Myth Busting

The Laissez-Faire Origins of American Higher Education

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Harvard University is named after its first private benefactor, John Harvard, a statue of whom remains a landmark on its campus as a legacy of his generosity that helped finance the nation's first college in its infancy. Although Harvard's gift played an important role in the school's early development, the institution's history was powerfully shaped by a significant amount of state intervention that sheltered it from competition and kept its doors open with a steady stream of subsidies and protections during its formative years.

Similar stories of state intervention contributing to the development of colleges can be found for most of America's colonial institutions, but many scholars nevertheless conclude that American higher education had become a laissez-faire market in the decades before the Civil War. This view has been shaped largely by knowledge of the rapid expansion in the number and diversity of colleges following America's independence, which resulted in the establishment of as many as eight hundred colleges by 1861 (Westmeyer 1997). For example, John Brubacher and Willis Rudy suggest that the sector's growth was "fostered by the conditions characteristic of the laissez-faire, individualistic society of the time" (1997, 59).

The 1819 Supreme Court ruling in *Trustees of Dartmouth Coll. v. Woodward* (17 U.S. 518) is widely viewed as contributing to the rapid growth of private institutions during the period, with many education scholars depicting the decision

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as unleashing capitalism on higher education. Jurgen Herbst, for instance, suggests that the decision "ensured that higher education . . . would draw on the strengths and suffer the liabilities of laissez faire capitalism" (1982, 147). Arthur Cohen and Carrie Kisker add that with this decision the "federal government enhanced the free and open market" in higher education (2010, 65).

The sector's growth during the period has also been attributed to a liberal regulatory environment. Referring to the diversity of colleges that emerged during the period, Martin Trow suggests that the lack of regulation constituted a "kind of license for unrestrained individual and group initiative in the creation of colleges of all sizes, shapes, and creeds" (1989, 12). Cohen and Kisker comment that "[i]n the absence of regulations . . . [a]ny group could solicit funds . . . obtain a business license . . . and open for instruction" (2010, 64).

Although aspects of the antebellum higher-education market were undoubtedly characteristic of free-market capitalism, this essay serves as a critical challenge to the hypothesis of the laissez-faire origins of American higher education. An examination of the political economy of the period against a true free market for higher education shows clearly that the state was more involved in shaping the sector than has generally been recognized. The laissez-faire origins hypothesis is largely a myth that has been propagated by a misunderstanding of the enduring effects of state intervention in altering the market process.

Framework for Analysis

What would a truly free market for higher education look like? A free-market economy is devoid of distortionary government interventions such as regulatory requirements and government subsidies, which often add unnecessary costs, constrain competition, redirect market allocations, or impede economic agents' decision-making ability. When the market process is unhindered by state intervention, a great deal of experimentation is undertaken as entrepreneurs and nonprofit organizations try out different ideas to determine what the market will sustain. Consumers vote with their wallets for the products and services that they most highly value. Products with a high demand remain in production and generally attract additional investment. Products and services with weak demand are rooted out by market forces. As such, free markets are characterized by experimentation that involves both success and failure as the market process leads to innovation and the production of highly valued products and services (Kirzner 1973, 1985; Bennett, Lucchesi, and Vedder 2010).

As a benchmark, a free market for higher education would consist of three features: property rights, privatization, and competition. Recognizing the potential collective-action problem of higher education that may arise if students do not accrue the full benefits of higher education and thus may be unwilling to bear its full costs, this framework is general enough to apply to a diverse set of institution types with heterogeneous objectives such as profit, reputation, and revenue maximization. This allows for colleges to offer a product that can be construed as an investment, consumption, club good, or some combination of the three.

Property rights would be clearly defined, and colleges would be free to manage their institutions and resources without governmental interference in a free market for higher education. This feature has several implications. First, colleges would be autonomous entities that make decisions and enter contracts that are independent of political influence. Second, their property would be protected from arbitrary extraction from government or other aggressors. Last, regulations that arbitrarily alter the value of an institution's property or increase its costs of doing business would be avoided, particularly if they are discriminatorily imposed such that they benefit some colleges at the expense of others. The latter two points ensure that the full costs of investment are foreseeable and that the full benefits are realizable, enhancing the efficiency of the market and reducing the risk of malinvestment (Kirzner 1985).

Privatization encompasses several underlying factors. First, colleges should be established by groups of private individuals who finance the institutions with capital and revenues contributed voluntarily. This system necessitates the exclusion of government subsidies as a source of capital or direct revenue because such subsidies are generated through the involuntary taxation of other individuals' economic activities.[1] The operating costs of colleges would be met with revenues generated from tuition-paying students, philanthropic gifts, or other voluntary means of generating revenue. Colleges should be operated as private rather than government enterprises, but this does not necessitate that all institutions be organized as profit-seeking entities. Private nonprofit institutions are permissible so long as their revenues are raised through voluntary channels.[2] Indeed, many of the institutions established during the period under examination were affiliated with religious denominations for the purpose of instilling a certain set of values in young men and the community such that the nonprofit organizational structure was appropriate (McAnear 1955; Manne 1973).

