

**THE DISTRIBUTION OF BENEFITS FROM
PREPAID TUITION PROGRAMS:**

New Empirical Evidence About the Effects of Program Design on
Participant Demographics

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Distributional Effects of Program Design

The Michigan Education Trust ("MET"), was the most widely publicized government action in the field of higher education finance during the 1980's. Widely heralded as a bold innovation, MET promised to protect parents against the perceived risk that college would become unaffordable by the time their children were ready to enroll. Emulated by other states, MET stood as Governor James Blanchard's preeminent legislative achievement during his two terms in office.

Today the bloom is off the rose. Governor Blanchard is out of office, and MET is in disarray. Concerns about MET's solvency have led the MET Board to suspend sales of new prepaid tuition contracts. The new

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state treasurer describes the program as "a deal that was too good to be true."² The once-glowing press reviews have turned sour.³

I have argued elsewhere that students of public policy can learn a great deal from the worst mistake of the MET Board.⁴ During its first year of operations, the MET Board set prices for MET contracts, and it set them way too low. I believe that this error resulted from the interaction between certain widely prevalent political incentives and the breakdown of the cultural institutions that ordinarily counteract them. Moreover, in the long run this error is likely to redistribute wealth up the income distribution in Michigan, assisting wealthy contract holders to the detriment of working- and middle-class taxpayers.

In this paper, I will argue that students of public policy can also learn a great deal from the most virtuous action of the MET Board. During its third year of operations, the Board decided to change the terms on which MET participants could pay for their contracts. The Board authorized the sale of contracts under a "monthly purchase / payroll deduction Plan" (hereafter referred to as the "Monthly Payment Option"). The hope was that families that could not afford to advance the money for a MET contract would be able to commit themselves to buy the contracts a little at a time.

This change in policy provides an interesting natural experiment. Do the terms of purchase really affect the income distribution of program participants? Was the state able to induce more lower-income families to participate by (in effect) offering to lend them the money directly? More generally, is the skewed distribution of participants in prepaid tuition programs primarily a function of credit market failure -- the inability of low-income families to borrow against future earnings?

² See, e.g., Mitchell, "Michigan Flunks Its Tuition Trust Fund," *Wall St. Journal*, p. C1 (March 20, 1992).

³ *Ibid.*

⁴ Jeffrey S. Lehman, "Social Irresponsibility, Actuarial Assumptions, and Wealth Redistribution: Lessons About Public Policy from a Prepaid Tuition Program," 88 *Mich. L. Rev.* 1035 (1990).

This paper unfolds as follows. In Part I, I present a brief history of MET, from Governor Blanchard's initial call for the creation of a "Baccalaureate Education Savings Trust" through the sale of approximately 39,000 contracts in the fall of 1988. In Part II, I summarize the critique of MET that I published during the summer of 1990. In Part III, I describe the political response to that critique -- in particular, the decision to establish the Monthly Payment Option during the autumn of 1990. In Part IV, I examine data about the distribution of Monthly Payment Option contracts to determine the distributional consequences of the new program. Finally, in Part V, I offer some general interpretations of these findings, and suggest their significance for future policymakers.

Deep Background

The Michigan Education Trust is the nation's first government-sponsored prepaid college tuition program. MET sold contracts to parents (and grandparents) of young children, promising to pay the tuition (including all mandatory fees but not room and board) of any beneficiary child who ends up attending one of Michigan's fifteen public four-year colleges and universities. The contracts provide that MET will cover the state-resident tuition for any MET beneficiary who attends a Michigan public college. If the child does not attend a Michigan public college, he or she can obtain a cash refund in an amount that depends upon what the child does instead, but that roughly approximates the average in-state tuition prevailing at Michigan public colleges during the child's senior year in high school.

Governor James Blanchard first proposed a state-run prepaid tuition program in his State of the State Address on January 30, 1986, and he signed the Michigan Education Trust Act before the end of the year.⁵ The Act created MET as an autonomous subunit within the Michigan Department of Treasury, managed by a nine member Board of Directors.⁶ Its assets are not considered state money and may not be loaned or trans-

⁵ 1986 Mich. Pub. Acts 316, Mich. Comp. Laws 390.1421 et seq.

