

January 9, 2009

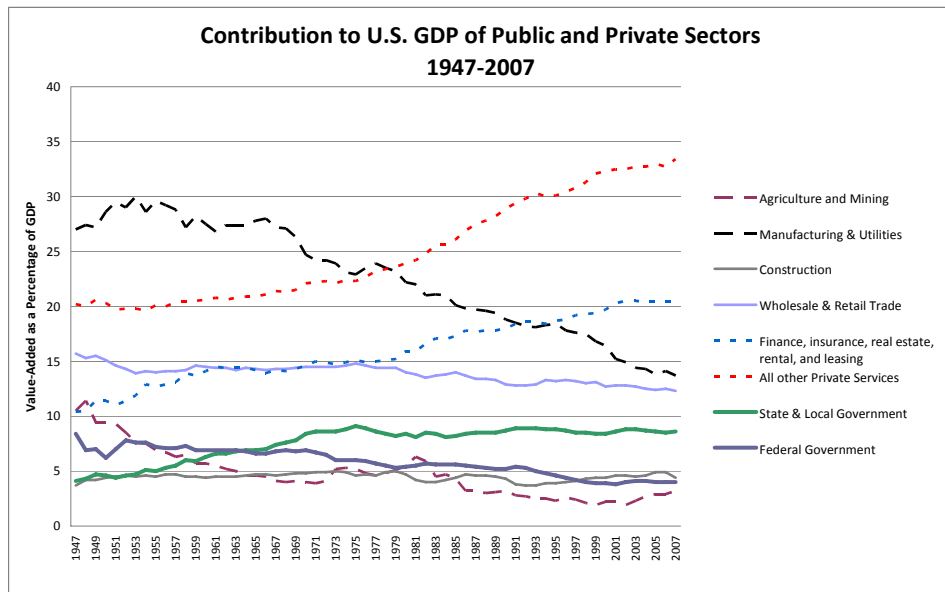
Dear Ron,

Congratulations on the publication today of your guest column, “Colleges Must Face Reality and Recognize Opportunity in the Economic Downturn,” in the *Chronicle of Higher Education*. I read the column with interest. I agree with some of your points, but hesitate on some others. Please pardon me if I focus primarily on the issues I think are subject to debate.

Because your view on this matter may affect the university, and this is thus not just an academic disagreement between two economists, I will copy this letter to President Glick and a couple others within the university’s chain of command. I will leave it an internal matter, however, and not take my disagreement to either the media or outside the state.

The argument you make about the differential growth in productivity between manufactured goods and services is well accepted. As productivity improves in some sectors (say, bed manufacturing), it raises the real wage in all sectors. So goods with relatively slower rates of productivity growth (say, haircuts, restaurant meals, or economics lectures) become relatively more expensive. It is one of the explanations for why richer countries tend to spend a greater proportion of their income on services, and why these countries also have a higher cost of living than purchasing power parity would predict, even for countries with minimal barriers to free trade and floating exchange rates.

Applied to government, we call this the “cost disease” hypothesis. Since government provides mostly services, we would expect the share of GDP devoted to the production of government services to rise over time. It is important to remember that this does not necessarily imply that government is wasteful or inefficient, only that it provides services where productivity growth is, by logic, relatively slower. However, if you consider the share of our GDP produced by different public and private sectors, as shown in the following figure, this prediction does not actually hold for the United States.



What you should notice in looking at this is that the share of private services increased, in both the financial sector and all other services (except for wholesale and retail trade, which

actually fell somewhat), as the productivity-differential hypothesis would suggest. However, this did not happen for government, which goes against your primary argument. Federal government production decreased gradually over time, much of it due to a decreased military as well as – in the nineties at least – a declining number of civilian employees. State and local government production, which includes public higher education, has remained more or less flat as a share of GDP since 1975.

Note that I am setting aside the debate you and I have in the past about the “optimal” size of government. You keep citing numbers of 25% or less in total spending, and I keep saying that number is based on opinion but not much evidence. A colleague and I have reviewed dozens and dozens of economic articles on the subject, both international and domestic, and find there is no consensus, in spite of what the Heritage Foundation and the Cato Institute write. But no matter.

