THE NATIONAL CENTER FOR
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IN BRIEF...

Primary Finding

States, and higher education in particular, are likely to face very tight budget conditions for the next decade.

Other Key Findings

★ All but a handful of states will find it impossible to maintain current levels of public services within their existing tax structures.

★ Just to maintain current services, state spending for higher education would have to increase faster than state spending in other areas.

About These Projections

These projections were developed for the National Center for Higher Education Management Systems by the Rockefeller Institute of Government. The full report, as well as more detailed state-by-state data, can be obtained at **www.higheredinfo.org.** These projections also build upon an earlier study by Harold Hovey called *State Spending for Higher Education in the Next Decade: The Battle to Sustain Current Support*, available at **www.highereducation.org.**

STATE SHORTFALLS PROJECTED THROUGHOUT THE DECADE

Higher Ed Budgets Likely to Feel Continued Squeeze

by Dennis Jones

After almost a decade of good economic conditions and strong revenue growth, most states entered fiscal year 2003 facing sharply reduced revenues, and are now struggling to constrain expenditures. Unfortunately, this situation is unlikely to change any time soon, according to projections developed for the National Center for Higher Education Management Systems by Donald Boyd of the Rockefeller Institute of Government. Even if states experience normal economic growth over the next eight years, all but a handful of states will find it impossible, given their existing tax policies, to continue funding their current level of public services.

Maintaining funding for the wide range of existing state services will place enormous pressure on state legislatures to continue the recent practice of sharply reining in, if not reducing, their appropriations to higher education. This trend is in stark contrast to state actions during much of the 1990s, when most states substantially increased their support for higher education. This boom-and-bust cycle has become a traditional state pattern of treating colleges and universities disproportionately well during prosperous times—and disproportionately poorly in tight budgetary circumstances.

State actions during the good economic times of the nineties are likely to exacerbate the fiscal challenges that lie ahead—particularly for higher education. This is because, during the strong fiscal conditions:

1. States funded popular new programs that will now compete with higher education for funding in both good times and bad; and
2. Many states reduced tax rates, and many did so in ways that will require explicit action to increase them again—which lawmakers are very reluctant to do.

Further, due to demographic and economic factors in most states, the claims on the public purse will be greater for other programs than for higher education—continuing the trend that results in colleges and universities getting a consistently smaller slice of the state appropriations pie.

If economic growth is slower than normal, if states continue to cut taxes, or if states increase spending in areas outside of higher education, then the outlook for support of public higher education will be even worse.

Fiscal Outlook for States

The analysis by the Rockefeller Institute suggests that even if state and local governments close their current budget gaps with recurring actions rather than gimmicks that provide only temporary relief, most states will continue to face difficulty financing current services through existing revenue structures; they will not have resources for real increases in spending. This would mean either:

- State residents would have to scale back their appetite for public services. This would be a reversal of a long-term trend; each of the past five decades has witnessed significant increases in real per-capita expenditures by state and local governments.

— or —

- State residents would have to accept tax increases to finance new growth. Support for this option likewise appears problematic.

"On the expenditure side, many states will need to rapidly increase their outlays for Medicaid, the health insurance program for the poor and medically needy."

These findings are based on projections, over the next eight years, of the revenues and expenditures that would be required in each state (1) to maintain current public service levels (2) given the current tax structures and (3) given conservative estimates of expenditures, (4) if state economic conditions were to improve to their average, that is, "normal," conditions.

Based on these projections, five states face a *structural surplus* by year eight (see table 1). Forty-four states face a *structural shortfall.* Twelve states face shortfalls of five percent or more. These projected shortfalls are smaller than the crisis-induced budget gaps that many states face today. They suggest, however, that state and local governments will continue to face fiscal stress even after their economies strengthen.

The primary reasons for these continuing fiscal difficulties are twofold, one concerning revenues and the other dealing with spending requirements. First, state and local tax revenues are unlikely to grow as fast as state economies because:

- Economic growth is projected to be more balanced than in the late 1990s, which generated extraordinary surges in capital gains income.

