State Support: On the Upswing but Still Near Pre-Recession Levels

By William Zumeta

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As 2014 drew to a close, state support and private giving for higher education began to recover from the deepest downturn academe faced since the Great Depression. Fiscal year 2015, which began on July 1, 2014 in most states, marked the second straight year of decent increases in aggregate state appropriations to higher education. As a result, it was also the second consecutive year of moderate tuition increases in the public sector, averaging not much more than consumer price inflation.

Analysts expressed cautious optimism about the economy in the near term, seeing modest growth as the likely path. Based on past experience, this path likely means modest gains for state budgets and for higher education support. But modest growth would leave state support well below 2008 levels, on an inflation-adjusted per-student basis. Meanwhile, the published tuition prices at public at two- and four-year institutions—growing by 43 and 44 percent, respectively, since 2007–08—won't be rolled back.[1]

Competition for substantial budgetary growth will be stiff. Most states must also address pent-up demands from underfunded pension plans, K–12 education, and infrastructure replacement needs. Many states will also take on thousands of new Medicaid clients under the Affordable Care Act.

This chapter discusses the latest economic developments and prospects for 2015, the fiscal condition of the states, and trends in state support of higher education, tuition, and student aid. It then comments on the implications of these developments and trends for the health of public higher education.

THE NATIONAL ECONOMY

The unemployment rate fell slowly but steadily since its 10.0 percent peak in late 2009 (Figure 1). This bellwether of economic health declined by 1.7 percentage points, to 5.6 percent of the labor force, between October 2013 and December 2014.[2] The government's broader measure of unemployment includes involuntarily employed part-timers and workers who gave up looking. That indicator declined from about 17 percent to around 11 percent between the worst point in the recession and late 2014. The economy added about 246,000 jobs per month through November 2014. The preliminary new jobs figure for December was 252,000; that for November was over 300,000—the best gains of the 21st century.[3] Individual earnings—largely stagnant in inflation-adjusted terms for several years—finally showed signs of real growth at the end of the year.

Gross Domestic Product (GDP), the broadest measure of total economic output, grew strongly in the second and third quarters—at 4.6 percent and 5.0 percent annual rates, respectively. Most analysts expected better than normal holiday sales and a 2015 GDP growth rate in the three percent range.[4] Economic forecasting is uncertain, and downside risk factors included the slowdown in China's growth rate, Japan's continuing recession, Europe's self-inflicted stagnation, always-volatile Middle East politics, and the prospect of major terrorist acts. But OPEC was powerless to stop a sharp decline in oil prices, generally a good sign for the domestic economy. In early 2015, though, the markets viewed the large decline as a sign of global economic weakness. Still, American economic prospects, on balance, look better than they have in several years, though a boom is not in sight.[5]

FISCAL CONDITION OF THE STATES

State coffers have slowly recovered from the effects of the Great Recession of 2007–09. Total state general fund spending fell from $687

Figure 1. Seasonally Adjusted U.S. Unemployment Rate, 2007–2014

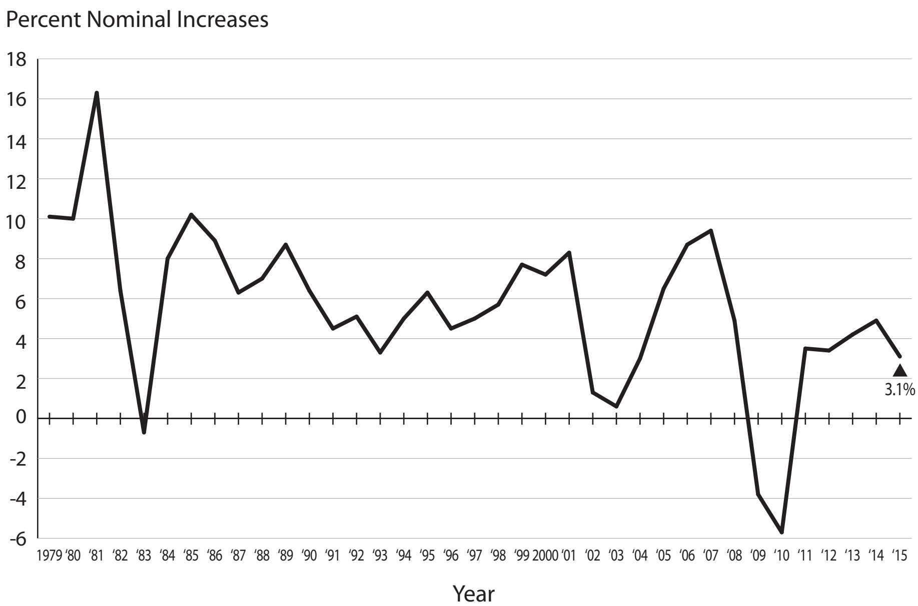
Source: U.S. Bureau of Labor Statistics, www.bls.gov.

