Higher Education Enters a New Era

By William Zumeta

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As the nation looked forward to four more years under President Barack Obama's leadership, public higher education was on the verge of major change. Enrollments climbed during five years of deep economic doldrums, but the sector suffered losses in state financial support not seen since the 1930s. Significant federal government help to the states buffered some budget cuts early in the crisis, but that support was gone by fiscal year (FY) 2013.[1] Huge federal fiscal imbalances made it unlikely that substantial further help for higher education would come from that source. The states—in only modestly better shape and inclined to budget conservatively—eschewed major tax increases. Both governmental levels sagged fiscally in a slow economy, weighed down by an aging population needing more health care services and retirement income.[2]

For fiscal and philosophical reasons, state policymakers allowed public colleges and universities to replace some tax revenues with sharply higher tuition and fees. This shift from taxes to student and family payments goes back several decades, with the sharpest movements occurring after recessions. The present downturn is no exception, but its length and depth produced a louder outcry. We may have reached the limits of large annual tuition increases as taxpayers face continued high unemployment rates, flat wages if employed, and mounting debt.

Even as public higher education faced tightened constraints on its two main financing sources, pressures grew to do more with less. Enrollments grew strongly during the 2008-12 half decade, typical during slack labor markets. In addition, state policymakers called upon colleges and universities to improve retention and graduation rates. Some states no longer linked the crucial funding they still provide to enrollments. Instead, they used their funding to "buy" course completions or degrees.[3] During his first term, President Obama targeted a return by the U.S. to first place in the proportion of its youthful population earning associate's and bachelor's degrees by 2020. Achieving this goal would require a prodigious degree production growth rate: over four percent more *each year*. A number of states, along with foundations and associations, also set ambitious goals for increased degree production, though many now target 2025, not 2020. In October 2012, the members of the American Association of State Colleges and Universities and the Association of Public and Land-Grant Universities committed to a three percent per year increase in their degree output through 2025. The associations then called upon state and federal governments to help them achieve that goal.[4]

Where will the money come from? And, what kinds of institutional and systemic changes might increase degree production without additional instructional revenues? What unintended consequences must be anticipated and prevented? This chapter reviews the condition of the economy and of states' finances as of late 2012. It then documents the accelerating shift in higher education financing from the states to students and families, taking into account student aid and tuition trends. The chapter then discusses the contemplated changes as higher education struggles to reinvent itself. Add to this mix the stunningly rapid changes in information and communications technology affecting higher education and the new competitors these changes helped spawn, and we are indeed on the cusp of a brave new academic world.

THE NATIONAL ECONOMY

In December 2012, more than three years after the official end in mid-2009 of the longest and deepest recession since the Great Depression, the economic recovery remained unusually sluggish.[5] The "Great Recession" cost the nation about eight million jobs and led to unemployment rates that peaked at ten percent. Average family incomes declined for several consecutive years. Facing unavoidable entanglements with European monetary and fiscal problems, and plagued by political and ideological polarization that limited the amount of fiscal stimulus that was feasible, the Obama administration had few policy options. The economy, therefore, grew only slowly and in fits and starts once the recession officially ended. The unemployment rate fell gradually from ten percent in October 2009 to 7.7 percent in November 2012, still a problematic level (Figure 1). Combined unemployment and underemployment stood at around 17 percent, and the labor force participation rate declined to its lowest level in many years.[6]

Most signs pointed in a positive direction shortly after Election Day 2012.[7] The monthly jobs report, a key indicator, showed a net gain of 146,000 jobs in November; the average monthly gain for the year stood at 157,000.[8] These gains represented the 33rd consecutive month of private sector employment growth. Gross Domestic Product, the best available measure of total economic output, increased at an estimated 2.7 percent annual rate in the July through September quarter, up from 1.3 percent in the April–June quarter.[9] Most economists thought that the higher, though still sluggish, growth rate would continue in the October–December quarter.[10]

