The Rising Costs of a U.S. College Education

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Welcome to the PwC-KWHS Podcast Series for High School Educators on Business & Financial Responsibility.

*I'm Diana Drake, managing editor of Knowledge@Wharton High School, and today we are talking about the economic value of higher education and how to help students prepare to manage college costs and debt. During our discussion, we will traverse the rugged financial landscape that surrounds higher education. Students are faced with ever-rising tuition costs, staggering student-loan debt, a difficult job market and the inevitable question: Is college worth the investment? I'm here today with two experts who will help us sort through these important issues, and offer high school educators some practical insights and advice to help their students make more informed decisions about their financial lives after high school and on college campuse*s.

This is part one of our four-part discussion on the value of higher education with Wharton management professor Peter Cappelli and PwC Partner Michael Deniszczuk. Here, we provide an overview of the price of college today and discuss the changing landscape of rising college costs. (Note: Michael Deniszczuk has retired since the taping of this podcast)

Below is an edited transcript of the conversation.

Knowledge@Wharton High School: Let's start with the big picture. Looking at money and college, we've all seen the headlines. The cost of college tuition is staggering. Some of the latest annual numbers suggest that tuition, room and board are estimated at around $13,500 for public universities, $37,800 at private non-profit universities and the $23,300 at private for-profit institutions, and those numbers are increasing year after year. Help us to better understand what is behind these rising costs. Is it driven by college administrative needs, reduced government funding to colleges, more students attending four-year colleges? What is behind it?

Michael Deniszczuk: Let's start with some statistics that further support your question. For at least a century, tuition at selective private colleges and universities has risen annually by two to three percentage points more than the rate of inflation. In its annual analysis of college prices, The College Board found that for the most part, higher education costs continued to outpace the average growth in workers' incomes. Why is this? First, the cost of public universities is rising as state funds are cut or allocated elsewhere.

Public universities have sustained deep funding cuts as a consequence of the recession our country faced recently. While in the past year many public universities have been able to moderate tuition inflation because the economic rebound has increased state tax coffers, on average, states are still providing about 20% less funding for students at public colleges than they were prior to 2007.

Another factor driving the increase in tuition, which has affected private as well as public universities, is rising costs based on the objective of most academic institutions to be the best they can be in every aspect of their offerings. Let's face it: Colleges compete with each other for students by offering distinctive experiences such as star professors, new buildings, latest technology, research facilities, beautiful grounds, etc.

Let's just take technology as an example. Colleges must offer an education that gives students the tools they need to succeed in a modern economy. Technology can be a key competitive advantage. Top institutions have chosen to maintain quality largely by spending more, not necessarily by increasing efficiency, reducing costs or reallocating funds.

Finally, it's a matter of simple economics — the laws of supply and demand. Universities have found that they could raise tuition at rates that outpace inflation to meet a rising demand. According to the National Center of Education Statistics, in the past decade the number of college-age Americans grew by 3.7 million, and the proportion of 18- to 24-year-olds enrolled in college rose from 35% to 41%. As demand increases and supply remains steady, prices will go up.

Peter Cappelli: One other thing we might notice here, in fairness to the colleges, is that the sticker prices don't tell us what most people pay because of financial aid.

Financial aid has been going up since the recession faster than the cost of college. As such, one of the reasons that college tuition prices go up is because there's a kind of redistribution going on, particularly at the private schools, and that is that they are spending a lot of their money on financial aid. The average family that gets financial aid in the United States now is making an annual income of $100,000. It isn't just going to people we thought of as being poor anymore. In terms of figuring out what the real costs are for students, it's very difficult because the sticker price doesn't tell you very much about what you actually are going to pay. You don't really know that until you start being admitted to colleges and seeing what kind of financial aid they'll give you.

KWHS: The nation's overall student loan balance is way up, having risen throughout the recent financial crisis. What will be its resulting economic impact? Will millennials delay buying homes, for instance, under the burden of their debt? What's the ripple effect of the financial burden on young Americans?

Deniszczuk: College tuition and loans top the list of money matters that are worrying millennials ages 18 to 29, and 21% of them claim it's their family's main financial problem. Now, one third of those with student loans are shelling out over $300 per month, and 5% are paying more than a $1,000 per month. According to research from Junior Achievement and my firm, PwC, nearly one in four millennials believe their student loan debt will ultimately be forgiven. Whether that proves ultimately true or not, student debt is still a major issue impacting the decisions of many millennials.

