

LIMITS



On Power and the Use of Coercion

The Real Problem of Rising College Costs

by Dan Lips

Someone wise once defined insanity as doing the same thing over and over but expecting different results. Members of the 110th Congress should keep this in mind when they try to address the problem of college affordability.

In the 21st century, a college education is considered by many to be a key to financial security in the new knowledge-based economy. But ever-rising tuition prices offer a financial challenge for many American families.

According to the College Board, the price of higher education rose sharply again last year following trends over recent decades. The annual costs at four-year public and private colleges increased by 6.3 and 5.9 percent respectively, a rate well ahead of inflation. Since 1986, tuition and fees at public and private colleges have grown at staggering rates: 122 percent at public and 80 percent at private

colleges (after adjusting for inflation).

Increasing college costs since the 1980s make the price of gasoline look cheap in comparison. Since 1986, the real cost of a gallon of gasoline has grown from \$1.58 to \$2.50. If gas prices had risen as quickly as public college tuition, we'd be paying \$3.51, a dollar more than we do today.

As with growing gas prices, increasing college tuition costs have led to frequent calls for the federal government to act. The federal government has responded by providing dramatically-increasing subsidies for higher education aid. According to the College Board, total federal aid for postsecondary education totaled \$94 billion in 2005-06, a real increase of 95 percent during the last ten years.

But doubling higher education aid over the past

decade hasn't been enough, according to some liberals in Congress. New subsidies for higher education are at the top of the Democrats' agenda for the 110th Congress.

One Democratic initiative that will likely be considered is new Education Committee Chairman George Miller's plan to cut interest rates on federally-subsidized student loans. Depending on the structure of the plan, the measure could cost up to \$18 billion over five years, according to one published estimate.

Unfortunately, there's little reason to believe that billions in new federal subsidies will do anything to address the root problem of rising college costs. In fact, federal spending may be exacerbating the problem.

One of the reasons colleges and universities have been able to charge more is that third-

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Do You Still "Remember the Maine"?

by Amy K. Frantz

Remember the Spanish-American War — with its rallying cry of "Remember the Maine" following the sinking of the battleship? Probably not, first hand anyway, as that war took place in 1898. You should, however, remember funding this war, because most of us are still paying the tax created to pay for the war.

In February 1898 the U.S.S. Maine exploded in Havana harbor, and, following an inquiry by the U.S. Navy, the United States declared war against Spain two months later.¹ In order to fund the war, a luxury tax was implemented on telephone service. In 1898 only the wealthiest of Americans had a telephone, so the argument in favor of this tax probably echoed those often used today, that the telephone tax would only impact the "rich," who should be paying their fair share and more to fund the government. The Spanish-American War ended in December 1898 with the signing of a peace treaty between the two countries. However, the tax to fund the war is still being

collected more than a century later.

In May 2006 U.S. Treasury Secretary John Snow announced that the Internal Revenue Service (IRS) would no longer collect the federal excise tax on long-distance telephone service. Secretary Snow commented, "Today is a good day for American taxpayers; it marks the beginning of the end of an outdated, antiquated tax that has survived a century beyond its original purpose, and by now should have been ancient history."² The IRS will be refunding the tax collected on long-distance service from March 2003 through July 2006 to those who request a refund on the 2006 federal income tax return. Individual tax filers can request a standard refund based on the number of exemptions claimed or the actual amount of tax paid. Businesses and non-profit organizations can use an IRS formula to determine the refund.

While the IRS will no longer be collecting the federal excise

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Socrates and the Minimum Wage

by Lawrence W. Reed

The ancient sage Socrates, a giant in the foundation of Western philosophy, was known for a teaching style by which he aggressively questioned his students. He employed his “Socratic Method” as a way to stimulate logical, analytical thought in place of emotive or superficial pronouncement. Rather than lecture or pontificate, he would essentially interrogate. The result was to force his Greek pupils to see the full implications of their conclusions or to realize that what they had accepted as solid was nothing more than the intellectual equivalent of crumbled feta cheese.

The U.S. Congress is moving to enact a hike in the hourly minimum wage from \$5.15 to \$7.25, with the increase phased in during the next two years. Economists have long argued that raising the cost of labor, especially for small and start-up businesses, reduces the demand for labor (as with anything else). But Congress will likely do it anyway — and probably with the usual, over-sized measure of self-righteous breast-beating about helping workers. Maybe what members of Congress need is not another lecture on the minimum wage from an economist, but rather an old-fashioned Socratic inquisition. If the old man himself were with us, here’s how I imagine one such dialogue might go.

