

Financing Higher Education: The Need for a New Approach

The current approach to funding public higher education may have worked well in past decades, but fiscal changes at the federal and state levels make reform inevitable. Present financing models are unsustainable and the incentives created by them need to change.

-National Association of State Budget Officers, *Improving Postsecondary Education Through the Budget Process: Challenges & Opportunities* (Spring 2013)

May 15, 2013

Introduction

A confluence of several key factors – slowing tuition revenue growth, the need for continued postsecondary attainment growth to meet future workforce demands, and limited public funds – calls for a new approach to higher education finance. With college graduation time upon us, this message has come across in a host of recent press articles as well as a new book published this month by Jeffrey J. Selingo, *College (Un)bound: The Future of Higher Education and What It Means for Students*. Selingo explains:

“At the colleges and universities attended by most American students, costs are spiraling out of control and quality is declining just as increasing international competition demands that higher education be more productive and less expensive.”¹

To respond to this challenging environment, NASBO encourages states and institutions to work together to find creative, innovative solutions that enhance productivity, improve results and achieve sustainable savings.

This *Issue Brief* provides an overview of this landscape and explains why the current way that public higher education is financed in this country is not sustainable.

The higher education funding context described in this brief is examined in more detail in NASBO's recently released report, *Improving Postsecondary Education Through the Budget Process: Challenges &*

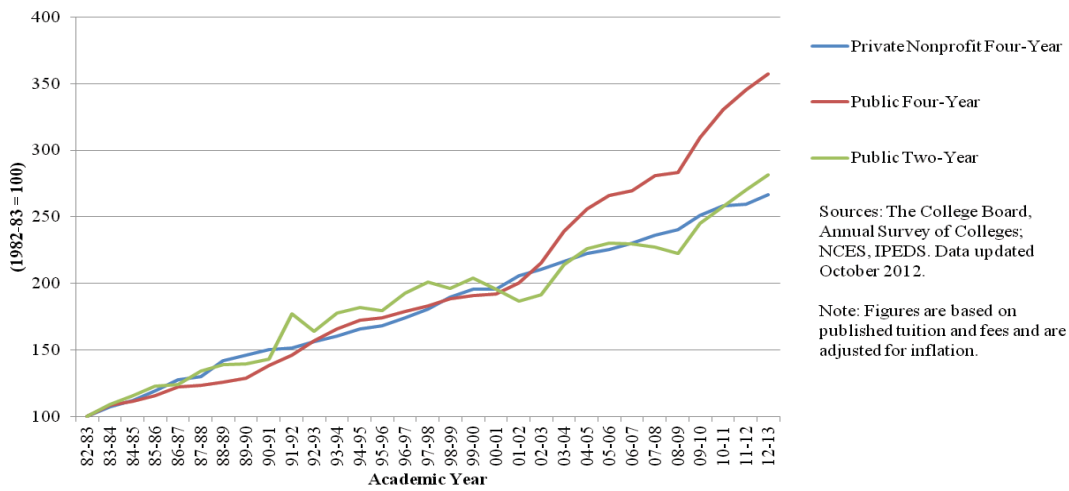
Opportunities. The report also documents ongoing state efforts focused on funding performance, restricting tuition, expanding access, improving information and increasing cost-efficiency, and charts a path forward for states and higher education institutions to work together to improve postsecondary education outcomes and put public higher education on a sustainable fiscal path. To read NASBO's recent report, visit: <http://www.nasbo.org/higher-education-report-2013>.

Most Colleges and Universities Cannot Necessarily Keep Increasing Tuition at Current Rates

Over the past three decades, college tuition rates and fees have risen at a rate far exceeding inflation. This is true for both public and private institutions. As Figure 1 (see page 2) shows, individuals attending public four-year institutions have seen the greatest percentage increase in published prices over this period – the published “sticker price” for tuition and fees for the 2012-2013 academic year was more than 3.5 times the published price thirty years earlier, after adjusting for inflation.

