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WHY THE FINANCE MODEL FOR PUBLIC HIGHER EDUCATION IS BROKEN AND MUST BE FIXED

BY JONI E. FINNEY

The United States currently has the best 20th-century model for public finance of higher education in the world.

If the nation wishes to "tread water" in higher education degree attainment compared to other countries, as it now is doing, its outdated system of higher education finance will ensure this outcome. But, if the U.S. wants to increase both the quantity and quality of workforce certificates and degrees, its unsustainable and opaque finance model for higher education must be changed in order to rise to the challenges of the 21st century. The reasons for this go beyond some well-documented inefficiencies of our colleges and universities. This policy brief explores how the broken model of higher education finance reveals a fundamental mismatch between how we pay for public higher education and our current economic and social needs.

The first section of this policy brief describes the economic and demographic context in which higher education finance challenges must be resolved. The second section highlights the barriers that state governments erect that make the reform of public higher education finance challenging. Third, the brief focuses on specific state higher education finance policies that are mismatched with goals for a more educated nation. To encourage debate, the conclusion of the brief outlines a series of criteria that states should consider when implementing any higher education finance policy.

BRIEF IN BRIEF

- In order for the U.S. to remain competitive in the 21st-century economy, more individuals are going to need to earn workforce credentials and college degrees.
- While the need for a more educated workforce is rising, the students entering postsecondary education are increasingly diverse and coming from relatively modest economic means.
- At the same time, state governments have been facing financial challenges wrought by chronic structural budget deficits and rising Medicaid expenses, translating into reduced support for higher education.
- Instead, families now are expected to shoulder more of the burden of paying for higher education—increasingly, through loans and not grants—at a time when they are struggling with rising costs of living that exceed the growth in their incomes.
- The current system of higher education finance is unsustainable. This brief recommends that state leaders take action so as to insulate higher education funding during recessionary periods; incentivize innovation in the efficient use of public dollars; prioritize funding for low-income and first-generation students; and link tuition policy to family income.

STATE CONTEXT

The 21st-century economy requires that more individuals earn high-quality workforce credentials and college degrees than did the economy of the last century. By 2020, 65 percent of the population will require some form of postsecondary education (workforce certificate or degree) in order to be competitive in the new economy.[1] This translates into an average annual increase in degree productivity of approximately 10 percent.[2] While the number of workforce certificates and college degrees needed varies by state, no state can reach the necessary levels of education attainment based on current rates of college participation and completion, as well as the current rise in costs for attending colleges and universities.

Table 1 shows the projected percentage of jobs in the ten most populous states that will require at least some postsecondary education by 2020. In general, the percentage of certificates and degrees needed at the sub-baccalaureate level is larger than that needed at the baccalaureate level, though both are high.

The increasing demand for more education coincides with growing diversity in—but not limited to—the most populous states (see Table 2). For instance, the young population of Hispanics is growing in all but two of the ten most populous states. The young Black population is relatively stable in the proportion of high school graduates; but in four of the largest states (FL, GA, MI, NC), this young population will be larger than the national average by 2027, with Georgia leading the nation in the highest concentration of young Black high school graduates. The young Asian population of high school graduates is also increasing in many states, but their numbers are relatively small compared with other groups. Additionally, many new students entering postsecondary education are of modest economic means. For instance, the real median income of families by race in 2012 was $69,000 for Asians, $57,000 for non-Hispanic whites, $39,000 for Hispanics of any race and $33,000 for Blacks.[3]

TABLE 1: WORKFORCE AND EDUCATION DEMANDS OF THE 10 MOST POPULOUS STATES

State	2013 Population Rank	Percent of jobs in 2020 that will require: Some kind of postsecondary education	Some college, an associate's degree or a postsecondary vocational certificate	Bachelor's degree	Master's degree or better
California	1	67%	32%	24%	12%
Texas	2	62%	33%	21%	9%
New York	3	69%	28%	26%	15%
Florida	4	65%	35%	21%	9%
Illinois	5	70%	31%	26%	13%
Pennsylvania	6	63%	29%	22%	11%
Ohio	7	64%	34%	21%	10%
Georgia	8	65%	33%	22%	10%
Michigan	9	70%	37%	22%	11%
North Carolina	10	67%	36%	22%	9%
United States	N/A	65%	33%	23%	11%

