates for Course Redesign are the forty or so general education courses. These represent about one-third of all enrollments in higher education. So, even if Course Redesign principles were applied to all applicable courses, the total price reduction would be 1.6 percent at a community college and 1 percent at a four-year college.

Another often touted cost reduction strategy is greater use of open and free content. Indeed, many foundations, state governments, and the federal government have subsidized the creation of open and free content. The rather nebulous justification is that, if content is free, then somehow college costs will be reduced. However, whether it reduces college costs or not, open and free content have zero impact on college prices. This is because 1) professors already build courses with their own materials as part of their compensation. Free and open online materials do not change this cost equation; 2) the cost of the digital materials in course development when

Draft: Please do not cite without permission from the author.

amortized over all the students taking the course is trivial; and 3) students pay for textbooks separately from tuition, which lets professors get digital materials from major publishers for free.

What's more, any cost savings derived from Course Redesign or the use of open courseware are often promised to the departments who adopted the innovation to get their buy-in. These savings may be used to support lower class loads, hire additional personnel, or support additional research. While these activities may be useful, they don't result in lower prices. Finally, even if there were cost savings that were not promised to the department making reforms, they would be quickly absorbed into the other areas of a college that are supported by cross-subsidies from these courses—like structural cost increases devoted to benefits, facilities maintenance, inflation, and more. Even where online courses have lower student/teacher ratios than large lecture-style courses, the savings derived from the reduction in overhead dramatically overwhelm the increase in labor costs.

If cost saving strategies won't reduce the price of college, can policymakers focus on price-based strategies? Successful price-based strategies must incorporate all of the necessary elements of efficient markets. There must be sufficient sellers, sufficient buyers, sufficient transactional information, and definition of the product that is consistent between the buyer and the seller. Below is a list of price-based strategies that are most often discussed. Unfortunately, these are all lacking one or more elements:

- **Performance Funding:** Performance funding initiatives tie taxpayer support to higher completion rates. Though not exactly a price reduction strategy, it aims to get greater value for the existing price. Performance funding is elegant in theory, but without objective, course-level outcome assessments, it is unlikely to further diminish the credibility of a college degree. Grade inflation is already rampant in America's colleges, and students are

already studying 40 percent less than they did twenty years ago. Without a consistent and public definition of the product between the buyer and the seller, performance funding is more likely to harm than help.

- **Shaming:** Shaming is the practice of publicly listing the colleges with the highest tuition and tuition growth. For the most part, this is only relevant to those colleges that are the most selective or the colleges that are using tuition as a proxy for quality. This represents about 15 percent of the national enrollment. Further, because these colleges are selective, the students that apply are not particularly price sensitive. Such a policy is not likely to have a material impact on college behavior. In essence, this is a solution without a problem. Students willing to pay the premiums charged by colleges with the best reputations can certainly do so.

Indeed, the second iteration of such a list was recently released. According to *Inside Higher Ed*, “The second annual edition of the Education Department’s lists of the country’s most expensive and least expensive colleges was released Tuesday. Like last year, there were few surprises.”²⁶

- **Pricing Transparency of full-time enrollment:** Colleges were recently required to put “net price calculators” on their websites. These calculators are supposed to allow students to input financial information to determine what their net price would be. The theory is that, by creating greater pricing transparency, students will make choices based on net price and force colleges to reduce the overall price of tuition. Unfortunately, most colleges are not able or are unwilling to give a complete view of the true cost because many financial decisions won’t actually be made until enrollment. Further, the net price calculator doesn’t allow for the possibility of completing some parts of a college in one place (like at a community college or StraighterLine) and completing the rest of college at the school. Lastly, there are multiple

Draft: Please do not cite without permission from the author.

versions of a net price calculator with varying inputs and outputs. Such variability not only requires multiple information inputs on the part of the student but also makes it difficult to compare results.