This picture of the rising cost of public higher education changes somewhat when grant aid and tax benefits are factored into the equation, though students at public four-year institutions have still seen the cost of a college education increase significantly in real terms, particularly over the last ten years. In the 2002-2003 academic year, net tuition and fees (published rates less grant aid and tax benefits) averaged \$1,490 in 2012

Figure 1: Rising Cost of Tuition and Fees, 1982-83 to 2012-13



constant (inflation-adjusted) dollars. Ten years later, that figure had nearly doubled, averaging \$2,910. (See Figure 2.)

In light of tuition increases and rising student loan default rates,² along with certain recent studies calling into question the value of a four-year college degree,³ some economists and policy experts have asked whether higher education could be the “next bubble to burst” after the housing market crisis. Others dispute the “bubble theory,” arguing that the student loan market is not large enough to be a structural problem for the U.S. economy and citing evidence that investment in higher education still more than pays off in the long run.⁴ For example, data from the U.S. Census Bureau show that bachelor’s degree holders earned nearly twice the amount that high school graduates did in 2011, on average, while advanced degree holders earned closer to three times as did those with just a high school diploma.⁵ At the same time, other

studies show that more young adults today are delaying actions such as purchasing a home or car, or starting a family, as they pay off student debt, trends which have important societal and economic implications as well.⁶

Even with the alarming trends with respect to tuition increases and student loan debt, a number of indicators do signal that the growth rate of tuition is beginning to slow. According to a recent survey, one third of higher education institutions anticipate net tuition revenue to decline or grow below the inflation rate in 2013. Meanwhile, on average, this year’s net tuition per student is projected to increase 2.7 percent – still above the inflation rate but much lower than the annual average tuition increase of 6.7 percent over the past five years.⁷ This is partly attributable to softened demand for higher education as family income has declined and post-college employment prospects have weakened due to the high unemployment rate and

Figure 2: Net Tuition & Fees and Grant Aid & Tax Benefits, Public Four-Year Institutions

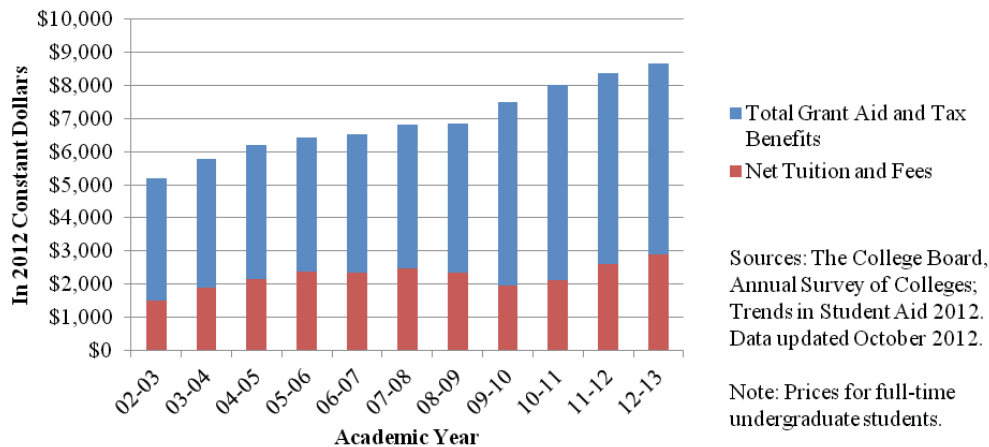
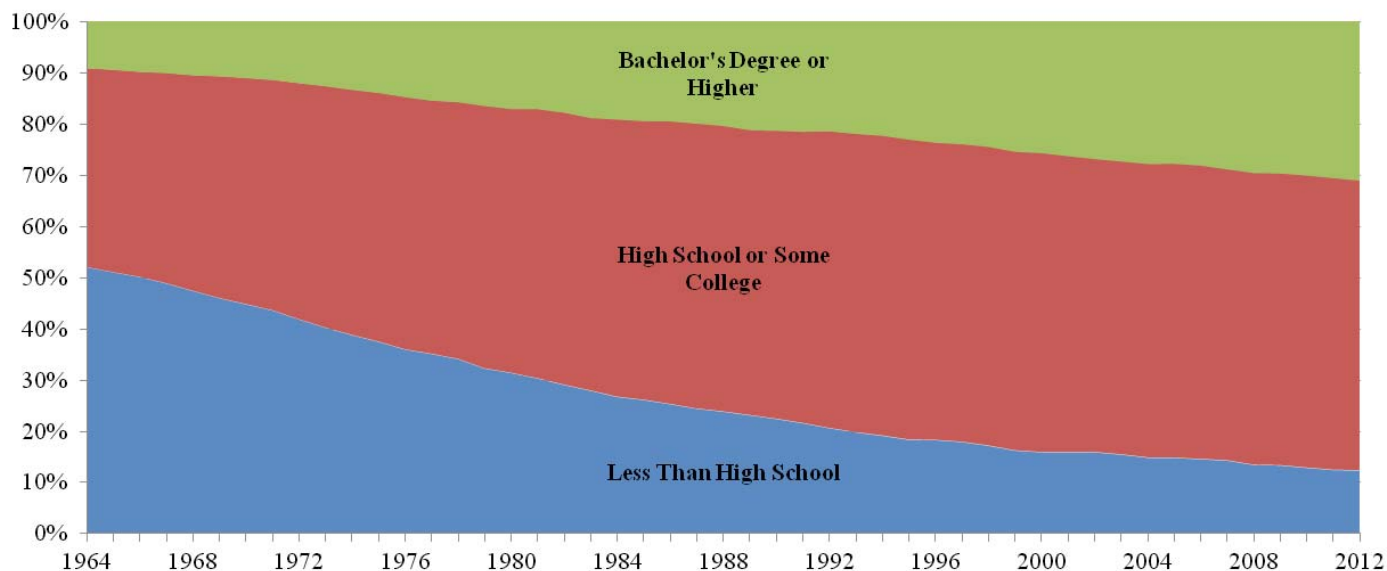


