Testimony of

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Keeping College Within Reach: Exploring State Efforts to Curb Costs

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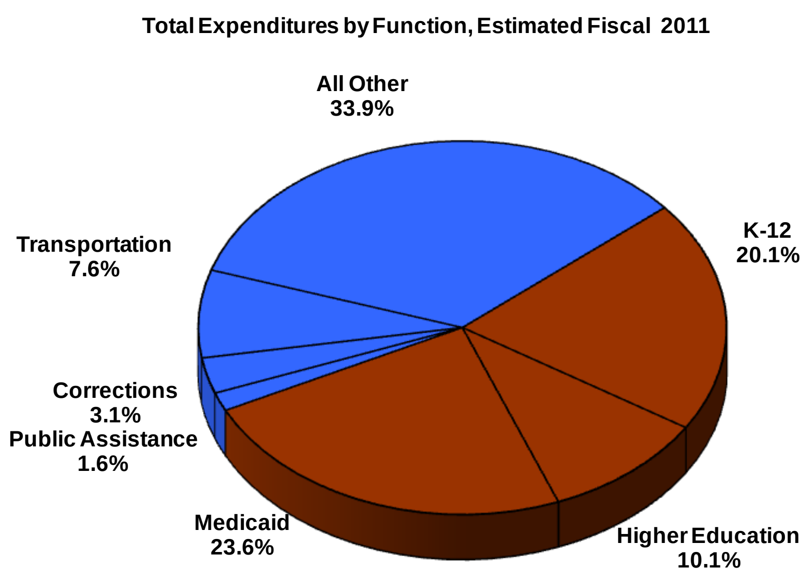
Chairwoman Foxx, Ranking Member Hinojosa and members of the Subcommittee, thank you for inviting me to appear before you today on behalf of the budget and finance officers of the nation's 50 states and territories. For over 60 years, the National Association of State Budget Officers (NASBO) has been the professional membership organization for state budget and finance officers. As chief financial advisors to our nation's governors, NASBO members are influential decision makers in state government. They guide their states in analysis of budget options and formation of sound public policy.

Fiscal Outlook: A New Era for State Budgeting

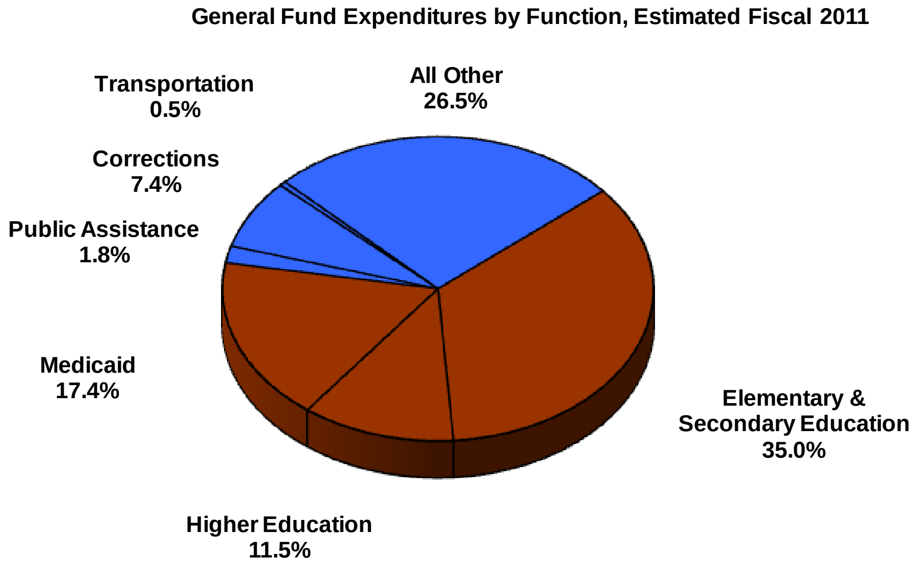
The state fiscal landscape has changed dramatically in recent years. Even with a recovering economy, the fiscal environment for state higher education support is expected to be very different and much more constrained compared to past decades. State budgets continue to be impacted by the recent recession, and funding for all areas of state government, including higher education, is expected to be constrained. This is because future state spending is likely to grow more slowly than in past decades, meaning that resources will continue to be limited for years to come. At the same time, the demand for funding continues to rise in a number of high-priority program areas, particularly Medicaid. As a result, competition for state funds is and will continue to be stiff, leaving support for traditional higher education funding arrangements possibly permanently and unalterably different from the past.

The fiscal challenges facing state governments are largely tied to the fact that a few program areas consume very large shares of state budgets. As shown in the figure below, elementary and secondary education and Medicaid – the two largest state expenditure areas – together consumed nearly 44% of all estimated state expenditures for fiscal 2011.



