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# State Financing of Higher Education: Policy Implications

Community College Leadership  
Development Initiatives (CCLDI)  
Policy Seminar  
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## Outline of Topic

- Importance of state finance policy
  - Role of the states
  - Trends in higher ed finance
- Funding models in theory
- Funding models in practice
- National policy issues
- California policy issues



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## Role of the State in Higher Ed Finance

### Determine public/private mix of support:

- Set General Fund appropriations to institutions
- Set tuition levels in most states (this is beginning to change)
- Appropriate funding for state financial aid

### Influence outcomes:

- Set policy goals that *should* drive finance mechanisms



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# State Financing of Higher Education: Policy Options

Policy Objectives	Policy Focus	
	Institutions	Students
Capacity Building	Mechanisms for base General Fund support	Tuition and aid policy focused on revenue generation
Capacity utilization	Targeted funding: rewards and incentives	Tuition and aid policy focused on policy goals

Source: Dennis Jones, "Financing in Sync"



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## Importance of State Finance Policy

- States provide largest share of public higher education revenues
- 77 % of postsecondary enrollment is in public institutions
- Higher education has become vital to state economic and social health
- State fiscal distress and declining revenues require wise finance policy
- Not just a matter of maintenance: huge performance gaps must be addressed



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# Key Trends in State Finance of Higher Education

- Declining state revenues
- Declining share to higher education
- Increasing tuition (increasing share)
- Decreasing student aid
- Decreasing affordability
- Increasing privatization



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## National Decline in State Support of Higher Education

- Total state general fund budgets (real dollars) decreased in 2003 for first time since 1983
- Decreased by a larger amount for 2004
- 44 states face structural shortfalls
- Fiscal 2002 – 2004 is slowest period of growth in nominal GF spending since 1979



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## Higher Ed is Declining Share of Budgets

- As percent of state budgets:
  - FY 2001: 11.3%
  - FY 2002: 11.2%
  - FY 2003: 10.7%
- As percent of state + local budgets:
  - 1990: 7.2%
  - 2002: 6.5%





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## State Share v Student Share