Laissez-faire higher education would also be characterized by *competitiveness.* It would be free of legal or political barriers to entry or exit. The only obstacle to entering the sector would be access to the private capital necessary to finance the startup costs of a college. Exit from the sector would always be an option when desired and mandatory upon failure. Politically sanctioned monopolies or other restrictions on the number of colleges would not exist in a free market, and taxpayer-financed bailouts or government as lender of last resort policies would not be an option for financially defunct colleges. Colleges that met the market's

1. Subsidization could be consistent with the laissez-faire framework if there were unanimous agreement among a given population concerning the mechanism for generating the revenue and the allocation of the funds.

2. The desirability of state subsidization of higher education as a means to realize spillover effects is not discussed here.

demands by attracting tuition-paying students and voluntary donors would survive and grow, whereas colleges that failed to do so would falter. Higher education would thus be characterized by both entry and exit, each dictated by market forces rather than by political decisions.

The State and Colonial Higher Education

Frank Blackmar describes eight ways the state aids higher education and suggests that "nearly all of these methods originated among the colonies and were adopted by the states" (1890, 24). As such, an understanding of state intervention in higher education during the colonial era will provide perspective on the development of the industry after the nation's founding. Nine colleges were established during the colonial era. The colonial colleges were founded primarily as religious institutions, with most receiving substantial economic assistance from government. The sector was unambiguously uncharacteristic of a free market as the colonial colleges received monopoly protection and a variety of subsidies. Politically erected barriers to entry and competition as well as rent seeking existed in American higher education from its inception, stifling the market process. These arrangements altered the path of the sector and the economy, putting it on a different trajectory than it otherwise would have taken in the absence of state intervention (Kirzner 1973, 1985).

Regional Monopolization

Colonial colleges required a charter from either the Crown or the colonial government to begin legally operating. This requirement granted government officials the power to control the number of college charters issued and thus the capacity to erect a political barrier to entry for potential entrants. Trow describes the charters as "a monopoly grant to an institution of the power to grant degrees in a specific colony" (2003, 10). Herbst indicates that the colonial colleges "enjoyed the official sanction, if not always the financial support, of the colonial legislatures, and from them derived [their] claim to a monopoly on higher education" (1982, 128).

Both the colleges and the government had incentives to preserve a monopoly on higher education in the colony. From the colleges' perspective, new entrants would undoubtedly compete for private donations, tuition-paying students, and government subsidies. It has been suggested that the colonial colleges held a monopoly over the training of colonial leaders and that the colleges had enough influence and power to block entry by potential competitors (Herbst 1982; Whitehead and Herbst 1986). Because public officials were often alumni of the colonial colleges, the colleges' ability to influence the colonial government was likely strengthened. If this pipeline of young men educated at the college and later employed as government officials (an old boys' club) was preserved by preventing entrants that might also train leaders for public office, the monopolist college also increased the probability that its flow of subsidies would continue. John Whitehead and Herbst suggest that "[d]uring the colonial period the provincial college enjoyed and jealously guarded its monopoly on higher education in the province" as a means to preserve economic rents (1986, 344) and to "perpetuate an elite class," as Alan Karp indicates, by maintaining this monopoly over the training of leaders (1983, 247).

The colonial colleges, like public officials, were often tied to a particular religious denomination. The stated objective of most colonial colleges was to train civic leaders and ministers (McAnear 1955). By preserving the monopoly status of a higher-education institution with denominational ties, colonial officials increased the probability of maintaining their positions and preserving control of the colony and college in the hands of men holding similar religious views. The populations of the early colonies were initially largely homogeneous in terms of religious affiliation, enabling the monopoly over the training of leaders to persist. As the colonial populations began to assimilate, the connection between denomination and colonial government weakened. An increasingly diverse religious population within the colonies would eventually be a factor in abatement of the colonial colleges' monopoly protection status (Herbst 1975).

The colonial governments did at times explicitly exercise their authority to prevent competition by not granting charters to dissenting academies. Queen's College (later Rutgers), which was affiliated with the Dutch Reformed Church, originally attempted to obtain a charter in 1762 in the western region of the Massachusetts colony. Its attempt was thwarted by Harvard, the Puritan-affiliated incumbent monopolist (Herbst 1975; Whitehead and Herbst 1986).[3] Reuben Guild (1897) documents a competition between the Baptist and Presbyterian Churches for the monopoly charter in Rhode Island that would ultimately lead to the founding of the Baptist-affiliated Rhode Island College (later Brown University) in 1764.

The eight original colonial colleges maintained monopoly status in their respective colonies until New Jersey bucked the trend when it issued a second charter to Queen's College in 1766. The colony had originally granted a sole charter to the Presbyterian-affiliated College of New Jersey (later Princeton) in 1746. Queen's College, earlier prevented from operating in Massachusetts, managed to gain entry into the previously monopolized New Jersey market and to initiate a trend of "demonopolization" as all of the colonies except Delaware began efforts to expand higher education following America's independence (Thwing 1906).

Colonial Subsidization of Higher Education

Colonial colleges benefited from state subsidization in addition to monopoly protection. They received both direct and indirect subsidies from their respective governments.

3. Harvard's monopoly in Massachusetts ended in 1793 when Williams College was chartered by the state legislature.

The former comprised cash, land, and in-kind subsidies, while tax exemption and special privileges made up the latter. The subsidies were often financed through specific schemes such as excise taxes, government enterprises, and lotteries.

