

Quasi-efficient Tuitions and Subsidies in American Public Higher Education

Samuel Burer* and Gary Fethke**

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Abstract

A two-stage setting for determining subsidies and tuitions in a public university context is developed where fixed costs introduce a welfare-enhancing role for taxpayer-financed appropriations. The optimal subsidy per enrollment is shown to be proportional to students' maximum net willingness to pay. This result extends a well-known quasi-efficiency proposition associated with Ramsey pricing to include endogenous appropriations to public higher education. Realistic restrictions are imposed on the subsidy structure, and multiple scenarios for determining tuitions are addressed analytically and also illustrated numerically, using budget data for the University of Iowa and the University of Michigan.

*Samuel Burer: Professor of Management Sciences, Tippie College of Business, University of Iowa; phone: 319-335-0931; email: samuel-burer@uiowa.edu

**Gary Fethke: Professor Emeritus of Economics and Management Sciences, Tippie College of Business, University of Iowa; phone: 319-335-0914; email: gary-fethke@uiowa.edu

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1. Introduction

As state appropriations for public higher education have declined, universities have used tuition increases to maintain expenditures (College Board, 2013 and SHEEO, 2013).¹ This shift of funding obligation from taxpayers to students has been accompanied by robust enrollment growth, even as universities increased average tuition. Universities have generally not adjusted their tuition structures to reflect changes in program costs and shifts in student demand.² As a result, tuition revenue from low-cost programs increasingly subsidizes high-cost graduate programs, higher-income students subsidize lower-income students (WSJ, 2014), and instructional revenues subsidize research. In an increasingly contested national market, the viability of a more tuition-dependent approach to financing public higher education is challenged by focused low-cost educational providers and potentially threatened by scalable Internet instructional technologies.

Why are universities reluctant to embrace differentiated tuitions, and why do they persevere in supporting innumerable cross-subsidies? A traditional answer, which loses traction

¹ Reductions in state support per student in public higher education have been ongoing for nearly three decades; see Duderstadt and Womack (2003), Ehrenberg (2006), and Fethke and Pollicano (2012).

² Economists have long recognized the importance of considering willingness to pay and costs in the determination of tuitions (Hoenack and Weiler, 1975, Siegfried and Round, 1997).

in a high-technology environment, is that charging differential tuitions to reflect significant discipline-based differences in instructional costs is not “practical” (Middaugh et al, 2003). Another explanation is that centrally-administered budget allocations to individual programs are anchored in tradition—what a program gets this year is based on last year’s allocation plus some percentage increment, which is the same for all programs. While supported by distinctly different demands, the traditional allocation typically co-mingles tuition revenues and the state appropriation. Even though the proportions of the two have significantly changed over time, greater tuition revenue has offset the declining subsidies thus perpetuating existing cross-subsidies.³ A third explanation for cross subsidies derives from the claim that a student’s choice of career should not be influenced by charging different tuitions. Said differently, a more flexible tuition structure has enrollment implications that many do not support—even if overall average tuition might be lower or even if the current tuition structure inefficiently distributes value among programs.⁴

Notwithstanding these observations, there have been limited modifications to the tuition structure. State nonresidents are charged substantially higher tuition than residents; undergraduates in business, engineering, and nursing are charged a premium; and graduate and

³ Inertia is the usual explanation given for the historical percentage distribution of legislative funds to three Iowa universities by the Board of Regents. Recent rejection of the historically-based allocation of state support prompted development of performance-based criteria that recognizes outcome measures: resident enrollments, student progress, access, research funding, and the graduate program mix (Agnew, 2014 and Rivard, 2014). It also appears the overcoming inertia was the motivating factor that led to the “rebenching” exercise for the University of California System (Kiley, 2013).

⁴ The Academic Senate of the University of California opposed even the consideration of differential fees because they indicated a threatening move toward the “privatization” of public higher education (University of California, Academic Senate, 2010).

professional students, especially those in dentistry, law and medicine, are charged more (Yanikaski and Wilson, 1984, Nelson, 2008, CHERI, 2011 and Stange, 2013). Emergent decentralized budgeting helps to focus attention on the tuition structure. Specifically, the adoption of resource-centered management (RCM), which allocates tuition revenue to the units producing it, stimulates interest in making more informed tuition-structure adjustments.

This paper explores the social welfare implications of making differentiated tuition and subsidy choices in the framework of standard public university budgeting. There has been considerable empirical research on setting resident and nonresident tuitions that treat subsidies as exogenous; see Rizzo and Ehrenberg (2004) and Epple, et al (2013).⁵ A more limited literature treats both tuitions and subsidies as jointly determined; see (Fethke, 2005 and 2011) and (Lucca, et al, 2015). The primary intent here is to extend, both analytically and empirically, assessments of the impact on program enrollments and university budgets of optimal changes in the structures of tuitions and subsidies.⁶ We examine unrestricted subsidy and tuition structures, which are amendable to standard optimization methods for maximizing social welfare. Then, we consider realistic cases where subsidies are restricted to account for residency status, lack of willingness to pay, and higher program costs. Restrictions on the subsidy structure, apparently imposed for

⁵ Rizzo and Ehrenberg (2004) argue that for flagship public universities, resident and nonresident tuitions both increase in response to reductions in state support; consequently, they assert that nonresident tuition is not being used to shelter residents from tuition increases. Epple et al (2013) examine the effects of a reduction in an exogenous state subsidy, accompanied by increases in resident and non-resident tuition. In their general equilibrium model, a \$2000 reduction in the state appropriation per student accompanied by a \$2000 increase in tuitions drops total enrollment substantially in public universities.

⁶ In a review of the implementations of differential tuitions across public universities, it was noted that: “None of the schools that had implemented differential tuition reported that it affected enrollment patterns in significant ways, but there were no data cited to back up these claims.” (University of Washington, 2011).

reasons of fairness, introduce enrollment inefficiencies. We illustrate the various cases using comprehensive budget data from the University of Iowa and University of Michigan.

We use a multi-stage decision process for legislatures, university governing boards, and students whereby the legislature determines the structure of the subsidy, the university establishes tuitions, and students enroll in a mixture of academic programs that feature different tuitions, costs, and subsidies. In this game-theoretic formulation, the legislature is viewed as the leader that can credibly commit to the subsidy structure, and the university is viewed as a follower that makes tuition decisions based on student demands and the subsidies provided by the legislature. The goal of the university is to maximize student welfare (net consumer surplus) subject to a break-even constraint that incorporates tuition revenues, program-specific variable costs, shared fixed costs, and the state appropriation.⁷ The academic programs (colleges) are linked by shared fixed costs, and the university is constrained to at most break even. The objective of the legislature in selecting subsidies is similarly to maximize student welfare, while accounting for the cost of the appropriation. An implication of the fixed cost structure, even with subsidy support, is that tuitions and enrollments can only achieve quasi-efficiency. Roughly speaking, as long as fixed costs exceed the appropriation, the university sets tuitions that minimally deviate from marginal costs.

The subsidy structure used throughout can accommodate a mixture of enrollment subsidies and direct offsets against fixed expenditures, and we show that the highest achievable

⁷ This preference structure assumes that legislatures, governing boards, and university administrations all seek to maximize student welfare. Admittedly, the objective of universities is a widely debated issue. For example, Epple, et al. (2013) claim that private universities seek to maximize quality, which depends on student ability and university expenditure, while public universities seek to maximize the “achievement” of resident students, this later approach to resident preferences appears sympathetic to that adopted here.

social welfare occurs when the state appropriation is used to offset fixed costs. The same outcome can also be achieved when enrollment subsidies are unrestricted and there is no direct offset. With optimal unrestricted subsidies, enrollments are shown to be quasi-efficient; this result implies that changes in the state appropriation will have no effect on the ratio of subsidized enrollments between any two programs. If marginal costs do not depend on residency status (as we assume), an implication of quasi-efficient enrollments is that resident tuitions will differ from nonresident tuitions only by differences in their demand elasticities. *Ad valorem* subsidies (subsidies per enrollment relative to maximum net willingness to pay) take the form of efficient “Ramsey subsidies,” with every enrollment receiving the same percentage subsidy.

While closed-form solutions are developed for the unrestricted subsidy cases, the restricted cases are not analytically tractable. Nevertheless, we reduce the restricted-subsidy cases to the solution of two nonlinear equations in two unknowns and use an iterative procedure to solve them. The solutions provide the optimal values for the unrestricted *ad valorem* subsidy rates and the proportional degree of efficiency.

Finally, we illustrate the results using decentralized budget data (FY2014) for the University of Iowa and the University of Michigan. Linear demand curves, marginal costs, fixed costs, and enrollment subsidies are calibrated to match publicly available base-case allocations for each university. We numerically determine quasi-efficient tuitions, enrollments, and subsidies for all academic colleges (or programs) of the two universities. Subsidies facilitate the setting of lower tuitions, usually for residents, by effectively reducing marginal costs. An appealing feature of the formulations is the ability to evaluate alternative tuition-subsidy options using standard budgeting templates. Three scenarios are presented: 1) unrestricted subsidy

structures; 2) resident-only subsidies; and 3) differentiated subsidies applied to selected high-cost resident programs.

The paper is organized as follows: Section 2 discusses the specifications of student welfare, demand curves, and costs. Section 3 considers the second-stage problem of setting tuitions based on a predetermined subsidy structure. Section 4 contains the main analytical results of the paper, solving the first-stage problem of determining the unrestricted and restricted subsidy structures. Section 5 presents calibrated demand and cost formulations that replicate the decentralized budget allocations of the two public universities, and, using those frameworks, it numerically analyzes three tuition-subsidy scenarios. Section 6 concludes.

2. Demand, cost, and welfare specifications

To develop the concept of student value (or *student welfare*), assume there are many students who exhibit different willingness to pay for education. Each student purchases one unit of education, or they purchase nothing. Ranking students from the highest to lowest willingness to pay reveals a downward (discretely stepped) demand function for enrollments, E , in terms of tuitions, T . This relationship can be approximated by a continuous demand function, $E = D(T)$, for which higher tuition implies lower enrollment, that is, $dD / dT < 0$. As tuition (the price of education) declines, students with high willingness to pay realize value that exceeds tuition. Measuring value in this way leads to the concept of net consumer surplus, where T^0 is current tuition and \bar{T} is maximum willingness to pay.

$$NCS(T^0) = \int_{T^0}^{\bar{T}} D(T) dT.$$

The area under the demand curve measures what some students are willing to pay beyond the amount $T_0 E_0$ they currently spend. The change in consumer surplus per dollar increase in tuition is the negative of the value of the initial enrollment, that is, $dNCS(T^0) / dT^0 = -E_0$.