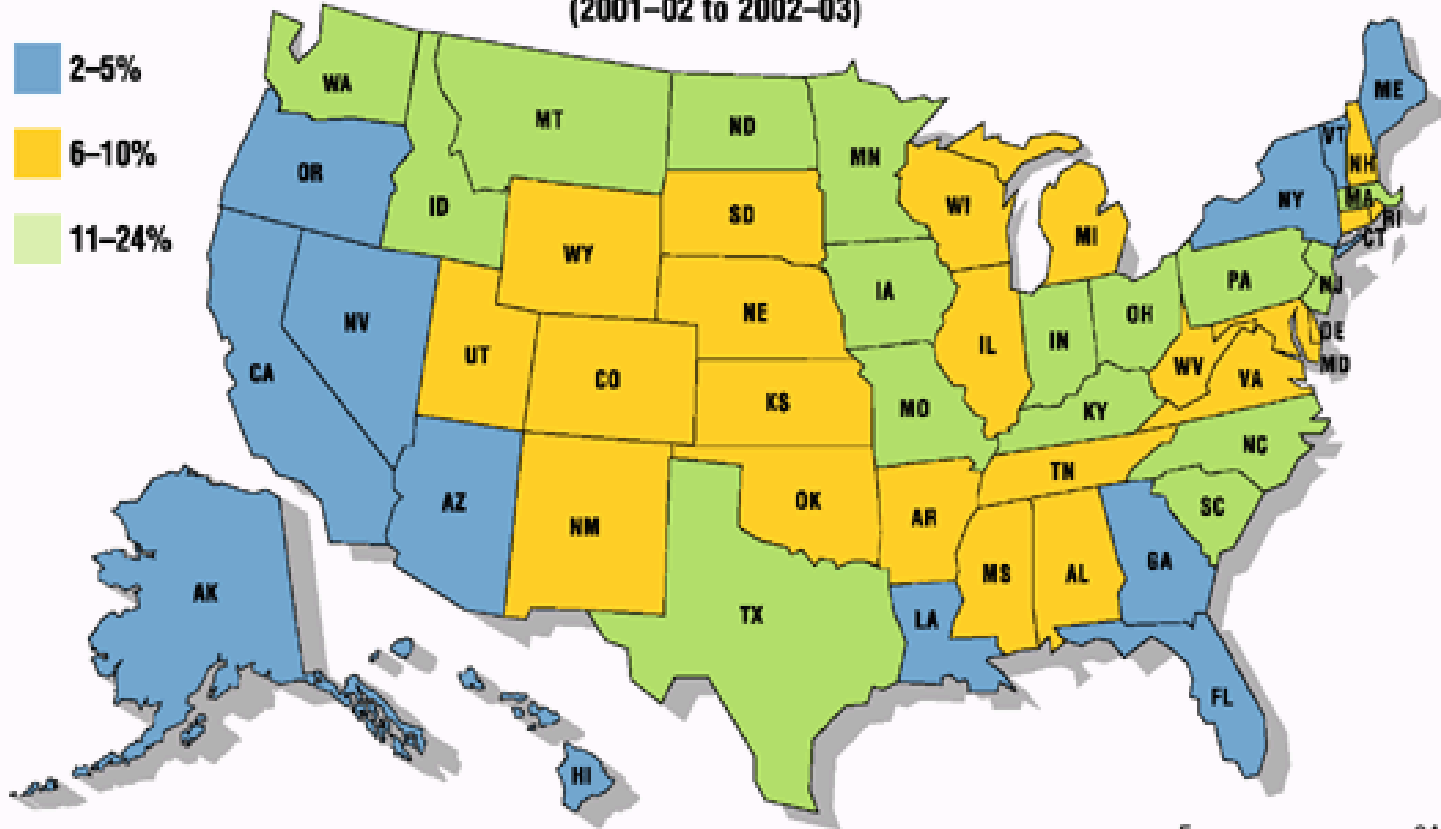
- Tuition as share of annual college budgets
  - 1980: 12.9%
  - 2000: 18.5%
- This raises the key issue in higher ed finance
  - Who benefits and who should pay?
  - What is an appropriate student/family share?
- Theme of higher ed finance today:
  - These decisions are not made on any reasoned basis
  - General fund declines; institutions raise fees as far as they can to make up lost revenue



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## Percent Increase in Public Four-Year Tuition and Fees

(2001-02 to 2002-03)

