



TUITION AND FINANCIAL AID:  
NINE POINTS FOR BOARDS TO CONSIDER  
IN KEEPING COLLEGE AFFORDABLE

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*Tuition and Financial Aid in Difficult Economic Times*

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# TUITION AND FINANCIAL AID: NINE POINTS FOR BOARDS TO CONSIDER IN KEEPING COLLEGE AFFORDABLE

**T**he headlines report that college tuition is rising rapidly and students are struggling to pay for college. Financial-aid issues have also been in the news lately, with questions about student debt particularly prominent. Non-tuition revenues are weak because of declining state appropriations, depleted endowments, and anemic annual giving. At the same time, institutional expenditures continue their upward spiral as health-care costs rise, demands on the financial-aid budget increase, new regulations demand compliance, and maintenance and facilities repairs can no longer be deferred.

How should trustees think about the options available for tuition and financial aid in these difficult economic times? What questions should they be asking to guide their efforts to support the fiscal strength and educational quality of their institutions, at the same time assuring students and their families that college is affordable?

## 1. IS TUITION RISING AT UNPRECEDENTED RATES?

In 2010-11, the tuition and fees for full-time students enrolled in public four-year colleges and universities in their states of residency average \$7,605; for out-of-state students the average is \$19,595. At private, nonprofit institutions, it is \$27,293. Public two-year colleges list an average price of \$2,713, while for-profit institutions charge about \$13,935.

Residential colleges frequently focus on the comprehensive fee, which also includes room and board charges. That averages \$16,140 for in-state, public, four-year college students and \$36,993 at private, nonprofit colleges.

Over the past decade, tuition at public four-year colleges has risen at an average annual rate of 5.6 percent beyond general inflation. That compares to 3.3 percent in the 1990s and 4.2 percent in the 1980s. The early years of the first decade of the 21st century saw the largest increases. Tuition and fees were 38 percent higher in constant dollars in 2005-06 than in 2000-01, and 24 percent higher in 2010-11 than in 2005-06.

Although private-college prices have also been rising much more rapidly than the Consumer Price Index, the growth rate of 3 percent per year beyond inflation in the past decade is just slightly higher than the rate of growth in the 1990s—and much lower than the 5.1 percent per year in the 1980s. Public two-year-college published prices rose more slowly in the most recent decade than in either the 1980s or the 1990s.

So it's true that published prices are rising faster than average prices in the economy, and prices at public four-year colleges have been rising especially rapidly by historical standards. But it's also true that this is a long-term pattern, not a new development.

#### Questions trustees should ask:

- How do tuition and fees at your institution compare to the national average for your sector? For your type of institution within the sector?
- Tuition levels vary considerably across regions of the country and by state. How does your institution compare to others near you?
- Why is your price higher or lower than the relevant average?

## 2. WHY DOES THE PRICE OF COLLEGE GO UP SO RAPIDLY?

Some of the pressures on tuition are similar across sectors, while others affect public and private colleges differently. The obvious difference leading to larger increases in the public sector in recent years is the impact of state budget constraints.

In 1999-2000, state governments appropriated \$73 billion in 2009 dollars for the operation of public colleges and universities. In 2009-10, they appropriated \$79 billion—down from a high of \$83 billion in 2007-08. But the real story emerges only when rising enrollments are also considered. The \$73 billion in 1999-2000 generated \$9,156 (in 2009 dollars) per full-time equivalent (FTE) student. That amount had fallen to \$8,571 in 2007-08 and \$7,418 by 2009-10. Over the decade, the number of FTE students in public four-year colleges increased from 8 million to 10.7 million. Clearly the need to supplement declining per-student state support is one explanation for rising tuition levels in the public sector.

Private colleges face their own revenue problem in these tight economic times: Those fortunate enough to have endowments that contribute significantly to operating expenditures were jolted by the collapse of the financial markets. In 2008-09, endowment assets in private nonprofit colleges were at about 70 percent of their 2006-07 values. While these values have partially recovered, annual giving remains weak, and non-tuition revenues are viewed as much less reliable than they were just a few years ago.

Colleges and universities also face cost pressures. Productivity has increased in the economy along with the sophistication of both capital and labor; technological innovation and a more highly skilled labor force have allowed Americans to produce things using fewer resources over time. But the prices of personal services tend to go up more rapidly than the prices of manufactured goods. So, just as it still takes four violinists to play a quartet in live performance, most classroom learning environments still require a professor interacting with students. Productivity increases have not been easy to come by in higher education.