billion to $623 billion between FY 2008 and FY 2010.[6] Spending then rose to $695 billion in FY 2013 (with no adjustment for inflation or population growth), just slightly above the FY 2008 amount. Taxpayer steps to shift income in the prior year in response to federal tax law changes partly explains the healthier 4.9 percent increase in FY 2014.[7] Enacted FY 2015 state budgets projected a more recently typical 3.1 percent gain in expenditures over FY 2014, with total state spending projected to reach $752 billion.[8] Forty-three of the 50 states budgeted positive expenditure growth in FY 2015 of which 29 planned for less than a five percent increase over 2014.[9] Still, 11 states budgeted lower spending in FY 2015 than their FY 2008 levels.[10]

Figure 2 depicts annual percentage changes in state general fund budgets, covering all 50 states, over more than three decades. State budgets respond to economic cycles. Expenditures (and revenues) grow faster than inflation when the economy is strong, but fall to near zero growth in economic downturns. State spending actually declined in FY 2009 and 2010 for the first time in many decades. It then climbed back into positive, if modest, growth territory in the last five years.

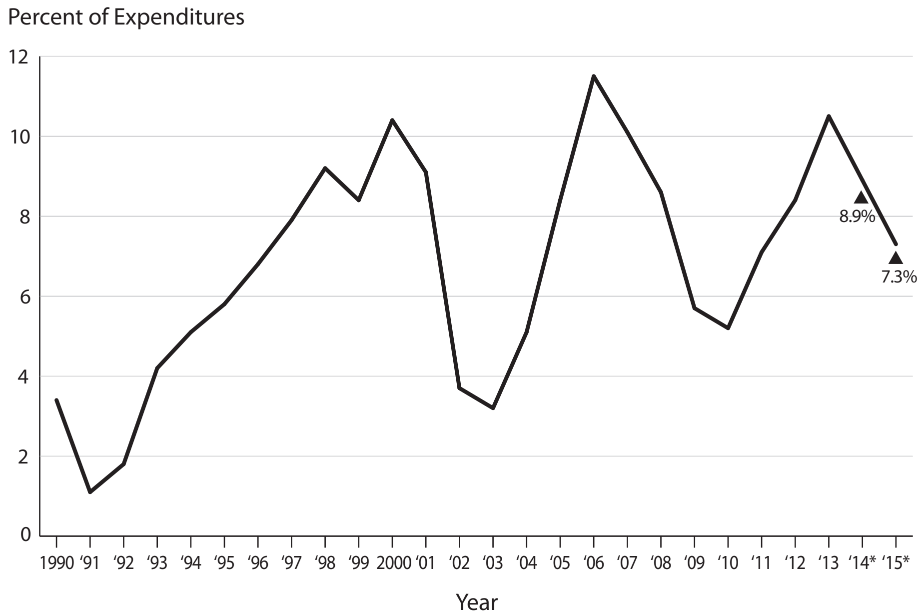
Fiscal year-end treasury balances (including "rainy day" funds)— another key indicator— buffer states a bit against the sudden revenue decline that accompanies economic downturns (Figure 3). Financial analysts call prudent a balance of at least five percent of annual expenditures. The aggregate ending balance projected for FY 2015 is a healthy 7.3 percent, a slight decline from FY 2013.[11] This estimate is misleading, though, for the very large balances in Alaska and Texas distort the picture. The aggregate year-end balance projected by the other 48 states is a more modest 4.8 percent.[12] Fifteen states projected FY 2015 year-end balances below five percent of expenditures; five of those states project a margin of less than one percent.[13] Most states are in decent fiscal condition, but their expenditure budgets are vulnerable to another economic downswing.