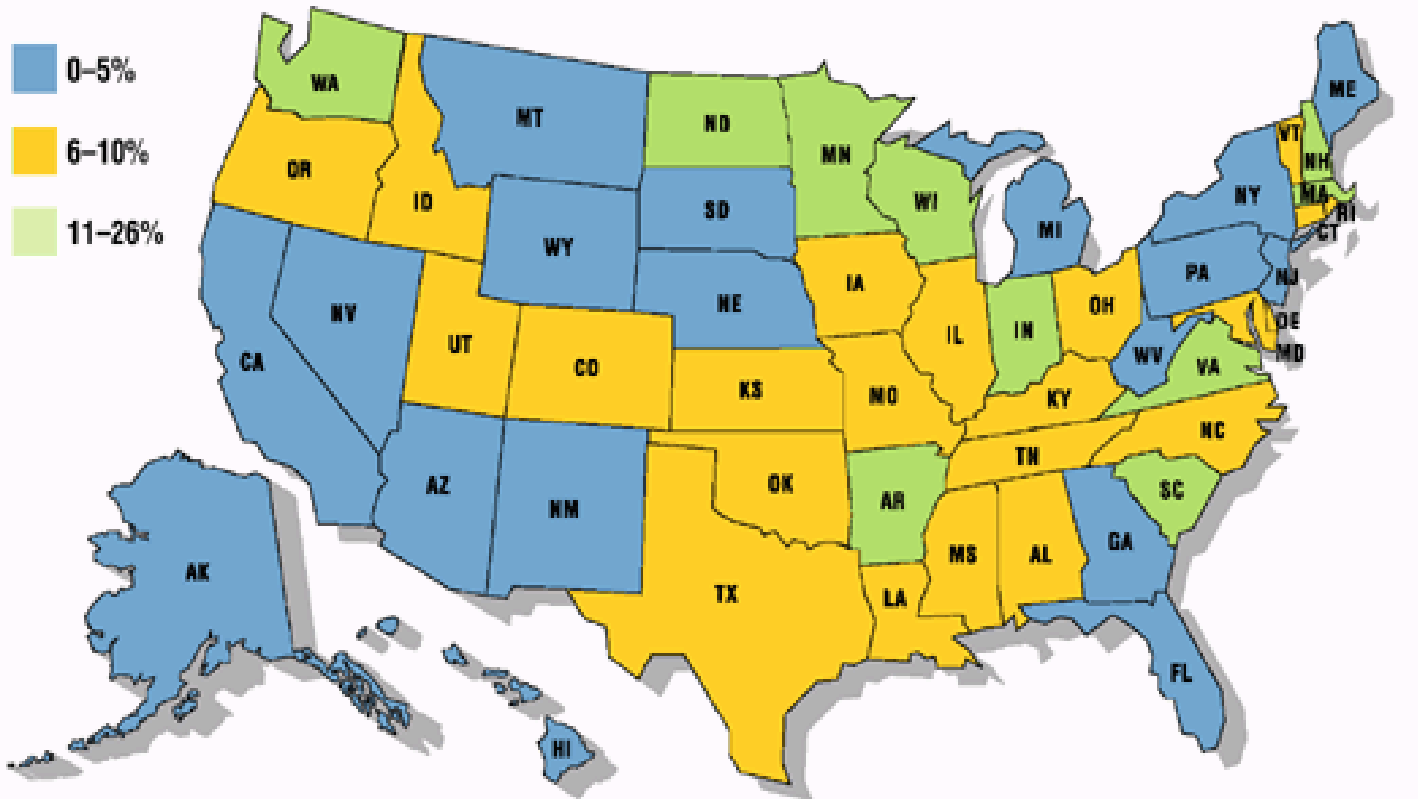


For sources, see page 3A.



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## Percent Increase in Public Two-Year Tuition and Fees (2001-02 to 2002-03)



For sources, see page 3A.



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## Additional Fee Increases

2003-04

Four-year public institutions average

- Increase of \$579
- 14.1%

• Two-year public institutions average

- Increase of \$231
- 13.8%



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## Trends in Student Financial Aid

- Increasing share of federal aid in form of loans (not grants)
- Decreasing portion of federal and state aid targeted to low-income families
- Average size of Pell grant shrinking as portion of college costs
- Increasing share of state grants awarded based on merit (from 10% - 24% in 10 years)
- Unmet need increasing in all states



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## Affordability

- Concerns about % of income for college as tuition rises faster than personal income
- Gap in attendance at types of institutions by income level
  - New study by Century Foundation: 75% of students at elite universities from top 25% of income level; less than 10% from bottom 50%
- Terry Hartle of ACE: “smart poor kids go to college at the same rate as stupid rich kids.”



