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4. THE DANGEROUS ROLE OF ECONOMISTS IN SHAPING AMERICAN HIGHER EDUCATION POLICY

Europeans Should Take a Different Path

INTRODUCTION

The United States has world class higher education. Often we Americans offer our system as a model for other nations to replicate or adapt. Before other nations move in that direction too quickly, however, it is essential to take another look at how the American system is being transformed and may no longer inspire emulation.

This chapter makes five points:

1. American economists made serious mistakes when they analysed higher education, beginning in the 1970s.
2. These mistakes led to bad policy advice.
3. Bad policy advice has led to unwanted consequences.
4. These unwanted consequences have contributed to national disasters for Americans.
5. Europeans should hasten to achieve different outcomes.

These observations are based on experience and insights gained, starting in the 1970s, when the author of this contribution had the privilege of serving as the Chief Economist of the American Council on Education, Washington D.C. She came to these conclusions as an insider. More than thirty years of subsequent experience make it possible to track the consequences of the bad analysis, as well as the outcomes of the bad policy advice.

In this chapter ten significant education policy areas are examined where the author believes the economists made mistakes in their analysis – which mistakes then led to bad policy recommendations. These ten policy areas include: (1) College enrolment projections, (2) Tuition policy, (3) Explaining tuition increases, (4) Student financial aid policy, (5) Adjusting the value of student grants for inflation, (6) Inequality in higher education, (7) Productivity, (8) Measuring the benefits of higher education, (9) Impact of technology on college costs, and (10) Higher education among federal and state budget priorities.

COLLEGE ENROLMENT PROJECTIONS

Bad analysis: Starting in the early 1970s American economists saw the demographers' projections of a substantial decline in the number of traditional college-age young people aged 18–24 (see California Postsecondary Education Commission, 1982; Carter, 1976; Dresch, 1975; Freeman, 1976; Froomkin, 1976; see also Breneman, 1983). They made widely accepted projections of a substantial decline in college enrolment. The two panels in Figure 1 show the actual American college enrolment trend up to the late 1970s and the demographers' projections of the decline in the traditional college-age population aged 18–24 in the 1980s. Most of the economists were led by the demographers' projection of the decline in the college-age population to project a commensurate decline in the college enrolment (A). However, the actual college enrolment did not decline, but rather increased substantially (B).

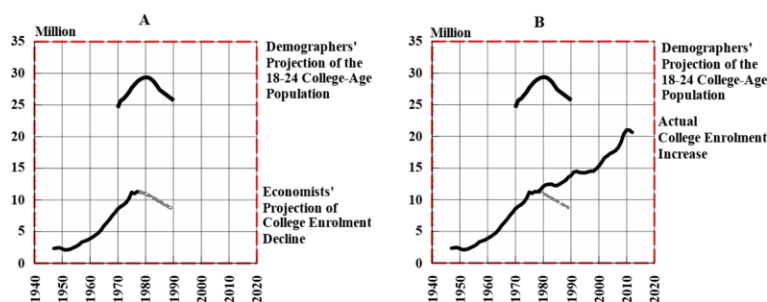


Figure 1. Economists' mistaken projection of the decline in college enrolment based on the demographers' projection of the decline in the 18–24 year-old college-age population

Source: College Enrolment: U.S. Department of Education. Digest of Education Statistics: 2013, Table 303.10; U.S. Department of Commerce (1967), p-25, page 381.

The problem was that the economists' enrolment projection models of that time were much too simple. They saw the demographers' projected decline in the college-age population and on that basis predicted a decline in college enrolment. In reality, however, a multitude of factors have an impact on college enrolment. Therefore, a model for projecting college enrolment should look more like the one shown in Figure 2.

Bad advice: Accompanying the bad analysis of enrolment was the bad advice that the job of colleges and universities was to retrench. The Ford Foundation even funded a nationwide road show arguing that responsible managers should make the tough decision to down size and showed them how to do it (Crossland, 1980; cf. the critique by Frances, 1980a).

What actually happened?

