

Higher Education Funding: Stagnation Continues; Financial Restructuring Underway

By William Zumeta

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The Alfred P. Sloan Foundation supported his research on federal policies designed to attract our ablest young people to careers in science. The report, "Attracting the Best and Brightest" (with Joyce S. Raveling), appeared in *Issues in Science and Technology*, Winter 2002–03.

Higher education finances stood at a crossroads at the end of 2003. The 2001 recession and its aftermath produced three years of turmoil in state budgets with no clear end in sight. As usual, higher education appropriations felt the brunt of sharp budget cuts. FY 2004 was the worst so far, and FY 2005 promised to be almost as bad.¹ But student demand—fueled by the growing "baby boom echo" generation and a slack economy that made school more attractive—attained record levels.

Colleges and universities, needing to shore up their revenue bases, looked for alternatives to state funding. The main alternative: student tuition, which escalated dramatically during the recession and its aftermath. Maintaining capacity and quality, agreed some state politicians and policymakers, required tuition increases. Others—including some federal politicians—sought to limit the burdens on students and families by minimizing the increases. State student aid budgets grew only slowly—the recession spared few categories of state appropriations for higher education. Fiscal pressures also constrained federal student aid programs. The culprits: suddenly mounting budget deficits fueled by economic stagnation, the costs of war and occupation in Iraq, and the Bush Administration's large tax cuts.

This chapter updates higher education's finances as of late 2003, emphasizing states and students—the key sources of dollars. It summarizes the condition of and outlook for the national economy and fiscal trends affecting state revenues and spending. It then examines implications for state support of higher education, recent and longer-term trends in higher education funding, and trends in tuition charges—especially the changing role of tuition in institutional finance. Finally, the essay examines trends in student financial aid.

THE ECONOMY

The U.S. economy—vibrant through the second half of the 1990s—sputtered into recession in 2001 even before the September terrorist attacks. Two near-stalls—in the first half of 2002, and from late 2002 to early 2003—followed a quick initial recovery. Gross Domestic Product (GDP) gains grew to

a 3.1 percent annual rate in the second quarter of 2003 followed by a 7.2 percent jump in the third quarter, and seemed on a positive course.² But the bumpy economic recovery was painfully jobless. The country lost 2.6 million jobs from early 2001 through September 2003—one million since the recession officially ended in November 2001.³ September 2003 marked the 38th consecutive month of decline in manufacturing jobs.⁴ But September also marked the first time in eight months that overall employment grew—by 57,000 jobs, though more than 33,000 were temporary. This gain was still well below the 100,000 net new jobs per month needed to bring down the unemployment rate, unchanged at 6.1 percent in September.

Analysts at Global Insight, a leading economic forecasting firm, foresaw a second-half 2003 GDP growth rate of 4.2 percent, high enough to reduce unemployment gradually.⁵ Annual GDP growth rates, GI predicted, would range from 3.4 to 3.7 percent through 2007. GI envisioned no new recession, but concluded that the jobless rate—4.0 percent as recently as late 2000—would not likely drop below 6.0 percent until mid-2005 and would remain above 5.5 percent far into the future.⁶ GI's assessment took account of President Bush's \$87 billion dollar spending plan for Iraq, the emerging record federal budget deficits, and projected lackluster Japanese and European growth rates. GI's main caveat: consumer spending could lag if Americans became anxious about the weak job market and sagging retirement portfolios. This lag could translate into another period of slow growth. But GI put the probability of this scenario at only 20 percent.⁷

THE STATE FISCAL CRISIS

After the robust growth of the late 1990s, state revenues, dominated by sales and income taxes, felt the effects of the recession and its sluggish aftermath. Revenues came in below budgeted levels in 41 states in FY 2002, as budget-makers underestimated the extent of the slowdown.⁸ FY 2003 projections were more conservative but, according to a survey published in June 2003, revenues still came in significantly below targets in 30 states.⁹ Personal and corporate income tax collections

showed the biggest shortfalls—each more than eight percent below target in the aggregate. Sales tax receipts were down 2.5 percent.¹⁰ FY 2004 revenue projections contained in governors' proposed budgets—based on reduced baselines due to previous years' experience and including \$17.5 billion in tax increases in 29 states¹¹—were surprisingly optimistic. Governors expected total growth of about five percent nationwide over estimated FY 2003 collections from states' three largest tax sources.¹² But over-optimistic projections posed a risk of mid-year budget cuts.¹³