Earl Cheit and Theodore Lobman III (1977) suggest that cash subsidies accounted for 35 to 65 percent of the colonial colleges' operating revenues over the period 1690 to 1775. Yet some scholars have treated this subsidization as barely adequate to meet the financial obligations of institutions that struggled to attract paying students and private donors (Brubacher and Rudy 1997; Cohen and Kisker 2010). Christopher Lucas (1994) estimates that less than one in a thousand colonists attended one of the colonial colleges prior to the signing of the Declaration of Independence. The difficulty to procure sufficient funds through voluntary channels reflects a market friction. Most prospective students were unwilling to pay the price being charged for the product being offered—a classical education—and many potential donors were not inclined to support this mission, either.

In a free economy, the market drives providers of goods and services that are not profitable either to innovate to become financially sustainable or to close up shop. Without a reallocation of resources from productive economic activities and monopoly privileges granted by a government with coercive powers, the colonial colleges that emerged as among the most elite, wealthy, and emulated universities in the world would likely have either changed their business model to offer more practical education, such as that provided by the fee-for-service evening schools that operated during the colonial period (Seybolt 1925), or disappeared altogether. Brown University's fourth president, Francis Wayland, reflected this economic realization, suggesting that "since colleges were not self-supporting they had two choices: either they could give people a product that they needed and were willing to pay for, or they could throw themselves on the mercy of the broader society and beg for funds like any charitable organization" (qtd. in Cohen and Kisker 2010, 170). They pursued the latter option, seeking both charitable gifts and government subsidies. Although the subsidies may not have permitted the colonial colleges to generate massive perpetual endowments during their infancy, these economic rents nonetheless contributed to their survival and distorted the natural allocation of resources.

The practices of Harvard, William and Mary, and Yale in particular demonstrate some of the sources of rent extraction by the early colonial colleges. Frederick Rudolph describes America's first three colleges as "creatures as much of the state as of the established churches they were intended to serve" (1962, 13). The remaining colleges established during the colonial era also benefited from subsidies, but often to a lesser extent.

Harvard holds the distinction as the nation's oldest college and the first to benefit from economic rents generated through the political process. It was chartered in 1650 following a £400 grant from the Massachusetts Bay Colony Legislature in 1636 and an £780 bequest from John Harvard in 1638, although administrative records indicate that only £375 of that bequest was actually received by the college (Morrison 1936).[4] The Massachusetts General Court transferred 2,000 acres of land to the college in 1652 and authorized a £100 tax levy for its benefit in 1653 (Rudolph 1962). The college soon began to benefit from proceeds collected from patrons of the Charlestown Ferry and a later toll bridge crossing the Charles River, a revenue source that lasted for two hundred years (Rudolph 1962; Lucas 1994). Cohen and Kisker (2010) indicate that more than half of Harvard's annual income was attributable to government subsidies in the late seventeenth century and that less than 10 percent was derived from tuition. The college had received more than one hundred different subsidies from the legislature by the end of the eighteenth century (C. Adams 1898). The original state constitution contained a section for the continued state support of Harvard (Rudolph 1962). Although Harvard is named after its first private benefactor and is regarded as a private university today, its birth and early development are at least partially attributable to the economic rents and protection that it received from government.

William and Mary is the nation's second-oldest college, founded after receiving a charter and package of economic rents from Queen Mary in 1691. The package included £2,000 in quitrents, 20,000 acres of land, and subsidies from a tobacco export tax and land surveys (H. Adams 1887; Lucas 1994; Cohen and Kisker 2010).[5] It also benefited from a number of subsidization schemes imposed by the colonial government, including taxes on the export of furs and skins, the import of liquor, and the purchase of spirits, as well as fees charged for peddler licensing. William and Mary received an estimated average annual subsidy of £2,300 prior to the American Revolution (H. Adams 1887; Blackmar 1890; Thwing 1906). In addition to receiving significant economic rents that distorted productive economic activities, the college's students were granted special privileges relative to their peers, including exemption from both taxes and military service (Cohen and Kisker 2010). The college would, however, lose access to many of its sources of rents once the revolution began. College officials lobbied Virginia governor Thomas Jefferson for additional subsidies in 1779, an effort that fell short when Jefferson managed to influence the founding and subsidization of the University of Virginia (H. Adams 1887; Rudolph 1962).

Yale University also benefited from government subsidies, although they were more sporadic than those for Harvard and William and Mary. The college's eighth president, Timothy Dwight, suggested that the "State of Connecticut had been the chief benefactor of Yale College" (qtd. in C. Adams 1898, 4). The school received annual subsidies that accounted for about one-eighth of the colonial government's budget (Beck 2006). It also received periodic subsidies, including proceeds from

4. The £400 subsidy represented 25 percent of the total colonial government budget (Thelin 2011).

5. Quitrents represented a payment by a freeholder that released him from liability to perform services. Tobacco exports to England were not taxed. The college was assigned responsibility to oversee the land surveyor-general's office.

the sale of land, taxes on rum imports, and the sale of a French prize vessel captured by the colonial frigate (Rudolph 1962). It was the first college to receive subsidies based on enrollment, a public funding scheme that has become characteristic of state funding today.

