

State Outlook: Fiscal and State Policy Issues Affecting Postsecondary Education

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Fiscal Conditions and Economic Outlook

Global/U.S. Economic Output

A return to positive growth domestically: Despite Wall Street having served as the epicenter for this recession, ripple effects from the downturn have been felt throughout the world economy. The recession spared few countries, resulting in an anticipated contraction in total global output of about 1 percent in 2009, its lowest rate since World War II, before expanding by about 3 percent in 2010 according to International Monetary Fund (IMF) projections. Following its worst six-month performance in 50 years, U.S. economic output returned to positive growth in the third quarter of 2009, with an expected year-end overall net increase of less than 1 percent, according to the National Association of Business Economics (NABE). As a subtle reminder of the swiftly changing geopolitical landscape, the recession has dampened China's and India's economic growth to the point where their GDPs will *only* grow in 2009 by 7.5 percent and 5.4 percent, respectively, according to IMF projections.

Economic Recovery Projections

After a 21-month recession, a return to positive national growth, but with a multi-year state budget hangover: Despite increases in unemployment and reduced state revenues there are several economic indicators that suggest that the worst is behind us and a recovery is underway. A majority of economists believe that the recession (as formerly defined) came to an end in the third quarter of 2009; however, the National Bureau of Economic Research, a private firm that calculates the official dates of recessions, has yet to declare an end to the current downturn. Based on an analysis of employment rates, home prices, residential construction and manufacturing production figures by Moody's Economy.com, 10 states and the ***District of Columbia*** have entered economic recovery mode. These include ***Alaska, Idaho, Indiana, Iowa, Louisiana, Mississippi, Missouri, Montana, Nebraska, North Dakota*** and ***South Dakota***. While key national economic indicators are returning to positive growth, such is not the case when it comes to most states' budget conditions, which will likely continue to be severely constrained for several years.

Unemployment – Taking a Stark Human Toll

Continued bad news for a leading economic indicator

The most pronounced human toll of the recession is reflected in unemployment figures. Since the start of the recession in December 2007, an astonishing 7.3 million payroll jobs have evaporated. The national unemployment rate reached 10.2 percent in October 2009, the highest level in 26 years. Unemployment declined in 36 states in November, resulting in a national average of 10 percent. The number of individuals working part-time jobs but seeking full-time employment has reached a record 9.2 million. The combined unemployment and "under-employment" rate is 17 percent, the highest level in the 16 years that this reading has been calculated. It includes the officially unemployed, all part-time workers who prefer full-time jobs, and discouraged job seekers who have stopped looking for work. The average time jobless individuals have been out of work has extended beyond six months for the first time since data collection began 60 years ago. All told, nearly 15 million Americans are currently seeking employment. Metropolitan centers of auto and auto parts manufacturing continue to post sharp declines in overall employment. Forty-nine of 50 states have lost manufacturing jobs in the past year (***Alaska*** being the exception).

Harmful Effects of High Unemployment

Recently released U.S. Census Bureau data provide insight into the effects of rising unemployment in the early part of the recession: among them, decreasing household incomes and increasing poverty. In 2008, median U.S. household incomes plummeted 3.6% from the prior year, the steepest rate decline since 1947. Meanwhile, the proportion of people living in poverty reached 13.2%, an 11-year high. Additionally, domestic (state-to-state) migration has been impaired by the fact that 15.6 million homeowners are “under water” on their homes—owing more than their homes are worth, thus making it difficult and arguably imprudent to sell.

On the Bright Side: An Affirmation of the Public College Mission

One silver lining is that the unemployment numbers associated with the recession once again bear out that education pays. As of November 2009, those with a college degree were less than one-half as likely to be unemployed compared to those with a high school diploma (10.4 percent compared to 4.9 percent). The numbers also affirm the importance of a core tenet of state colleges’ missions: facilitating college access and success that leads to upward economic mobility for traditionally underserved populations. While the national unemployment rate is 10.0 percent, for African Americans it is 15.6 percent; among the ranks of the nation’s fastest growing demographic population, Hispanics, 12.7 percent are unemployed.