Elements of a New Market—Unbundling, Re-bundling, and Validity

In 2001, MIT, one of the world's great educational brands, announced that it was putting all of its academic materials online. Now, anyone in the world could study the same materials and see the same lectures as MIT students. Many others quickly followed. At Carnegie Mellon University, another world class educational brand, the Open Learning Initiative took free content one step further. It created free adaptive learning software that would not only present the content, but identify student strengths and deficiencies and drive students toward subject mastery. Concurrently, online tutoring services, like SMARTHINKING and Tutor.com, arose to provide academic help from trained and credentialed people up to 24 hours a day, 7 days a week. Other services, like life coaching from companies like InsideTrack and lab kits that could replicate lab environments at home, came to market. With ubiquitous and free content, academic experts and mentors available at any time and place, and a host of tangential products available as needed, one would expect the price of college classes to plummet. Instead, tuition in every sector of higher education has risen by at least 40 percent in constant dollars without any price differentiation between online courses and face-to-face courses. Non-profit colleges are deriving tremendous profits from online learning. Despite the potential for enormous cost and price reductions and better segmentation by customer and need, the opposite has occurred.

Only in the last couple of years have alternatives like StraighterLine, StraighterLine's ETS/CAE partnership, edX, and Udacity emerged. Not surprisingly, all of these parallel

Draft: Please do not cite without permission from the author.

credentialing efforts are happening outside of the traditional accreditation system, are focusing on distinct pieces of the college experience and receive none of the taxpayer subsidies provided to existing providers. In fact, various terms are popping up to describe the phenomenon such as “DIY U” (Do It Yourself University), “curating the degree,” and “stackable credentials.”

What’s emerging outside of the accreditation structure are better-priced solutions for specific market segments, despite having none of the taxpayer subsidies offered to accredited colleges. For instance, StraighterLine offers only general education courses at prices that are much lower than even community colleges without any taxpayer subsidies. These courses are exactly the same as a college’s, but are priced closer to the true cost of delivery. For students seeking a “value added” business model for one or more general education courses, StraighterLine provides it at an appropriate price. The Educational Testing Service (ETS) and the Council for Aid to Education (CAE) are both offering critical thinking skills tests directly to students starting in fall 2012. A student will be able to take a critical thinking skills score to an employer to prove critical thinking prowess. Such a score may be equal or more accurate and predictive than the proxy of a two- or four-year degree. It’s also a way to prove success at solving an “unstructured problem.” Similarly, “facilitated user networks” are popping up outside college through social networking sites like Facebook and LinkedIn and academic websites like Piazza and OpenStudy. Admittedly, these virtual networks create weaker ties than personal networks, but personal networks require a level of fixed investment that is only available to accredited providers. Given that almost all the structural and pricing innovation is happening outside of the heavily subsidized accrediting framework, one would think that federal and state policymakers would want to expand the subsidy structure to encourage these innovations.

Draft: Please do not cite without permission from the author.

If “college” can be unbundled by course, by business model, and by service, what is necessary to “re-bundle” into something meaningful for students and employers? In the software and technology market, application programming interfaces (API) let different systems talk to each other. For instance, if you read an article in an app on your iPhone and want to tweet it or post it on Facebook, the ability for the app to send information to Twitter or Facebook is controlled by Twitter’s and Facebook’s APIs. To function properly, API’s need to be clear and public. Like in the software industry, unbundled elements need to be “inter-operable” in other education offerings. In higher education, the API equivalent is the articulation agreement. Unfortunately, colleges’ private incentives to drive revenue through delivery of their courses is at odds with creating clear and public “interoperability.”

There’s a saying in the IT industry that “bad data in equals bad data out.” This means that one can build a great system, but if the data going into a system is unreliable, then the data coming out (and the resulting conclusions) are also unreliable. Given the fact that over a third of all college students are transferring their transcribed credentials from one school to another and that colleges accept credit from a wide variety of unaccredited sources like ACE Credit, dual enrollment, AP, CLEP, and more, it’s worth taking a closer look at the humble transcript. In fact, it’s not a stretch to say that the integrity of the transcript is what undergirds the entire higher education system.