Six additional colleges were founded during the colonial period, none of which received an annual subsidy from its colonial government, despite repeatedly seeking one (McAnear 1952).[6] However, the colonial governments did provide other means of subsidization and preferential regulatory treatment in addition to monopoly rights. All of the colleges received land subsides and were generally exempted from property taxation. Many were also authorized to operate public lotteries (Thwing 1906; McAnear 1952; Brubacher and Rudy 1997; Cohen and Kisker 2010). Beverly McAnear (1952) indicates that a total of eighteen lotteries, not all of which were profitable, were held for the benefit of colonial colleges, netting an estimated £12,000 in aggregate revenue.

Political Economy of Postcolonial Higher Education

Following the American Revolution, a college building boom ensued. In the twenty-year period from 1782 to 1802, nineteen permanent colleges were established, more than twice as many as had been created in the prior century and a half since Harvard was founded. By the start of the Civil War, nearly 250 colleges were operating in the country (Dannelly 1931; Burke 1982; Trow 1989). Colleges were established typically as one of three types of entities, all of which were required to obtain a charter from their state to operate legally: a civil corporation that later became known as a public institution; a private denominational college associated with a particular religious denomination; and a private college established by one or more religious, civic, or professional groups (Herbst 1982; Cohen and Kisker 2010).

Growth in the number and diversity of colleges during the period has often been attributed to a laissez-faire marketplace for higher education characterized by strong property-rights protections and institutional autonomy for colleges as well as to a liberal regulatory environment that imposed few barriers to entry. This view ignores important interventions by the state.

Property Rights and Institutional Autonomy

The nine institutions that emerged from the colonial era were public–private partnerships, given the colonies' financial fostering and protection of them. This type of partnership presented a challenge to the evolution of the industry after the nation's founding, particularly because the U.S. Constitution did not authorize the federal

6. In addition to Brown, Princeton, and Rutgers, these six colleges include College of Philadelphia (1740, University of Pennsylvania), King's College (1754, Columbia University), and Dartmouth College (1769).

government to develop a centralized system of education or a role in regulating education.[7] The colleges valued both their autonomy from the state and the subsidization and protection granted by it. Government officials meanwhile believed that their fostering of higher education granted them a role in the control of the colleges. The ambiguity of the legal and property rights of colleges would manifest itself in struggles for power between government and college officials for at least six of the colonial colleges. Elmer Brown describes the late eighteenth century as "marked by repeated efforts to bring the existing colleges under some sort of direct government control" (1903, 31). These power struggles led to a Supreme Court decision in 1819 that secured colleges' property rights and institutional autonomy.

The University of Pennsylvania was the first to encounter such trouble. In 1779, the Commonwealth of Pennsylvania revoked the college's original charter, replacing it with a new one that assigned the state government six of the twenty-five seats on the board of trustees and gave the House of Assembly power to veto thirteen of the additional seats. This decision led to dissension and a temporary splitting of the institution into two rival colleges in 1789. The dissolution was resolved, and the two remerged in 1791 to form what remains the University of Pennsylvania when the government relinquished much of its control by authorizing a self-perpetuating board and preserving only one seat to be held by the state governor. A similar struggle for control occurred between Yale and the Connecticut government, but a compromise was reached in 1792 that prevented a separation. The state gained eight seats on the board, and the college continued to receive annual cash subsidies.[8] Similarly, both Harvard and William and Mary would concede some control to their respective governments. Both Columbia and Dartmouth Colleges would experience temporary takeovers by their respective governments, but the latter case culminated in a legal battle that resulted in an important Supreme Court decision in 1819 (Brown 1903; Tewksbury 1932). Prior to the case, conflicts over charter rights and state power over higher education were vested in the state legislatures rather than in the courts, subjecting both to the plight of partisan politics. This case thus had significant implications for the evolution of the sector.

Dartmouth College was chartered in 1769 after receiving a land grant from the British Crown. In 1816, the New Hampshire legislature, which was providing substantial subsidies to the college, attempted to alter Dartmouth's charter as a means to gain political authority to appoint members to the college's governing board and to give the state veto authority over it. Dartmouth's trustees did not cede to the government's takeover attempt, and the college split into two rival institutions as a legal battle ensued. In 1817, the Superior Court of New Hampshire

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7. Failed efforts to establish a centralized system of education occurred as early as the 1787 Constitutional Convention (Thwing 1906; Rudolph 1962; Cohen and Kisker 2010).

8. The arrangement was altered in 1869, limiting state representation on the board to the governor and lieutenant governor.

ruled in favor of the state, indicating that the institution was a public corporation and that its trustees were public officials subject to legislative control (Rudolph 1962). The case was appealed, and in 1819 the U.S. Supreme Court reversed the decision by ruling in favor of Dartmouth College on the grounds that its charter was a contract between a private corporation and the British Crown and that the American Revolution did not dissolve the contract. The state legislature's attempt to amend the contract was rendered a violation of the U.S. Constitution, Article 1, Section 10, which forbids states from passing laws that impair the obligation of contracts.

Prior to the Dartmouth ruling, generally no distinction was made between public and private colleges. Most of the colonial colleges were financed by a mix of public and private funding, yet it was not clear who controlled the colleges. After the decision in the case was rendered, much of this ambiguity was removed as the Court ruled that a college's charter was a contract and that state legislatures were forbidden by the U.S. Constitution to alter these contracts unilaterally. Some scholars have suggested that the distinction between public and private institutions arose in the aftermath of the case, but this view is not unanimously shared (see, e.g., Whitehead and Herbst 1986). The ruling has nonetheless been described as protecting educational institutions from legislative tampering and fueling the growth of American higher education by clarifying ambiguity over colleges' legal and property rights.