Current State Budget Conditions

Historic revenue drop-off: For the first time on record, states’ overall spending declined for two consecutive years, shrinking 4.8 percent in FY09 and at least 4 percent in FY10, according to an analysis of latest state budget conditions by the National Governors Association (NGA) and National Association of State Budget Officers (NASBO). A historic 7.5 percent drop in state revenues in FY09 reflects sharp declines in tax collections. State and local tax revenues fell 7 percent in the third quarter of 2009 from a year prior, according to the Census Bureau. Sales taxes declined 9 percent and income taxes plunged 12 percent. Combined, sales and income taxes make up roughly half of state and local tax revenues.

Few states spared: Budgets in the great majority of states have been significantly and negatively affected by the current recession. The few states that have to this point largely weathered the economic downturn include ***North Dakota, Montana*** and ***Wyoming***, thanks largely due to strong returns in agriculture and energy production (oil, coal). States previously thought to be escaping the recession’s wrath are now witnessing delayed effects in the form of tax revenue reductions; these include ***Oklahoma, Texas,*** and ***West Virginia.***

Several states hit particularly hard by the recession: A recent Pew Center on the States study looked at a number of factors leading to both chronic and severe state budget gaps and have identified 10 states that have been especially hard hit by the recession. Collectively, these 10 states account for more than one-third of the nation’s population and economic output. Leading the list is ***California***, the most populous state and eighth-largest economy in the world. Lawmakers in that state closed a \$60 billion budget gap in closing out fiscal year 2009, and a \$21 billion deficit already looms for the current and coming fiscal years. The ability of California lawmakers to address budget problems are constrained by unrealistic budget assumptions and a number of voter-imposed restrictions, including requirements that all budgets and tax increases pass the legislature by a two-thirds majority. Other states include neighboring ***Arizona, Nevada*** and ***Oregon***, and fellow Sun Belt state ***Florida***, which were hit especially hard by the burst housing bubble. The Midwestern states of ***Illinois, Michigan*** and ***Wisconsin*** and Northeastern states of ***New Jersey*** and ***Rhode Island*** were among those with the greatest declines in revenues, largest budget gaps, highest unemployment and foreclosure rates and poor state government money-management practices. Close behind on the Pew Center list of especially hard-hit states are ***Colorado, Georgia, Kentucky, New York*** and ***Hawaii.*** The report cites four common threads that have led to increased fiscal vulnerability in these states: unbalanced economies, revenues and expenditures out of alignment, a limited ability to act by the legislature and the putting off of tough decisions by state policymakers.

State Budget Deficits

Big, structural, and here to stay: States passed fiscal year 2010 general fund budgets totaling \$628 billion, 5.4% less than the year prior, according to the NASBO/NGA. Since the fiscal year began, states have cut \$56 billion. According to the National Conference of State Legislatures (NCSL), persisting shortfalls totaling \$28 billion exist for 36 states in the current fiscal year. The group's assessment predicts another \$56 billion in shortfalls across 35 states for fiscal year 2011 and \$69 billion in shortfalls across 23 states in fiscal year 2012. All but two states, *Montana* and *North Dakota*, faced budget shortfalls for FY10.

Medicaid—The greatest pressure on state spending: States face increasing health care costs, need to replenish state pension programs funded by decimated investments, and face additional spending requirements stemming from provisions associated with acceptance of federal stimulus monies. Increased Medicaid spending has particularly problematic. States' enrollment in Medicaid grew by an average of 5.4 percent in fiscal year 2009, the highest rate in six years, according to a recent Kaiser Family Foundation report. To fund the increasing caseload, states' Medicaid spending grew by 7.9 percent, higher than the 5.8 percent projected growth. The current health care overall legislation in Congress seeks to expand Medicaid coverage, adding to states' spending burden; this may well further erode general fund discretionary dollars that compose the public finance portion of state colleges and universities.

State unemployment compensation funds running dry: The recession's jobless toll is draining unemployment compensation funds so fast that according to federal projections, 40 state programs will go broke within two years and need \$90 billion in loans to keep issuing the benefit checks, reports the *Washington Post*. Currently, 25 states have run out of unemployment money and have borrowed \$24 billion from the federal government to cover the gaps. The shortfalls are adding pressure to state governments to either raise taxes or decrease the aid payments to unemployed individuals. State unemployment compensation funds are separated from general budgets, so when shortfalls exist, only two primary solutions are considered – either reducing the benefit or raising the payroll tax. Debates over the state benefits programs are taking place in *Indiana, Kansas, Nevada, South Carolina* and *Vermont*.