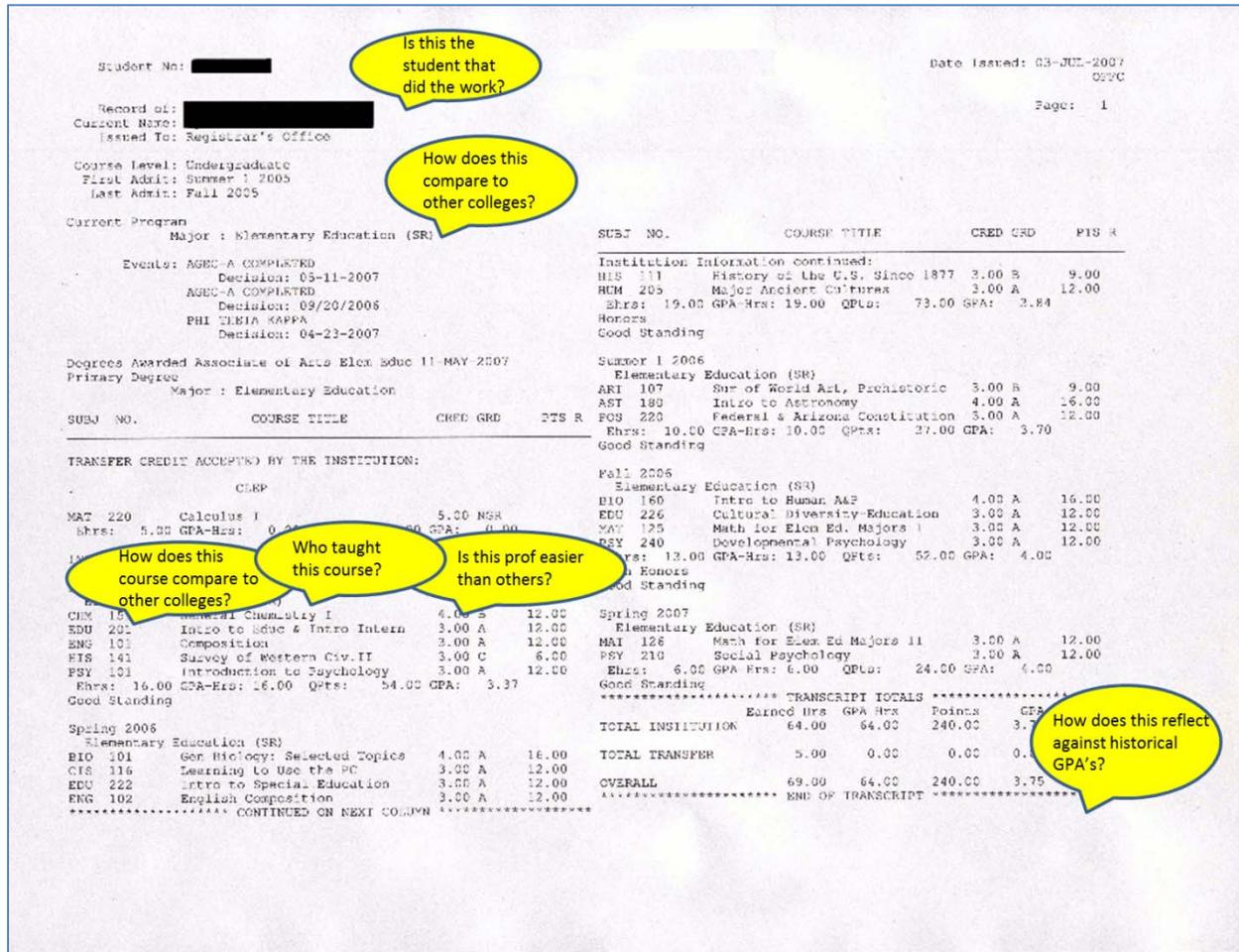
If a student presents their college transcript to an employer or another college, what does it tell that employer or college? Is this “good” data? The transcript itself is a product and relic of “scarcity.” Its form is based upon the data that could be included on a physical sheet of paper and mailed from one school to another. Given the personal profile information collected and easily

Draft: Please do not cite without permission from the author.

shared on social and professional networking sites, the amount of information available through the transcript is shockingly paltry. Unfortunately, as a receiver of a transcript, I don't know:

- If this is the person that completed the coursework: Accredited colleges have no uniform identity verification standards or processes. Further, colleges do not check for such standards or policies when awarding credit in transfer. Lastly, such information is never listed on a transcript.
- The relative value of any given grade: Some professors are harder than others. Some professors are more likely to make exceptions than others. It's easier to cheat in some classes than in others. Today, professors are giving far higher grades than they did ten years ago. Grades vary by sections within courses, courses within institutions, and institutions over time. What does a "B" mean?
- The elements of a major: Majors are assortments of courses. Course grades have little objective validity. The same major at different colleges may have different requirements. Different majors at the same college may be dramatically different.
- How this degree compares to other schools: Colleges have widely varying distribution requirements, and, given all the ambiguity around professors, classes, and majors, it is almost impossible to compare a degree from one school to a degree from another.
- If I have any other skills: The college degree provides no information on critical thinking skills, teamwork, information literacy, or other "non-cognitive" skills that are supposedly delivered by colleges and desired by employers.