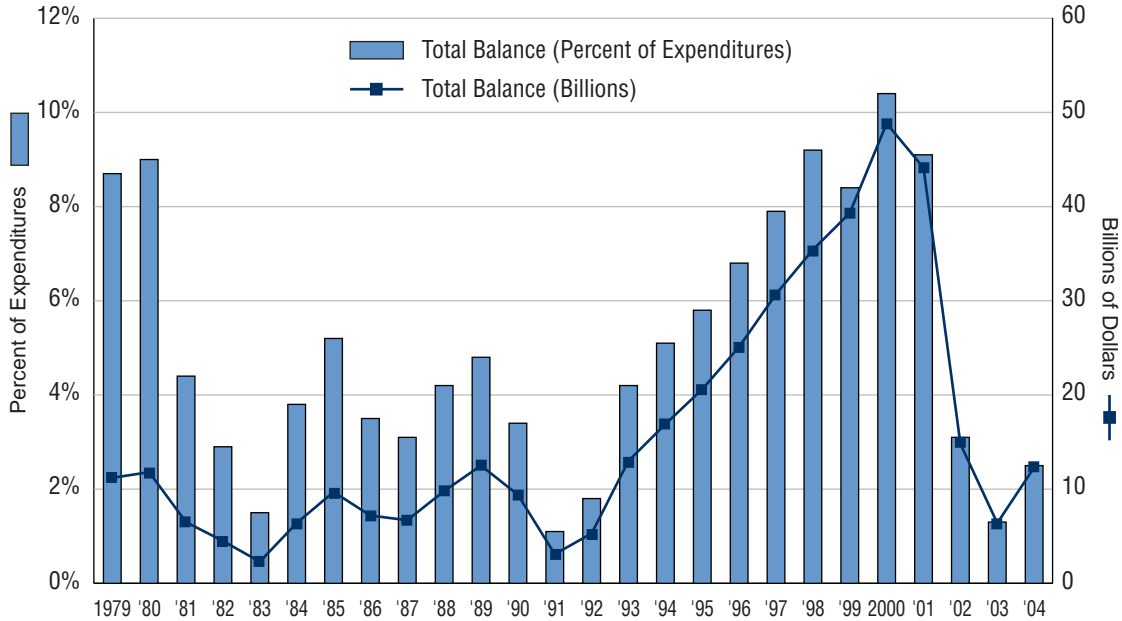
Budget cuts would be needed in such an event because states had run out of places to turn for fiscal relief. States had built their aggregate savings accounts—fiscal year-end balances including reserve funds—to a record \$48.8 billion, or 10.4 percent of expenditures, nationwide at the end of FY 2000. But three years of soft revenues resulted in a precipitous decline in reserves to just \$6.4 billion (1.3 percent of expenditures) at the end of FY 2003 (Figure 1). Governors' budgets—boosted by tax increases and hopes for economic improvement—projected a bump up to \$12.3 billion, or 2.5 percent of planned expenditures, in year-end balances by the end of FY 2004. This was still only half the level recommended by Wall Street financial analysts, whose dictums affect the interest rates states pay on bonds. Precariously low balances were widespread at the end of FY 2003—32 states reported 2003 year-end balances below three percent of expenditures; half of these were below one percent. But more eastern than western states had problems (Figure 2).

Precarious fiscal conditions dramatically affected state budgets. Figure 3 shows the 25-year trend in aggregate nationwide annual state general fund budget growth. The graph depicts the cyclical pattern in state budgets—a response to the economic downturns of the early 1980s, early 1990s, and the present period. Over the quarter century, annual budget growth averaged 6.2 percent, and this figure decreased only once: -0.7 percent in FY 1983.¹⁴ The lowest point reached after the early 1990s recession was +3.3 percent in 1993.¹⁵

In contrast, aggregate annual budget increases plunged from the seven to eight percent range between 1999 and 2001 to 1.3 percent in FY 2002, an estimated 0.3 percent

Figure 1

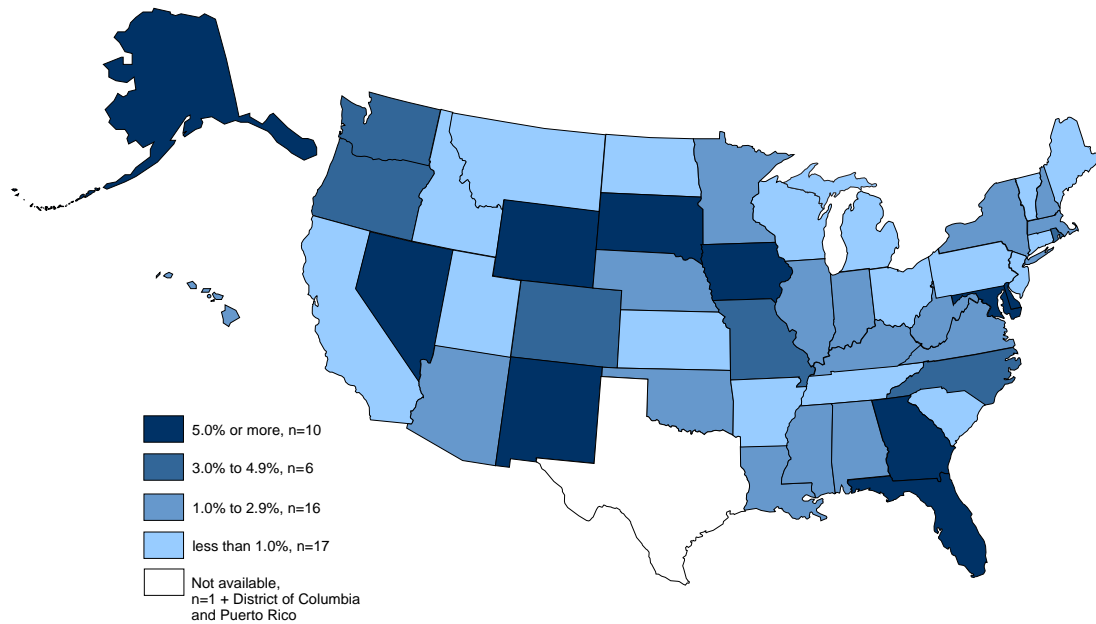
Total Year-End Balances in Billions of Dollars and as a Percentage of Expenditures, FY 1979 to FY 2004