Gambling revenues no longer a safe bet: One atypical weakness in state revenues is gambling proceeds, which have historically been buffered during downturns. States that have relied on gambling revenues the longest have been hit the hardest, among them, *Illinois, Nevada* and *New Jersey*. This unfortunately coincides with an increase in an expansion of gambling among the states in efforts to shore up state revenues. The 12 states that have casinos made \$4.5 billion in FY 2009, which ended June 30, a 7.4 percent decline. Among the 42 states with lotteries, 38 have reported a collective income of \$14.5 billion, a 2.6 percent drop in revenues from a year prior. October marked the 22nd straight month of declining gaming revenues in Nevada and was the lowest monthly figure since December 2003. In 1979, gamblers had to head to *Las Vegas* or *Atlantic City* to bet legally. Today, 12 states have commercial casinos, 12 have “racinos,” or slot machines and other games that are placed at racetracks, 29 states have Indian casinos, and at least 42 states and the *District of Columbia* have lotteries. Racinos were the one form of legalized gambling that generated increased revenue in the past year, posting a 6.7 percent increase.

The latest state to bet on gambling is *Ohio*, where voters in November approved a constitutional amendment allowing for the construction of casinos in *Cincinnati, Columbus, Cleveland* and *Toledo*. It was the fifth time that Ohio voters have considered gambling measures on the state's ballot. Officials in *Kentucky* and *Indiana* are now strategizing on measures to fend off lost gambling revenues, which could reach hundreds of millions annually.

State Budget Reduction Strategies

Cut, and cut again: To remedy budget shortfalls, states have turned to a number of strategies. Half of states have either have laid off or plan to lay off employees this fiscal year. Several states have tapped their reserve accounts – so-called “Rainy Day” funds. Thirteen states have completely drained these funds. Pay freezes, state employee furloughs, reductions in police and fire protection, the premature release of nonviolent felons

from state prisons, the closure of state parks and the selling of state assets have been commonly used strategies for paring back spending.

State Revenue Enhancement Strategies

Record tax and fee increases, but nowhere close to addressing budget gaps

Not surprisingly, state policymakers have been hesitant to raise taxes during the recession. Nevertheless, the pressure to address gaping budget shortfalls has led states to increase taxes and fees by a record \$24 billion and additional revenue measures totaling \$7.7 billion for FY10. Some states are turning to increasing borrowing to meet spending obligations. *Illinois* lawmakers are on pace to take out more than \$6.5 billion in loans to shore up budget shortfalls. *Arizona* lawmakers are poised to borrow money to shore up a budget deficit for the first time in the state's history, seeking \$700 million from outside lenders to address a \$2 billion current year shortfall. Municipal revenue enhancement strategies may also impact colleges and universities. For the second time in a year, a mayor of a large city has called for a tuition tax (*Providence's* in April, *Pittsburgh's* in December). The mayor of Pittsburgh had proposed a 1 percent tuition tax to be applied to all students attending both public and private postsecondary institutions in the city in hopes of raising \$16 million annually. After much debate, the proposal was done away with after the city's postsecondary institutions agreed to make significant annual contributions in monetary aid to the city.

