Fiscal and State Policy Issues Affecting Postsecondary Education

State Outlook

Compiled by the AASCU State Relations and Policy Analysis Team

The Leadership Association of 420 Public Colleges and Universities Delivering America's Promise

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Dynamics Affecting Public Higher Education Financing in Fiscal Year 2012

Slow U.S. Economic Recovery

Despite the passing of a full two years since the official end of the recession, U.S. economic growth has remained sluggish, inching along at about a 2.8 percent annual growth rate. The annualized GDP growth rate for the first quarter of 2011 was 1.8 percent, below the expected three percent, and still further short of the historical average of 3.3 percent. Estimates for the second quarter (ending June 30) have been scaled back from 3.5 percent to closer to two percent. Forecasts for overall 2011 U.S. economic growth are being revised downward to around 2.6 percent from an originally anticipated three-four percent rate.

While a double-dip recession appears unlikely, a host of factors are battering the U.S. recovery. Among them are continued high unemployment combined with weak job creation; high oil, gas and energy prices; the impact of natural disasters in Japan and the U.S.; the European sovereign debt crisis; and the debate involving federal lawmakers over the statutory debt limit. These, to name a few, are causing unease in the markets, and are contributing to the slowness of the recovery.

The main ingredient necessary for boosting economic activity—increased consumer demand (spending)—may be further elusive if political rhetoric turns to action and government payrolls are further pared as a primary method for cutting government spending. Most economists agree that while limiting government spending in the long term may be a prudent goal, doing so in a short term, abrupt manner will further decrease consumer spending, and further inhibit economic growth.

Continued Weak Job Market

The key force behind economic growth and states' revenue generation capacity—job growth—has been lackluster in the second quarter of 2011. U.S. monthly job growth averaged 220,000 from February through April, and then slumped to just 25,000 in May and 18,000 in June. The June unemployment rate edged upward to 9.2 percent, up from 9.1 percent in May. A drag on the employment numbers has been the shedding of public sector jobs. In May and June, some 69,000 government jobs were eliminated, whereas private companies generated 130,000 new jobs, according to the U.S.

Department of Labor. State governments have shed about 100,000 jobs since the start of 2009, according to the Bureau of Labor Statistics. Payrolls for local governments are down more than 400,000 over the same time period.

American corporations are sitting on $2 trillion in cash reserves, but given continued mixed economic signals, are reluctant to dedicate the money to the hiring of new employees. It may take until 2015 to return to pre-recession employment levels, and several more years to reach full employment. Rana Foroohar, a *Time Magazine* economist, estimates that the U.S. economy would need to create 187,000 jobs a month, growing at a rate of 3.3 percent, to get to a healthy unemployment rate of five percent by 2020.

Limited Remaining Federal Policy Options to Spur Recovery

It is the consensus among many economists that few large scale macroeconomic policy options remain at the federal government's disposal for spurring job creation and short-term economic growth. Measures already taken include a massive federal stimulus package, an extension of federal income tax cuts and unemployment benefits, a reduction in long-term interest rates, and two rounds of so-called "quantitative easing" (the Federal Reserve's purchase of government bonds with newly printed money). The depletion of these traditional go-to monetary and fiscal policy measures has led to what *The Economist* describes as "policy fatigue." With the aforementioned options exhausted and ample political gridlock heading into the 2012 national elections, additional federal economic triage measures appear unlikely.

Rebounding State Revenues, but Still Below Pre-Recession Levels

After the longest and steepest decline on record, states' tax collections increased five consecutive quarters, through the end of the first quarter of 2011. In that quarter, revenues rebounded 9.1 percent in nominal terms compared to the first quarter of 2010, according to an analysis of tax collection data by the Nelson A. Rockefeller Institute of Government. Still, overall state tax collections were 3.1 percent lower than the same period in 2008. The latest biannual fiscal survey conducted by the National Governors Association and National Association of State Budget Officers indicates that overall state general fund (GF) revenues rose 5.9 percent in fiscal year 2011, with fiscal year 2012 state general fund spending expected to increase approximately 2.6 percent.

