John Kincaid

Austerity, affordability, and accountability will be key watchwords for higher education during the 1990s. Entitlement spending and anemic national growth will constrain federal aid to higher education. Other social priorities are competing for state budget dollars. State and local taxpayers are restive. Under these circumstances, state legislatures can be expected to press for greater accountability from public universities and colleges. As the cost of financing higher education shifts more to students and their families, moreover, citizens can be expected to demand greater affordability and accountability from all institutions of higher education.

Government Financing of Higher Education in the 1990s:

Austerity, Affordability, and Accountability

The golden fiscal years of higher education have ended for the foreseeable future. Fiscal conditions will vary among the states and, nominally, while federal and state funding for higher education may increase during most of the 1990s, the decade is likely to be marked by austerity relative to real costs, perceived needs, and faculty and student preferences. For the first time in 35 years, state appropriations for public colleges and universities were reduced at the outset of the 1990s. Approximately 60 percent of all public and private colleges had to cut operating budgets in 1991, some in mid-year. Tighter state budgets for higher education were evident in 1992–1993 and anticipated again for 1994. Hence, leading private institutions, leading state university systems, and the City University of New York system, for example, have faced cutbacks and/or deficits.

In one sense, this austerity should not be surprising. The growth associated with an expanding economy and maturing baby-boom generation of previous decades could not be sustained indefinitely. However, the fiscal squeeze for higher education is tighter than one might have expected, even with the brief 1990–91 recession. Past recessions and the recession of the early 1980s had minimal effects on higher education.

Higher education's current fiscal squeeze reflects a convergence of many factors, both internal and external, but certainly among the leading factors are the changing priorities of federal and state budgets. Put simply, higher education has become a less viable contender in the political competition for public funds. This competition is likely to become stiffer during the 1990s because economic growth is expected to be comparatively slow, voters are likely to resist state tax increases, and government debt burdens will persist well into the next century. Furthermore, signals of fiscal trouble have been evident for more than a decade. Overall, the U.S. economy has not performed as well since 1973 as it did from 1947 to 1973. Federal and state government support for higher education generally increased during the 1970s and 1980s, but was more constrained during the latter decade. Thus, higher education's fiscal problems reflect long-term trends likely to persist through the 1990s. These trends are likely to make austerity, affordability, and accountability key watchwords for the remainder of the decade.

The Federal Fiscal Crisis: Students vs. Grandparents

The fiscal crisis of the federal government does not augur well for federal aid to higher education. The federal government has incurred annual deficits since 1969. During the 1980s, however, deficits soared to unprecedented peacetime heights, producing a total federal debt of more than $4.4 trillion by 1993. A more telling measure is federal debt as a percentage of gross domestic product (GDP). Federal debt declined from 43.5 percent of GDP in 1968 to 33.5 percent by 1981, but then increased to 68.2 percent of GDP by 1992, thus consuming a larger share of the nation's productive capacity and pushing heavy costs onto future college-bound generations and their parents.

A similar pattern can be seen when federal debt is measured in relation to national personal income. Debt dropped from 51.9 percent of personal income in 1968 to 39.2 percent in 1981, but then soared to 79.1 percent of personal income by 1992. This growth in debt increased federal interest costs from 8.9 percent of federal outlays in 1980 to 14.4 percent in 1992, thereby diverting a larger share of national investable funds to debt service. Even if annual deficits are reduced in 1993–1996, the size of the cumulative debt will still push interest payments upward as a proportion of federal outlays.

The increased federal debt stems, in part, from a significant growth of federal expenditures in both current and constant dollars since 1974, with a further acceleration after 1987. Although federal receipts also increased significantly after 1976, they did not keep pace with expenditures, and actually declined in constant-dollar terms from 1988 to 1992. There has also been a noticeable shift in federal tax sources. Taxes paid primarily by individuals (i.e., income and Social Security) increased from 67 percent of all federal receipts in 1968 to about 82 percent by 1992. This shift, primarily caused by higher Social Security tax rates, has reduced the discretionary income of individuals and families to finance higher education at the same time that public debt and deficits have constrained the federal government's ability to aid higher education.

Equally important has been the changing composition of the federal budget. In addition to the growth of federal interest payments, entitlement spending increased to 50 percent of the federal budget in 1992—a proportion that is expected to grow during the 1990s. Furthermore, despite a dramatic decline in defense spending as a proportion of federal expenditures, education (i.e., K–12 and postsecondary) captured only 3 percent of federal spending in 1992 compared to 4 percent in 1968. The "peace dividend" has gone mostly to health, welfare, Social Security, and interest on the federal debt.

Nevertheless, higher education did receive a larger share of the total federal education budget pie in 1992 (see Figure 1). The share of the federal budget for education, however, was smaller in 1992 than it was in 1968. Thus, higher education is getting a bigger piece of a smaller share of the federal budget.