Socrates: So you want to raise the minimum wage. Why?

Congressman: Because as Sen. Ted Kennedy pointed out, minimum wage workers haven’t had a raise in 10 years.

Socrates: Can you name one single worker who was making \$5.15 an hour a decade ago and who is still making \$5.15 today? And if you can’t, then please tell me what caused their wage to rise if Congress didn’t do it. Come on, can you name just one?

Congressman: Well, no, but they must be out there somewhere. In any event, \$5.15 just isn’t enough for anybody to live on. Workers must have more to meet their basic needs.

Socrates: An employer doesn’t have anything to pay an employee except what he first gets from paying customers. I wonder, whose “needs” do you consider when you decide to buy or not to buy — the workers’ or your own? Have you ever offered to pay more than the asking price just to help out the guy who made the product?

Congressman: That’s not a fair question. My intent here is purely to help.

Socrates: Sounds to me like the answer is “no,” but let’s move

on. Why do you assume your intentions mean more to a worker than those of his employer? It’s the employer who’s taking the risk to offer him a job, not you. You’re only making speeches about it.

Congressman: Employers are interested only in profits.

Socrates: Are you saying employees are not? Are they more interested in working for companies that lose money, and if so, then why don’t they all line up for government jobs?

Congressman: Look, \$7.25 isn’t much.

Socrates: I’d like to know how you arrived at that figure. Was it some sophisticated equation, divine revelation or toss of the dice? Why didn’t you choose \$20.00, which is not only a nice round number but also a lot more generous?

Congressman: Well, \$20 would be too high, for sure. Too much of a jump at once.

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Government Negotiated Prices Creates Drug Shortage

by Linda Gorman

The latest fairy tale floating out of Washington claims that the federal government will do a better job than the private sector in negotiating low prices for Medicare drugs. Backers rely on the Costco Fallacy to support their case. It asserts that big buyers always get the best prices.

If the Costco Fallacy were true, it would follow that big buyer government would be the best possible purchaser of everything. Therefore the Soviet Union, a country in which government bought everything for everyone, should have been a consumer paradise. In reality, of course, it was a consumer hell that featured low, low prices, execrable quality, lousy distribution systems, appalling waste, a complete lack of innovation, and unending shortages.

Believers in the Costco Fallacy forget that the U.S. government is not Costco. The government has dependents, not customers. It does not care about profits, which show whether customers like what a firm is doing and how well it is minimizing costs, it doesn't care about value, and it certainly doesn't care about individual patients. What government does care about is avoiding responsibility for poor outcomes, and increasing both its power

and its ability to take money from productive people and give it to politically favored groups.

To see how the American government creates a consumer hell via price negotiation, one need only look at the federal government's attempt to purchase children's vaccines. In 1993, Hillary Clinton's Vaccines for Children (VFC) program was set up to buy children's vaccines from manufacturers and provide them to Medicaid clients and the uninsured free of charge. To ensure low prices, the program legislation capped the price of the three vaccines then in use.

The price controls did what price controls always do, they created a shortage. As a 2005 Department of Health and Human Services (HHS) budget brief pointed out, "the price caps [were] so low, however, that the tetanus vaccine was removed from the VFC program in 1998 when no vendor would bid on the contract."¹

The fact that no bids were submitted should have given the government a clue that its price offers were below production costs. But the government doesn't have to answer to consumers, so for seven years tetanus boosters were not available to children dependent on the VFC program. As is so often the case when people

depend on government for health care, the children mattered only when the cameras were rolling. Once the program was enacted they were out of sight, out of mind, and out of luck.

The problem is that bureaucrats see budgets, not patients. Large swathes of the political and health policy establishment both loathe private business and have little understanding of what it takes to make real products. By 2002, the VFC program was purchasing slightly more than 40 percent of U.S. pediatric vaccines. Its focus on low prices likely helped destabilize long term vaccine supplies by eroding profit margins. When profit margins are low, firms move scarce capital to other, more highly valued, uses. Production facilities do not get repaired, replaced, or upgraded. When current plant and equipment wear out, producers simply exit the market.