Figure 3: What a Transcript *Doesn't* Say



To be clear, the problem is not that some college courses and degrees aren't rigorous and valid. The problem is that it's impossible to determine which courses and degrees are and which aren't. It seems apparent that the courses listed on a transcript and the degree that is awarded suffers terribly from a "bad data" problem. Given the stakes involved, it would seem that higher education regulatory agencies would feel compelled to assure the validity and meaning of the transcript.

However, neither accreditors nor ED are in a hurry to set objective course and data requirements. Accreditors, the entities that should be responsible for assuring academic validity, are staffed and financed by colleges themselves. Requiring greater assurances of outcome and

Draft: Please do not cite without permission from the author.

performance validity would lead to industry-wrenching change and, more importantly, transparent information on institutional and student performance. It would also allow unaccredited providers to meet objective assessments, which would expand the number of providers in the market and bring into question the relevance of accreditation. Not surprisingly, accreditors do not have the incentive to enforce such validity requirements. Instead, schools make decisions about credit transfer based only on whether the course comes from another accredited provider rather than on whether there is any validity to the credential being presented.

Lastly, accreditors do not review courses, only institutions. So, colleges are making course-level articulation decisions based on whether the provider has undergone an institutional review – a misapplication of the accreditation standard. Despite having little internal validity, colleges have de facto credentialing authority due to accreditation and its gateway to taxpayer subsidies. Colleges can use this credentialing ambiguity to keep comparable providers out because there is no objective standard to which new providers can appeal. To provide some level of objectivity, it is necessary to better define the “degree.”

Credentialing Authority in a “Post-Access” World

Colleges and universities have a private-sector business model with a public sector mandate. Despite a “degree” being a uniform measure of achievement, it has different measures and value depending on the institution. Until the notion of a “degree” is more artfully explained, unbundling within the accreditation system will remain difficult.

The authority to award a degree derives from either public or private sources. Take a typical graduation ceremony: the long robes, silly hats, multi-colored sashes, and the solemnity of the occasion create a sense of continuity, extending all the way back to the Middle Ages. In

Draft: Please do not cite without permission from the author.

this model, where one group welcomes a new member, the granting of a credential is a “private” asset. “Private” means that the decision to award or withhold the credential lies with the group, and the group determines the standards. The “private” credentialing model resembles the inclusion in a guild or the completion of an apprenticeship. It is also the model around which the accreditation structure is organized. Accreditation assumes that all colleges are awarding credentials derived from a “private” authority.

While this iconic model continues to thrive, particularly among small liberal arts colleges, many students now have a very different college experience. For them, proofs of course-completion—i.e., credits—are increasingly accumulated from multiple sources. Students may get college credit while in high school, continue at a community college, move to a public university, take coursework from an employer, or, now, from many alternative providers of college courses. To the extent that they’re transferable, these credits, or “stackable credentials,” are eventually assembled into a publicly-recognized degree that is conferred by one of the colleges, usually the last one the student attends.

With stackable credentials, the authority to grant a degree or course credit becomes a “public” asset. By “public,” I mean that the student has met standards that apply to a wide variety of institutions. Getting a diploma is a little like getting a building permit or a driver’s license or passing a bar exam. Individuals who meet the standard are entitled to the credential—unlike the private credential, which is determined by the group that accepts its graduates. Most students and colleges are operating under a “public” credentialing model, yet are regulated as if they have a “private” model.

As free or low-cost online courses that are comparable to a college’s own online courses become widely offered by many providers outside of the accredited environment, the

Draft: Please do not cite without permission from the author.

credentialing element of a college's mission becomes more important than the course delivery element. Because alternative providers of college courses are not allowed to participate in the existing accreditation system, they must rely on the good faith of those with "public" credentialing authority. This tension will require colleges and policymakers to think much more carefully about where degree granting authority originates and the responsibilities that it entails.

