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Higher Education: Fund Learning, Not Buildings

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INTRODUCTION

Many claim that state support for higher education has been declining over the last decade and blame inadequate funding for rising tuition, but a look at state appropriations tells a very different story.

The truth is that appropriations for higher education have, at the very least, remained constant and in many cases have increased from year to year. For the 2008-09 biennium, the Texas Legislature appropriated $19.9 billion in All Funds and $11.4 billion in General Revenue for higher education, an increase of 17.1 percent and 12.68 percent respectively.[1]

The fact that tuition has continued to rise in spite of increasing state funding shows that it is not a lack of money that has caused the rise in tuition, but a continued increase in spending—made possible by the lack of price competition between universities. This situation has allowed these institutions to continually raise tuition without the fear of losing students to more affordable alternatives.

The manner by which the state provides financial support to these institutions allows this constant escalation to continue by encouraging these institutions to compete for financial support from the state, rather than relying on satisfied customers to finance their operations.

TEXAS FUNDING

Almost all of the money for higher education goes directly to universities and is then distributed to students at the discretion of the school. Even financial aid and student grants are allocated in bulk to universities, and then given to students to help pay for tuition at that school.

Rather than compelling universities to compete for students based on the quality and price of their product, this structure incentivizes institutions to compete for funding from the Legislature and encourages them to continually raise costs with the expectation that taxpayers will pay the difference.

Every year nearly 25 percent of the funds appropriated to general academic institutions supports projects that have been identified by the Legislature. The Legislature identifies these projects based on the needs institutions have presented to them. These needs range anywhere from capital expenditures to additional funding for universities with a disproportionate share of students whose families are unable to pay more than $4,000 a year toward educational expenses.

The bulk of higher education funding, approximately 75 percent,[2] relies on formulas to determine the amount of state support each school will receive. A variety of formulas are used to allocate the billions of dollars dedicated to formula funding, but the majority of formula funding, 81 percent,[3] incorporates the previous year's enrollment numbers to determine the amount of funding.

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That 81 percent, or $3.3 billion in 2007,[4] was distributed based on weighted semester credit hours and was used to pay for faculty salaries, administration, and other student services. The remaining $800 million of formula funding went to sponsor infrastructure development at universities and provide bonuses to tenured or tenure track professors who are willing to teach undergraduate classes.[5]

Interestingly, of all the money dedicated by the state to reduce the burden of getting a post-secondary degree, none of it is actually given directly to the students. The problem with this funding structure is that it is not focused on the quality of the education the school provides or the satisfaction of the students enrolled in the previous year. Nor does this funding structure have repercussions for poor management of funds or reward higher education institutions that are fiscally efficient.

Unlike in the private sector where competition leads to cost cutting and savings, the system of higher education is structured so that competition for funds leads to more spending, since the more universities commit to spending one year the more they will be awarded in the upcoming budget process. This explains why, as Dr. Richard Vedder states, the "marginal propensity to consume at institutions is one—universities spend every dollar they make."[6]

As a result, universities spend more hoping that the state will pick up the tab. In the very likely event that university spending outpaces the state's ability to cover the institutions' expenses, the difference is passed on to their customers in the form of higher tuition.

Without incentives to contain costs, colleges and universities will continue to spend excessively and expect the state and taxpayers to pick up the tab, while forcing those seeking a post-secondary degree to pay much more than necessary for their education.

The only way to inject competition into the higher education marketplace is to force universities to compete for students' money by putting state funds into the hands of students and letting them decide who earns the state's money.

Right now, "the benefits of subsidizing universities are concentrated among the university communities, but the cost of these subsidies are disbursed among the taxpaying population."[7] Shifting money from universities (producers) to students (consumers), would encourage students to consider how far their money will go at each university, thereby holding higher education institutions accountable for their spending habits.