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In fact, we are not even sure how to define productivity in education. Is it the number of class hours or degrees produced per hour of professorial time? Would larger classes mean more productivity? How does quality factor in?

The fact that a high percentage of college and university employees are highly skilled exacerbates the cost issue. As earnings inequality has increased over time, with the gap between the wages of people with a high-school diploma and those with a college education widening, the pressures on service industries that employ highly trained labor have been greater than those on other industries. The prices of legal services and medical/dental care have also gone up much faster than the average price level.

Many other factors contribute to the rapid rise in college tuition. Employee benefits have increased much faster than salaries, largely because of the rise in the cost of health care. Energy prices have been very volatile. Colleges spend much more on technology than they did before they had to provide computers all over campus, wired classrooms, and access to other high-tech innovations.

Unfortunately, colleges and universities have responded with less agility than many other organizations to such cost pressures. Most institutions have not been very successful at increasing the efficiency of their operations, cutting programs and services when new ones are added, or finding ways to carry out their mission using fewer resources.

Financial aid constitutes a growing portion of the budget for most colleges and universities. As prices rise more rapidly than family incomes, more students need assistance to make enrollment possible. In addition, colleges have increased their use of financial aid as a strategic tool helping them to compete with other institutions for desirable students. Smaller financial-aid budgets might allow lower sticker prices but, as discussed below, could in fact make college less affordable.

#### Questions trustees should ask:

- How fast has your institution's sticker price gone up in recent years?
- How have non-tuition revenues changed in recent years?
- What are the major cost pressures at your institution?

### 3. DOES THE STICKER PRICE REALLY MATTER?

Whether or not a student can afford to go to college—or to a particular college—does not depend on the sticker price. More than half of all undergraduate students, including over two-thirds of those who are enrolled full-time, receive grant aid to help them pay the price.

It is the net price—the price after taking grant aid (and federal education tax credits and deductions) into consideration—that hits students' pocketbooks and determines whether or not they can manage. Because much of this grant aid, particularly for students at private nonprofit colleges, comes from the institutions themselves, efforts to keep sticker prices low may actually diminish affordability.

Colleges and universities awarded about \$33 billion in grant aid to postsecondary students in 2009-10, an increase of about 70 percent in inflation-adjusted dollars over a decade. If they did not award this aid, they might be able to have lower sticker prices. But many who now rely on this assistance to enroll would face insurmountable financial barriers.

The importance of net prices does not mean that sticker prices don't matter at all. Many students do pay these prices. About 20 percent of students in public four-year institutions and over half of those in private nonprofit institutions received institutional grants in 2007-08. The rest paid the sticker price, many with the help of grant aid from other sources.

Sticker prices also matter for perceptions. The financial-aid system is quite complicated and many potential students do not understand that they won't have to pay the full price. They may fail to apply because they believe they won't be able to afford the tuition. And only those who apply and are accepted are told exactly how much it will cost them to attend.

As of October 2011, all institutions will be required to post net price calculators on their Web sites. These calculators will provide students with estimates of how much they would probably have to pay if they enrolled, given their financial and academic characteristics. It is possible that such calculators will significantly increase the information on which students base their decisions about where to apply. But they will certainly not fully solve the problem.

#### **Questions trustees should ask:**

- How many students at your institution pay the full sticker prices without a discount?
- When does your institution inform students about the financial aid they will receive?
- Has your institution developed its net price calculator yet?

#### **4. HOW MUCH SHOULD YOUR INSTITUTION RAISE ITS PRICE?**

Unfortunately, there are no simple rules to follow in setting your institution's tuition for the coming years. For some institutions, a cut in the sticker price might be a healthy move. For others, freezing tuition for a year or two could have a positive impact. But for most institutions, the question is how much to raise the price. One consideration is what your competitors will be doing. Both public and private colleges face considerable pressure to keep price increases in check.

For instance, beginning in 2011, the U.S. Department of Education will be required by law to publish annual lists of the 5 percent of colleges and universities in nine different categories with the highest tuition and largest tuition increases. It is unclear what the impact of that practice will be, but it clearly adds to the public pressure to mitigate price increases. There is also some evidence that students are becoming more price-sensitive as prices rise relative to incomes.