Higher consumer spending and housing investment—considered keys to a stronger and sustained recovery—drove the uptick. Retail sales showed solid gains.[11] Hurricane Sandy caused a noticeable blip in early November but Thanksgiving weekend sales were strong. "You're seeing solid single-digit [percentage

Figure 1. Seasonally Adjusted Unemployment Rate: 2009–12

Source: United States Bureau of Labor Statistics, www.bls.gov.

increase] numbers not just one month but consistently for the past few months," noted one well-informed observer.[12] The University of Michigan's much watched consumer confidence survey increased sharply in October to its highest reading since the pre-recession September 2007 report.[13] Business investment remained weak, though corporate profits recovered after a dip in the second quarter. Exports fell in the third quarter as China's growth slowed and the European Union entered a largely self-inflicted recession. Still, another observer noted, "The U.S. economy is beginning to find its rhythm."[14]

On the negative side, the economy remained vulnerable to uncontrollable sources of negative shocks such as the ongoing European fiscal uncertainties, volatility in the Middle East, and even China's slowing rate of growth. The uncertainty created by the so-called "fiscal cliff" theoretically remained within policy control. But Congress and the president needed to address large statutorily mandated federal budget cuts (sequestration), the end of the Bush-era tax cuts and of the temporary reduction in Social Security tax rates, and the need to raise the ceiling on the national debt all by very early 2013, or risk deflating the economy seriously at an inopportune time.

Related concerns include the effect of the mandates related to the Affordable (Health) Care Act on smaller businesses, and the longer-term fiscal implications of the health care needs of an aging population. All these uncertainties, many observers asserted, sapped the willingness of corporations and consumers to invest and thereby create jobs. The election results did little to assure resolution of the political stalemate so as to reassure markets.

STATE FINANCES

The 50 states faced the staggering task of eliminating $500 billion in budget gaps between FY 2008 and FY 2012.[15] Accomplished mainly by reducing expenditures, combined state and local spending declined by 0.8 percent between FY 2011 and FY 2012, a year in which this spending reached its lowest point as a share of the economy since the 1980s.[16]

After this painful experience, it is not surprising that states budgeted conservatively when finalizing FY 2013 budgets.[17] "Today, both Republicans and Democrats are rejecting spending requests even from traditional allies—police, businesses, teachers, doctors, and others—and keeping budgets balanced as federal aid recedes," reported *USA Today* in June 2012.[18] Perhaps as a result, year-end fiscal balances were generally on the upswing.[19] A summer 2012 survey of legislative fiscal officers reported a $46.5 billion sum of estimated FY 2012 year-end balances across the 50 states (seven percent of FY 2012 expenditures), up almost 14 percent from FY 2011.[20] Thirty states expected their FY 2012 year-end balances to exceed the standard five percent benchmark for a healthy balance used by bond rating agencies (Table 1).

FY 2013 projections envisioned little change. Of the 26 states that estimated year-end balances greater than five percent, 11 expected balances of over ten percent.[21] Only Arkansas and Illinois projected precariously low ending balances of less than one percent. In contrast, the aggregate balance for the 48 states, excluding Alaska and Texas, was just 1.8 percent at the trough of the recession in FY 2009.[22]

After several years of decline, state general fund revenues grew by a modest 2.9 percent in FY 2012, compared to a forecasted gain of 1.9 percent.[23] Revenues grew by more than ten percent in five states. Growth was in the five to 9.9 percent range in 14 more, and another 25 states saw gains of less than five percent. Several large energy producers, facing volatile prices but with ample financial reserves, were among the few states where revenues fell.[24] Revenue growth for the 50 states in aggregate was expected to increase by 3.7 percent for FY 2013 over FY 2012. Of the 44 states foreseeing revenue growth, 36 expected growth of less than five percent.[25] But total revenues remained below FY 2008 levels in nominal and inflation-adjusted terms across the 50 states in total.[26]

On the spending side, state general fund spending increased by 3.1 percent between FY 2011 and FY 2012, modestly higher than the 2.7 percent forecast.[27] Spending increased in 44 states in FY 2012; eight states reported growth above ten percent, and 19 more saw growth of five to 9.9 percent. Budgeting conservatively, states as a group projected FY 2013 general fund spending increases of just 2.4 percent, similar to the expected inflation rate.