⁶ Id. 5, 10.

ferred to the state (although they may be pooled with state pension funds for investment purposes).⁷ If MET becomes insolvent, the state has no statutory obligation to bail it out; rather, whatever assets of MET remain are to be immediately prorated among the investors.⁸

During the summer of 1988, MET announced a price schedule for the first year's contracts. The cost of a MET contract covering four years of tuition ranged from \$6,756 for a newborn baby to \$9,152 for a child entering tenth grade in the fall of 1988. That fall, 38,842 contracts were purchased, at a total purchase cost of \$261,493,807.⁹

In establishing prices for the first cohort, the MET Board approved a somewhat controversial set of actuarial assumptions. The most significant of those assumptions had to do (i) with the relationship between future tuition inflation and MET's pre-tax future earnings, and (ii) with the federal income tax treatment of MET. Those assumptions enabled MET to sell contracts at prices discounted by up to 25% off then-prevailing tuition rates.¹⁰

⁷ Id. 9(2).

⁸ Id. 13.

⁹ Coopers & Lybrand, Michigan Education Trust Actuary's Report on 1988 Enrollments 1, 5-11 (1989) [hereafter 1989 Actuary's Report]. An additional 1,567 contracts (having a purchase cost of \$3,946,084) were sold that provide for more restricted benefits than the standard contract described in the text. In March 1990, the actuaries made a "data adjustment" and concluded that 38,860 full-benefits contracts were sold. Coopers & Lybrand, Michigan Education Trust Actuary's Report: Valuation as of September 30, 1989, at 9 (1990) [hereafter 1990 Actuary's Report]. In February 1991, the actuaries made more data adjustments and reduced the number to 38,858. Coopers & Lybrand, Michigan Education Trust Actuary's Report: September 30, 1990, at 9, 10 (February 1991) [hereafter 1991 Actuary's Report]. In January 1992, the actuaries stood their ground. Coopers & Lybrand, Michigan Education Trust Actuary's Report: September 30, 1991, at 9 (January 1992) [hereafter 1992 Actuary's Report].

¹⁰ In 1989, tuitions at Michigan public colleges rose by approximately 9%, and the MET Board raised the prices of MET contracts by amounts

My Original Critique

In my earlier article on MET, I made two sets of empirical assertions. First, I asserted that the MET Board had set prices too low in 1988, based on the information that was available to the Board at that time. "[I]f MET had made more appropriate tax and actuarial assumptions, it would have collected almost 50% more from the program's participants than it did -- over 100 million dollars more."¹¹ Second, I asserted that if future taxpayers are required to make up for that mistake by allowing MET contract purchasers to keep the benefit of their bargain, "the undeniable net effect will be a transfer of wealth up the income distribution."¹²

My assertion that the MET Board had set prices too low followed from several corrections to the actuarial assumptions that the MET Board had given to its actuaries. Two corrections were particularly significant. First, even though tuition inflation over the prior two decades had held fairly constant at 8.7% per year (approximately equal to the average annual pre-tax total return on a diversified portfolio over that period), MET had assumed that tuition inflation over the next eighteen years would average 7.3% (2.5% less than MET's assumed pre-tax return).¹³ Second, even though it had not sought a private letter ruling from the I.R.S. (or even a formal opinion letter from its law firm), the MET Board had based its price on a federal tax assumption that was "the most daring of the [plausible] options."¹⁴

ranging up to 16%. For a newborn, the cost went up to \$7,840; for a tenth grader, the cost went up to \$10,172. Purchases of new "full-benefits" contracts fell to 8,950. 1991 Actuary's Report, *supra* note 9, at 13.

¹¹ Lehman, *supra* note 4, at 1107.

¹² *Id.* at 1113.

¹³ *Id.* at 1072-81.