Source: NASBO 2010 State Expenditure Report

The relative size of these two spending areas is even more prominent when just looking at expenditures out of states' general funds, which are states' own source funds over which they have more control and discretion. As shown below, in fiscal 2011, K-12 and Medicaid expenditures were estimated to account for over half all state general fund spending. Both areas are generally top funding priorities for states, leaving state officials with limited room in their budgets to make program adjustments to close gaps when necessary. Thus, in severe revenue downturns, state officials face constituent and political pressures to avoid K-12 education and Medicaid budget cuts, forcing difficult choices and spending cuts – at times severe – to other areas of state spending, in particular higher education.



Source: NASBO 2010 State Expenditure Report

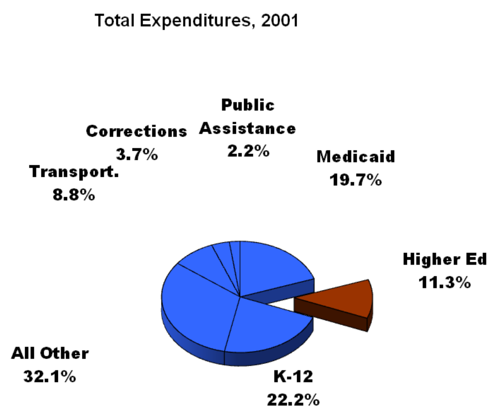
According to NASBO's *Spring 2012 Fiscal Survey of States* report, state fiscal conditions are projected to continue slowly improving in fiscal 2013, although general fund expenditures and revenues remain below pre-recession levels in many states.[1] The national economic recovery is causing aggregate state tax collections to increase, prompting general fund expenditure growth and a further restoration of budgetary reserves. Governors' recommended spending plans deliver a relatively positive outlook for many states, but valid concerns persist with slowing general fund expenditure growth rates compared to fiscal 2012, constrained revenue growth and a lingering high unemployment rate. Such concerns ensure budgetary challenges will continue for states in fiscal 2013 and possibly beyond. Thus, though revenue growth could help mitigate the funding squeeze and restore more resources for critical areas that were cut during the recession, the fiscal situation will entail budgetary decisions that must balance the recent rise in Medicaid costs over

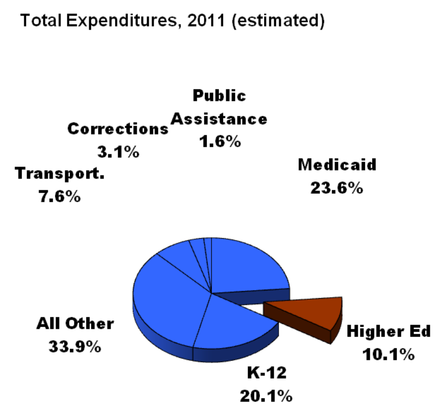
[1] National Association of State Budget Officers. *The Fiscal Survey of States*. (June 2012).

the past two years with increased demand for education and other state services. In this new funding environment, now more than ever, public higher education institutions and state officials will need to work together to improve access and performance while spending resources wisely and cutting costs.

Recent trends in public higher education finance

Higher education is in stiff competition for state funds and its share of the budget has certainly been affected by significant funding increases for large and high priority budget items like health care programs, especially Medicaid. This can be seen in the figures below.





