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Is college still worth the price?

Costs are soaring twice as fast as inflation, even as salaries for graduates are falling. Time to examine the old belief that college is worth whatever you can pay.

By [Penelope Wang](#), Money Magazine senior writer
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(Money Magazine) -- In May, more than 20,000 spectators gathered under blue skies at Wesleyan University in Middletown, Conn. to hear Democratic presidential candidate Barack Obama deliver the commencement address.

After recalling his days as a low-paid community organizer, Obama urged the graduates to consider careers in public service. "I ask you to seek these opportunities when you leave here," Obama declared. "The future of this country - your future - depends on it." His message was received with enthusiastic applause.

Calls to "give back" always seem to resonate at elite schools like [Wesleyan](#), a picture postcard of academic abundance on its 360-acre wooded campus, complete with state-of-the-art film center, 7,500-square-foot fitness facility, skating rink, 11-building arts complex and a new \$47 million student center offering everything from Mongolian grill entrees to organically grown coffee.

As for actually entering a career in public service, Graduate, good luck with that. Given the steep price tag for a Wesleyan degree (\$200,000 for four years) and the substantial amount you may have borrowed to pay those bills (\$21,500 for the average student, with some families carrying loans of \$50,000 or more), choosing a profession that often pays less than \$30,000 a year might be, well, let's just say a bit of a financial challenge.

For more than two decades, colleges and universities across the country have been jacking up tuition at a faster rate than costs have risen on any other major product or service - four times faster than the overall inflation rate

and faster even than increases in the price of gasoline or health care (see the chart to the right). The result: After adjusting for financial aid, the amount families pay for college has skyrocketed 439% since 1982.

Granted, the fact that college costs are spiraling wildly out of control is not exactly a news flash. The real eye-opener is why.

College finance experts point to a record number of applicants in recent years as the baby boomlet comes of age (many of the more selective schools reported double-digit increases for 2008); that trend, coupled with growing demand for degrees (undergraduate enrollment has jumped more than 20% over the past decade), puts heavy upward pressure on prices. Dwindling support for higher education from cash-strapped federal and state governments doesn't help the situation.

Normal supply and demand can't begin to explain cost increases of this magnitude, though. If the usual rules applied, tuition would eventually stop rising because families would cut back enrollment, especially at the most expensive private schools, just as they curtailed consumption of gas once prices hit \$4 a gallon.

Colleges would then be forced to cut costs or entrepreneurs would flood the market with lower-cost alternatives. But for the most part - all those invitations you see to get your degree online notwithstanding - that hasn't happened.

Instead, prices for college have begun to follow their own peculiar logic. In the absence of any objective measure of the value of an education, price becomes the default yardstick. The more expensive a college is, the better the education it presumably provides. (After all, if other families were willing to pay this much to send their kids here, it must be worth it.)

And the better the education is presumed to be, the higher the price the college can charge. In that respect, it's like home values during the housing boom or dotcom stocks during the late-'90s tech frenzy: Prices go up on sheer momentum.

But families don't shell out money for college in the belief that their investment will someday bring them riches, as they did with real estate and tech stocks. Rather, the perceived payoff is that going to a brand-name school will one day make their children richer.

Even if the financial value of a degree is hard to measure, however, one thing's for sure: It's not infinite. Already a backlash is brewing in Congress about the spending and pricing policies of the wealthiest schools, and some parents may soon join in.

Says Charles Miller, who chaired the U.S. Department of Education's Commission on the Future of Higher Education: "If college costs continue to escalate at this rate, you may reach a point where the investment simply isn't worth it."

The critical question for you to ask: When it comes to college, will you and your child get what you think you're paying for? Here are the facts. You decide.

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If colleges were spending most of their money on initiatives that improve the quality of education for students, you might regard price hikes running at two to four times the rate of inflation as a necessary evil. But spending on palatial dorms, state-of-the-art fitness centers and a panoply of gourmet dining options? Maybe not.

Yet that's precisely what many schools are doing to attract students - engaging in a luxury arms race, fueled by the wealth of such elite institutions as [Harvard](#) and [Yale](#).