¹⁴ *Id.* at 1098, 1127-32. Specifically, the MET Board assumed that, while MET would be taxed as a corporation, it would not have to include in its income the amounts it received by selling contracts but would be

My assertion that a bailout of MET would be distributionally disturbing was based on two different sources of data about who had bought MET contracts. First, in May 1989 MET had issued a news release purporting to show the percentage of MET families whose Adjusted Gross Incomes fell into each of five brackets. Second, at approximately the same time, MET had released the distribution of all MET participants by zip codes. I used both sources of data to compare MET participants with representative reference populations of families, children, and public college freshmen. I concluded that, "[n]o matter which set of figures one uses, it remains obvious that MET beneficiaries are not representative of the typical Michigan child. MET participants are far more heavily concentrated in the wealthier reaches of the population than in any of the plausible reference groups."¹⁵

Subsequent Developments

When my article appeared, then-Governor Blanchard and then-Treasurer Bowman promptly denounced it as politically motivated.¹⁶

able to deduct all tuition payments on behalf of a student to the extent they exceeded the student's original purchase cost.

Early in its history, MET had sought a private letter ruling from the I.R.S., arguing that it should be wholly exempt from federal income taxation. The ruling that emerged was, however, unfavorable. Priv. Ltr. Rul. 88-25-027 (March 29, 1987).

¹⁵ Id. at 1141.

¹⁶ I had begun raising questions about MET publicly in 1988. See Jeffrey Lehman & Kent Syverud, "Tuition Plan: Is It Just Pie in the Sky?" Detroit Free Press, June 8, 1988. During the summer of 1989, an assistant to John Engler, the Republican Senate Majority Leader, called me to ask if I would permit Senator Engler to nominate me to serve on the MET Board. (By statute, the Governor appoints the MET Board, but one seat is to be filled with an appointee nominated by the Senate Majority Leader. Mich. Comp. Laws Ann. §390.1430 (West 1988).) I agreed to let him do so. Governor Blanchard did not act on the nomination until after my article appeared during the summer of 1990, at which time he rejected it.

The controversy was (for a brief moment) front-page news.¹⁷ For the most part, editorial writers took the charitable position that my article had, at a minimum, raised important questions about the way MET had been implemented.¹⁸

But mine was not the only criticism of MET to surface and receive public attention during 1990. In March, Peter Boettke of Oakland University released a paper criticizing MET under the auspices of The Mackinac Center.¹⁹ And in November, Paul Horvitz of the University of Houston released an analysis of MET under the auspices of the College Savings Bank Research Division.²⁰

It is not surprising that, in the midst of controversy over MET, the state government did not merely remain passive. In an effort to shore up MET's solvency, Governor Blanchard successfully pressured state colleges to minimize tuition increases.²¹ At the same time, the MET Board

While I have no doubt that Senator Engler's motivation in nominating me was a "political" desire to embarrass Governor Blanchard, my own motivations for studying MET have always been more prosaic.

¹⁷ E.g., Tobin, "Professor: MET Based on Bad Math," *Detroit News*, p. 1 (July 3, 1990); Beachum, "MET Needs To Get Lucky' -- Prof," *Jackson Citizen Patriot*, p. 1 (July 3, 1990). See also Bell, "State Tuition Plan Shaky, U-M Professor Says in Study," *Detroit Free Press*, p. B3 (July 2, 1990); "Trust Plan Merits a Close Look," *Crain's Detroit Business*, p. 8 (July 9, 1990); "\$100 Million Shortfall in MET's Future?" *Oakland Press*, p. A-3 (July 3, 1990); Gabor, "Will the IRS Kill Tuition Trusts?" *U.S. News & World Report*, p. 43 (July 30, 1990).

¹⁸ E.g., "More MET Threats?" *Detroit News*, p. 6A (July 23, 1990); "Blanchard's Tuition Protests Shortchange Universities," *Detroit Free Press*, p. 8A (July 27, 1990).

¹⁹ Peter Boettke, "The Michigan Education Trust: A Political Economy Perspective" (March 12, 1990).