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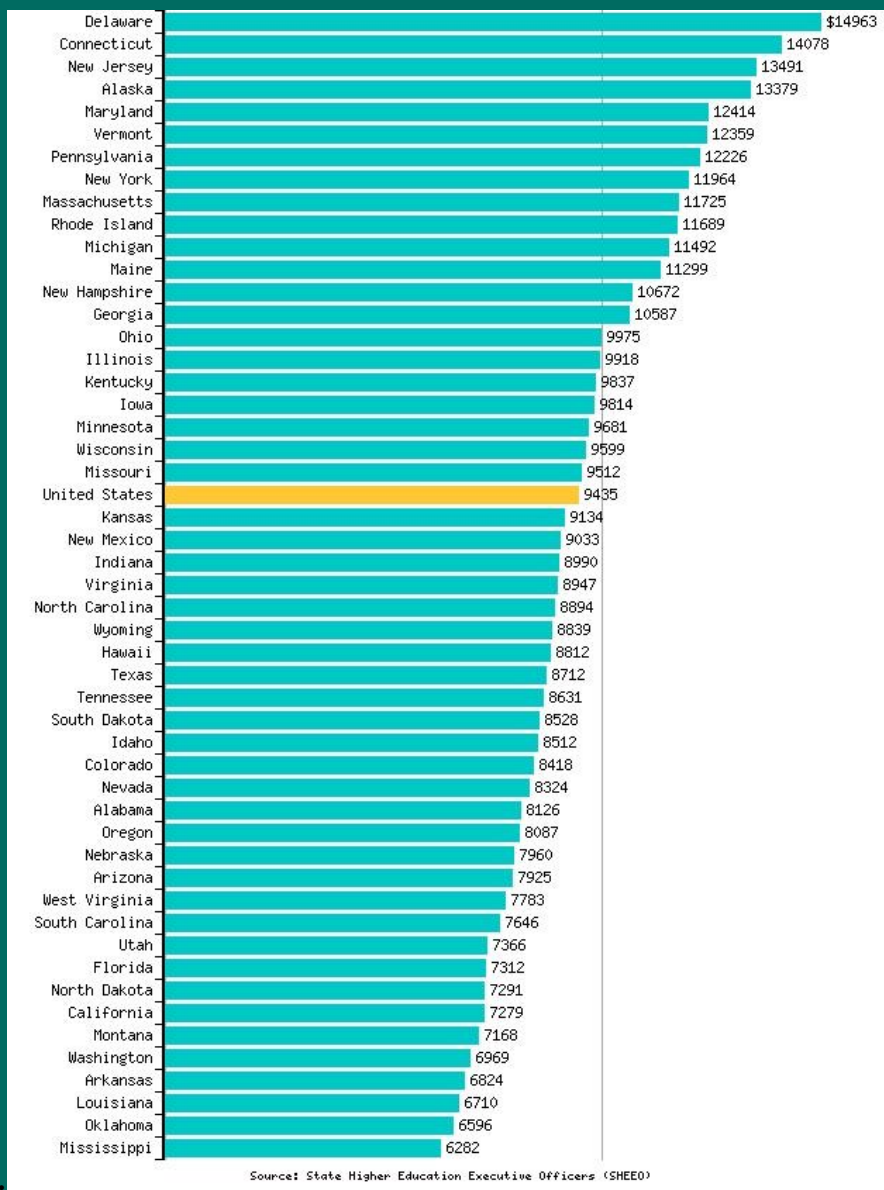
## California in the National Context

- Level of state support
- State v family share
- Fee levels
- Student aid
- Differential subsidies
- Affordability