Sure, they're also putting funds into cutting class sizes and hiring top professors. But they're spending even more on building Hogwarts-style dorms with mahogany casement windows of leaded glass ([Princeton's](#) newest \$136 million student residence); installing 35-foot climbing walls and hot tubs big enough for 15 people ([Boston University](#)); providing multiple eateries with varied cuisines and massive fitness and recreation centers (too many schools to name).

"There's a lot of competition from other colleges," says Steven Knapp, president of [George Washington University](#). "In today's consumer culture, parents and students expect a certain level of comfort - and they compare the amenities."

The goal of all this collegiate bling is to entice more people to apply. Not just because the school gets a bigger pool of qualified students to choose from but also because the more students who apply, the more it can ultimately reject. That lowers its acceptance rate and makes it appear more selective in the critical U.S. News & World Report college ranking system.

"The rankings are a measure of wealth, exclusivity and fame, not quality," says Kevin Carey, research manager at the nonprofit Education Sector. "Still, they've become a de facto standard for parents, students and the colleges themselves."

The rankings generate a lot of criticism, and nearly 70 colleges refuse to participate. Many more try to work the system to their advantage by spending in ways that will boost their standing - say, offering more merit aid to attract top students.

Here's the rub: More merit aid means less money for need-based aid - which means many families end up paying more, unless their child is one of the lucky few to earn a scholarship.

The appearance of misguided spending by colleges has prompted some lawmakers to question whether wealthy schools still deserve their tax-exempt status. After all, they argue, the colleges are spending only a small fraction of their endowments on the public good - often less than 5%, which is the mandatory payout for private foundations.

The implied threat caused a minor panic attack in academe and prompted many wealthy colleges to announce plans to raise their spending on financial aid. Harvard, the nation's richest university with a \$35 billion endowment, now guarantees that families earning up to \$60,000 will pay nothing and those earning \$180,000 or less will pay no more than 10% of their income.

Yale (\$23 billion) promises that families earning \$120,000 or less will pay no more than 10% of their income. Many other highly selective colleges, including Wesleyan, have followed the Ivy League leaders. Says Sen. Chuck Grassley (R-Iowa), a leading voice on the issue of college affordability: "The quick response by the schools is admitting that something's not right."

The improved aid for the fortunate few, however - less than 1% of students attend Ivy League schools - may result in higher costs for everyone else. Public colleges and less wealthy private ones are now under intense pressure to compete, yet few can afford to match the largesse of the rich schools.

At the [University of California-Berkeley](#), for example, a family earning more than \$90,000 would get little or no aid, so they'd have to pay the total cost of nearly \$25,000. At Harvard they'd now pay less than \$9,000.

"That puts middle-class families at a huge disadvantage in our system," says Berkeley chancellor Robert Birgeneau. "Many colleges may have to raise fees to funnel more money into financial aid or risk losing many of the best middle-class students."

The high sticker price is actually part of many colleges' marketing strategy. For as counterintuitive as it seems, schools have often found that raising tuition attracts more applicants because families tend to equate high price with quality. Marketers call it the Chivas Regal effect.

In 2000, for example, [Ursinus College](#) in Collegeville, Pa. boosted tuition and fees by 17.6%. The following year the school received nearly 200 more applications than the year before, and within eight years the freshman class had grown 56%.

[Hendrix College](#) in Conway, Ark. had a similar experience in 2005 when it hiked its tuition rate by 29% to \$22,000. The college in effect gave back much of the increase as financial aid or merit scholarships to 99% of the students; still, it seemed that tuition was as high as at places like the [University of Richmond](#). Since then the number of incoming freshmen has increased by nearly 40%.

Says Hendrix College president Timothy Cloyd: "We are competing with schools that charge more, so it was hard to convince people that we were as good as our rivals when we charged so much less."

The outlet for students who can't play this game has always been public colleges, which 80% of undergraduates attend. But as states struggle to meet the growing cost of Medicaid and federal requirements for elementary and high school education, less money is available for colleges.