It is important not to let that pressure lead to the idea that students will simply not choose your institution if it is more expensive than an alternative. Price is only one factor in college choices—and net price matters most. Students choose location, academic programs, facilities, and the opportunities they think they will have. If the institution's leaders don't believe that their institution can attract students through the quality of its program, it will probably be a hard sell for students. Too low a price and too much bargaining can convey the idea that price is the best thing the college or university has going for it.

#### **Questions trustees should ask:**

- How does your institution's tuition compare to the tuition of institutions with which you compete for students?
- What do you know about why students choose your institution—or your competitors?
- When you raise your tuition, how much new net revenue is generated?

## 5. IS TUITION DISCOUNTING THE SAME THING AS FINANCIAL AID?

Institutional grant aid sounds like a good thing. Institutions are giving students money to help them pay the tuition. The funds may be based on student and family financial circumstances or on academic or athletic performance, rewarding students for their accomplishments and inducing them to choose the institution making them the offer.

Tuition discounting sounds more questionable. It sounds like what car dealers do. “You seem like someone who is likely to go elsewhere if we don’t give you a good deal. We’ll lower the price for you.” But in fact, these are just two different names for exactly the same pricing strategy.

Colleges and universities use a pricing pattern that economists call “price discrimination.” They charge different people different prices for the same product. Movie theaters do this when they charge lower prices for children or senior citizens. Airlines do this when they charge different prices depending on when and where you buy your ticket and how long you plan to stay. Car dealers do this when they bargain differently depending on their sense of how much you are willing to pay.

Price discrimination is not a bad thing. At most public and private nonprofit colleges and universities, even full-pay students are subsidized. The sticker price is less than the average cost of educating a student. The difference is made up through a combination of government subsidies and revenues from endowments and other private sources.

Some students can easily afford the sticker price, and would be able and willing to pay even more. They are not being cheated, and lower prices would not necessarily change their opportunities or their choices. Other students are not able or willing to pay the current sticker price. Charging them a lower price makes it possible and desirable for them to enroll.

Some institutions have long waiting lists of students willing to pay their sticker prices. Most of these are highly selective, nationally known, private colleges or flagship public universities. These institutions discount their prices to attract different students than those who would enroll without financial aid. They want the best students they can get, and many of those students simply cannot pay on their own. They may also want students with particular capabilities who will be drawn in by financial aid. For those institutions, financial aid is an expenditure made to shape the student body.

Many other institutions would have empty seats if they did not discount so generously. If they lowered the sticker price enough to fill the class, their total revenues would be too low to operate. But if they can draw in some full pay students, while charging others a lower price—something close to the maximum each student is willing and able to pay—they can fill their classes while taking in adequate net revenues. It would not be efficient for them to operate with empty seats. The full-pay students are

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no worse off because of the presence of other students who are there only because of the lower net prices they are offered. In fact, those extra students probably increase the quality of the education everyone on campus receives.

#### Questions trustees should ask:

- What percentage of your students receives institutional grants?
- What is the average grant received by students on financial aid at your institution?
- How fast have the numbers been increasing in recent years?

## 6. NET VS. GROSS REVENUES

Discounting is a sensible pricing policy, but some colleges and universities are doing too much of a good thing. At certain institutions, almost no one pays the sticker price. Perhaps the practice is effective because the high sticker price conveys a sense of quality, and individual students feel wanted when they are told they are special and offered an institutional grant. But the sticker price may also scare off qualified applicants.

As long as institutions are discounting their prices for some students, the total tuition revenue they bring in is lower than the sticker price multiplied by the number of (full-time equivalent) students. For accounting purposes, many colleges think about the “gross tuition” revenue as the starting point. However, the net revenue—the amount students actually bring in, considering the lower prices that those who receive institutional grants actually pay—should be the institution’s baseline in considering available resources.

Some colleges and universities have made a choice to generate lower revenues than they might be able to. Those are the few institutions described before as having long lines of qualified students willing and able to pay the sticker price. But for most institutions, the financial aid they offer is not optional. If they charged everyone the current sticker price, they would enroll many fewer students.