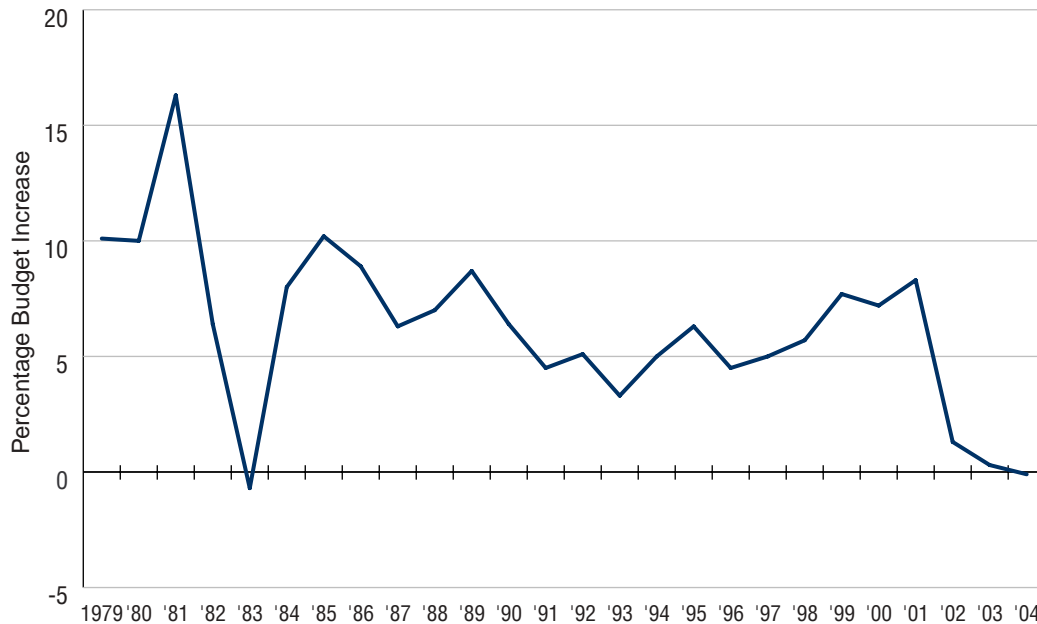
Source: Adapted from National Governors Association and National Association of State Budget Officers, 2003, 47.

Figure 2

State Year-End Balances, FY 2003 Ending Balance as a Percentage of General Fund Expenditures



Source: Adapted from National Governors Association and National Association of State Budget Officers, 2003, 48.

Figure 3**Annual State General Fund Percentage Budget Increase, FY 1979 to FY 2004**

Source: National Governors Association and National Association of State Budget Officers, 2003, 45.

in 2003, and to -0.1 percent in 2004, based on governors' proposed budgets.¹⁶ In FY 2002 and FY 2003, a record 37 states made mid-year budget cuts.¹⁷ As for the impact, the National Governors Association stated:

As states struggle to balance their budgets, they have tried to exempt certain high priority programs such as Medicaid, K-12 education, higher education, debt service, public safety, and aid to towns and cities. Few states have succeeded, however. If economic conditions remain stagnant or worsen—and as options for countering a down economy are exhausted—the future of these programs could be in even greater jeopardy if budget shortfalls grow in fiscal 2004.¹⁸

Twenty-eight states made across-the-board spending cuts in FY 2003, 17 laid off employees, and eight offered early retirement packages to their workers. States also reduced budget gaps by depleting reserve funds, hiring freezes, debt refinancing, fund transfers, deferred payments, and "securitization"—tapping future payments from tobacco settlements.¹⁹

Many states could no longer avoid serious programmatic budget cutting. In both 2003 and

2004, a record 19 states expected to spend less than in the prior year; about two-thirds expected to increase spending by five percent or less.²⁰ States had reined in spending growth in most budgetary areas sharply, though not painlessly. A summer 2003 survey found that legislative fiscal officers in 36 states projected K-12 education spending to grow by just 1.5 percent in FY 2004, corrections spending by just 1.1 percent.²¹ The officers projected state spending on higher education to *decrease* by 2.3 percent.

States had the most trouble controlling health care spending, particularly Medicaid. This federal-state partnership program of health insurance for low-income or disabled participants now approaches 20 percent of state general fund spending and about 15 percent of all state expenditures.²² Medicaid spending jumped by 13 percent in FY 2002 and by eight percent in FY 2003, even as state revenues fell far below projections.²³ Expenditures exceeded budgeted amounts in this program in 28 states in FY 2003.²⁴ The governors' aggregate budget projection of "only" 4.9 percent growth in FY 2004 Medicaid spending appeared questionable,²⁵

despite serious efforts to control costs.²⁶ The U.S. Department of Health and Human Services, in contrast, projected Medicaid spending to grow by 8.7 percent per year over the next five years.²⁷ Medicaid was described as the Pac-Man of state government,²⁸ eating all around it with its voracious budget appetite while the state budget pie hardly grew. The insatiable fiscal demands of Medicaid present a vexing problem for other major state-supported functions, including higher education.

IMPLICATIONS FOR HIGHER EDUCATION

Higher education has long ridden the roller coaster created by the state financial swings (Figure 3). This sector traditionally absorbed harder hits than other state-supported functions during economic downturns. The reason: the needs of welfare, criminal justice, and Medicaid increased in such periods and policymakers identified alternative sources of finance available to higher education—tuition, endowments, and grants, for example. States usually treated higher education more generously than other functions during prosperity to make up for prior neglect. But there was little catch-up in most states for several years after the recovery from the economic slump of the early nineties. The reasons: states budgeted more conservatively than in the past; they had to meet other needs like K-12 education reform and burgeoning Medicaid rolls, and they rolled back taxes for eight consecutive years. During the boom years 1998–2001, nationwide aggregate increases in state appropriations for higher education ranged from six to seven percent, similar to the growth in general fund spending. But states failed to make much of a dent in the huge accumulated backlog of facilities construction and maintenance, or to prepare for the surge of enrollment demand from the children of the baby boomers.²⁹

Higher education felt the effects when state revenues crashed in FY 2002. Budgeted growth in state support for FY 2002 was originally 4.6 percent, but more than half the states cut spending in midyear.³⁰ FY 2003 was far worse; the aggregate increase in initial state appropriations was just 1.2 percent.³¹ Table 1 summarizes FY 2002 (including midyear revisions)

and FY 2003 appropriations in the 50 states for higher education operating expenses.³² FY 2003 funding was below FY 2002 enacted levels in 21 of the 50 states. The largest declines: 16.6 percent in Missouri (following several years of cuts) and 15.5 percent in Oregon. Reductions ranged from seven to eight percent in Idaho, Iowa, South Carolina, Utah, and Virginia.³³ The increase was less than three percent in 21 of the 29 states reporting higher enacted appropriations in FY 2003 than FY 2002.