The outcome depended significantly on whether the education system was decentralized or centralized. To illustrate the difference between decentralized

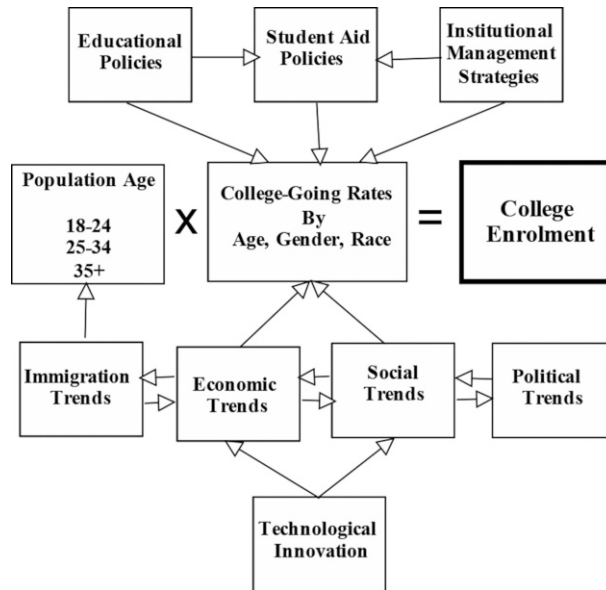


Figure 2. Model for projecting college enrolment

and centralized educational systems, consider that the U.S. would be described as ‘decentralized’. It has no centralized or national Education Ministry but instead 50 State Departments of Education. In contrast, the Parisian French Ministry of Education which oversees education in all of the French Departments would be characterized as a ‘centralized’ educational system. In the U.S. the individual college and university executives developed an entrepreneurial spirit and created new education markets. Women and minorities accounted for a very large share of the increased enrolment (see Frances, 1980b). More centralized educational systems, where the top-down command from a national education ministry to retrench became a self-fulfilling prophecy, did not see the same growth in enrolment. The consequence of the bad advice based on the mistaken forecast of declining enrolment was that education markets were viewed as weaker than they actually were, and colleges and universities were hesitant to raise tuition to cover their actual increase in costs. In fact, the real problem was inflation, not weak markets. Actually, the 1970s and 1980s were characterized by much higher rates of cost increase than decades before or after that period, as shown in [Figure 3](#).

Annual price increases during the 1970s and 1980s reached as high as 13%, more than twice the rate of increase before or after those decades. In the 1970s and early 1980s academics’ salaries did not increase as much as their living cost, and individual faculty members faced a substantial loss of purchasing power. A few years later, when the institutions saw that they needed to increase faculty salaries to

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Figure 3. Trends in U.S. inflation as measured by year-upon-year percent changes in the Consumer Price Index
Source: U.S. Department of Labor (2015), Table 24.

keep quality professors, the fact that these costs then rose at a faster rate than the overall Consumer Price Index was highlighted in the media and was then regarded by the public as taking advantage of the students. This contributed to the new wave of demands for stricter accountability standards in higher education. American faculty did not recover the earlier purchasing power of their salaries until the 1990s, close to two decades later, as shown in Figure 4. By 2013, faculty salaries on average were only slightly higher in real value than they were in the early 1970s (see the data published by the National Center for Education Statistics in the Digest of Education Statistics, 2013).

TUITION POLICY

Bad analysis and bad advice: American economists characterized tuition as ‘elastic’, meaning that if tuition fees were raised, enrolment would fall off. Initially, the advice was to hold down the increases in tuition, even when more resources were needed to cover real cost increases. As a consequence, colleges and universities grew weaker financially.

Beginning in the 1970s there was a new economic view of tuition. Low tuition came to be characterized from an economic perspective as ‘inefficient’. It was seen as benefiting higher income students who could easily afford to pay higher tuition,