Rudolph describes the ruling as "making it clear that no exclusive or monopolistic relationship necessarily existed between a college corporation and the state that had chartered it. . . . [O]nce chartered a college was beyond the control of the state. Each new college was now assured of its right to exist, if not of its right to survive the competition that the decision helped to unleash" (1962, 211). Brubacher and Rudy claim that the decision legalized "the existence of a great private sector in American higher education, immune from government interference" (1997, 59). Cohen and Kisker suggest that "the decision in effect gave a license to any . . . group to apply for a corporate charter and organize itself . . . without fearing the state would intervene by appointing trustees, rescinding the charter, or otherwise jeopardizing the autonomy of the institution" (2010, 67). Trow indicates that the decision safeguarded "the founding and proliferation of privately controlled colleges," making them "secure in the future control of the institution" (1989, 11). Donald Tewksbury describes how "a competitive era of higher education was ushered in . . . when it became possible for institutions of higher education to remain in general free from legislative supervision or control" (1932, 150). Clarence Dannelly suggests that the ruling "gave impetus to the establishment of schools and colleges by the churches" (1931, 183).

Higher-education scholars appear in agreement that the *Trustees of Dartmouth Coll. v. Woodward* ruling secured colleges' legal and property rights and granted institutions autonomy from government control unless otherwise specified by charter.

Economic theory suggests that these institutional arrangements would incentivize private investment in the sector. The ruling thus appears to have contributed to a more market-oriented sector than would have evolved had the original ruling not been overturned and states been unconstrained in their authority to intervene in the affairs of colleges.

The Market Process: Competition, Experimentation, and Regulation

Consistent with the federalist construction of the U.S. Constitution, higher education was largely subjected to decentralized regulatory and political environments during the antebellum period. The political economy was heterogeneous as each state developed its own set of policies concerning the colleges attempting to operate in their jurisdiction. In many states, obtaining a charter was the only legal restriction to entry into the sector. The issuance of state charters for colleges has been described as very liberal, given the large number and diversity of new colleges that emerged during the period. For instance, Cohen and Kisker comment: "In the absence of regulations it was easy to form colleges" (2010, 65). It has been suggested that the chartering of new colleges was generally met with approval from state governments so long as it did not require them to directly appropriate financial resources for the purpose (Brubacher and Rudy 1997; Cohen and Kisker 2010).

Such a liberal regulatory regime was not uniform across the country, however, as some states such as Michigan and New York extensively regulated higher education, often protecting the interests of institutions with high political capital through regulations that acted as legal barriers to entry, imposed compliance costs on colleges, and constrained both growth and innovation in the sector.[9] In Michigan, as a means to insulate the University of Michigan from competition, the 1850 state constitution explicitly prohibited the granting of charters to denominational colleges (Tewksbury 1932). A law was passed in 1855 that lifted this explicit prohibition, but the University of Michigan continued to be sheltered from market competition as new regulatory measures such as minimal capital startup requirements, a limit on annual income, curricular restrictions, and administration reporting requirements were imposed (Dunbar 1935).

Competition was also hindered in New York through the political process. The State University of New York was established in 1784 as the centralized education regulatory body, entrusted with the authority to grant charters and degrees as well as to inspect educational institutions in the state. Politically powerful incumbent institutions such as Columbia College were exempt from most regulations that served as barriers to entry for prospective colleges. For example, an 1801 resolution established that before a charter was to be issued, "a proper building for the

9. See Bennett (2013) for additional details on regulatory barriers in Michigan and New York.

purpose had been erected, finished, and paid for, and that funds had been obtained and well secured, producing an annual net income of one hundred dollars" (Blackmar 1890, 145). These requirements would rise considerably over time, making it increasingly difficult for new colleges to enter the market. By 1836, an endowment of $100,000 and property valued at $30,000 were required for an institution to become incorporated. The state also imposed other regulations that weakened competition and limited the potential for innovation in the sector. For instance, an 1838 act by the New York legislature required any institution with more than $2,500 in property to pass an on-site inspection from regulators. In addition, schools offering classical education curricula were shown favor in obtaining charters as well as in receiving subsidies (Blackmar 1890).

In other states, there is some evidence that competition and experimentation were present in higher education, a sign of a well-functioning market. Trow suggests that the "many institutions that sprang up . . . all competed for very scarce resources and all thus suffered to some degree from malnutrition . . . [a] characteristic of a system of institutions influenced so heavily by market forces" (1989, 10). Cohen and Kisker indicate that "experimentation was everywhere, and with hundreds of colleges opening and closing and trying different ideas to attract support," this experimentation resulted in a variety of institutional types (2010, 70). John Thelin describes how "market forces made American higher education susceptible to innovation, and . . . abuses" during the first half of the nineteenth century (2011, 58). By "innovation," Thelin refers to the diversity of colleges that emerged during the period, including liberal arts colleges, proprietary law and medical schools, colleges for women and African Americans, military and engineering colleges, denominational colleges, and municipal and state colleges.[10] Meanwhile, as the number and diversity of colleges grew, the original colonial colleges began to evolve into "increasingly homogenous and socially exclusive" institutions, further diversifying the higher education market. By "abuses," Thelin refers to "diploma mills" that sold degrees, presumably without any educational requirements. He provides one example of degree peddling by John Cook Bennett to extrapolate the general phenomenon of opportunistic behavior manifested by the "excessive spirit of enterprise in an era in which state regulation was marginal at best and largely unenforceable when present" (58). Although such fly-by-night providers can arise in any market, regulated or not, they generally do not endure as reputational information spreads and their brand becomes tarnished (Bennett, Lucchesi, and Vedder 2010).