Community colleges did better than the rest of higher education, with an aggregate appropriation increase of two percent in the states where it was possible to make this calculation.³⁴ Appropriations for student aid also fared better in aggregate, but this masked wide variation across the states.³⁵ Some specialized groups of institutions also received relatively “generous” treatment. Independent colleges received an aggregate increase of 4.4 percent in the 12 states reporting such data, and historically Black institutions in 18 states received an aggregate increase of 4.1 percent.

Table 2 compares data on enacted appropriations for FY 2003 and FY 2004, as well as midyear revisions to 2003 appropriations, for 31 states.³⁶ About half of these states made significant downward revisions during FY 2003 (middle column). Comparing enacted FY 2003 and FY 2004 appropriations yields a sobering pattern of decline. Twenty-two of the 31 reporting states showed decreases, ranging as high as 27.6 percent in Colorado, 20.8 percent in Massachusetts, 19.9 percent in South Carolina, and 13.2 percent in Virginia. Missouri and Oregon, which had the biggest reductions in FY 2003, reduced spending further in FY 2004, though by less than five percent in each case.

Reports from the states revealed the extent of the pain. In Illinois, a state that substantially cut higher education in each of the two previous years,³⁷ the governor’s FY 2004 budget proposed cutting higher education appropriations by \$112 million. This cut, according to administrators, “could lead to shuttered libraries, larger classes, mass layoffs and fewer courses.”³⁸ “There is going to be impact on the day-to-day activity of the educational experience,” warned University of Illinois president James Stukel.³⁹ Budget cutbacks at

Table 1**Appropriations of State Tax Funds for Operating Expenses of Higher Education,
FY 2001–2002 (Initial and Revised) and FY 2002–2003**

State	FY2002 Enacted	FY2002 Revised	FY2003 Enacted	% Change Enacted 2003/2002
	(In thousands of dollars)			
Alabama	\$1,116,129	\$1,115,999	\$1,148,152	2.9%
Alaska	204,837	204,706	212,747	3.9
Arizona	949,926	884,175	907,227	-4.5
Arkansas	653,386	625,112	625,987	-4.2
California ¹	9,468,062	9,473,522	9,590,129	1.3
Colorado ²	781,303	756,809	817,236	4.6
Connecticut	761,942	753,681	762,600	0.1
Delaware	189,228	186,398	192,889	1.9
Florida	2,837,584	2,725,210	2,916,595	2.8
Georgia	1,699,438	1,707,734	1,734,481	2.1
Hawaii	349,159	349,231	369,649	5.9
Idaho	330,853	323,340	305,337	-7.7
Illinois ³	2,922,598	2,904,184	2,786,204	-4.7
Indiana ⁴	1,321,191	(no revision)	1,326,682	0.4
Iowa	830,226	786,640	769,854	-7.3
Kansas	715,585	712,923	712,027	-0.5
Kentucky ⁵	1,084,605	1,063,668	1,094,599	0.9
Louisiana	997,813	(no revision)	1,055,455	5.8
Maine	239,892	239,002	242,082	0.9
Maryland	1,297,406	1,282,690	1,301,845	0.3
Massachusetts	1,009,921	1,017,564	989,019	-2.1
Michigan	2,273,532	2,257,732	2,263,572	-0.4
Minnesota	1,382,576	1,379,832	1,419,395	2.7
Mississippi	805,964	765,014	775,243	-3.8
Missouri ⁶	1,049,504	974,646	875,070	-16.6
Montana	149,738	149,838	146,034	-2.5
Nebraska	525,220	521,316	520,691	-0.9
Nevada	346,845	(no revision)	370,593	6.8
New Hampshire	107,608	107,573	111,135	3.3
New Jersey	1,798,085	1,751,643	1,791,323	-0.4
New Mexico	611,175	(no revision)	620,718	1.6
New York	3,574,159	3,602,215	3,823,188	7.0
North Carolina	2,442,690	(no revision)	2,449,659	0.3
North Dakota	201,497	201,497	201,497	0.0
Ohio	2,181,991	2,084,535	2,112,609	-3.2
Oklahoma	824,891	796,312	811,474	-1.6
Oregon	714,837	679,831	604,330	-15.5
Pennsylvania	2,035,092	2,044,695	2,011,110	-1.2
Rhode Island	174,939	174,473	169,438	-3.1
South Carolina	896,773	856,200	830,305	-7.4
South Dakota	141,973	143,163	148,588	4.7
Tennessee	1,073,136	1,071,515	1,153,989	7.5
Texas	5,074,633	5,135,147	5,209,765	2.7
Utah	608,644	586,208	566,431	-6.9
Vermont	73,195	71,354	75,455	3.1

Table 1 (continued)

State	FY2002 Enacted	FY2002 Revised	FY2003 Enacted	% Change
				Enacted 2003/2002
(In thousands of dollars)				
Virginia	\$1,681,646	\$1,631,856	\$1,545,680	-8.1%
Washington	1,373,895	1,370,342	1,375,255	0.1
West Virginia	392,051	392,051	393,695	0.4
Wisconsin	1,192,913	1,194,852	1,220,788	2.3
Wyoming	169,929	161,917	189,786	11.7

Source: <http://www.coe.ilstu.edu/grapevine/individual.html>.