Sources: U.S. Census Bureau, Population Division, Annual Estimates of the Population for the United States, Regions, States and Puerto Rico, July 2013, Table 1. Anthony P. Carnevale, Nicole Smith, and Jeff Strohl, Recovery: Job Growth and Education Requirements Through 2020 (Washington, DC: Georgetown University Center on Education and the Workforce, 2013), 3-7.

STATE BUDGET BARRIERS TO FUNDING HIGHER EDUCATION

Even before the Great Recession, state governments faced serious challenges in financing their systems of higher education—challenges that are even more evident now: (1) state structural budget deficits have not been addressed by political leaders; (2) Medicaid in particular is taking up a greater share of state budgets and crowding out funding for higher education; and (3) financial pressures on families for many goods and services exceed growth in income.

STATE STRUCTURAL BUDGET DEFICITS

As economic growth slowed during the Great Recession, state revenues plummeted, resulting in large cuts to public services. While many states are now reinvesting modestly in higher education, it is unlikely that this funding will rebound to the levels of the late 1990s. State budget problems vary depending upon the nature of each state's economy and demographic shifts in the state's population, as well as the political capital needed to address budget challenges. But increasingly, the long-term imbalance between state revenues and state expenditures—referred to as structural budget deficits—has contributed to the volatility of state budgets since the 1980s. Economists define structural budget deficits as the "chronic inability of state revenues to

1 Anthony P. Carnevale, Nicole Smith, and Jeff Strohl, Help Wanted: Projections of Jobs and Education Requirements through 2018 (Washington, DC: Georgetown University Center on Education and the Workforce, 2012), 121-122. Anthony P. Carnevale, Nicole Smith, and Jeff Strohl, Recovery: Job Growth and Education Requirements Through 2020 (Washington, DC: Georgetown University Center on Education and the Workforce, 2013), 15.

2 Joni E. Finney, Laura W. Perna, and Patrick M. Callan, Renewing the Promise: State Policies to Improve Higher Education Performance (Philadelphia, PA: Institute for Research on Higher Education, 2014).

3 https://www.census.gov/prod/2013pubs/p60-245.pdf.

4 Iris J. Lav, Elizabeth McNichol and Robert Zahradnik, Faulty Foundations: State Structural Problems and How to Fix Them (Washington, DC: Center on Budget & Policy Priorities, 2005).

5 Ibid.

6 Donald J. Boyd, What will happen to State Budgets When the Money Runs Out? (Albany: The Nelson A. Rockefeller Institute of Government, 2009). Dennis Jones, State Shortfalls Projected to Continue Despite Economic Gain: Long-Term Prospects for Higher Education No Brighter (San Jose: National Center for Public Policy and Higher Education, 2006).

7 Don Boyd, State Fiscal Outlooks from 2005 to 2013: Implications for Higher Education (National Center for

TABLE 2: RACIAL AND ETHNIC COMPOSITION OF HIGH SCHOOL GRADUATES AND PROJECTED GROWTH IN HISPANIC HIGH SCHOOL GRADUATES IN THE NATION AND THE 10 MOST POPULOUS STATES