²⁰ Paul Horvitz, "Is MET Insolvent? An Analysis of the Financial Performance of the Michigan Education Trust Under Bank Regulatory Accounting Principles" (Nov. 20, 1990).

²¹ See, e.g., "Tuition Increase Inspires Threat From Governor," *New York Times*, p. 36, c. 6 (Aug. 5, 1990); Kellogg & Beachum, "Tuition

moved to respond to MET's country-club image.²² At special meetings on August 29, 1990, and September 21, 1990, the MET Board approved the sale of Monthly Payment Option contracts during the coming autumn's enrollment period.²³

The Monthly Payment Option enabled contract purchasers to deviate from the traditional lump-sum method of purchasing contracts, spreading payments over a period of four, seven, or ten years as follows.²⁴

Table 1
Cost of Participation in Monthly Payment Options
(for 4 years of tuition)

Expected Year of Matric'n	Lump Sum Contract Cost	Monthly Cost, 4-Year MPO	Monthly Cost, 7-Year MPO	Monthly Cost, 10-Year MPO
2008	8,380	216	140	112
2007	8,540	220	144	114
2006	8,704	224	146	116
2005	8,888	228	150	118
2004	9,084	236	152	120
2003	9,296	240	156	124
2002	9,516	244	160	126

Ultimatum: Blanchard Will Cut Funding If Colleges Exceed Guidelines," Ann Arbor News, p. A1 (July 25, 1990). In response to that pressure, the universities ultimately settled on tuition increases for 1990 averaging only 6.5%.

²² A political cartoon from the Detroit News reflecting the "Club MET" theme is attached as Appendix A.

²³ Michigan Education Trust Board of Directors Meeting Minutes, Sept. 21, 1990; *ibid.*, Aug. 29, 1990. The increase in the price of MET contracts ranged up to 7% above the previous year's prices. For a newborn, the cost went up to \$8,380; for a tenth grader, the cost went up to \$10,908.

²⁴ The Monthly Payment Option took two forms. Under the "monthly purchase plan," the purchaser makes direct payments to MET each month, over a period of four, seven, or ten years. The "payroll deduction plan" requires the same level of monthly payment, but under it a participating employer withholds payments directly from the purchaser's paycheck.

2001	9,748	252	164	130
2000	9,972	256	168	
1999	10,196	264	172	
1998	10,356	268	174	
1997	10,504	272		
1996	10,648	276		
1995	10,780	280		

In addition to the amounts shown above, the purchaser was also required to pay an extra \$25 each year after the first one in which he took advantage of the Monthly Payment Option.

The Monthly Payment Option was indeed popular. Part way through the 1990 enrollment period, which extended from October 15 through November 9, MET issued a press release declaring that it had appointed a "liaison for the new payroll deduction plan, due to the overwhelming response MET has received since the payment option was introduced."²⁵ That burst of enthusiasm may have been premature -- ultimately it turned out that MET contract sales fell by 41% from the level of the previous year. Nonetheless, more than one third of the new contracts were bought through the Monthly Payment Option.²⁶

In Part IV of this paper, I conclude that, however well-intentioned, the creation of the Monthly Payment Option had little effect on the income distribution of MET participation. Nevertheless, the 1990 enrollment period may well prove to have been a watershed for MET -- for reasons largely unrelated to the program itself. Two days before the close of the enrollment period, Michigan voters awoke to the surprising news that they had turned out Governor Blanchard in favor of Republican John Engler.²⁷ Although Engler had voted for MET as a state sena-

²⁵ PR Newswire, October 23, 1990 [available on NEXIS].

²⁶ In 1990, a total of 5202 contracts were purchased: 4959 providing benefits at four-year colleges, and 243 providing benefits only at community colleges. Of that total, 1864 were bought through the Monthly Payment Option. 1992 Actuary's Report, *supra* note 9, at 15-19.