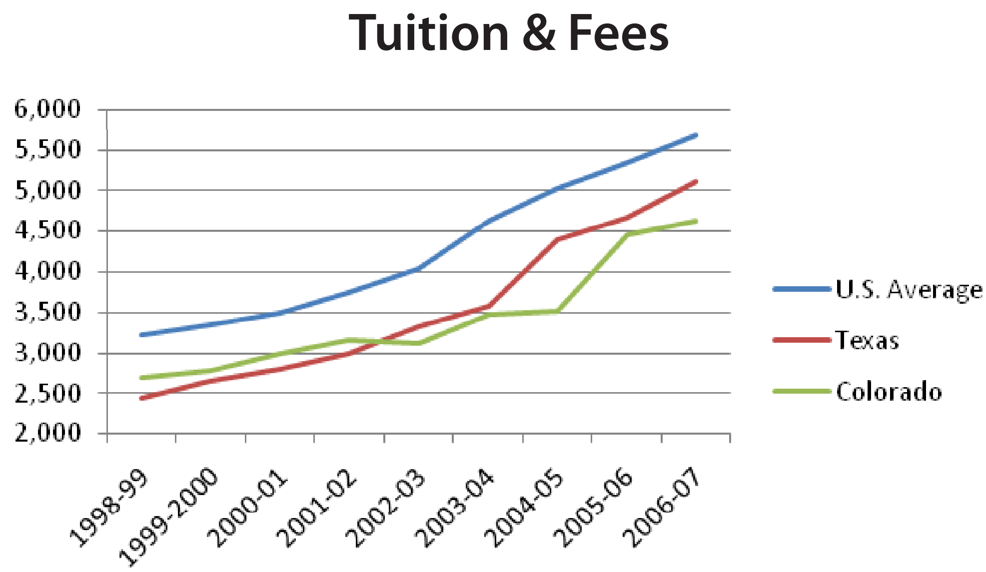
COLORADO: COLLEGE OPPORTUNITY FUND

In 2004, the Colorado Legislature made a revolutionary decision when it decided to "no longer provide financial transactions to its public institutions for undergraduate education."[8] Instead, the state created the College Opportunity Fund, which provides undergraduate students with a stipend to put toward their tuition at a public or private higher education institution.

The amount of the stipend is set annually by Colorado's General Assembly during the budget process. For the 2008-09 academic year the stipend is worth $92 per credit hour at public universities and colleges and $46 per credit hour at a private institution.[9] This means that a full-time student taking 15 credit hours at a public university would generate a stipend of $2,760 a year, or $1,380 a semester. That money is given to the university once the student has enrolled at the university. The amount of the stipend is then credited to the student's account and deducted from their cost of tuition.

To further increase the competitiveness of higher education in Colorado, students attending private institutions that are eligible to receive Pell-grant student funding are eligible to receive a half stipend. Private institutions seeking to participate in the College Opportunity Fund program are required to meet seven criteria. These institutions must:

- Enter into a performance contract with the Colorado Department of Higher Education;
- Participate and provide data to the Colorado Department of Higher Education's Student Unit Reporting Data System (SURDS);
- Be a not-for-profit college or university;



Source: National Center for Education Statistics

- Not be pervasively sectarian;
- Maintain its primary place of business in the State of Colorado;
- Offer general Baccalaureate degrees in the Arts and Sciences; and
- Be regionally accredited by one of the six national accrediting agencies.[10]

Performance contracts are not unique to private universities wishing to partake in the College Opportunity Fund. All public institutions are also required to enter into a performance contract with the Colorado Department of Higher Education.