	Racial and ethnic composition of public high school graduates 2012			Racial and ethnic composition of public high school graduates 2007			Growth in Hispanic graduates (2012 - 2027)	Percent growth in Hispanic graduates (2012 - 2027)	Percent share of Nation's total Hispanic graduates 2012	Percent share of Nation's total Hispanic graduates 2027
	Asian	Black	Hispanic	Asian	Black	Hispanic				
California	15%	6%	44%	17%	5%	49%	7,548	5%	29%	24%
Texas	4%	12%	45%	6%	10%	57%	61,619	49%	22%	26%
New York	9%	17%	18%	12%	11%	17%	6,422	1%	6%	5%
Florida	3%	21%	25%	5%	20%	34%	13,198	35%	7%	7%
Illinois	5%	16%	18%	8%	13%	20%	(1,951)	-8%	4%	3%
Pennsylvania	3%	13%	7%	6%	12%	12%	6,492	76%	2%	2%
Ohio	2%	13%	2%	3%	12%	4%	1,608	58%	0%	1%
Georgia	4%	36%	8%	8%	37%	15%	6,486	89%	1%	2%
Michigan	3%	18%	4%	4%	21%	5%	(55)	-1%	1%	1%
North Carolina	3%	26%	9%	6%	33%	15%	273	85%	1%	2%
Nation	6%	14%	19%	8%	14%	24%	154,278	27%		

Note: National rates include all 50 states and D.C. State ethnic shares are calculated as a percent of total state public high school graduates.
Source: Western Interstate Commission on Higher Education, *Knocking at the College Door: Projections of High School Graduates*, 8th Edition, November 2013.

grow in tandem with economic growth and the cost of government."[4] Several colliding trends cause these structural deficits, including: the shift from a goods to services economy in which many, if not most, services are untaxed; the growth of untaxed internet sales (at the expense of brick-and-mortar stores charging sales taxes); and the erosion of corporate taxes as the result of the easy movement of corporate headquarters to countries with lower tax rates, combined with spending and expenditure limitations passed in many states.[5]

State structural budget deficits can potentially harm all public services, but the impact on higher education has been especially damaging, triggering cuts in institutional appropriations and often in state programs for student financial aid. Because higher education is one of the few public services that can generate its own revenue, state leaders often acquiesce to institutional pleas for tuition increases during economic downturns. Rarely, if ever, does tuition then decline in the face of economic recovery (although this year several states have announced tuition freezes as the result of growing public pressure in response to years of increases).

Until the early 1990s, there was little political concern about structural budget deficits, since economic growth usually rebounded after short–lived recessions, masking longer term problems. During the last decade, many state budget analysts and think tanks called attention to the serious threat of structural deficits in terms of the long-term fiscal health of states, and the ability of states to continue to provide public services—particularly higher education. [6]

An analysis by the Rockefeller Institute predicted that between 2005-2013, every state would face a potential budget deficit based on expected revenues (status quo tax policies) and expected expenditures (status quo spending policies), with about 30 states facing deficits as large as 5 percent or more annually.[7] Since this analysis, the Rockefeller Institute has refrained from updating projections of state structural budget deficits. The challenge involved in developing reliable projections of structural deficits arises from the ongoing reduction in federal outlays to states, increased demands for Medicaid, and a slow recovery in the housing market in many parts of the country.[8] However, confirming the analysis of previous projections, the National Conference of State Legislatures shows that while state revenues for 2014 are gradually

Higher Education Management Systems, 2005).

8 Phil Oliff, Chris Mai, and Vincent Palacios, States Continue to Feel Recession's Impacts (Washington, DC: Center on Budget and Policy Priorities, 2012).