Twenty years ago, nearly 75% of state university general funds came from state appropriations vs. 63% today. And in the current economic downturn, which is reducing tax revenue in many states, college officials worry, rightly, about additional cutbacks.

Public colleges have been making up the shortfall by raising tuition at an even faster clip than private schools - 31% compared with 14% over the past five years. Last year alone, Illinois public colleges raised rates 12%, while in Colorado costs jumped 16%.

And prices at some flagship public universities are starting to look more like what you'd pay at a private institution. At the [University of Michigan](#), for instance, in-state freshmen now pay nearly \$20,000, and out-of-state first-year students pay almost \$42,000 - \$10,000 more than the \$32,000 cost of the average private institution, although still less than the \$50,000 or so charged by top private schools.

Colleges could help ease the pressure by adopting cost-containment practices that are standard in private business. But most schools are nonprofits. And without the pressure to produce earnings, they have little incentive to slash expenses or improve productivity.

Says Ron Ehrenberg, an economics professor at [Cornell University](#) and author of "Tuition Rising": "For nonprofits the goal is to raise all the money you can, then spend it."

Then too, teaching is an inherently labor-intensive process that isn't conducive to economies of scale. "It's not like automating a factory - one professor can only grade so many papers and teach so many classes," says [Vassar College](#) president Catharine Hill. "If you were to double the class size, the quality would go down."

Classroom instruction is just one part of a college's budget, however, and not even the biggest part. In a study of spending at nearly 2,000 public and private schools over 18 years, researchers for the Delta Cost Project found that the percentage of operating expenses going to classroom instruction (mainly professor salaries and benefits) accounted for 34% to 44% of spending - and those percentages actually fell over the period reviewed.

By contrast, an increasing amount was being spent on such items as faculty research and recruiting. "We see indications that institutions are spending more money in areas that may not fit in with the public priority of

preparing more graduates," says Jane Wellman, the project's executive director.

That ought to leave plenty of room to cut costs without sacrificing quality. Brit Kirwan, chancellor of the University System of Maryland, has kept tuition level for three years with moves such as centralizing purchasing and increasing faculty teaching hours. Meanwhile, 20 private colleges and universities in Wisconsin have banded together to consolidate administrative functions, saving \$16 million over the past three years.

These schools are largely the exception, though. Most colleges don't approach cost-cutting in a systematic way. The American Association of State Colleges and Universities has found that more than three-quarters of schools fail to devote significant resources to identifying and carrying out cost-containment measures and 60% do not regularly quantify results.

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Runaway college costs are a matter of growing concern in Washington. In addition to pushing wealthy schools to spend more of their endowments, Congress recently passed legislation that requires greater disclosure about pricing and encourages states to maintain steady funding for public colleges by promising to withhold federal grants if they don't.

But in the end, no matter what lawmakers do, college costs will continue to defy gravity as long as we parents are willing to pay ever-higher prices to give our kids a head start in life. We assume that an expensive college will provide a superior education (there's that "high price equals better quality" bias) and an inside track to a high-paying job after graduation.

After all, at a brand-name school, your child will hang out with the scions of senators, hedge fund managers and captains of industry, and those connections can only help, right?

Well, maybe not. Says [Ohio University](#) economics professor Richard Vedder, author of "Going Broke by Degree": "There's virtually no data that allow families to evaluate the quality of [an elite college's] educational offerings or the outcomes of its graduates."

In theory you could quantify the added value you get from going to a highly selective school - which, in turn, would help determine what a reasonable tuition premium would be - by comparing the salaries earned by its graduates with those of workers who attended less selective schools.

Colleges, however, don't hand out that information. And some independent studies suggest the value is less than people think. Take a well-known 1999 paper by Princeton economist Alan Krueger and researcher Stacy Berg Dale at the Andrew W. Mellon Foundation.

The study compared the salaries of graduates who earned degrees from top-tier colleges with those of graduates who were accepted by these schools but chose to attend less selective institutions.

The research found that the two groups of students ended up with similar incomes. It appears that bright students excel no matter where they get their degree. The one exception: Low-income students did benefit from attending the most selective colleges - in their case, the impact of social networking seemed to pay off.