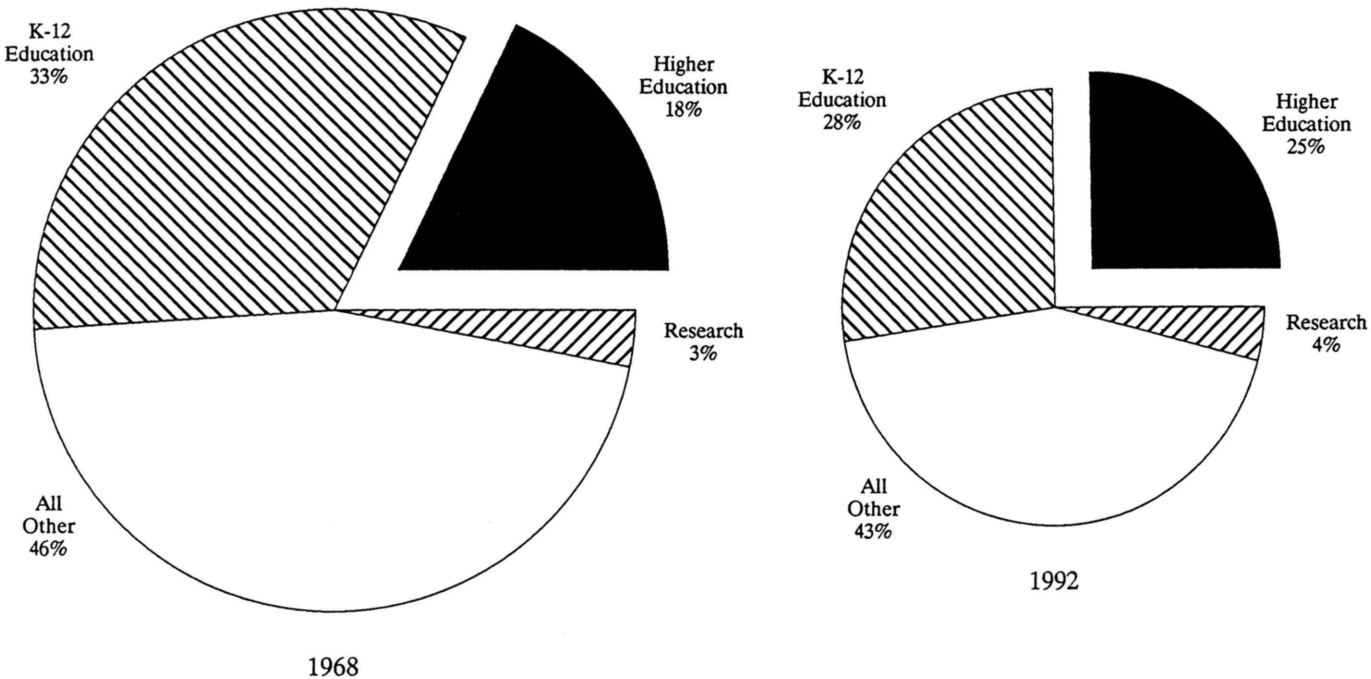
Figure 2 shows direct federal outlays for higher education from 1968 to 1992. In both current and constant dollars, higher education received sizable increases in federal outlays from 1974 to 1981. Since 1981, however, the picture has been less bright, especially in constant-dollar terms. Given the outlooks for the federal budget and the national economy, the prospects for significant real increases during the 1990s are slim.

With respect to federal assistance, higher education's fiscal problems have been shaped significantly by the generational entitlement imbalance that has developed in the federal budget system. This is reflected, for example, in the decline of the poverty rate among persons over age 65 from 24.6 percent in 1970 to 12.4 percent in 1991 and the increase in the poverty rate among children from 14.9 percent in 1970 to 21.1 percent by 1991—a development that bodes ill for the ability of higher education to meet the needs of upcoming generations. Although the growth in federal entitlement spending since the 1960s has been driven ostensibly by equity concerns for the poor and minorities, the principal financial beneficiaries have been senior citizens, who have consumed the lion's share of growing federal spending on individuals (which exceeded 70 percent of federal outlays in 1992). Placed in graphic perspective in a study by Laurence Kotlikoff and Jagadeesh Gokhale, the average 70-year-old woman in 1970 received $5,120 in transfer payments, including Social Security, Medicare or Medicaid, and welfare benefits, while the average 10-year-old girl received $350. In 1990, the respective transfer payments were $10,467 and $410. Federal entitlement spending is expected to grow by 28.5 percent from 1991 to 1994.

In effect, federal budget priorities and tax policies have set current and prospective college students against their grandparents. Symptomatic of this contest was the refusal of the President and the Congress to make Pell Grants an entitlement during reauthorization of the Higher Education Act in 1992 because there were already more than 80 entitlement programs, spending on many of which is out of control. Federal budget priorities, therefore, have shifted toward senior-citizen benefits to the disadvantage of younger generations, which face: (1)