9 Megan Comlossy and Jacob Walden, "Silver Tsunami," State Legislatures Magazine 39 (2013), 14.

10 Report of the State Budget Crisis Task Force (New York: State Budget Crisis Task Force, 2012).

11 Comlossy and Walden, "Silver Tsunami," 14.

12 State Higher Education Executive Officers, State Higher Education Finance FY 2012 (Boulder, CO: SHEEO, 2013).

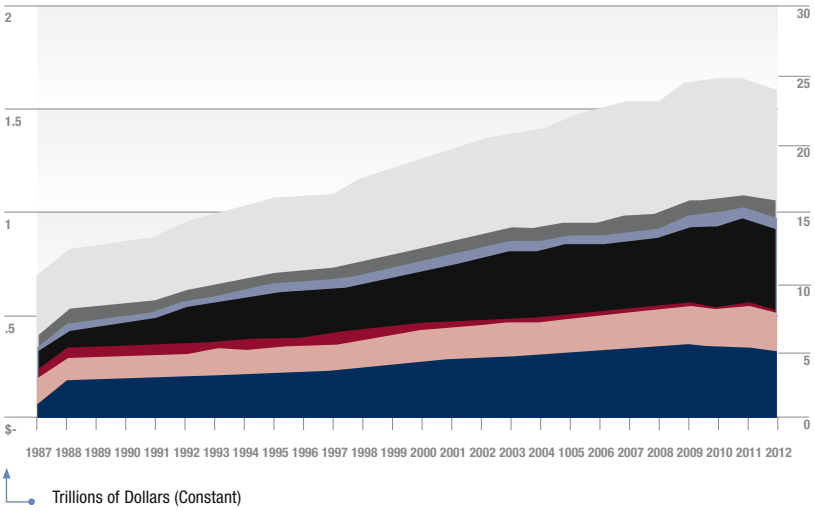
13 National Center for Public Policy and Higher Education. Measuring Up 2008: The National Report Card on Higher Education (San Jose: National Center for Public Policy and Higher Education, 2008).

14 To estimate financial aid by income, data on student grant aid awarded to first-time, full-time students and aid source (federal, state/local, and institutional) is drawn from Title IV institutions from the Integrated Postsecondary Education Data System (IPEDS). From these data on averages awarded to states, sectors by aid source can be estimated.

15 U.S Department of Education, IES National Center for Education Statistics, The Condition of Education 2014, NCES 2014-083 (Washington, DC: U.S. Government Printing Office, 2014).

16 Laura W. Perna and Joni E. Finney, The Attainment

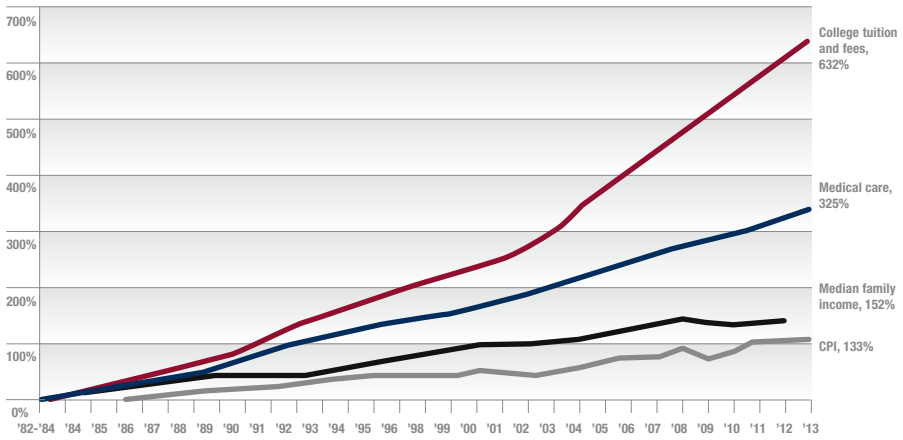
FIGURE 1: COMPOSITION OF TOTAL STATE EXPENDITURES BY FUNCTION (2012 DOLLARS): 1987-2012



Source: National Association of State Budget Officers, State Expenditure Report, 2011-2013, Figure 5, Inflation adjustments by author.

All other · Transportation · Corrections · Medicaid
Public assistance · Higher education · Elementary & Secondary Education

FIGURE 2: PERCENT GROWTH IN EXPENSES FOR HIGHER EDUCATION AND OTHER GOODS, 1982-84 TO 2013



Note: Percent Growth is from an average of 1982, 1983, 1984 prices. Using an average helps control for outlier data where prices had uncharacteristic spikes in one year. Median Family Income data is from 1982-84 to 2012: (2012 is the most recent data available).
Sources: Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers, Median Family Income is from U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements, and American Community Survey.