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# Total Funding per FTES



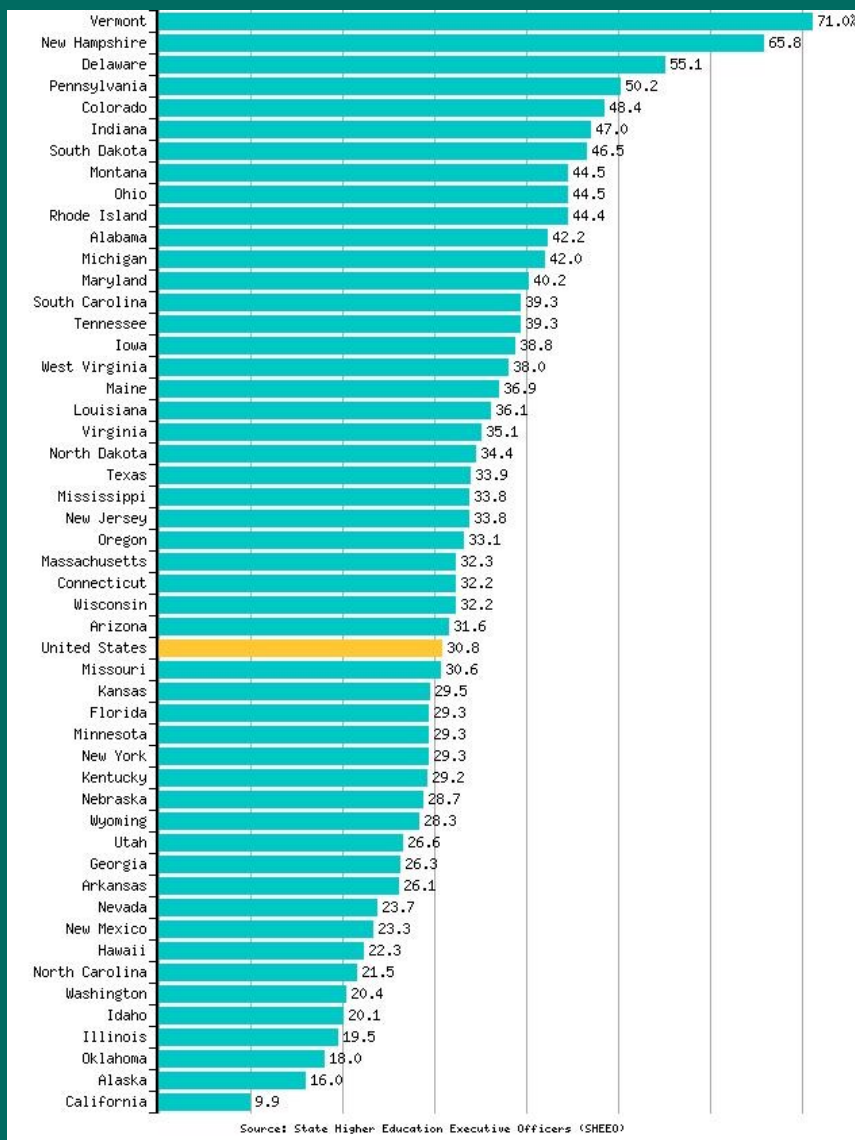
Source: State Higher Education Executive Officers (SHEEO)



