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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In this issue:

Overview of Economic and Fiscal Dynamics

1. ***Tepid U.S. Growth for 2011***: Domestic output is projected to grow modestly in 2011, but at a rate far below historical levels, and at about half the pace of anticipated global growth. Discordant global monetary policy and huge trade imbalances heighten the need for short-term macroeconomic policy reform, while demographic trends in the West will add to long-term economic challenges.

2. ***The Great Recession's Corrosive Effects***: While the recession "technically" ended in June 2009, the extent of its human toll are borne out in a variety of indicators that collectively paint a portrait of persistent economic distress for many American families—and correlating skyrocketing public spending for safety net programs.

3. ***A Turnaround in State Revenues, but a Long Climb Back***: Most states have witnessed a rebound in revenues, with growth forecasted for this year, but income streams are still well below pre-recession levels.

4. ***State Budget Planning in a Pressure Cooker***: Burgeoning Medicaid rolls, huge spending demands for unemployment insurance benefits and severely underfunded public pension programs—not to mention keeping up with the current provision of state-provided services—has placed state budget planners in an unusually tough bind. Add to this a wave of incoming governors who ran on "no new taxes" pledges in many states that are anticipating huge budget shortfalls, budget crafting will be done with plenty of tension and urgency.

5. ***No Relief in the Fight Against the Cost-Shift in Who Pays for College***: Given that most federal stimulus monies have been exhausted, long-term state revenue forecasts are lean, and lawmakers have little appetite for increasing taxes, significant increases in state funding for public higher education are unlikely. When these factors are combined with increasing cost and enrollment pressures, preventing a continued shift in who pays for college—from states to students and families—will remain a persistent challenge.

6. ***Moving Forward in the National Interest***: Despite myriad economic, funding and fiscal constraints, America's state colleges and universities will continue to navigate these challenges. Driven by innovation and the incessant call to fulfill the vital public-purpose missions of these institutions, college leaders will continue focusing on increasing efficiency and productivity while striving to maintain academic quality in order to meet ambitious—and necessary—national college completion and educational attainment goals.

Global and Domestic Growth Prospects

A Lackluster Recovery and Slightly Dimmer Long-Term Prospects for the West

The trajectory of the U.S. economic recovery has vacillated, as largely predicted by economists. The pace of recovery slowed in 2010, but there remains little fear of a double-dip recession. After growing at a fast clip throughout 2009, U.S. GDP—the nation's total output of goods and services—stumbled in the first half of this year, but witnessed a modest uptick in the July–September quarter. The 2% annual growth rate for the quarter was still down from the historic average of 3.3%.

As 2010 draws to a close, it is estimated that global economic expansion for the year will be 4.8%, with U.S. growth at a stunted 2.7%, according to International Monetary Fund (IMF) projections. For 2011, the IMF projects a global economic expansion of 4.2%, with the U.S. growth at about half that, 2.2%.[1] The figures bear out the consensus among many economists that the next few years will be marked with sustained, but modest growth domestically.

The cooled-down U.S. and European Union economies (Germany's aside) have quickened the shift in economic clout from Western economies to emerging ones. While many older, rich economies are embarking on deficit spending (U.S.), and austerity programs (notably in the U.K., where massive cuts in higher education funding are set to take place), many emerging economies are booming, with annual output rising at near double-digit paces. Meanwhile, the world's rich economies are planning tax increases and spending cuts equal to 1.25 percent of their collective GDP in 2011, the largest synchronized fiscal tightening on record.[2]

Considerable focus is being given to recalibrating macroeconomic policy among the G-20 economies in the hope of spurring structural reform to address huge trade imbalances and deficient monetary policy. Microeconomic (national) economic policy reforms notwithstanding, the world's wealthier economies face long-term challenges. Demographics are not on their side. The annual growth rate of the G-7 group of wealthy economies between 1998 and 2008 was 2.1%. According to one study, based on current demographic trends and assuming productivity improves at the same rate as in the past decade, that growth rate will slow by about one quarter over the next ten years—the slowest pace since World War II.[3]