Figure 1

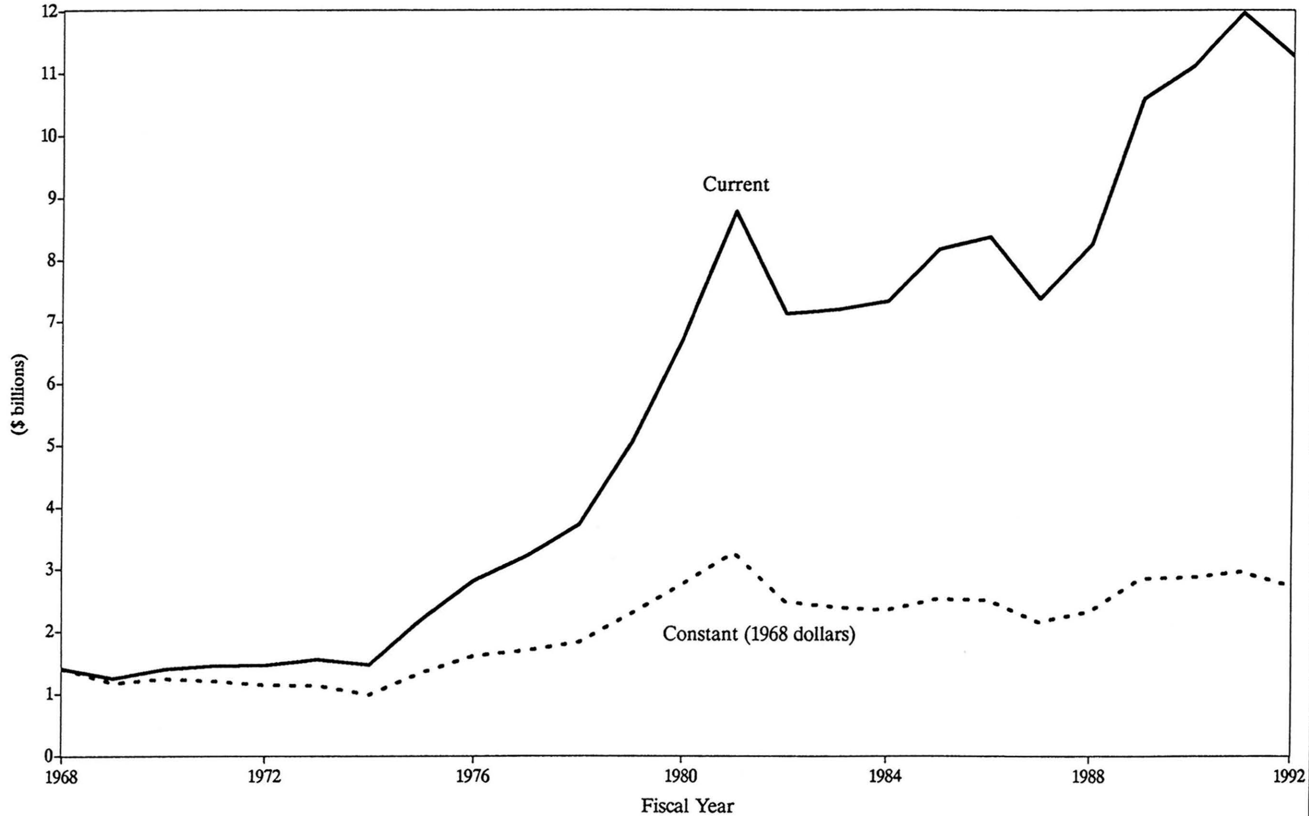
Federal Education Expenditures by Function, 1968 and 1992



Source: U.S. Office of Management and Budget, *Budget Baselines, Historical Data, and Alternatives for the Future* (January 1993).

Figure 2

Direct Federal Outlays for Higher Education, 1968-1992



Source: U.S. Office of Management and Budget, *Budget Baselines, Historical Data, and Alternatives for the Future* (January 1993).

federal budgets constrained by entitlements, deficits, and interest payments that primarily benefit their elders, (2) the need to finance these federal policies out of an increasing share of their pre- and post-college income, while (3) having larger proportions of their members growing up in poverty in an economy likely to be characterized by slow growth and (4) facing higher tuition-and-fee costs and the need to finance their education less from grants and more from loans requiring repayment from post-college income in the form of principal plus interest and/or lost income through community service.

The State-Local Fiscal Squeeze: Students vs. Nursing Home Owners, Prisoners, Welfare Mothers, EPA, and Taxpayers

Trends in state and local government finances look roughly similar to federal finances, though not as severe. Total state-local debt increased from \$121.2 billion in 1968 to \$915.7 billion in 1991. State-local debt declined from 13.6 percent of GDP in 1968 to 12.0 percent in 1981, and then climbed to 16.1 percent of GDP in 1991. Similarly, state-local debt declined from 17.1 percent of personal income in 1968 to 14.4 percent in 1981, but increased to 19.0 percent of personal income by 1991. It should be noted, though, that unlike much of the federal debt, state and local debt is incurred mostly for capital rather than operating purposes. A portion of this state-local debt, of course, helped to finance higher education facilities, such as dormitory construction. Overall, state and local general revenues exceeded general expenditures in every year from 1976 to 1991 when, for the first time in 15 years, expenditures exceeded revenues by over \$6 billion.

Like federal spending, state and local expenditures increased significantly, from \$102.4 billion in 1968 to \$435.3 billion in 1982, and then \$908.5 billion in 1991. In constant dollars, however, state-local expenditures increased from \$102.4 billion in 1968 to \$151.5 billion in 1982, and then to \$245.3 billion in 1991. Similarly, state-local revenues grew significantly, from \$101.3 billion in 1968 to \$457.7 billion in 1982 and then \$902.2 billion in 1991. In constant dollars, state-local revenues increased from \$101.3 billion in 1968 to \$158.8 billion in 1982 and then \$243.6 billion in 1991. Indeed, state and local revenues increased at a greater rate (106 percent) than federal revenues (92 percent) from 1980 to 1989. This, plus the lighter debt load, gave state and local budgets a somewhat healthier hue at the beginning of the 1990s than the federal budget, although the 1991 fiscal picture was not encouraging.

Another important development is that patterns of federal aid to state and local governments have changed substantially since 1978, with significant effects on state and local budgets. Federal aid as a percentage of total state-local outlays increased from 18.3 percent in 1968 to a high of 26.5 percent in 1978, but then dropped to 17.3 percent in 1989 and increased again to 22.0 percent in 1992. Thus, state and local governments must rely more on their own revenue sources to finance services than was true 15 years ago.