# Family Share of Funding for Higher Ed



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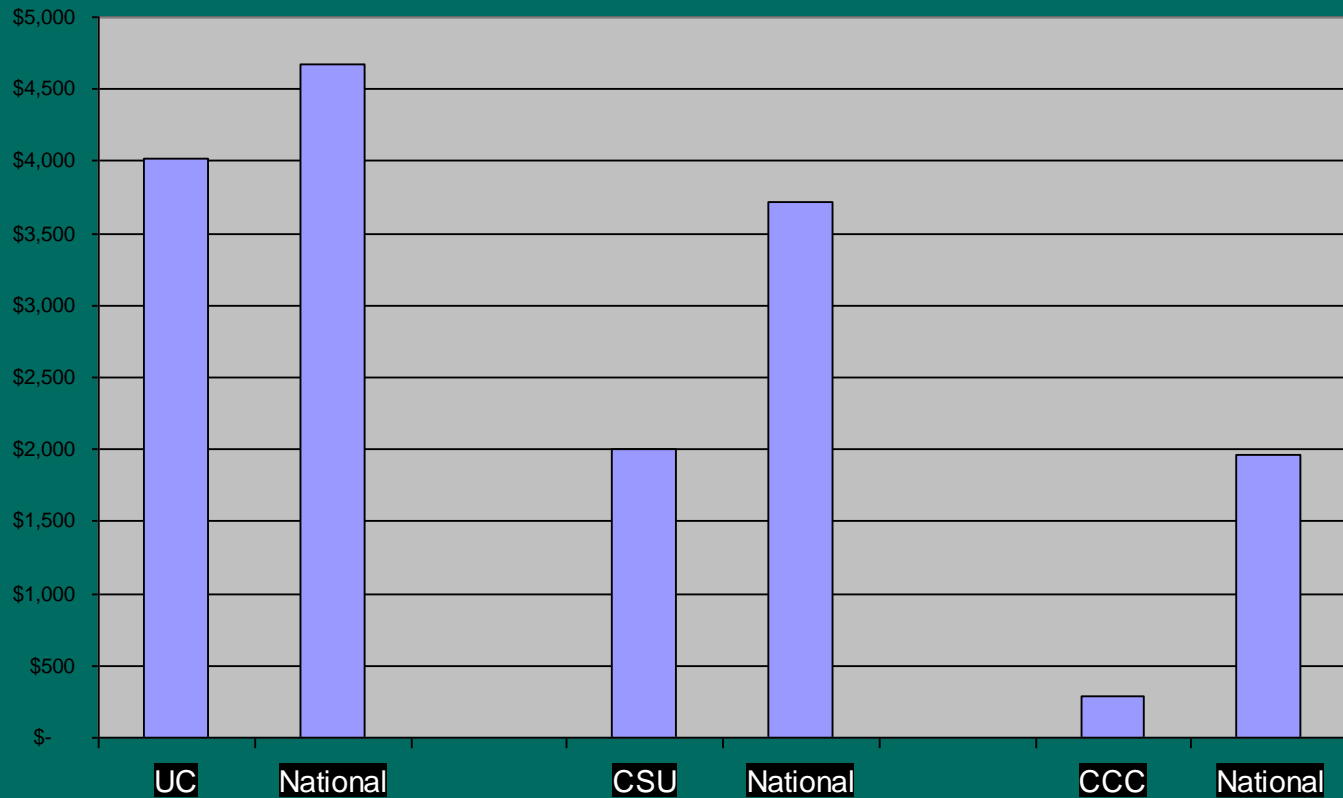