Notes:

¹ FY 2002 funding levels may be reduced by up to five percent, per a provision in the FY 2002 state budget.

² Does not take into account a gubernatorial order restricting four percent of FY 2003 appropriations at the beginning of the new fiscal year.

³ FY 2002 and FY 2003 appropriations to public universities include \$45 million for contributions to the state group health insurance fund.

⁴ FY 2003 figures reflect appropriated amounts. Administrative reductions totaling \$12.7 million have been implemented for FY 2003, but in conformance with long-standing Grapevine definitions, they have not been included above.

⁵ The FY 2003 appropriations budget was not passed by the General Assembly; therefore these figures are based on a spending plan implemented by the governor.

⁶ These figures do not include additional withholdings by the governor for FY 2002.

the University of Wisconsin, Madison may eliminate 200 courses, 90 administrative jobs, up to 60 faculty positions, and several research centers.⁴⁰ The University of Massachusetts-Amherst cut seven varsity sports teams, laid off workers, and declined to fund pay raises it negotiated with union workers. About one-eighth of the faculty took advantage of early retirement incentives offered in 2002—resulting in larger classes and fewer course offerings in 2003–04.⁴¹ The administration at the University of Nebraska-Lincoln closed the research division of a museum, mothballing collections in anthropology and zoology, and laying off 55 faculty and staff, including eight tenured faculty members.⁴² Another proposed round of cuts would eliminate the jobs of 15 more tenured faculty members.⁴³

In Florida, a special session of the legislature called to enact a budget for FY 2004 reduced higher education appropriations and authorized a substantial tuition hike.⁴⁴ Institutional representatives attested to a desperate need for the revenue, but the tuition increases became tangled in a complex, politicized, and contentious governance crisis. The tuition plan was likely to face a court challenge, whose outcome was uncertain. Representatives of Florida colleges and universities still talked of

enrollment freezes despite the state's burgeoning young population. "We are just not going to be able to provide every student with every course they need," said Harry T. Albertson, executive director of the Florida Association of Community Colleges.⁴⁵

California's finances and politics were even more tumultuous. As of October 2003, the massive state budget deficit that led to the recall of Governor Gray Davis produced FY 2004 budget cuts of ten percent for the University of California, seven percent for the California State University system, and four percent for the state's community colleges.⁴⁶ These reductions came on top of sudden cuts made in the middle of the 2002–03 academic year. In response, the University of California postponed opening its tenth campus at Merced for a year, stopped accepting applications from freshmen and community college transfers for winter 2004 admission, and contemplated freezing or reducing enrollments in fall 2004.⁴⁷ The California State University system slashed planned enrollment growth by about 30,000 students for 2003–04 and said it would not increase enrollments at all in 2004–05.⁴⁸

California's community colleges reduced their offerings by about 8,200 courses in spring 2003 in response to the midyear budget

Table 2**Appropriations of State Tax Funds for Operating Expenses of Higher Education, FY 2002–2003 (Initial and Revised) and FY 2003–2004**

State	FY2003 Enacted	FY2003 Revised	FY2004 Enacted	% Change Enacted 2004/2003
	(in thousands of dollars)			
Alaska	\$212,747	no revision	\$217,245	2.1%
Colorado	817,236	685,529	591,511	-27.6
Connecticut	762,600	754,768	750,975	-1.5
Florida	2,866,138	2,891,876	2,807,232	-2.1
Georgia ¹	1,734,481	1,669,191	1,671,850	-3.6
Hawaii	369,649	no revision	398,836	7.9
Illinois	2,787,049	2,763,756	2,703,279	-3.0
Indiana	1,326,682	no revision	1,360,318	2.5
Iowa	769,854	no revision	753,915	-2.1
Kansas	712,027	679,830	685,832	-3.7
Kentucky	1,094,599	1,068,484	1,115,174	1.9
Maine	242,082	236,682	239,110	-1.2
Massachusetts	989,019	970,780	783,207	-20.8
Michigan ²	2,263,572	2,151,247	2,080,228	-8.1
Mississippi	775,243	765,185	797,246	2.8
Missouri ³	875,070	no revision	838,597	-4.2
Montana	146,034	no revision	150,576	3.1
Nebraska	520,691	520,769	498,809	-4.2
New Hampshire	111,135	111,042	112,830	1.5
North Dakota	201,497	203,801	200,430	-0.5
Ohio	2,112,609	no revision	2,080,196	-1.5
Oklahoma	811,474	750,656	731,375	-9.9
Oregon ⁴	604,330	553,499	588,920	-2.5
Rhode Island	169,438	169,615	172,816	2.0
South Carolina	830,305	738,789	664,994	-19.9
South Dakota	148,588	148,976	152,299	2.5
Tennessee	1,153,989	1,106,889	1,046,163	-9.3
Utah	604,583	602,086	603,196	-0.2
Virginia ⁵	1,545,680	1,421,683	1,340,942	-13.2
West Virginia ⁶	393,695	379,672	357,966	-9.1
Wisconsin	1,211,788	1,211,419	1,117,395	-7.8

Source: <http://www.coe.ilstu.edu/grapevine/individual.html>

Notes:

¹ FY2003 and FY2004 included \$6.586 million in tobacco funds

² Appropriation reductions reflected in the revisions for FY2003 and FY2004 reflect higher education's share of overall state budget reductions necessitated by declining state revenues.

³ FY2004 does not include additional Governor withholdings.

⁴ Oregon also allocates state lottery fund dollars for higher education: FY2003 = \$4241; FY2004 = \$2720.