You argue that government growth is unsustainable, citing that it increased from 8% of GDP a century ago to 33% now. It is not a simple comparison to contrast the horse-and-buggy era, when life expectancies were half of what they are today, with the cellphone age. That change was also not gradual, but rather took place in between the Great Depression and the 1970s. Since then, the overall share has remained fairly stable, though transfers such as Social Security and Medicare have gradually risen. I would thus assume that these transfers are really the unsustainable portion you refer to, not spending on higher education.

But your argument about differential productivity is relevant for what government produces, not for the transfers it provides. The prior figure suggests that either the government sector is not actually becoming less relatively productive or if it is, then government is actually providing fewer real services than it used to.

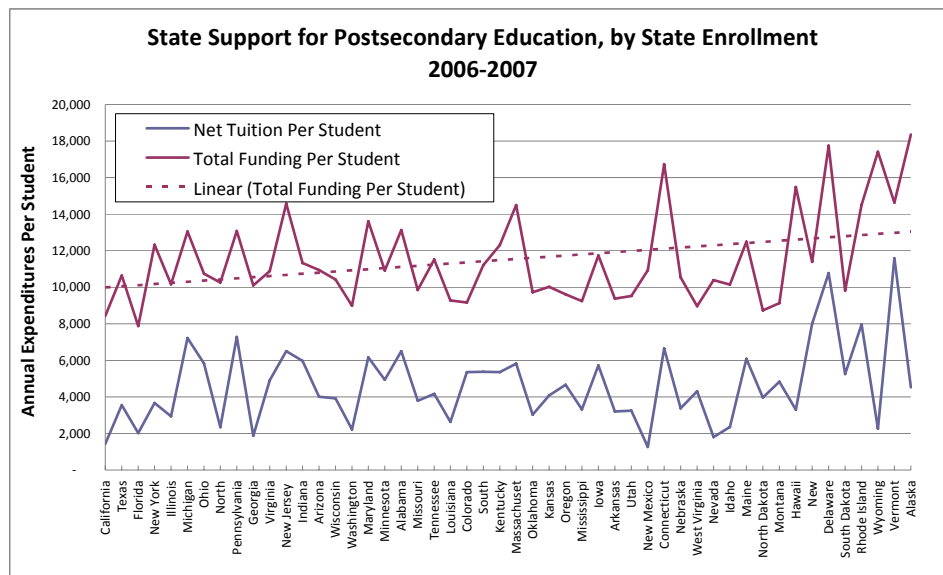
In arguing that the cost of higher education is out of control, you note that expenditures on higher education in the United States doubled, as a share of GDP, between 1960 and 1992, and then rose over the next decade by another 50 percent. I don't mean to quibble, but during the same period higher educational enrollments rose from roughly 3.6 million students to almost 15 million, a 2.6-fold rise as a share of population. The number of degrees conferred grew almost four-fold, relative to population, and the share of graduate degrees doubled. We spent more because we did a lot more.

It is also worth noting, I think, that Nevada did not fit the pattern you observed for the rest of the country, at least not in its spending on higher education. The data I've collected only goes back to the mid-1980s, but the state-supported NSHE budget in 1985 was about 0.63 percent of our Gross State Product. By 2005, this had risen to only 0.65 percent, hardly what I would call unsustainable growth. While the direction of causality is hard to determine, it also appears that NSHE's total enrollments also remained more or less flat during this period as a share of our population. Meanwhile, the relative number of college enrollments increased for the country as a whole, and Nevada fell further behind in that regard.

You argue that “people blithely assume that education is entitled to public support at a growth rate above that of the economy,” but this statement certainly does not characterize the state of Nevada. Public support for education has remained more or less flat for decades and now threatens to shrink instead, leaving us forever in last place. We ask you to understand that our concerns are legitimate, and not just because our own ox is being gored. We care about our university and our state, we worry about the future, and we are hardly being blithe about it.