Even more important, the composition of federal aid has changed dramatically. Much of the federal aid received now, especially by the states, is dedicated for payments to persons through entitlements and other safety-net programs (see Figure 3). The amounts of federal aid going to state and local governments (i.e., places) for capital and human investment and for their own operational uses have declined almost continuously since 1978. It is such aid for persons that accounts for most of the increase in federal aid since 1989.

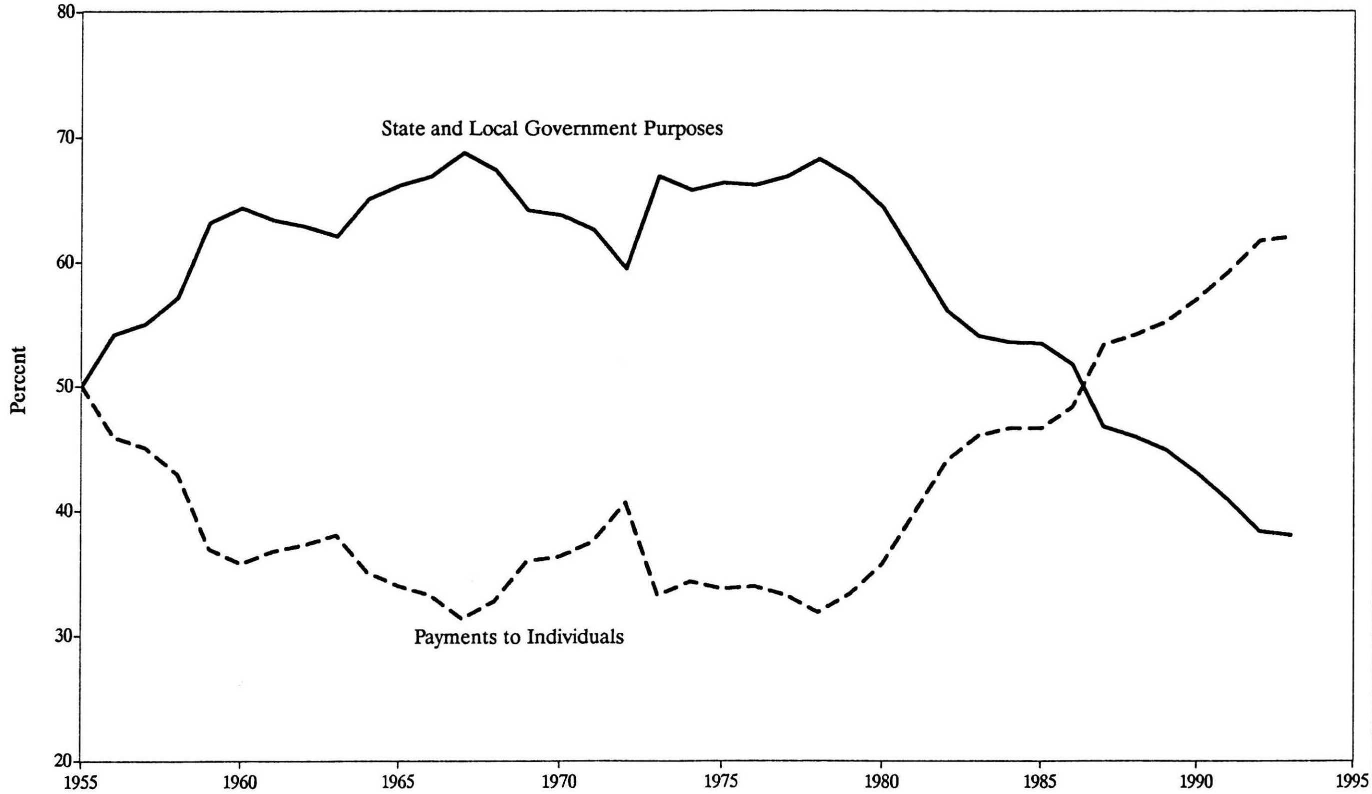
This shift of federal aid from places to persons has had two other important consequences for state and local finances. For one, because states administer and often co-finance many of the federally initiated safety-net programs (e.g., Medicaid and AFDC), direct federal aid to local governments dropped from 10.0 percent of local revenues in 1978 to 3.5 percent in 1991. Overall, federal and state aid as a proportion of local general revenue declined from its post-World War II high of 44.7 percent in 1979 to 37.3 percent in 1991. At the same time, local governments are experiencing some dramatic cost increases, especially for environmental protection. By 2000, local governments will spend about $12.8 billion more per year, or 65 percent more than in 1988, simply to maintain current levels of environmental protection. Between now and 2000, local governments will have to raise 32 percent more money to keep up with current regulations, at a time when GDP is expected to grow only by about 2.4 percent per year. Consequently, local governments will have less fiscal capacity to be generous to institutions of higher education with respect to public service costs and tax and fee exemptions.