Now distinguishing between different colleges (programs) at the university and between resident and nonresidents, let the set of colleges be $I = \{1, \dots, n\}$, indexed by i , each with a per credit hour variable cost of c_i , and let $J = \{1, 2\}$ be the enrollment types within each college (resident and nonresident), indexed by j . For each pair $(i, j) \in I \times J$, there are linear demand curves $E_{ij} = a_{ij} - b_{ij}T_{ij}$ for given parameters a_{ij} and b_{ij} , where E_{ij} are semester-credit-hour enrollments (SCHs) of type j in college i , and T_{ij} are the corresponding tuitions. The parameters a_{ij} and b_{ij} reflect maximum enrollment and the tuition responsiveness for each program, and a_{ij} / b_{ij} is maximum willingness to pay. The tuition elasticity is $\eta_{ij} = -b_{ij}(T_{ij} / E_{ij})$, and the expression for student welfare (or net consumer surplus) is $E_{ij}^2 / 2b_{ij}$.

The university cost structure exhibits constant marginal costs, c_i , and shared fixed costs, F , with total cost $C = \sum_{i=1}^n c_i \sum_{j=1}^2 E_{ij} + F$. The total subsidy consists of a (linear) subsidy, s_{ij} , applied to SCHs in each program plus a lump-sum offset against fixed cost, S , and is given by $\sum_{i=1}^n \sum_{j=1}^2 s_{ij} E_{ij} + S \leq M$, where M is the appropriation determined exogenously by state tax revenues. The ultimate purpose of subsidizing public higher education is to facilitate the setting of reduced tuitions. Public universities face a break-even budget constraint, whereby tuition

revenue plus the appropriation equals total expenditures:

$$\sum_{i=1}^n \sum_{j=1}^2 (T_{ij} - c_i + s_{ij})(a_{ij} - b_{ij}T_{ij}) + S - F = 0,$$

where $E_{ij} = a_{ij} - b_{ij}T_{ij}$. Linear enrollment subsidies permit lower tuitions by reducing a program's marginal cost, while a lump-sum subsidy acts to offset fixed costs. We require throughout that $s_{ij} \geq 0$.

3. A two-stage decision problem for the legislature and the university

This description for setting tuitions in a high fixed-cost public university environment is motivated by formulations that seek to maximize a general measure of consumer welfare subject to a constraint on producer revenue (Baumol and Bradford, 1970, and Goldman, et al, 1984). The key contextual extensions incorporated here are: inclusion of the break-even constraint on university net revenue, addition of a flexible subsidy structure, and development of a realistic sequential decision process.

We initially presume a two-stage decision process for determining subsidies and setting tuitions that draws upon Fethke (2011, 2014). In the first stage (the upper level), the legislature, acting as the leader, determines subsidies that meet its budget constraint and maximize social welfare (the net value students get from their education minus the total subsidy paid to the university). Since the legislature moves first, it can credibly impose subsidies that determine the tuitions set by the university. In the second stage (the lower level), the university governing board, acting as the follower, sets tuitions that account for the predetermined subsidies. The university chooses tuition and consequently enrollments that are quasi-efficient in the sense that

fixed costs must be covered to achieve a break-even budget. We solve the problem by starting at stage two and moving back to stage one.

3.1 Stage 2: The university governing board's problem

In the second stage, the governing board takes the legislature's subsidy structure (s, S) as given and selects tuitions to maximize net consumers' surplus subject to demand equations and the break-even requirement:

$$\max_{T, E} \sum_{i,j} \frac{E_{ij}^2}{2b_{ij}} \quad (1a)$$

$$\text{s. t. } E_{ij} = a_{ij} - b_{ij}T_{ij} \quad (1b)$$

$$\sum_{i,j} (T_{ij} + s_{ij} - c_i)E_{ij} + S \leq F \quad (1c)$$

To economize on notation, we here and subsequently define $\sum_{i=1}^n \sum_{j=1}^2 \equiv \sum_{i,j}$. Stage 2 decisions are predicated on a predetermined subsidy structure. Enrollment subsidies can be unrestricted, applying to all programs and students, or they can support particular programs, for example, by subsidizing only residents. Enrollment subsidies are generally intended to decrease tuition and increase enrollments by reducing net marginal costs or, equivalently, by increasing maximum willingness to pay. Restricted subsidies introduce inefficiencies into the tuition structure by increasing tuition in some programs above marginal cost to accommodate tuitions elsewhere that are below marginal cost. Alternatively, the subsidy can be applied as a lump sum, S , which offsets a portion of shared fixed costs (an "offset"). An offset increases consumers' welfare without distorting tuitions.

Given the subsidies (s , S) the optimal “quasi-efficient” enrollments, as determined by the university (Fethke, 2014), are

$$\tilde{E}_{ij}(s, S) = \rho(s, S)b_{ij}(d_{ij} + s_{ij}) \quad (2)$$

where

$$d_{ij} \equiv (a_{ij}/b_{ij} - c_i) \quad (3)$$

$$\kappa(s, S) \equiv \frac{(F - S)}{\sum_{i,j} b_{ij} d_{ij}^2 / 4} \quad (4)$$

$$\rho(s, S) = (1/2)(1 + \sqrt{1 - \kappa(s, S)}) \quad (5)$$

satisfy $\kappa(s, S) \leq 1$ and $1/2 \leq \rho(s, S) \leq 1$. A sufficient condition via (2) for positive program enrollment is that maximum net willingness to pay must be positive, that is,

$$d_{ij} \equiv a_{ij}/b_{ij} - c_i > 0.$$

In the absence of subsidies, a quasi-efficient enrollment structure requires a proportionate changes in all enrollments from levels that would occur if tuitions were set at marginal costs; see (2) above, and Baumol and Bradford (1970, p. 271). In (2), the term $\rho(s, S)$ reflects the common divergence of enrollments from those occurring when tuitions equal to net marginal costs. Interpretation of $\rho(s, S)$ involves using (4) and (5). The numerator of $\kappa(s, S)$ in (4) is fixed cost net of the offset, and the denominator is the maximum net revenue the university can realize by setting (subsidized) monopoly tuitions in every program. Depending on the value of $\kappa(s, S)$, the degree of efficiency can vary between two extremes cases: i) $\kappa(s, S) = 0$ where $\rho(s, S) = 1$ and tuition equals net marginal cost (efficient case) and ii) $\kappa(s, S) \rightarrow 1$ where $\rho(s, S) \rightarrow 1/2$ and tuition equals one-half net marginal cost (monopoly pricing). Enrollment

subsidies s_{ij} have two effects on enrollments: i) they are equivalent to changing the maximum willingness to pay net of marginal cost, as measured by $d_{ij} \equiv a_{ij} / b_{ij} - c$; and ii) they influence the common factor $\rho(s, S)$, by changing the denominator of $\kappa(s, S)$. A direct offset against fixed cost affects $\rho(s, S)$ by changing only the numerator of $\kappa(s, S)$.

With subsidies given, the intuitive implication of (2) is that any positive deviation of tuition from net marginal cost that arises from the need to accommodate increases in net fixed costs will lead to distortions in enrollments. The resulting loss in consumers' surplus will be minimized if relative enrollments across all programs are not allowed to change from their net marginal cost proportions, since $\rho(s, S)$ is a common scalar for all enrollments. This relative enrollment-proportionality condition defines quasi-efficient enrollment structures.

Given the demand curve $E_{ij} = a_{ij} - b_{ij}T_{ij}$ and (2), the relative tuition margin is

$$\frac{\tilde{T}_{ij} + s_{ij} - c_i}{\tilde{T}_{ij}} = -\left[\frac{1 - \rho(s, S)}{\rho(s, S)}\right] \eta_{ij}.$$

In the case of linear demands, $\eta_{ij} \equiv -b_{ij}\tilde{T}_{ij} / \tilde{E}_{ij}$ is the tuition elasticity of demand and $1/2 \leq \rho(s, S) \leq 1$. When there are no subsidies, (2) implies that all enrollments will adjust by the same proportion, $\rho(0, 0)$, in response to changes in fixed cost. To accommodate fixed costs, unsubsidized tuitions are set to minimally exceed marginal costs, with the highest relative tuition markups over marginal cost associated with programs that feature the least elastic demands. This is a standard result from Ramsey pricing, which implies that high-willingness-to-pay students pay higher tuitions relative to marginal cost than do low-willingness-to-pay students. For example, if demand for engineering is less elastic than the demand for nursing and marginal

costs are similar, an increase in fixed cost will lead to an increase in tuition charged in engineering that exceeds that charged in nursing.

An increase in the enrollment subsidy leads to a decrease in tuition, that is,

$$\frac{\partial \tilde{T}_{ij}}{\partial s_{ij}} = -\frac{1}{2} \left[1 + \sqrt{1 - \kappa(s, S)} + \frac{\kappa(s, S) b_{ij} (d_{ij} + s_{ij})^2}{\sqrt{1 - \kappa(s, S)} \sum_{i,j} b_{ij} (d_{ij} + s_{ij})^2} \right] < 0.$$

In anticipation of the legislature's stage one problem of determining (s, S) and the effect of doing so on enrollment efficiency, an increasing subsidy increases social welfare when $\tilde{T}_{ij} > c_i - s_{ij}$

and $\frac{\partial \tilde{T}_{ij}}{\partial s_{ij}} < -1$. This situation requires the presence of fixed costs. If $\kappa(s, S) = 0$, $T_{ij} = c_i - s_{ij}$,

$\frac{\partial \tilde{T}_{ij}}{\partial s_{ij}} = -1$, and net marginal willingness to pay $(\tilde{T}_{ij} - c_i)$ is inefficiently negative.⁸

3.2 Stage 1: The legislature's problem

At stage 1, the legislature determines the structure of the subsidies to maximize social welfare to satisfy a budget constraint. Define social welfare taking into account the second-stage problem as

$$\tilde{W}(s, S) = \sum_{i,j} \frac{\tilde{E}_{ij}(s, S)^2}{2b_{ij}} - \left(\sum_{i,j} s_{ij} \tilde{E}_{ij}(s, S) + S \right). \quad (6)$$

The legislature seeks to

⁸ Rizzo and Ehrenberg (2004) estimate the tuition elasticity of a per unit subsidy for flagship public universities, and find the (absolute value) estimate to be “far less” than one.

$$\max_{s,S} \tilde{W}(s, S) \quad (7a)$$

$$\text{s.t. } \sum_{i,j} s_{ij} \tilde{E}_{ij}(s, S) + S \leq M \quad (7b)$$

where $M \leq F$ is exogenous. Specifically, the legislature weighs students' welfare against the taxpayers' appropriation. Since enrollments depend on the subsidies according to (2), the legislature in determining the structure of the subsidies anticipates enrollment responses.