- Increases in sales tax revenues are projected to slow significantly due to (a) continued shifts in consumption from goods to lightly taxed services and (b) the inability to collect sales taxes on Internet-related transactions.

Table 1

Eight years from now, given a return to normal (that is, better) economic conditions:

- **Which states have a structural fiscal surplus?**
- **Which states have a structural fiscal shortfall?**
- **How big is the surplus or shortfall, as a percentage of revenues?**

States with Surplus	***Surplus as a % of Revenues***
Vermont	3.1
North Dakota	2.2
Maine	1.3
New Jersey	0.6
Delaware	0.2
No Surplus or Shortfall	***Surplus/Shortfall as a % of Revenues***
Wisconsin	0.0
States with Shortfall	***Shortfall as a % of Revenues***
Kansas	–0.3
Montana	–0.4
Maryland	–0.5
New Hampshire	–0.6
Arizona	–0.7
Massachusetts	–0.8
Utah	–0.8
Oklahoma	–1.3
Oregon	–1.3
Nebraska	–1.4
Ohio	–1.4
Michigan	–1.7
South Dakota	–1.7
Minnesota	–1.9
Rhode Island	–1.9
Colorado	–2.3
Alaska	–2.4
California	–2.5
Connecticut	–2.9
Pennsylvania	–2.9
West Virginia	–2.9
Virginia	–3.0
Georgia	–3.2
U.S. Average	**–3.4**
Kentucky	–3.4
Arkansas	–3.5
Hawaii	–3.6
New Mexico	–3.6
Iowa	–3.7
New York	–3.8
Illinois	–4.2
Missouri	–4.7
Washington	–4.9
Idaho	–5.0
Indiana	–5.2
North Carolina	–5.6
Florida	–5.7
Texas	–5.7
South Carolina	–6.3
Wyoming	–7.8
Mississippi	–8.6
Louisiana	–8.8
Alabama	–9.2
Nevada	–9.2
Tennessee	–9.7

Source: Donald Boyd, *State Spending for Higher Education in the Coming Decade* (Boulder, CO: NCHEMS, 2002).

Table 2

Over the next eight years, just to maintain current levels of all public services (given current spending patterns):

- **Which states will face greater funding requirements from other services than from higher education?**
- **Which states will face greater funding requirements from higher education than from other services?**
- **How much additional % growth in spending is required to fund either the other services or higher education?**

*States that will face greater funding requirements from higher education than from other services**	*Extra annual % growth in spending required for higher education compared to all services*
Nevada	1.9
New Jersey	1.3
Virginia	0.6
Connecticut	0.4
Arizona	0.3
Illinois	0.3
Massachusetts	0.3
Pennsylvania	0.1

**(given current spending patterns)*

*States that will face greater funding requirements from other services than from higher education**	*Extra annual % growth in spending required for all services compared to higher education*
Delaware	0.1
Colorado	0.2
Maryland	0.2
Rhode Island	0.2
California	0.3
Michigan	0.3
North Carolina	0.3
Florida	0.6
New York	0.6
U.S. Average	**0.7**
Alaska	0.7
Missouri	0.7
New Hampshire	0.7
Ohio	0.7
Tennessee	0.9
Georgia	1.0
Indiana	1.0
Kentucky	1.1
Wisconsin	1.1
Texas	1.2
South Carolina	1.4
Iowa	1.5
Minnesota	1.5
Washington	1.5
Arkansas	1.7
Kansas	1.7
Oklahoma	1.7
Hawaii	1.9
Oregon	1.9
Alabama	2.0
West Virginia	2.0
Nebraska	2.1
Utah	2.1
Idaho	2.2
Maine	2.2
Mississippi	2.2
Montana	2.2
Louisiana	2.7
Vermont	2.9
New Mexico	3.0
South Dakota	3.2
North Dakota	3.3
Wyoming	4.5

**(given current spending patterns)*

Source: Donald Boyd, *State Spending for Higher Education in the Coming Decade* (Boulder, CO: NCHEMS, 2002).