For several years, my company, StraighterLine, has offered online courses that are ultra-affordable because we do not price our courses as if they had the same overhead as face-to-face courses. Recently, many others have jumped on the bandwagon. Joining StraighterLine is a mix of for-profit and non-profit entities—Harvard's and MIT's edX, Coursera, Udacity, Cappella's Sophia, and Pearson's Propero—all offering free or very affordable online college courses. Because they are individual courses, they exist outside of the accreditation system and students rely on other institutions to accept them for credit.

The interest and money tied up in these initiatives will make students aware that online college courses ought to be much less expensive than face-to-face courses and that, online, anyone can offer a college course. By 2013, I predict that both students and policymakers will start asking tough questions about why accredited colleges price their online courses at the same or higher rate than face-to-face courses.

Though colleges are not accustomed to seeing themselves as licensers, the explosion of possible providers of online courses changes the public's requirement of many of the nation's colleges. Colleges are no longer the sole provider of college coursework. More than ever, they are needed as a credentialer of other's coursework. This new role requires the kind of objectivity and transparency expected from licensing agencies and written into government contracting

Draft: Please do not cite without permission from the author.

processes. Without these basic safeguards, the “degree” will be less a measure of student accomplishment and more a tool to drive revenue.

“Post-Access” Regulatory Suggestions

Today’s subsidization and regulatory structure is ill-suited for a market with a wide variety of product options at a wide variety of price points. Course providers with preferred market status—public and non-profit colleges—can use this status to drive profits at the expense of the student. Examples range from substantial over-pricing of online courses, to big-time college sports, to entering partnerships that end up charging fees to students for the delivery of financial aid.²⁷ Clearly, institutions of all stripes are engaged in profit-maximizing behavior. This, by itself, is expected in an efficient market where all entities are expected to maximize profits. However, non-profit and public colleges are given taxpayer subsidies under the expectation that they *will not* maximize profits. When working well, markets—and well-designed subsidy systems—pit provider self-interests against each other to the benefit of the consumer and taxpayer.

In 2010, in response to increasingly vocal critics of the accreditation—and, by extension, financial aid—system, the American Council of Education (ACE) convened a task force to report on the state of accreditation. The members of this panel all came from colleges and accrediting bodies and, not surprisingly, the result was a report that largely supported accreditation and suggested tweaks to existing policies. However, even this report acknowledged “the current regional basis of accreditation is probably not the way America would structure the system if starting from scratch.”²⁸

Draft: Please do not cite without permission from the author.

This regulatory ineffectiveness is compounded by the widely-recognized trends in public college financing on both the institutional and student sides. Already, states have dramatically reduced direct subsidies to public colleges, resulting in even further tuition increases. Both federal and state governments are pulling back, or will soon pull back, on direct student aid given budget deficits at both levels of government. Median individual family net worth dropped nearly 40 percent between 2007 and 2010 and is now at 1992 levels, so families have fewer resources to contribute. Even if state and federal coffers were to replenish more quickly, the demands on them created by health care, pensions, debt service, and the ever-more-popular K-12 system, will crowd out higher education spending. If the nation is really serious about addressing the price of college and deriving the promised productivity benefits of online learning, now is the time to think more radically than ever before.

If the existing regulatory model is no longer appropriate for a market with an abundance of suppliers, demanders, and tools that could provide greater transactional transparency, what is? The answer for online learning might be none—or very little, anyway. The answer for all of higher education might be a model that focuses its subsidies only on consumers, rather than subsidizing both providers and consumers.

Let's assume that, as a society, we continue to believe that advanced training and education is critical to our future national competitiveness. Therefore, the public will continue to subsidize postsecondary education. Given that today's students and technology create a vastly larger array of supply and demand possibilities, what would a "post-access" higher education regulatory structure look like? How would it meet the core elements of an effective market: sufficient suppliers, sufficient consumers, sufficient transactional information, and shared definition of the product?

Draft: Please do not cite without permission from the author.