Everyone knows that a debt load can impact the way someone spends going forward. There was a collection of studies that show the burden of student debt may cause people to make different decisions than they would otherwise, affecting not just individual lives but also the entire economy.

According to research by the Federal Reserve Bank of New York, fewer millennials have bought homes since the recession. But the decline has been steeper for people with a history of student loan debt and it has continued even as the housing market has recovered. According to Harvard University's Joint Center for Housing Studies, home ownership among millennials in the 25 to 34 age group has decreased by eight percentage points between 2004 and 2013.

More specifically, according to a report on household debt issued by the New York Fed, the proportion of adults in the 27-to-30 age bracket who have a mortgage has fallen most sharply among those who have student loans as well. That's just the mortgage picture. We see a similar story with auto loans.

The second point is people with student loans are less likely to start businesses of their own, according to a study on the impact of student loan debt on small business formation. Sixty percent of jobs are created by small business, so if you shut down the ability to create new businesses, you're going to adversely affect the economy.

This next statistic is probably the most disturbing to me. According to a Merrill Edge report focused on millennials with between $50,000 and $250,000 in investable assets, slightly over half of the survey respondents had no retirement savings in 2014. Only 35% of those people said that they planned to save in 2015. The survey noted that 65% of student debtors intend to pay off their student loans first and then save more for retirement.

The student loan issue does not only have short-term implications but it could also have an impact on the ability of people to retire comfortably years down the road.

Cappelli: To put this in perspective, at the moment student loan debt is second only to mortgage debt in the United States. It now exceeds credit card debt – so it's a huge chunk of dough that's sitting out there. It's burdensome, partly because the nature of the loans makes it very difficult for them to ever go away unless you pay them off. The students who expect these loans will be forgiven are in for a nasty wake-up call because, at least at the moment, even bankruptcy doesn't get you out from under these loans.

Deniszczuk: What you're seeing then in early years is that student loans are replacing mortgage loans as the key loans that families have in their early 20s after they graduate from college.

KWHS: President Obama has vowed to make college affordable for all Americans by investing $60 billion over the next 10 years to provide free community college tuition to as many as 9 million students a year across the country. Does this program and other similar efforts suggest that young people reaching college age can expect their next two or four years to be more affordable? When it comes to managing college costs, is relief in sight?

Cappelli: Going back to our earlier points about why tuition has gone up so much, these are largely political choices about how much society wants to spend on education.

President Obama's proposal to provide more money for tuition at community colleges is something that sounds very nice. The problem with it is that community colleges, like most state institutions but especially community colleges, are really underfunded and they pretty much are losing a lot of money with every student they take in. The big problem for students at community colleges is availability of courses. Even if I get admitted and I can afford to pay, can I get the courses because they're so underfunded? They can't offer enough programs; they can't offer enough courses.

The problem of offering a lot more tuition assistance is it basically ramps up the demand at these community colleges. But they don't have the resources to meet it. It's kind of shifting the burden, creating a lot more demand onto the local communities that are the ones paying for community colleges. Whether or not they'll be able to meet that is an open question.

If I was someone thinking about going to college in the next couple years, I wouldn't think it's going to get much easier. The proposal the president has put forward hasn't been agreed to by Congress and it's not clear it's going to be. I wouldn't hold my breath as to whether things are going to get a lot easier.

Deniszczuk: Community colleges do serve as a worthwhile starting point for many students. But when you look at higher-paying professions, particularly in business, it certainly is better if you start at a community college and transfer to a university at some point, usually after one or two years.

KWHS: What do you feel government should do or not do about costs and availability for higher education?

Cappelli: The federal government is not much of a player in higher education except for student loans. About 12% of the budget for higher education comes from the feds. Most of it comes from state governments and local governments. Eighty percent of students in the U.S. go to state universities or state systems, so it is the states that carry the burden for this. And states, even before the recession, were squeezed by increasing demand, particularly in Florida and California – growing states that weren't funding universities and the colleges at the level of the demand for them.

They're admitting kids and they are not providing the support for them –tuition goes up as a result. Sometimes, the states are limiting the amount of tuition increases that the universities can put in, and then they basically end up just not offering many courses, or changing the kind of education you get — much bigger classes, fewer seminars and fewer choices.