Second, federal aid is pulling more state spending toward entitlements, with corresponding benefits for senior citizens and other recipients of public assistance. Medicaid, for example, is the single largest intergovernmental aid program, accounting for 38.0 percent of all federal aid in 1992. Medicaid increased from 11.6 percent of state general expenditures in 1980 to about 17.1 percent in 1993, eclipsing higher education as a proportion of state spending by 1990. In that year, the elderly and the disabled represented 27.4 percent of all Medicaid enrollees but received 70.0 percent of all Medicaid funds. Long-term care for Medicaid clients in nursing homes and their own homes accounted for 43.4 percent of Medicaid expenditures in 1990 compared to 34.2 percent in 1973. The Congressional Budget Office expects total state and local spending for Medicaid to increase from $66 billion in 1993 to $132 billion in 1999. In mid-1993, the National Conference of State Legislatures reported that state funding for Medicaid would be 24 percent higher than tax-supported state funding for higher education. Given the growing elderly population, the needs of older Americans for nursing-home and other long-term care will increasingly compete with the needs of young people for higher education.

Indeed, in 1992, financing Medicaid rivaled balancing the state budget as a leading fiscal issue cited by state legislative fiscal officers (see Figure 4). The short 1990–91 recession, which was followed by negligible growth, had a substantial impact on state budgets. The average annual increase in state budgets was 3.4 percent in 1984–1989, but only 0.5 percent in 1990–1993. Actual declines occurred in 1991 and 1993.

Figure 3

Federal Grants-in-Aid to State and Local Governments for Payments to Individuals and for General Government Purposes as a Percentage of Total Grants, 1955-1993*

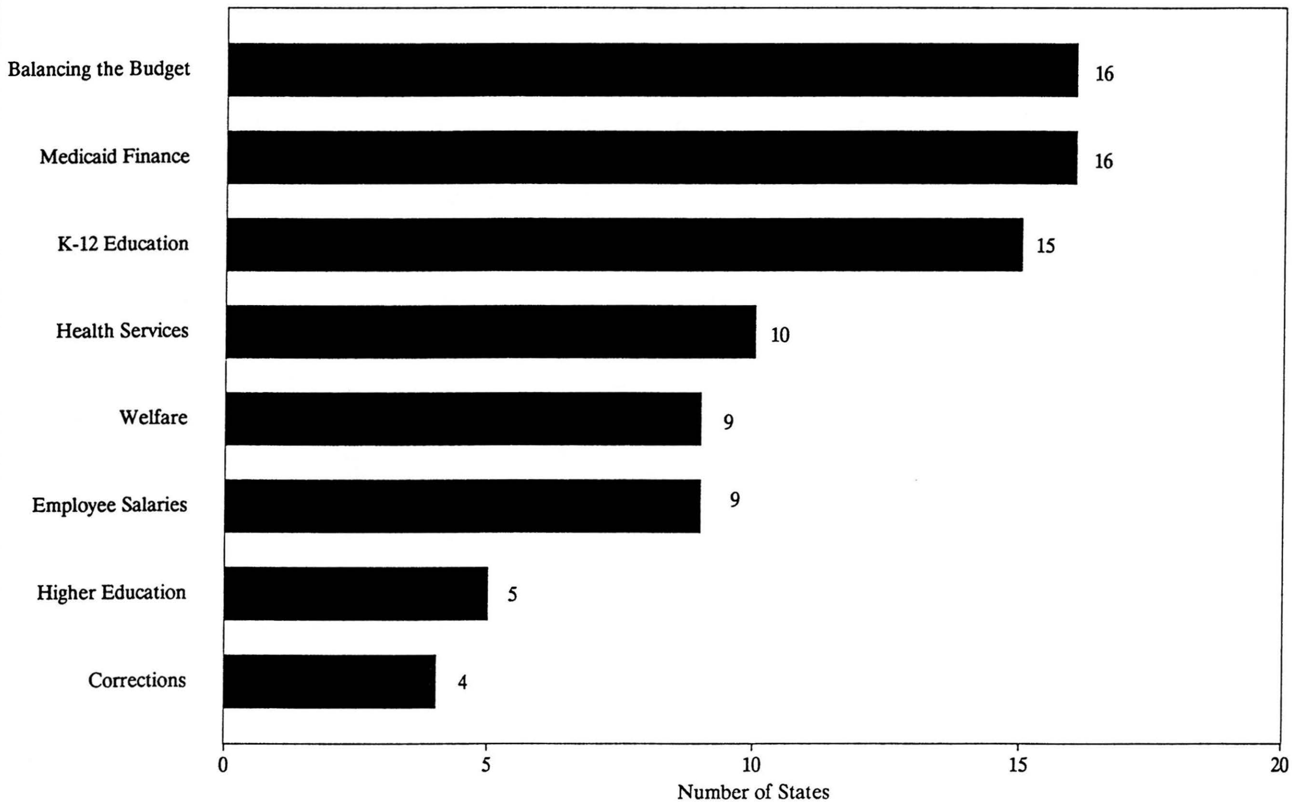


* 1993 is estimated.

Source: ACIR, *Significant Features of Fiscal Federalism, Volume II, 1993.*

Figure 4

Leading Fiscal Issues Identified by State Legislative Fiscal Officers, 1992



Source: National Conference of State Legislatures, *State Budget Actions, 1992* (December 1992).

Economic growth may be more sluggish in 1994–1999 than in 1984–1989, thus constraining state budget growth. In addition, if proposed caps on federal entitlement spending are enacted by the Congress, states will face increased costs requiring tax increases and/or program cutbacks.