- 1) Shift Supply Side Subsidies to Demand Side: First, to encourage innovation in business model and price, supplier subsidies need to be removed and shifted to consumers. The overall subsidy amount can remain constant, yet the structure would be radically clearer. Today, we have for-profits and non-profits each subsidized to varying degrees by either the federal or state governments and sometimes both offering the same product and working under different regulatory structures.
- 2) Standardize Demand Side Subsidies: Let higher education aid flow to consumers in the form of vouchers, or to not use the politically charged “v” word, Lifetime Learning Accounts (LLA). \$163 billion per year in annual higher education subsidies divided by the number of students equals at least \$7,750 per student annually. By delivering this to students, enabling equal competition, better defining the product, and making outcome information public, the value of higher education will rise dramatically. To ensure that the LLA is best used, it can use the same data currently used by federal financial aid to adjust the total LLA, the value could diminish over time, it could be inherited by children or family members (like current 529 dollars), and other modifications.
- 3) Minimum Objective Outcome Assessment: Like open-source operating systems, colleges should award equal credit for equal courses, no matter where the course is taken. This could be accomplished by setting uniform outcome standards for commonly taken courses and/or creating an independent review mechanism for course providers. Though not authorized to confer the same market benefits as accreditation, some reviewing entities already exist like ACE’s Credit Recommendation Service, the National College Credit Recommendation Service that serves the state of New York, and, to a lesser extent, the College Board’s Advanced Placement review service. Similarly, require

Draft: Please do not cite without permission from the author.

assessment to be separated from instruction wherever possible—at least one-third of all college courses are relatively standard across colleges. There is no reason why statewide or even nationwide pools of assessors can't evaluate student work independently and impartially. The current system where professors have total authority to deliver and assess instruction is an inherent conflict of interest that undermines the integrity of higher education. Given common standards and/or publicly reported employment information, students have a provider's performance baseline to which they can compare. This, combined with reputational information, provides a better (though never perfect) informational baseline than what students currently receive.

Options available to policymakers include the dramatic—like reorganizing provider and consumer subsidies into a voucher model that best serves the characteristics of today's higher education market—and the passive—"do no harm." The principles driving reform should be that they allow for business model innovation and they focus on outcomes rather than inputs and processes. Others include:

- "Escape Hatch": Because the existing accreditation is so entrenched, it is unlikely to be scrapped. However, the growth of viable postsecondary delivery models outside of accreditation shows just how much accreditation needs to be expanded to include them. Like the "Distance Education Demonstration Program" conducted by the Department of Education in the middle part of the previous decade, ED could grant accreditation on a case-by-case basis for postsecondary models that seem promising. While promising, to be effective such a program must allow for a much wider variety of organizational models than those offered previously. The original Demonstration Program simply changed the locus of delivery from face-to-face to online without changing the basic pre-requisites of

accreditation. Today's emerging models are much more granular, engage faculty in entirely new ways (if at all) and are far cheaper. A Demonstration Program today would need to look at course-level rather than degree-level accreditation and return-on-investment rather than completion.

- “Choose Your Own Outcome”: Today, accreditation applies to over 4,000 colleges with widely divergent missions. Some, like the Ivies, are extremely selective and expensive. Some, like community colleges, are “open-access” and much more affordable. Clearly, every college should not be required to meet the same outcomes. Today, the closest we’ve come to setting a desired outcome is Foundation and ED focus on degree completion. However, even degree completion is problematic due to the dilution of the rigor of a degree nationally, the inability to compare degrees across schools, and the selection bias among students attending any given college. One way to overcome this is to create a finite set of outcome measures from which a college could choose. Once chosen, the education provider would be evaluated by its ability to meet its metric.

Examples might include:

- Average ten-, twenty-, and thirty-year income of graduates: likely to be chosen by highly selective colleges
- Value added on a pre-determined critical thinking skills measure like the CLA or ETS iSkills: likely to be chosen by open-access institutions.
- Job placement rates: likely to be chosen by vocational programs.
- Cohort default rate: likely to be chose by any of the above.
- Individual course pass rate and price: likely to be chosen by the emerging parallel credentialers that are providing courses.

Draft: Please do not cite without permission from the author.

