

TECHNICAL PAPER A

THE HIGHER EDUCATION COST ADJUSTMENT: A PROPOSED TOOL FOR ASSESSING INFLATION IN HIGHER EDUCATION COSTS

INTRODUCTION

Prices charged to students, the total cost of higher education, and the effect of inflation are all important issues for the public, state and federal governments, and colleges and universities. This brief technical paper discusses two relevant dimensions of inflation in higher education—the consumer and the provider perspectives—and describes a tool to benchmark the inflation experienced by providers, colleges, and universities.

THE CONSUMER PERSPECTIVE

The student, parent, or student-aid provider most often views higher education prices compared to how much consumers pay for other goods and services. The Consumer Price Index for Urban Consumers (CPI-U) is most often used for such comparisons.

The CPI-U “market basket” consists of: housing (42 percent of the index), transportation (19 percent), food and beverage (18 percent), apparel and upkeep (7 percent), medical care (5 percent), entertainment (4 percent), and other goods and services (5 percent). To calculate the CPI-U, the Bureau of Labor Statistics measures average changes in the prices paid for these goods and services in 27 local areas.

Prices for different goods and services generally change faster or slower than the average rate of increase in the CPI-U. Incomes also grow or decline at different rates. Consumers notice when prices increase and they become concerned when prices for important goods and services grow faster than their incomes. Prices for higher education and health care, for example, have grown faster than overall consumer prices over the past 15 years. While consumer prices, as measured by CPI-U, grew by 43 percent between 1995 and 2010, the cost of medical care grew by 85 percent,¹ and enrollment-weighted tuition and fees for four-year public universities grew by 175 percent.² U.S. income per capita grew by 85 percent³ during the same period—more than prices in general, but less than the health care and college tuition price increases.

In view of these facts, it is not surprising that college prices are attracting national attention. Colleges and universities are certainly aware of the issues and of the increase in their prices. At the same time, however, they face growth in the prices that they pay.

1. “Economic Report of the President.” February 2007. Appendix B, Table B-60: “Consumer Price Indexes for Major Expenditure Classes” (www.gpoaccess.gov/eop/2007/B60.xls).

2. Source: Washington Higher Education Coordinating Board

3. Source: Bureau of Economic Analysis

THE PROVIDER PERSPECTIVE

The CPI-U is based on goods and services purchased by the typical urban consumer. Colleges and universities spend their funds on different things—mostly (about 75 percent) on salaries and benefits for faculty and staff; and lesser amounts on utilities, supplies, books and library materials, and computing. Trends in the costs of these items don't necessarily run parallel to the average price increases of the goods and services tracked by the CPI-U.

Kent Halstead developed the Higher Education Price Index (HEPI) to track changes in the prices paid by colleges and universities. This index, which tracks price changes since 1961, is based on a 1972 market basket of expenditures for colleges and universities. To estimate price changes for components in this market basket, Halstead used trends in faculty salaries collected by the American Association of University Professors (AAUP), and a number of price indices generated by federal agencies.

Dr. Halstead last updated the HEPI in 2001, using regression analysis to estimate price increases for more recent years. Since 2005, Commonfund Institute has maintained the HEPI project, continuing to provide yearly updates to the data based on a regression analysis.

The HEPI has made an important contribution to understanding the cost increases borne by colleges and universities. Over the past years, the State Higher Education Executive Officers association (SHEEO) and chief fiscal officers of higher education agencies discussed the feasibility and desirability of a fresh analysis of higher education cost inflation and reached the following conclusions:

- While the HEPI has been useful, it has not been universally accepted because it is a privately developed analysis, and one of its main components, average faculty salaries, has been criticized as self-referential.
- The HEPI has not diverged dramatically from other inflation indices over short time periods. Hence, many policymakers reference indices such as the CPI-U in annual budget deliberations, especially in budgeting for projected price increases.
- It would be costly to update, refine, and maintain the HEPI in such a way that would meet professional standards for price indexing. The most labor-intensive work would be in refreshing the data in the higher education market basket.

For these reasons, SHEEO decided not to develop a successor to the HEPI. But, over an extended period of time, differences between the market basket of higher education cost increases and the CPI market basket cost increases are material. The most fundamental problem is that the largest expenditure for higher education is salaries for educated people. In the past 20 years, such people have demanded increasingly higher compensation in both the private and public sectors, including colleges and universities.

