Fiscal and State Policy Issues Affecting Postsecondary Education
State Outlook
Compiled by the AASCU State Relations and Policy Analysis Team
The Leadership Association of 420 Public Colleges and Universities Delivering America's Promise
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# Economic Update and Elections Preview
## *October 2012*

## U.S. "Fiscal Cliff" and EU Debt Crisis Lead to Further Global Forecast Downgrade

***U.S and E.U. policymaker inaction weakening global recovery***

The International Monetary Fund has marked down U.S. and global economic growth forecasts for the second time this year, indicating that European and U.S. policymaker-induced risks have increased the threat of reduced economic activity in the months ahead. IMF officials fault the unwillingness by Congress to address the forthcoming "fiscal cliff" and E.U. officials' inability to adequately address the Eurozone debt crisis for heightening the risk of a stalled recovery, or worse, sending the U.S. and European economies back into recession.

The IMF global economic forecast was downgraded to 3.3 percent this year and a still sluggish 3.6 percent in 2013. In its latest World Economic Outlook, the IMF said advanced economies are projected to grow by 1.3 percent this year, compared with 1.6 percent last year and 3.0 percent in 2010, with public spending cutbacks and the still-weak financial system weighing on economic prospects. Growth in emerging market and developing economies was marked down to 5.3 percent, from 6.2 percent last year. Leading emerging markets such as China, India, Russia, and Brazil are all projected to see slower growth. Growth in the volume of world trade is projected to slump to 3.2 percent this year from 5.8 percent last year and 12.6 percent in 2010. The IMF predicts a little more than a 2 percent growth rate for the U.S. this year and next.

***U.S. economy strengthens slightly in third quarter, marking continued slow post-recession growth***

On October 26th the Commerce Department reported that U.S. Gross Domestic Product (GDP)—the broadest measure of the nation's economic activity—grew at an annual rate of 2 percent in the third quarter (July-September). By comparison, GDP grew 1.3 percent in the second quarter and 2 percent in the first quarter. The slight increase in economic output was due to increased consumer spending (which accounts for nearly 70 percent of economic activity), increased spending in the housing sector and a jump in federal defense spending. The third quarter growth rate of 2 percent is still modest in historical terms; over the past 65 years, the average annualized U.S. GDP growth rate has been 3.2 percent. This latest GDP figure affirms the steady but slow recovery from the Great Recession which began in 2009; a recovery that has been the slowest of all post-World War II era recessions.

## Slow But Steady U. S. Job Growth

***Unemployment rate continues to fall, but so too has the labor market participation rate***

The U.S. unemployment rate in September fell below 8.0 percent for the first time since February 2009. Monthly job growth in the third quarter averaged 186,000, with 114,000 coming in September. The unemployment rate metric may be a somewhat poor proxy for the U.S. economy's health, given overall tepid economic output (GDP). The notable decline in the unemployment rate, despite only moderate job growth, stems from large numbers of people leaving the labor force and who are thus not counted among the unemployed. The U.S. labor force participation rate has dropped by nearly 2.5 percent since 2007. The labor force is currently almost six million workers smaller than it would be had labor force participation remained at 2007 levels, reports *The Economist*. Treating all of those people as unemployed would raise the jobless rate to 11 percent. However, only about a third of those dropouts actively want a job; the others have dropped out for various reasons, including retirement, disability, or enrollment in college.

## Forthcoming Federal Spending Decisions to Impact State, Regional Economies

***With pending fiscal cliff, much at stake in Congressional lame duck session***

Congress will face an agenda with profound fiscal and economic implications in the post-election lame duck session that will have macro- and micro-level economic ripple effects. The choices to be made by Congress include the following:

Tax-Extenders: Confronting Congress will be the major task of addressing a number of expiring tax provisions. The questions before Congress will involve which tax provisions to continue and how to pay for them. The cost of extending the most popular provisions total more than $380 billion in fiscal year 2013, including $221 billion in personal federal income taxes (the so-called "Bush tax cuts") and $95 billion for the payroll tax holiday; all of which are part of $4 trillion in cuts slated to take place over the next decade. According to the Congressional Budget Office (CBO), allowing the tax provisions to expire and sequestration to move forward unabated would contract U.S. economic growth to 0.5 percent, enough to sink the economy back into a recession.