In sum, there has been little catch up in spending after the significant reductions of 2008 to 2012. Just one state projected FY 2013 spending growth of more than ten percent—a technical anomaly. Only 13 were in the five to 9.9 percent range, while 29 projected FY 2013 spending growth of 0.1 to 4.9 percent. One state forecasted flat spending and six more planned to spend less than in FY 2012.

Table 1. State Year-End Balances as a Percentage of General Fund Spending: FY 2012–13

	Number of States/Jurisdictions	
	FY 2012 (Estimated)	**FY 2013 (Projected)**
10 percent or more	11	11
5% to 9.9%	19	15
0.1% to 4.9%	17	23
Zero balance	2	2
Negative balance	2	0

Source: National Conference of State Legislatures, *State Budget Update: Summer 2012*.

Looking ahead, fiscal officers were concerned (as usual) about growth in the Medicaid rolls and also about the implications of federal health care reform and rising pension costs.[28] They also expressed concern about the impact of possible federal spending cuts.

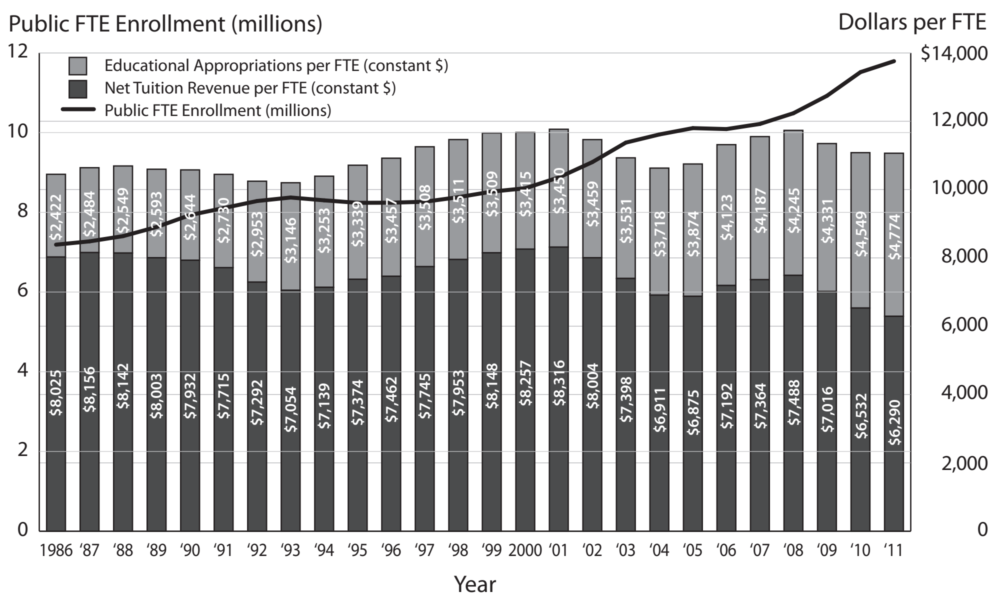
HIGHER EDUCATION APPROPRIATIONS

State support of higher education fell steeply over the past five years (Table 2). The decline from FY 2008 to FY 2013 was $8.7 billion, or 10.8 percent across the 50 states. The small bit of good news was that, after a 7.5 percent decline in the previous year, the change from FY 2012 to 2013 was small, 0.03 percent. The precipitous free fall in state funding has ended, at least as a national total. But $8.7 billion is a lot to make up, especially in light of growing enrollments and a half decade of inflation.