Source: NASBO 2010 State Expenditure Report

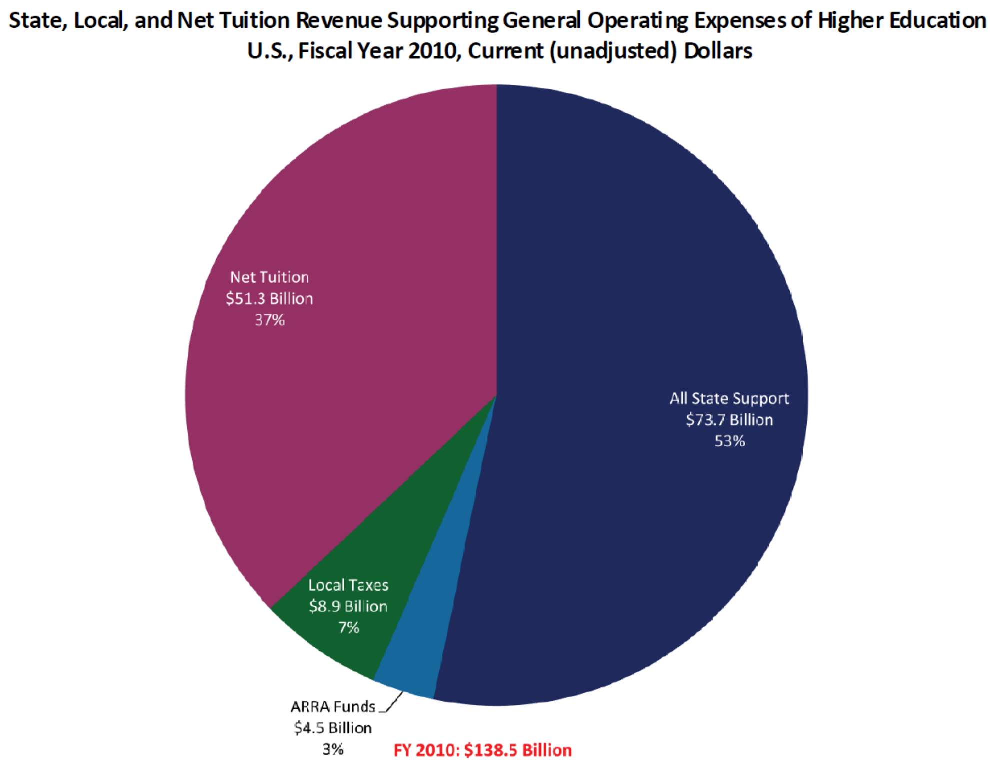
The proportion of state budget dollars directed towards higher education has only decreased slightly over the past decade; however, total state spending on higher education has increased steadily over time (48 percent between fiscal 2001 and 2011, without adjusting for inflation)[2], except during recessionary periods. On the surface this may appear positive, but the actual cost of acquiring a degree from the public higher education system has gone up significantly more, placing an ever greater reliance on tuition dollars. According to College Board, published tuition and fees for four-year public universities and colleges increased by 72 percent, after adjusting for inflation, over roughly the same time period (from 2000-2001 to 2010-2011 academic years). In nominal terms (without adjusting for inflation), four-year public institution tuition and fees increased by 117 percent.[3]

And yet, state governments have in the past and continue to be a tremendously critical source of funding for public higher education institutions. While public university presidents often claim that state funds may make up a small percentage of their institutions' budgets, these statistics can be misleading, since they include all parts of the institution's budget, including hospital and other expenditures that the state has no part in subsidizing. State dollars comprise a much larger share

[2] National Association of State Budget Officers. *State Expenditure Report*. (2002; 2010).
[3] The College Board, *Annual Survey of Colleges*. (2011).

of these institutions' yearly expenditures on educational activities – or on what the Delta Cost Project refers to as "education and related" (E&R) expenses per student. Using this measure, the national average state subsidy for higher education in 2009 accounted for 48% of E&R spending per student at public research institutions, 51% at public master's institutions, and 68% at community colleges.[4]

Using a different metric, the share of general operating expenses of higher education institutions supported by the state was 53% for fiscal 2010 according to the State Higher Education Executive Officers (SHEEO), as displayed in the pie chart below.



Source: SHEEO State Higher Education Finance FY 2011 Report

In addition to this assistance, states have also historically and annually provided enormous financing assistance for capital projects at public universities. States often issue bonds for public university capital projects.

Funding for public higher education has been volatile over time. States usually are generous to higher education in good fiscal periods, only to cut significantly during severe revenue downturns. In fact, state funding to higher education experiences outright declines during recessionary periods. For instance, state spending for higher education was nearly $62 billion in FY 2002, but dropped slightly to $61.6 billion in FY 2003 and was down to roughly $60 billion in FY 2004. Affected again by the latest recession, state funds (that is, excluding federal

[4] Delta Cost Project IPEDS database. www.deltacostproject.org.

assistance) spent on higher education fell by 0.8% between fiscal 2009 and fiscal 2010; however, when federal funds are included in the calculation, total state higher education expenditures went up by 0.8% in this period due to increased federal assistance resulting from the American Recovery and Reinvestment Act. Recessions have led to an unfortunate—and almost unique—cycle of state funding for higher education. A long-time budget director in Ohio and Illinois, the late Hal Hovey provided analysis in the 1990s about this volatile cycle in state budgeting. According to Hovey, states use higher education as a "balance wheel" during economic downturns. Essentially, states cut higher education funding in bad fiscal times (allowing significant tuition increases to make up for the reductions) but then dramatically increase higher education spending when state revenues rebound. A group convened by the National Center for Public Policy in Higher Education (NCPPHE) put it more starkly when they said in a 2009 statement, states "follow past patterns of responding to revenue shortfalls by shifting the financial burden [of higher education] to students and their families and by shutting out undergraduate students. Even when growth returns, states will still face structural budget deficits."[5]

More recently additional data on this issue of cyclical funding for higher education has been analyzed by William Doyle of Vanderbilt University and Jennifer Delaney of the University of Illinois at Urbana-Champaign. The two authors analyzed data on state support for higher education between 1979 and 2007 and demonstrated the volatility in higher education funding. Echoing Hovey's point, they write, "When state revenues are low, higher education is an attractive option for heavy cuts because it has the ability to collect fees for its services (an ability lacking in most other state spending categories). When states revenues are high, higher education is a politically attractive area on which to spend money."[6] This past recession has been no different with declines in state support for higher education (along with significant cuts to nearly all parts of state budgets) and increases in tuition.