Your argument is largely about wasteful government, but the fact that NSHE is state-funded does not necessarily make it less efficient. According to the Census's *Statistical Abstract*, Table 279, between 1970 and 2005 the price of higher education rose faster than the rate of consumer price inflation, and as a result was 20% higher in real terms by 2005. Much of this was driven by higher salaries for faculty, and this pattern of paying skilled workers relatively more is widespread across our economy, and even more pronounced in the private sector. In Table 284, for example, we find that private colleges and universities paid their faculty roughly 20% higher salaries than in public ones. The fact that education makes one more productive and enables a higher salary too is a major economic reason why we do this job, even though many of the benefits from it spill over from the student to the greater society.

Nor is Nevada particularly high in its cost per student. Table 281 lists state educational appropriations for post-secondary education, and the state has significantly higher than average appropriations per student, which was generous. But students pay an average net tuition for public education that is among the lowest amounts in the country – though California appears to have an even lower net tuition on average, which may make it more difficult for us to raise our tuition without losing students. Adding the two together, Nevada is ranked 30th in the country in per-student funding, slightly below the mean. This is shown in the next figure, sorting the states in order of their total enrollments.



This figure also suggests that smaller states may have some diseconomies of scale in higher education, as is illustrated by the trend line, and Nevada is significantly below this trend.

One thing I do agree with you about is the idea that we can frame this budget crisis as an opportunity to take a hard look at what we do and how we do it. I agree, actually, that we all “have a responsibility to do better than we have been doing,” and state institutions need to be especially vigilant in this regard because it is too easy to keep doing what we have always been doing without regard to whether it is worth the cost. I would argue that at my university, at least, we are already doing this. But it is much harder to do than it appears on the surface, in part because of the nature of the university, and in part because of the nature of a budget crisis.

The university is filled with wide array of faculty with very specialized skills. Large universities may have several faculty in each subfield, but in my department, like many others here, we have only one of each in most areas: one labor economist, one macroeconomist, one international economist, one behavioral economist, et cetera. This deep specialization is characteristic of the modern economy, and what makes us a university. It is thus harder for us to cross subdisciplines and teach any but the most general courses – the kind of courses taught at the community colleges – with larger student-faculty ratios. If we lose our graduate macroeconomics professor, for example, who will teach the course instead? Nobody else knows the subject well enough to teach it, especially not in our graduate programs, but our students really need to learn it.

There is, as a result, a minimum efficient scale to a university. If we want higher student-faculty ratios, we need to attract more students, not just reduce the number of our faculty. All this discussion of dramatic budget cuts just scares them off, and we are going the wrong way.

It is not that we are all teaching small boutique courses. I usually teach 250-300 students per year, and that is not unusual here. In addition, when we teach in specialized fields at a higher level, it takes faculty a lot more time per class to prepare, and it takes much more time per student to assess their performance. We also lack large enough classrooms to teach greater numbers, and if we were to ask faculty to teach a significant increase in their sections – assuming we had any free classroom space – we might lose our best researchers to other universities that can afford them more time for their research.

We are gradually becoming a respected doctoral research university. Good research is hard, valuable, and time-consuming. If we lose our best researchers, we no longer provide the research that benefits society, helps it grow faster, and improves all our lives. In the more narrow self-interest, we risk losing the quality and respect we need to attract our best students and keep them in Nevada. If they go elsewhere, Nevada fails to develop the skilled workforce we need. And so on.

An old axiom is that it takes money to make money. It takes a substantial new investment – in new learning technologies, for example, or in larger classrooms – to be able to deliver education in new ways. The nature of a budget crisis, however, is that we do not make these new investments. Instead, we cut salaries and we cut positions, and after we are done we are shocked to find that our most productive people have gone elsewhere, and our students are receiving a poorer education. When the economy recovers and we try to attract new business to our area, in order to broaden our tax base and diversify our economy, we find they don't want to come here unless they have no need for skilled labor whatsoever and are also excused from taxation. And what benefit does that bring to the state?

Sincerely,

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