Figure 2 shows the effects of these factors, through FY 2011. The *darker* bars are inflation-adjusted state appropriations to colleges and universities and for student aid, per full-time-equivalent (FTE) student, over the last 25 years. The *lighter* bars are yearly tuition revenue per student, net of state-funded student aid, and the *ascending* line is FTE enrollment. Enrollment climbed steadily over the quarter century, but real state support per student fluctuated with the business cycle, declining by a sobering 21.6 percent since 1986. The decline from FY 2001, the highest level reached, to 2011 was even larger (24.4 percent). Per student tuition revenue made up the difference, nearly doubling over the 25 years. The total of state support and tuition approximates total available general revenue per student. For all the talk of runaway costs in higher education, this sum increased little since the late 1980s. Of course, with tuition now much higher, more institutional resources go to student aid. So the funds schools have for education-related costs are less than they appear.

Spending on higher education decreased between FY 2008 and FY 2013 in 38 of 50 states (Table 2). Some decreases were large: Alabama -28.4 percent; Arizona -36.6 percent; California -23.9 percent; Florida -24.9 percent; Louisiana -31.2 percent; Massachusetts -22.1 percent;

Figure 2. Public FTE Enrollment and Educational Appropriations per FTE: FY 1986–2011



Source: State Higher Education Executive Officers, *State Higher Education Finance Report, FY 2011.*

Table 2. State Fiscal Support for Higher Education, by State: FY 2008, FY 2012, and FY 2013[a]

	State Fiscal Support ($)			% Change	% Change
	FY 2008 State Monies[b]	FY 2012 Total Support[c]	FY 2013 State Monies[b]	FY 2008–13 State Monies Only	FY 2012–13 State Monies Only
Alabama	$ 1,961,808,342	$ 1,494,583,182	$ 1,405,063,916	-28.4%	-6.0%
Alaska	298,615,000	357,025,101	365,195,297	22.3	2.3
Arizona	1,325,906,400	823,654,000	840,320,500	-36.6	2.0
Arkansas	879,882,230	894,531,078	906,500,781	3.0	1.3
California	11,620,239,000	9,379,003,000	8,843,276,000	-23.9	-5.7
Colorado	747,481,054	647,496,274	640,628,978	-14.3	-1.1
Connecticut	1,034,480,989	949,946,216	957,256,412	-7.5	0.8
Delaware	243,130,000	213,193,700	216,492,700	-11.0	1.5
Florida	4,448,930,438	3,631,070,101	3,341,628,971	-24.9	-8.0
Georgia	2,959,753,896	2,709,389,686	2,757,055,556	-6.8	1.8