College tuition and fees · Medical care · Median Family Income · Consumer price index

recovering from the large declines experienced during the Great Recession, the recovery is not sufficient to keep pace with the spending required by Medicaid costs, pensions and other state obligations.[9] This perspective is reinforced in a Report of the State Budget Crisis Task Force, in which co-chairs Paul Volcker and Richard Ravitch point out: "The conclusion of the Task Force is unambiguous. The existing trajectory of state spending, taxation and administrative practice cannot be sustained. The basic problem is not cyclical. It is structural."[10]

MEDICAID SPENDING GROWS FASTER THAN PUBLIC SERVICES

Contributing to state budget woes, specifically for higher education, is the growth of Medicaid. Medicaid consumes a greater portion of the state budgets than any other public service. Currently, all states participate in the Medicaid program. As Medicaid grows, so does its share of the general fund state budget. In 1987, Medicaid's share of total state expenditures was 10.2 percent; in 2012 it was 23.9 percent. In contrast, between 1987 and 2012, state expenditures for higher education declined from 12.3 percent to 10.2 percent. While a declining share of the state budget does not necessarily mean a reduction for higher education budgets in good economic times (as the total general fund grows), the need to educate more Americans means either increased spending for higher education (tax increases or expenditure reductions in other public services), improved productivity in higher education, or both.

Furthermore, pressure on Medicaid is not likely to abate anytime soon. According to the National Conference of State Legislatures, about 41 million Americans (more than 1 in 8) are over age 65. By 2030, that number will jump to about 72 million, an increase from 13 to 20 percent. The cost of medical treatment for this population —dubbed the "Silver Tsunami" —also will increase. [11] As Figure 1 shows, the growth

(Baltimore: Johns Hopkins Press, 2014).
17 Ibid.

in Medicaid expenditures poses a significant threat to the ability of states to invest in higher education.

FINANCIAL PRESSURES ON FAMILIES ARE GROWING

The economic pressures facing families are a third force influencing an unsustainable cost model for higher education. This means there will be real limits to relying on steep tuition increases as a way to improve funding for higher education. Figure 2 shows the growth in many family expenses, but the large growth of tuition and fees from the mid 1980s-2013 (632 percent) is notable, particularly in comparison to the lower increase in family income (152 percent) and the often-cited (and much lower) increase in health care costs (325 percent).

THE MISMATCH BETWEEN FINANCE POLICIES AND EDUCATIONAL NEEDS

Intertwined with the larger public context just described are state higher education policies that are mismatched with the changing economic and demographic environment of the states. These policies are characterized by: (1) a shift in who pays for higher education; (2) an increase in the portion of family income required to pay for postsecondary education; (3) state-funded financial aid programs that cannot keep pace with tuition increases; and (4) a shift from grants to loans.

STATE BUDGET VOLATILITY AND COST SHIFTS

Figure 3 shows the volatility of state budgets for higher education as a result of structural budget deficits. Data from the early 1990s, early 2000s and again after the Great Recession show that states reduced support per student during these times. While state support for higher education per enrolled student rebounded after the early 1990s, it has not rebounded since the recession in 2001.

