



PolicyPerspective

Tuition Deregulation & Higher Education Spending

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Key Findings

Tuition deregulation has:

- reduced the incentive for Texas universities to keep spending under control;
- shifted some higher education costs from taxpayers to students;
- exposed the lack of price competition in higher education; and
- not significantly reduced the *long-term* pressure on state appropriations for higher education.

Introduction

In 2003, the Texas Legislature faced a \$10 billion budget shortfall; rather than filling the hole by increasing taxes, legislators sought to control spending. One way they did so was by “deregulating” tuition.

Prior to 2003, the Legislature set tuition rates at all Texas public universities. The political process of setting tuition had led to tuition rates far below the actual cost of the educational services provided. This necessitated significant taxpayer subsidies for higher education. Unwilling to continue the rapid growth of those subsidies—particularly in light of the state’s budget woes, members of the Legislature passed HB 3015, transferring the authority to set tuition to the state’s public universities.

Former University of Texas (UT) System Chancellor Mark Yudof supported tuition deregulation when presenting the UT System’s budget priorities to the Legislative Budget Board in 2002. Yudof expressed his support for the policy, stating that higher education in Texas “is the most regulated system I’ve ever seen,” and that the current system “just makes it more difficult to do business.”¹ A consistent complaint from universities is that they are underfunded by the state, and deregulating tuition seemed to be a way to address this problem by giving them a way to increase revenue independent of the Legislature.

Legislators saw the measure as a way to relieve taxpayers from rapidly growing educational spending by shifting more of the growing costs to the actual customers of the system—

students, and often their parents. It was also seen as a way to introduce more competition into the system and thus perhaps reduce the growth in educational costs.

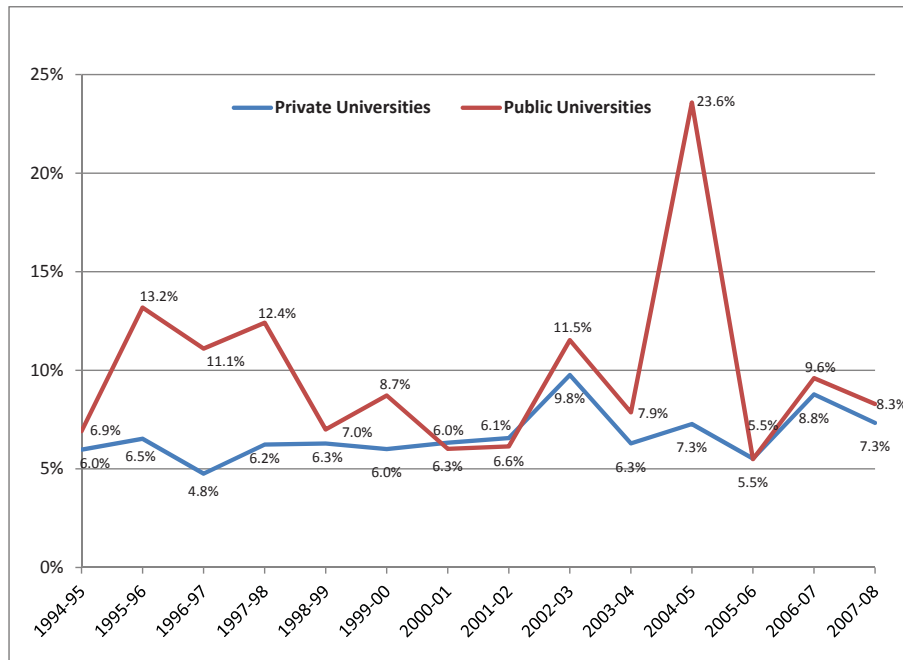
Since tuition was deregulated, total revenue at public universities has increased 31.9 percent per student.² Revenue from tuition has increased 68.8 percent per student, while revenue from the state has increased 11.7 percent per student.³

So legislators achieved at least one of their goals for tuition deregulation—higher tuition has shifted some of the costs of higher education off of taxpayers and on to consumers. However, with university revenues increasing at close to twice the rate of inflation (31.9 percent vs. 16.6 percent) during this time, it does not appear that tuition deregulation has brought about much efficiency to help reduce the increases in higher education spending.

Universities now have the ability to raise tuition *and* receive increased funding from the state. With what seems to be limited price competition—students continue to show up for classes despite the tuition increases—universities are able to sustain increased levels of spending.