Sequestration: On January 2, $109 billion is set to be automatically cut from the federal fiscal year 2013 budget, part of $1.2 trillion in required cuts over the next decade. Half of these reductions will come from cuts in defense spending, the other half from non-defense accounts. These across-the-board forced cuts come courtesy of the Budget Control Act; legislation passed by Congress last year intended to force implementation of a long-term deficit reduction strategy. The White House Office of Management and Budget, in an assessment of the automatic cuts, known as sequestration, indicated that most federal spending related to higher education would be reduced by 8.2 percent (for discretionary programs) or 7.6 percent (for mandatory programs). The Pell Grant Program is exempt from the mandatory cuts. If sequestration were to occur, states' receipt of federal dollars for K-12 education programs would be impacted significantly, notes *Stateline*. Yet, in many states K-12 education spending is dictated by state constitutions or court decisions, which could force legislatures to backfill the reductions—possibly by raiding funds previously allocated for public higher education.

U.S. Borrowing Limit: At about the same time as the Congressional lame duck session, the U.S. Treasury will once again reach its borrowing limit, which will necessitate legislative action to raise the debt cap. Last year, the near failure of Congress to raise the debt limit nearly caused a credit default, shaking U.S. markets and resulting in the first-ever downgrading of the nation's previously sterling AAA credit rating.

The so-called "fiscal cliff,"—the combined impact of massive reductions in federal spending brought about by the non-renewal of the expiring tax provisions, and possible sequestration, if not addressed by Congress in the lame duck session, will negatively affect federal allocations to states, hurt regional economies, especially those that are home to major military installations and federal contactors, pare back personal income, and with it, consumer spending that fuels economic activity. All eyes will be on Congress to see if, and how, it addresses this mix of fiscal and tax policy issues that taken together may well foretell the trajectory of the U.S. economy in 2013 and beyond. In October, the IMF warned that going over the fiscal cliff could plunge the U.S. into a full-fledged recession.

## State Budgets: Continued Slow Growth, Threats to Long Term Fiscal Sustainability

***Tepid tax revenue growth in the states***

Preliminary tax collection data for the April-June quarter compiled by the Rockefeller Institute at SUNY-Albany showed growth in overall state tax collections, up three percent compared to the same quarter in 2011. However, the pace of growth has slowed in the last four quarters. In total, 40 states reported second quarter gains while eight reported declines. States' tax collections have been in positive territory for 10 straight quarters, beginning in the first quarter of 2010, after five consecutive quarters of declines that took place in tandem with the Great Recession.

Looking at current fiscal tax collection estimates, a summer 2012 survey of state legislative fiscal directors conducted by the National Conference of State Legislatures (NCSL) predicts continued slow growth. Thirty-six states expect growth in overall tax collections of between one and 4.9 percent, while nine states expect total tax collections to grow at least five percent above FY 2012 levels. Only ***Alaska*** (-17.9 percent) and ***Kansas*** (-3.6

percent) anticipate FY 2013 total tax collections to decline by at least one percent. In Alaska, the falling price of oil is the primary driver of the decline.

Playing a role in the modest projections for FY 2013 is the fact that 2012 has been a quiet year for notable state tax changes, which largely affect collections in FY 2013. According to a report on changes in state tax policy compiled by the NCSL in August, the first half of 2012 saw the smallest aggregate change in tax revenues (-0.2 percent) directly attributed to modifications in state tax policy in the 32-years that the NCSL has been collecting the data. ***Idaho***, ***Kansas*** and ***New York*** reduced net taxes by more than one percent, while ***Illinois*** and ***Maryland*** increased taxes by more than one percent. Forty-five states made no significant net tax change.