A 2003 report from the Institute of Medicine on vaccine finance reported that the number of vaccine producers licensed for the U.S. market fell from 26 in 1967 to 4 in 2002. Factors cited for the decline included more stringent regulation, concerns about tort liability, and "poor returns on investment."² In short, the government's myopic

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focus on low, low prices likely destroyed the U.S. vaccine industry.

Government focus on price also harms patients by denying them drugs. Research by Columbia University professor Frank Lichtenberg shows that after the imposition of the Veteran's Administration National Formulary in 1997, VA patients were less likely to be prescribed new drugs than patients in the rest of the U.S. health care system. Professor Lichtenberg notes that veterans' life expectancy "increased substantially before the National Formulary was introduced (during 1991-1997) but did not increase, and may even have declined, after it was introduced (1997-2002). The life expectancy at birth of all U.S. males increased after as well as before 1997."³

People advocating direct government negotiation for Medicare drugs apparently think low prices are more important than anything else. Medicare beneficiaries, who know how important a wide choice of medications is to their health, might beg to disagree. If allowed to, they would likely prefer to stick with the successful private system, possibly paying a little more now to ensure that they drugs they need will be available in the future.

Endnotes:

¹ Department of Health and Human Services, FY 2005 Budget in Brief, p. 25 as numbered by Adobe Acrobat software. Original document lacks page numbers. <<http://www.acf.dhhs.gov/programs/olab/budget/fy2005bibfinal.pdf>>.

² Board on Health Care Service, Institute of Medicine, "Financing Vaccines in the 21st Century: Assuring Access and Availability," National Academies Press, Washington, D.C., 2003, p. 122, <<http://www.nap.edu/books/0309089794/html/122.html#pagetop>>.

³ Frank R. Lichtenberg. October 2005. Older Drugs, Shorter Lives? An Examination of the Health Effects of the Veterans Health Administration Formulary, Medical Progress Report No. 2, The Manhattan Institute. New York, New York, <http://www.manhattan-institute.org/pdf/mpr_02.pdf>.

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Question of the Quarter:

Which is more important to you — paying the lowest price possible for prescription drugs or having a wide choice of medications?

Send your thoughts on this issue to us at public.interest.institute@limitedgovernment.org. We may publish some of your ideas in the June 2007 issue of *LIMITS*.

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The Real Problem of Rising College Costs

by Dan Lips

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parties — like federal and state taxpayers — are footing much of the bill. Many students are less sensitive to price increases than they would be if they had a more direct financial stake. This means that higher education institutions have few reasons to keep costs low to attract students.

Ohio University economist Richard Vedder discusses this problem in his book *Going Broke By Degree: Why College Costs Too Much*. “Students receiving grants or subsidized loans are far less sensitive to tuition increases than they would be if they were paying their own way,” Dr. Vedder argues. “Where entrepreneurs in a free, unsubsidized market seek to cut costs and lower their prices to lure new customers away from businesses that are raising theirs, there is very little of that in higher education.”

To begin to create greater competition in education and return the federal government to its original role in higher education, Congress could refocus existing tuition aid programs on those who could not otherwise afford college. This would likely reduce inflationary pressures on college

tuition while addressing the policy concern of expanding higher education access.

An increasing share of federal grant and loan subsidies are being provided to students from non-economically disadvantaged families. The College Board recently reported that “changes in student aid policies have benefited those in the upper half of the income distribution more than those in the lower half.” A recent Department of Education report found that 47 percent of students from middle-income families accepted federal loans in 2000, compared to 31 percent in 1993.

Workers are subsidizing students from upper- and middle-income families...

These subsidies are inequitable. They are largely paid for by taxpayers who don't have college degrees — only one in four adults have bachelor's degrees. Workers are subsidizing students from upper- and middle-income families, who can go on to expect far higher lifetime earnings.

It may be too much to ask for fundamental reforms, at least during Speaker Pelosi's 100 hour agenda. In the short run, conservatives would be wise to shift the policy discussion to the relationship between federal subsidies and rising college

costs. Congress should investigate whether ever increasing subsidies for higher education lead to higher college costs.

In addition, they could call on universities to be more financially accountable to students, parents, and taxpayers. Greater financial transparency would lead to greater understanding about the problem of rising college costs and encourage state-policymakers and school leaders to explore ways to make higher education institutions more efficient.