4. The extension to include an endogenous subsidy structure

In Fethke (2014), it is demonstrated in a similar two-stage setting that social welfare is increasing in S for all $M < F$. Additionally, for an enrollment subsidy, numerical results are developed by iterating on a common resident subsidy rate, i.e., s_{ij} is a fixed constant for residents. Here, we consider a general subsidy structure (s, S) , where the legislature selects a feasible mix of a direct offset and enrollment subsidies. When enrollment subsidies are unrestricted, the optimal subsidy per enrollment is shown to be proportional to maximum net willingness to pay for that program, with the factor of proportionality being the same for all programs. We then examine the implications of imposing commonly encountered restrictions on the subsidy structure. These restrictions require the use of optimization approaches that can deal with potential issues of non-convexity, and we address these issues.

4.1 Unrestricted subsidies and the k -ratio rule (“Ramsey subsidies”)

In this section, optimal subsidies are determined for *every* program. Consider the following optimization problem, which is a representation of the two-stage problem (7) with the exception that ρ is not forced to equal $\rho(s, S)$:

$$\max_{s, S, T, E, \rho} \sum_{i,j} \frac{E_{ij}^2}{2b_{ij}} - \left(\sum_{ij} s_{ij} E_{ij} + S \right) \quad (8a)$$

$$\text{s.t.} \quad E_{ij} = a_{ij} - b_{ij} T_{ij} \quad (8b)$$

$$\sum_{ij} (T_{ij} + s_{ij} - c_i) E_{ij} = F - S \quad (8c)$$

$$\sum_{i,j} s_{ij} E_{ij} + S \leq M \quad (8d)$$

$$E_{ij} = \rho b_{ij} (a_{ij} / b_{ij} - c_i + s_{ij}) \quad (8e)$$

$$\frac{1}{2} \leq \rho \leq 1 \quad (8f)$$

Conveniently, even though ρ is not required to equal $\rho(s, S)$, it does indeed equal $\rho(s, S)$ if (8e) holds.

Lemma 1: Suppose (s, S, T, E, ρ) satisfy, (8e). Then (8c) and (8f) hold if and only if $\rho = \rho(s, S)$.

Proof: Constraints (8c) and (8e) ensure

$$\begin{aligned} F - S &= \sum_{i,j} ((a_{ij} - E_{ij}) / b_{ij} - c_i + s_{ij}) E_{ij} \\ &= \sum_{i,j} ((a_{ij} - \rho b_{ij} (d_{ij} + s_{ij})) / b_{ij} - c_i + s_{ij}) \rho b_{ij} (d_{ij} + s_{ij}) \\ &= \rho \sum_{i,j} (d_{ij} + s_{ij} - \rho (d_{ij} + s_{ij})) b_{ij} \rho (d_{ij} + s_{ij}) \\ &= \rho (1 - \rho) \sum_{i,j} b_{ij} (d_{ij} + s_{ij})^2 \end{aligned}$$

We thus have a quadratic equation such that $\rho (1 - \rho) = \frac{1}{4} \kappa(s, S)$ from (4). So

$$\rho^- = \frac{1}{2} (1 - \sqrt{1 - \kappa(s, S)}) \quad \text{or} \quad \rho^+ = \frac{1}{2} (1 + \sqrt{1 - \kappa(s, S)})$$

Since $\frac{1}{2} \leq \rho \leq 1$ by (8f), only the second root is valid. Moreover, the second root equals $\rho(s, S)$

by (5). This proves the result.

Given the subsidy structure specified by the break-even constraint (8c) and the university's rule for determining enrollments (8e), Lemma 1 implies that any feasible assignment of the efficiency scalar will be consistent with the subsidy structure actually implemented in the break-even condition.

Substitution for T_{ij} using (8b) and for E_{ij} using (8e), problem (8) can alternatively be expressed as

$$\max_{s, S, \rho} \sum_{i,j} \frac{1}{2} \rho^2 b_{ij} (s_{ij} + d_{ij})^2 - \left[\sum_{i,j} \rho b_{ij} (s_{ij} + d_{ij}) s_{ij} + S \right] \quad (9a)$$

$$\text{s.t. } \sum_{i,j} \rho b_{ij} (s_{ij} + d_{ij}) s_{ij} + S \leq M \quad (9b)$$

$$\sum_{i,j} \rho(1-\rho) b_{ij} (s_{ij} + d_{ij})^2 = F - S \quad (9c)$$

$$1/2 \leq \rho \leq 1 \quad (9d)$$

Optimal unrestricted subsidies can be shown to be proportionate to maximum net willingness to pay, with the factor of proportionality denoted as "k" being the same for all unrestricted programs.

Proposition 1: Consider problem (9) with restrictions placed on certain s_{ij} and/or on S in such a way that the Lagrangian is separable. Then there exists some scalar variable k such that

$$s_{ij}^* = k d_{ij} \text{ for all of the otherwise unrestricted } s_{ij}.$$

Proof: Consider the restriction of (9) in which ρ is fixed to ρ^* but (s, S) remain variables. It is clear that (s^*, S^*) is optimal for this restriction, and we can examine the corresponding first-order KKT conditions. Let α be the Lagrange multiplier for (9b) and λ the multiplier for (9c).

The corresponding Lagrangian is

$$L_{\alpha,\lambda}(s, S) = \sum_{i,j} b_{ij} \left[\frac{1}{2} (\rho^*)^2 (s_{ij} + d_{ij})^2 - (1 + \alpha) \rho^* (s_{ij} + d_{ij}) s_{ij} - \lambda \rho^* (1 - \rho^*) (s_{ij} + d_{ij})^2 \right] \\ - (1 + \alpha S + \lambda S) + \alpha M + \lambda M + \lambda F.$$

In particular, the Lagrangian is separable in (s, S) . Focus on the summand

$$l_{\alpha,\lambda,ij}(s_{ij}) = \frac{1}{2} (\rho^*)^2 (s_{ij} + d_{ij})^2 - (1 + \alpha) \rho^* (s_{ij} + d_{ij}) s_{ij} - \lambda \rho^* (1 - \rho^*) (s_{ij} + d_{ij})^2.$$

Corresponding to a single unrestricted s_{ij} , the first-order conditions ensure $l'_{\alpha,\lambda,ij}(s_{ij}) = 0$, which simplifies to

$$s_{ij}^* = \frac{(1 - \rho^*)(1 + \rho^* + 2\lambda\rho^*) + \alpha}{(\rho^*)^2 - 2(1 + \alpha) - 2\lambda(1 - \rho^*)\rho^*} d_{ij},$$

which proves the result.

The efficiency-based motivation for subsidies in our framework is to increase social welfare by offsetting fixed costs. To maximize social welfare, subsidies should therefore be highest where maximum willingness to pay is *high* relative to marginal cost. Thus, when there is an increase in the state appropriation, efficient assignment of subsidies is accompanied by reducing tuitions relative to marginal costs the most for programs featuring the least elastic demands. If engineering students express a higher willingness to pay than nursing students, and marginal costs are similar, then a higher subsidy per enrollment is assigned to engineering. The higher subsidy in engineering allows a larger reduction in the tuition charged for engineering students. Note, the subsidy measured relative to net maximum willingness to pay, the k-ratio, is the same for both engineering and nursing students.

From (8e), k-ratio subsidies imply that optimal enrollments are proportional to efficient enrollments, where the scalar variable ρ ($1/2 \leq \rho \leq 1$) reflects the degree of efficiency. Thus, k-ratio subsidies maintain the quasi-efficiency property. The k-ratio subsidies can therefore be called “Ramsey subsidies,” since they represent the subsidy-equivalent to “Ramsey taxes.” (Ramsey, 1927).⁹ Since the subsidy structure for unrestricted s_{ij} ensures corresponding quasi-efficient enrollments, a sufficient condition for the legislative budget constraint (9b) to bind, with positive unrestricted subsidies, is for the appropriation plus the maximum net revenue received from the enrollments on restricted subsidies to not exceed fixed cost: $M \leq F - \frac{1}{4}\theta_r$, where

$$\theta_r = \sum_r b_{ij} d_{ij}^2.$$

Subsidies per unit (SCH or headcount) are difficult to compare across programs-a subsidy of \$500 per SCH may be significant in liberal arts but insignificant in medicine. An *ad valorem* subsidy permits standardized comparisons across programs, and is conveniently provided by $k = s_{ij} / d_{ij}$. Here, for example, $k = .33$ implies a 33 percent subsidy for every program. Using the k-ratio result, equation (2), and the binding expression for (9b), the optimal *total* subsidy for a particular program is

$$\tilde{s}_{ij} \tilde{E}_{ij} = \frac{b_{ij}(a_{ij} / b_{ij} - c_i)^2}{\sum_{i,j} b_{ij}(a_{ij} / b_{ij} - c_i)^2} (M - S).$$

⁹ An insightful discussion of optimal Ramsey taxes when demand curves are linear and marginal costs are constant is provided by Casey Mulligan, accessible at: <http://home.uchicago.edu/~cbm4/econ260/E203rams.pdf>

A program's total subsidy is given by the ratio of maximum net consumer surplus for that program relative to that for all programs, times the net appropriation. Programs that display higher consumer value receive higher subsidies.

When no restrictions are placed on the structure (k, S) , a continuum of feasible values of k and S are consistent with quasi-efficient enrollments.