Figure 3 also shows that total revenue available for higher education from net tuition and state/local governments has remained largely unchanged from 1987-2012, even after adjusting for inflation. Total state and local appropriations plus net tuition revenue (tuition less all financial aid) per full-time student was $11,095 in 1987 and $11,085 in 2012. During the peak years of 1998-2001, support from the states grew, even as enrollment was relatively flat. The decline in state support for higher education during the Great Recession was softened as a result of an infusion of stimulus dollars from the American Recovery and Reinvestment Act (ARRA). Funds from ARRA were used to supplement state and local funding for education from 2009-11 (and are included in Figure 3). By 2012, however, most of these dollars were depleted and state and local support for higher education fell 7 percent.[12]

Most notable in Figure 3 is the shift in who pays for postsecondary education. Total revenue per student from state and local governments declined from $8,497 in 1987 to $5,906 in 2012, while net tuition revenue per student increased in constant dollars from $2,588 in 1987 to $5,189 in 2012. Currently, on average, 47 percent of the net tuition revenues (in inflation-adjusted dollars) for public higher education comes from students. It is important to note there are wide variations in these trends among the states based on economic conditions, the philosophy of funding higher education and other factors.

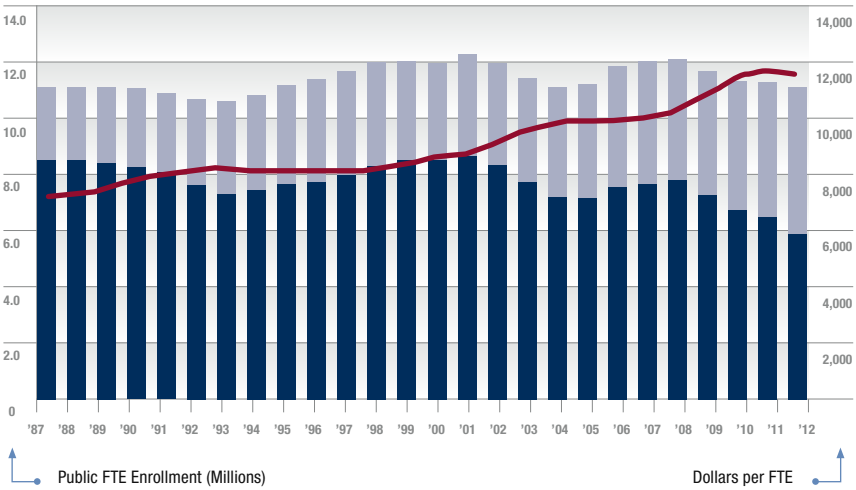
Also notable in Figure 3 is the consistent growth in enrollment from about 7 million students in 1987 to about 12 million in 2012. This is likely the result of an economy that rewards postsecondary education credentials and the counter-cyclical nature of higher education enrollments (more students enrolling during economically poor times) to protect against downward economic mobility. However, higher enrollments have not substantially resulted in higher degree attainment. Degree attainment has remained relatively flat since the early 1990s.[13]

SHARE OF FAMILY INCOME REQUIRED TO PAY FOR HIGHER EDUCATION

Figure 3 shows the average net tuition revenue to higher education from all students and families, but Table 3 shows how tuition affects lower- and middle-income families differently.[14]

For middle-income families, the net cost as a share of family income to attend

FIGURE 3: PUBLIC FTE (FULL-TIME EQUIVALENT) ENROLLMENT AND STATE AND LOCAL EDUCATIONAL APPROPRIATIONS PER FTE, U.S., FISCAL YEARS 1987-2012



Note: FTE includes both undergraduate and non-medical graduate students.
Net tuition revenue used for capital debt service are included in the above figures.
Constant 2012 dollars adjusted by SHEEO Higher Education Cost Adjustment (HECA).
Years 2009-2012 include federal funding to states through the American Recovery and Reinvestment Act (ARRA).
Source: State Higher Education Executive Officers, State Higher Education Finance 2012, Figure 3.