***A multitude of factors challenge fiscal sustainability of states' budgets***

Despite the fact that states, unlike the federal government, must balance their budgets each year, the mechanisms used to balance their ledgers too often include accounting gimmicks and reliance on nonrecurring revenue sources. A task force led by New York lieutenant governor Richard Ravitch and former Federal Reserve chairman Paul Volcker examined the short and long term fiscal sustainability of six states. The Ravitch Volcker State Budget Crisis Report articulates a number of state budget dynamics that pose varying degrees of threat to all states. These include:

- Medicaid spending growth that is crowding out other state needs and services
- Federal deficit reduction efforts that threatens state economies and budgets
- Underfunded state retirement plans that create risks for future budgets
- Narrow, eroding tax bases and volatile tax revenues that undermine state finances
- Local government fiscal stress that poses challenges for states
- State budget laws and practices that hinder fiscal stability and mask imbalances

## State Funding of Public Higher Education Stabilizes in Fiscal Year 2013

***After the largest year-over-year drop in nearly a half century, an improvement in the state funding scenario***

A year after the largest decline in state funding of public higher education in nearly a half century—during which an overall reduction of 7.5 percent took place—state lawmakers sought to buffer higher education from additional steep cuts as they crafted their fiscal year 2013 budget plans.

Based on the results of an informal survey conducted by AASCU in July, 30 states witnessed a year-over-year increase in state operating support for public four-year universities heading into fiscal year 2013, which began July 1 in 46 states. This is a notable improvement compared to last year, when only eight states invested more in their public four-year universities compared to the prior year. Still, 11 states cut their support for public four-year universities this fiscal year, but nonetheless a notable improvement compared to the 36 states that cut funding last year. Nine states provided flat-funded this year, compared to six last year.

There was less variation in year-to-year changes among the states this fiscal year—a 25 percent spread, with ***South Dakota*** receiving the biggest boost, at 11.3 percent and ***Florida*** receiving the largest cut, at 14 percent. Last year, there was a 57 percent spread between the state with the largest gain (***North Dakota***, at 9.5 percent) and the state with the steepest cut (***New Hampshire***, at 48 percent). Public universities in only two states received funding reductions in excess of 10 percent this year, compared to 14 last year. Overall, the collective average percent change in year-over-year state operating support for public four year universities heading into fiscal year 2013 was 0.9 percent. In the 31 states with annual budgeting cycles, the collective average increase was one percent for this fiscal year, compared to -4.9 percent last year, a positive swing of nearly 6 percent. It should be noted that fiscal year 2013 marks the second year of a two-year budget in a number of states, therefore in these states the annual fluctuation in appropriations was typically marginal compared to last year.

The drop-off in state investment in public higher education in recent years has been dramatic in historical terms. State appropriations per-full-time-student at public postsecondary institutions increased by 1 percent from 1981-82 to 1991-92 and by 9 percent from 1991-92 to 2001-02 after adjusting for inflation, but declined 5 percent from

2001-02 to 2006-07, and by another 25 percent from 2006-07 to 2011-12, including a 10 percent decline in 2011-12, according to College Board data. Given ongoing increasing enrollment demand in many states and public spending pressures, this continued downward trend in per-student state support may well be evident once this year's final state appropriation and institutional enrollment numbers are known.

## Declining Rate of Increase in Public University Published Tuition Prices; Continued Recent Trend of Increases in Average Net Prices

***Continued price increases in response to state-to-student cost shift***

At 4.8 percent, the increase in average published tuition and fees at public four-year colleges and universities for the 2012-13 academic year is smaller than it has been in recent years—and below the average growth rate for the decade from 2002-03 to 2012-13, according to the just-released annual report, *Trends in College Pricing 2012*, produced by the College Board.

In 2012-13, full-time undergraduates at public four-year institutions received an estimated average of $5,750 in grant aid from all sources and federal tax benefits to help them pay the average $8,665 in published tuition and fees, resulting in students paying an average net price of just over $2,910, according to the College Board *Trends* report data. Because of unusually large increases in grant aid and tax credits, the average net tuition and fees paid by full-time in-state undergraduates at public four-year institutions declined in real terms between 2007-08 and 2009-10, falling from $2,470 (in 2012 dollars) to $1,950—the lowest level since 2003-04. Over the three years since, the average net tuition and fees have increased by an estimated $960 (49 percent), with the past year reflecting a $290, or 11 percent, increase.