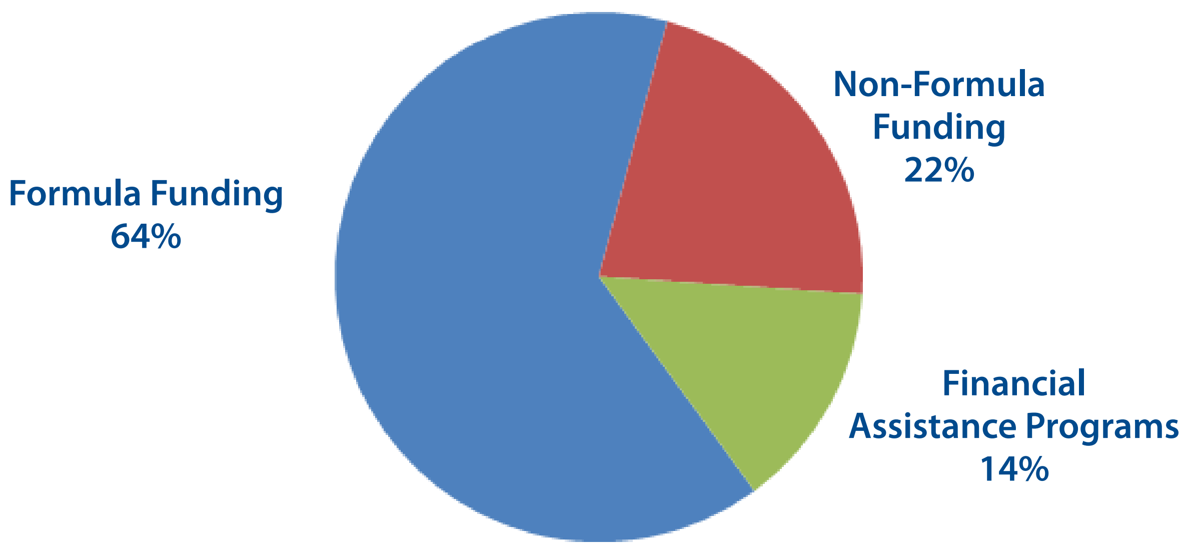
The purpose of the contracts is to "provide greater [institutional] flexibility and a more focused accountability for institutions to students and the people of Colorado," and ensure that statewide goals, such as graduation rates, institutional costs and productivity, and student satisfaction are being met.[11] These contracts also allow universities to clearly define their mission and layout a vivid description of how they will fulfill that mission so that students have a very clear understanding of what to expect from the university.

State funding for higher education institutions does not stop with student stipends. Colorado uses General Fund dollars to enter into fee-for-service contracts where the state can purchase "specified educational services and facilities required for the full development of Colorado's educational and economic opportunities."[12] Most of these contracts go to fund graduate and doctoral programs that would not be viable operating on the state's stipends.

Transitioning to this type of funding has increased the competitive environment of higher education in Colorado and allows its Legislature to focus on providing financial support to everyone that wants to earn a post-secondary degree while competitively driving down the price of tuition.

However, if you look at Colorado's tuition rates before and after the change in funding, you will find that tuition rates have continued to climb. This is largely due to Colorado's failure to truly increase consumer sensitivity or competitive pricing. Since the program's implementation in 2005, the amount of the stipend has increased by 15 percent,

Texas 2007 Funding Approach



Source: Fiscal Size Up 2006-07, Legislative Budget Board, http://www.lbb.state.tx.us/Fiscal_Size-up_Archive/Fiscal_Size-up_2006-2007_0106.pdf.

increasing the burden on the state and allowing universities to raise tuition without facing an outcry from their consumers.

According to Colorado's Office of State Planning and Budgeting, the state's Department of Higher Education has requested an "increase of $75,150,799 cash funds to support the anticipated increase in tuition revenue in FY 2009-10. This request limits the effective resident undergraduate tuition rate increases to 5 percent for instate undergraduate students who are Pell 1 or 2 eligible (about half of all instate undergraduates). The remaining half of in-state undergraduate students will see a tuition increases of no more than 9 percent, 7 percent, and 5 percent for research institutions, state colleges, and community colleges respectively."[13] In short, the state is attempting to absorb the increase in tuition and limit the impact on consumers, thereby eliminating resistance to the increase.

The stipends were intended to increase competitive pricing between universities by increasing consumer sensitivity to the price of tuition and allowing consumers' demands for lower prices to contain the growth of tuition. By continuing to increase the amount of the stipend, the Legislature has drastically limited the impact increasing tuition has on consumers and undermined its own attempts to influence the competitive environment in higher education.