State Revenue Forecast

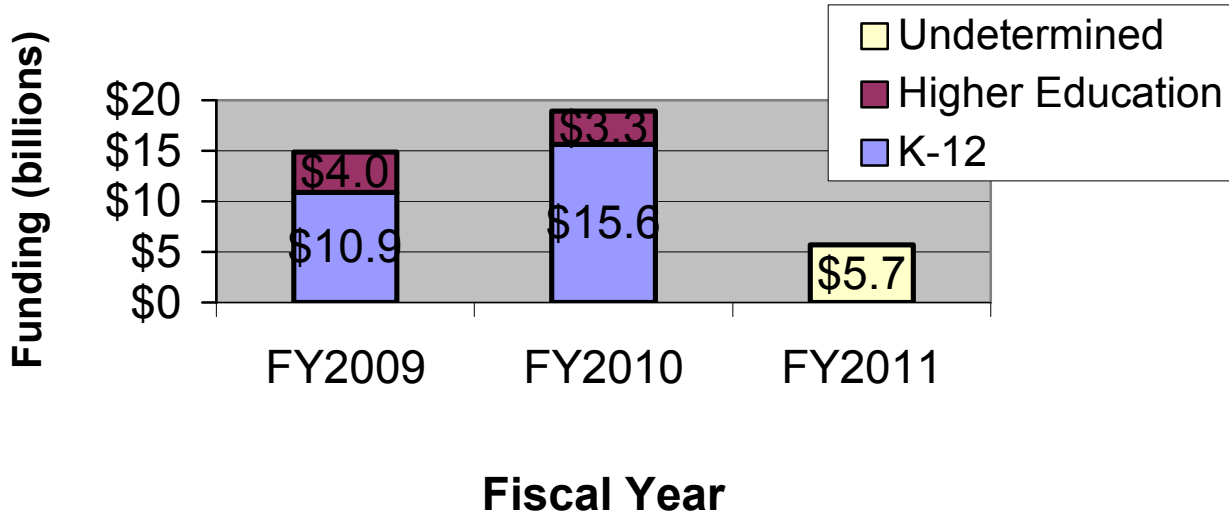
A return to sunny skies – in 2013: State revenues are expected remained depressed throughout FY10 and likely into fiscal years 2011 and 2012, continuing downward for another one or two quarter before returning to positive, but slow growth, according to NGA/NASBO estimates. State revenues will not return to 2008 levels in real terms until fiscal year 2013, predicts Moody's Economy.com chief economist Mark Zandi. The national unemployment rate, which is closely coupled with state revenues and remained at a rather consistent 5.5 percent during the 2001–2007 period, will not return to that level until 2014 based on projections.

Federal Stimulus

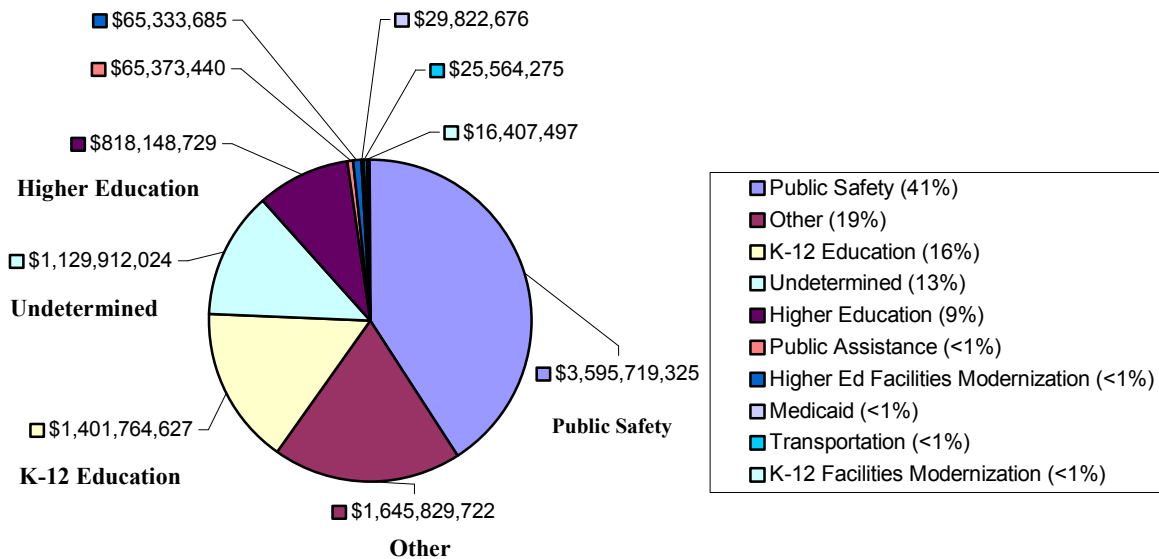
Much needed – short-term – relief: The American Recovery and Reinvestment Act (ARRA) was passed by Congress and signed into law by President Obama in February of 2009. Included in the \$789 billion package was a \$53.6 billion State Fiscal Stabilization Fund (SFSF) that invests in state K-12 and postsecondary education programs for fiscal years 2009, 2010 and 2011. The ARRA stipulates that the Secretary of Education may retain \$5 billion of this fund to target certain “education-related” activity. Of the remaining \$48.6 billion, 81.8 percent is designated to fill funding gaps in state budgets for K-12 and postsecondary education. The remaining 18.2 percent of the funds are designated for a Government Service Fund to be prioritized for the state at the discretion of the state's governor. States have filled 30% to 40% of their fiscal year 2010 budget gaps with the federal stimulus monies.