Figure 2. Nominal General Budget Increases, FY 1979 to FY 2015



Source: National Association of State Budget Officers, *Fiscal Survey of the States, Spring, 2014*, 2.

Figure 3. 50-State Total Year-End Balances as a Percentage of Expenditures, FY 1990 to FY 2015



Source: National Association of State Budget Officers, *Fiscal Survey of the States, Spring, 2014,* 55.
* Figures for FY 2014 are preliminary actual; figures for FY 2015 are appropriated.

A recession leads to widespread budget cuts, so recovery brings multiple pressures to restore lost funding. During the recent downturn, many states withheld actuarially needed contributions to employee pension plans and froze or cut employee salaries. Many states also cut K–12 education, the largest component of general fund budgets.

These areas need attention now. For FY 2015, 39 states budgeted for more than $11 billion in increases for K–12 education.[14] Medicaid was slated to receive $8.5 billion in new money.[15] Some states rolled back taxes. The 50-state net sum of tax changes came to a $2.3 billion rollback, following a $2.1 billion net tax cut in 2014.[16] By comparison, hard-pressed states enacted $23.9 billion net in tax and fee *increases* in FY 2010 to help balance budgets. States will likely continue to support these priorities, including tax cuts.[17] Moreover, states that expanded their Medicaid rolls under the incentives provided by the Affordable Care Act must pay some of the associated costs in FY 2017.

Higher education is a possible priority area for state reinvestment, but it faces stiff competition at a time of slow revenue growth and when budgeting is conservative. States tend to reduce higher education appropriations disproportionately once they experience a substantial downswing. That's because legal mandates drive these expenditures less than other state functions, and academe's customers have shown they will pay more if they must.

STATE HIGHER EDUCATION SUPPORT

Today's decent gains in state support for higher education are actually somewhat greater than the growth rate in state general fund revenue and in overall spending. Based on all 50 states reporting to the annual joint Grapevine-State Higher Education Executive Officers Association higher education finance survey,[18] total state support of higher education in FY 2015 was projected to gain 5.2 percent, similar to the 5.3 percent gain in FY 2014 (Table 1). Yet, the effect of the Great Recession and its aftermath lingers. FY 2015 state and federal American Recovery and Reinvestment Act (ARRA) appropriations are just 3.4 percent higher than the comparable total for FY 2010. Were inflation and enrollment growth over this five-year period factored in, per-student funding in constant dollars would be *down* roughly 20 percent from five years ago.

As usual, there was a wide range across the states in the treatment of higher education in FY 2015 state budgets. The largest year-to-year increases were: 21.1 percent in Illinois (a misleading figure that includes large catch-up contributions to state retirement funds neglected during the recession); 14.6 percent in Colorado (the second-lowest state in per student funding); 13.0 percent in New Hampshire (the lowest funding state); 11.2 percent in Utah; 10.9 percent in California, and 10.0 percent in Oregon. Among these states, only Illinois (up 46.0 percent but with the lion's share not truly funding higher education services), Utah (up 19.1 percent), and California (up 15.6 percent) reached substantially higher support levels in FY 2015 than in FY 2010. Colorado and New Hampshire were still "underwater" compared to FY 2010, in spite of their strong gains in the latest year.

Ten states budgeted reduced amounts for support of higher education between FY 2014 and FY 2015. Another eight showed a zero increase or a gain of below two percent, that is, below inflation. These reductions were small compared to those of the recent near-depression. There was little to cut!

Compared with FY 2010—a year reflecting two prior years of steep cuts from the pre-recession peak in state support—half the states (25) still reported lower public funding in FY 2015.[19] Louisiana and Arizona remained more than a fifth below their nominal support levels of FY 2010, down 24.3 and 21.1 percent, respectively. Another four states—Nevada, New Hampshire, Oklahoma, and Pennsylvania—were down by amounts in the 10 to 16 percent range over this period. Higher education in 19 more states received up to 10 percent less state money in unadjusted dollars than in FY 2010. Assuming that inflation and enrollment growth expanded financial needs by roughly 20 percent over this period—a rough calculation because the situations of states differ—higher education's five-year support gains cross this "break even" threshold in only three states—North Dakota at 31.4 percent; Wyoming at 21.4 percent; and Massachusetts at 21.0 percent. Utah's five-year increase came close at 19.1 percent. The Great Recession left long-term scars on higher education.