Proposition 2: *When the subsidy structure is completely unrestricted, the legislature's optimization problem (7) simplifies to a one-dimensional strictly-convex programming problem, which has a unique optimal solution x^* . Given x^* , the value of $\rho \in [\frac{1}{2}, 1]$ can be selected arbitrarily, and then $k = x^*/\rho - 1$. Then, we can determine $s_{ij} = kd_{ij}$ and $S = F - \theta\rho(1-\rho)(1+k)^2$. By Lemma 1, it follows that $\rho = \rho(s, S)$.*

Proof: When the subsidies are completely unrestricted, Proposition 1 allows us to replace every s_{ij} with kd_{ij} . Defining $\theta = \sum_{i,j} b_{ij}d_{ij}^2 > 0$, problem (9) can be rewritten as

$$\max_{S, \rho, k} \frac{1}{2} \theta \rho^2 (1+k)^2 - \theta \rho (1+k) k - S \quad (10a)$$

$$\text{s.t. } \theta \rho (1+k) k + S \leq M \quad (10b)$$

$$\theta \rho (1-\rho) (1+k)^2 = F - S \quad (10c)$$

$$1/2 \leq \rho \leq 1 \quad (10d)$$

Solving for S , substituting, and simplifying, we get

$$\max_{S,\rho,k} \frac{1}{2} \theta \rho (1+k) (2 - \rho(1+k)) - F \quad (11a)$$

$$\text{s.t. } \theta \rho (1+k) (\rho(1+k) - 1) + F \leq M \quad (11b)$$

$$S = F - \theta \rho (1-\rho)(1+k)^2 \quad (11c)$$

$$1/2 \leq \rho \leq 1 \quad (11d)$$

Introducing a new variable $x = \rho(1+k)$, we arrive at

$$\max_{S,\rho,k,x} \frac{1}{2} x (2-x) - F \quad (12a)$$

$$\text{s.t. } \theta x (x-1) + F \leq M \quad (12b)$$

$$S = F - \theta \rho (1-\rho)(1+k)^2 \quad (12c)$$

$$1/2 \leq \rho \leq 1 \quad (12d)$$

$$x = \rho(1+k) \quad (12e)$$

Note that k and S can be derived from x and ρ . The resulting optimization does not depend on ρ . So, we arrive at the simplified convex-optimization problem:

$$\max_x \frac{\theta}{2} x (2-x) - F \quad (13a)$$

$$\text{s.t. } x(x-1)\theta + F \leq M. \quad (13b)$$

The optimal x^* is either the critical point $\bar{x} = 1$ of the objective, or it is one of the endpoints:

$$x^- = \frac{1}{2} (1 - \sqrt{1 - \kappa(0, M)}) \text{ or } x^+ = \frac{1}{2} (1 + \sqrt{1 - \kappa(0, M)}), \text{ where } \kappa(0, M) = \frac{4(F - M)}{\theta}$$

Since $M < F$, $\bar{x} = 1$ is infeasible. In addition, since x^+ yields a higher objective value, we assign $x^* = x^+$. Note that $x^* \in [\frac{1}{2}, 1]$. Once we have x^* , the value of $\rho \in [\frac{1}{2}, 1]$ can be selected arbitrarily to calculate: $k = x^*/\rho - 1$. Then, we can determine $s_{ij} = kd_{ij}$ and $S = F - \theta\rho(1-\rho)(1+k)^2$. By Lemma 1, it follows that $\rho = \rho(s, S)$. The resulting subsidy structure (s, S) is optimal for (7). This proves the proposition.

The primary insight provided by Proposition 2 is that the optimal degree of efficiency, x^* , is independent of the unrestricted subsidy structure. In the unrestricted case, it makes no welfare difference whether the appropriation is used as a direct offset against fixed cost or is applied, in any combination, as a direct offset and unrestricted enrollment subsidies. This implies a continuum of values of (s, S) that yield the optimum (quasi-efficient) tuitions. This will not be the case below when the subsidy structure is restricted, for example, to favor only residents.

Even though we have an optimal solution to problem (7), via Propositions 1 and 2, we now show the additional property that (9) is convex in the variables (s, S) – or said differently, (9) is a convex optimization problem when ρ is fixed. This convexity property will prove useful when we impose additional restrictions on the subsidy structure, such as imposing the condition $S = 0$.

Corollary 1: *Problem (9) is convex in the variables (s, S) when ρ is fixed.*

Proof: Consider ρ fixed in (9). Using (9c) to eliminate S , (9) simplifies to

$$\max_s \sum_{i,j} \left[\frac{1}{2} \rho^2 b_{ij} (s_{ij} + d_{ij})^2 - \rho b_{ij} (s_{ij} + d_{ij}) s_{ij} + \rho(1-\rho) b_{ij} (s_{ij} + d_{ij})^2 \right] - F \quad (14a)$$

$$\text{s.t} \quad \sum_{i,j} [\rho b_{ij}(s_{ij} + d_{ij})s_{ij} - \rho(1-\rho)b_{ij}(s_{ij} + d_{ij})^2] \leq M. \quad (14b)$$

The objective and the left-hand side of the constraint are both separable with respect to the s_{ij}

variables. In the objective, the quadratic term in s_{ij} is

$$\frac{1}{2}\rho^2 b_{ij}s_{ij}^2 - \rho b_{ij}s_{ij}^2 + \rho(1-\rho)b_{ij}s_{ij}^2 = [\frac{1}{2}\rho^2 - \rho + \rho(1-\rho)]b_{ij}s_{ij}^2 = \frac{1}{2}\rho^2 b_{ij}s_{ij}^2.$$

It follows that the objective is concave. In a similar manner, the left-hand side of the constraint is convex. So, the overall problem (14) is convex when ρ is fixed. In fact, it is strictly convex, ensuring that it has a unique optimal solution.

4.2 Computation with restricted subsidies

In practice, notions of fairness and entitlement influence the determination of (s, S) . For example, while it's not efficient to subsidize residents, it's considered fair to do so. Nonresidents are typically not subsidized, while residents are differentially subsidized, often with high-cost programs being favored. As a result, subsidized resident tuitions are less than marginal costs and nonresident tuitions exceed marginal costs. Similarly, residents in high-cost programs often pay about the same tuitions as do residents in low-cost programs; this also leads to distortions in the relationships between tuitions and marginal costs that lead to inefficient enrollments. With social welfare represented here as total consumers' surplus net of the appropriation, we have a benchmark against which to measure the welfare losses associated with restricted subsidies.

In developing the stage 1 optimization, our computational strategy is to presume that ρ^* is given and then determine (s^*, S^*) . As shown in the Appendix, this exercise results in expressions for k^* , S^* , and social welfare, all in terms of ρ^* :

$$k^* = \frac{1}{2\rho^*} [1 - 2\rho^* + \sqrt{\frac{4(\rho^*(1-\rho^*)\theta_r - F + M) + \theta_u}{\theta_u}}], \quad (15)$$

$$S^* = F - \rho^*(1-\rho^*)[(1+k^*)^2\theta_u + \theta_r], \quad (16)$$

and, after substituting for k^* and S^* in the objective,

$$W(\rho^*) = \frac{1}{4}(-2F - 2M + 2\rho^*\theta_r + \theta_u + \sqrt{\theta_u}\sqrt{-4F + 4M + 4(1-\rho^*)\rho^*\theta_r + \theta_u}). \quad (17)$$

Here, $\theta_l = \sum_i b_{ij}d_{ij}^2$, with $l \in \{u, r\}$ representing unrestricted and restricted values.

Selection of the relative degree of efficiency, ρ^* , will determine the subsidy structure (k^*, S^*) , and s_{ij}^* is determined by $s_{ij}^* = k^*d_{ij}$. For example, with an unrestricted subsidy structure, the critical point of (17) is: $\rho^*(0, M) = \frac{1}{2}[1 + \sqrt{1 - \frac{4(F-M)}{\theta_u + \theta_r}}]$, with $S^* = M$ and $k^* = 0$. In this case, welfare is optimized using the entire appropriation to offset fixed cost.

For the restricted cases, closed-form solutions for ρ^* and k^* are not apparent. Here, we develop numerical results by imposing restrictions on the subsidy structure and then iterating on ρ to identify the value, ρ^* , which yields the highest attainable welfare. For example, when only residents are subsidized, we impose the restriction $S = 0$ and solve the breakeven constraint for the associated value of k^* .¹⁰ For this case, (16) provides an equation in $(1+k^*)^2$, with the relevant (positive) root:

¹⁰ It was suggested to us to generalize the preference structure as follows: retain the university's stage 2 specification of preferences - there being no reason at this level to differentially favor residents – and represent the legislature at stage 1 by discounting non-resident net consumer surplus at rate δ , where $0 \leq \delta \leq 1$. Then, the subsidy and tuition structures will depend on δ , with the cases we consider, $\delta = 1$ and $\delta = 0$, two of the possibilities. Conveniently, we can

$$k^* = -1 + \sqrt{\frac{F/\rho^*(1-\rho^*) - \theta_r}{\theta_u}}. \quad (18)$$

To find the optimal numerical solution, (18) is inserted into the objective, and we iterate on ρ to find the value, ρ^* , that maximizes social welfare and satisfies the legislative budget constraint. Lemma 1 implies that

$$\rho^* = \frac{1}{2} \left[1 + \sqrt{1 - \frac{4F}{(1+k^*)^2 \theta_u + \theta_r}} \right]. \quad (19)$$

Effectively, the iterative solution for determining ρ^* implies that (18) and (19) are simultaneously satisfied. The remaining check ensures that the legislative budget constraint is not violated. A similar iterative approach is adopted for the case where selected resident programs receive differentiated subsidies and nonresidents are not subsidized.

5. Examples of determining optimal tuitions for three subsidy structures

Using 2014 budget data for the University of Iowa and the University of Michigan, this section numerically evaluates the possibilities associated with varying the structure of the subsidy to allocate resources among multiple academic programs. Demand and cost parameter estimates are constructed, and optimal tuitions, enrollments, and subsidies are developed. Altering the structure of the subsidy imposes constraints on tuitions that have welfare

achieve the same relative weighting flexibility by imposing a restriction on S^* . For example, using the appropriation as an offset, with $S^* = M$, implies equal treatment of residents and nonresidents. Reduced values of S^* combined with no enrollment subsidies for nonresidents will favor residents.

implications. Three situations are considered. Case 1 examines the unrestricted subsidy structure. Case 2 restricts the structure to providing support only to resident enrollments. Case 3 provides higher subsidies to selected high-cost resident programs.

5.1 University of Iowa (UI)

Traditionally, tuitions for the three Iowa regent universities are determined by a governing board (Board of Regents), with tuition revenues collected and retained by each of the system's universities. To support low resident tuition, a taxpayer-financed appropriation is provided.¹¹ At the UI, tuition revenue and the appropriation are combined centrally, then base-adjusted budget allocations are distributed to the colleges and shared service units. In Table 1, the actual 2014 UI budget allocations and revenues (UI, 2014) are displayed in Column 1, and resident and nonresident SCHs for each college are presented in Columns 2 and 3.

In Column 4 of Table 1, variable cost per SCH for each program is measured as the amount distributed to each college divided by student credit hours produced.¹² All expenditures

¹¹ Historically, an amount is appropriated by the governor and the legislature and allocated to the regents. Once the appropriation is known, resident and nonresident undergraduate tuitions are adjusted based on the proposed (incremental) budgets submitted by each campus. Periodically, requests are made to adjust the tuition structure, with some increments added to tuitions in professional programs, particularly undergraduate programs in business, engineering, nursing, and professional graduate programs. This budgeting-tuition process motivates the formal two-stage model used here, where the legislature initially determines the appropriation and the regents allocate that appropriation and then interacts with the three public universities to set tuitions based on the appropriation.