Higher education, therefore, will increasingly compete with other claimants for state appropriations. Aside from Medicaid, criminal justice is a potent competitor. Criminal justice

has been the fastest growing category of state spending since 1973. State taxes now fund about 36.5 percent of criminal justice services, especially corrections, compared to 24.6 percent in 1973. Fiscal 1994 marked the third consecutive year in which corrections received more new state dollars than higher education. Two other strong competitors are social welfare and K–12 education. If the national economy remains sluggish, if the number of children in poverty continues to increase, and if the public continues to press for tougher measures against crime and better performance from K–12 schools, there will be continual upward pressure on state spending for criminal justice, social welfare, and K–12 education. Figure 5 illustrates the projected outcome of this competition for 1993.

Finally, state budgets are likely to be further constrained by public restiveness about taxes. Increases in federal taxes, moreover, will place greater political pressure on state and local governments to limit their own tax increases. Although voters have not been unwilling to accept some state and local tax increases, they have been less than enthusiastic about increases, more likely to demand strong justifications for increases, and often insistent on approving increases only for specific purposes.

In summary, direct state support for higher education is likely to be constrained for the remainder of the 1990s by tight budgets subject to stiff competition for pieces of those budgets.

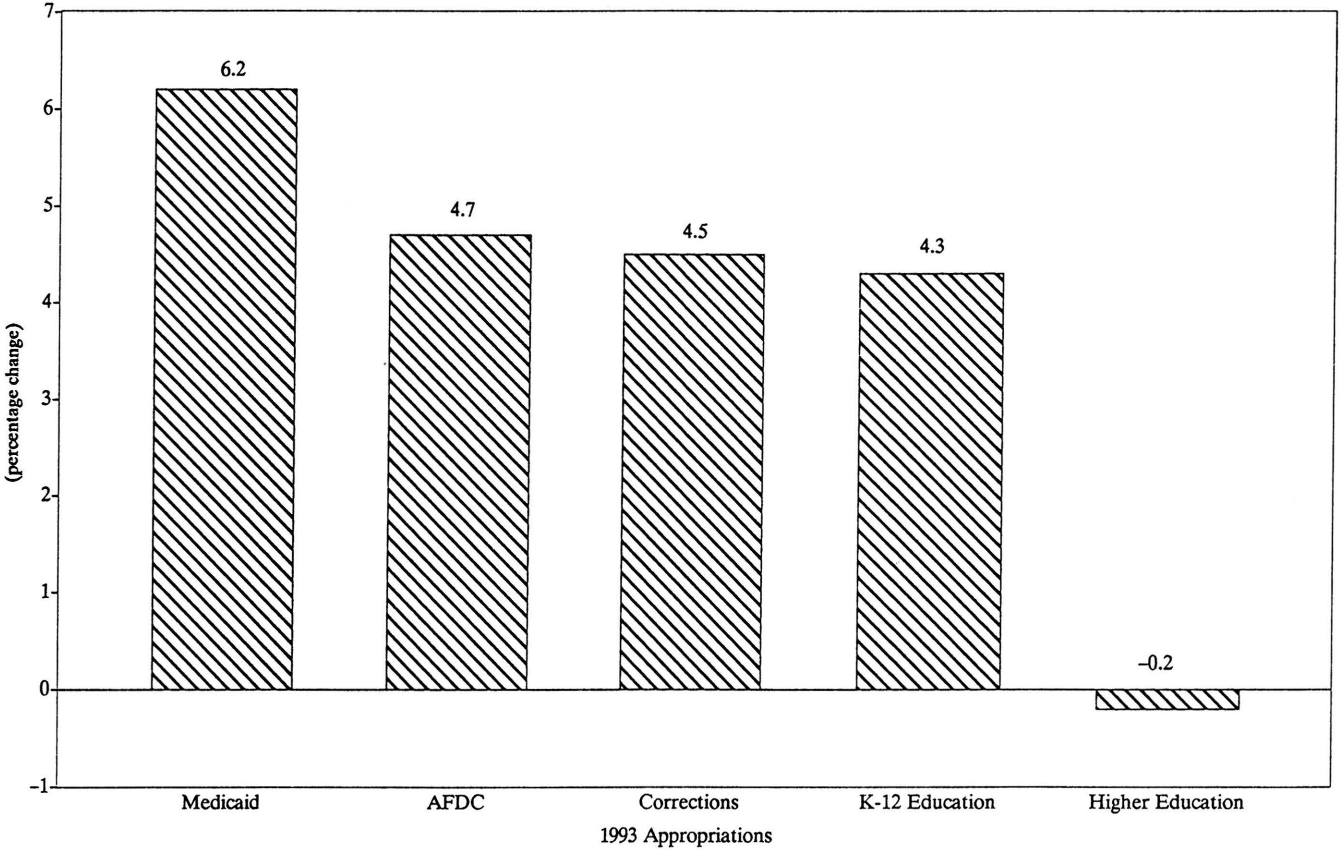
Austerity, Affordability and Accountability

State spending on higher education has been trending slightly downward. Higher education's share of total state general spending dropped from 14.9 percent in 1968 to 12.8 percent in 1974, and then remained essentially flat until it dropped to 12.1 percent in 1988 and then 11.8 percent in 1991. Direct state appropriations for higher education increased from $1.44 per $100 of personal income in 1968 to $1.57 in 1971, then dropping to $1.42 in 1983 and to $1.39 in 1989, and then increasing to $1.40 in 1990 and 1991.