TUITION AND STUDENT AID

As in past cycles, tuition increases at public institutions moderated sharply as state support for higher education recovered. Average published tuition rates in public four-year colleges and universities increased by up to ten percent in the worst years of budget cutting. The average rate of increase fell to under three percent in each of the last two years, the lowest such rate in many years (Figure 4).[20] Public two-year colleges showed a similar pattern. Average increases in published prices in the public sectors ran below hikes in the private nonprofit sector—a change from a long-standing pattern.

The moderate increases in published prices are good news for students, but the long-term trend in these prices remains troubling. In 2014 dollars, published tuition rates at public four-year schools increased by 225 percent between 1984–85 and 2014–15. Public two-year institutions showed a 150 percent increase and private nonprofit four-year colleges increased their published charges by 146 percent over this period.[21] All but the top quintile of households saw minimal real income growth over the three decades, so it is small wonder that college charges are difficult for most families to cover. The resulting political sensitivity likely explains why published tuition increases moderated especially quickly and sharply in this

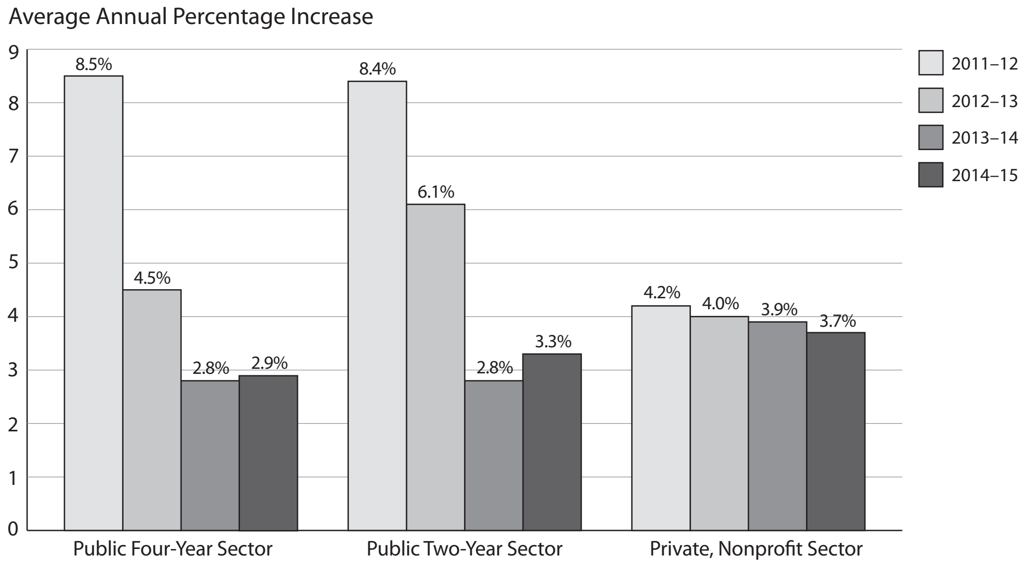
Table 1. State Fiscal Support for Higher Education: One-Year (FY 2014 to FY 2015), and Five-Year (FY 2010 to FY 2015) Percent Changes, by State[a]