²⁷ Engler had been trailing in the polls by as much as 26% only a month before election day. See Pluta, "Engler Feels He Won First Debate," UPI wire service (October 7, 1990) [available on NEXIS].

tor in 1986, he had become a vocal critic of the program during his gubernatorial campaign.²⁸

Almost immediately after the election results were final, Engler indicated that MET "would be closely looked at ... [He] said that the state would honor tuition contracts that have already been taken out but hinted that future buyers might be looking at higher prices. 'I think we're \$50 million to \$100 million short right now.'"²⁹

During 1991, the Engler administration adopted a decidedly more guarded attitude towards MET. In late spring, the new state Treasurer publicly voiced skepticism about the program's ability to sustain itself in future years.³⁰ Consistent with those doubts, the newly reconfigured MET Board first voted to ask the state legislature to acknowledge a "moral obligation" to bail the program out in the event of insolvency.³¹ The Board then declined to sell new MET contracts during 1991, proposing instead that the state sell College Savings Bonds similar to those sold by twenty-three other states.³²

Thus, the change from a Democratic to a Republican administration increased official willingness to acknowledge the possibility that MET contracts were sold too cheaply. (It is, of course, not at all surprising that

²⁸ See, e.g., Pluta, "Engler Accuses Blanchard Administration of MET Fraud," UPI wire service, March 15, 1990 [available on NEXIS]. See also note 16, *supra*.

²⁹ Pluta, "Engler Says Careful Assessment, Paring Back, Will Be Done," UPI wire service, November 9, 1990 [available on NEXIS].

³⁰ Tobin, "Prepaid Tuition Plan Faces Price Hike," Detroit News, p. 1A (May 10, 1991); Pluta, UPI wire service story, June 7, 1991 [available on NEXIS].

³¹ Holyfield, "Tuition Plan Wants Firm Backing," Ann Arbor News, p. A1 (August 7, 1991); Pluta, "Treasurer Says Higher Ed Trust Fund Offers No Guarantees," August 6, 1991 [available on NEXIS].

³² Tobin, "State May Scrap MET Tuition Plan," Detroit News, p. 1A (Dec. 3, 1991); PR Newswire, December 4, 1991 [available on NEXIS]; Hornbeck, "State To Offer Alternative to MET," Detroit News, p. 2B (Dec. 5, 1991).

the new administration would be willing to suggest that its predecessor mishandled the implementation of a new program.) Moreover, the new administration has renounced its predecessor's practice of attempting to enforce program solvency by restricting universities' ability to raise tuition revenues.³³

And yet the new administration is decidedly unwilling to take the public position that if MET is ultimately found to be insolvent, contract holders should receive less than the full benefit of their bargains with the Blanchard administration. Notwithstanding what is widely referred to as a state fiscal "crisis," Governor Engler has persisted in the view that if MET becomes insolvent, the taxpayers have a "moral obligation" to ensure that program beneficiaries receive more than just a refund of their purchase costs and a proportionate share of MET's earnings.³⁴

A variety of factors are surely relevant to whether the state should feel a moral obligation to give MET participants an extraordinary return on their investments -- a return that was promised but may prove unattainable without public subsidy. The flat-footed, unequivocal promises of former Governor Blanchard surely strengthen case for such a moral obligation.³⁵ The more precise language of the MET contract, however, might tend to weaken it, as might public warnings from commentators

³³ See Wendland, "Bill Would Tie Tuition Increases to Inflation," Ann Arbor News, p. C1 (August 1, 1991) (quoting Engler spokesman saying that "the governor continues to respect the autonomous nature of the universities").

³⁴ Holyfield, "Tuition Plan Wants Firm Backing," Ann Arbor News, p. A1 (August 7, 1991)("[Engler spokesman] Truscott said Blanchard and Bowman oversold the program. 'It was sold to the people with the understanding that it was guaranteed by the state,' he said. 'It clearly is not, so Governor Engler is trying to take steps now to make sure it will be guaranteed.'We still believe the people weren't told the truth about the program," said Engler Press Secretary John Truscott. 'We're doing our best to cover the people who have purchased the contracts.'")