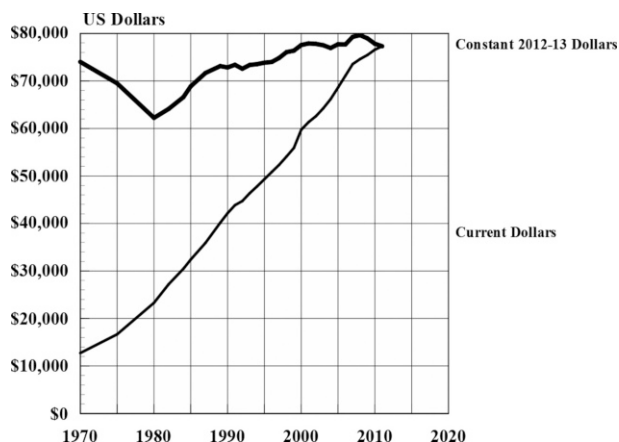


Figure 4. Salaries of faculty in the U.S. since 1970

Source: U.S. Department of Education. *Digest of Education Statistics: 2013, Table 316.10.*

and low tuition was therefore a waste of taxpayers' money. A policy of relatively high tuition offset by high aid for needy students was recommended by the economists as far more 'efficient' (see for example Hartman, 1974).

Explaining Tuition Increases

Most analysts trying to explain tuition cost increases rely primarily on reasons relating to institutional costs. Explaining tuition increases is indeed complicated and there are many factors that need to be taken into consideration. The most important factor to stress, however, is not cost increase but rather revenue shortfall. Simple arithmetic will help to explain how a revenue shortfall compounds its impact on tuition. For example, if the total cost per student is \$10,000 in one year at a state university and if the state provides \$5,000 per student, the university has to charge \$5,000 tuition. If the cost rises in the subsequent year by \$1,000, to \$11,000, that is 10%, but the state funds are reduced by \$1,000 that is by 20%, the tuition has to rise by \$2,000, to \$7,000, that is by a staggering 40%. An increase in total cost accompanied by a shortfall in state support could result in a tuition increase many times the original increase in the underlying costs. This helps to explain why tuition generally rises at a much faster rate than the overall Consumer Price Index (CPI). The reasons why tuition increases are actually quite complex are shown in Figure 5. This model to help explain tuition increases takes into account cost trends in the overall economy, costs relating particularly to higher education, measured by the Higher Education Price Index (HEPI, Common Fund, 2015), offsetting trends in the productivity of teaching and learning, quality competition especially among the elite institutions, shortfalls in non-tuition revenues, and shortfalls in federal

and state student aid, for which the colleges and universities compensate with institutionally funded student aid.

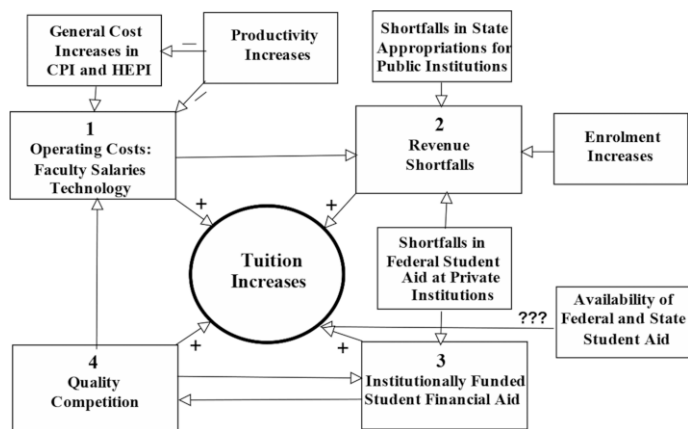


Figure 5. A model to help explain increases in college tuition

STUDENT FINANCIAL AID POLICY

Tuition increased at higher education institutions in the U.S. under the policy of high tuition offset by student aid for needy students. Sceptics were reassured that ‘aid’ meant ‘grants’ for low income students. This was not to be. ‘Aid,’ meaning grants that do not have to be paid back, was redefined to include loans which do have to be paid back – with interest. By as early as the 1980s the amount of money in loans to students substantially exceeded the amount in grants (see Figure 6).

In the mid-1970s, loans and grants were about equal in the amount of aid provided. According to the most recent data, however, the amount awarded in grants is now only half as much as that provided in loans. In 2013 the Federal Reserve Bank of New York reported that unpaid student loans amounted to a staggering 1.3 trillion dollars, more than all other consumer debt outstanding in the whole country, except for mortgages (Federal Reserve Bank of New York, 2013).