Snapshot of Economic Indicators – November 2010

- ▲ Real Gross Domestic Product (Third Quarter 2010): +2%
- ▲ Consumer Price Index (last 12 months through Sep. 2010): +1.1%
- ▲ Employment: (October 2010) +151,000
- — Unemployment Rate: (October 2010) unchanged (9.6%)
- ▼ Disposable Personal Income (September 2010): -.2%
- ▲ Housing Starts: (September 2010): +0.3%
- ▲ Housing Sales: (September 2010): +6.6%
- ▼ Industrial Production/Capacity Utilization: (September 2010) -.2%
- ▲ Retail Sales: (August 2010) +.6%
- ▼ Consumer Confidence: (October 2010) +1.6 pts. (50.2 on 100 pt base)

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

Labor Market Conditions and Post-Recession Economic Impacts

Modest Job Growth, but Far Short of What is Needed to Return to Pre-Recession Levels

The U.S. labor market continues a modest recovery in the wake of the deep economic recession. The unemployment rate has essentially remained unchanged since May. According to economists Michael Greenstone and Adam Looney of the Hamilton Project at the Brookings Institution, roughly half of the unemployed have been without a job for over four months, a quarter have been out of work for more than a year and 10 percent have been jobless for at least two years.[4]

Greenstone and Looney have also noted the daunting "jobs gap" that exists in the labor market, a calculation of the number of new jobs required to return to pre-recession employment levels, including the assimilation of new workers into the labor market. The researchers project the job gap shrank in October—from 11.9 to 11.8 million.

They write:

> "If the economy adds about 208,000 jobs per month, the average monthly rate for the best year of job creation in the 2000s, then it will take 142 months, or about 12 years to close the jobs gap. At a more optimistic rate of 321,000 jobs per month, the average monthly rate for the best year of the 1990s, the economy will reach pre-recession employment levels in 60 month, or about 5 years."

Latest National Unemployment Statistics

- The Bureau of Labor Statistics (BLS) reported that the U.S. unemployment rate stood at 9.6% in October, with 14.8 million individuals unemployed. This is essentially unchanged since May. The number of long-term unemployed (those jobless for 27 weeks or more) stands at 6.2 million, or 42% of those unemployed.
- BLS also reported that 151,000 jobs were added in October. Since December 2009, nonfarm payrolls have increased 874,000.[5]
- As of September, the U.S. still had 7.8 million fewer jobs than at the start of the recession in December 2007.[6]
- Underemployment—the proportion of individuals working part-time, but who prefer full time work, fell in September. The rate, which also includes unemployed and discouraged workers, fell by .1% to 17 percent.[7]
- State and local public-sector employment has been reduced by 258,000 (or 1.3%) in the past year, mostly by not filling vacancies. The federal government workforce grew 3.4% during the same period.[8]
- As of September 2010, Nevada had the highest unemployment rate at 14.4 percent. North Dakota's 3.7% unemployment rate was the lowest.[9]

The Great Recession—Taking a Lasting and Pervasive Economic and Societal Toll

For good reason, much attention is given to the unemployment metric as a measure of economic conditions and the toll taken by the recent recession. However, the recession's potency is reflected in many other measures:

- **Declining incomes**: Median inflation-adjusted household income fell 3.6% in 2008 and by another .7% in 2009. It stood at $49,777 in 2009, its lowest level in inflation-adjusted dollars since 1997.[10]
- **Increasing Medicaid enrollments**: Medicaid rolls have increased at least 17% since the recession began in December 2007, and the federal price tag for the program has jumped 36% in two years.[11]
- **Jump in welfare rolls and spending**: More than 4.4 million people are on welfare, an 18% increase during the recession. Program costs have risen 24% to $22 billion.[12]
- **More people on food stamps**: More than 40 million people receive food stamps, an increase of nearly 50% during the economic downturn. Program costs have risen 80% to $70 billion.[13]
- **More foreclosures and homes "underwater"**: October marked the 20th consecutive month in which over 300,000 U.S. homeowners received a foreclosure notice.[14] At the end of the third quarter of 2010, 23.2% of U.S. mortgage holders were underwater, owing more money than their homes are worth, up from 21.7% a year ago. Roughly 13.9 million homes now have negative equity.[15]
- **Skyrocketing spending on jobless benefits**: Close to 10 million individuals are receiving unemployment insurance, a near four-fold increase from 2007. Jobless benefits have jumped from $43 million to $160 billion.[16]
- **Increasing poverty rates**: The national poverty rate stood at 14.3% in 2009, its highest level since 1994.[17]
- **Declining employer-provided health care**: Employer-provided health insurance benefits have dropped from 64.2% in 2000 to 55.8% in 2008, marking the lowest share since the Census started recording the data in 1987.[18]