The main challenge with tuition deregulation is not that it has resulted in higher tuition, but that it has reduced the incentive for Texas

Figure 1: Annual Tuition Increases at Texas Public and Private Universities
(Year to Year Percent Tuition Growth)



Source: National Center for Education Statistics
Note: Tuition deregulation began the Spring Semester of 2004

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school year, the first year universities could set tuition rates.* This is higher than the annual 9.2 percent increase in tuition that universities charged before deregulation. Additionally, there is a larger spread between increases in tuition at public and private universities since deregulation than there was before. Tuition deregulation appears to have led to growth in the rate of tuition increases.

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Who Should Set Tuition: Universities or Legislators?

The state of Texas has tried both methods; neither of their attempts work particularly well.

Figure 1 shows the annual tuition increases for public and private universities since the 1994-95 school year. Public tuition increased about 11 percent annually since the 2003-04

Table 1: Tuition Increases at Private and Public Universities Before and After Tuition Deregulation

	Private	Public
Annual Average Before	6.50%	9.21%
Annual Average After	7.04%	10.98%

This was not surprising. In fact, legislators sought a way to fund the growth in higher education expenditures while at the same time relieving some of the pressure of that growth on state appropriations and taxpayers through higher tuition rates. The resulting shift of costs from taxpayers to consumers was expected. Table 2 shows the results.

* Tuition deregulation became effective in Sept., 2003. Universities began setting tuition rates in the spring semester of 2004.

Table 2: Revenue Growth at Public Universities 2004-2009

	2003	2009	Increase
Enrollment	372,616	417,895	12.15%
Total Revenue	\$5,643,814,168	\$8,347,598,046	47.91%
<i>per student</i>	\$15,146	\$19,975	31.88%
Tuition Revenue	\$1,346,724,431	\$2,549,495,939	89.31%
<i>per student</i>	\$3,614	\$6,101	68.80%
State Revenue	\$2,406,294,666	\$3,015,056,301	25.30%
<i>per student</i>	\$6,458	\$7,215	11.72%

Source: Texas Higher Education Coordinating Board, Texas Higher Education Accountability System

Total revenue at universities has increased 47.9 percent since the fall of 2003. However, while revenue from tuition has increased 89.3 percent, state revenue has increased 25.3 percent. Students did indeed begin to pay a higher share of education costs beginning in 2004.

State revenue for public universities actually decreased for several years following tuition deregulation. Funding dropped from \$2.41 billion in 2003-04 to \$2.36 billion in 2004-05, and state funding for universities didn't reach 2003-04 levels again until 2007-08.⁴ It is clear that legislators accomplished their primary goal with tuition deregulation—reducing pressure on the state budget to pay for the rapid increases in higher education spending.

University Spending Is the Problem

Despite the success in achieving some savings for taxpayers, there is little evidence that the Legislature was successful in reigning in higher education spending overall.

This is largely because tuition deregulation did not “deregulate” tuition; rather, it shifted the tuition-setting responsibility from the Legislature to university administrators and regents. The government—rather than market participants—is still setting tuition rates. So tuition deregulation has simply helped expose the true problem: the lack of price competition in higher education.

Total university revenues in Texas have increased 47.9 percent since 2003, or 31.9 percent on a per student basis.⁵

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When compared to inflation of 16.6 percent during that same period, it is obvious that legislators hopes of introducing price competition—and therefore cost discipline—into the system have not borne fruit.

A primary reason for this is the growth in subsidies to help students pay for education. Every time tuition goes up, so does the availability of student grants and loans. TPPF Senior Fellow and well-known economist Richard Vedder explained the problem grants and loans have caused in a recent interview with *Reason Magazine*.

“It takes a larger percentage of a family’s income to go to college today than it did 30, 40, 50 years ago,” he explained, blaming government interference in the market.⁶ This has occurred despite government policies aimed at making college more affordable. Vedder argues that well-intentioned government policies have backfired by increasing demand for higher education.⁷

Vedder explains that in a free marketplace supply would go up to counteract this, but in higher education, governmental policies limit the downward pressure on prices. For instance, regulations and the accreditation process make it more challenging for new providers to enter the marketplace.⁸ Furthermore, government subsidizes public universities to a much larger degree than new for-profit colleges.⁹ This allows public universities to continue increasing their prices even when faced with competition in the private sector.

Universities in Texas exercise little spending discipline because they have little need to exercise discipline when setting tuition rates.

Since universities see little decrease in demand when they increase tuition, it is not surprising that spending at Texas universities is on the rise. In 1991, the statewide average operating cost per student was \$10,665.* By 2008, this number had increased to \$18,571—a 74.1 percent increase.¹⁰ Universities in Texas exercise little spending discipline because they have little need to exercise discipline when setting tuition rates.