³⁵ See the statements quoted in Lehman, *supra* note 4, at 1120-21.

that the deal was "too good to be true."³⁶ Perhaps more importantly, the current MET Board could weaken the case for such a "moral obligation" still further by coming forward now, only three years into the program, and offering all participants the opportunity to withdraw.³⁷

In contemplating the appropriateness of a "bailout," those history-based equitable considerations are appropriately supplemented by sensitivity to distributional concerns. Who would be required to fund a bailout? Who would benefit? How do the contract holders' particular claims of need and desert fit into more general claims of need and desert in a society feeling the pinch of scarcity?

As it was originally designed, MET drew its participants disproportionately from the more advantaged sectors of the state. MET's current political situation gives special significance to the question whether that distributional pattern was altered by the new Monthly Payment Option. According to then-Treasurer Bowman, that was the reason for the change.³⁸ Did it work?

Distributional Effects of Structural Change

The Executive Director of the Michigan Education Trust kindly furnished me with the distribution by zip code of the purchasers of the 1864 contracts that selected either the monthly purchase plan or the payroll deduction plan. 22 of those contracts reflected purchasers from zip codes outside the range reflected in Michigan (48000-49999), and another 15 contracts showed zip codes for which reliable data was not obtainable

³⁶ Jeffrey Lehman & Kent Syverud, "Tuition Plan: Is It Just Pie in the Sky?" Detroit Free Press, June 8, 1988.

³⁷ See generally Jeffrey S. Lehman, "MET Needs a Different Kind of Bailout," Detroit News, p. 3B (August 18, 1991).

³⁸ "MET Board Sets Prices for 1990; Adopts Monthly Purchase Plan," PR Newswire, August 29, 1990 [available on NEXIS] ("The monthly purchase plan increases the accessibility of MET for even more Michigan families," Bowman added.").

from the Census Bureau. That left a usable within-Michigan base of 1827 contracts.

Michigan's zip codes can be ranked according to median family income. If one sorts the 1827 contracts according to zip code, ranked in that manner, one can observe the extent to which participants in MET's plan are drawn disproportionately from children who live in high-income zip codes. One can identify what percentage of Monthly Payment Option contracts came from the "richest" quintile of Michigan children (where children are ranked by the median income of their zip code), and what percentage came from the "poorest" quintile of Michigan children.³⁹ One can then compare that picture of the distribution with a variety of "reference" pictures to see whether the new payment options are accomplishing their goal of increasing MET's "accessibility."

An absolute tabulation of the share of Monthly Payment Option contracts purchased by each quintile looks as follows:

Table 2

Income Distribution of MPO Contract Purchasers	Quintile Share of MPO Contracts
Richest	39%
2 nd	22%
3 rd	17%
4 th	15%
Poorest	7%

This table certainly offers little comfort to those who would contend that the new Monthly Payment Option makes a positive contribution to the cause of distributional justice.

A proper analysis of the problem should not end, however, with a simple descriptive table. Questions concerning the distributional impacts of public policy necessarily require one to pay explicit attention to the question, "Compared to what?" If Monthly Payment Option MET contracts are supposed to "increase access" to higher education, the "in-

³⁹ See generally Lehman, *supra* note 4, at 1138-41.

crease" should be measured by reference to some other, identifiable state of the world. Precisely which "improvement" one has in mind determines the appropriate reference group against which the distribution of MPO contracts should be compared.

One plausible reference group is the group consisting of all children living in Michigan. I take as my starting point the proposition that by purchasing MET contracts, families improve their financial well-being. If that is the case, one might well want to know how financial well-being is distributed among Michigan children generally. If financial well-being generally is more skewed than the distribution of MPO contracts, one might plausibly argue that the contracts are redistributing wealth towards the less fortunate.