While public colleges and universities benefited greatly by the federal stimulus legislation – it has largely served as a “jobs retention” and “tuition mitigation” program – an inevitable funding cliff is likely to occur, given a slow return to stronger state revenue streams.

Distribution of State Education Stabilization Funds from the American Recovery and Reinvestment Act ($\$40$ billion or 81.8% of total state stabilization fund allocation)



Governors' Discretionary Use of American Recovery and Reinvestment Act Government Services Fund ($\$8.8$ billion or 18.2% of total state stabilization fund allocation)



Detailed data on ARRA state applications and funds distribution available at:
congressweb.com/aascu/FederalRecoveryAct.htm

Recessionary Impacts on State Higher Education Finance, Policy and Programs

Recession-Induced Reductions in State Support for Higher Education: The recession's impact on public postsecondary funding is evident in preliminary, soon-to-be released data from the State Higher Education Executive Officer's *State Higher Education Finance* report. In fiscal year 2009 state appropriations for higher education fell by 2 percent, but federal fiscal stabilizations funds permitted an increase of 1 percent. State funding fell another 3 percent in fiscal year 2010, but fiscal stabilization funds attenuated that decrease to a -2 percent. In fiscal year 2010, 5 percent of all support from higher education came from the fiscal stabilization fund. Within the states, that percentage ranges from zero to 18 percent. Fiscal year 2009 funding comprised 10 percent or more of stabilization funds in three states. For fiscal year 2010, funding comprised 10 percent or more of stabilization funds in nine states.

Inflation – In Check for the Moment: The costs of goods, services, pay and employee benefits in higher education rose 2.3% for the year ending June 30 – a figure that is (as typical) nearly a percentage point higher than the Consumer Price Index for the same period but less than the 5 percent rate that colleges experienced in the 2008–09 academic year. Administrative salaries and fringe-benefit costs witnessed the biggest increases.

State Student Loan Guarantee Programs: Credit remains tight for some states' student loan programs. The programs have also been impacted by reduced federal subsidies and the threat of legislation in Congress to end the Federal Family Education Loan (FFEL) program.

State Student Aid Programs: While a politically unpopular move, some states are scaling back their student aid and scholarship programs. States that have either made changes or at least threatened to make changes in funding allocations or eligibility to grant and scholarship programs include ***Georgia, Florida, Illinois, Michigan, Missouri, Ohio, Rhode Island, Utah, Washington*** and ***West Virginia***. ***California*** students were spared in 2009 from a major cut to the huge Cal Grant program.

State Loan Forgiveness Programs: Reductions are being made to state loan forgiveness programs aimed at incenting students to pursue training in high-demand occupations and/or serve in geographically remote or underserved areas. Cuts have been made to such programs in ***California, Connecticut, New Hampshire, Iowa, Kentucky, Missouri*** and ***Pennsylvania***.

State Pre-Paid and 529 Savings Programs: Turbulence in the stock market has led to huge losses to some states' college savings programs. A recent *New York Times* investigation revealed that 16 of the existing 18 state prepaid college savings plans currently have funds insufficient to meet future obligations as a result of the stock market slump and rising college costs. Programs under particularly severe fiscal stress include those in ***Alabama, Illinois*** and ***South Carolina***. The board of ***Alabama's*** pre-paid tuition plan has just announced that it will no longer pay participants' full tuition at public state universities. Instead, starting next fall, it will pay a fixed amount based on average tuition costs. Only two states have programs that do *not* have actuarial deficits, those in ***Colorado*** and ***Florida***.