Despite the improving revenue picture in most states, a return to pre-recession revenue levels may still be another two years out. In the meantime, state policymakers and budget analysts face many challenges as they craft and execute annual or biennial spending plans. Spending pressures include the exhaustion of federal stimulus monies and obligations involving Medicaid, unemployment insurance and public pension programs, many which are severely underfunded. Such pressures have resulted in nine consecutive quarters in which rating downgrades have exceeded upgrades for state and local governments by Moody's Investors Service. A negative outlook has been forecast by the ratings firm for all municipal sectors through the end of 2011. The forecast cites three predominant factors: still insufficient revenue streams, major spending obligations and the loss of federal stimulus monies.

Fiscal Year 2012 Higher Education State Funding: Arrival of the Long-Anticipated "Funding Cliff"

A steep decline in fiscal year 2012 state funding has been anticipated, given lagging state revenues and the loss of federal stimulus monies. In fiscal year 2009 state appropriations for higher education fell by two percent, but an offset by federal fiscal stabilization funds permitted an increase of one percent. State funding fell another three percent in fiscal year 2010, but fiscal stabilization funds tempered that decrease to minus two percent, according to the State Higher Education Executive Officers' latest report on state postsecondary appropriations.

A review of approved budgets for fiscal year 2012 shows historic cuts in state operating support for four-year public universities. Based on data from 49 states compiled by AASCU, 35 states saw declining state appropriations for public four-year universities compared to fiscal year 2011, contrasted with just eight that received increased funds. Six states had flat funding (see table). There was wide variation, with ***North Dakota*** providing the largest increase, at 6.8 percent, and ***New Hampshire***, which witnessed an astonishing 48 percent cut in state appropriations to its public colleges and universities. All told, the collective average change for the states included in the analysis was a negative 6.1 percent. Thirteen states witnessed double-digit decreases. Following New Hampshire with the most severe reductions were ***Arizona*** (-24 percent), ***California*** (-23 percent), ***Washington*** (-23 percent), ***Colorado*** (-21 percent), ***Pennsylvania*** (-18 percent), ***Michigan*** (-15 percent), ***Nevada*** (-15 percent), ***North Carolina*** (-14 percent), ***Oregon*** (-13 percent), ***Ohio*** (-11 percent), ***Wisconsin*** (-11 percent) and ***South Dakota*** (-10 percent).

Approximate Percentage Change in FY 2012 State Operating Support for Four-Year Public Universities

State	Change	State	Change
Alabama	+5.2	Montana	-2
Alaska	+3.1	Nebraska	-.7
Arizona	-24	Nevada	-15.3
Arkansas	-0-	New Hampshire	-48
California	-23	New Jersey	-0-
Colorado	-20.9	New Mexico	N/A
Connecticut	-1.7	New York	-6.5
Delaware	+.3	North Carolina	-14.4
Florida	-1.2	North Dakota	+6.8
Georgia	-9	Ohio	-11.2
Hawaii	+.5	Oklahoma	-5.8
Idaho	-3.5	Oregon	-13.5
Illinois	-1.1	Pennsylvania	-18
Indiana	-1.9	Rhode Island	+2
Iowa	-3.6	South Carolina	-6
Kansas	-2	South Dakota	-10
Kentucky	-1	Tennessee	-1.1
Louisiana	-0-	Texas	-5
Maine	-0-	Utah	-2
Maryland	-.5	Vermont	-3
Massachusetts	-0-	Virginia	-7.2
Michigan	-15	Washington	-23
Minnesota	N/A	West Virginia	+2.8
Mississippi	-1	Wisconsin	-11
Missouri	-7	Wyoming	+1.2

Approximations: Figures are as of July 12, 2011. Data compiled by AASCU.

Smaller Regional State Colleges Face Especially Tough Fiscal Challenges

In its *2011 Outlook for U.S. Higher Education*, the ratings firm Moody's Investors Service cites a number of challenges facing small and mid-sized public colleges and universities, leading to continued negative credit conditions for these institutions. Compared to their larger public university counterparts, they are characterized by a more regional student/consumer draw, less diversified revenue streams, limited financial reserves, weaker pricing power, less insularity against cuts in state funding, and greater susceptibility to enrollment competition from community colleges.