⁵ Included in the totals are general fund appropriations related to independent institutions and non-state agencies.

⁶ Net total of general revenue funding less lottery funds.

reductions. The result: an estimated 90,000 lost enrollments,⁴⁹ with little hope for improvement in 2003–04 in a state where the young population—often characterized as “Tidal Wave II”—was increasingly of color. The severity of the crisis led the State Assembly’s Higher Education Committee to plan hearings on radical financing changes, including voucher-like proposals, high tuition/high aid financing models in order to increase tuition intake from the affluent, and tying state funds to degree completions rather than enrollments in order to encourage faster throughput.⁵⁰

In Colorado a drastic student-based, voucher-type funding proposal, though seriously considered, did not pass in the legislature.⁵¹ The idea is likely to arise again because Colorado’s current fiscal statutes severely limit the growth of state spending and the ability of institutions to raise tuition. In Missouri, a succession of deep budget cuts eviscerated a promising program for rationalizing a fragmented higher education structure and for focusing resources on the state’s most pressing needs and policy goals.⁵² Instead the stakeholders again fought one another for resources with little attention to broader state priorities. The state’s higher education commissioner resigned in frustration when her agency’s budget was cut by 30 percent in FY 2003.⁵³

Figure 4 depicts the continuation of the long-term declining pattern in the proportion of state wealth invested in higher education. The nationwide figure for FY 2003 of \$7.35 for higher education appropriations per \$1,000 of personal income is the lowest since the 1960s and represents a 30 percent decrease from the peak levels of investment reached in the late 1970s. One analysis attributes much of the decline to competition with Medicaid for funding.⁵⁴

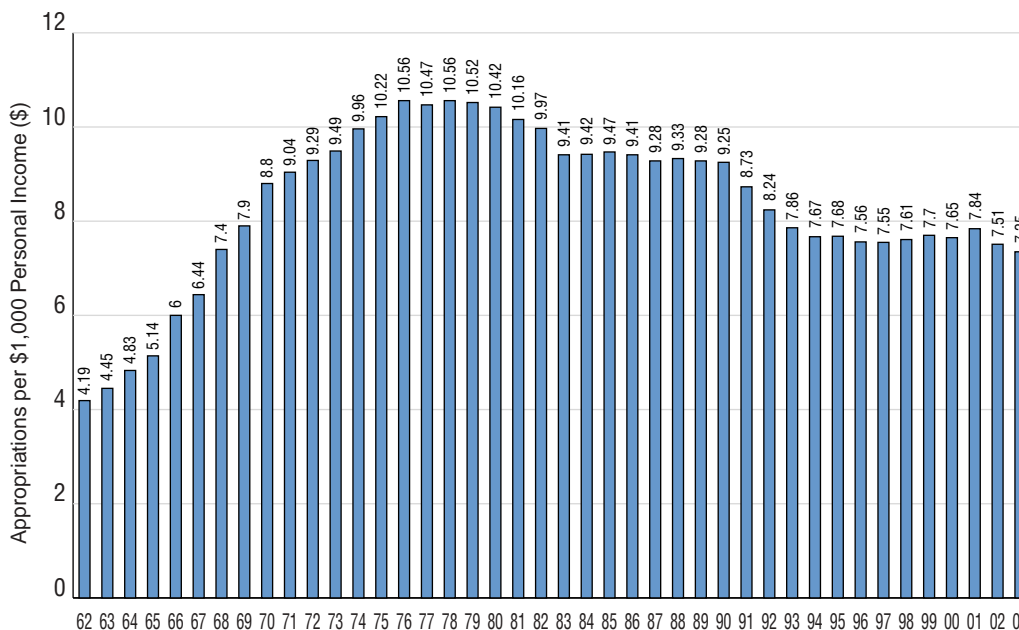
TUITION AND STUDENT AID TRENDS

Following the historic pattern, public college and university tuition and fees jumped sharply in response to cuts in higher education appropriations. Between 1997–98 and 2000–01, average (enrollment-weighted) annual tuition growth for state resident undergraduates at four-year public colleges and universities ranged from 3.5 to 4.5 percent.⁵⁵ The average

tuition increase figure then jumped to 6.8 percent in 2001–02, 10.5 percent in 2002–03, and 14.1 percent in 2003–04.⁵⁶ For public two-year colleges—designed to maximize accessibility, especially for low-income students—recent increases were more moderate until this year when the average jumped by 13.8 percent.⁵⁷ Increases in the four-year independent sector, though less directly tied to the economy, crept up in recent years to 6.4 percent in 2001–02, 7.7 percent in 2002–03, and 6.0 percent in 2003–04.⁵⁸ Three-year inflation-adjusted increases in the private sector were last this high in 1984–1986.⁵⁹ These price increases, combined with diminished enrollment capacity, will reduce participation in higher education just when the demographic bulge and the effects of the slack labor market are producing booming enrollment demand. The discouraging effect of prices will be strongest on ethnic minority students and those of modest means.⁶⁰

The continuing upsurge in public sector tuition reflects the lack of alternatives for coping with inadequate state funding. A July 2003 survey of more than 70 public multi-campus college and university systems found that well over half the systems planned tuition increases of more than ten percent in 2003–04; five reported increases of more than 20 percent, four reported more than 25 percent, and another four reported more than 30 percent.⁶¹ Long-standing political resistance to tuition increases finally gave way in several states. Virginia froze tuition for several years and even reduced prices in 1998, but enacted substantial increases midyear in 2002–03,⁶² and larger hikes for 2003–04 (19 percent at the University of Virginia).⁶³ Virginia faces strong population pressures on enrollment so these large increases will restrict access.