Cohen and Kisker (2010) imply that the large number of colleges chartered in several states is evidence of a liberal licensing environment during the period. Before the start of the Civil War, twenty or more colleges were charted in Alabama,

10. An estimated 175 medical and 36 law schools existed in the United States before the Civil War (Thelin 2011).

Georgia, Kansas, Louisiana, Maryland, Mississippi, Missouri, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, and Virginia (Tewksbury 1932). Anya Kamenetz suggests that "colleges were built to further" the interests of their organizers, who may have been "political leaders, philanthropists, subcultures, sects, or ethnic groups," while student interests were often of secondary importance (2010, 2). The misaligned interests between educational providers and students and the high opportunity cost of foregoing labor in a growing economy provide an economic explanation for low demand, exemplified by an enrollment rate of 0.6 percent among men ages sixteen to twenty-five in the early 1800s, a figure that rose to 1.75 percent over the next half century (Rudolph 1962).[11]

The growth of denominational colleges in particular has been described as evidence of a competitive marketplace with few entry barriers. Kamenetz indicates that "colleges multiplied because each Protestant denomination in each colony wanted its own" (2010, 2). Thelin adds that the "enthusiasm for founding [colleges] had spread to every church in every small town" (2011, 61). The proliferation of denominational colleges was driven by college organizers' desire to impart Christian values to young men and their community so that college may have been viewed more as a consumption good for trustees and their donors than as an investment in human capital for students (Dannelly 1931; Manne 1973). Arguing that this was the case and that students at denominational schools did not realize the full benefits and were therefore unwilling to bear the full costs of education, Henry Manne (1973) contends that higher learning was congenial to the formation of nonprofit institutions that operated in a fashion similar to other private charities.[12] This nonprofit approach required that the colleges engage in fundraising. Common fundraising initiatives included soliciting large individual bequests and small voluntary subscriptions from private individuals, borrowing from commercial enterprises, and seeking subsidies through the political process (Beadie 1999). Of these initiatives, all but rent seeking are consistent with the free-market framework outlined earlier.

Genesee Wesleyan Seminary in Lima, New York, employed an innovative market-based capitalization scheme by selling joint-stock securities that promised subscribers future educational services as the return on their investment. This "practice of offering free tuition as a dividend or return on stock joint 'shares' . . . became more common after 1830," particularly among Methodist-affiliated institutions (Beadie 2010, 234). The Methodist Church was well organized and had a wide social network, allowing it to call on its congregations for financial support and to recruit large numbers of students for its affiliated

11. As an imperfect contemporary comparison, the college enrollment rate among people ages eighteen to twenty-four years old in 2010 was 41 percent (U.S. Department of Education 2012).

12. Nancy Beadie (1999) offers several illustrations of institutions that were able to cover their operating expenses fully with tuition revenues, most of which were single-sex academies owned by stockholders who earned returns from tuition profits.

colleges. Contrary to the laissez-faire origins hypothesis, the church's vast social capital was also leveraged to generate political capital that increased its ability to seek rents from government, which would have provided its institutions with a competitive advantage over less well-organized institutions (Beadie 2010).

The number of new denominational colleges during the period generated an increasingly competitive environment for fundraising and attracting students, such that some of the college leaders began to form cartel-like organizations to apportion "territory among contending sectarian factions" in order to contain unrestricted competition that "would be ruinous to all" (Lucas 1994, 120). For instance, the Society for the Promotion of Collegiate and Theological Education at the West noted in its seventh annual report that "the tendency to the undue multiplication of Colleges at the West is notorious, and by none more deplored than by the members of this Board. The whole influence of the Society has been to terminate the day of college building, having its origin in the pecuniary interest of individuals or localities" (1850, 39). The American Home Missionary Society, founded in 1826, was another interdenominational Protestant organization with a similar purpose (Lucas 1994). Although the formation of cartels does not promote free and open competition, it does provide some indication that markets are to some extent competitive because competitors are willing to cooperate as a means to secure greater returns for participating members.