Pressure on state appropriations will be a chief credit challenge faced by the majority of public colleges and universities in the next half decade, according to Moody's, as states struggle with insufficient tax revenues, increases in service demands, and the depletion of accumulated reserves (rainy day funds). To counter the likely continued loss of state operating support, the ratings agency expects smaller public postsecondary institutions to continue the adoption of the common strategies of raising tuition, increasing the enrollment of higher paying out-of-state students, and achieving new spending efficiencies.

Continued Tuition Price Increases in Response to State-to-Student Cost Shift

The upcoming academic year will witness another round of higher-than-average tuition rate increases at public colleges and universities around the country, as these institutions struggle to offset major funding reductions that have taken place in many states. In-state tuition and fee increases will continue their multi-year upward spike, which saw rates at public four-year universities increase an average 6.5 percent in 2009-10 and 7.9 percent in 2010-11, according to College Board data. In most states, published tuition price increases for the 2011-12 academic year will again be double or triple Consumer Price Index (CPI) increases, in percentage terms, with double-digit increases occurring at some institutions located in states that have enacted the most drastic funding cuts. In their effort to maintain college affordability for students from the lowest-income households, most universities are simultaneously boosting their institutional student aid dollars.

State Higher Education Governance Reform Efforts Aimed at Efficiency, Accountability Improvement

In light of the severe fiscal pressures on public higher education, states' 2011 legislative sessions saw considerable activity in efforts to reform state higher education governance. General intent behind the legislation was to improve coordination among and between secondary and postsecondary coordinating boards and agencies, increase institutional and system accountability, and provide greater flexibility and a reduced bureaucratic burden to public universities.

State actions aimed at boosting coordination include ***California*** Governor Jerry Brown's line item veto of continued state funding for the California Postsecondary Education Commission and his corollary call for the state's three public higher education systems to strengthen coordination. In ***Connecticut***, aspects of that state's Department of Education were consolidated into the Board of Regents and Office of Finance and Academic Affairs for Higher Education. In ***New Jersey***, Governor Chris Christie appointed that state's first ever secretary of higher education, a cabinet level position, and dismissed the Commission on Higher Education, whose responsibilities will now lie with the new secretary.

Elsewhere, legislative proposals to improve the coordination and efficiency of public resources through the merger and consolidation of institutions and coordinating bodies were introduced—but subsequently failed to pass. In ***Louisiana***, a measure to consolidate the Southern University at New Orleans (SUNO) and the University of New Orleans (UNO) was rejected. The legislature also debated, but fell short of approving, a measure dissolving the state's five higher education boards and creating a single "super board" to oversee public higher education. In ***North Dakota*** and ***Rhode Island***, measures to consolidate those states' K-12 and higher education coordinating entities failed to pass.

To mitigate the effects of deep state funding cuts, several state legislatures passed measures aimed at expanding institutional flexibility, intended to improve revenue generation (primarily through tuition policy) and to enhance spending efficiencies. The ***Washington*** legislature eliminated the state's higher education coordinating board, effective next year, and is in the process of creating a replacement governance structure that will likely include greater institutional involvement. The legislature also passed a measure giving wider authority to public university governing boards to set tuition. Legislators in ***Oregon*** passed a measure providing greater authority and flexibility for the Oregon University System, such as in tuition-setting, and terminated the system's former status as a state agency. The measure also creates a Higher Education Coordinating Committee, combining the Oregon Students Assistance Commission and Office of Degree Authorization.

The ***Louisiana*** legislature passed a measure that will provide the state's colleges and universities greater discretion over budgetary, procurement and construction matters. After considerable debate, ***Wisconsin*** lawmakers' withdrew a plan to remove the University of Wisconsin-Madison from the University of Wisconsin System to provide the research university with full autonomy. Legislative leaders are now considering options for granting greater flexibility to all UW institutions while preserving the current higher education structure.

Affirmation of the "New Normal" in State Higher Education Financing—and a Diminishing Capacity to Affect the State Policy Agenda through the State Budget

There has been much talk about the "new normal" in higher education state funding, and for good reason. It's not just about a sluggish economy stalling state revenue growth that's in play; it's the fact that lawmakers are having less and less discretion over budgetary matters, crowding out their ability to fund espoused policy priorities. A recent *Stateline* analysis cites a number of major challenges that are whittling away at lawmakers' ability to allocate the dwindling share of state discretionary dollars: huge budget pressures, major spending obligations, interference by the courts, restrictions imposed by voter-approved referendums, and public sentiment that simultaneously demands services, but balks at paying for them through taxation.