## With Legislative Sessions Concluded, Limited Higher Education State Policy Activity

***Strong continuing focus on incentivizing postsecondary system performance***

Most state legislatures wrapped up their sessions by early summer. AASCU's July *State Outlook: Dynamics Affecting Public Higher Education Financing and Highlights from States' Legislative Sessions,* provided an overview of state policy activities from the 2012 session (see pages 6-9). One policy theme perpetuated in the legislative off-season has been state performance-based funding systems for higher education. Following the lead of many states that have implemented such systems, lawmakers and policy officials in several states are in the process of designing funding formulas aimed at incentivizing institutional performance. A key attribute of such systems is an orientation toward rewarding outcomes (i.e., student retention benchmarks and degree completions) as opposed to inputs (i.e., enrollment). Some of the states that are either currently considering or implementing higher education performance based funding systems include ***Florida***, ***Georgia***, ***Missouri***, ***Nevada***, ***Ohio***, ***South Carolina***, ***South Dakota***, ***Texas*** and ***West Virginia***.

## 2012 State Elections Preview

***Higher education policy and funding priorities in the balance***

While much of the nation's attention is focused on the presidential vote in the November 6 elections, there will be considerable impact on the composition of, and turnover in, state legislative ranks based on the outcomes of the elections. State lawmakers, new and returning, will craft, debate, and pass legislation affecting many aspects of public higher education. And given continued strained economic conditions, the priorities of the 2013 legislative cohort will influence spending decisions involving state operating support, capital outlay funding, and state student aid programs, among other state investments.

***State elections—by the numbers***

Forty-four states will hold legislative elections on November 6th. States *not* holding legislative elections are ***Louisiana***, ***Mississippi***, ***New Jersey*** and ***Virginia***, where elections are held in odd-numbered years. All legislators in ***Alabama***, ***Maryland***, and senators in ***Michigan*** are elected to four-year terms, and given that elections were held in 2010, lawmakers in these states won't face re-election this year. In total, 6,030 of the 7,382 state legislative seats, 82 percent, will be voted on in the elections. This year's elections are the first to follow the once-a-decade redrawing of district boundaries based on new census data.

Provided below are excerpts from a pre-elections analysis provided by Tim Storey, legislative elections specialist with the NCSL.

Among governors currently in office, 29 are Republicans, 20 are Democrats and one is an independent. Only 11 of them are up for election this year, and the consensus among analysts is that only three states have contests that are truly toss-ups: ***Montana***, ***New Hampshire*** and ***Washington***. Thus, the competition over which party will control state government in 2013 will mostly be fought out in the state legislative contests.

***Pre-election, Republicans at a historical high-water mark***
Coming off remarkably strong gains in the 2010 elections, when Republicans picked up 720 seats and gained control of 23 legislative chambers, the GOP is at a high water mark heading into the November elections, with more Republican legislators now in office that at any point since 1930.

**Pre-2012 Elections—State-Level Party Control**

| Governorships | | | Legislative Chambers | | | Full Legislatures | | |
|---|---|---|---|---|---|---|---|---|
| Democrat 20 | Republican 29 | Independent 1 | Democrat 36 | Republican 59 | Tied 3 | Democrat 15 | Republican 26 | Split 8 |

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*Notes: Nebraska has an officially nonpartisan, unicameral legislature.*

Currently, 3,979 state legislators are Republicans—a little less than 55 percent of all partisan seats (Nebraska elects its 49 lawmakers on a nonpartisan basis). Fewer than 20 legislators are independent or from a third party. This 55 percent to 45 percent GOP advantage is the mirror opposite of the partisan breakdown before the 2010 election when Democrats held 55 percent of the seats.

Historically, an average of 13 chambers switch party control in every two-year elections cycle. And the "coattail" effect that comes with a presidential election may also be in play this year. In 20 of the 28 presidential elections held since 1900 the party winning the White House also gained state legislative seats.

***Legislative turnover will be at a new high—institutional memory will be at a new low***
While movement in party control among the state legislative ranks is unclear in advance of the November 6 elections, one outcome is much more certain: there will be many new lawmakers in state capitols come January. In the first election following redistricting, turnover is always high. While other elections average turnover rates around 17 percent (factoring in all 50 states), in the 2002 election following redistricting, turnover reached 24 percent. All signs point to at least that level in 2012, if not higher. Legislative term limits are another factor that will spur turnover this elections cycle in the 15 states that have these limits in place, barring lawmakers from running for office again.