¹² Similar approaches to measuring variable cost are adopted in moving from centralized to decentralized budget-allocation models; see the University of Florida (2014) for the determination of relative-costs weights for undergraduate and graduate programs. Relative costs for lower division and upper division undergraduate programs are also examined in four states by SHEEO (2010) and calculated in a definitive study of direct instructional costs for twenty-four academic disciplines (Middaugh et al, Table 3, 2003). As points of comparison with the UI, the

for the shared-service units (net of indirect costs recovered to support research) are treated as fixed costs. While the average variable cost per SCH is \$424, there is considerable variation across programs. For example, the College of Liberal Arts and Sciences (CLAS), which accounts for 60 percent of the total credit hours, receives an allocation of \$281 per SCH, while the College of Dentistry receives \$1,842. Column 5 contains the estimate for fully-allocated cost per SCH, which is marginal cost plus average fixed cost calculated at the optimum total enrollment. On the revenue side, average resident tuition revenue per SCH actually collected is \$561, and the appropriation per resident SCH is \$570.

Place Table 1 Here

Linear demand curves, $E_{ij} = a_{ij} - b_{ij}T_{ij}$, are developed for residents and nonresidents, where $\eta_{ij} = -b_{ij}(T_{ij} / E_{ij})$ is the tuition elasticity expression. We assume that the demand elasticity for every resident programs is $-.25$, and the demand elasticity for every nonresident programs is $-.5$.¹³ To establish net tuitions (what students actually pay net of subsidies), list tuitions for all

variable-cost estimates reported in Table 1 for Liberal Arts, Business, and Engineering are \$281, \$237, and \$559, respectively. The corresponding estimates for the University of Florida are \$216, \$207, and \$571 (Fethke, 2014, Table 3), and those (calculations done by the authors) for Iowa State University are \$244, \$300, and \$572. At the UI, in developing a recent incremental scheme to accommodate variable instruction costs, all colleges other than the professional colleges (Dentistry, Law, Medicine and Pharmacy), are allocated \$100,000 for each incremental change of 485 SCH that occurs relative to the FY2015 base-year total; this implies a variable-cost estimate of \$206.19 for these colleges (email to the authors from the UI Office of the Provost, March 19, 2015).

¹³ A commonly reported (“consensus”) estimate of demand responsiveness in higher education is that a \$1,000 change in tuition in real dollars is associated with a 3-5 percentage decrease in enrollment (Kane 2006). In 2014, UI undergraduate tuition was \$8061, so the standard estimate implies a tuition elasticity of between $-.25$ and $-.4$. More specifically to the Iowa context, the Board of Regents asserts that a one percent increase in tuition will yield a \$4.5 m increase in

colleges are measured relative to resident list tuition in the Colleges of Liberal Arts and Sciences (CLAS). These normalized tuitions are weighted by enrollment shares, and the weighted value for resident tuition in CLAS is determined to match actual total tuition revenue per SCH, which is \$561. In other words, the tuition revenue using the calculated net tuitions is measured to equal actual tuition revenue. The calculated tuitions derived from this estimate are presented in Columns 6 and 7. To compute demand-curve parameters for each program, we use:

$b_{ij} = -\eta_{ij} E_{ij} / T_{ij}$, $a_{ij} = E_{ij} + b_{ij} T_{ij}$, the presumed elasticities (-.25 and -.5), actual SCHS, and the calculated net tuitions. The resulting demand-curve parameters are presented in Columns 8-11.

Typically, calculated resident net tuitions are below marginal costs, while calculated net nonresident tuitions are above marginal costs, reflecting the tuition reductions for residents. Nonresident tuitions in CLAS, Business, and Pharmacy exceed fully-allocated costs, but are less for all others. Average nonresident tuition is less than average fully allocated cost.¹⁴ Net consumers' surpluses by residency status, presented in Columns 12 and 13, are:

$\sum_{i=1}^n E_{i1}^2 / 2b_{i1} = \$242m$ and $\sum_{i=1}^n E_{i2}^2 / 2b_{i2} = \$292m$, respectively. Subtracting the appropriation of \$222m from their sum yields social welfare estimate of \$312m.

5.1.1 Case 1: Unrestricted subsidy structure and quasi-efficient enrollments

When quasi-efficient enrollments (2) are presumed and no restrictions are placed on the structure of the subsidy (s , S), optimal solutions to problem (10) are provided in Columns 1-6 of

system-wide tuition revenue (<http://www.iptv.org/iowapress/episode.cfm/3416>.) This relationship translates into an estimate for the UI tuition elasticity of demand of about -.5.

¹⁴ Data provided by the Office of the Provost at the UI to the authors indicates that average net resident tuition is \$392 per SCH and average nonresident tuition is \$750 per SCH, implying that average nonresident tuition is even further below average fully-allocated cost of \$862.

Table 2. As indicated by Proposition 2, enrollments in this case depend only on the size of the appropriation, M . In particular, using either a direct offset, $(0, M)$, or unrestricted subsidies, $(k, 0)$, provides the same enrollment and welfare outcomes. With subsidies determined solely by maximum net willingness to pay, under the k-ratio rule, optimal total enrollment is lower than that for the base case, with resident enrollments declining and nonresident enrollment increasing. There are increases in enrollments for CLAS and Business, and decreases for all other colleges, with a total decrease of 9,145 SCHs. All tuitions exceed marginal costs, and the enrollment adjustments are the expected result of a welfare-enhancing narrowing of resident-nonresident tuition differentials, with higher nonresident tuitions reflecting higher willingness to pay. There is considerable variability in the optimal tuition structure. For Liberal Arts, optimal resident tuition is \$342 per SCH, while optimal nonresident tuition is \$452, which compare to the base-case estimates of \$206 and \$787, respectively. For Medicine, optimal resident tuition is \$1,768 and optimal nonresident tuition is \$1,729, while the base-case estimates are \$997 and \$1505. A Laspeyres tuition index, computed as tuition revenue using Case 1 tuitions and the base enrollments relative to base tuition revenue, indicates that a decline in average weighted tuitions occurs in moving from the base case to Case 1. Total welfare of $\$338m$ in Case 1 is the largest attainable with $M < F$.

With unrestricted enrollment subsidies, optimal subsidies as indicated by Proposition 1 are given by the k-ratio rule, $s_{ij} = kd_{ij}$. In Column 2 of Table 2, we report the scalar values: $x^* = .9178$, $\rho^* = .7769$, $k^* = x^*/\rho^* - 1 = .1814$, and $S^* = F - \theta\rho^*(1 - \rho^*)(1 + k^*)^2 = 0$. With unrestricted subsidies, enrollments are 92 percent of the efficient enrollments (those determined where tuitions equal marginal costs). Every program receives subsidy support of 18 percent per

SCH, with the highest subsidies assigned to programs with the highest net maximum willingness to pay. The more highly subsidized programs on a per SCH basis are nonresident programs generally, and the graduate professional programs specifically.

Place Table 2 Here

5.1.2 Case 2: Subsidies applied only to resident enrollments

The results for Case 1, which seek to maximize welfare regardless of residency status, conflict with actual practice where subsidies for any number of equity issues are restricted to favor residents. When the entire appropriation is used to support only resident enrollments, equations (18) and (19) provide the solution for k^* and ρ^* . Tuitions enrollments and the resident subsidies are provided in Columns 7-11 of Table 2. As expected, resident tuitions decline substantially from those in Case 1, while nonresident tuitions increase. The optimal k-ratio applied to residents is increasing in the appropriation, M , decreasing in the efficiency scalar, ρ^* , and decreasing in maximum net tuition revenue associated with the unrestricted programs, which is $\theta_1 / 4$. For Case 2, $\rho^* = .7682$, $\theta_1 = \$380.9m$, $M = \$221m$, $k_1^* = .504$ (residents). Restricting the subsidy to residents introduces a pattern of enrollment inefficiency, with resident tuitions below marginal costs and nonresident tuitions above marginal costs. Resident enrollments exceed efficient enrollments by factor of 1.16, while nonresident enrollments are below efficient enrollments by a factor of .77. Average resident tuition is \$268, average nonresident tuition is \$859, and the average resident subsidy is \$554; not surprisingly, since subsidized resident tuition are set substantially below nonresident tuitions at the UI, these outcomes align closely to the base case values of \$206, \$787, and \$570, respectively. Total enrollment is lower than that achieved with the unrestricted subsidy structure, but is closer to the

base case. Social welfare of \$312.4m is below the \$338m in the unrestricted subsidy case, but is nearly equal to the \$311.8m base case.

Case 2 is a restricted version of Case 1, with the restriction placed on the use of the offset ($S = 0$). If the restriction against an offset is relaxed, the efficiency scalar will increase, the k-ratio will decrease, and social welfare will increase, as resident tuitions increase and nonresident tuitions decrease. For example if $S^* = \$100m$, then $k^* = .297$, $\rho^* = .8317$, with $SW^* = \$327.9m$. This adjustment response will continue until $S^* = \$222m$, and $k^* = 0$, which are optimal values for Case 1.

5.1.3 Case 3: Subsidies differentially applied to dentistry, law, and medicine

Introducing flexibility into the tuition structure has substantial enrollment implications. As shown in Case 2, optimal resident tuitions for dental and medical students can be nearly eight times those for liberal arts students. The enrollment reductions in these high-cost programs associated with this kind of tuition increase are often deemed unacceptable. To address this issue, prominent public universities have moved toward differentially assigning levels of support for students in academic programs based on program cost. For example, the University of California System’s “rebenching” exercise recommends applying different funding weights (Pitts, 2010, Kelly, 2012 and Kiley, 2013). Under their approach, each UC campus retains its tuition revenue, with the state appropriation allocated as follows: undergraduate, post baccalaureate, graduate professional and graduate academic master’s students are weighted at 1, doctoral students at 2.5, and health sciences students at 5. Similarly, the University of Florida at Gainesville is implementing a budgeting process whereby credit hours generated by each program are weighted by their respective “cost of delivery” to determine the budget allocations (University of Florida, 2012).

To illustrate the implications of targeted subsidies, Columns 12-17 in Table 2 present the results of assigning differential subsidies of \$2,000 *per SCH* to resident enrollments in Dentistry, Law and Medicine, with all other resident programs receiving unrestricted subsidies and

nonresidents not subsidized. The assigned subsidy is selected to exceed those determined for these programs in the unrestricted case. In this illustration, all unrestricted resident programs receive a 46 percent subsidy, nonresidents receive zero, Dentistry receives 54 percent, Law receives 86 percent, and Medicine receives 57 percent. The targeted subsidies increase enrollment and consumers' surplus in the targeted programs, but they reduce consumer's surplus in all the other programs. Social welfare of $\$311.8m$ is about the same as the base case of $\$312.8m$ but lower than the $\$388m$ realized under the unrestricted subsidy. Weighted-average resident tuition is \$276 and nonresident average tuition of \$857, compared to the base tuitions of \$313 and \$840.