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# California v National Fee Levels: 2002-03

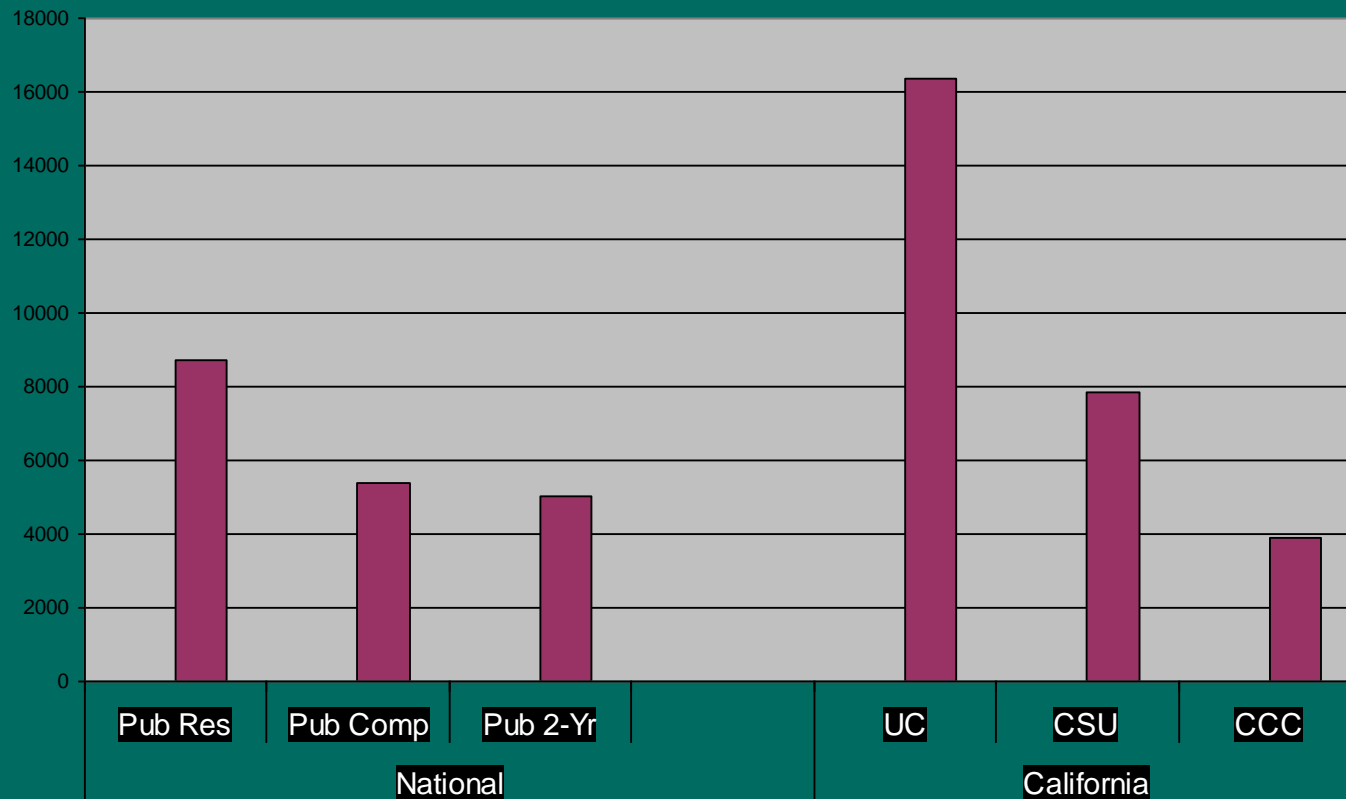


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# Differential Public Subsidies



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## Student Aid and Affordability

- CA above average in targeting aid to financially needy students
- “A” in affordability
- But new trends raise big concerns



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## Funding Models in Theory

- Began after WW II with growth and diversity of institution
- Two purposes
  - Traditional: estimate costs (institutional capacity)
  - Newer: achieve public policy goals (capacity utilization)
- Needs changed over time: from growth and equity to performance and reform
- States now need to think as investors in long-term economic and social health



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## Ideal Principles of Finance Models

- Adequacy of funding
- Sensitivity to different missions (equity)
- Stability and predictability
- Responsiveness (to change)
- Simplicity
- Objectivity (minimize political competition)
- Balance between state control and institutional autonomy
- Promote public purposes (state goals)



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## Main Factors Used in Formulas

- Workload Factors
  - FTES
  - Headcount
  - Square footage
- Differentiated by:
  - Institutional type
  - Program/discipline
  - Student level
  - Function within institution (instruction, research)

# Funding Models in Practice



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- Driven by institutional goals
  - Focus is on capacity building and prestige at expense of state policy goals
- Policies not coordinated
  - Insufficient focus on affordability
  - Insufficient focus on overall revenue adequacy
- Too vulnerable to budget cycles
- Incentives may not match needs





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## National Policy Issues (Finance-Related)

- Affordability
- Access
- Productivity and Efficiency
- Accountability
- Privatization



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# Affordability

- How much should students pay?
  - Share of total cost?
  - Share of personal income?
- Differential charges based on:
  - Ability to pay
  - Costs of programs (e.g., graduate/professional)
  - Other policy goals, (for strategic objectives)
    - day/time of class
    - Units completed
- How much should taxpayers subsidize?



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## Access

- Affordability and access both a consequence of interplay of
  - Tuition
  - General fund appropriation
  - Student aid (the need/merit debate)
- Trade-offs
  - Total revenues => access
- Access to what (the new question with no answers yet)



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## Productivity and Efficiency

- Policymakers and the public want to know: why can't spending be controlled?
  - After huge state appropriation increases in late 1990s, first response to downturn was huge tuition hikes
- Many national efforts aimed at cost containment
  - Congress proposal to limit student aid



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## Accountability

- Rising costs and persistent performance shortfalls → calls for accountability
- Policymakers looking for results/return on investments
- Often punitive, but should be driver for better finance policies
- Performance budgeting – the bad idea that won't go away



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## Common Weakness in State Accountability Systems

1. Too much focus on institutional performance
  - too little on state policy
2. Attempt to develop measures of student learning for use in state reporting system
  - no differentiation between state and governing boards responsibilities
3. Lack of workable mechanisms for using data to influence budgets
  - rely on ineffective formulaic performance budgeting



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# Performance Budgeting

## Performance Budgeting in Theory:

- Reward performance → improve performance
- Budget is best motivator
- Reserve 2-5% of budget for performance
- Determine performance areas to reward
- Determine levels (targets) that must be met
- Review performance, apply rules/formulas
- Reward!