- **Declining mobility**: Census data show a number of other recessionary impacts, such as near-historic declines in U.S. mobility, lower birth rates and delayed marriages.[19]
- **Growing income inequality**: The top earning 20% of Americans—those making more than $100,000 annually—received 49.4% of all income generated in the U.S. in 2009, compared with 3.4% earned by those below the poverty line.[20] The gap in U.S. income gap is the greatest among Western industrialized nations, nearly doubling in a generation, and is now at its highest level since the Census Bureau began tracking household income in 1967.[21]

Employment–Education Interconnect
The economic recession has reinforced the importance of obtaining a postsecondary education.

Seasonally adjusted unemployment rate	**October 2009**	**October 2010**
Less than a high school diploma	15.5	15.3
High school graduates	11.2	10.1
NATIONAL AVERAGE	10.1	9.6
Some college or associate's degree	9.0	8.5
Bachelor's degree or higher	4.7	4.7

Source: U.S. Bureau of Labor Statistics, November 2010

The recession has widened the employment divide between college-educated and non-college-educated workers. The unemployment rate for workers 25 and older with a bachelor's degree or higher was 4.7% in October 2010, compared with 10.1% for those with a high-school diploma. The 5.4 percentage point gap is more than twice as large as the 2.6 percentage point gap that existed in December 2007.[22]

A report from the Georgetown University Center on Education and the Workforce predicts that by 2018, 63 percent of all jobs will require at least some postsecondary education. According to the report, employers will need 22 million new workers with postsecondary degrees. However, under the current trajectory, the nation will fall short by three million workers—a deficit of 300,000 college graduates annually between now and 2018.[23]

State Revenue Trends and Forecast

At Long Last, a Rebound in Revenues
The second quarter of 2010 marked the second consecutive period of overall gains in states' tax collections—following five straight quarters of decline, according to a state revenue report released in October by the Nelson A. Rockefeller Institute of Government at the University of Albany.[24] In that quarter, overall state tax revenues grew by 2.3%. Thirty-four states reported gains, 12 of which reported double-digit growth.

A Sunnier Revenue Forecast
Continued improvement in states' income streams is evidenced by a recent study of anticipated state revenues, coordinated by the National Conference of State Legislatures (NCSL) and based on a survey of legislative fiscal directors. The report found that revenue growth is expected in 40 states this fiscal year, with only ***Alaska*** expecting reduced income, a result of volatility in oil prices that generate the balance of the state's income. ***Oregon*** and ***Washington***—states that have witnessed major revenue declines in the past two years—are expecting the largest current year increase in revenues, at 12% and 14%, respectively. ***Colorado*** is expecting the third-largest growth nationally, at nearly 11%. Six states (***Alabama***, ***Michigan***, ***Nevada***, ***Rhode Island***, ***South Carolina*** and ***Wyoming***) are projecting flat revenues for the current fiscal year.[25]

But revenues still far short of pre-recession levels
The good fiscal news needs to be put in context, however. State tax collections had fallen so precipitously since the start of the recession in December 2007 that even sharp upticks may not bring many states' revenues up to pre-recession levels for several quarters, if not years, to come. For the year ending June 2010, the period corresponding with most states' fiscal years, total state tax collections declined by $19 billion or 2.7% from the previous year, and were down $84 billion or 10.8% compared to fiscal year 2008, according to the Rockefeller Institute state revenue report.

State Budget Pressures

Pension Programs
One of the biggest pressures on states' budgets stems from public pension programs for current employees and retirees. A recent study estimates states' pension shortfall at $3.4 trillion. States have total pension liabilities of $5.3 trillion, compared with only $1.9 trillion in pension fund assets. The report, produced by Joshua Rauh at Northwestern University, calculates that seven states will have exhausted their pension assets by 2020, even when factoring in a remarkably optimistic—yet common—assumption of an 8% annual return in pension fund growth. Further, Rauh estimates that half of the states will deplete their pension assets by 2027.[26] Massive shortfalls in future pension program obligations are not limited to state programs. In his analysis of 50 major city and county pension fund programs that collectively account for two-thirds of the nation's three million local government employees, Rauh has estimated a total unfunded liability of $574 billion.