The targeting of subsidies to selected programs requires budget reallocations that increase average tuitions for other resident programs, while decreasing the tuitions of the targeted programs. For example, in moving from Case 2 to Case 3, resident tuition in Law declines from \$1,362 to \$726, which is the largest reduction for the targeted programs. This adjustment occurs because the maximum net willingness to pay in Law of \$2,323 is substantially below, for example, Dentistry's \$3,692; thus a \$2,000 subsidy in Law has a larger effect on enrollment than does a similar subsidy in Dentistry. The net increase in value realized by students in the targeted programs does not compensate for the value lost by students in the non-targeted programs. Here, the less than \$1m loss of social welfare encountered is modest. If the maximum willingness to pay across programs is nearly uniform, targeted subsidies will have much larger welfare effects.

5.2 University of Michigan (UM)

Using budget and enrollment data for the University of Michigan for FY2014 (UM, 2014a and 2014b), we consider the same cases presented for the UI. The results for the UM base case are presented in Table 3. Columns 1 and 2 are *head-count enrollments* for the winter semester, by residency status. In Column 3, variable cost per enrollment is determined by dividing the college budget allocation by its total enrollment. The enrollment-weighted average

variable cost per student is \$24,125.¹⁵ Fixed costs of \$503.4m are measured as all expenditure not directly allocated to the colleges, minus indirect cost recoveries from research grants and “other” income, which is mostly interest income earned on General Education Funds. Fully allocated total costs per enrollment are given in Column 4. Again, there is considerable variation in cost among programs. For example, the variable cost per enrollment in Liberal Arts is \$18,694, while that in Medicine is \$67,485.

In calibrating linear demand curves for the UM base case, it is assumed the elasticity of demand used for every resident program is -.25, and the elasticity used for every nonresident program is -.5. Total tuition revenue is \$1,218m. To determine net tuitions, list tuitions are measured relative to resident tuition in the Colleges of Literature, Arts and Sciences (LAS). Then, the enrollment share-weighted value of resident tuition in LAS is determined to match actual tuition revenue per enrollment, which is \$29,589. The calculated resident and nonresident net tuitions are presented in Columns 5 and 6 in Table 3. Typically, net tuition for residents is below marginal cost, while net nonresident tuition, with the exceptions of Dentistry, Medicine, and Social Work, exceed marginal cost. Using the enrollments in Columns 1 and 2, the calculated net tuitions, and the elasticity assumptions, the parameter estimates for the demand curves are calculated in the same way as those for the UI, and they are presented Columns 7-10. Even though a standard approach to the parameterization of cost and demand functions is applied to every college, there is considerable variable in maximum net willingness to pay. Columns 11

¹⁵ The UM has a resource-centered-management program in place, whereby tuition revenue earned by each college is allocated based on a formula that equally weights credit hours by source of teaching and by major areas (University of Michigan, 2007).

and 12 provide the values for net consumers' surpluses for residents and nonresidents. Social welfare for the UM base case is calculated as \$1.31bn.

Place Table 3 Here

5.2.1 Case 1: An unrestricted subsidy structure with quasi-efficient enrollments

Outcomes for the three cases developed for the UM are presented in Table 4. The results for unrestricted subsidies are provided in Columns 1–6. The modest differences between resident and nonresident tuitions again reflect differences in willingness to pay. The scalar-variable solutions to problem (13) are: $x^* = .9365$, $k^* = .0789$, and $S^* = 0$. Weighted-average tuitions of residents and nonresidents are \$26,662 and \$31,472, which differ from the base values of \$16,472 and \$46,218. Measured against the UM base case, resident enrollment in the unrestricted case declines and nonresident enrollment increases, with total enrollment declining by two percent (904 students). The largest percentage declines in enrollment are in high-cost programs in Dentistry (24 percent) and Medicine (25 percent). While all enrollments receive a 7.89 percent subsidy, the highest per enrollment subsidies are directed at programs where students express the highest maximum net willingness to pay, which are nonresident students generally and the professional graduate programs specifically. Moving from the base case to accommodate quasi-efficiency enrollments and unrestricted subsidies increases social welfare by \$58.6m.

Place Table 4 Here

5.2.2 Case 2: Subsidies applied to resident enrollments

With subsidies restricted to residents, the results are presented in Columns 7-11 of Table 4. These results more closely resemble the base case. Average resident tuition is \$19,675 and average nonresident tuition is \$39,432, as compared to the base case tuitions of \$17,809 and \$44,523. Total enrollment of 41,128 is slightly less than base-case total of 41,158, with lower resident enrollment and higher nonresident enrollment. The k-ratio subsidy, which applies only to resident programs, is 21.7 percent. With this restricted subsidy structure, nonresident enrollments are 13% lower than efficient enrollments and resident enrollments are 5% more than efficient enrollments. Even with the entire appropriation assigned to residents, quasi-efficient enrollments require reducing nonresident tuitions as a way to increase welfare. Social welfare of \$1.359bn in this case is lower than the unrestricted subsidy value of \$1.376bn.

5.2.3 Case 3: Subsidy differentially applied to dentistry, law, medicine, and social work

The results of applying a \$30,000 subsidy to each resident student in Dentistry, Law, Medicine, and Social Work are presented in Columns 12-16 of Table 4. As expected, a differentiated subsidy leads to declines in resident tuitions in the selectively-subsidized programs. In the case of Law, however, the \$30,000 subsidy for residents is less than \$50,897 resident subsidy Law receives in Case 2, so Law's tuition actually increases. Since these selectively subsidized programs also express higher willingness to pay, there is only a small reduction of social welfare in moving from Case 2 to Case 3.

6. Conclusions

The main purpose of this paper has been to develop and implement a model for determining the welfare-maximizing structures of tuitions and subsidies in a realistic, multi-program public university budgetary setting. Student welfare (net consumers' surplus) maximization is the goal of the university governing board; the legislature seeks to maximize student welfare net of the taxpayers' appropriation; and the public university is required to at

most break even. Fixed costs, combined with the break-even requirement, introduce a role for subsidies- they are used to offset the need to charge tuitions that excessively exceed marginal costs. Specifically, to accommodate fixed costs, subsidies support quasi-efficient enrollments that deviate minimally from those achievable when tuitions equal marginal costs.

We develop a two-stage decision process where the legislature initially determines the subsidy structure and a university governing board subsequently sets tuitions based on these subsidies. We demonstrate that any feasible mixture of unrestricted enrollment subsidies and a direct offset is compatible with unique quasi-efficient enrollments. A case of special interest occurs with the exclusive use of enrollment subsidies. Under the resulting k-ratio rule (“Ramsey” subsidies), social welfare is increased by offering higher subsidies per enrollment to programs that express higher willingness to pay net of marginal cost. In this case, ad valorem subsidies provide the same percentage support to every program. With restricted subsidies, the k-ratio rule holds for all unrestricted programs. Restrictions placed on the subsidy structure always reduce social welfare, with the gains for those in favored programs unable to offset the welfare losses in the not favored programs.

Economist William Baumol, an early advocate of using quasi-efficient prices, later argued that such pricing was difficult to implement (Baumol and Sidak, 1994). We show that representational demand and cost parameters can be calibrated to match the decentralized budget allocations of major public universities, and that the comparative results we obtain are not particularly sensitive to variation in demand elasticities.¹⁶ We use the parameter estimates to

¹⁶ Vogelsang and Finsinger (1979) develop an algorithm for implementing differential tuitions in a regulated environment that does not require regulators to have information about demand elasticities; see Fethke (2014) for an implementation of their algorithm in the context of tuition setting.

calculate three subsidy-structures: unrestricted subsidies, subsidies restricted to residents, and differential subsidies for selected high-cost resident programs. A structure of unrestricted subsidies yields closed-form enrollment solutions, while restrictions placed on the subsidy require a numerically tractable iterative solution. These scenarios provide comparable budget allocations for two public universities, University of Iowa and University of Michigan, which satisfy break-even requirement and the legislative budget constraint. Tuitions, enrollments, subsidies, and social welfares are calculated and compared, providing quantitative measures of the welfare costs associated with restricting the subsidy structure. When student welfare is a high priority, restricting subsidies to supporting residents reduces social welfare, and the same appropriation applied as a direct offset against fixed costs will always lead to higher welfare. Differential subsidies that favor high-cost resident programs at the expense of high value-added programs lead to inefficient distortions in enrollment patterns and thereby to declines in welfare. The primary insight provided is that adding flexibility to achieve quasi-efficient tuition and subsidy structures will always increase social welfare and, typically, will reduce average tuition, benefitting the (collective) interests of students, the university, and taxpayers.

7. Appendix: Restricted subsidies

If selected $s_{ij} = 0$ are restricted in (9) and $\rho = \rho^*$ is fixed, then the optimization occurs over the remaining unrestricted s_{ij} and S , that is

$$\max_{s_{ij}, S} \left\{ \sum_u \frac{1}{2} \rho^{*2} b_{ij} (s_{ij} + d_{ij})^2 + \sum_r \frac{1}{2} \rho^{*2} b_{ij} d_{ij}^2 - [\sum_u \rho^* b_{ij} (s_{ij} + d_{ij}) s_{ij} + S] \right\} \quad (\text{A-1})$$

$$\text{s.t. } \sum_u \rho^* b_{ij} (s_{ij} + d_{ij}) s_{ij} + S \leq M \quad (\text{A-2})$$

$$\sum_u \rho^* (1 - \rho^*) b_{ij} (s_{ij} + d_{ij})^2 + \sum_r \rho^* (1 - \rho^*) b_{ij} d_{ij}^2 = F - S \quad (\text{A-3})$$

$$\frac{1}{2} \leq \rho^* \leq 1 \quad (\text{A-4})$$

This problem looks like the optimization (9), except for the presence of *fixed* (restricted) variables $s_{ij} = 0$, and with $F - S$ being replaced by $F - S - \sum_r \rho(1 - \rho)b_{ij}d_{ij}^2$. For the unrestricted subsidies, $s_{ij}^* = kd_{ij}$ by Proposition 1. The optimization can now be rewritten as

$$\max_{S,k} \left\{ \frac{1}{2} \theta_u \rho^{*2} (1+k)^2 - \theta_u \rho^* (1+k)k - S + \frac{1}{2} \theta_r \rho^{*2} \right\} \quad (\text{A-5})$$

$$\text{s.t. } \theta_u \rho^* (1+k)k + S \leq M \quad (\text{A-6})$$

$$\theta_u \rho^* (1 - \rho^*) (1+k)^2 = F - S - \rho^* (1 - \rho^*) \theta_r \quad (\text{A-7})$$

where $\theta_l = \sum_j b_{ij}d_{ij}^2$, with $l \in \{u, r\}$. After eliminating S in (A-5) through (A-7), the problem becomes:

$$\max_k \left\{ \frac{1}{2} \rho^{*2} (\theta_u (1+k)^2 + \theta_r) - \theta_u \rho^* (1+k)k - [F - \rho^* (1 - \rho^*) (\theta_u (1+k)^2 + \theta_r)] \right\} \quad (\text{A-8})$$

$$\text{s.t. } \theta_u \rho^* (1+k)k + [F - \rho^* (1 - \rho^*) (\theta_u (1+k)^2 + \theta_r)] \leq M \quad (\text{A-9})$$