Taxpayers Once More Under Pressure

While legislators accomplished their goal of reducing the share of higher education costs being paid for by taxpayers, the continued rapid growth may make this a short-term victory. Already there is evidence of this being the case.

As previously mentioned, state revenue to universities fell in real terms after tuition deregulation passed. As Table 3 shows, revenue for fiscal years 2004 and 2005 were \$68.7 million below the baseline cost established in 2003, not taking into account any growth.¹¹ This was a change of -1.43 percent.

However, the last two bienniums have seen significant growth. State revenue increased 10.1 percent in 2006-07 and 14.2 percent in 2008-09.¹²

Recommendations

Allowing universities to set their own tuition rates has its problems, but neither was the tuition-setting process perfect when the Legislature performed this function. The problem is that both tuition-setting methods are flawed; neither allows the market to determine the appropriate price of tuition and overall revenue to the system. So, higher education spending continues to climb.

Unless something is done to reduce the upward spiral in higher education costs, Texas will soon be facing a crisis in higher education funding similar to the one it faced in 2003. In fact, as Texas faces a 2012-13 budget deficit upwards of \$11 billion, the crisis may already have arrived.

It is important to note that this crisis is not one where Texas cannot provide the needed higher educational resources that its students and economy need. Instead, this crisis is one that has been created by the inefficiencies of a higher educational system operating with limited price competition.

Table 3: State Funding for Public Universities by Fiscal Year¹³

FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
\$2,406,294,666	\$2,356,905,957	\$2,386,973,289	\$2,599,091,546	\$2,623,776,679	\$2,949,486,914	\$3,015,056,301
Change	-2.05%	1.28%	8.89%	0.95%	12.41%	2.22%

* in 2008 dollars.

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We can continue to educate Texans, slow the growth in education funding, and address our budget problems, but only if we are willing to change the way we operate and fund universities. Infusing price competition into a highly regulated higher education market is the best way to address rapidly-growing university spending and the resulting tuition increases.

The following recommendations are simple changes universities and/or the Legislature can make to increase price competition and thus strengthen incentives for universities to keep spending as low as possible.

- Improve transparency and accountability by:
 - Requiring universities to make easily available: budgets, faculty salaries, student evaluations of faculty, graduation rates, 5-year-out student surveys including employment and earnings data, and any other information that measures efficiency or student learning. Post all collected data on a public website that is easily accessible, searchable, and understandable;
 - Placing detailed check registers online. Doing so would provide complete spending transparency and ultimately could save universities money by reducing the number of open records requests filed;
 - Creating an annual report issued by the Texas Higher Education Coordinating Board that measures the value added by each university and the value added per state and student dollar spent;
 - Requiring the Texas Higher Education Coordinating Board to identify universities with administrative expenses disproportionate to enrollment and require submission and adoption of a plan to control administrative costs with implementation tied to a budget rider; and
 - Studying the feasibility, pros, and cons of placing universities under sunset review.
- Shift to student-centered funding: place state appropriations in the hands of students rather than universities.
- Separate research and teaching budgets. ★

Endnotes

¹ Pace, Katherine, UT Outlines Budget Priorities, *The Daily Texan* (Sept. 2002) <http://www.dailytexanonline.com/2.8480/ut-outlines-budget-priorities-1.1261877#4>.

² Texas Higher Education Coordinating Board, Texas Higher Education Accountability System, 2003-2009, <http://www.txhighered-data.org/Interactive/accountability/default.cfm>.

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ "Economist Richard Vedder on why college costs so much," *Reason Magazine* (July 2009) <http://reason.tv/video/show/author-richard-vedder-discusse>.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid.

¹⁰ Texas Higher Education Coordinating Board Accountability Data.

¹¹ Ibid.

¹² Ibid.

¹³ Ibid.

About the Author

Elizabeth Young joined the Texas Public Policy Foundation in March 2009 as a Higher Education Policy Analyst for the Foundation's Center for Higher Education and in June 2009 added health care policy to her portfolio. Her research focuses on consumer driven solutions for health care policy reform and higher education costs, affordability, value, and transparency.

Prior to joining the Foundation, Elizabeth worked as a Legislative Assistant for State Representative Phil King. During that time she analyzed Texas legislation and policy in areas such as abortion, property taxes, energy, education, and welfare.

Elizabeth graduated *magna cum laude* with a B.A. in Government from the University of Texas at Austin. Currently residing in Austin, she grew up in Kingwood, Texas.

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