Other Recessionary Impacts Affecting Higher Education Institutions

Enrollment Up, at an All-Time High: Managing enrollment has been a particularly turbulent exercise in this recession. Preliminary data released by the National Association of College Admissions Counselors (NACAC) indicated that for the fall 2009 semester, enrollment increased across the board, with 71 percent of publics and 52 percent of privates reporting gains. However, more private institutions than publics (24 percent vs. 14 percent) reported declines. In terms of freshman enrollment, public colleges were more likely than privates to see increases (58 percent vs. 44 percent). And the gap was greater for new transfer students, suggesting that cost may be a motivating factor for the rising numbers of transfers. Of public institutions, 72 percent reported increases in transfer enrollment, compared to only 45 percent of private institutions. Still not

known is the extent to which public colleges will enroll fewer out-of-state students as a result of decreasing ability for students to pay non-resident tuition rates – or whether the opposite will be true, based on state institutions’ stepped up efforts to recruit higher tuition-paying students.

The share of 18- to 24-year-olds attending college in the United States hit an all-time high in October 2008, driven by a recession-era surge in enrollments at community colleges, according to a Pew Research Center analysis of newly released data from the U.S. Census Bureau. Just under 11.5 million students, or 39.6 percent of all young adults ages 18 to 24, were enrolled in either a two- or four-year college in October 2008 (the most recent date for which comprehensive nationwide data are available). Both figures—the absolute number as well as the share—are at their highest level ever.

Institutional Financial Aid on the Rise: The aforementioned NACAC survey found that 90 percent of colleges reported increases in financial aid applications this year, with 74 percent of colleges reporting an increase in the number of students offered institutional grant aid.

Private Fundraising Expected to Rebound After Slump: The latest Council for Advancement and Support of Education (CASE) Fundraising Index (released in July) predicts an average decline of giving to education of 3.9 percent for the 2008–09 academic year. However, the index also predicts a relatively modest 2.5 percent increase in giving to education for the 2009–10 academic year. Over the last 20 years, the average annual rate of growth for giving to education has been 7.1 percent.

Endowments Take a Hit: The average investment return for more than 500 college and university endowments was minus-19 percent for the fiscal year ending June 30, as reported by the Chronicle of Higher Education, and based on the preliminary annual report on endowments by the National Association of College and University Business Officers (NACUBO) and the Commodityfund Institute. Since 2000 there have been only two other years when average endowment returns were negative: 2001, when returns were down 3.6 percent, and 2002, when they fell 6 percent.

Some Private Institutions in Tough Straits: Broader economic circumstances are affecting the various sectors within higher education differently. Perhaps most vulnerable are small and less well-endowed private liberal arts institutions. Even a small decline in enrollment combined with massive losses in their endowment portfolios can result in financial catastrophe. In a recent assessment, the U.S. Department of Education indicated that 114 private nonprofit degree-granting colleges were in such fragile financial condition at the end of their last fiscal year that they had failed the department’s fiscal-responsibility test. Such conditions could lead to closures and/or consolidations in some cases. Meanwhile, some private colleges have increased financial aid and decreased selectivity to help sustain enrollment in the economic downturn, with a significant number still expecting tuition and fee revenues to decline this year, based on a recent survey by Moody’s Investors Service. However, some institutions have budgeted conservatively, resulting in upgrades in bond ratings for 19 colleges in 2009.

Other Higher Education State Policy Issues in the Mix

Tuition Policy for Undocumented Students: Considerable legislative activity continues in state legislatures regarding public college admissions and resident tuition eligibility for undocumented individuals. At the federal level, President Obama has indicated intentions to initiate substantive immigration reform. It is debatable whether congressional action will take place in 2010 given mid-term elections and more pressing issues being addressed such as health care reform, climate and energy legislation, and financial regulatory changes. On the state level, much attention will be given to the first state supreme court case on the issue, in *California*, where that state’s statute providing for in-state tuition to non-residents is being challenged. The *New Jersey* legislature recently failed to pass a hotly contested measure to provide in-state tuition rates to undocumented students who meet specific conditions.

Concealed Weapons Policy on Campus: Legislation to allow concealed weapons on campus was introduced in 11 states in the last session, including in *Louisiana*, *Missouri* and *Texas*. The issue is currently

being debated in the *Georgia* legislature. A total of 33 bills seeking to ease restrictions of firearms on campus have been introduced in 22 states in the past three years. None have passed.