TABLE 3: POST-RECESSION FAMILY ABILITY TO PAY FOR COLLEGE (2008-2012) NET COST FOR FIRST-TIME FULL-TIME UNDERGRADUATES

College affordability for families in the middle income bracket

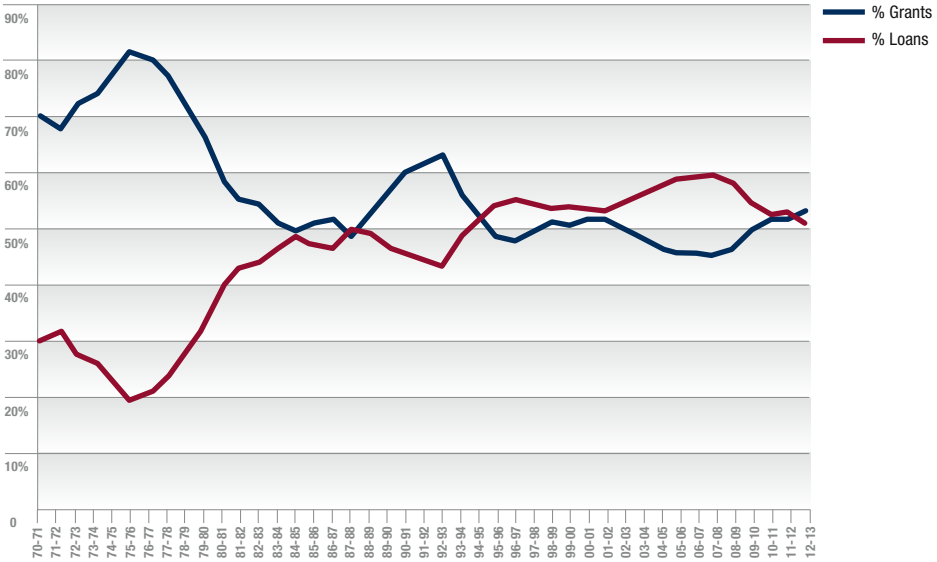
		Public 2 year colleges:		Public 4 year colleges:	
Year	Median family income*	Total cost (average tuition & fees, room & board)	Net cost as a percentage of median family income**	Total cost (average tuition & fees, room & board)	Net cost as a percent of median family income**
2008-09	$60,968	$10,058	12.9	$14,251	16.9
2009-10	$60,457	$10,640	12.9	$15,014	17.2
2010-2011	$61,094	$11,179	13.1	$15,866	17.6
2011-12	$62,527	$11,670	13.5	$16,775	18.6

College affordability for families in the lowest income bracket (bottom 20%)

		Public 2 year colleges:		Public 4 year colleges:	
Year	Low family income*	Total cost (average tuition & fees, room & board)	Net cost as a percentage of median family income**	Total cost (average tuition & fees, room & board)	Net cost as a percent of low family income**
2008-09	$16,991	$10,058	46.4	$14,251	60.7
2009-10	$16,727	$10,640	46.5	$15,014	62.1
2010-2011	$16,597	$11,179	48.2	$15,866	64.8
2011-12	$16,971	$11,670	49.9	$16,775	68.7

*Note: All data is for the U.S., including all 50 states and Washington D.C. Median Family Income is defined as income in the 50th income percentile in the United States. Low Quintile Family Income is the median income of those families in the bottom 20 percent of the income distribution.
**Net Cost as a Percent of Income is calculated as follows: average tuition and fees plus room and board, minus average financial aid (federal, state, local and institutional) divided by family income level.
Source: National Center for Higher Education Management Systems (NCHEMS).

FIGURE 4: PERCENT SHARE GRANTS AND LOANS: 1970-2013



Note:Total Grants and Loans does not include Work-Study or Education Tax Benefits. Total Grants includes Federal, State, Institutional, and Private and Employer grants. Total Loans includesFederal, State, Institution-Sponsored and Private. Source: College Board Trends in Student Aid 2013.

a public two- or four-year institution increased from about 13 percent to 14 percent between 2008-09 and 2011-12. For these same families to attend a public four-year institution, the net cost as a percent of family income to pay educational expenses increased from about 17 percent to about 19 percent. Median family income grew slightly during this time, but the share of income these families must pay to attend either a public two-year or four-year institution consumes a significant portion of family income, especially as other family expenses grow (shown earlier in Figure 2).