American students should be wary of Congressional promises to make higher education more affordable. If history is any guide, federal spending and college prices will both keep climbing.

Dan Lips is an Education Analyst at The Heritage Foundation.

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Socrates and the Minimum Wage

by Lawrence W. Reed

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Socrates: It sounds like you think the cost of labor might indeed affect the demand for it. Good! That's progress. You're not as oblivious about market forces as I thought. What I want to know is why you apparently don't think higher labor costs matter when you raise the minimum wage from \$5.15 to \$7.25. Do you think everyone, regardless of skill level or experience, is automatically worth what Congress decrees?

Congressman: Now hold on a minute. I'm for the worker here.

Socrates: Then why on earth would you favor a law that says if a worker can't find a job that pays at least \$7.25 per hour, he's not allowed to work?

Congressman: I'm not saying he can't work! I'm saying he can't be paid less than \$7.25!

Socrates: I thought we were making progress, but perhaps not. Can you tell me, if your scheme becomes law, what happens to a worker who is worth only \$6.00 because of his low skills, lack of education, scant experience or a low demand for the work itself? Will employers happily employ

him anyway and take a \$1.25 loss for every hour he's on the job?

Congressman: Businesses need workers and \$1.25 isn't much, so common sense and decency would suggest that of course they would.

Socrates: So employers who employ people are too greedy to pay \$7.25 unless they're ordered to, but then when Congress acts, they suddenly become generous enough to hire people at a loss. Who was your logic instructor?

Congressman: Can we hurry this up? I've got other plans for other people I have to think about.

Socrates: I give up. You congressmen are incorrigible. You're the only people on whom my teaching method has no discernible impact.

Congressman: You ask too many questions.

At this point, in utter frustration, Socrates drinks the hemlock. The congressman votes to price many of the nation's most vulnerable employees out of work and gets re-elected.

Whoever warned us to beware of Greeks bearing gifts apparently never met a congressman.

Lawrence W. Reed is President of the Mackinac Center for Public Policy, a research and educational organization headquartered in Midland, Michigan.

For more information, visit the Mackinac Center for Public Policy's web site at www.mackinac.org.

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For more on the minimum wage, read the following publications at Public Interest Institute's website, www.limitedgovernment.org

“Should Congress Raise the Federal Minimum Wage?”

by Jonathan Miltimore

September 2006 *INSTITUTE BRIEF*

“Do Workers a Disservice – Raise the Minimum Wage”

by Robert N. Stewart

October 2005 *INSTITUTE BRIEF*

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**Do You Still
"Remember the Maine"?**

by Amy K. Frantz

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tax on long-distance service, Americans are still paying the excise tax on local telephone service. Treasury Secretary Snow, in his May 2006 press release, called upon Congress to repeal the remainder of the excise tax, however Congress has yet to take this action.

The federal government is expected to refund \$13 billion to individuals, businesses, and non-profit organization for payments of the excise tax on long-distance service made from March 2003 to July 2006.³ The

Library of Congress reports that the cost of the entire Spanish-American War was \$250 million. I am fairly certain, even with inflation, that particular war debt has surely been paid.

There are two lessons to be taken from the long-lived Spanish-American War tax. First, taxpayers should be wary when supporters of a new tax claim the tax will only be paid by the "rich," because the longer some taxes remain in existence, the number of Americans that are subject to the tax grows larger and larger. The alternative minimum tax (AMT) and capital gains taxes are two examples of taxes that started out applying to a small group but impact more and more taxpayers each year. Second, even if a politician

promises that a tax will be temporary, unless the tax legislation also includes a sunset provision, that promise isn't worth much.

Endnotes:

¹ For an introduction to the history of the Spanish-American War, visit the Library of Congress' website, <<http://www.loc.gov/tr/hispanic/1898/intro.html>> (February 6, 2007).

² "Treasury Announces End to Long-Distance Telephone Excise Tax," U.S. Department of the Treasury Press Release, May 25, 2006, <www.treas.gov/press/releases/js4287.htm> (January 31, 2007).

³ Bruce Meyerson, AP Business writer, "Column: How to Get a Phone-Tax Refund," ABC News, November 28, 2006 <<http://abcnews.go.com/Business/wireStory?id=2684413>> (November 28, 2006).

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