Hawaii	554,292,000	512,327,897	516,769,774	-6.8	0.9
Idaho	410,595,600	333,669,600	360,070,800	-12.3	7.9
Illinois	2,948,632,100	3,594,470,100	3,566,692,200	21.0	-0.8
Indiana	1,525,216,628	1,549,460,261	1,555,282,625	2.0	0.4
Iowa	873,724,167	740,351,670	787,419,692	-9.9	6.4
Kansas	825,697,884	739,612,189	759,215,686	-8.1	2.7
Kentucky	1,320,540,000	1,237,726,232	1,178,977,000	-10.7	-4.7
Louisiana	1,707,668,337	1,237,070,397	1,175,660,258	-31.2	-5.0
Maine	271,117,262	270,884,116	264,064,554	-2.6	-2.5
Maryland	1,555,048,366	1,609,179,797	1,612,475,870	3.7	0.2
Massachusetts	1,347,344,567	1,055,948,599	1,049,106,956	-22.1	-0.6
Michigan	2,033,709,000	1,547,832,500	1,596,324,500	-21.5	3.1
Minnesota	1,560,644,000	1,283,690,000	1,285,247,000	-17.6	0.1
Mississippi	1,045,937,317	954,183,795	924,952,654	-11.6	-3.1
Missouri	1,021,705,137	933,329,405	968,723,086	-5.2	3.8
Montana	196,547,880	202,105,316	202,187,817	2.9	0.0
Nebraska	657,011,774	650,437,323	659,571,367	0.4	1.4
Nevada	620,032,581	473,148,326	472,368,017	-23.8	-0.2
New Hampshire	133,093,000	82,697,778	85,622,352	-35.7	3.5
New Jersey	2,044,508,000	1,998,300,000	1,888,439,000	-7.6	-5.5
New Mexico	1,016,380,902	798,972,305	799,405,505	-21.3	0.1
New York	4,853,312,900	4,733,250,166	4,989,658,488	2.8	5.4
North Carolina	3,837,233,489	3,914,552,032	4,092,304,288	6.6	4.5
North Dakota	253,901,000	343,964,303	343,805,783	35.4	0.0
Ohio	2,288,294,736	2,013,731,126	2,039,964,448	-10.9	1.3
Oklahoma	1,098,881,179	997,857,169	981,069,415	-10.7	-1.7
Oregon	725,761,919	566,031,614	552,063,188	-23.9	-2.5
Pennsylvania	2,193,274,000	1,800,947,000	1,792,655,000	-18.3	-0.5
Rhode Island	191,329,662	189,764,322	164,147,170	-14.2	-13.5
South Carolina	1,211,068,342	859,408,982	942,770,165	-22.2	9.7
South Dakota	198,949,272	181,016,376	190,251,431	-4.4	5.1
Tennessee	1,639,550,600	1,414,996,174	1,455,168,883	-11.2	2.8
Texas	6,347,752,622	6,464,046,632	6,425,707,479	1.2	-0.6
Utah	812,337,500	728,922,600	748,759,000	-7.8	2.7
Vermont	90,801,444	90,109,661	87,996,319	-3.1	-2.3
Virginia	1,885,553,314	1,624,026,722	1,703,083,307	-9.7	4.9
Washington	1,768,291,000	1,361,782,000	1,372,858,000	-22.4	0.8
West Virginia	562,253,000	543,467,484	545,760,686	-2.9	0.4
Wisconsin	1,242,536,879	1,153,558,680	1,182,780,084	-4.8	2.5
Wyoming	290,507,515	337,988,717	384,199,290	32.3	13.7
Total	**80,681,264,224**	**72,224,711,705**	**71,976,998,248**	**-10.8**	**-0.3**