These are political choices. In the United States, we pay about seven times more as private citizens for college education than our colleagues in other industrial countries do. The U.S. pays more for college by far than any other country, public and private. We've made political choices that make this pretty expensive for families. Now, part of the reason we did was because of the belief that it was going to pay off for you to have a college degree and so it was okay for you to pay for it yourself and take out loans to pay for it.

It's not quite clear that that's still the case, and so politically, it is a bit of a problem. We're encouraging people to go to college. We're telling parents it's important to send your kids to college. It's incredibly more expensive than it was a generation or so ago to do it and there's a lot of risk involved if you go to the wrong school or you don't graduate, which is a big issue. Like a lot of things in the U.S., these are political questions upon which people have very different points of view. And the lack of consensus explains why nothing much is happening to help.

KWHS: Our first question from a high school educator is about opportunity costs. Mark Bichler, a business teacher at Port Washington High School in Wisconsin, would like to know how he might address the idea of opportunity costs with students when they are considering where to go to school in relation to the financial commitment.

Cappelli: Opportunity costs mean, basically, what else would you be doing if you weren't going to college? The opportunities are kind of limited these days. The idea that you could, for example, go to vocational school is something that more or less has been cut out of the U.S. system. Vocational schools at the high school level have kind of disappeared. The kind of jobs that you could have had working in factories a generation or so ago and get some real-world experience and maybe make some money before you go to college, for example, those are gone as well.

But there are opportunities for kids, particularly for kids whose families can support them a little bit if they take jobs that are not-for-profit experiences, unpaid or lesser-paid jobs. For example, doing things in the community — the kind of program that lets them get involved in public service in different kinds of ways to serve their communities.

Those things are pretty useful for kids. They help them grow up. One of the things we probably need to remember is that there's nothing magical about going to college at age 18. There's nothing that makes it better for you than going to school at 19 or 20. In fact, at least the anecdotal evidence and some hard evidence suggest that students who are a little more mature probably get more out of college. I don't think it hurts you to delay going to college at all. You don't want to just sit on the couch for a couple years though. That's not going to help you.

But if there are opportunities to do the kinds of things that you might not be doing after college, it's probably a very useful thing to think that more kids ought to be pursuing some of those opportunities. Even if they don't set them up well for life afterwards, you learn all kinds of interesting things from those experiences, as long as you can find them.

Deniszczuk: If you decided to defer college for a year or two, you could also be working in some job that would help you potentially pay for college going forward, as well.

Cappelli: That's one of the aspects of opportunity costs that's gotten worse is that well-paid jobs for kids right out of high school have more or less disappeared. If you're living at home you might be able to save a little bit of money, but for middle-class kids, I'd say more likely they're going to be looking for opportunities to have some experiences that might broaden them and maybe would help them in college, get into a college or maybe some life experiences that help them become a better person afterwards. And all that's pretty reasonable to do.

Deniszczuk: In comparing colleges, you don't have to go to the most expensive college to get a good education and get a good job. State universities still offer a very good deal, and particularly when you're paying tuition as an in-state resident.

Just as an example, I went to a state university in Missouri and had several job offers and a very successful career at PwC. Students and parents should research schools, focusing not only on costs but on rates of placement in jobs, average starting salaries and reputation among employers, etc., when choosing a school. You don't have to pay for the most expensive school to get good opportunities coming out of college.

Cappelli: It is very tricky for parents though because it often can be the case that a private school could be cheaper for you than a state university because state universities don't offer as much financial aid as private universities do. If you get into an Ivy League school and your family doesn't have a ton of money, it might very well be cheaper. At Penn, for example, we've more or less guaranteed that if your family earns $100,000 or less you get free tuition. You won't get that if you go to Penn State here because they don't have deals like that.

One of the reasons this gets too complicated is you've actually got to apply to these different places in order to figure this out – and it's worth doing. It's worth applying to different colleges; it's worth filing out all the financial aid forms. Some of it seems like a pain to do but I guess I would encourage anybody who's worried about this that you could get an accountant to help you fill out those forms if you find them daunting to do. It's worth paying him to do it because there are a lot of people who are eligible for financial aid who never apply — about 20% of people are eligible and never apply. That's a lot of money that would otherwise be available.