The large number of colleges established during the period before the Civil War is indicative of the existence of low barriers to entry in many states. There is also evidence of high rates of exit in many states. The failure rate of colleges during the period has been estimated to range from 17 to 80 percent. Cohen and Kisker (2010) suggest that more than 500 colleges were established, among which 210 to 250 became permanent. Tewksbury (1932), in a nonrandom sample of sixteen states, estimates that a total of 516 colleges were founded, but only 20 percent remained in existence by 1927. Paul Westmeyer (1997) reports a similar failure figure in suggesting that more than 800 colleges were established over the 1776–1861 period, but only 180 survived until 1900. Roger Williams (1991) claims that Tewksbury's analysis is flawed in that it accounts only for college charters issued without verifying that they actually were operational. An analysis by Colin Burke (1982) considers the latter factor, indicating that 241 colleges were founded over the 1800–1860 period and that 40 of them failed, implying a 17 percent exit rate.[13]

Though the rapid expansion in the number and diversity of new colleges following America's independence has been described as a period of innovation in higher education unique to America, not everyone accepted the trend as a positive one at the time. Many educators and college officials, such as the University of Michigan's first president, Henry Tappan, suggested that the market

13. Thomas Snyder (1993) reports that 381 permanent colleges emerged from the period.

process was generating a multiplicity of colleges and leading to duplication and waste. They promoted reforms aimed at centralization and extensive regulation of the sector (Tewksbury 1932). These critics ignored the fact that centralization breeds a homogeneous and inefficient government monopoly that has little incentive to produce goods and services that reflect consumers' preferences (Ostrom and Ostrom 1999).

Experimentation is part of the market process that leads to innovation, with good ideas and products proliferating and bad ones dropping to the wayside. In 1876, University of Rochester president Martin Anderson alluded to this process in responding to criticisms of overexpansion of higher education, stating that "the law of supply and demand is the only possible corrective. . . . If a college attracts to itself patronage and endowment, it has a right to live; if it does not, it will die" (qtd. in Tewksbury 1932, 7–8). As discussed earlier, there is evidence of both entry and exit from higher education during the period, which may be an indication of experimentation that rewarded with continued existence those providers who best met the needs of their customers and donors and that punished with exit those that failed to do the same.

There are, however, several alternative explanations for the number of institutions that emerged in the period. One is that survival was a result of collusive behavior such as the formation of cartel-like organizations to limit entry or the assignment of regional markets among cooperative units, which would have been deemed illegal following enactment of antitrust legislation in 1890. Another possibility is that survival may have been the result of successful rent seeking, which led to subsidies and other regulatory advantages that gave politically favored providers an edge over their competitors in the marketplace. There is clear evidence that both rent seeking and cartel-like behavior were present among colleges during the period, suggesting that one should be cautious in interpreting evidence of entry and exit from the sector as definitive support of the laissez-faire origins hypothesis.

The Antebellum Rise of State Institutions

As described earlier, the 1819 ruling in the Dartmouth case is believed to have served as an impetus for the proliferation of privately chartered institutions of higher learning. The effect of the ruling on the development of the state sector is less clear and has been the subject of some debate among scholars. Tewksbury, for instance, notes that the case not only paved the way for "a multiplicity of private and denominational colleges" to emerge but also served as momentum for the "establishment of state universities" (1932, 65). Trow (1989, 2003) offers an alternative perspective in suggesting that the ruling resulted in weak growth of state institutions by making it more difficult to establish them. Although it is true that the public sector's market share was small prior to the Morrill Land Grant Acts of 1862 and 1890, which resulted in rapid expansion in the number of state institutions, government efforts to establish public universities originated well before the start of the Civil War and passage of the Morrill Acts.[14]

Land subsidies were the most common and perhaps the largest source of subsidization for colleges during the pre–Civil War period, generally serving one of two purposes. First, the land was sometimes used for the site development of a college. Alternatively, lands were often held as an endowment and either sold or leased as a means of generating income. State universities were often established using proceeds from the sale of federal lands, but colleges were also often endowed with land subsidies from their state governments (Cohen and Kisker 2010).

Federal policy to subsidize state universities with land began with the Ordinance of 1787. It passed after Manasseh Cutler successfully negotiated with the federal government for the sale of 1.5 million acres of land to his Ohio Company and Associates, with a stipulation that two townships be set aside for the founding of a university. American Western University, later renamed Ohio University, was established in 1802 in Athens. Similarly, the Scioto Company purchased land from the federal government with the stipulation that a township be set aside, from which Miami University emerged in 1809 (Blackmar 1890).[15]

Federal policy to establish public universities continued beyond the Ohio land grants. The primary purpose for the sale of federal lands was to raise revenue and pay down federal debt. Subsidizing public education was a by-product of the initiative rather than the primary objective (Tewksbury 1932), although the establishment of schools in new territories would likely have been an incentive used to attract settlers and grow the tax base. Tewksbury (1932) reports that of the twenty-one states admitted to the union before the Civil War, all but Vermont, Kentucky, Maine, and Texas were recipients of federal land grants.[16] He also estimates that nearly one million acres were set aside for the development of state universities during the period. By the start of the Civil War, thirteen state institutions had been established in twelve states that received a land grant.[17] Federal land-grant policies that supported the growth of state universities would later be expanded with the Morrill Acts.

Lucas attributes the existence of most state universities to the federal land-grant policies, suggesting that these policies provided a "stimulus for the founding of state colleges" (1994, 147), a sentiment shared by Tewksbury (1932). State governments also contributed to the development of state institutions, however.

14. Less than 10 percent of college graduates attended a public institution in 1860 (Dannelly 1931). In contrast, 65 percent of degrees awarded in 2009–10 were from public institutions (U.S. Department of Education 2012).

15. A township is 23,040 acres. Brubacher and Rudy (1997) suggest that Cutler's proposal to Congress was not taken seriously until the politically influential Scioto Company was included in the deal.

