



**POLICY
MATTERS**

State Fiscal Conditions and Higher Education Funding: Improvement Now, Trouble Ahead

Summary

Following two years of slumping tax revenues, mid-year spending cuts, and crisis mentality budgeting, states are beginning to catch their collective fiscal breath. Recent economic expansion is helping to stabilize, if not improve, states' finances. The rebound from deficit to surplus in a number of states is giving advocates for public higher education cause for optimism that the worst of this downturn has passed, and that better days lie ahead. Indeed, several key fiscal indicators, as well as preliminary state higher education appropriations data for Fiscal Year 2005 (FY05), appear to underscore the case for at least some degree of recovery.

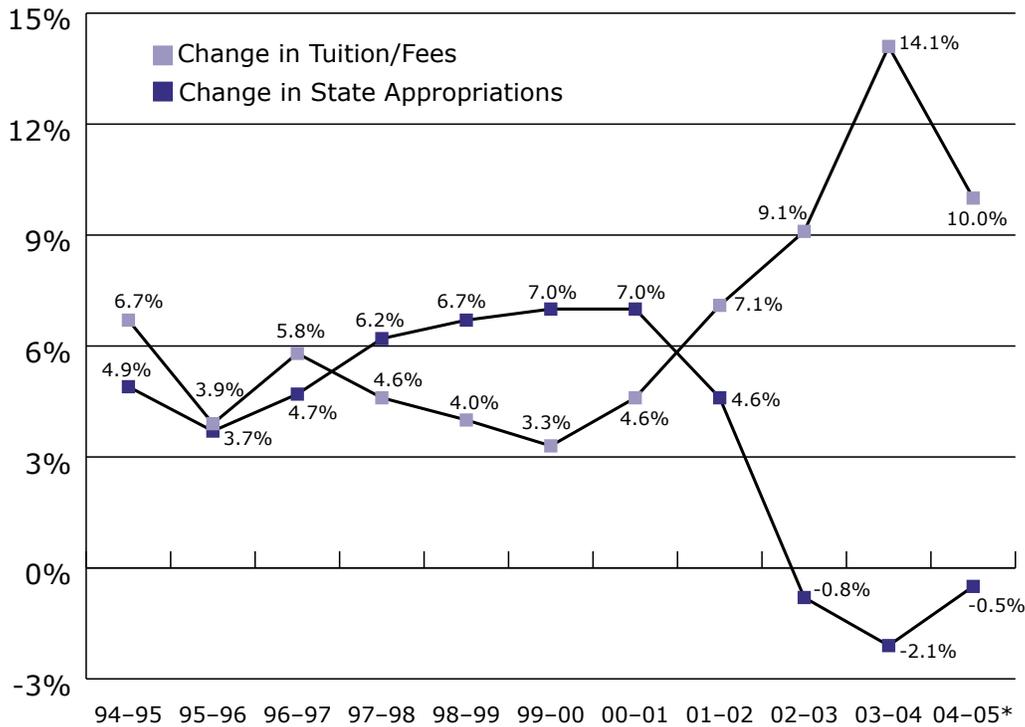
The positive near-term trends, while welcome news amid rising enrollments and mounting infrastructure needs at state colleges and universities, belie nagging issues of structural imbalances in states' taxing and spending systems. Several recent analyses point to a future of very real funding constraints absent significant revenue and fiscal policy change. Such a scenario leaves public higher education, as the largest single discretionary item in states' budgets, especially vulnerable.

Observations

An improving economy is contributing to stronger state finances. Despite recent indications of softness in the recovery, economic activity and consumer confidence have improved over the past two years, adding to states' bottom lines. Newly released data from the Rockefeller Institute of Government reveal that state tax revenues posted a year-over-year increase of 6.7 percent for the 2nd Quarter of 2004 (net of inflation and legislated tax changes), marking three consecutive quarters of year-over-year growth and the largest single-quarter jump in four years. Additionally, new data from the National Conference of State Legislatures (NCSL) indicate that year-end budget balances increased \$6 billion (50 percent) from FY03 to FY04.* Moreover, the National Association of State Budget Officers (NASBO) reports that mid-year budget reductions fell from 37 states cutting \$14.5 billion in FY03 to 18 states cutting \$4.8 billion in FY04. Amid the positive news, however, analysts warn that continuing spending pressures from Medicaid, as well as the end of one-time federal aid, will exert pressure on FY05 budgets.

*Based on data from 44 states.

Change in Resident Undergraduate Student Charges and State Appropriations at Four-Year Public Colleges and Universities



*AASCU Projection
Sources: The College Board and Grapevine (Illinois State University)

The healthier state fiscal situation is showing up in stable/increased funding for public higher education. After two consecutive years of cuts totaling \$2.5 billion (4 percent), state higher education appropriations are likely to hold steady or even improve for FY05 (i.e. -1 percent to +1 percent), according to a recent estimate by the State Higher Education Executive Officers (SHEEO). Accordingly, AASCU expects moderation in the rate of increase in resident undergraduate tuition rates for 2004-2005, keeping with historical recession/recovery patterns. Average resident undergraduate tuition at state colleges and universities nationwide is expected to increase somewhere in the range of 10 percent (\$475), compared with 14.1 percent (\$583) last year.

Near-term improvement in the economic/fiscal situation is clouded by a fundamental imbalance between revenues and spending demands in the states. Most state tax structures simply do not reflect the activity of an information- and service-

intensive economy (e.g. failure of most state sales taxes to include a broad array of services in its base), which means that the tax base of these states will shrink over time. That, combined with the rising education and health care demands of a society that is simultaneously aging and forced to compete globally, results in structural deficits in state budgets. A recent analysis by the Rockefeller Institute revealed that 39 states currently have structural deficits, including some of the largest and fastest-growing. In such an environment, higher education, whose share of the state general fund budget has fallen over the past decade, is in a particularly precarious position. The current political climate makes such change very difficult, as illustrated by the mixed results from recent tax reform efforts in Alabama and Virginia.

The role of the federal government in easing—or exacerbating—this imbalance cannot be overlooked. One example of this impact is regulation of interstate commerce, as efforts

by states to tax remote sales (including on-line sales) will require congressional authorization. Another comes in the form of Medicaid, where changes in the federal/state match requirements could compel more state spending in an area of already explosive growth in state budgets. Still another surfaces in the area of education, where compliance with the mandates of the No Child Left Behind Act are expected to cost the states millions over the next several years.

Resources

National Association of State Budget Officers (NASBO)—NASBO regularly tracks state budget conditions, primarily through its semi-annual *Fiscal Survey of the States* (published in April and December) and annual *State Expenditure Report* (published in June). nasbo.org

National Conference of State Legislatures (NCSL)—Like NASBO, NCSL conducts regular surveys of the state fiscal landscape, and publishes findings through annual publications such as *State Budget* and *Tax Actions*, as well as special reports (all available for purchase by non-members). ncsl.org

Rockefeller Institute of Government—Housed at the State University of New York–Albany, the institute tracks state revenue collections on a quarterly basis (*State Revenue Report*) and issues other reports on topics related to state finance. rockinst.org

Grapevine—This 50-state higher education funding survey is administered through the College of Education at Illinois State University, and contains data on tax appropriations for higher education, as well as data on state higher education funding effort and capacity. coe.ilstu.edu/grapevine/

State Higher Education Executive Officers (SHEEO)—SHEEO now publishes *State Higher Education Finance*, an annual look at state higher education spending on a per-student basis. SHEEO also compiles 50-state data on tuition/fee policies and other finance-related areas. sheeo.org