- Let Student Loans Be Dischargeable at Bankruptcy: Arguably, one of the drivers of higher education price increases is the availability of guaranteed money. Private loans are effectively guaranteed by the federal government because it is extremely difficult to get a student loan discharged. If lenders faced risk, then they would be more likely to evaluate the investment. Like in the mortgage industry, formulas that evaluated student, provider, occupation, and interest rate would quickly emerge. To guard against “red-lining,” the federal or state government could provide interest rate subsidies for desired socioeconomic groups using the data already collected by the FAFSA. While such an approach does not focus on outcome measurement nor does it encourage new organizational models, it lets the market determine the best financial risk. Organizational models that are better at delivering a positive return will succeed while others won’t. This might include students taking courses outside of the accredited environment prior to enrollment to demonstrate the aptitude and attitude for program completion.
- “Do No Harm”: Without doing anything, the existing regulatory and financing structure of higher education will begin to collapse. College prices will continue to rise because of structural inflation, the withdrawal of state support, and the defection of high margin customers to lower priced offerings. Concurrently, sources of student aid will continue to dwindle and the ROI to college will continue to come under attack. Combined, rising prices and declining aid will accelerate the growth of parallel markets which will accelerate price increases and so on. By simply avoiding bail outs, additional loan burdens for students and additional anti-competitive regulation, the “Do No Harm” scenario avoids political confrontation and allows incremental change. It also creates a

Draft: Please do not cite without permission from the author.

politically favored and taxpayer subsidized service without a viable business strategy, like the USPS.

Conclusion

Whether it is black market products during wartime, speakeasies during Prohibition, or jitney cabs at the airport, when a government regulated market becomes too dysfunctional, new ones emerge. In the U.S., the demand for higher education has grown dramatically and the cost of delivery has fallen, yet prices continue to rise despite massive public subsidies. With the proliferation of viable, affordable, and unsubsidized providers of college courses emerging outside of the accreditation system, parallel markets are emerging. With the advent of these new markets, policymakers need to decide whether taxpayers should be subsidizing higher education at all. If the answer is yes, then should policymakers subsidize higher education or subsidize accredited colleges? To whom should subsidies be delivered and how?

Historically, because the brick-and-mortar college was the only scalable organizational model to combine information, communication, and reflection, colleges were synonymous with higher education. The rationale for subsidizing colleges was to create access for learners. The subsidization of learners came with tangential benefits like the subsidization of research and scholarship and the contribution of service and culture to local communities. However, as this rationale unravels—brick and mortar aren't the only scalable organizational model, ergo colleges are not synonymous with higher education, ergo the rationale and model of subsidies needs to be rethought – the continued subsidies of these tangential benefits need to stand on their own merit.

However state and federal governments choose to respond to the, now obvious, presence of ultra-affordable online courses, it should be clear that colleges cannot keep raising the price of

Draft: Please do not cite without permission from the author.

college while lowering the cost of delivery forever. As former British Prime Minister Margaret Thatcher famously remarked, “The problem with socialism is that you eventually run out of other people’s money.” As state and federal governments turn off the spigots, family assets plummet and students become unwilling to go into dramatic debt, other people’s money is drying up. Eventually, even the best protected markets buckle under these conditions.

