



Dynamics Affecting Public Higher Education Financing

Daniel J. Hurley, Director, AASCU State Relations & Policy Analysis

In the short-term, a downgraded U.S. growth forecast

The U.S. economy grew just 0.8 percent during the first six months of 2011, expanding at the slowest pace since the end of the Great Recession. The International Monetary Fund (IMF), the 187-nation global financial institution, has sharply downgraded its expectations for the U.S. through the end of 2012. U.S. economic growth is now forecast at 1.5 percent for 2011 and 1.8 percent in 2012 (see chart). In its revised assessment, the IMF urged U.S. officials to not further harm the nation's economic recovery by cutting public spending too aggressively in its effort to lower deficit levels. Further out, the Congressional Budget Office (CBO) in August forecasted U.S. economic growth to average 3.6 percent annually from 2013 through 2016. A large number of factors are buffeting the U.S. economy: persistently high unemployment, financial markets spooked by the European debt crisis, a continued weak housing market and deteriorating consumer and business confidence.

	<u>June IMF Growth Forecast</u>		<u>September IMF Growth Forecast</u>	
	2011	2012	2011	2012
U.S.	2.5%	2.7%	1.5%	1.8%
E.U.	2.0%	1.7%	1.6%	1.1%
China	9.6%	9.5%	9.5%	9.0%
Global	4.3%	4.5%	4.0%	4.0%

Source: IMF World Economic Outlook, September 2011

A long slog back to full employment

The U.S. economy added 57,000 new jobs in August and another 103,000 in September—positive numbers—but far below what is needed to reduce the unemployment rate. Approximately 125,000 new jobs per month are needed just to keep the unemployment rate level. Reducing the rate one percent over the course of a year would require the creation of an additional 200,000 jobs per month. The CBO projects the unemployment rate to dissipate slowly—from the current 9.1 percent to 8.5 percent in the fourth quarter of 2012—but to remain above 8 percent until 2014. Reductions in the public sector workforce and weak private sector hiring are contributing to the employment malaise. From February 2010 to August 2011 the private-sector added 2.4 million jobs, but this growth was partially offset by the loss of 462,000 public-sector jobs at the state and local level during the same time period. Long term unemployment remains near record levels, with 43 percent having been without work for more than six months.

Strong rebound in state revenues, but still short of pre-recession levels

After the longest and steepest decline on record—five consecutive quarters—states' tax collections have increased for six consecutive quarters through the end of the second quarter of 2011. In that quarter, revenues rebounded 11.4 percent in nominal terms compared to the first quarter of 2010, according to an analysis of preliminary tax collection data by the Nelson A. Rockefeller Institute of Government. This is the strongest year-over-year growth since the second quarter of 2005. Still, overall state tax collections were 7.8 percent lower than the same period in 2008. All states witnessed growth in personal income tax during the second quarter of 2011. All but four reported gains in sales tax revenues. Only *New Hampshire* reported a decline in overall tax collections for the quarter, and for the 2011 fiscal year. Preliminary figures indicate an 8.4 percent increase in state tax revenues nationally for fiscal year 2011.

One unexpected and promising development that may signal the prospect of a future boost in state revenues involves the collection of sales taxes by online retailers. For years, states and giant retailers such as Amazon.com have disputed whether corporations should be held accountable for collecting them. According to one University of Tennessee study, in 2012 alone, states and localities may lose \$11.4 billion by failing to collect sales taxes from online retailers. In a surprise move, Amazon, the nation's largest online retailer, struck a deal with *California* in September that will require it and other online retailers to begin collecting sales taxes in that state beginning in fiscal year 2013. In early October, Amazon agreed to begin collecting sales taxes from *Tennessee* residents in 2014, *Stateline* reports. Undoubtedly, other states will pursue similar agreements. In the meantime, Congress will feel added pressure to create a national policy governing the collection of sales taxes by online merchants—federal legislation for which the National Conference of State Legislatures has long been advocating, known as the Main Street Fairness Act.