A number of states have passed legislation in the past two years to limit cost-of-living increases previously promised to current and future retirees, whose courts have historically protected attempted benefit reductions. Still, additional major reform is needed. Trimming benefits, raising retirement ages, using more plausible pension fund growth rate projections and switching from defined benefit to defined contribution programs are among the solutions to cutting costs. Four newly elected governors—those in ***Alabama***, ***Nevada***, ***Tennessee*** and ***Wisconsin***—have indicated support in changing their state's retirement programs for public sector workers to a 401(k)-style defined contribution program. Incoming governors in ***Pennsylvania*** and ***Rhode Island*** are considering a hybrid between the two types of programs. So far, only ***Alaska*** and ***Michigan*** have adopted 401(k)-type public pension systems as their primary plan for state workers.[27]

In addition to affecting states and local governments, the pension-funding problem is also touching public university systems. The University of California has a nearly $13 billion unfunded liability on its pension program. UC President Mark Yudof has released recommendations for major reforms to the system's plan, including raising the minimum retirement age for future employees and reducing retiree health care benefits for existing employees.

Medicaid
A record 3.7 million additional Americans signed up for Medicaid last year, a spike of 8.8%, much higher than had been anticipated by state officials, according to a 50-state survey by the Kaiser Commission on Medicaid and the Uninsured. Much of the additional Medicaid spending was provided by the Federal government, which included $87 billion in the 2009 stimulus package for additional Medicaid enrollments, followed this year by an additional $16 billion that extends until next July. One of the conditions of states' acceptance of the additional federal Medicaid funds is that they could not reduce eligibility for the program. States—of which 48 of 50 actually cut spending on their portion of the Medicaid program commitment—did so by limiting benefits to patients and reducing rates to medical providers.[28] The pervasive impact of the recent recession on family income ensures that financing Medicaid will remain a key pressure point on states' budgets.

Unemployment Assistance
Persistently high unemployment has continued placing budget pressure on states' unemployment insurance funds. ***California***, with 2.5 million jobless workers, is paying out more than $11 billion annually in benefits while only collecting $4.5 billion in employer payroll taxes. Projections are for the gap in the state's unemployment insurance fund to rise to $20 billion by the end of 2011. By the start of 2010, 25 states had run out of unemployment money and had borrowed $24 billion from the federal government to cover the gaps. State unemployment compensation funds are separate from general budgets, so when shortfalls exist, only two primary solutions are considered—reducing the benefit or raising the payroll tax. Debates over the state benefit programs are taking place in several states.

Political Pressures to Keep Spending in Check

In November's election, the electorate sent a message by electing many fiscally conservative candidates who ran on platforms of reducing spending, deficits and debt. Despite cutting tens of billions in state spending in the past two years, states still face a $72 billion shortfall for the coming fiscal year, and yet the incoming class of state lawmakers will likely be loath to raise taxes as a method of addressing budget gaps.

A *Stateline* analysis of the governors' races found that at least 12 of the nation's new governors have ruled out tax hikes even as they face billions in collective deficits. They include the incoming governors of ***Florida***, ***Nevada***, ***New York***, ***Ohio*** and ***Pennsylvania***—all states anticipating multi-billion budget gaps in the year ahead. Starting in January 2011, a full 40 percent of the U.S. population will be represented by governors who have vowed not to raise taxes, according to the *Stateline* analysis.[29] ***California's*** incoming governor, Jerry Brown, while not pledging to refrain from calling for tax hikes, faces a $25 billion budget shortfall, at the same time state tax rates are slated to fall in 20l1.

For a more detailed analysis of the 2010 elections and possible implications for higher education, see AASCU's policy brief, *Higher Education and the 2010 Elections*.

State Support for Higher Education

Reductions in State Support for Higher Education

The recession's impact on public postsecondary funding is evident based on data from the State Higher Education Executive Officers' *State Higher Education Finance* report.