ADJUSTING THE VALUE OF STUDENT AID FOR INFLATION

If economists analyse the effectiveness of student aid in achieving the goal of providing accessible, affordable, quality higher education, it is essential to know the purchasing power of the aid being provided to students over time. This is done by adjusting the current dollar amount of the aid for inflation, by calculating the constant dollar amount of aid. For instance, to calculate constant dollar purchasing power of faculty salaries the current dollar amount is divided by the Consumer Price Index. But this procedure is seriously flawed when it is applied by the economists

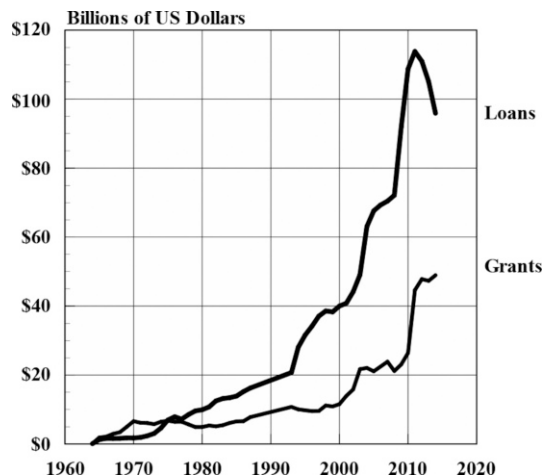


Figure 6. Trends in student grants and loans in the U.S. from 1963–64 to 2013–14
 Source: College Board, *Trends in Higher Education Series*,
Trends in Student Aid: 2014 (and earlier editions).

to calculate the purchasing power of student aid in constant dollars. To put it simply, the price index used to calculate constant purchasing power has to be made up of items that the purchaser actually buys with the money. Students do not use student aid to buy the items in the Consumer Price Index; they use student aid to pay for such items as tuition and fees, room, board, books and travel – most of which items have increased in cost at vastly greater rates than the CPI. Thus, using the CPI to adjust student aid for inflation substantially underestimates the impact of the cost increases eroding the purchasing power of student aid. Actually a Student Cost Index should be constructed and used for the purpose of calculating trends in the real value of student aid in dollars of constant purchasing power. The author Frances (n.d.) has constructed a Student Cost Index using actual trends in such student costs as tuition and fees, room, board, books, and travel, as well as student budget data from the College Board to calculate the weights of the cost components. Beginning in the early 1980s, the Student Cost Index increases at a much faster rate than the CPI. As a consequence, using the CPI to calculate the inflation-adjusted real value of student aid over time significantly overestimates the true value of student aid awarded to students.

Over even a few years, the difference in the real value to students of the student aid purportedly awarded to them amounts to billions of dollars. In current dollars, federal grants to students in the U.S. more than doubled over the ten years from 1994–95 to 2004–05. When the CPI is used for inflation adjustment, federal grants to students increase in real value by about two thirds. According to the author's calculation, using the Student Cost Index to make the inflation adjustment shows that federal grants to students increased by only about one third (ibid.). Calculating

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the real value of student aid is not just a technical issue. The impact of economists using the wrong index is so large that it should become a political issue. The bad analysis leads to the mistaken conclusion that higher education is ‘affordable’ and students can, with aid, handle the costs when, in fact, this greatly overestimates the real value of the aid actually awarded to students to pay for college.

INEQUALITY IN HIGHER EDUCATION

Student aid is recommended by the economists to promote greater educational opportunity and to narrow the gaps between students from low and high income families and between different race and ethnicity groups. The fact is, however, that students from high income families continue to enrol in colleges and universities at rates much higher than those of students from low income families. And while the college-going rates of all racial groups are generally increasing, the gaps between the Asian and White rates and the Black and Hispanic rates have not been eliminated (see Figure 7). This is true even after close to half a century of implementing existing higher education policies (see U.S. Department of Education, 2014).