Some colleges rely so heavily on discounting that when they raise their tuition, they don’t manage to generate new net revenues. They actually increase their grant aid by more than the extra revenues they bring in from students paying the higher prices. Recent studies of tuition discounting indicate declining net revenues in whole categories of institutions, even as sticker prices are rising. In today’s economic climate, where students and families are struggling financially, some institutions are so afraid of losing students to lower-priced institutions that they are discounting away their needed operating revenues. That is not a viable long-term strategy and threatens the institution’s ability to offer the educational opportunities that allow it to fulfill its mission.

### Questions trustees should ask:

- How does the path of net tuition revenues over the past few years compare to the path of gross tuition revenues at your institution?
- When you raise your tuition by \$100, how much of that extra tuition increases your net revenues, and how much gets spent as additional financial aid?
- How much attention do people on your campus pay to the concept of net revenues?

## 7. NEED-BASED AID VERSUS MERIT-BASED AID

Although the proportion of institutional grant aid that is awarded to students who cannot afford to enroll without assistance is slightly higher than it was earlier in the decade, institutions are distributing much of their aid on the basis of characteristics other than need. Some “merit” awards go to students with financial need and increase affordability as much as those dollars awarded explicitly to meet need. But many of the dollars go to students who could afford to enroll without help. Given the limited resources available, this practice increases the unmet need of students from low-income and moderate-income families.

The motivation for merit awards varies across institutions. Some colleges want to increase the academic quality of the student body, perhaps to move up in the rankings. Others are just trying to attract enough students to survive.

Some institutions rely only on need-based aid. Many of these are selective private colleges that have no difficulty filling their classes with qualified students. Their goal is to use financial aid to allow the most qualified students to enroll, including those who cannot afford to pay. They also hope to increase diversity on campus and provide educational opportunities.

Other institutions think of themselves as relying exclusively, or almost exclusively, on merit-based aid. They give the most generous grants to students with the highest test scores or the best high-school GPAs. Some of these institutions may be heavily subsidizing relatively wealthy students, while leaving lower-income students to fend for themselves. But others may be in a situation where almost all accepted students have financial need that is not met by federal and state grant aid. These institutions should establish a system to ration their aid among the students with need. This amounts to a practice of “merit within need.” There are many variations on this approach. Some may involve using both financial need and academic qualifications to allocate aid.

Most institutions use some combination of need-based and non-need-based aid. They use financial aid as a strategic tool to appeal to the students they find most desirable or who have the best alternatives and are harder to get. They also use financial aid to help students who cannot afford to pay on their own. The balance between these two forms of aid varies considerably across institutions.

It is important to articulate the goals of your institution’s financial-aid policies carefully, to measure the effectiveness of current aid policies and practices in meeting these goals, and to consider alternative means of reaching the same ends.

### Questions trustees should ask:

- How much of the financial aid at your institution is allocated on the basis of financial need and how much is allocated on the basis of academic, athletic, or other characteristics?
- How much of the financial aid at your institution that is not need-based goes to students who have financial need?
- Has there been careful thought given on your campus to the pros and cons of subsidizing students who can afford to pay the full sticker price?

## 8. CAN WE AFFORD TO HELP STUDENTS AND FAMILIES PAY WHEN INSTITUTIONAL FINANCES ARE SO STRAINED?

Despite the fact that many of the most-qualified students are not able to enroll without it, need-based aid is frequently viewed as a practice based exclusively on equity. The temptation to view equity concerns as a luxury that must be sacrificed in difficult economic times is great. Without a strong bottom line, the rationalization goes, we cannot accomplish any of our goals. It is easy to look around and find other, better-funded institutions and become convinced that it is their responsibility to help low-income students. They can afford it. We cannot.

This quandary is not a new one and is not limited to times of particular financial distress. As long as there has been the possibility of using financial-aid funds to fill or shape the class—not just to provide opportunity—colleges have faced questions about balancing what is right and what is affordable. Yet, in fact, while we certainly face difficult choices, we do not have to choose between abandoning the goals of diversity and educational opportunity and risking institutional insolvency. The idea that need-based aid wins on equity grounds and non-need-based aid wins on efficiency grounds is too simplistic.