16. Each state admitted to the union since 1800, with the exception of Maine, Texas, and West Virginia, has received a land grant (Blackmar 1890; Thwing 1906). All three were excluded because the federal government did not own land in them (Rudolph 1962).

17. The twelve states were Tennessee, Ohio (two), Louisiana, Indiana, Mississippi, Alabama, Missouri, Michigan, Iowa, Wisconsin, California, and Minnesota.

The original constitutions of states such as Indiana, Maryland, North Carolina, Pennsylvania, and Vermont addressed the need for the protection and fostering of higher education, with some calling for the establishment and financial support of one or more state institutions. In other states, a similar provision was established through legislative enactment. An estimated thirty-two colleges were established by states prior to 1865 (Cheit and Lobman 1977).

Many states subsidized the establishment of state institutions with land, a resource that was relatively abundant and likely viewed as an expendable resource, particularly in lieu of cash subsidies. A few examples are illustrative. The University of Georgia was chartered in 1789 through a land grant of 40,000 acres (Westmeyer 1997).[18] In 1798, the University of Vermont was endowed with 29,000 acres of land by the state. The State of Indiana provided land subsidies to both Vincennes and Indiana Universities (Blackmar 1890). In some states, escheated lands were often given as subsidies for the establishment or endowment of state institutions. South Carolina established three colleges in this manner, of which the College of Charleston was the only successful venture. The University of North Carolina was endowed with escheated property as well as with a loan, which was later converted to a gift. Hampden-Sidney College in Virginia was subsidized with 412 acres of escheated land in 1784 (Blackmar 1890).

Such initiatives by the states, coupled with the federal land-grant policies described earlier, provided an impetus for the founding of state institutions. As noted, land was a relatively abundant resource at the time, and, as such, it "represented the principle endowment of colleges and universities" (Thwing 1906, 186). Land subsidies were nonetheless a direct form of subsidization and thus not without an opportunity cost. The privatization of government land holdings represents a move toward a freer economy, but attaching strings to the sale such that the land or revenue (or both) be used to establish a college is uncharacteristic of laissez-faire practice, particularly if subsidization of the college continues.

Discriminatory Subsidization

Prior to the Dartmouth Supreme Court case, most colleges were chartered as private organizations but were at least partially funded by government with some combination of land, cash, and other indirect forms of subsidization. These subsidies were often provided to private and sectarian institutions because they had been previously established, and state-chartered institutions were not yet common (Blackmar 1890).[19] In the aftermath of the case, most states continued to permit

18. The University of Georgia received 630 acres of land from a private donor in 1801 near Athens, which is the university's current hometown. The state land grant constituted an endowment.

19. Several states (e.g., North Carolina, Georgia, Tennessee, and Vermont) chartered state colleges prior to 1800 (Rudolph 1962).

private charters for colleges governed by privately chosen boards, but a trend toward publicly chartered colleges that were at least partially governed by legislatively appointed boards gained momentum.

The trend toward the chartering of state institutions coincided with a trend toward the discriminatory subsidization of colleges by the states, with preference eventually given to public institutions over private ones in most states.[20] For instance, Harvard, which had received cash subsidies from Massachusetts since its inception, was finally cut off from the public dole in 1823 as the state transitioned toward subsidizing other institutions and eventually limited subsidization to its state-chartered and federally endowed colleges (Rudolph 1962). As states began to exclude private institutions from receiving subsidies so that they could support public ones instead, the competitive environment was significantly weakened because the subsidies allowed state colleges to price tuition below cost and potentially reduced their transaction costs associated with fundraising in that the rent-seeking costs of convincing public officials to impose a tax on a large base of citizens are likely lower than convincing those citizens to make voluntary contributions.

Despite a trend toward discriminatory subsidization, many private colleges continued to seek and find subsidies from their state governments. As Rudolph describes, the private colleges enjoyed the "rights of corporate independence, but did not construe their private nature as forbidding endless petition to state governments for financial relief" (1962, 188–89). Whitehead and Herbst add that "some denominational colleges quite eagerly sought state aid and often received it" (1986, 334).

As described earlier, land subsidies were the most common means of subsidizing higher education. Although state institutions were the primary beneficiaries of land subsidization policies, some privately chartered institutions also benefited from similar schemes. In Maine, for instance, Bowdoin College was endowed with five townships when founded in 1794, and in 1820 Colby College received two half townships from the state.[21] Massachusetts subsidized Williams College with at least two townships in Massachusetts, and Amherst and Colby Colleges received a half and a full township, respectively, in Maine (Blackmar 1890).[22]

Colleges also received cash subsidies from state governments. Some states restricted subsidies to state-chartered institutions, but others did not discriminate

20. Tewksbury (1932) suggests that constitutional requirements for the separation of church and state are largely responsible for states abandoning the subsidization of private denominational colleges.

21. Bowdoin was also provided with three lots of 320 acres apiece, bringing its total endowment to 116,160 acres (Blackmar 1890). Cohen and Kisker (2010) suggest that Bowdoin was endowed with 144,000 acres, but they do not specify the time period for this endowment, so their figure may include later subsidies. Colby had previously been subsidized with a township from the Massachusetts General Assembly, so it received a total of 46,080 acres.

22. Williams College received the land subsidies in 1805 and 1809. Proceeds from the sale of the two townships yielded $9,500.