It should be noted, moreover, that the largest share of state support for higher education comes from state general funds (58 percent in 1992). Because these funds are supported largely by taxes, they are most vulnerable to cutbacks during periods of budget austerity induced by recessions, tax revolts, and competition for funds. Figure 6 shows seven major state functions and the extent to which each is reliant on state general funds. For example, 83.2 percent of funding for corrections comes from general funds.

Figure 5

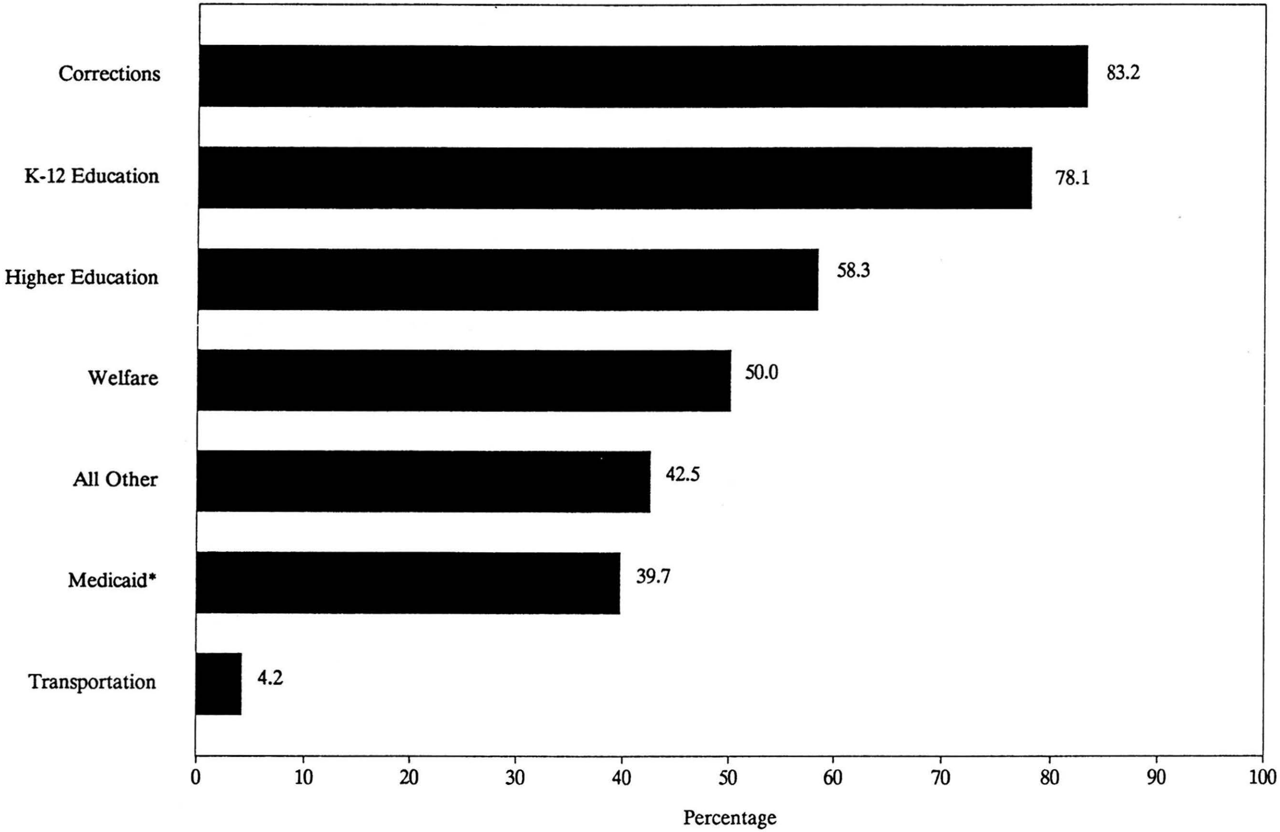
Percentage Change in Major Categories of State Spending, FY 1992 to FY 1993



Source: National Conference of State Legislatures, *State Budget Actions, 1992* (December 1992).

Figure 6

Share of Major State Programs from General Funds, FY 1992



* Medicaid from FY 1991.

Source: National Association of State Budget Officers, *1992 State Expenditure Report* (April 1993).

Figure 6 helps to illustrate what has been called "the balance wheel" theory of higher education financing. That is, higher education is a relatively discretionary function that can be used to balance state budgets in times of austerity, and then be targeted for increases during more affluent periods. Corrections and K–12 education are heavily reliant on state general funds, with K–12 education becoming more so in recent years. These two functions are in high public demand, but alternative sources of funding are not readily available. Hence, states have little maneuvering room here.

Welfare and Medicaid receive large amounts of federal aid; however, this aid also comes with many federal requirements, thus reducing state funding discretion. Welfare costs, moreover, tend to increase during periods of budget austerity produced by recessions.

Lastly, transportation is too small a portion of state general funds to be of much account. This, therefore, leaves higher education and "all other" as being the most vulnerable spending categories under tight budget conditions. Higher education is particularly vulnerable because other sources of funding are potentially available. Indeed, there have been dramatic increases in tuition and fees at most institutions of higher education. These increases have exceeded the rate of inflation and have been rising more rapidly than state appropriations for higher education, especially in recent years. According to the National Commission on Responsibilities for Financing Postsecondary Education, the average cost of attending colleges and universities increased by 126 percent from 1980 to 1990. During that period, the average cost of new cars increased by only 37 percent, food by 53 percent, new homes by 90 percent, and medical care by 117 percent. Median family income rose by only 73 percent. In the 1970s, "sticker shock" was associated with new-car purchases; now it is associated with higher education.