Moving towards a new approach to state higher education finance

On a nominal basis, state spending growth has averaged 5.5 percent annually over the last few decades.[7] Economic forecasts for slower growth—the new normal—make this scenario unlikely to continue. Based on governors' recommended fiscal 2013 budgets, state spending is expected to increase by just 2.2 percent,[8] and average spending growth may actually be closer to 3 percent to 4 percent on a nominal basis for years to come, in line with slower national economic growth. Consequently, even if states want to be generous to higher education, they may not be able to be. With resources even scarcer, state Governors and lawmakers are going to be asking administrators tough questions about state-supported programs and this will include higher

[5] The National Center for Public Policy and Higher Education. *The Challenge to States: Preserving College Access and Affordability in a Time of Crisis*. (March 2009).
[6] Delaney, Jennifer. A. and William R. Doyle. "The Role of Higher Education in State Budgets." *The Challenges of Comparative State-Level Higher Education Policy Research*. Kathleen M. Shaw and Donald E. Heller (Sterling, Virginia: Stylus, 2007). 55–76.
[7] National Association of State Budget Officers. *The Fiscal Survey of States*. (June 2010).
[8] National Association of State Budget Officers. *The Fiscal Survey of States.* (June 2012).

education. State officials will be reluctant to provide funding increases unless they know how the money will be spent wisely and that there will be an improvement in program performance.

State officials, for example, will be less patient with universities that have empty classrooms for significant portions of the day, or that cannot accommodate all of the students who want a particular course. State officials also will be less patient with institutional duplication. Too often, each separate institution within a public university system wants to do what its peers are doing, leading to extensive duplication. When the institutions are able to complement each other rather than duplicate, funds can be allocated more efficiently. Increases in appropriations for the institutions will need to lead to increased performance in some way.

According to College Board, over the past five years, average posted tuition and fees at public four-year higher education institutions increased at an annual growth rate of 5.1% after adjusting for inflation.[9] Granted, in some cases universities are simply replacing lost state dollars, but state officials still want to understand whether this is always necessary and when institutions should seek to be significantly more efficient. One major concern among state officials was raised by a recent study that found that much of the new incoming revenue to institutions was not necessarily spent on educating students or producing degrees. There needs to be a serious commitment among state and education policy leaders to set specific goals, align spending with those goals, improve degree productivity and improve public accountability. Goals need to be based on the public's needs not necessarily on the interests of individual public institutions.

Funding has rarely been tied directly to results and performance in the case of higher education but the scarce resource environment at the state, and ultimately at the federal level, may cause this to change. More and more officials are focusing on the importance of accountability. There will be opportunities in the states to adopt different approaches to this dilemma and in fact there are some examples to examine. At the same time, certain obstacles impede states from tying spending to performance, such as the Maintenance of Effort (MOE) provision of the 2008 Higher Education Opportunity Act. With this requirement in place, states have less flexibility to allocate resources based on need and evidence, and furthermore have a disincentive to make a large or one-time increase in higher education spending in a given year.

The bottom line is: Money will be tight for all areas of state government. The ability of states to fund higher education at previous growth rates may be limited and in many states not possible. The old pattern of making up for significant cuts with generous increases to higher education when good times return may no longer be possible. With resources so scarce, state officials will increasingly expect improved efficiency and funding tied to outcomes and results. Working with university systems, state officials can improve the situation by determining ways to provide more predictable revenue to higher education. At the same time, public university officials will need to understand and acknowledge the "new normal," and determine ways to improve efficiency and performance.

[9] The College Board. *Trends in Higher Education Series: Trends in College Pricing 2011*. (2011).

NASBO commends this subcommittee on their attention to this critical and timely issue. Our organization also recognizes the importance of state higher education finance and is very interested in strategies to reform the system to make it work better for all. In light of this, among many other projects, NASBO is partnering with the Bill and Melinda Gates Foundation to have state budget officers engage in an open dialogue on the critical issues associated with higher education finance. This effort will culminate in a final report offering best practices and recommendations in this area. Ultimately, we expect these efforts and the efforts of many other groups to lead to the adoption of changes to higher education finance to make it more closely tied to successful outcomes.

Thank you again for the opportunity to testify here today on the subject of higher education finance and share the perspective of the nation's state budget officers.