-
- ¹ United States Postal Service “Annual Report 2001: Financial Review,” accessed June 22, 2012, <http://about.usps.com/who-we-are/financials/annual-reports/fy2001/welcome.htm>.
- ² United States Postal Service “Annual Report 2001: Financial Review,” accessed June 22, 2012, <http://about.usps.com/who-we-are/financials/annual-reports/fy2001/welcome.htm>.
- ³ <http://www.census.gov/hhes/school/data/cps/historical/index.html>
- ⁴ Mitch Smith, “Duncan Defends Spending Hikes,” *Inside Higher Ed*, March 29, 2012, accessed June 22, 2012, <http://www.insidehighered.com/news/2012/03/29/duncan-back-house-push-obamas-budget>.
- ⁵ Peter Smith, *Harnessing America’s Wasted Talent* (San Francisco: Jossey-Bass, 2010), 96.
- ⁶ State Higher Education Executive Officers, *State Higher Education Finance FY2011*, (Boulder, CO, 2012), 18.
- ⁷ National Association of Student Financial Aid Administrators, *National Student Aid Profile: Overview of 2012 Federal Programs*, (Washington, DC, 2012), 5.
- ⁸ Based on Chase Select Private Student Loan maximum starting interest rate (see here: <http://www.chasestudentloans.com/apr-example.html>). Multiply difference in student loan interest rates by total loan subsidized Stafford loan volume (8.62 percent-3.4 percent x \$39.7 billion). Calculated using data from National Association of Student Financial Aid Administrators, *National Student Aid Profile: Overview of 2012 Federal Programs*, (Washington, DC, 2012), 6.
- ⁹ U.S. Government Accountability Office, *Improved Tax Information Could Help Families Pay for College*, GAO-12-560, (Washington, DC, 2012), 5.
- ¹⁰ Kelly Field, “Government Doesn’t Profit From Student-Loan Defaults, Budget Analysis Shows,” *The Chronicle of Higher Education*, February 14, 2011, accessed June 22, 2012, <http://chronicle.com/article/Government-Doesnt-Profit-From/126373/>.
- ¹¹ “Federal Campus-Based Programs Data Book 2010,” ed.gov, last modified July 23 2010, <http://www2.ed.gov/finaid/prof/resources/data/databook2010/databook2010.html>. and “Federal Campus-Based Programs Data Book 2011,” ed.gov, last modified June 17 2011, <http://www2.ed.gov/finaid/prof/resources/data/databook2011/databook2011.html>.
- ¹² State Higher Education Executive Officers, *State Higher Education Finance FY2011*, (Boulder, CO, 2012), 18.
- ¹³ Cordes, Joseph J., Marie Gantz, and Thomas Pollak. 2002. What is the property-tax exemption worth? In *Property-tax exemption for charities*, ed. Evelyn Brody, 81–112. Washington, DC: Urban Institute Press. Table 4-6
- ¹⁴ <http://www.census.gov/hhes/school/data/cps/historical/index.html>
- ¹⁵ <http://www.census.gov/population/estimates/nation/popclockest.txt>
- ¹⁶ Russ Poulin, “Should Online Courses Charge Less? It Doesn’t Just Happen,” *WCET Learn* (blog), March 22, 2012 (9:25a.m.), <http://wcetblog.wordpress.com/2012/03/22/should-online-courses-charge-less/>.
- ¹⁷ Clayton Christensen, Michael Horn, Louis Caldera, Luis Soares, “Disrupting College: How disruptive innovation can deliver quality and affordability to postsecondary education” (Center for American Progress, Innosight Institute, February 2011).
- ¹⁸ Clayton Christensen, *The Innovator’s Dilemma*, (Cambridge, MA: Harvard Business Press, 1997).
- ¹⁹ Center for Law and Social Policy, Yesterday’s Non-Traditional Student is Today’s Traditional Student, June 29, 2011, <http://www.clasp.org/admin/site/publications/files/Nontraditional-Students-Facts-2011.pdf>
- ²⁰ Anne Ryman, “ASU seizing online future,” *The Arizona Republic*, June 5, 2011, accessed June 22, 2012, <http://www.azcentral.com/arizonarepublic/news/articles/2011/06/05/20110605arizona-state-online-classes.html>.
- ²¹ Marc Parry, “Online Venture Energizes Vulnerable College,” *The Chronicle of Higher Education*, August 28, 2011, accessed June 22, 2012, <http://chronicle.com/article/How-Big-Can-E-Learning-Get-At/128809>.
- ²² Greene, Jay, Administrative Bloat at American Universities: The Real Reason for High Costs in Higher Education, Goldwater Institute, August, 2010.
- ²³ Course Redesign is a set of principles that colleges can use to redesign high enrollment courses. For more information, contact the National Center for Academic Transformation (www.thencat.org).
- ²⁴ http://www.mass.gov/bb/h1/fy12h1/brec_12/dpt_12/hhe2.htm.
- ²⁵ Coalition on the Academic Workforce, A Portrait of Part-Time Faculty Members: A Summary of Findings on Part-Time Faculty Respondents to the Coalition on the Academic Workforce Survey of Contingent Faculty Members and Instructors (2012), <http://www.academicworkforce.org/survey.html>.

²⁶ Elise Young and Libby A. Nelson, “‘Hall of Shame,’ Year Two,” *Inside Higher Ed*, June 13, 2012, accessed June 22, 2012, <http://www.insidehighered.com/news/2012/06/13/education-department-focuses-state-role-cost-increases-annual-lists>.

²⁷ Daniel Wagner, “Colleges’ bank deals saddle students with big fees,” *Yahoo! News*, May 31, 2012, accessed June 22, 2012, <http://news.yahoo.com/colleges-bank-deals-saddle-students-big-fees-152242593--finance.html>.

²⁸ American Council on Education (ACE), Assuring Academic Quality in the 21st Century, Self Regulation in a New Era, June, 2012.