

Higher Education in an Evolving Economy

Endowment and Debt Management Forum
National Association of College and University Business Officers
New York, NY

February 8, 2018

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President and Chief Executive Officer
Federal Reserve Bank of Philadelphia



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Good morning and thank you. It's a pleasure to be here.

In considering my remarks today, I found the narrative going in something of a spiral, because the topic of higher education is inextricably linked to so many others. Going down one route of inquiry leads inevitably to a dozen others, which branch off into a dozen more. Compounding that issue is that, while I view the subject from the perspective of a policymaker concerned with education's immense influence on the country's long-term economic strength, I also have the experience of an academic, a business school dean, and a university president. I've seen how the administrative sausage is made; so whatever your role in the process, I can commiserate.

One of the wonderful things about academia is that you can be provocative in your opinions on policy orthodoxy — and I've certainly been accused of that once or twice. As a Federal Reserve president, however, I tend to be more circumspect in my public declarations and am bound — just to be on the safe side — to deliver the standard disclaimer that absolves my colleagues from association with anything I might say to offend: The views I share today are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System.

With that out of the way, I'd like to talk today about the essential role that higher education plays in the economy, address some of the issues facing the sector on both a macro and micro level, and, at the end, perhaps question some operational orthodoxies. Just as a throwback to my academic days.

Education's Fundamental Economic Role

The issue of education's importance is easy to address and almost impossible to overstate. It is one of the constants of human history that throughout cultures and epochs, the foundation of every society has rested on the education of its people. From a policy perspective, education is the heart that pumps the blood into every other organ in the economy. It trains our workforce, it emboldens our innovation, it sharpens our competitive edge.

The institutions that perform this vital function of the American economy, and you, the people who help execute that mission, have a monumental amount of responsibility on your shoulders. And I am fully aware that you are doing it in the face of change and challenges, most of which you have no control over. But no pressure.

So I'd like to talk a little about the conditions in which you're operating, and some of the factors affecting your current and future work, that also impact the nation as a whole.

A Changing Landscape

While there is a lot of discussion about headline issues right now, I find that the underlying, secular trends that get less attention are significantly more impactful. We live in a world that is rapidly changing on both a demographic and technological level, and the old models aren't necessarily keeping up with the demand for change.

I am a great proponent of education for education's sake, but I'm also a pragmatist in that much of the goal of postsecondary education is to prepare students for work. And we have a very different labor landscape today than when I was in college.

Labor force participation in the United States is significantly lower than a decade ago. This is largely due to demographic factors and, according to research by my staff, is likely to continue to decline. I know that millennials are tired of hearing that everything is their fault, so the younger of you in the audience will be delighted to hear that this one you can blame on the boomers. The boomers represent the largest generation in our history to head into retirement, and they're living longer as well. And while I'm delighted at the prospect of the extended cut of my own golden years, this will put a strain on the economy.

For one, it means more people living on fixed retirement incomes, more people depending on Medicare and Social Security, and more people whose medical and general care expenses will be higher than they are now. Much of that burden will fall on the generations behind them.

It also means experiencing the downside of a simple economic equation: Growth is, fundamentally, growth in the labor force plus growth in productivity. Without an increase in one of those variables, GDP is likely to suffer, and in recent years, productivity growth has proven to be stubbornly low as well. Simply put, we need more people.

And while the millennial generation is actually larger than the boomers, millennials are both not yet in their prime earning years and not enough to increase the labor-force growth sufficiently. As for your demographic outlook, the birth drop-off in the mid-'90s means you're likely facing fewer occupants of classroom seats in the foreseeable future.

I want to reiterate the caveat about the views I express being my own, and I want to make clear that I'm a monetary policymaker — I don't add my two cents to fiscal, foreign, domestic, or any other policy. But people coming off the sidelines, as well as into the country, add much needed numbers to our workforce. They're a component of your financial success as well. Students coming from abroad are an important revenue stream for colleges and universities because they pay higher tuition fees and contribute substantially to business and STEM programs. If it becomes harder for them to come, or if increased competition from abroad gives them incentive to stay home or go elsewhere, your bottom lines suffer, and our economy overall misses out on U.S.-educated students in critical fields. This won't be remedied by simply filling the void with American students; there are entire programs that just don't have enough domestic candidates to survive.

Another aspect of the landscape that has changed significantly since my own college days is the way technology has affected all aspects of work. It's no longer uncommon for people to have several careers in their working lifetime, and constant retraining is essential in virtually every occupation. And I'm not just talking about, say, doctors keeping up with the latest surgical invention; I mean that being an auto mechanic today is as much about the computer as it is about the chassis.