Even with these increases and misguided government intervention, tuition in Colorado has remained below both the national average and below the average rate of tuition in Texas. However, if Colorado wishes to maintain this distinction, its Legislature will have to resist pressures to raise the amount of the stipend.

Critics have also pointed to the number of students that have not received their stipend as a failure of the program. Reports indicate that 3,000 students did not apply for, and therefore did not receive, their stipend and as a result had to pay the $2,600 out of their own pocket.[14] But as Rick O'Donnell pointed out in a response to these statistics, "this means 98.6 percent of the 213,655 Colorado students attending public colleges and universities in the state managed to figure out how to apply for and use their voucher."[15]

Achieving 98 percent participation in any program should be considered a success, and certainly providing financial support to 98 percent of college students, a portion of which might otherwise not have been able to attend, should be commended. Funding these students, as opposed to subsidizing the institutions, is a more appropriate use of taxpayer dollars and provides benefits to a broader base of taxpayers than simply paying universities to educate a select few.

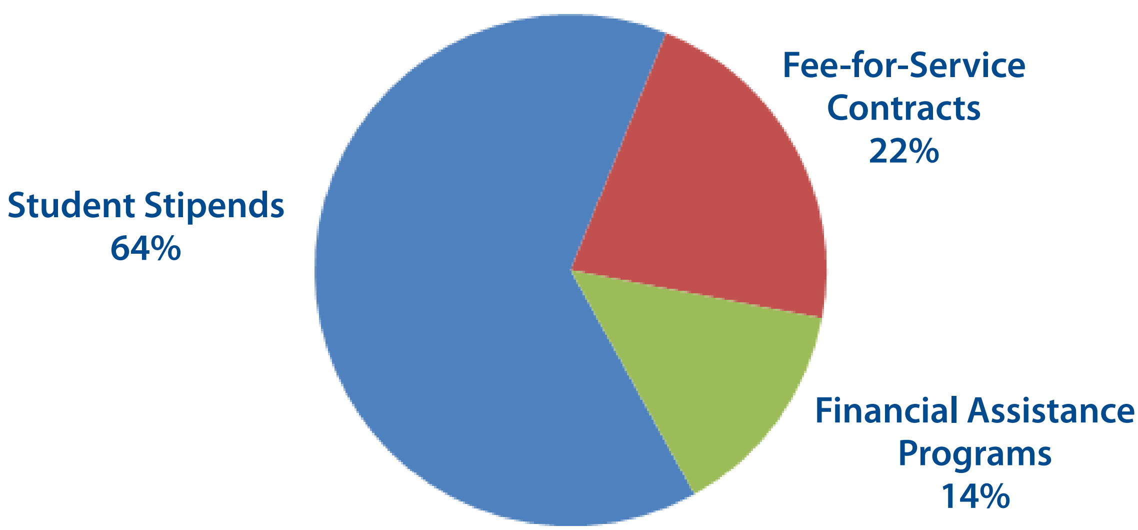
RECOMMENDATIONS

Texas is one of the highest spenders in the country when it comes to higher education. For the 2008-09 biennium, higher education accounted for 11.82 percent of All Funds appropriations and 14.22 percent of General Revenue appropriations.[16] Implementing a system similar to Colorado's in Texas could result in significant savings to students and taxpayers alike while allowing tax dollars to benefit any Texas resident who wishes to attend college.

The best alternative is to redirect the more than $4 billion that the Legislature currently allocates to universities based on formula funding[17] and provide Texas residents attending a public or private university to receive a $3,000 stipend towards their tuition. By putting the state's money directly into the hands of students, universities would be forced to earn state funding by providing a value-based service as opposed to relying on an arbitrary formula to determine their funding.

The amount of the stipend would be reviewed each legislative session and would be subject to surviving the legislative process. Universities would no longer be able to increase spending without directly raising prices to consumers who would have to pay tuition increases out of pocket—thus looking more critically at what they are getting for the increase in tuition. This would require universities to evaluate

2007 Funding Under Student-Centered Funding



Source: Author's calculations; Fiscal Size Up 2006-07, Legislative Budget Board, http://www.lbb.state.tx.us/Fiscal_Size-up_Archive/Fiscal_Size-up_2006-2007_0106.pdf.

the quality of their product and weigh the cost and benefit of each expense they incur.