In today's fast-changing economy, however, the value of those old-boy networks may be eroding. According to a 2004 [University of Pennsylvania](#) study, prestigious degrees aren't as valuable at major corporations as they were a generation ago.

The study looked at the top executives at Fortune 100 companies in 1980 and 2001. During that time the percentage of top guns with Ivy League undergraduate degrees dropped by nearly a third, from 14% to 10%,

while the percentage who attended other highly ranked schools, such as [Williams](#) or [Notre Dame](#), fell from 54% to 42%.

Meanwhile, public university graduates soared to nearly 50% from 32%. Meritocracy in corporate America is a good thing, but it doesn't support the notion that whatever you pay for an elite education is worth it.

Given the steep price tag on the Ivies and similar schools and the uncertainty of the payoff, families need to do a harder-nosed evaluation when determining which college is right for their child. When you compare the best private and public undergraduate programs, says Vedder, you'll find that private schools rarely confer an unbeatable advantage.

If a student is considering engineering, for example, [Cooper Union](#) (where tuition is free to all) and the University of California at Berkeley have top-ranked programs. For economics, the [University of Texas-Austin](#), the [University of Wisconsin-Madison](#) and [UCLA](#) are highly regarded.

There are, of course, situations where the expensive degree may trump the less costly alternative. Maybe Deluxe U. offers the most comprehensive courses in astrophysics or Korean literature. Perhaps a dream employer routinely recruits there and not at other schools. Or perhaps your child simply falls in love with the storied tree-lined campus and fieldstone halls.

Then you'll face some tough decisions. Just keep this in mind if opting for Deluxe U. will force your family to borrow heavily: After decades of steady increases, the median salary for workers with a bachelor's degree fell 4.6% from 2001 to 2006. (College grads still earn far more than workers with only a high school diploma, though, as the chart on page 1 shows.)

Meanwhile, salaries rose 4.3% for workers with professional degrees and shot up 9.4% for those with doctorates. So you don't want the debt from getting that B.A. to make grad school unaffordable.

Mind you, some borrowing can actually be a good thing, giving students a built-in investment in their education. But today many kids leave school with unprecedented amounts of debt - \$20,000 on average, up from \$9,000 a decade ago - and one in 10 private college students borrows over \$40,000.

Moreover, that figure doesn't include parent loans, home-equity loans and credit-card debt. "It remains to be seen whether this kind of borrowing is economically sound or just a form of faith-based financing," says Barmak Nassirian, associate executive director of the American Association of Collegiate Registrars and Admissions Officers.

One chilling sign: Among students who graduate from four-year schools with more than \$15,000 in debt, the default rate is nearly 20%.

As a rule of thumb, financial advisers recommend that student-loan payments not exceed 10% of a young adult's starting salary. At [New York University](#), for example, about 60% of last year's graduates had loans, which averaged a hefty \$34,000.

If they took out the maximum in federal loans and made up the difference with private loans, the typical borrower would owe about \$460 a month, which is considered affordable if you earn at least \$55,000.

That may be no problem for chemical engineers, with an average starting salary of \$63,000, according to the National Association of Colleges and Employers. But the typical liberal arts major earns just \$33,000, which would make those payments a real challenge.

Of course, for most families, choosing a college is not simply a financial decision; it's a highly personal one as

well. Yes, you have to think about what kind of career that degree will lead to.

College, though, is also about forging lifelong friendships, being challenged by professors and students and sharing traditions - all of which are impossible to quantify. Still, there's no reason to overpay for the experience. From a purely economic point of view, the best advice might be this: Save your money; you'll need it for graduate school.

How does your religion affect your finances? Money Magazine is seeking families willing to discuss the dollars-and-cents expenses involved in practicing their faith - the cost of everything from religious schools and dietary restrictions to tithing and faith-based investment limitations. If interested, please email your name, contact information and family snapshot, along with a brief summary of your salary, savings and religion-related expenses, to gmannes@money.com. ■

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