After simplification, the objective (A-8) is seen to be strictly concave, and the constraint (A-9) is strictly convex in k . The optimal k^* is either the critical point $k^* = (1 - \rho^*)/\rho^*$ of the objective, or one of the endpoints. Inserting $k^* = (1 - \rho^*)/\rho^*$ into (A-9) indicates that

$M + \rho^* (1 - \rho^*) \theta_r \geq F$. In this case, the appropriation plus net tuition revenue provided by the programs with restricted subsidies exceeds fixed cost. Enrollments and tuitions in programs with unrestricted subsidies are $E_{ij}^* = \rho^* (1 + k^*) d_{ij} = d_{ij}$ and $T_{ij}^* = a_{ij}/b_{ij} - d_{ij}/b_{ij} = c_i$. The tuitions charged in each of these programs equal marginal costs. For example, if unsubsidized nonresident net tuition revenue plus the appropriation exceeds fixed cost, tuitions optimally charged resident enrollments equal marginal costs, that is, $T_{i1} = c_i$ for $i = 1, \dots, n$.

When fixed costs are not covered by the appropriation and net revenue of unsubsidized programs, the optimal solution associated with the right endpoint of (A-9) is

$$k^* = \frac{1}{2\rho^*} [1 - 2\rho^* + \sqrt{\frac{4(\rho^*(1-\rho^*)\theta_r - F + M) + \theta_u}{\theta_u}}]. \quad (\text{A-10})$$

Equations (A10) and (A7) provide unique values of k^* and S^* for a fixed ρ^* .

The expression (A-10) can be used to eliminate k^* in (A-5), yielding

$$W(\rho^*) = \frac{1}{4}(-2F - 2M + 2\rho^*\theta_r + \theta_u + \sqrt{\theta_u} \sqrt{-4F + 4M + 4(1-\rho^*)\rho^*\theta_r + \theta_u}) \quad (\text{A-11})$$

Here, $W(\rho^*)$ is concave function. Selection of a value for the efficiency scalar, ρ^* , determines a unique subsidy structure. The critical point of (A-11) is

$$\rho^*(0, M) = \frac{1}{2}[1 + \sqrt{1 - \frac{4(F-M)}{\theta_u + \theta_r}}]. \quad (\text{A-12})$$

Substituting (A-12) into (A-10) reveals that $k^* = 0$, and, with $k^* = 0$, (A-6) implies $S^* = M$.

Using the entire appropriation as a direct offset against fixed costs attains maximum achievable social welfare.

Restrictions on the subsidy structure reduce social welfare. Closed-form results are not apparent for the restricted cases, nevertheless, we can develop numerical solutions by imposing restrictions on (A-7) and then iterating on ρ to identify the maximum value of the restricted objective. For example, with $S = 0$ imposed, we solve (A-7) to determine the optimal value of

k^* as function of ρ^* , which is $k^* = -1 + \sqrt{\frac{F/\rho^*(1-\rho^*) - \theta_r}{\theta_u}}$. To determine ρ^* we iterate on

ρ to determine the maximum achievable value of the objective consistent with the legislative budget constraint.

For a given ρ^* , the value of social welfare that applies to all of the cases considered is:

$$W(\rho^*) = \frac{F\rho^*}{2(1-\rho^*)} - M.$$

Optimal social welfare depends on fixed costs, the appropriation, and the value of ρ^* selected by the legislature in determining the subsidy structure (s, S) . This expression for social welfare

implies that: $\frac{d\rho^*}{dM} = \frac{2(1-\rho^*)^2}{F} > 0$ and $\frac{d\rho^*}{dF} = \frac{-2\rho^*(1-\rho^*)}{F} < 0$.

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Table 1

Budget Allocations, Revenues, Expenditures, and Demand and Cost Parameters for the University of Iowa, 2014

Table 1	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9	Col. 10	Col. 11	Col. 12	Col. 13
UI 2013-14	Budget Allocations	Resident SCH	Nonres. SCH	Var. Cost/SCH	Full Cost/SCH	Cal. Res. Tuition	Cal. Nonres. Tuition	Res. Intercept	Nonres. Intercept	Res. Slope	Nonres. Slope	Res. NCS	Nonres. NCS
Colleges													
Liberal Arts & Sciences	\$125,689,038	231,757	215,825	\$281	\$719	\$206	\$787	289,696	323,738	281.6	137.1	\$95,358,408	\$169,866,119
Business	\$24,941,689	43,706	61,480	\$237	\$675	\$237	\$819	54,633	92,220	46.2	37.5	\$20,676,031	\$50,331,561
Dentistry	\$23,937,910	9,133	3,866	\$1,842	\$2,280	\$1,107	\$1,808	11,417	5,798	2.1	1.1	\$20,217,628	\$6,990,463
Education	\$15,482,702	22,506	14,719	\$416	\$854	\$206	\$787	28,133	22,078	27.3	9.4	\$9,260,209	\$11,584,801
Engineering	\$19,525,891	17,104	17,803	\$559	\$997	\$206	\$787	21,380	26,705	20.8	11.3	\$7,037,686	\$14,011,753
Law	\$18,723,326	6,172	4,693	\$1,723	\$2,161	\$809	\$1,456	7,715	7,039	1.9	1.6	\$9,991,288	\$6,831,755
Medicine	\$63,678,621	28,273	14,785	\$1,479	\$1,917	\$997	\$1,505	35,341	22,177	7.1	4.9	\$56,388,840	\$22,251,194
Nursing	\$9,127,182	8,564	5,059	\$670	\$1,108	\$777	\$861	10,706	7,588	7.7	2.9	\$4,742,369	\$4,358,342
Pharmacy	\$8,863,313	9,778	4,154	\$636	\$1,074	\$653	\$1,217	12,222	6,231	3.7	1.7	\$12,764,993	\$5,055,111
University College	\$2,471,461	12,506	4,379	\$146	\$584	\$206	\$206	15,633	6,569	15.2	10.6	\$5,145,450	\$900,802
Total Colleges	\$312,441,136	389,500	346,763	\$424	\$862	\$313	\$840	486,675	520,144	413.7	218.2	\$241,582,902	\$292,181,902
Shared Services	\$343,479,728												
Total Expenses	\$680,369,954												
State Appropriation	\$222,014,572	Appro / Res SCH		\$570.00									
Tuition Revenue	\$412,973,000	Tuitio Rev/SCH		\$560.90									
Other Income	\$46,240,428												
Total Income	\$680,369,954												
Resident Elasticity	-0.25												
Nonresident Elasticity	-0.5												
Fixed Cost	\$322,546,436												
Total Enrollment	736,263												
Social Welfare	\$311,750,232												

Table 2
Tuitions, Enrollments, and Subsidy Structures for the University of Iowa

UI 2013-14	Case 1											Case 2												
	Unrestricted Subsidies											Unrestricted Subsidy to Residents												
	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9	Col. 10	Col. 11	Res. Tuition	Res. Enroll.	Nonres. Tuition	Nonres. Enroll.	Res. Tuition	Res. Enroll.	Nonres. Tuition	Nonres. Enroll.	Res. Subsidy				
Colleges	Res. Tuition	Res. Enroll.	Nonres. Tuition	Nonres. Enroll.	Res. Subsidy	Nonres. Subsidy	Res. Tuition	Res. Enroll.	Nonres. Tuition	Nonres. Enroll.	Res. Subsidy													
Liberal Arts & Sci.	\$342	193,263	\$452	261,742	\$136	\$378	\$164	243,386	\$763	219,112	\$377													
Business	\$315	40,082	\$420	76,454	\$172	\$404	\$90	50,477	\$751	64,002	\$477													
Dentistry	\$2,146	6,991	\$2,137	3,514	\$672	\$652	\$1,267	8,804	\$2,672	2,942	\$1,863													
Education	\$466	15,377	\$576	16,691	\$111	\$354	\$321	19,365	\$867	13,973	\$309													
Engineering	\$598	8,950	\$708	18,700	\$85	\$328	\$486	11,271	\$977	15,654	\$237													
Law	\$1,915	4,065	\$1,941	3,911	\$423	\$481	\$1,362	5,119	\$2,336	3,274	\$1,172													
Medicine	\$1,768	22,811	\$1,729	13,685	\$638	\$552	\$933	28,728	\$2,183	11,456	\$1,769													
Nursing	\$729	5,070	\$828	5,158	\$130	\$348	\$559	6,385	\$1,114	4,318	\$360													
Pharmacy	\$853	9,030	\$884	4,721	\$478	\$548	\$227	11,371	\$1,335	3,952	\$1,325													
University College	\$219	12,304	\$185	4,599	\$160	\$86	\$9	15,496	\$256	3,850	\$445													
Totals/Averages	\$530	317,943	\$541	409,175	\$200	\$387	\$268	400,402	\$859	342,532	\$554													
Total Enrollment (SCH)	727,118																							
Appropriation	\$222.01 M											\$222.01 M												
Social Welfare	\$338.01 M											\$312.4 M												
x*	0.9176											NA												
Rho*	0.7764											0.7682												
k*	0.1819											0.5044												
Laspeyres Index	0.9895											0.9746												
		Case 3																						
		Differentiated Subsidies to Residents																						
UI 2013-14	Col. 12	Col. 13	Col. 14	Col. 15	Col. 16																			
Colleges	Res. Tuition	Res. Enroll.	Nonres. Tuition	Nonres. Enroll.	Res. Subsidy																			
Liberal Arts & Sci.	\$191	236,007	\$763	219,058	\$343																			
Business	\$123	48,946	\$752	63,986	\$434																			
Dentistry	\$1,162	9,019	\$2,673	2,941	\$2,000																			
Education	\$342	18,778	\$867	13,969	\$281																			
Engineering	\$503	10,930	\$977	15,650	\$215																			
Law	\$726	6,330	\$2,337	3,273	\$2,000																			
Medicine	\$757	29,978	\$2,183	11,453	\$2,000																			
Nursing	\$584	6,191	\$1,114	4,317	\$328																			
Pharmacy	\$319	11,027	\$1,336	3,951	\$1,206																			
University College	\$40	15,026	\$256	3,849	\$405																			
Totals/Averages	\$276	392,232	\$857	342,447	\$550																			
Total Enrollment (SCH)	734,680																							
Appropriation	\$222.01 M																							
Social Welfare	\$311.8 M																							
Rho*	0.7680																							
Laspeyres Index	0.9801																							