SHEEO developed the Higher Education Cost Adjustment (HECA) as an alternative to the CPI-U and the HEPI for estimating inflation in the costs paid by colleges and universities. HECA is constructed from two federally developed and maintained price indices—the Employment Cost Index (ECI) and the Gross Domestic Product Implicit Price Deflator (GDP IPD). The ECI reflects employer

compensation costs including wages, salaries, and benefits.⁴ The GDP IPD reflects general price inflation in the U.S. economy.⁵ The HECA has the following advantages:

1. It is constructed from measures of inflation in the broader U.S. economy;
2. It is simple, straightforward to calculate, and transparent; and
3. The underlying indices are developed and routinely updated by the Bureau of Labor Statistics and Economic Analysis.

Because the best available data suggest that faculty and staff salaries account for roughly 75 percent of college and university expenditures, the HECA is based on a market basket with two components—personnel costs (75 percent of the index), and non-personnel costs (25 percent). SHEEO constructed the HECA based on the growth of the ECI (for 75 percent of costs) and the growth of the GDP IPD (for 25 percent of costs).

Technical Paper Table 1 displays three indices—the CPI-U, HEPI, and HECA—for the years 1998 to 2013. For comparison purposes, per capita income growth is shown.

SUMMARY OF THE INDICES

Between 1989 and 2014:

- Consumer prices grew by 90.6 percent;
- Provider prices for higher education grew 106.6 percent (as estimated by HECA); and
- Provider prices for higher education grew 130.9 percent (as estimated by HEPI).

Between 2009 and 2014:

- CPI-U grew by 10.2 percent; and,
- HECA grew by 9.5 percent, due to flat or declining salaries, a primary driver of the measure.

4. The Employment Cost Index (ECI) for White Collar Workers (excluding sales occupations), which has traditionally been used in SHEF, was discontinued in March 2006. The ECI for management, professional, and related occupations (not seasonally adjusted) is the closest to the discontinued index and is now used in SHEF. This index is available back to 2001, and historical SHEF data have been adjusted to represent this new series.

5. Gross Domestic Product (GDP) is the total market value of all final goods and services produced in the country in a given year. It is equal to total consumer, investment, and government spending, plus the value of exports, minus the value of imports. The GDP Implicit Price Deflator is current dollar GDP divided by constant dollar GDP. This ratio is used to account for the effects of inflation by reflecting the change in the prices of the bundle of goods that make up the GDP as well as changes to the bundle itself.

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CPI-U, HEPI, AND HECA INDEXED TO FISCAL YEAR 2014

FISCAL YEAR	CPI-U 1	HECA 2	HEPI 3
1989	52.46	48.40	43.30
1990	55.29	51.02	45.91
1991	57.62	53.14	48.32
1992	59.35	54.87	50.05
1993	61.13	56.72	51.48
1994	62.69	58.37	53.24
1995	64.47	59.96	54.81
1996	66.38	61.52	56.41
1997	67.90	63.05	58.17
1998	68.96	64.84	60.22
1999	70.48	66.59	61.66
2000	72.85	69.14	64.20
2001	74.92	71.89	68.05
2002	76.10	74.06	69.35
2003	77.84	76.47	72.87
2004	79.91	79.05	75.55
2005	82.62	81.70	78.51
2006	85.28	84.31	82.52
2007	87.71	87.31	84.87
2008	91.08	89.87	89.08
2009	90.76	91.31	91.07
2010	92.25	92.67	91.88
2011	95.16	94.64	94.03
2012	97.13	96.35	95.60
2013	98.55	98.06	97.10
2014	100.00	100.00	100.00
% CHANGE 2009-2014	10.2%	9.5%	9.8%
% CHANGE 1989-2014	90.6%	106.6%	130.9%

Note:

CPI-U and HEPI are fiscal year (July 1 to June 30). HECA data are Quarter 2 of the calendar year, coinciding with the final quarter of the comparable fiscal year.

Sources:

- 1) U.S. Bureau of Labor Statistics
- 2) SHEEO, from BLS and BEA data
- 3) Kent Halstead, Research Associates of Washington, DC.