Source: Preliminary data from *Grapevine* FY 2013 survey of state appropriations for higher education. Courtesy of James Palmer, Illinois State University.

Notes:

[a] Initial data as of January 15, 2013. Subject to change.

[b] State funds include state tax appropriations and other state funds allocated to higher education. Excludes government services funds used for modernization, renovation, or repair.

[c] Includes small amounts of remaining federal American Recovery and Reinvestment Act fiscal stabilization funds in a few states.

Michigan -21.5 percent; Nevada -23.8 percent; New Hampshire -35.7 percent; New Mexico -21.3 percent; Oregon -23.9 percent; South Carolina -22.2 percent, and Washington -22.4 percent. Eleven more states reduced state support by between 10 and 20 percent, and another eight sliced more than five percent. The states gaining the most state support between FY 2008 and FY 2013 were North Dakota, Wyoming, and Alaska, all with natural resource wealth to buffer economic downturns.

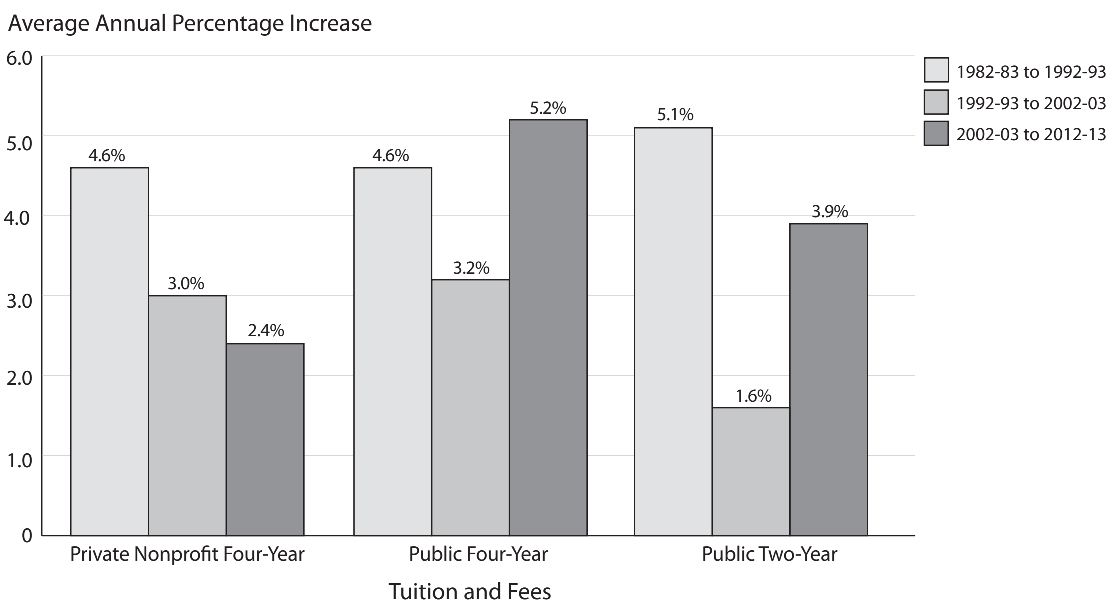
Only Rhode Island (-13.5 percent) had a double-digit percentage drop between FY 2012 and FY 2013, and just five other states showed declines of five percent or more.[29] A majority of states (32) finally showed increases, though modest, and state support levels generally remained well below 2008 levels.

TUITION AND STUDENT AID

Average published tuition and fee charges at two-year and four-year public colleges and universities increased by 5.8 percent and 4.8 percent, respectively, in FY 2013.[30] While well above the general inflation rate, these increases were smaller than those of the previous few years. The decade-long pattern is more troubling. Figure 3 depicts the *inflation-adjusted* average annual growth in tuition and fees by sector for each of the past three decades.[31] All three sectors showed real price increases in all three decades. Between 2002–03 and 2012–13, a period spanning two economic downturns, increases in charges averaged 3.9 percent and 5.2 percent per year beyond general inflation in the public two-year and four-year sectors, respectively.

These are large increases when compounded over a long time and are significantly greater than the increases in the private nonprofit sector. It is not surprising that students and families and their elected representatives call for moderating prices while unemployment remains high and earnings stay flat or decline. Campus spending will have entered a much more challenging era if, as seems likely, state support remains weak, enrollments and pressures to improve degree completion rates increase, and sizeable tuition hikes are banned.

Figure 3. Average Annual Percentage Increases in Inflation-Adjusted Published Prices by Decade, 1982–1983 to 2012–2013



Source: College Board. *Trends in College Pricing,* 2012, figure 4.

Scholarships, grants, tax benefits, and loans can substantially offset tuition charges. These sources provided nearly $245 billion to finance postsecondary expenses in 2011–12, according to the College Board. Non-repayable aid made up more than half the total.[32] The Board uses its data on aid and on tuition and fees to calculate average *net* prices by institutional sector—after accounting for non-repayable aid—paid by students. The figures may be surprising.

After aid, net tuition and fees, in 2012 dollars, at public four-year institutions averaged $2,910 in 2012–13, a 49 percent increase from the 2009–10 net tuition figure, $1,950.[33] The 2009–10 amount was a low point reached after several large infusions of federal funds into the Pell Grant program and aid to veterans. Average net price rose from $1,490 in 2002–03 to $2,470 in 2007–08, before the drop in 2009–10. The net price paid by students at public four-year colleges nearly doubled from 2002–03 to 2012–13, but it remained under $3,000, excluding the other costs of college attendance. For example, room and board charged by public institutions averaged $9,200 in 2012–13.

The College Board calculated that aid exceeded tuition and fees on average among public two-year institutions for most of the past decade. Aid exceeded tuition on average by $570 in 2002–03. Net tuition and fees were $30 in 2006–07, the year when net costs were highest. But aid again exceeded tuition and fees by $1,220 in 2012–13, leaving the average community college student with that amount to put toward books, transportation, or living expenses. Student aid makes a substantial dent in tuition expenses, but most students in the two- and four-year sectors must work many hours during the school year to subsist.