- In fiscal year 2009 state appropriations for higher education fell by 2%, but federal fiscal stabilization funds permitted an increase of 1%.
- State funding fell another 3% in fiscal year 2010, but fiscal stabilization funds tempered that decrease to –2%.
- In fiscal year 2010, 5% of all support for higher education came from the fiscal stabilization fund. Within the states, that percentage ranges from zero to 18%. Fiscal year 2009 funding comprised 10% or more of stabilization funds in three states. For fiscal year 2010, funding comprised 10% or more of stabilization funds in nine states.[30]

Economic Stimulus Funding Cliff

According to an AASCU analysis of states' use of the State Fiscal Stabilization Fund (SFSF) from the American Recovery and Reinvestment Act (ARRA), an estimated $33.8 billion, or over 85%, of state stimulus aid was exhausted in fiscal years 2009 and 2010. The remaining balance of $5.7 billion will be exhausted this fiscal year.[31]

ARRA Maintenance of Effort Provision Crucial to Higher Education in Some States

The Maintenance of Effort (MOE) provision contained in the American Recovery and Reinvestment Act (ARRA) proved valuable to preventing large-scale reductions in state appropriations for higher education according to an AASCU analysis. Nine states allocated fiscal 2010 funding for higher education to less than 1% of the minimum funding threshold established in the provision.[32] Under MOE, state lawmakers cannot receive federal stimulus funds designated for education if they reduce state appropriations below fiscal year 2006 levels. States are, however, allowed to apply for MOE waivers in the face of severe circumstances.

State Student Aid Programs

Although a politically unpopular move, some states are scaling back their student aid and scholarship programs to save money. States that have either made changes or threatened to make changes in funding allocations or eligibility for grant and scholarship programs include ***Arizona***, ***Georgia***, ***Florida***, ***New Jersey***, ***Texas***, and ***Washington***.

Fiscal Conditions and Higher Education Institutions

Campus Budgets

Given that institutions and systems in 39 states surveyed by the Association of Governing Boards (AGB) reported reduced state allocations from fiscal year 2009,[33] it is unsurprising that state colleges and universities are continuing to impose hiring freezes/restrictions, salary freezes and travel freezes/restrictions. Early retirement incentives are also being offered to save money. The sustained impact of the recession—and resulting cuts in state higher education funding—has forced institutions and systems to further reduce academic programs, course offerings, academic support services, and student services. The announcement by SUNY Albany that it was ending admissions to its French, Italian and Russian language programs and closing its theater department is one prominent example of such cuts.[34]

Tuition Prices

According to the College Board's *Trends in College Pricing 2010* report, published in-state tuition and fee charges at public four-year institutions averaged $7,605 for 2010-11, 7.9% ($555) higher than in 2009-10. By comparison, published tuition and fee charges at private nonprofit four-year institutions averaged $27,293 in 2010-11, 4.5% ($1,164) higher than in 2009-10.

Some state systems and institutions have already approved or are considering mid-year tuition/fee increases:

- California State University recently approved a mid-year 5% tuition increase ($105) effective January 1, 2011 and a 10% tuition increase ($444) for the 2011-12 academic year effective Fall 2011. As a result, Cal State tuition prices will be 60% higher than two years ago.
- In the 2010 legislative session, the Florida legislature approved Florida state universities' charging new fees to students and/or increasing existing fees; implementation was delayed to allow the Florida Board of Governors to develop policies regarding the fees. Institutions that wish to increase fees or charge new fees will present proposals to the Board in February 2011. The Board has also approved universities' ability to charge "block tuition" (i.e., a flat rate for a range of credits, such as 12-18 credits) rather than charging per credit hour.

Endowments

Based on preliminary data from the annual endowment study conducted by the National Association of College and University Business Officers (NACUBO), colleges' endowment investment returns averaged 12.6% for the 2010 fiscal year.[35] Endowments on average lost 18.7% on investments for the 2009 fiscal year, so the gain should be viewed in light of the previous year's negative returns.

Private Fundraising

Private contributions to colleges and universities fell by 11.9% in 2009, according to the Council for Aid to Education—the worst single-year drop since the Great Depression.[36] However, the latest Council for Advancement and Support of Education (CASE) Fundraising Index (as of July 2010) still predicts a 5.7% increase in giving to education for the 2010–11 academic year.

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

Resources

Associated Press Economic Stress Index: An interactive index providing a visual presentation of major economic indicators down to the county level.

Federal Reserve Bank of New York – Economic Indicators

Pew Center on the States works to advance state policies that serve the public interest.

Moody's Economy.com, a division of Moody's Analytics, is a leading independent provider of economic analysis, data, and forecasting and credit risk services.

Stateline.org is a nonprofit, nonpartisan online news site that practices journalism in the public interest by reporting on emerging trends and issues in state policy and politics.

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