So, on this vast, macro level, we have the two irresistible forces of demographics and technology affecting the very movable object of the American workforce.

Barriers to Entry

But we also have myriad financial factors affecting the individuals who make up the nation's student body and our current and future workers.

First, we can't talk about higher education without talking about the financial cost. Both the sticker price of tuition and the discounted rate have risen faster than incomes over the past 20 years, putting pressure on households' finances.

Second, as everyone in this room will be acutely aware, there is the issue of dwindling state funding. Demographics are bound to impact this issue even further as an increasing share of budgets on the local, state, and federal levels goes toward retirement benefits, pensions, and health care.

These factors both contribute to the growing share of student loans, which now makes up the second-largest slice of the consumer debt pie, surpassed only by mortgages. While the issue of tuition prices and decreased funding have fueled the market for student loans, I worry that mounting numbers, combined with uncertainty about the future of repayment and forgiveness programs, may deter some lower- and moderate-income students from entering higher education.

While those determinants have received a lot of attention, there are other, less tangible factors that either erect barriers to entering college or affect students' success once they've enrolled. There are more elements to the school experience than just tuition and books, and campuses around the country have done great work to address that fact. Whether it's navigating office hours or finding resources like free tutoring, programs that focus on underserved students have been important factors in their success. There's a good body of research to back that up, both qualitative and quantitative.¹ In fact, one of the Philadelphia Fed's research teams is currently working with Rutgers University–Camden to assess the outcomes in one of its financial aid

¹ James J. Heckman and Tim D. Kautz, "Hard Evidence on Soft Skills," National Bureau of Economic Research Working Paper 18121 (2012), <http://www.nber.org/papers/w18121.pdf>.

programs — in this case, one that offers financial relief to students well into the middle-class cohort. Part of the goal is to clarify those additional support needs.

When I was at the University of Delaware, we had a program for students who were the first in their families to attend college. We had them arrive in June so they could spend a few months familiarizing themselves with experiences their families just couldn't give them first-hand advice on. Some of it was academic, but a lot of it was soft skills, and it worked. Those students had first-year GPAs equivalent to their classmates whose families had a history of college attendance.

Increased cost pressures on institutions may force them to cut or curtail those programs, which would be a great loss, and disproportionately affect lower- and middle-income students.

The Resonating Impact

The overall issue of student debt is important because it doesn't just affect individuals, it resonates across generational lines in families and spreads into the wider economy.

Research shows that in the decade leading up to 2015, the number of adults over 60 who took on student debt quadrupled, with roughly three-quarters of that being assumed on behalf of children or grandchildren.² Given the same demographic shifts I mentioned earlier, that means debt is being held by a substantial number of people living on fixed incomes, while the extended duration of their lives leaves them more likely to encounter increased care costs, making default a real threat.

² CFPB Warns Student Loan Servicing Problems Can Jeopardize Long-Term Financial Security for Older Borrowers (2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-warns-student-loan-servicing-problems-can-jeopardize-long-term-financial-security-older-borrowers/>.

On the national level, research by the Philadelphia Fed’s Consumer Finance Institute, along with others, shows that student debt is affecting both small business formation and homeownership rates.^{3, 4}

Those obviously pose a risk far outside the confines of individual debt.

Financial uncertainty and cuts to programs that support underrepresented students could also exacerbate the achievement gap and increase income inequality. This isn’t just a social issue; research shows that inequality exacts a financial cost to the country as a whole.⁵ We are also missing out on vast opportunities on a national scale if we’re not tapping all our resources. It makes logical sense that if sharp minds are denied access to a good education, they won’t reach their full potential. It’s an old argument, but new research backs this theory up, investigating what the authors call our “lost Einsteins.” The researchers looked into the backgrounds of patent holders in the United States and found some common themes: People who scored well on elementary math tests made up the majority, which wasn’t a surprise. But they also came overwhelmingly from privileged backgrounds — low-income students who scored the highest on the tests weren’t any more likely to hold a patent than wealthy kids with below-average math scores. There were similar results for women, minorities, and people who lived in the southeast portion of the country.⁶ Women alone make up more than half the population; the simple numbers tell us we’re missing out on a lot of potential and productivity in a majority of the population.

That, in turn, comes back to an issue for higher education: Some of the best minds out there aren’t being recruited; institutions have to invest in ways to reach new and different

³ Brent Ambrose, Lawrence Cordell, and Shuwei Ma, “The Impact of Student Loan Debt on Small Business Formation,” Federal Reserve Bank of Philadelphia Working Paper 15-26 (2015).