Figure 3: Percent of Population Over Age 25 by Educational Attainment, 1964–2012

Sources: U.S. Census Bureau, 1964 to 2002 March Current Population Survey, 2003 to 2012 Annual Social and Economic Supplement to the Current Population Survey.

skill mismatch between institutional curriculums and the labor market. Tougher governmental scrutiny of higher education institutions at the federal, state and local levels, as well as institution-led efforts to keep college affordable, may also be playing a role in slowing the growth in tuition costs.

Postsecondary Attainment Will Need to Keep Rising to Meet Workforce Demand

Despite the high cost of a college education, the share of the adult population with at least a bachelor's degree has increased steadily for decades, though the growth rate of postsecondary attainment has begun to slow. (See Figure 3.) Studies show that postsecondary attainment growth will need to continue for the foreseeable future to meet labor market demand, and furthermore, that the nation's current postsecondary education system is not on track to meet projected future demand for educated workers.⁸

To tackle the postsecondary attainment challenge and ensure a skilled workforce, the federal government, states, charitable foundations and advocacy organizations have established and started working towards various college attainment goals. In 2009, the White House set a national goal that by 2020, 60 percent of adults ages

25-34 will hold an associate's or bachelor's degree. The Lumina Foundation, a private foundation focused on increasing U.S. higher education attainment, is also aiming to reach a 60 percent degree attainment benchmark by the year 2025. And states across the country have worked with organizations like Complete College America to set statewide education attainment targets, based on state-specific future workforce demands, as well as projected and identified achievement gaps.⁹

While attainment goals vary across states and institutions, there remains widespread consensus that society and individuals benefit from increased educational attainment.¹⁰ According to data analyzed by the National Center for Higher Education Management Systems (NCHEMS) and the Center for Law and Social Policy, achieving a 60 percent credential attainment rate at the national level by 2025 could result in an additional \$800 billion in revenue – including \$600 billion in personal income and the remainder divided between state and federal government revenues.¹¹ The view of higher education access and attainment as public goals is also reflected in governors' 2013 State of the State addresses. According to an analysis of the addresses by the American Association of State Colleges and Universities, 48 of the 50 speeches reviewed mentioned gubernatorial priorities related to higher education, with

31 specifically discussing the role that higher education plays in economic and workforce development.¹²