The City University of New York increased undergraduate tuition by 25 percent in 2003–04 and the State University of New York went up nearly 28 percent.⁶⁴ California was one of six states that raised tuition in mid-2002–03. These sudden hikes were followed by 2003–04 increases of around 30 percent in the UC and CSU systems and of 64 percent in the California Community Colleges.⁶⁵ Arizona, a low tuition bastion, posted the two largest percentage increases among public four-year schools for 2003–04: around 39 percent at the University of Arizona and at Northern

Figure 4**Appropriations of State Tax Funds for Operating Expenses of Higher Education per \$1000 of Personal Income, FY 1962 to FY 2003**

Source: Mortenson, 2002, 1.

Arizona University.⁶⁶ In Texas, another traditionally low-tuition state, the legislature granted the Board of Regents full authority over tuition but no increases were planned for 2003–04. Observers speculated, though, that tuition increases as large as 50 percent over the next two years might be in the offing.⁶⁷

“Student aid”—scholarships, grants, work-study, and loans—can help offset the impact of tuition increases. The federal government is the largest source of student aid—over \$70 billion in 2002–03.⁶⁸ But the economic downturn, combined with the effects of the 2003 tax cuts and the Iraq war and occupation, affected the finances of the federal government. The imbalanced federal budget—the deficit for FY 2003, ending September 30, 2003, reached a record \$374 billion⁶⁹—affected the climate for all domestic spending unrelated to security. The maximum grant size in the core Pell student aid program had demonstrated six years of healthy increases, jumping from \$2,470 in 1996 to \$4,000 in 2002. But the maximum then became stuck at around the

\$4,000 level, despite skyrocketing tuition.⁷⁰ Other federal grant programs fared little better, and even a proposed increase in loan limits is contentious and unsettled.⁷¹ Federal tax credits for college tuition expenses, while costly in foregone tax revenue, have had limited impact on participation in higher education since the credits mainly benefit better-off students who would likely have enrolled anyway.⁷²

The states are also significant players in the student aid arena, providing in aggregate nearly \$6 billion during 2001–02.⁷³ State grants grew by two-thirds between 1996–97 and 2001–02, and by nearly ten percent in 2001–02, the latest year for which complete data were available.⁷⁴ But the gains slowed just when students most needed the aid. Aggregate growth in grant aid, by one estimate, dropped to about five percent in 2002–03,⁷⁵ and could disappear entirely in 2003–04. The aid also appears maldistributed. Sixty percent of the total comes from just six states, and several states provide little aid on a per-enrolled-student basis. Further, the proportion of state grant aid

awarded for financial need eroded as states adopted “merit-based” aid programs to reward academic achievement and to retain top students.⁷⁶ The need-based share of all state grant aid fell steadily from around 85 percent in the early 1990s to 75 percent in 2001–02.⁷⁷

In sum, student aid may not be able to mitigate the impact of sharp tuition increases, since federal budget deficits will probably climb to over a half-trillion dollars annually and since states’ finances remain precarious.

CONCLUSION: TIME FOR FISCAL RESTRUCTURING?

The current crisis has provoked much soul-searching. States want to rethink the financial terms of federal-state partnership programs, especially Medicaid, and federal limitations on their ability to tax Internet sales. These limitations, plus a political unwillingness to extend sales taxes to most services, are resulting in the erosion of state tax bases since the economy is shifting towards these untaxed sectors. Higher education also faces a structural inequity in its ability to compete for resources with Medicaid, elementary and secondary education, prisons, and public welfare, which serve growing, mandatory caseloads. In contrast, policymakers believe enrollment growth in higher education can be postponed.

Many in higher education may now realize that its cuts in state appropriations result from structural factors, and are not just a function of the current trough in the economic cycle. The need to serve more students from the “baby boom echo” generation over the next several years will exacerbate the pressure on slender budgets. Public colleges and universities already pursue private fund development programs aggressively. They also implement instructional programs—often non-degree and/or distance learning—that tap new markets and revenue possibilities. Perhaps most significant, their administrators are thinking differently about tuition.

Most in public higher education have long wished to encourage the attendance of all by keeping tuition low. But growing numbers of public colleges and universities are seeking ways to make palatable needed large increases in tuition revenue. The University of

California’s Regents may consider an unprecedented fee surcharge restricted to upper income families; the University of North Carolina also weighed this idea.⁷⁸ Even if this proposal is judged unworkable, more public institutions may move towards the independent academic sector’s high tuition-high aid financing model. This model seeks to extract much higher revenue from affluent students while recycling some of the additional income to meet the increased financial need created by a high “sticker price.” Aid decisions are made on an individual student basis, so students pay a wide variety of different “net prices.” The arrangement is similar to the price differentiation used in selling airplane seats.

Some public universities are moving toward differential pricing by field, hoping that lucrative professional degree programs, such as law, business, and medicine, can command higher prices. Differential pricing could reduce claims on general campus resources, if the professional schools would keep the added tuition revenues. But these schools would also have to meet the expectations for higher quality of high-paying students. These moves can exacerbate inequalities across disciplines, and the different revenue and pricing structures can complicate cross-campus collaboration. Even in law and medicine—and certainly in less lucrative professional fields like public administration and education—the high tuition structure poses problems for students who choose lower-paying, public interest-oriented career tracks. Financial restructuring may produce a less smooth-functioning and less collaborative university, whose graduates are not as willing to serve society.

Structural pressures on traditional sources of financing, combined with rapid technological change, portend major transformations for higher education. The public college or university of ten or twenty years hence will be even more complex than today’s agglomerations of divisions, departments, and programs. Students will enroll in wide-ranging non-degree and degree programs, available at widely varying prices in multiple locations and formats. Maintaining coherence, internal equity, and a sense of institutional purpose will be a major challenge.