An expected increase in turnover in 2012 would not necessarily be noteworthy except that it comes on the heels of an unusually high turnover in 2010 of just under 25 percent, spurred by the Republican landslide that swept hundreds of Democratic incumbents out of office. Combine that with the high rates anticipated this year, and it's likely that approximately one-half of all state legislators will have served for two years or less at the start of 2013 legislative sessions. These two elections will likely result in the highest rate of turnover in state legislatures in the last 50 years.

***Ballot measures will put parameters on tax, spending policy in many states***
On November 6, voters in 37 states will vote on a total of 176 state ballot measures, according to *Ballotpedia.org*. The themes this year are more diverse than in recent election cycles, with citizens' having their say on a range of issues across the fiscal policy—social policy spectrum.

Here's a look at some of the measures that either directly involve or may indirectly impact higher education:

**Revenue Implications**
**Arizona—Proposition 204—Sales Tax Renewal Amendment**: Known as the Quality Education and Jobs Act, Proposition 204, if passed by voters, will renew a one-cent sales tax with monies generated dedicated to education funding and other state services. Of the projected $1 billion the sales tax extension would raise annually, $50 million would be earmarked for a University, Scholarship, Operations and Infrastructure Fund.

**California—Proposition 30—Sales and Income Tax Increase**: As passed by state policymakers, the fiscal year 2013 state budget calls for a modest increase in state operating support for the University of California system and flat funding for the California State University system. These budgetary intentions, however, are built on the assumption that voters will approve an increase in personal income taxes on the wealthy and a slight sales tax increase via the Proposition 30 ballot initiative. Estimated revenues generated by the tax increases range from $6.8 billion to $9 billion annually. If voters turn down the measure, it will trigger an automatic $250 million in cuts to both the UC and CSU systems. These cuts would come on top of an astounding $1.2 billion (30%) in state funding reductions to just the CSU system in the past 24 months. A competing measure, Proposition 38, would increase state income tax rates for most Californians, with most of the revenues generated earmarked for public schools and early childhood development programs.

**Florida—Amendment 3—State Revenue Limitation**: This Taxpayer Bill Of Rights (TABOR) initiative proposes replacing existing revenue limits with a new limitation based on inflation and population change. Any funds that exceed the revenue limits would be placed in the state's "rainy day fund." Once the fund reaches 10 percent of the prior year's total budget the Florida State Legislature would be required to vote to either provide tax relief or reduce property taxes. The proposed measure requires 60 percent voter approval for adoption. Modeled after the first TABOR initiative, passed in Colorado in 1992, education funding in Florida will face a severe threat if the amendment passes, as Colorado education funding was slashed dramatically after implementation of the TABOR initiative—so much so that in 2005 voters approved a ballot measure that loosened many of TABOR's restrictions.

**Maryland—Question 7—Gaming Expansion Question**: This measure, if passed, would allow one additional casino to be constructed in the state and would expand the type of games allowed at existing casinos, with revenues earmarked for education.

**Michigan—Proposal 5—Michigan Taxation Amendment**: An initiated constitutional amendment, Proposal 5, if passed by voters, will require that increases in state taxes must be approved by either a two-thirds majority of both chambers of the Legislature or by a statewide vote. A similar provision in effect in California has starved that state of revenues for higher education and other public services and led to heightened policymaking and budgetary dysfunction. The proposal is being funded and championed by a wealthy businessman and is being opposed by stakeholders across the business, non-profit and political spectrum. With passage of Proposal 5, funding for public higher education in Michigan would be further imperiled; a state in which per-student state support is forty percent lower than the U.S. average and where lawmakers have cut higher education funding at a rate five times deeper than the 50-state average over the past half decade.

**Missouri—Proposition B—Missouri Tobacco Tax Initiative**: Passage of Proposition B will create a Health and Education Fund, with a portion of the revenues generated from a tax increase on cigarettes and tobacco products to be allocated for elementary, secondary, college, and university public school funding. Estimated additional revenue to state government is $283 million to $423 million annually.