Lower-income families must commit an even greater portion of family income to attend either a public two-year or four-year institution, after all financial aid. For low-income families, the share of family income to pay for educational expenses at a public two-year institution increased from 46 percent to nearly 50 percent between 2008-09 and 2011-12. For those same families to attend a public four-year institution, the net cost increased from about 61 percent to 69 percent during the same period.

The large financial commitment required of these families to enroll in post-secondary education undermines not only access, but also the likelihood of completion. Many low- and middle-income students are left with few options: amass large amounts of debt to enroll, work more hours to pay for postsecondary education (which may require remaining in school for an additional year or more) or simply postpone or forgo enrollment in higher education. Unfortunately the level of educational attainment has remained relatively flat, increasing from 28 to 32 percent from 1990-2013, but with growing gaps in educational attainment by race.[15]

STATE FINANCIAL AID PROGRAMS CANNOT KEEP PACE WITH TUITION INCREASES

During the Great Recession, few states were able to invest enough in their financial aid programs to keep up with the rising cost of higher education, thereby resulting in a decline of purchasing power for aid programs. While total spending on state undergraduate grant aid increased in con-

stant dollars from $6.5 billion in 2001-01 to $9.4 billion in 2011-12, state grant aid per undergraduate student moved from $620 in 2001-02 to $700 in 2006-07 to $670 in 2011-12.

State investment in need-based student financial aid is woefully inadequate in light of the changing demographics and must be fundamentally rethought to meet changing economic and demographic needs.

POLICY SHIFT FROM GRANTS TO LOANS

Even though grant dollars have recently grown, Figure 4 shows the general policy shift over time from a reliance on grants to a reliance on loans, to pay for postsecondary education, taking into account all grant aid (institutional, state and federal). These trends are particularly problematic for low-income students: evidence suggests that low-income students are discouraged by tuition increases, as they are reluctant to amass large amounts of debt.[16]

Loans obviously play an important role in financial planning for college. However, little is known about what level of debt is appropriate given educational costs for students at different income levels attending different types of institutions. Most worrisome is the number of students who begin postsecondary education and fail to complete but are still saddled with debt without the benefit of an educational credential that might lead to higher earnings.

CONCLUSION

The political leadership for addressing these complicated and intertwined challenges is sorely lacking. Public investments in higher education, coupled with courageous political and institutional leadership, paid off in catapulting the nation after World War II into becoming the most advanced economy in the world. While the context for states and the nation has changed, the challenge for leadership is just as compelling. Recent research reveals the importance of state policy leadership in creating a new framework for higher education to meet contemporary needs.[17] It is beyond the scope of this brief to offer specific policy recommendations, but any public policy to address these problems should pass a litmus test. For the sake of debate, I propose the following criteria for consideration: (1) state policy must prevent disproportionate harm to higher education funding, compared to other state services, during times of recession; (2) state policy should provide powerful incentives for innovative efforts to effectively and efficiently use public dollars; (3) state policy should prioritize support to first-generation and low-income students and the institutions that most effectively and efficiently serve them; (4) tuition policy should be linked to family income. While others may disagree or propose additional criteria, the fact remains that a policy debate about how the nation and states finance the future of American higher education is long overdue.

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Dr. Finney pioneered the development of Measuring Up, the nation's first report card on higher education. She currently researches state policy and its relationship to state performance; she also assists states in developing public policies to increase educational attainment and reduce gaps in performance. Most recently, she co-authored *The Attainment Agenda: State Policy Leadership in Higher Education*.

Dr. Finney is a frequent speaker, resource for the media, and advisor to non-for-profit policy organizations. She is a board member for the National Clearinghouse Research Center and Research for Action. She chairs the national selection committee for the Virginia B. Smith Innovative Leadership Award sponsored by the Higher Education Policy Institute and the Council for Adult and Experimental Learning.

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