NOTES

- ¹ Forty-six of the 50 states begin their fiscal year on July 1 of the prior calendar year; FY 2004, for example, began on July 1, 2003 in most states.
- ² Behravesch and Latta, 2003, 8.
- ³ Los Angeles Times and Washington Post, 2003.
- ⁴ Ibid. The other statistics in this paragraph are from the same source.
- ⁵ Behravesch and Latta, 2003, 3-4.
- ⁶ Latta and Newport, 2003, 24.
- ⁷ Ibid.
- ⁸ National Governors Association and National Association of State Budget Officers, 2003, 9.
- ⁹ Ibid.
- ¹⁰ Ibid., 10.
- ¹¹ Ibid. This was only the second year of net state tax increases after a string of eight straight years of tax cuts from 1995 through 2002.
- ¹² Calculated from *ibid.*, 33.
- ¹³ Moreover, projections for FY 2005 were sobering: states were thought likely to face gaps between projected expenditures and revenues of at least \$40 billion (Lav, 2003, 3). As of November 2003, ten states reported that a gap had emerged between projected FY 2004 expenditures and revenues or other sources of funds, totaling about \$2.75 billion (National Conference of State Legislatures, 2003b). Although worrisome, this was an improvement over the same point in the previous year when 31 states had reported budget gaps totaling \$17.5 billion.
- ¹⁴ National Governor's Association, 2003, 1.
- ¹⁵ Ibid., 4.
- ¹⁶ Ibid.
- ¹⁷ Ibid., 1.
- ¹⁸ Ibid.
- ¹⁹ Ibid. Securitization essentially means selling the right to future payments at a steep discount in return for cash up front.
- ²⁰ Ibid. The figures for 2004 do not take account of a \$20 billion federal transfer to the states enacted as part of the 2003 tax cut bill.
- ²¹ National Conference of State Legislatures, 2003a, 3. Six states had not yet enacted FY 2004 budgets and others were unable to provide detailed spending projections by field.
- ²² National Governors Association, 2003, 1.
- ²³ Ibid., 4.
- ²⁴ Ibid., 5.
- ²⁵ National Governors Association, 2003, 4. Relief provided under the federal tax cut bill should help: \$10 billion of the \$20 billion provided in fiscal relief for states was designated for a temporary increase in the federal Medicaid matching rate (National Conference of State Legislatures, 2003c, 11).
- ²⁶ Lemov describes some of the steps and what might lie ahead (2003, 60).
- ²⁷ Ibid., 5. The enactment by Congress of a prescription drug insurance program under Medicare would provide considerable relief to states for their most expensive clients are the growing numbers of low-income elderly who are also eligible for Medicare.
- ²⁸ Wilgoren, 2003. Raymond Scheppach, executive director of the National Governors Association used the metaphor.
- ²⁹ June, 2003.
- ³⁰ Schmidt, 2002b, A23-24.
- ³¹ Arnone, 2002.
- ³² Grapevine is based at the Center for the Study of Higher Education at Illinois State University (<http://www.coe.ilstu.edu/grapevine/individual.html>).
- ³³ In Virginia an 8.1 percent reduction in FY 2003 followed upon several years of deep cuts and tuition freezes that threatened quality, morale, and the ability of institutions to respond to surging enrollment demand (Irving, 2002).
- ³⁴ Arnone, 2002. The documentation for the other points in this paragraph came from the same source.
- ³⁵ More than a dozen states provided data that did not permit this calculation.
- ³⁶ FY 2004 data were incomplete at the time of writing.
- ³⁷ As documented in Burdman, 2002, 3-4.
- ³⁸ Associated Press, 2003a.
- ³⁹ Ibid.
- ⁴⁰ Ibid.
- ⁴¹ Ibid., 2.
- ⁴² Fogg, 2003.
- ⁴³ Ibid.
- ⁴⁴ Schmidt, 2003.
- ⁴⁵ Ibid.
- ⁴⁶ Hebel, 2003, A21.
- ⁴⁷ Ibid.
- ⁴⁸ Ibid., A22.
- ⁴⁹ Ibid.
- ⁵⁰ Ibid.
- ⁵¹ Associated Press, 2003b.
- ⁵² Schmidt, 2002a.
- ⁵³ Ibid.
- ⁵⁴ Kane and Orszag, 2003.
- ⁵⁵ Computed from figures in College Board, 2001, 6.

⁵⁶ Calculated from College Board, 2003a, 8. This year's inflation-adjusted increase, notes the College Board, is the highest in three decades (ibid., 3).

⁵⁷ Ibid, 8.

⁵⁸ Ibid.

⁵⁹ Ibid, 3.

⁶⁰ Kane, 1999, 101-114.

⁶¹ Arnone, 2003c.

⁶² Irving, 2002.

⁶³ Arnone, 2003c.

⁶⁴ Ibid.

⁶⁵ Ibid.; Hebel, 2003, A22.

⁶⁶ Arnone, 2003c.

⁶⁷ Ibid.

⁶⁸ College Board, 2003b, 4.

⁶⁹ Seattle Times, 2003.

⁷⁰ The maximum grant was raised to \$4,050 in FY 2003 and was likely to remain at this level once the federal budget for 2004 is enacted (Brainard, 2003).

⁷¹ Burd, 2003.

⁷² Arnone, 2003a.

⁷³ DeSalvatore, Hughes and Gee, 2003.

⁷⁴ Arnone, 2003b.

⁷⁵ Ibid.

⁷⁶ Georgia's HOPE scholarship program, initiated in 1993, was the leader in this trend.

⁷⁷ Reeher and Davis, 1991; DeSalvatore, Hughes and Gee, 2003.

⁷⁸ Selingo, 2003.

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