It is true that depriving low-income students of the opportunity to enroll in the institution of their choice in the interest of increasing its average SAT scores or chances of making the basketball playoffs is hard to sell as a strong ethical position. But the reality is that many institutions have difficulty attracting enough middle-income and upper-income students to bring in the needed tuition revenues. Institutions with very large endowments don't generally have this problem. But other institutions with fewer resources may find it difficult to fill seats and particularly hard to attract students from families with ample financial resources. These institutions are less selective, less prestigious, and have much less affluent student bodies. And they will not survive if none of their students can pay. Some amount of non-need-based aid designed to attract students who can pay a significant portion of their own way may increase net revenues and make it possible to provide better educational experiences—and more need-based aid than the budget would otherwise allow.

Another seemingly obvious ethical choice related to financial aid is the idea of meeting full need. The choice is between providing accepted students enough grant aid—supplemented by aid from other sources like loans and work—that they can afford the total cost of attendance or leaving them with a gap, so they have to search high and low to make ends meet if they enroll. Surely it looks “right” to meet full need. And surely it is right—if available resources are ample and the choice is between meeting full need and throwing more money at the applicants with the highest SAT scores.

But more often, meeting full need will collide with the practice of need-blind admissions, which seems similarly appealing. Meeting full need may well be feasible if the number of students with high need is limited. But it will become impossible at most institutions if they admit needy students without limit.

Some institutions solve this problem by redefining either need or financial aid. Measured need might be reduced by counting previously ignored resources or disallowing consideration of expenses such as childcare or medical costs. Need might be “met” by including a parent loan or a private bank loan and calling it student aid. A claim to equity is asserted, but the reality is much more complicated.

Similarly, the purported efficiency of strategic financial-aid practices, many of which take a very short-term perspective, may be more ambiguous than appears at first glance. Over the longer run, some of the practices adopted may backfire.

For example, if a college denies admission or financial aid to high-need students, but offers generous grant aid to less-qualified, more-affluent applicants from the same high school, this pattern will become apparent to college counselors. The institution is likely to lose both respect and qualified applicants.

Moreover, if the college succeeds in winning desirable applicants from peer institutions by offering non-need-based aid, the peer institutions are not likely to sit by idly. They will offer competitive packages. It is easy to see how competition for these students can lead to a price war, depleting institutional funds without bringing any more qualified and well-heeled students into the applicant pool. Everyone will lose in the long run—except those lucky students who could have paid full price, but who now enjoy lower net prices than even students from the lowest-income families.

The issue of destructive competition that can lead to losses for all is frequently difficult for institutions to grasp. They look at short-term successes and can't see how it could be in their interest to sacrifice those successes for the greater good. But the reality is that if all institutions behave this way, those students without the ability to pay will simply drop out of the pool and collectively the colleges will not be able to improve the quality of the students they enroll.

In fact, equity and efficiency frequently reinforce each other, both from society's perspective and for the individual college or university. Equity dictates that each institution provide the best possible education to the students who are qualified to enroll—regardless of ability to pay. That means making need-based aid a priority—possibly at the expense of institutional prestige, some campus amenities, programs, or other worthy expenditures.

Efficiency means making decisions that allow the institution to provide as much quality education at the lowest cost possible and assuring that the institution has a strong bottom line in both the short term and the long term. Rising in the rankings might be a good way to attract more applicants. Providing discounts to students who could afford to enroll elsewhere to draw them to campus might increase net revenues. Assuring financial strength is a pre-requisite to providing equitable opportunities. In other words, a focus on equity does not mean ignoring efficiency. And a focus on efficiency cannot exclude equity.

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Recognizing that making ethical choices is not always straightforward does not diminish—and in some ways underscores—the importance of keeping ethics in the forefront of the decision-making process. There is no question that, in recent years, the pendulum in admissions and financial aid has swung too far from a focus on equity and access and toward a focus on improving the prestige or the bottom line of the institution. This imbalance is probably exacerbated by the financial constraints imposed by the current economic circumstances, making it all the more vital that campus decision makers reject the notion that ethical priorities are a luxury they cannot afford.

#### Questions trustees should ask:

- How do your institution’s merit aid awards compare to those of your competitors?
- Is there a good balance between long-term and short-term goals for aid?
- Do people tend to debate need-based versus merit-based aid or are they open to the idea that these policies may complement each other?