State budget pressures persist, with shortfalls on the horizon in several states

Despite increases in tax revenues, states continue to contend with acute budget pressures, among them: Medicaid obligations, rising public employee health care costs and shoring up underfunded state pension programs. Another immediate pressure is the paying back by states of interest payments to the federal government for loans made to help states provide unemployment checks to workers who have lost their jobs. The first interest payment, totaling \$1.3 billion and owed by 28 states collectively, was due Sept. 30. In total, states owe nearly \$37 billion to the federal government in unemployment insurance loans. Of that amount, *California* owes \$8.5 billion and *Michigan, New York, Pennsylvania, Ohio* and *North Carolina* each owe more than \$2 billion. Despite having closed budget gaps of more than \$510 billion in recent years, states continue to deal with budget imbalances. The nation's five most populous states are facing budget deficits—*California* and *Illinois* for the current fiscal year, and *Florida, Texas* and *New York* in the coming two years, according to *Stateline* reporting.

State higher education funding: gradual disinvestment followed by a precipitous drop

After a nearly three percent collective reduction in state funding for higher education during the past two fiscal years, additional cuts have been implemented in many states for fiscal year 2012; cuts exacerbated by the exhaustion of federal stimulus funds. Thirty-six states recorded declining state appropriations for public four-year universities compared to fiscal year 2011, contrasted with just eight that received increased funds, based on data from all 50 states compiled by AASCU. Six states had flat funding. All told, the collective average change for the states included in the analysis was a negative 6.4 percent, with 15 states witnessing double-digit decreases.

State Operating Support for Higher Education—Fiscal Year 2012
Decreased funding: 36 states
Increased funding: 8 states
Flat funding: 6
Average Percent Change: -6.4%
Largest cut: New Hampshire (- 48%)
Largest increase: North Dakota (+6.8%)

Source: AASCU informal survey, July 2011

Regardless of Congressional action, states will be impacted by coming changes in federal spending

Legislative and policy considerations currently before Congress aimed at economic growth and deficit reduction could have far-sweeping implications for states' budgets. President Obama's proposed \$447 billion American Jobs Act includes more than \$100 billion in aid to states for transportation projects and school and community college modernization, and to preserve public sector jobs, such as those for teachers, police officers and firefighters. Having failed its first test on Oct. 11 in the Democratic-controlled U.S. Senate, the package will now be dismantled and considered in smaller individual parts. Included in the president's original proposal is a "maintenance of effort" provision, stipulating that if states accept education funding to preserve teacher jobs, funding for elementary, secondary and higher education must be maintained for fiscal years 2012 and 2013, at minimally fiscal year 2011 levels; a provision which AASCU supports.

Meanwhile, recommendations from the 12-member congressional Joint Select Committee on Deficit Reduction ("Super Committee") are due November 23. The Super Committee's proposals will include major spending cuts and

could include tax policy reforms. Regardless of whether the Super Committee's recommendations are approved by the full Congress or, failing to do so, automatic spending cut triggers take effect, states will be impacted by federal spending cuts. The federal debt deal reached in August specifically exempts Medicaid, the Children's Health Insurance Program, welfare and food stamps from the \$1.2 trillion in automatic cuts that will be triggered if the committee fails to reach agreement. If the Super Committee's recommendations are not adopted, thus triggering federal spending reductions, funding for education and military installations are among the areas that could impact states' budgets the hardest.

Current economic conditions spurring state higher education governance reforms

Strained state budgets and the resulting disinvestment by states in their public postsecondary systems have fueled lawmakers' efforts to instigate reforms in higher education governance. Objectives common to measures enacted in many states this legislative session include improving coordination among and between secondary and postsecondary coordinating boards and agencies, increasing institutional and system accountability, and providing greater flexibility and a reduced bureaucratic burden to public universities. ***Louisiana, New York, Oregon, South Carolina, Washington*** and ***Wisconsin*** are among states whose legislatures passed measures providing public universities with greater control over fiscal matters, such as those involving tuition setting authority, procurement, personnel policy, and rules regarding campus construction.

2011 witnessed renewed interest by states in higher education performance-based funding systems, aimed at maximizing the efficient use of taxpayer dollars while boosting student success, improving institutional performance and meeting state workforce and economic goals. Performance-based funding and incentives were enacted or considered this legislative cycle in ***Arizona, Arkansas, Colorado, Illinois, Massachusetts, Mississippi, Missouri, Texas, Utah*** and ***Virginia***. A full accounting of state higher education policy reforms is provided in the September 2011 [*State Governance Action Report*](#), released by the Association of Governing Boards of Universities and Colleges.