Mitchell's Musings 4-9-12: Pareto Not Optimal for Higher Ed?

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Students in economics courses, early in their studies, learn about the concept of "Pareto optimality," a concept developed by the Italian economist pictured above, Vilfredo Pareto (1848-1923). In essence, the idea is that if you can find an action that makes nobody worse off and at least somebody better off, you should clearly do it. No one is harmed and someone is helped, so why not? It seems so obvious (to economists).

Sadly, in the real world, almost any policy change is likely to benefit some folks and harm others. Reduce greenhouse gases because you think it's good for the world at large? It's probably bad for coal miners, however. Usually the economist's comeback is that in theory the winners could compensate the losers. That may be true. But it isn't Pareto optimal for the winners to do so *if* they can get the policy enacted without paying the cost of the income transfer! And most policy changes are not made by unanimous consent but rather by majorities in legislatures (so there are minorities against) or through other non-unanimous political processes. Getting the ear of the king before your opponents did was once the usual route to policy success. Nowadays, it might be lobbying some regulatory agency more effectively than the opposition. You win; someone else loses.

So are there any examples of Pareto optimal choices and are they automatically accepted if they present themselves? Recently, I found one quite locally in my home town of Santa Monica. The interesting thing is that it produced violent opposition – although the police and other authorities are still sorting out what actually happened. I suspect there is a larger lesson for economists – something about perceptions of fairness which outweigh Pareto logic. And that lesson may have implications in particular for public higher education in a period of fiscal distress and of tight state and local budgets.

California in the Cold War prosperity of the 1950s found itself with three systems of public higher education that had evolved independently. There was the University of California which was transforming itself from a single land-grant campus at Berkeley into a multi-campus enterprise. There were four-year colleges scattered around the state. And there were junior colleges that were two-year institutions offering a route into four-year institutions, a terminal AA degree, and various forms of voc ed. Under the proctorship of then-Governor Pat Brown (father of the current governor) and Clark Kerr, president of the University of California (UC), a "Master Plan for Higher Education" was developed in

1960 outlining distinct functions for each of the three systems. The plan was ratified by the state legislature and seemed to promise tuition-free higher education for every California high school grad.

The idea of free higher ed actually didn't last long and the original Master Plan expired in 1975. But the Plan is still considered to be at least an aspirational document. Under its provisions, the top one-eighth of California high school grads was to be eligible for admission to a UC campus. The top third was eligible for a state college campus. (The state colleges are now called the California State University or CSU system.) Junior colleges – now termed community colleges – were to be the higher ed institutions of last resort. If you had a high school degree, you could go to a community college and, if you did well enough, you could eventually transfer to a UC or CSU campus.

California has long had a system of diffused authority. Community colleges are run by elected members of community college districts. They receive a complicated mix of state and local funding. However, certain statewide policies, notably tuition levels, are set by the legislature and the California Community College Board of Trustees.

As might be expected, California – which had a disproportionate share of the housing bubble and flaky mortgage practices – was especially hard hit by the Great Recession. Among the consequences were sharp cuts in funding for higher ed generally and for community colleges in particular as state and local tax revenue dropped. For UC and CSU, the partial offset to state funding was hiking tuition. However, there was great pressure to hold down community college fees. Local community college districts cannot on their own initiative raise fees. As a result, course offerings have been rationed as dollars were rationed. Students might enroll in the community colleges but there is no guarantee they will get the courses they need to graduate on a timely basis or to move on to a four-year institution.

Faced with this predicament, the president of Santa Monica College came up with a Pareto optimal solution.[1] His college would continue to offer the courses that state funding plus fee revenue could provide. But it would then create a quasi-independent entity that would offer additional sections of required courses *at cost*, i.e., at a cost significantly higher than the fees charge for state-provided courses.[2] Some students would presumably be willing voluntarily to pay more to have a guaranteed place in the higher-price sections and the ability to graduate on time. Those students who could not or

[1] Full disclosure: In 2007, long before the events described below or the plan described below, the president of Santa Monica College was a guest speaker in a class I teach at UCLA.

[2] There apparently are some legal issues as to whether the creation of a separate entity would allow the College to charge more for courses the entity offered than the official state rate. If the plan is ever implemented, presumably there will be litigation challenges. The California Community College Board takes the position that the plan is illegal. A somewhat similar plan at CSU is under consideration but apparently does not raise the same legal issues. See http://www.nctimes.com/news/state-and-regional/csu-exploring-two-tiered-course-pricing/article_8b74a228-7258-58d1-907e-2c5adc3146e2.html. A radio interview with the president of Santa Monica College can be heard at http://www.kcrw.com/news/programs/ww/ww120404tensions_with_law_en/#. (It is at the beginning of the broadcast.)

chose not to enroll in the higher-cost sections would have less competition for seats in the state-provided courses since they would not compete with the students who paid to enroll in the incremental sections. Those students who chose to pay extra presumably would be better off or else they would not make the choice to pay extra. Those students who chose not to pay extra would have a better chance at landing a seat in the cheaper state-provided courses at the official state tuition. No one was worse off and some – indeed, it could be argued, all – were better off under the proposal.

So what was the upshot of this seeming win-win solution? A major student protest against the plan erupted at a recent session of the College's Board of Trustees which led to disruption of the meeting and protesters and others being pepper-sprayed by police.[3] The original plan's outline and rationale was then submerged by a debate over police tactics and who did what at the meeting. The shorthand description in the news media was that students were protesting against a fee increase. That the fee increase was one that no one was forced to pay tended to be lost. The idea that whether you paid the higher fee or not, you would be a net gainer was also obscured. How the controversy will ultimately be resolved is unknown at this writing.

Nonetheless, it is obvious that the Pareto logic that so appeals to economists did not find favor with student protestors. It is possible, of course, that they did not understand the plan, but that explanation is dubious. The plan had been publicized well in advance of the meeting. What the opponents didn't like was that some subset of students would be able to buy their way into the extra course sections even though such purchases would make the non-buyers better off. I suspect that economists, confronted by this apparent aversion to Pareto logic, would end up with some explanation about interdependent utility functions. I am offended that you are better off.

Whatever rational is applied, however, the events at Santa Monica College suggest a major challenge for public higher education. Most solutions to the state and local funding squeeze that has afflicted public higher ed involve clear gains and losses; they are not Pareto optimal. For example, at the University of California, a certain amount of tuition collected at the sticker price is recycled back as student aid. So there is a redistribution going on when tuition rises; everyone is not better off. Another approach at public institutions in California and elsewhere is to take in more out-of-state students who pay much higher tuition than in-state residents. But it is hard to recruit more out-of-staters without reducing the number of slots available for state residents. If the Santa Monica College approach cannot succeed, there will be still more resistance down the road to these alternative solutions for public higher ed that are much more zero-sum in outcome.

[3] The use of pepper spray was particularly controversial in California because of the pepper-spraying of "Occupy" demonstrators at UC-Davis in the fall of 2011. Photos and YouTube videos of the pepper-spraying cop became a viral Internet sensation. On the Santa Monica event, see http://www.latimes.com/news/local/la-me-0405-pepper-spray-20120405,0,6834089.story; http://www.smmirror.com/#mode=single&view=34411. Video of the incident was posted at http://www.youtube.com/watch?v=_eNJtYcPaiw.

Of course, one can argue that the issue is ultimately a matter of fiscal policy and spending priorities and that legislators should one way or another find more dollars for higher ed. In that case, however, the demonstrators at Santa Monica College and, for that matter, at other campuses and systemwide meetings, should be protesting at the state capitol.