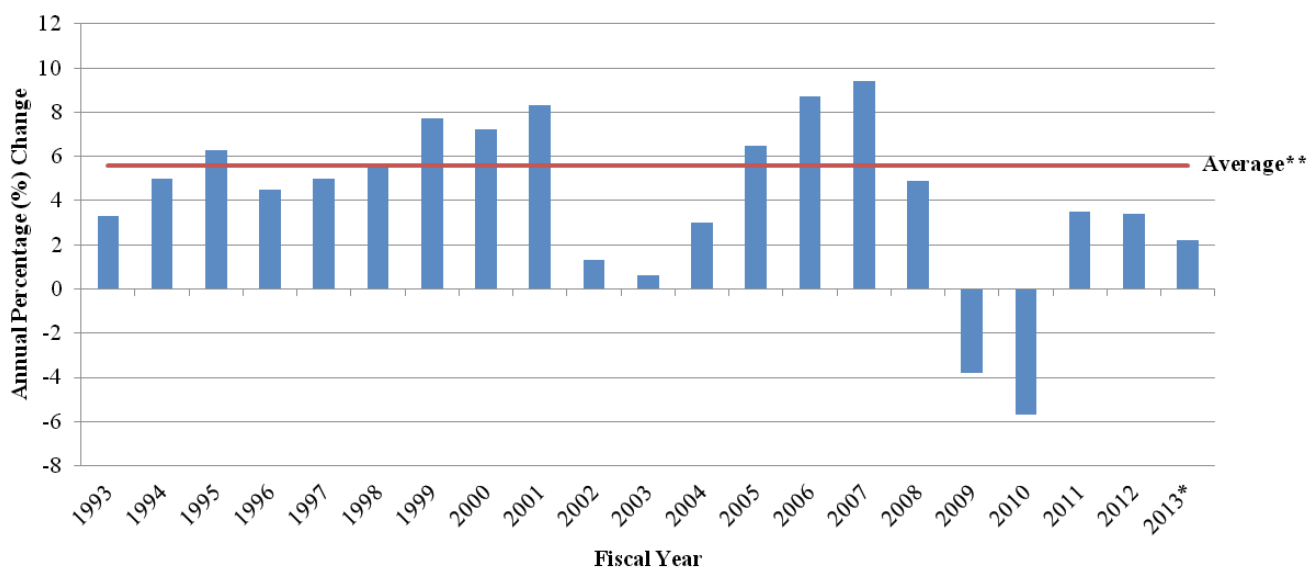
Additional State Funds for Higher Education Will Continue to be Limited

While increasing higher education attainment continues to be a priority of state governors and legislatures, 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 feel the impacts of the recent recession, and funding for all areas of state government, including higher education, is expected to be limited for years to come. State expenditures and revenues are growing, but more slowly than they have in past economic recoveries (See Figure 4), a trend that is expected to persist and one many analysts are calling the “new normal.” At the same time, the demand for funding continues to rise in a number of high-priority program areas, such as Medicaid and infrastructure. 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.

State funding for public higher education has tended to be more volatile over time compared to other spending areas. Traditionally, states are disproportionately generous to higher education in good fiscal periods, followed by larger than average budget cuts during severe revenue downturns. In the past, institutions have turned to tuition increases rather than cost-cutting strategies to partially or fully make up for state funding cuts. However, as previously discussed, due to various market forces, colleges and universities will find it more difficult to increase tuition at similar rates going forward. Meanwhile, with state resources more constrained, the old pattern of making up for significant cuts with generous increases to higher education when good economic times return may no longer be possible.

Lean state revenues and rising spending demands in other program areas have already led to a decline in state funds for higher education on a per student basis and as a share of total state appropriations. With resources scarcer, state officials will increasingly expect improved efficiency and look to tie funding to outcomes and results. Public higher education officials will need to understand and acknowledge the “new normal,” and determine ways to control costs while also enhancing performance. At the same time, state officials can help make the transition to this new funding landscape easier

Figure 4: The "New Normal" for State Expenditure Growth



Note: *Fiscal 2013 numbers are appropriated. ** 35-year historical average annual rate of growth is 5.6 percent.