Textbook Costs: Since 2004, 36 states have introduced and 17 have enacted legislation addressing college textbook issues such as greater transparency from publishers and institutions, faculty behavior and ethics in adopting texts, student access to credit, and exemption of textbooks from state sales tax. Several studies have also been requested by state legislatures. In the summer of 2008, as part of the Higher Education Opportunity Act, new provisions were included that address textbook concerns related to publishers, institutions, faculty, and bookstores, as well as accessibility for students with disabilities. Since HEOA's passage, some state legislatures have focused on incorporating the federal provisions into state law and others have introduced new requirements going beyond federal law. In 2009 a number of state legislatures, including *Washington*, *California*, *Texas*, and *Florida*, have also turned attention to promoting the development and use of open source course materials as a possible way to lower textbook prices at both the K-12 and postsecondary level.

System Governance, Restructuring and Tuition-Setting Authority: The recession has facilitated discussion and action on issues of governance and restructuring. Discussions have taken place in *Maine*, and calls for system realignment have taken place in *Georgia* and *Tennessee*. Most recently, *Mississippi* Gov. Haley Barbour unveiled a budget that includes sweeping reorganization of state government, including proposals to merge eight universities into five, involving the consolidation of three HBCUs.

Affirmative Action: *Arizona* is the first state to put affirmative action on the state's 2010 general election ballot. It marks the first time that a ban on preferences in the public hiring process has been put on the ballot by the legislature, as opposed to by Ward Connelly and his network. *California*, *Washington*, and *Michigan* are other states that have passed bans on affirmative action via the ballot box. A federal appeals court is about to consider a lawsuit challenging *Michigan's* ban against racial preferences in public university admissions and government hiring. Civil rights groups and University of Michigan students, faculty and applicants say the 2006 ballot measure approved by voters is unconstitutional, and cite that the constitutional amendment has created an unfair process where universities give weight to geographical diversity and legacy status but not racial identity. Supporters say the law reflects the will of the people.

Veterans' Education: Some states are taking complementary measures to facilitate college access that was greatly expanded via the New GI Bill. The Yellow Ribbon Program contained in the legislation may affect the enrollment pattern of veterans differently across the various higher education sectors.

Finally, On the State Elections Front...

2009: Only two statewide elections took place in 2009, and since the 2008 general election in which the Republican Party lost control of the White House, control of Congress and majorities in governorships and state legislatures. *New Jersey* and *Virginia* had gubernatorial contests; both seats are currently held by Democrats but were won by Republicans.

This year's elections included 26 ballot measures across the states, smaller than the average 33 that have occurred in odd-year general elections in the past decade. Three measures on November's state ballots are of note, given their intended effect on higher education:

Taxpayer Bill of Rights (Maine, Washington): Voters in *Maine* turned down a ballot measure aimed at severely restricting state spending, including that for higher education. Voters in *Washington* denied passage of a similar, albeit less restrictive, spending cap measure. Maine voters rejected a similar initiative in 2006, as did voters in *Nebraska* and *Oregon*. Measures were withdrawn from ballots that same year in *Michigan*, *Montana*, *Nevada* and *Oklahoma* due to unverifiable signatures. While these votes mark an additional setback to the anti-tax movement as reflected in the outcomes of state ballot measures, some 14 states are set to proceed with tax restriction measures.

University Research Fund (Texas): In this November's general election, voters in ***Texas*** strongly endorsed a constitutional amendment that will create a \$500 million fund designed to help turn seven institutions in the state into top tier research universities. The overwhelmingly approved amendment is part of a larger effort to elevate more institutions into the top national tier of research universities. The change in the Texas Constitution will transfer \$500 million from a largely dormant existing fund into a new National Research University Fund, which will spin off money – about \$25 million a year – to hire faculty members and for other purposes at the seven institutions: University of Texas campuses at Dallas, Arlington, El Paso and San Antonio; Texas Tech University; the University of Houston and the University of North Texas.

2010: Thirty-seven states will hold elections for governor next year. Democrats will defend 19 of those, and Republicans 18. The races will be open in at least 20 states because incumbents either will retire or are term-limited. The severe economic pressures that call for either further sharp reductions in state spending or additional tax increases are sure to heighten the political and policy debate encompassing these elections.

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