It is important to note that these stipends would not take the place of financial assistance programs. Because the funding for the stipends would be taken directly from money allocated to formula funding, the approximate $900 million appropriated for financial assistance programs[18] would remain intact and would be distributed to students as it is now, based on financial need. Additionally, non-formula funding, which accounted for $1.4 billion in 2007,[19] could be used to support graduate and Ph.D. programs through fee-for-service contracts between universities and the state.

CONCLUSION

Most importantly, returning purchasing power to the consumer would inject missing market forces into the higher education marketplace. These forces, especially when combined with performance contracts, have the ability to improve accountability and efficiency at universities, while guaranteeing a quality education for students.

The success of student-centered funding in Texas hinges on the commitment of the Legislature to hold constant the value of student vouchers and to maintain student loan aid funding at current levels.[20] Without this commitment from the Legislature, simulating the forces of competitive pricing and consumer demand will fail to have the intended impact on the market.

Colorado has taken bold steps to restructuring the funding of its higher education system, and as one of the country's leaders in higher education reform, Texas is the perfect place to demonstrate the success that is to be had by giving students the ability to demand an affordable, quality education.

ENDNOTES

[1] *Texas Higher Education Quick Facts 2008,* Texas Higher Education Coordinating Board, 2008.

[2] *Fiscal Size Up 2006-07,* Legislative Budget Board, 206, http://www.lbb.state.tx.us/Fiscal_Size-up_Archive/Fiscal_Size-up_2006-2007_0106.pdf.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] Richard Vedder, *Going Broke by Degree: Why College Costs So Much*, American Enterprise Institute (2004) 196.

[7] Ibid.

[8] Rick O'Donnell, *The College Opportunity Fund Background and History,* Colorado Commission on Higher Education (2005) 5.

[9] *Answers to Questions from Students,* College Opportunity Fund, http://cof.college-assist.org/cofapp/cofapp/Default.aspx?pageID=7#qs08.

[10] Rick O'Donnell, *The College Opportunity Fund Background and History,* Colorado Commission on Higher Education (2005) 5.

[11] 99th Colorado General Assembly, *2nd Regular Session, Senate Bill 189* (2004) 3.

[12] Ibid.

[13] *Increases in Execution State Budget Requests 2009-10,* Office of State Planning and Budgeting (Nov. 2008) 3.

[14] Myuang Oak Kim, "College Voucher Program Under Fire," *Rocky Mountain News* (May 2008) http://www.rockymountainnews.com/news/2008/may/16/college-voucher-program-under-fire/.

[15] Rick O'Donnell, *Rope-a-dope With College Aid*.

[16] *Texas Higher Education Quick Facts 2008*, Texas Higher Education Coordinating Board, 2008.

[17] *Fiscal Size Up 2006-07,* Legislative Budget Board, 206, http://www.lbb.state.tx.us/Fiscal_Size-up_Archive/Fiscal_Size-up_2006-2007_0106.pdf.

[18] Ibid.

[19] Ibid.

[20] Richard Vedder, *Going Broke by Degree: Why College Costs So Much*, American Enterprise Institute (2004) 198.

About the Author

Kalese Hammonds joined the Texas Public Policy Foundation as a Health Care Policy Analyst in November of 2007.

Kalese graduated from Texas A&M with a degree in communication and a minor in business. After graduation, Kalese began working at the Foundation as an unpaid intern assisting with research in the Center for Education Policy.

As a policy analyst Kalese works on public policy issues including health care, higher education, and transportation. Kalese also serves on the Health and Human Services Commission's Frew Advisory Committee, which advises HHSC regarding strategic initiatives associated with the *Frew v. Hawkins* lawsuit and is a member of the American Legislative Exchange Council's Health and Human Services Task Force.

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