States' biggest spending obligations, Medicaid (22 percent share of states' budgets) and K-12 education (21 percent), are largely shaped by outside forces—federal law in the case of Medicaid, and multi-year collectively-bargained pay contracts for secondary education teachers and staff. And costs associated with states' Medicaid obligations are set to rise considerably. Implementation of the new federal health care reform package will forbid states from reducing eligibility or increasing the difficulty for individuals to apply for coverage. To meet the higher coverage threshold, states will need to spend an additional $20 billion annually, according to Congressional Budget Office (CBO) estimates. Other state spending obligations include retiree health care programs, currently some $600 billion underfunded, and public employee pension programs, which past estimates suggest are underfunded to the tune of $1 trillion.

Another source of recessionary-induced fiscal pressure involves state unemployment insurance funds. An analysis by the Council of State Governments (CSG) shows growing state borrowing from the federal government to cover costs associated with providing assistance to the unemployed. Twenty-nine states had borrowed more than $41 billion by mid-June 2011. By the fourth quarter of 2013, as many as 40 states may need to borrow upwards of $90 billion to fund their unemployment programs, according to the U.S. Labor Department. The loans could take more than ten years to pay back, according to the CSG.

A second force that has more recently impinged some spending decisions by states' executive and legislative branches has been an active third branch of government, the judiciary. Recent court decisions affecting at least three states had profound effects on spending commitments for fiscal 2012 budgets. A theme common among the court decisions was consensus opinions that lawmakers were attempting to pare back too far as they struggled with the recession's repercussions. In ***Nevada***, budget crafters were accused of illegally using local revenue to balance the state budget; in ***New Jersey***, officials were accused of inadequately funding poorer K-12 school districts (resulting in a requirement to allocate $500 million more in spending); and in ***California***, a U.S. Supreme Court decision blamed lawmakers for overcrowding the state's prisons in an effort to cut costs in corrections. Additional court decisions may be forthcoming in other states.

A third force that has led to a reduction in lawmakers' budgetary discretion is interference by voters via the ballot box (Exhibit "A" being California), which has led to the passage of measures that dictate how state taxpayer dollars are allocated. A fourth, but far from final, impediment that is hamstringing state budget crafting is a deep chasm in voter sentiment, whereby citizens want and expect the provision of an array of accessible public services, but don't want to pay for them via taxation, thus dampening lawmakers' political appetite to raise taxes and fees, as has been very apparent this budget cycle.

Snapshot of Economic Indicators—July 2011

▲ **Real Gross Domestic Product** (First quarter 2011, Third Estimate) +1.9%

▲ **Consumer Price Index** (last 12 months through May 2011) +3.6%

▲ **Higher Education Price Index** (2010) +.9% (2011 **Preliminary Forecast**) +2.3%

▲ **Employment** (May 2011) +18,000

▲ **Unemployment Rate** (June 2011) +.1% to 9.2%

▲ **Disposable Personal Income** (May 2011) +.3%

▲ **Housing Starts** (May 2011) +3.5% (last 12 months) -3.4%

▼ **Housing Sales** (May 2011) -2.1%

▼ **Case-Schiller Composite Index** (Housing Prices) -4% (20 City Composite, since April 2010)

▲ **Industrial Production/Capacity Utilization** (last 12 months through May 2011) +3.4%

▲ **Retail Sales** (last 12 months through May 2011) +7.7%

▼ **Consumer Confidence** (June 2011) -3.2 points (58.5 on 100 point base)

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, U.S. Census Bureau, U.S. Federal Reserve, The Conference Board.

AASCU State Relations and Policy Analysis Team

Daniel J. Hurley
Director

Lesley McBain
Senior Research and Policy Analyst

Tom Harnisch
Policy Analyst

Alene Russell
Senior State Policy Consultant

www.aascu.org/policy
202.293.7070