⁴ Zachary Bleemer, Meta Brown, Donghoon Lee, Katherine Strair, and Wilbert van der Klaauw, “Echoes of Rising Tuition in Students’ Borrowing, Educational Attainment, and Homeownership in Post-Recession America,” Federal Reserve Bank of New York Staff Report 820 (2017).

⁵ Era Dabla-Norris, Kalpana Kochhar, Nujin Suphaphiphet, Frantisek Ricka, and Evridiki Tsounta, *Causes and Consequences of Income Inequality: A Global Perspective*, International Monetary Fund (2015).

⁶ Alex Bell, Raj Chetty, Xavier Jaravel, Neviana Petkova, and John Van Reenen, *Who Becomes an Inventor in America? The Importance of Exposure to Innovation*, Institute for Economic Policy Research Working Paper 17-041 (2017).

communities, both because potential is going unfulfilled and because demographic trends are going to force them to.

Rethinking Old Models

Here's where I make the appeal to question the conventional wisdom. As I said earlier, I come at this issue from a lot of different angles, and I know that, with this audience, I'm preaching to the choir. I've seen a lot of inventive thinking on campuses, but I've also seen some of those proposals made in vain, purely out of a resistance to change.

Are we making the best use of all our resources? Language departments can partner with other schools with bigger budgets to provide career-based instruction, like nursing schools certifying health-care-oriented Spanish or business schools offering business Mandarin. This isn't a declared minor, it doesn't require tenured faculty, and much of it can be done with supplementary software and less time in the classroom. But I've heard of department heads retreating from ideas like this, even those fully funded by another school, because they don't fall within a traditional model. And those are the kinds of programs that can attract outside organizations as well.

Some of the most innovative thinking I've seen lately has come out of community colleges. As I said earlier, education for its own sake is important, and so is the range of learning that comes with a four-year degree. But there are also gaps to be filled in a constantly evolving workforce and new careers and areas of research that schools can branch out into.

I was recently touring Atlantic City and the wider Atlantic County, which are part of my District. Like a lot of places, when one industry drives the economy, it can be hard to diversify. Atlantic County is trying to optimize its assets beyond gambling to bring more growth to the area. I always knew they had an airport out there, but I hadn't realized the size and scope of it, even though I'm a New Jersey native. It's a hub of FAA research labs, they train U.S. Marshals, and the Coast Guard and Air National Guard have facilities there. It's got a 10,000-foot-runway that was built so the space shuttle could land in case of emergency. As far as resources go, it's a pretty great asset. But it wasn't being used as well as it could have been. So the county talked to the airline industry, found out there's a massive shortage of mechanics and other aviation

specialists, and are working in partnership with Atlantic Cape Community College to create an institute on-site.

Or take Philadelphia, where YouthBuild Philadelphia Charter School, which serves students who've previously dropped out of high school, has partnered with the local community college on training and apprenticeships.

Programs like these can help students avoid debt, funnel people into well-paying, understaffed occupations, and develop new revenue streams without disrupting four-year programs.

The Value of Skills-Based Learning

They do something else important, which is that they stress the value of skills-based training and unconventional paths to education. Not everyone needs a four-year degree and not everyone needs to go college right away. A singular university experience isn't right for everyone, and if we can shift the thinking on the different ways people engage in higher education, we can shift the thinking about the ways we provide it.

My staff has done research on what they call *opportunity occupations*, jobs that pay at or above the median wage without a traditional four-year degree. They don't just know what fields they're in; they know where they are geographically, which could make it easier to create a pipeline. These are good, solid careers that can support a middle-class life.

Apprenticeships can also be incredibly valuable, as can any "learn and earn" program. They are a path to a career, and people can save for school later on, go back for more training, or master a profession.

I'm not advocating that traditional four-year institutions change their models to practical training. I am saying that the pragmatic approaches these programs take to meeting the needs of business and industry, while simultaneously being creative in how they educate students, can help us rethink some of the old ways of doing business.

This is the most inventive, diverse economy on the planet, and our approach to education should be just as innovative. In the face of multiple forces applying financial pressure, it just makes sense to rethink some of the ways institutions operate.

Conclusion

Bob Zemsky has long argued that higher education has been almost unique in its resistance to taking the steps necessary to improve labor productivity, steps that virtually every other industry has and would take. I don't know that I want to wade far into that particular quagmire, if only to avoid a flurry of e-mails from my former colleagues and contemporaries. I do know that higher education is operating in changing economic circumstances, with financial pressures coming from multiple directions. I know that these institutions are hubs of intellect and creative thinking, so the tools are all there. I know that sometimes we all need a little push to move outside our comfort zones and try new ways to achieve our goals. And I know that the men and women in the room today can play a critical role in making that happen.

Thank you. I'm happy to take any questions.