- State revenue dependence on excise taxes is growing, and growth in these revenues lags behind overall economic growth.

On the expenditure side, many states will need to rapidly increase their outlays for Medicaid, the health insurance program for the poor and medically needy. According to the experts, Medicaid spending is expected to grow by about 10% a year, which will drive up overall spending considerably.

Projections for the data in table 2 are based on assumptions that:

1. **State revenue structures in place in fiscal year 2000 will continue. The projections incorporate assumptions about how taxes respond to economic growth and about the impact of Internet-related transactions on sales tax revenue.**
2. **State and local governments will increase spending based on inflation, population changes, etc., but will not increase expenditures per unit (per student, per Medicaid recipient, etc.) more than inflation.**

Impact on Higher Education

The Trend

During the nineties, the share of state budgets devoted to higher education decreased, as Harold Hovey noted in *State Spending for Higher Education in the Next Decade: The Battle to Sustain Current Support* (1999): "Over the past decade the percentage increases in state support for higher education have been smaller than the percentage increases in total state budgets. . . . In other words, higher education isn't competing successfully with the attentions of other forms of state funding."

Stated another way, higher education's share of the overall pie continues to get smaller, both nationally and in most states. The size of the pie increased significantly in the nineties. This provided additional revenues for higher education, but it masked the reality that in most states the share continued to shrink.

The Prospects

These projections suggest that the fiscal prospects for higher education are not rosy. The pie is no longer expanding; in some states it is shrinking. As higher education receives a smaller share of a smaller pie—a likely short-term scenario—colleges and universities and the students who enroll in them will face particularly difficult financial positions.

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Even if state economies were to rebound to normal levels, however, higher education would continue to face strong competition for resources from other state-supported programs. In only eight states are higher education's requirements expected to grow more rapidly than the needs of other state and local programs (see table 2). The rapidly escalating costs of Medicaid, more than anything else, explain why total state and local spending is projected to grow faster than spending for higher education in most states.

"If economic growth is slower than normal, if states continue to cut taxes, or if states increase spending in areas outside of higher education, then the outlook for support of public higher education will be even worse."

WHAT WOULD HAPPEN IF . . . ?

The data in table 2 reflect an assumption that services would continue at current levels (called "current services financing"). That is, tables 1 and 2 present the funding picture *if no real growth in expenditures occurs for any program.* However, history suggests that this kind of restraint would be most unusual. It is reasonable to assume, for example, that considerable public support exists for increasing real spending on K–12 education (for instance, to reduce class sizes, raise standards, raise requirements for teacher qualifications, and reduce social promotion).

Changing some of the key assumptions about current services funding would paint a different—and, in most cases, a gloomier—picture of the state fiscal environment.

For example:

- If state and local governments were to increase real per-pupil spending for K–12 education by 1.5% annually (rather than 0%, as assumed in the current projections), then the average projected structural fiscal shortfall would increase from 3.4% (see table 1) to 6.2%; 49 of 50 states would face a shortfall; and Tennessee would face the worst shortfall, at 12.4% of revenue.
- If states were to increase real per-pupil spending for *both* K–12 education and higher education by 1%, then the results would be similar to the above case, but the distribution would differ across states. There would be an average shortfall of 6%, and 49 states would face a shortfall.
- On the other hand, if states were able to immediately stem sales tax losses related to Internet taxation, the average shortfall would decrease from 3.4% (see table 1) to 2.4%, and 39 (rather than 44) states would face shortfalls.
- Finally, if Medicaid growth were slower by one percentage point across the board than assumed, then the average state shortfall would be reduced from 3.4% (see table 1) to 2.1%; 37 (rather than 44) states would face a shortfall; and the worst shortfall would be in Nevada (8.0%).

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