CONCLUSION

After a long period in the doldrums, the economy appeared to be looking up going into 2013. The recent deep state budget cuts are likely at an end, assuming that federal politicians get the government's fiscal house in order and there are no large external shocks. This modest good news for higher education does not change the structural fiscal constraints faced by the federal and most state governments. The pressures on states from Medicaid, other health costs, and underfunded pension plans, make the prospect of major cash infusions to higher education unlikely. The pattern of tuition increases well beyond inflation that have helped compensate for state stringencies may be nearing its limits too. Added to calls for affordability are demands to increase degree production and completion rates among students, many with weak academic preparation. Colleges will be challenged indeed in an era when equating academic quality with resources per student no longer computes. Serious restructuring seems inevitable if our institutions and systems are to adjust to the new realities.

NOTES

Thanks to Brian Zumeta for assistance with research and graphics for this chapter.

1 FY 2013 began on July 1, 2012 in 46 of the 50 states.

2 The fiscal problems facing Social Security, Medicare and Medicaid are well known. States are responsible for a significant share of Medicaid costs, up to 50 percent. All 50 states are reported to have underfunded employee pension plans despite a wave of upcoming baby boomer retirements (Pew Center, 2010).

3 Kelderman, 2012b.

4 Kelderman, 2012a.

5 It was the weakest post-recession recovery by far since World War II.

6 Sheppard, 2012. The labor force participation rate is the share of the working age population who are working or seeking work. A low rate implies increased discouragement and dependency.

7 The consensus of economists was that the economy would not likely return to pre-recession levels of employment in this decade (Lee, 2012).

8 Irwin, 2012a.

9 The Balance Sheet, 2012; Irwin, 2012b.

10 Puzzanghera, 2012.

11 "October Retail Sales Rose…," 2012.

[12] Ibid. The observer was Madison Riley, managing director at the retail-consulting firm Kurt Salmon.

[13] "Consumer Confidence at 5-Year High," 2012.

[14] Quoted in Lee, 2012. The observer was Mark Zandi, chief economist at Moody's Analytics.

[15] A budget gap is an imbalance between projected expenditures and projected revenues for a fiscal period such as a year. Since, unlike the federal government, states generally need to balance their budgets each year, they must close the gaps by expenditure cuts or revenue increases.

[16] Cauchon, 2012.

[17] Ibid.

[18] Ibid.

[19] These balances include funds remaining in the general fund at the end of the fiscal year plus any "rainy day" funds that a state may have.

[20] NCSL, 2012, 2. Large balances held by Alaska and Texas, two natural resource-rich states, somewhat distort the national figure, NCSL noted. By omitting these states, the 48-state balance in relation to expenditures fell from seven percent to around four percent.

[21] The small decline in number of states in relatively good shape is typical, as states tend to project these balances conservatively.

[22] NCSL, 4.

[23] Ibid. 5.

[24] Ibid.

[25] Ibid, 6.

[26] Rockefeller Institute, 2012.

[27] The data cited in this paragraph came from NCSL, 5.

[28] These expressed concerns were drawn from survey responses by legislative fiscal officers reported in ibid, 8-9.

[29] The 2012 data include a small amount of remaining federal American Recovery and Reinvestment Act funds in a few states.

[30] The data are from College Board, 2012a. As was typically true in recent years, average tuition charges grew less at private nonprofit institutions in 2012-13, by 4.2 percent. These figures are not adjusted for inflation, but the subsequent figures reported in this paragraph are so adjusted.

[31] Based on College Board, 2012a, Figure 4 on page 14. The College Board adjusts nominal price levels for inflation, using the Consumer Price Index.

[32] College Board, 2012b, 10. The 2011-12 data are preliminary. The 2010-11 aggregate figure was slightly higher, nearly $251 billion.

[33] Ibid, 19. These figures are preliminary estimates. The final figure for 2011-12 was $2,620. All figures in this and the next paragraph come from this source.

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