**Washington—Initiative 1185—Two-Thirds Vote Requirement to Raise Taxes:** This measure is similar to Michigan's Proposal 5 in that it would make it much harder for the legislature to generate additional revenues, in this case, by requiring either two-thirds legislative approval or a vote by the people in order to raise taxes. Therefore, a one-third minority of legislators in either chamber of the state's legislature could prevent the passage of any measure to raise revenue or repeal existing tax exemptions. With large business entities funding much of the campaign in support of the measure, it comes as little surprise that as worded, Initiative 1185's passage would require only a simple majority to pass a tax exemption, but a two-thirds majority of both legislative chambers to repeal one. Passage of the initiative will further dampen prospects for future higher education funding in a state that has been among the hardest hit by disinvestment in its public universities.

## College Access

**Maryland—Question 4—Maryland In-State Tuition Referendum**: The Question 4 referendum will allow voters to decide whether Senate Bill 167, approved by the Maryland General Assembly and signed by Gov. Martin O'Malley in 2011 legislative session, should be upheld. As passed, SB 167 allows undocumented immigrants to pay in-county tuition rates at community colleges and in-state tuition rates at the state's public universities, provided that they attended a Maryland high school for three years, they or their parents filed income taxes, and that they demonstrated intent to apply for permanent residency. Initially, students would have to complete 60 credit hours or have graduated from a Maryland community college before transferring to a state public university and qualifying for in-state tuition rates. Subsequent to passage in 2011, a state lawmaker led a successful petition drive to have a measure overturning the legislation appear on the 2012 ballot. Enactment of SB 167 was estimated to cost $3.5 million by 2016, but the legislation has been put on hold pending vote results.

## Capital Improvement / Bond Measures

**Maine—Question 2—Community College Bond**: If approved by voters, Question 2 will provide $11 million to build a diagnostic facility for the University of Maine System; for capital improvements and equipment, including machine tool technology, for the Maine Community College System; and for capital improvements and equipment at the Maine Maritime Academy.

**New Jersey—Question 1—State College Bond Issue**: By far the largest capital outlay bond question before voters in this year's elections, New Jersey's Question 1, if approved by voters, would allow the state to borrow $750 million for buildings and upgrades at the state's colleges. The state's last higher education facilities referendum was in 1988. If approved by voters, funds would be distributed across entire nonprofit sector of higher education, including senior public colleges and universities, independent colleges and universities, community colleges and special purpose religious institutions. The state college/university share would be $247 million. Institutions will be required to pay 25% of the cost of the projects supported by the bond proceeds. Proceeds are restricted to buildings for academic purposes, such as classrooms, laboratories and libraries.

**New Mexico—Question C—Higher Education and Special Schools Bonds**: By passing Question C, New Mexico voters will authorize the state to issue bonds up to $120 million for specified higher education and special school capital improvements and acquisitions.

**Rhode Island—Question 3—Higher Education Bonds**: Passage of Question 3 will authorize the state to issue general bonds of up to $50 million for renovations and modernization of academic buildings at Rhode Island College, the state's comprehensive public university.

## Governance

**Florida—Amendment 12—Appointment Process for State University System Board of Governors**: If approved by voter, Amendment 12 will lead to the replacement of the president of the Florida Student Association with the chair of the council of state university student body presidents as the student member of the Board of Governors of the State University System. The amendment also requires that the Board of Governors create a council of state university student body presidents.

**Guns on Campus**

**Louisiana—Amendment 2—Right to Bear Arms Amendment**: This amendment would change the legal standard by which courts would review challenges to gun laws, requiring the most stringent standard of judicial review when considering the legality of gun-control laws. Opponents argue that the measure is a back door attempt to overturn the state's prohibition of concealed handguns, including on public college campuses.

**Institutional Flexibility**

**Washington—Senate Joint Resolution 8223—Washington Public University Investments Amendment**: SJR 8223 would create an exception to constitutional restrictions on investing public funds by the state's research universities, the University of Washington and Washington State University, to invest specified public funds as authorized by the legislature, including in private companies or stock.

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