	One-Year Change, FY 2014 to FY 2015	Five-Year Change, FY 2010 to FY 2015	
State	**State Funds**	**State $ Only**	**State $ Plus ARRA Funds**
Alabama	1.6%	2.9%	-5.0%
Alaska	-0.5	14.7	14.7
Arizona	4.0	-15.9	-21.1
Arkansas	-1.0	5.7	4.2
California	10.9	16.0	15.6
Colorado	14.6	73.7	-6.2
Connecticut	9.7	4.9	1.7
Delaware	-0.4	0.0	-6.6
Florida	7.7	15.3	6.8
Georgia	3.9	11.1	-2.2
Hawaii	7.1	6.0	0.0
Idaho	7.2	14.0	8.6
Illinois[b]	21.1	50.2	46.0
Indiana	-0.9	7.7	5.4
Iowa	3.0	11.9	-1.9
Kansas	4.2	6.6	1.2
Kentucky	-2.0	-3.7	-8.9
Louisiana	0.5	-13.2	-24.3
Maine	0.1	4.9	0.8
Maryland	6.7	14.6	14.6
Massachusetts	9.0	49.5	21.0
Michigan	6.9	-2.9	-6.4
Minnesota	3.7	1.2	-7.7
Mississippi	3.6	0.3	-5.7
Missouri	8.2	5.3	-4.9
Montana	6.2	40.5	15.0
Nebraska	4.2	11.8	11.8
Nevada	1.1	24.3	-15.2
New Hampshire	13.0	-11.3	-14.8
New Jersey	4.0	3.0	-0.6
New Mexico	5.0	2.2	0.4
New York	3.5	9.6	6.3
North Carolina	3.0	3.1	-0.7
North Dakota	0.0	31.4	31.4
Ohio	1.4	6.9	-6.3
Oklahoma	-0.4	-6.4	-11.8
Oregon	10.0	8.0	0.6
Pennsylvania	0.9	-11.4	-15.7
Rhode Island	6.2	10.8	10.2
South Carolina	6.7	4.9	-5.6
South Dakota	4.6	16.2	9.5
Tennessee	-0.5	5.9	-4.6
Texas	-1.7	6.0	0.9
Utah	11.2	29.2	19.1
Vermont	-1.1	-1.7	-1.7
Virginia	1.7	4.9	0.5
Washington	0.6	0.5	-5.5
West Virginia	-2.0	3.0	-3.4
Wisconsin	7.2	-4.3	-4.3
Wyoming	6.0	21.4	21.4
Total	**5.2**	**9.6**	**3.4**

Source: Center for Study of Education Policy, *Grapevine,* 2015.

[a]FY 2015 figures on state support for higher education represent initial allocations and estimates reported by the states from September through December 2014 and are subject to change. [b]Includes rapidly increasing appropriations made to the State Universities Retirement System (SURS) to address the historical underfunding of pension programs. State appropriations to SURS in FY 2015 totaled to $1,548,659,500. These SURS appropriations do not go to individual institutions or agencies and are not available to be used for educational purposes.

Figure 4. Average Annual Increases in Published Tuition Prices, by Sector, FY 2011-12 to FY 2014-15



Source: College Board, *Trends in Higher Education* spreadsheet, trends.collegeboard.org.

cycle. It may also suggest that public colleges and universities will be unable to buffer state budget cuts with sharp tuition increases in the next downturn.

Published prices are not necessarily the best indicator of college affordability, because students and families also receive $115 billion annually in federal, state, institutional, and private grants for college costs. They also receive about $17 billion in tax credits and deductions.[22] Approximately two-thirds of students receive some non-repayable aid that reduces the price of college. The College Board therefore now calculates the average *net* price of college by subtracting total grant aid and tax benefits from published prices in each sector.

This calculation provides a somewhat different picture of prices and trends in them. The very large infusion of funds into the federal Pell Grant program between 2007–08 and 2010–11 influenced these trends. According to the College Board, average published tuition for a full-time student in a public two-year college in 2014–15 was $3,350. But grant aid and tax benefits averaged $5,090, so net tuition was -$1,740.[23] The hypothetical average community college student could put this sum toward room and board, estimated by the College Board at $11,050 per academic year. The average two-year college student was about $1,800 better off in 2014–15 than in 2006–07 (before the Pell Grant infusion), when the estimated $70 average net tuition left nothing for living costs.

Published tuition for the public four-year sector averaged $9,140 in 2014–15; and grant aid and tax benefits averaged $6,110, producing an average net price after aid of $3,030 per student.[24] Adding room and board charges brought the estimated total net price to $12,830 per year. Growth in grant aid and tax benefits between 2004–05 and 2014–15 resulted in a net average net tuition increase from $2,290 to only $3,030, in 2014 dollars, in the public four-year sector. Adding in room and board results in an increase from $10,150 in 2004–05 to $12,830 in 2014–15, larger in absolute terms but smaller in percentage growth. This amount is substantial, but including student aid and room and board—a reasonable proxy for living costs regardless of where the student resides—paints a different picture of college costs than relying on published prices.

Going forward, student aid must keep up with increases in tuition and living costs if affordability is to be preserved. These calculations apply to a hypothetical "average" student. But costs differ for students at different income levels who are eligible for varying amounts of aid, and for students in different states that provide widely varied amounts of aid and that impose different eligibility criteria.