Source: NASBO *Fall 2012 Fiscal Survey of States*.

by working with university systems to find ways to provide more predictable funding streams to higher education.

A New Funding Approach is Necessary

The combining forces of weakened pricing power on the part of institutions, the continued need for postsecondary attainment growth, and more limited state funds are ushering in the need for a new funding paradigm for public higher education. This will require state and higher education officials to build consensus on goals around college access and completion, degree attainment and economic development, and to develop ways to measure progress towards reaching these goals. They will also need to agree on the appropriate role for student tuition and financial aid, as well as how to account for and share financial and performance information.

States and higher education institutions will need to collaborate to identify and implement strategies that improve the effectiveness and cost-efficiency of our nation's postsecondary education system.

Different institution types (community colleges, bachelor's institutions, research universities, etc.) have unique missions and all play critical public roles. This diversity can be leveraged in different ways to maximize societal returns from available resources. Opportunities to collaborate rather than compete can help consolidate administration functions, reduce academic duplication, employ new technology and support multi-year investments. Finding smart, responsible ways to reward institutions for carrying out their defined missions, promoting student success and achieving efficiencies can go a long way to advance these strategies, improve results and reduce costs.

NASBO's recent report, *Improving Postsecondary Education Through the Budget Process: Challenges & Opportunities*, released in Spring 2013, is intended to help shape and improve the dialogue on the issues related to higher education finance touched upon in this brief. **To learn more and read the report, visit:** <http://www.nasbo.org/higher-education-report-2013>

¹ Jeffrey J. Selingo, *College (Un)bound: The Future of Higher Education and What It Means for Students* (Boston: New Harvest, 2013), IX.

² John Hechinger & Janet Lorin, "Student-Loan Default Rates Rise as Federal Scrutiny Grows," *Bloomberg* (September 28, 2012).

³ See, for example, Richard Arum and Josipa Roksa, *Academically Adrift: Limited Learning on College Campuses*, University of Chicago Press (January 2011).

⁴ For more discussion on this debate, see Megan McArdle, "Is College a Lousy Investment?" *The Daily Beast* (September 9, 2012) and Jordan Weissmann, "Don't Panic: Wall St.'s Going Crazy for Student Loans, but This Is No Bubble," *The Atlantic* (March 4, 2013).

⁵ See U.S. Census Bureau, *Current Population Survey*, "Table A-3: Mean Earnings of Workers 18 Years and Over, by Educational Attainment, Race, Hispanic Origin, and Sex: 1975 to 2011." Mean annual earnings in 2011 were \$32,493 for high school graduates, \$59,415 for workers with a bachelor's degree, and \$87,981 for workers with an advanced degree. <http://www.census.gov/hhes/socdemo/education/data/cps/historical/index.html>.

⁶ For more on these trends, see Pew Research Center, *Young Adults After the Recession: Fewer Homes, Fewer Cars, Less Debt* (February 21, 2013).

⁷ Moody's Investors Service, "Announcement: Moody's: One-third of US colleges facing falling or stagnant tuition revenues" (January 10, 2013), http://www.moodys.com/research/Moodys-One-third-of-US-colleges-facing-falling-or-stagnant--PR_263437.

⁸ See Anthony P. Carnevale and Stephen J. Rose, *The Undereducated American*, Georgetown University Center on Education and the Workforce (June 2011).

⁹ For more information, see http://www.completecollege.org/alliance_of_states/.

¹⁰ For more discussion of the private and public benefits of higher education, see Sandy Baum, Jennifer Ma and Kathleen Payea, *Education Pays: The Benefits of Higher Education for Individuals and Society*, College Board Advocacy and Policy Center (2010).

¹¹ Matt Crellin, Patrick Kelly and Heath Prince, "Increasing College Attainment in the United States: Variations in Returns to States and Their Residents," *Change Magazine* (July-August 2012).

¹² See American Association of State Colleges and Universities, "State Policy Advisory: 2013 Gubernatorial State of the State Addresses and Higher Education" (March 7, 2013), <http://congressweb.com/aascu/advisoryView.cfm?id=134784>.

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