Table 3
Enrollment, Cost and Demand Parameters for the University of Michigan 2014

Table 3	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9	Col. 10	Col. 11	Col. 12
UM 2013-14	Res. Enroll.	Nonres. Enroll.	Var. Cost/E	Full Cost/E	Res. Tuition	Nonres. Tuition	Res. Slope	Nonres. Slope	Res. Inter.	Nonres. Inter.	Res. NCS	Nonres. NCS
Colleges												
Arc&Urban Planning	270	371	\$ 26,581	\$38,490	\$14,308	\$45,213	0.005	0.004	338	557	\$7,726,483	\$16,773,965
Art&Design	279	286	\$ 19,282	\$31,191	\$14,308	\$45,213	0.005	0.003	349	429	\$7,984,033	\$12,930,873
Dentistry	386	247	\$ 49,802	\$61,711	\$25,837	\$40,419	0.004	0.003	483	371	\$19,946,283	\$9,983,613
Education	327	198	\$ 33,744	\$45,653	\$16,157	\$48,412	0.005	0.002	409	297	\$10,566,626	\$9,585,584
Engineering	4,570	3,765	\$ 20,886	\$32,795	\$15,326	\$45,478	0.075	0.041	5713	5,648	\$140,080,826	\$171,225,329
Kinesiology	549	373	\$ 13,927	\$25,836	\$16,157	\$48,412	0.008	0.004	686	560	\$17,740,299	\$18,057,691
Lit, Arts & Sciences	11,714	7,220	\$ 18,694	\$30,603	\$14,308	\$45,213	0.205	0.080	14643	10,830	\$335,214,910	\$326,436,733
Music	381	669	\$ 30,771	\$42,680	\$14,889	\$45,822	0.006	0.007	476	1,004	\$11,345,407	\$30,654,784
Natural Resources	113	180	\$ 38,404	\$50,313	\$14,308	\$45,213	0.002	0.002	141	270	\$3,233,676	\$8,138,312
Nursing	735	160	\$ 20,141	\$32,050	\$14,308	\$45,213	0.013	0.002	919	240	\$21,033,205	\$7,234,055
Pharmacy	285	142	\$ 30,482	\$42,391	\$25,046	\$41,853	0.003	0.002	356	213	\$14,275,941	\$5,943,085
Public Policy	117	179	\$ 34,305	\$46,214	\$16,157	\$48,412	0.002	0.002	146	269	\$3,780,719	\$8,665,755
Business	1,207	2,012	\$ 28,829	\$40,738	\$15,189	\$45,983	0.020	0.022	1509	3,018	\$36,666,522	\$92,517,271
Information	137	289	\$ 38,177	\$50,086	\$16,157	\$48,412	0.002	0.003	171	434	\$4,426,996	\$13,991,080
Law	226	791	\$ 42,026	\$53,935	\$55,437	\$58,699	0.001	0.007	283	1,187	\$25,057,428	\$46,430,953
Medicine	679	455	\$ 67,485	\$79,394	\$33,878	\$53,134	0.005	0.004	849	683	\$46,005,718	\$24,175,801
Public Health	466	472	\$ 35,308	\$47,217	\$27,177	\$44,926	0.004	0.005	583	708	\$25,328,831	\$21,204,961
Rackman	249	197	\$ 19,019	\$30,928	\$21,833	\$44,926	0.003	0.002	311	296	\$10,872,966	\$8,850,376
Social Work	319	143	\$ 43,753	\$55,662	\$26,203	\$41,998	0.003	0.002	399	215	\$16,717,213	\$6,005,775
Totals	23,009	18,149	\$ 24,126		\$16,472	\$46,218	0.370	0.197	28761	27,224	\$758,004,082	\$838,805,994
Total Tuition Revenue	\$1,217,808,035											
Total Enrollment	41,158											
Average Tuition	\$29,589											
Total Appropriation	\$279,108,700											
Appro./Resident	\$12,130											
Resident Elasticity	-0.25											
Nonresident Elasticity	-0.5											
Total Alloc. To Colleges	\$992,967,086											
Fixed Cost	\$503,449,609											
Social Welfare	\$1,317,701,376											

Sources:

<http://www.ro.umich.edu/report/14sp201.pdf>

<http://ro.umich.edu/enrollment/enrollment.php>

Table 4

Tuitions, Enrollments, and Subsidy Structures for the University of Michigan

Table 4.1 UM 2013-14	Col. 1 Res. Tuition	Col. 2 Res. Enroll.	Col. 3 Nonres. Tuition	Col. 4 Nonres. Enroll.	Col. 5 Res. Subsidy	Col. 6 Nonres. Subsidy	Col. 7 Res. Tuition	Col. 8 Res. Enroll.	Col. 9 Nonres. Tuition	Col. 10 Nonres. Enroll.	Col. 11 Res. Subsidy
Colleges											
Arc&Urban Planning	\$29,435	199	\$33,502	419	\$3,550	\$8,610	\$24,132	224	\$41,105	388	\$9,732
Art&Design	\$22,598	239	\$26,666	345	\$4,126	\$9,186	\$16,436	269	\$34,777	319	\$11,312
Dentistry	\$54,840	278	\$54,337	204	\$6,267	\$5,642	\$45,483	313	\$59,318	189	\$17,179
Education	\$36,757	223	\$40,847	213	\$3,712	\$8,800	\$31,215	251	\$48,618	198	\$10,174
Engineering	\$24,423	3,892	\$28,218	4,479	\$4,401	\$9,123	\$17,851	4,382	\$36,274	4,146	\$12,065
Kinesiology	\$18,170	532	\$22,260	474	\$5,278	\$10,367	\$10,287	599	\$31,414	438	\$14,470
Lit, Arts & Sciences	\$22,047	10,130	\$26,115	8,745	\$4,172	\$9,233	\$15,817	11,405	\$34,267	8,094	\$11,438
Music	\$33,543	262	\$37,542	729	\$3,448	\$8,424	\$28,394	295	\$44,980	675	\$9,453
Natural Resources	\$40,506	61	\$44,574	181	\$2,616	\$7,677	\$36,602	69	\$51,352	168	\$7,170
Nursing	\$23,403	618	\$27,470	191	\$4,058	\$9,119	\$17,343	696	\$35,522	177	\$11,125
Pharmacy	\$36,494	252	\$36,515	151	\$7,480	\$7,506	\$25,323	284	\$43,143	140	\$20,507
Public Policy	\$37,255	79	\$41,345	192	\$3,670	\$8,758	\$31,769	89	\$49,078	178	\$10,067
Business	\$31,819	877	\$35,754	2236	\$3,720	\$8,615	\$26,264	987	\$43,361	2069	\$10,198
Information	\$40,881	85	\$44,971	299	\$3,364	\$8,452	\$35,863	95	\$52,434	277	\$9,215
Law	\$56,949	224	\$50,534	846	\$18,566	\$10,585	\$29,224	253	\$59,881	783	\$50,897
Medicine	\$73,952	478	\$73,318	369	\$8,045	\$7,257	\$61,938	538	\$79,726	341	\$22,055
Public Health	\$41,690	404	\$41,620	489	\$7,941	\$7,853	\$29,832	455	\$48,554	453	\$21,769
Rackman	\$24,739	241	\$26,364	238	\$7,117	\$9,139	\$14,110	271	\$34,434	220	\$19,512
Social Work	\$49,291	249	\$48,972	131	\$6,889	\$6,493	\$39,001	280	\$54,705	121	\$18,888
Total/Averages	\$26,662	19,321	\$31,472	20933	\$4,679	\$9,015	\$19,675	21,753	\$39,432	19,375	\$12,827
Total Enrollment	40,254						41,128				
Rho*	0.8680						0.8668				
k*	0.0790						0.2165				
Appropriation	\$279,108,700						\$279,108,700				
Social Welfare	\$1,376,328,399						\$1,359,486,450				
Laspeyres Index	0.9935						0.9802				
Case 3											
Restricted Subsidy to Residents											
UM 2013-14	Col. 12 Res. Tuition	Col. 13 Res. Enroll.	Col. 14 Nonres. Tuition	Col. 15 Nonres. Enroll.	Col. 16 Res. Subsidy						
Colleges											
Arc&Urban Planning	\$24,395	222	\$41,110	388	\$9,432						
Art&Design	\$16,740	267	\$34,783	319	\$10,964						
Dentistry	\$34,374	354	\$59,321	189	\$30,000						
Education	\$31,487	249	\$48,623	198	\$9,864						
Engineering	\$18,174	4,358	\$36,279	4,146	\$11,697						
Kinesiology	\$10,674	596	\$31,420	438	\$14,028						
Lit, Arts & Sciences	\$16,122	11,343	\$34,273	8,094	\$11,089						
Music	\$28,646	293	\$44,985	675	\$9,164						
Natural Resources	\$36,788	69	\$51,357	168	\$6,957						
Nursing	\$17,640	692	\$35,527	177	\$10,785						
Pharmacy	\$25,873	283	\$43,148	140	\$19,879						
Public Policy	\$2,049	88	\$49,083	178	\$9,747						
Business	\$26,537	982	\$43,366	2069	\$9,886						
Information	\$36,098	95	\$52,439	277	\$8,947						
Law	\$47,350	234	\$59,887	783	\$30,000						
Medicine	\$55,057	573	\$79,730	341	\$30,000						
Public Health	\$30,413	452	\$48,559	453	\$21,105						
Rackman	\$14,633	270	\$34,440	220	\$18,914						
Social Work	\$29,374	309	\$54,709	121	\$30,000						
Total/Averages	\$19,813	21,728	\$39,437	19,374	\$12,841						
Total Enrollment	41,102										
Rho*	0.8668										
k* (Res.)	0.2098										
Appropriation	\$279,108,700										
Social Welfare	\$1,358,858,710										
Laspeyres Index	0.9621										