## 9. STUDENT DEBT

One of the side effects of student-aid policies that focus on student characteristics other than financial need is that low-income and moderate-income students are likely to face bigger funding gaps and accumulate more education debt if they are able to enroll. Still, the student debt problem is sometimes exaggerated. Student loans are an invaluable part of the college financing system. Many students’ lives have been significantly improved because of the availability of these loans—without them, we would have much lower college enrollment and success rates than we now do.

Some students do borrow recklessly and end up paying a high price. But many more have manageable levels of debt that can be repaid out of the earnings premium generated by college credentials. While headlines like “How Student Debt Will Ruin your Life” and “Students Drowning in Debt” are common, they are sensationalist and misleading. About two-thirds of bachelor’s-degree recipients borrow, and the typical borrower graduates with \$20,000 to \$25,000 in debt—depending on a combination of circumstances, including family income and the type of institution attended. The widely read stories of undergraduates who borrow \$80,000 or \$100,000, and of institutions where virtually all students borrow and the average debt level is close to \$50,000, are not nearly as common as news articles may suggest.

That does not mean, however, that such situations don't exist. And if they exist at your institution, the best interests of your students are at risk and need more attention. It's not just that the Department of Education and Congress have started to look more closely at colleges with many students who have high debt levels. It's also that some institutions may be leaving their students worse off than they found them. Higher education's mission certainly goes beyond increasing students' lifetime incomes, but putting students in a situation where they pay so much for college that they never see financial benefits is irresponsible and unethical.

Institutions share responsibility with students and their families for the amount of debt students are incurring. Even if the college includes only the amount of federal loans available to students in their financial-aid packages, students sometimes turn to private credit markets. Some institutions even package private loans—suggesting that they constitute financial aid. Such borrowing is concentrated in private nonprofit and for-profit institutions.

#### Questions trustees should ask:

- How many of your students borrow to help finance their education?
- What is the average debt level at graduation?
- How have borrowing patterns at your institution changed over time?
- Are there changes in your financial-aid policies that might reduce the extent to which your students have to rely on loans?

## CONCLUSION

Current economic pressures make questions related to tuition and financial aid more stressful than ever before for institutions depending on tuition revenues to fund their operations, as well as for students and families struggling to pay for college. A rational, informed approach to pricing requires considerable knowledge about the environment in which the institution operates, the particular circumstances facing the institution, and the characteristics of the students and potential students.

Sticker prices that are too high or that rise too rapidly can deter students from enrolling, make it difficult for students and families to plan their finances, and generate negative publicity for the institution. Sticker prices that are too low can diminish the quality of the education that the institution offers and make it more difficult to provide the financial aid that many students require to enroll and succeed in college.

The net prices students pay after taking grant aid into consideration and the net tuition revenues institutions receive are the amounts that matter most. Colleges and universities have complex pricing structures. Trustees should have a clear understanding of those structures and ask questions that will make campus administrators analyze their decisions carefully and consider alternatives. Economizing on financial aid when times are tough may well be counter-productive. Rethinking institutional priorities and the effectiveness of current practices can only be beneficial for both the college or university and its students.

### **About the Author**

Sandy Baum is an independent higher education policy analyst and consultant. A senior fellow at the George Washington School of Education and Human Development and professor emerita of Economics at Skidmore College, Dr. Baum earned her BA in sociology at Bryn Mawr College and her PhD in economics at Columbia University. She has written and spoken extensively on issues relating to college access, college pricing, student aid policy, student debt, affordability, and other aspects of higher education finance.

Dr. Baum is a senior associate at the Institute for Higher Education Policy and Affiliated Consultant for HCM Strategists. She has worked with numerous organizations including the Advisory Committee on Student Financial Assistance, the Association of Governing Boards of Universities and Colleges (AGB), Canada Student Loans Program, the Jack Kent Cooke Foundation, and the National Association of Student Financial Aid Administrators (NASFAA). Dr. Baum has managed and co-authored the annual publications, *Trends in Student Aid* and *Trends in College Pricing* for the College Board since 2002. She also developed and co-authored *Education Pays: The Benefits of Higher Education for Individuals and Society* for the College Board. She co-chaired the Rethinking Student Aid study group, which issued comprehensive proposals for reform of the federal student aid system and is managing a study of the impact of student aid simplification on states, funded by the Lumina Foundation. Other recent work includes studies of concepts of college affordability, the non-financial barriers to college access, and tuition discounting in public and private colleges and universities.





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