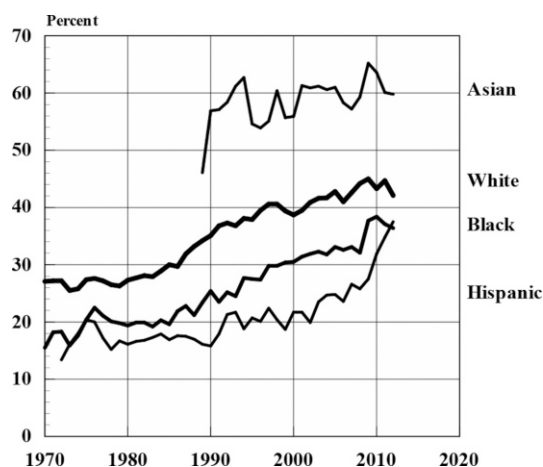


Figure 7. Percent of 18–24 years old enrolled in degree-granting institutions in the U.S., 1970–2012, by race
Source: U.S. Department of Education, *Digest of Education Statistics: 2013*, Table 302.60.

LOW PRODUCTIVITY

Even friends of higher education are content to characterize the function of instructing students as “low productivity.” Economists usually calculate productivity using something equivalent to student credit hours. However, student credit hours

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are inputs, not outputs of education. Outputs should be used in calculating the productivity of education. They should cover what is learned or what is created. Using outputs instead of inputs to measure the productivity of higher education would result in characterizing higher education as highly productive. Admittedly, however, higher education has not yet done a nearly adequate job of measuring educational outputs. Mistakenly characterizing higher education as “low productivity” often leads to recommendations to colleges and universities to adopt more business-oriented approaches to management.

MEASURING THE BENEFITS OF HIGHER EDUCATION

Historically the benefits of higher education were viewed as redounding to society. An educated citizenry was considered by the American founding fathers as essential to a functioning democracy. Benefits to society undergirded beliefs in the past about the importance of low tuition as a means of promoting broad access to higher education. Over the course of the 1970s and even more in the 1980s, when marketization of higher education began to take hold in the U.S., a concomitant sea change in ideas about who benefits from higher education began to take place. The idea that the primary beneficiary of higher education is the individual began to supersede the previous belief that society as a whole is the primary beneficiary of higher education, which belief had previously been the justification for convictions about the appropriateness of low tuition policies. If, in contrast, individuals are the primary beneficiaries of higher education, then individuals should pay for it. And not only should they pay for it, since higher education is a good investment, they should *borrow* to pay for it if they cannot afford it using current income. Out of this reasoning by economists emerges the justification for financing higher education with student debt.

IMPACT OF INFORMATION TECHNOLOGY

Economists offered the opinion that information technology (IT) held the potential for dramatically lowering the costs of education by substituting investment in IT for college faculty (see Massey & Zemsky, 1995). This did not happen (see Finkelstein et al., 2000). In general, up to now, IT has generally raised costs instead of lowering them, in part because of the extremely rapid evolution of the technology and the never-ending costs of updating it to the newest version.

HIGHER EDUCATION AMONG FEDERAL AND STATE BUDGET PRIORITIES

At the federal level economists saw the rise of spending on health and retirement benefits for the elderly, and at the state level the rise in spending on prisons. They declared that there simply would be no more funds for higher education and that the smart thing to do would be to adapt to the new more stringent financial

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environment. Educational leaders, cooperating, attempted to maintain the quality of their educational programs with even fewer resources.

In the U.S., it seems that educators are not even at the table where the national and state allocations of resources are being made. These allocations involve choices that should be explicit, acknowledged, and debated. But they are not. Without focusing on the actual choices being made, significant budget resources are allocated to protecting the retirement and health benefits of the older generation at the expense of education and job training programs benefiting the younger generation. For instance, in a few short years policy choices have transformed poverty in the United States from a condition associated with the elderly to a condition far more characteristic of the young. In 1959, 27% of the younger population aged 18 and under was living in poverty, as compared with the larger 35% of the older population aged 65 and over. By the year 2013, however, as a result of national policies benefiting the older population, the percentage of people aged 65 and over living in poverty had declined to 10%, only half the rate of 20% of younger people still living in poverty (Census Bureau, September 2014).