The following table compares the distribution of MPO contracts with the distribution of family income among children living in Michigan:

Table 3
Income Distribution of MPO Contract Purchasers
and Distribution of Family Income in Michigan

Quintile	Share of MPO Contracts	Share of Family Income
Richest	39%	28%
2 nd	22%	22%
3 rd	17%	20%
4 th	15%	17%
Poorest	7%	13%

This table suggests that the sale of MPO contracts has distributed financial benefits in a way that is even more skewed towards high-income taxpayers than the way the private market distributes income. If (as I believe), the enjoyment of this financial benefit by MET contract holders will ultimately require a subsidy from Michigan taxpayers, then the sale of Monthly Payment Option contracts appears to constitute a taxpayer-financed transfer of wealth up the income distribution.

One might argue, however, that the reference group used in Table 3 is inappropriate. One might contend that the income distribution of MPO contract purchasers should be compared to that of the families that were

sending their children to state universities before MET was in place. The argument might go something like this: "Public higher education is a sensible public investment, whose benefits redound to all the citizenry. This is a program designed to make public higher education more accessible than it currently is. As long as the distribution of MPO contracts is less concentrated than the pre-MET distribution of freshmen, the program is doing its job."

Table 4
Income Distribution of MPO Contract Purchasers
and Distribution of Freshmen attending Michigan Public Universities

Quintile	Share of 1990 MPO Contracts	Share of 1988 Freshmen
Richest	39%	33%
2 nd	22%	21%
3 rd	17%	17%
4 th	15%	16%
Poorest	7%	13%

Once again, the data appear to undermine any claim that the sale of Monthly Payment Option MET contracts improves access to higher education for families who might not otherwise be able to afford it.

If one wants to tell a favorable story about the effects of the Monthly Payment Option, it would seem that the most one can say is that it is not as badly skewed as the MET program was in 1988, when the monthly-payment option was not available. Consider the following comparison:

Table 5
Income Distribution of Participants in
1990 Monthly Payment Option Contracts
and Distribution of 1988 MET Contracts

Quintile	Share of 1990 MPO Contracts	Share of 1988 MET Contracts
Richest	39%	50%
2 nd	22%	22%
3 rd	17%	13%
4 th	15%	11%
Poorest	7%	4%

At last I have been able to produce a table with some encouraging news. The Monthly Payment Option contracts were not as badly skewed towards the top of the income distribution as the distribution of 1988 MET contracts. Unfortunately, all of the difference in participation by the poorest quintile revealed in this table could be accounted for by a difference in the way the data was reported between 1988 and 1990.⁴⁰ Moreover, even if the data were perfectly comparable, not even this table would demonstrate that the availability of the Monthly Payment Option improved the distribution of all 1990 MET contract sales from what it had been in 1988. (The distribution of non-MPO MET contracts in 1990 could have been more skewed than it had been in 1988, given that the monthly payment option was available!). Nonetheless, this appears to be the most encouraging table that the data will support.

How does one determine which table is the "right" one for purposes of policy analysis? One needs to know which alternative state of the world provides the proper "baseline" against which to evaluate our present condition. As I have argued elsewhere, the question is ultimately

⁴⁰ The 1988 data does not reflect purchasers of contracts whose benefits were limited to community colleges; the 1990 data does. See note 39, *supra*.

one of politics, not logic.⁴¹ One needs to know whether, as a matter of public perception and political compromise, MET is a necessary part of the political scene. If so, then marginal improvements in the distribution of MET's benefits are real improvements. But if it is a realistic possibility that MET could be transformed in ways that offer even greater net improvements along the various relevant policy dimensions (including distributive justice), then to accept the MPO as adequate is to sell oneself short.

Evaluation and Conclusion

Why did the Monthly Payment Option not have a more radical effect on the income distribution of MET participants? A number of possibilities suggest themselves.

Perhaps the most obvious possibility is that the implicit credit terms of the Monthly Payment Option were not sufficiently attractive. If one compares the lump-sum prices with the monthly-payment prices shown in Table 1 above, one discovers that MET was effectively charging interest at roughly 11% or 12% per year for the privilege of participating in the Monthly Payment Option plan.⁴² Those facts alone make it unsur-

⁴¹ See Jeffrey S. Lehman, "To Conceptualize, To Criticize, To Defend, To Improve: Understanding America's Welfare State," 101 Yale L.J. 685, 722-23 (1991).