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## Performance Budgeting in Practice

- Replaces discourse and discretion with arbitrary targets and formulas based on false precision
  - arguments about targets, metrics, base resources, uncontrollable factors
- Encourages audit mentality
  - how are “performance” funds spent?
  - why didn’t 2% of funding solve the problem?
- Marginalizes “performance”
  - what about the other 98%?





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## Performance Budgeting in Practice (cont.)

- Magnifies potential for perverse incentives
- Quandary of unmet targets
  - the downward spiral problem
  - “there need to be consequences but taking funds away from low performers is not the answer”
- Political will evaporates with non-performance
  - legislators resist loss of discretion
- Budget constraints!
  - what happens when the state can’t meet its end?
- Reinforces institutional (not statewide) approach

# Tiered Accountability



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**State Policy Goals**

**State Reporting System**

Statewide Indicators

Regional Indicators

Segment Indicators

Annual Report

Annual Report

Annual Report

Annual Report

**CCC Reporting System**

**CSU Reporting System**

**UC Reporting System**

**Independents Reporting System**

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## Privatization: Failure of Finance Policy

- State support reflects value judgment on public/private benefits
  - Influenced by institutional behaviors
- At what diminished level does funding no longer justify the strings of regulation?
- Does this lead to downward spiral?
  - Easier for policymakers to walk away when institutions flout public purposes
- Trends: Colorado, South Carolina, Wisconsin



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## Some Good (or at Least Interesting) Examples

- Washington state: appropriate higher amount for 1550 slots in high demand fields
- Kentucky: special allocations to attract top faculty to upgrade quality of universities
- Ohio: Governor's Commission on Higher Education and the Economy to establish links between higher ed funding and jobs
- Great Britain: fund completers; “learn, earn, reimburse”
- Southern states merit aid policies



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## California Higher Ed Finance Issues

- Redirection of UC/CSU eligible students to community colleges
- Differential funding by level, but common amounts across segments
- Subsidy limit on “excess” units (including 2<sup>nd</sup> BA in community colleges)
- Student fee policy (cap increases; graduate differentials)
- Community college mission focus



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## Redirection

- Fiscal impact on state
  - Difference in subsidy per FTES
  - Differences in time-to-degree
  - Which students will be affected
- Educational impact
  - Indirect impact on UC/CSU graduate and research (cross-subsidy issue)
  - Will students go along?
  - How will students be selected?
  - Impact on composition of community colleges



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## Differential Funding by Level

- What is this trying to accomplish?
- How would it change incentives facing colleges and universities?
- Who is in favor and opposed? Why?
- How might it affect educational outcomes?



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## Subsidy Limit on “Excess” Units

### Policy

- No subsidy for over 110% of required units at UC and CSU
- Reduced subsidy for second BA

### Issues

- Is this a reasonable way to target subsidies?
- What state goals is this intended to meet?
- Are there any “perverse” incentives?





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# Student Fee Policy

## Outlines of policy:

- Increase share paid by students
- Limit annual increases to changes in personal income or 10%
- Establish graduate differential of 50%
- Reduce student aid and de-couple Cal Grant awards from fee levels

## Issues:

- Does this meet criteria of coordinated policy?
- Can higher fees increase access?



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## Community College Mission

- Budget Language on priorities
  - Intent to target subsidies to transfer, basic skills, and vocational/workforce training
- New Governor’s Budget language
  - ...”improving the allocation of general apportionment funding and growth to encourage better resource allocation for state priorities.”
- What are current incentives built into formulas? How might they be improved, from perspective of meeting state priorities?