Problems with Economists' Analysis of Education Policies

Generalizing from an overall review of these ten policy domains, we can synthesise at least six over-arching problems with the economists' analyses. First, the underlying values of the economists are seldom stated. Second, the analyses are too simplistic, whereas the issues are extremely complex. Third, the economists generally ignore what other disciplines have to say about human behaviour and decision-making even when the economists' "rational man" fails to explain what is happening. Fourth, often the analysis is based on information that is shockingly out-of-date. Fifth, economists' methodology is generally static and cannot deal very well with issues which are evolving and dynamic. Sixth and finally, economists seem to be particularly ill-equipped to take into consideration the unintended consequences of their policy recommendations.

THE BIGGEST MISTAKE OF ALL

The biggest mistake of all is the shift from making higher education primarily a public responsibility to putting more and more of the burden of paying for higher education onto the students who are forced to borrow and to accumulate large amounts of student debt. This radical shift merits a more extended description and further discussion of the serious consequences.

Impact on the Students

Clearly, the prospect of incurring debt, probably major debt, affects virtually all of the decisions relating to the education of students and their families. These decisions

range from what classes to take in high school, whether or not to go to college, where to apply, where to enrol, what to study, whether to work while in college, how long to take to complete a programme, and the kind of work to look for after graduation. If students have to think about repaying debt, they are less likely to choose a low paying teaching job instead of a high paying job in finance. A young man might even think seriously about whether to marry a young woman who has as much student debt as he has. Having to take on student debt affects students' life chances. A simple model demonstrates the differences between two students identical in every relevant way, except that one has incurred student debt while the other has not. The two of them have the same major in college, graduate at the same time, go to work for the same company, start at the same salary, have the same career progression, and get the same rate of return on the investments that they make. The big difference is that one student has a student loan and the other does not. One student is paying off a loan and the other is accumulating assets. At the end of the term of the loan, depending on the time allowed for repayment and the comparative interest rates, the one that *did not* have a student loan has many times the assets of the student who *did* have the loan. It is assets that count, not just income, when considering the possibility of setting up a new business or surviving a period of unemployment.

In analysing whether students could handle their loans, economists looked only at the debt service in relation to the student's current income. They made a mistake in not taking into account the impact of the student loan on the student's comparative ability to accumulate assets over time. The economists have also overlooked student debt as a factor that may well contribute to the increasing income inequality evident in the U.S. The way that the United States is choosing to finance its higher education is creating a nation of debtors. The amount of student debt is staggering. It has quadrupled since 2001 when it was under \$300 million, exploding to over \$1 trillion in 2013. It has increased because of more student borrowers and higher loan amounts for each borrower. It now exceeds the total amount of credit card debt in the United States (Lee, 2013).

Impact on Institutions

Shifting higher education policy to a model of high tuition and high aid – but with aid not keeping up with need – also has substantial impacts on the institutions. With grant aid from federal and state sources not keeping up with student need, the colleges and universities are stepping up to provide larger and larger amounts of institutionally funded student aid in the form of tuition discounting, fellowships and scholarships. For example, in the public sector of higher education, the amounts of scholarship and fellowship aid have grown extraordinarily. In 2012 this aid to students amounted to an equivalent of 25% of tuition revenue. This means that a sizeable share of the increase in tuition costs to all the students could be accounted for by the institutional aid to some of the students. It is surely arguable that the aid to the needy students should be a broad public responsibility and should not be more

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than proportionately borne by the families of students who are paying tuition to attend college.

The institutionally funded student aid is also very large in relation to the institutional expenditures for salaries and wages of people employed to instruct students. In 2012 this aid was equivalent to 30% of the total expenditures for faculty salaries, and could certainly weigh against attempts to increase them (percentages calculated by the author using revenue and expenditure data from the U.S. Department of Education, Digest of Education Statistics: 2013). In addition to student debt, we should also take into consideration that the institutions themselves are beginning to take on massive amounts of new debt to finance their own operations and capital improvements.