As for student aid—the latest preliminary data covers the 2013–14 academic year—total federal grant aid decreased by nearly $3 billion in 2011–12 after the large surge in Pell Grant support in the early Obama years. In 2013–14, federal grant aid remained slightly below the 2010–11 peak.[25] Pell grants alone were nearly $2 billion lower in 2013–14 than in 2010–11. Still, both 2013–14 figures were more than twice the levels of 2007–08, so this substantial increase in student aid explains the declines in net price. The total of federal and other grants now exceeds the total of annual student loans, a positive development.[26] Observers decry high student debt, but annual student borrowing has declined for the last three years.[27] The experience of the years since 2010–11 suggests, though, difficulty in increasing federal aid in the current budgetary and political climate.

States also provide substantial direct aid to college students; these amounts are included in the figures on state appropriations. The preliminary estimate of total state student aid grants for 2013–14 was $9.45 billion.[28] This funding continued to grow modestly during the Great Recession and its aftermath, despite hard hits to institutional support. Presumably this support was a gesture to help students cope with the resulting steep tuition hikes.[29] State student aid support grew little since 2010–11—actually decreasing in real, per-student terms. It even declined in nominal dollars in the latest year. Prioritizing of institutional support after the deep cuts and moderating tuition increases may explain this flattening.

State student aid is unevenly distributed across states. Eight large states provide around 70 percent of the national total, though nearly all states provide some aid.[30] About 25 percent of state student aid is distributed on the basis of "academic merit" or because the student is studying a field the state wants to encourage. The need-based share fell gradually for more than a decade as "merit aid" became politically popular, but has increased a bit in the past few years.

CONCLUSION

The new year 2015 brought modest good news for higher education *and* ample reason for future concern. The national economy looked surprisingly strong, especially compared to rivals. State budgets, slowly recovering from the Great Recession and its aftermath, included more support for higher education. Tuition increased by its lowest percentage in decades, while student aid was at high levels, if not increasing much. Student borrowing finally decreased.

Down in the trenches, though, all was not well. Another recession is inevitable some day, and states and colleges are vulnerable when it comes. Constant pressures to increase spending and to reduce taxes hinder states from building adequate reserves for bad times. State operating support for higher education stands, in real, per-student terms, more than 20 percent below its 2008 level.[31] States have long starved capital budgets, enrollments are decreasing overall, and published tuition rates climbed nearly 45 percent since 2008.

This is not a good recipe for responding to the widely accepted challenge to increase the number of college graduates or for coping with another downturn. Further cuts to higher education will affect capacity to educate and graduate students. Steep tuition increases, the typical response to state budget cuts, seem politically unacceptable. Such increases further deter enrollment and completion, and add to student debt as well.

America badly needs a more robust higher education financing strategy to prosper in a knowledge-based, globally competitive world where other nations are rapidly enhancing their "human capital" bases.

NOTES

[1] Calculated from spreadsheet for College Board 2014a, table 3.

[2] "More Jobs," 2014; National Conference of State Legislatures, 2015.

[3] Ibid.

[4] "U.S. Economy Shows Strength," 2014.

[5] Applebaum, 2015.

[6] National Association, 2014b, 1.

[7] Ibid, 3.

[8] Ibid.

[9] National Association, 2014a, 1.

[10] Ibid.

[11] National Association, 2014b, 4.

[12] Ibid.

[13] National Association, 2014a, 55.

[14] National Association, 2014b, 2.

[15] Ibid.

[16] Ibid, 4.

[17] Ibid, 2.

[18] Grapevine is the name of an Illinois State University survey of state fiscal support of higher education that dates back to the 1960s.

[19] This comparison includes federal ARRA funding, which was significant in FY 2010.

[20] College Board, 2014a, 3.

[21] Ibid, 16.

[22] Both these figures are from College Board, 2014b, 3.

[23] Figures in this paragraph are from College Board, 2014a, 22.

[24] Figures in this paragraph are from Ibid., 23.

[25] From spreadsheet for College Board, 2014a, table 3.

[26] College Board, 2014b, 3.

[27] Ibid, 4.

[28] Estimate from spreadsheet for College Board, 2014b.

[29] Li, Hernandez, and Zumeta, 2014.

[30] National Association of State Student Grant and Aid Programs, 2014, 2. Other facts cited in this paragraph are from the same source.

[31] State Higher Education Executive Officers, 2014.

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