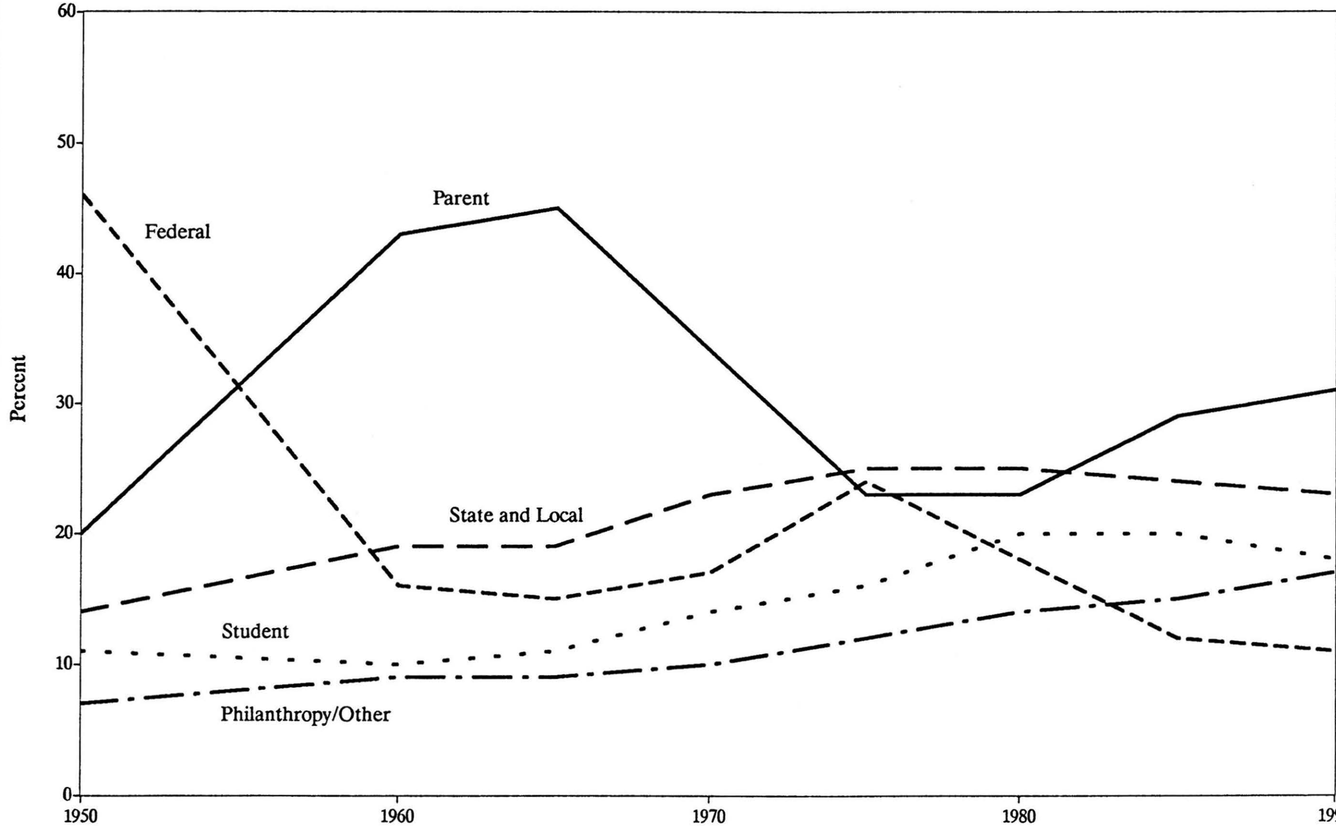
Coincident with the increase in prices has been a declining share of government financing for higher education since 1975 (see Figure 7). The rising costs of higher education, therefore, are being borne increasingly by families, parents, students, and philanthropists. The shift of rising costs toward families and students, moreover, has occurred during a period when personal savings have declined as a proportion of disposable income: from 9.0 percent in 1981 to 4.8 percent in 1992. Consequently, affordability is becoming a salient public issue.

Altogether, then, we see:

1. federal austerity with little prospect in the near future for much additional federal aid,
2. state contributions to higher education that have been declining slightly as they are nudged out by other spending priorities,
3. local budgets less able to provide free or discounted public services to institutions of higher education and their students, and
4. a shift of costs from government to citizens who are likely to have impaired abilities to pay higher education's prices.

Figure 7

Changing Percentage of Financing Burden for Postsecondary Education, 1950-1990



Source: National Commission on Responsibilities for Financing Postsecondary Education.

These trends could produce serious damage to public access to higher education, a significant change in the mission of higher education, and/or taxpayer/parent revolts. The prospects for the 1990s of slower economic growth, higher taxes, higher tuition and fees, and higher expectations of the income potential of higher learning constitute a politically explosive mixture for higher education.

Given the budget squeezes facing governments and families, both public officials and voters are likely to insist on greater accountability for the spending of higher education dollars. The real challenge of budget austerity is not simply cutbacks, but the clamor to get more bang for the buck. The kind of accountability that may be sought in the 1990s is perhaps captured by the quip that faculty salaries are inversely related to their teaching responsibilities. It is this pressure that can easily debase the mission of higher education.

Suggested Readings

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