Impacts on Society as a Whole

Huge amounts of student debt may be a major factor contributing to the increase in income inequality taking place in the United States. Lower income students with increasing amounts of student loans are paying them off in part to higher income holders of the loans. This helps widen the gaps between the lower income and the higher income families. In some more extreme situations, this system of using student loans to help finance higher education has resulted in an unacceptable number of seedy practices, conflicts of interest, and outright corruption. Banks began to pay college student aid administrators “consultancies” which were actually used to steer students to their particular bank. Government employees with responsibility for administering student loan programs have ended up owning shares in the loan companies (see FinAid, 2014). At the height of the financial crisis in the U.S., a Federal Reserve Report (2010) documented the fact that some student loans were being securitized. These student loans were being combined and sold to investors not in a position to evaluate the risk of buying these securities, thus contributing to the national financial crisis.

ESTABLISHMENT AND GROWTH OF THE FOR-PROFIT HIGHER EDUCATION SECTOR

A separate and complex concern is the role that student loans may be playing in the establishment and extraordinary growth of the for-profit education sector in the United States. Many of the for-profit institutions are long-established, accredited, and highly respected providers of quality higher education. Many more of the for-profit institutions are being challenged, however, as not providing value for the students’ money. Many for-profit institutions are accused of not providing the education that the students require to be employed in the jobs that they need to pay off the loans they have assumed. Some for-profit institutions have been found to be using illegal recruitment inducements, and executive compensation greater than the

compensation characteristic of the non-profit and public colleges and universities. Though most of the new for-profit higher education institutions are small, the increase in the number of them is extraordinary. These for-profit institutions also account for a large share of the increase in total enrolment, particularly in the private sector of higher education. They rely heavily on student aid as their major source of revenue. Typically, more than 85–90% of their revenue comes directly or indirectly from federal student aid, that is, primarily from Pell grants and student loans (see Federal Reserve Board, 2010).

Accompanying this is a phenomenon which should be examined carefully but which has received much less attention than it deserves. This American model of financing higher education allows the creation of a billionaire. Yes, a billionaire was created within the federal student aid system using federal resources. John Sperling, who died in August 2014 at the age of 93, established the University of Phoenix (UOPX) in 1976 to serve working adults, when he was still a tenured professor at the San Jose State University. UOPX is a wholly owned subsidiary of the Apollo Group, a publicly traded company listed on the NASDAQ stock exchange. It had grown to a peak enrolment of over 600,000 students by 2010 to become the largest higher education institution in the U.S. Then under pressure because of the high debt of students, high loan default rates, low graduation rates, and meagre job prospects for the students, enrolment dropped precipitously to less than 300,000; and more than a hundred campuses, close to half the earlier total, were closed.

John Sperling was recognized by the Forbes Magazine 400 for many years as one of the country's wealthiest men: he became a billionaire. He did it legally, based on expert knowledge of how to function within the American higher education model. Close to 89% of the University of Phoenix revenue in 2010 came from federal government student aid funds. In 2010, UOPX students were awarded more Pell grant aid (\$657 million) than the students at any other institution in the United States (U.S. Senate Committee on Health, Education, Labor, and Pensions, 2012). In 2010, well over \$1 billion was channelled from the federal government through the several student financial aid programs to the University of Phoenix (see Hanford, 2012). This is in spite of the fact that the University of Phoenix continues to harvest federal funds even though recently the student loan default rate of 26% was substantially greater than its graduation rate of 15% (Marklein et al., 2013). Should this phenomenon be viewed as an awesome individual entrepreneurial accomplishment or as an astoundingly bad education model in dire need of fixing?

THE DISASTERS BEING CREATED

In summary, there are at least four major disasters now negatively affecting the American higher education model as a result of the economists' bad analysis and bad policy advice beginning in the 1970s.

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1. Forcing students to borrow to pay for their college education is creating a nation of debtors.
2. The student debt burden is contributing to an unfortunate increase in income inequality.
3. Significant inequalities by race and ethnicity are persisting in opportunities for college education.
4. The basic shift of the financing of higher education to student loans is enabling the establishment and rampant growth of for-profit institutions managed by individuals driven in many cases more by profit than by traditional educational values.

The author of this contribution believes that the current American model for higher education is in desperate need of fixing, and that the Europeans should work hard and fast to avoid the extreme excesses of this damaged American higher education model. Europeans should aspire to produce a more worthy outcome.

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