⁴² If one compounds monthly, the effective annual rates were as follows:

<i>Year of Matric'n</i>	<i>4-Year MPO</i>	<i>7-Year MPO</i>	<i>10-Year MPO</i>
2008	11.8%	11.1%	11.2%
2007	11.8%	11.5%	11.2%
2006	11.7%	11.3%	11.1%
2005	11.5%	11.5%	11.0%
2004	12.3%	11.2%	10.9%
2003	11.9%	11.3%	11.1%
2002	11.5%	11.3%	10.9%
2001	11.9%	11.3%	11.1%
2000	11.5%	11.4%	
1999	12.0%	11.4%	
1998	12.0%	11.3%	
1997	12.0%		
1996	12.1%		

prising that relatively few low-income families bought MET contracts. The result is even more understandable when one considers that the MET contract may well be less valuable to the low-income purchaser. For such a purchaser, the MET contract is more likely to simply displace other forms of financial aid that would otherwise have been available when her child reached college.

* * *

For a designer of prepaid tuition programs, these findings should not be discouraging. They do not mean that prepaid tuition programs are a bad idea overall. They do not mean that prepaid tuition programs are a bad idea from the point of view of distributional equity.

Rather, these findings serve only to confirm that any prepaid tuition program that charges all participants the same price, however it is designed, is likely to draw primarily from the upper reaches of the income distribution. That fact is disturbing when, as in Michigan, the program has been designed to subsidize program participants. But it would be much less disturbing if the program had been priced so as to avoid providing such a subsidy. Indeed, if we felt that the program was charging participants a premium for this special kind of tuition insurance, we would undoubtedly be relieved to learn that most of the burden of that premium was falling on those best able to bear it.⁴³

It would appear that the only way to make a substantial difference in the distribution of program participants would be to adopt a sliding-scale price system. One would charge most participants "full freight," but provide a special subsidy to low-income contract purchasers. If one were to attempt to implement such a system directly through the prepaid tuition program itself, one would undoubtedly create an administrative nightmare. Moreover, if one were to attempt to provide such redistributive

1995	12.2%		
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⁴³ For a more extended discussion of the distributional issues, see Lehman, *supra* note 4, at 1053-55.

subsidies internally, through funds raised from other purchasers, one would strain the solvency of the program.

But there is another way. If one were committed to altering the distribution of program participants, one could piggyback onto the tax system. The program could charge prices that did not vary with participant income. Low-income participants, could then recoup part of the contract cost from the tax system, by claiming a refundable credit on their tax returns for the year of the purchase, where the amount of the credit depends upon the purchaser's taxable income for federal income tax purposes.⁴⁴ Because the funds for the subsidy would come out of general revenues, they would not affect the actuarial soundness of the program.

The moral of this story is that the price structure of prepaid tuition programs matters on several levels. It matters on the level of technical competence because it determines whether the program is likely to be solvent. It also can matter on the level of distributional equity.

But the reason it matters on the level of distributional equity is not because changes in the ways in which one might finance the purchase of a contract are likely to influence who will participate. If the price structure adopted is not a sliding-scale structure, then new financing options are unlikely to have much effect on who participates. Under those circumstances, participation will inevitably be skewed towards society's most advantaged.

Distributional considerations suggest that a prepaid tuition program should not embody a generalized, across-the-board subsidy. If a state wishes to broaden the base of participation, it should implement a sliding-scale price structure indirectly, through a system of tax credits. But whether or not it chooses to do so, the state should view skeptically any proposal to price the program in a way that (explicitly or implicitly) offers a generalized subsidy to all participants. The nominal contract price should reflect the fair market value of the contract.

⁴⁴ For example, if the purchase price for a newborn were \$12,000, the credit could be set equal to 30% of the extent to which the purchaser's taxable income fell short of \$30,000.