TESTIMONY

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A CASE FOR CHANGE

Financing Higher Education in California

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It is a distinct pleasure for me to be asked to present this testimony on financing California higher education to the Little Hoover Commission. The premise of this testimony is that the Government of the State of California, in defense of the public good, has a responsibility to assure that all residents who seek a postsecondary credential, be it a certificate, diploma, or degree, should be assured that they can afford to secure that education and that they be able to do so in an institution that has sufficient resources to provide an adequate education. This premise is essentially the same as that of the original 1960 California Master Plan for Higher Education.

This paper further argues that the 1960 master plan and the approach to financing higher education in California through public funds that has evolved from that master plan no longer serve the state well; indeed, that the current financing approach is both unwise and unsustainable.

How could this be so, when the plan was so appropriate for its time that it became the national model? The three-tiered plan assured access to all who sought postsecondary education. This efficiently differentiated system of higher education included world class universities, available only to the most academically able students; institutions that were highly subsidized by the state to assure their exceptional levels of scholarship. It provided well-resourced regional state colleges, later to become comprehensive universities, for those students who were clearly "college material," ranking well above average in their high school academic endeavors, but who were place bound or who simply preferred the campus environment of a college rather than a research focused university. It offered reasonably resourced community colleges in virtually every community to serve the needs of regular folk seeking higher education, but who did not have the academic credentials or sufficient financial resources to live away from home, or for other reasons chose not to attend one of the other two more selective types of institutions. And, for those students willing to pay the cost of choice, the state helped sustain a strong array of private institutions, which also contribute to the public good through the education they provide.

To assure that finances were not a constraint at any of the three types of public institutions, sufficient state subsidies (and local subsidies in the case of community colleges) were provided to the institution to avoid the need to charge tuition to students. In addition, the state established a robust state financial aid system to ensure that students could also afford other direct costs of attending a public university, including room and board, transportation, books, and other fees. Recognizing the public value of private institutions, the financial aid system also helped defray the costs of students choosing to attend private colleges and universities in the state.

The 1960 California Master Plan was recognized throughout the nation as an economically rational and generous approach to expanding access to higher education, and within California it was proudly espoused as an example of progressive government policy.

Unfortunately, that economically rational twentieth century approach to financing California higher education no longer serves the state, its citizens, or its institutions of higher education well. But "why not," say many supporters of higher education, who contend that the government once recognized the value of higher education, recognition that paid off handsomely for the state; all California needs is to renew that prior commitment. For a variety of reasons, however, what has become termed "the new normal" in public finance makes it impossible to go back to the future.

First, the increasing demands for an educated population will far exceed what the economy of California required in the past and what it received for its investment in higher education. Current projections indicate that California will require more than a million more postsecondary credentialed citizens within California over the next decade than are being produced today, and that level of growth can't be achieved in the current funding structure; indeed, it is clear that even today's demand for higher education, let alone tomorrow's, can't be served well within the current funding paradigm.

Second, the changing nature of higher education and the students it serves can't be sustained with the current funding approach. The increased costs associated with maintaining a large number of research intensive universities and educating an increasingly educationally at-risk population is already severely testing the current finance model.

Third, coupled with these higher education finance pressures are the increasing legitimate demands for government funds to support other state services, particularly elementary/secondary education, health costs, corrections, and environmental protection.

Fourth and finally, this is all within a state that is no longer as wealthy as it once was, and thus must find ways to live within more modest means. In 1970, as the original master plan was initially coming into being, California's per capita income was 18 percent above the national average; in 2011 the state's per capita income was only 7 percent above the national average.

As a result, higher education in California is in peril, particularly public higher education. While this dangerous situation has certainly been exacerbated by cuts in state and local funding over the past few years, the seeds for the decline of access and quality in California higher education have been germinating for at least the last decade. This gradual demise is reflected in reduced educational opportunity, as reflected in enrollment cuts for California residents within the University of California and the California State University and more insidious reductions in access at community colleges where students simply can't take the courses they need to progress toward their educational objectives.

Some point to the students or California's K-12 system as the problem, pointing to the increasing share of students requiring remediation, and the increasing share of students taking more relaxed class loads. While levels of preparedness and academic rigor are legitimate areas of concern, information from the National Student Clearinghouse, suggests that students are hardly the problem. Within both California's public and private universities, students are more likely, on average, to graduate than elsewhere in America, with 66 percent of public university students graduating in six years and 77 percent of private college and university students doing so. The story is a bit different for California's community colleges, where only 28 percent of students graduate in six years, compared to a national figure of 36 percent, but this isn't because these students don't care and drop out. In fact, if one looks at how many California community college students neither graduate nor remain enrolled over six years, California, which loses 42 percent, is a tad bit better than the national average of 44 percent. This suggests not that students aren't up to the task but that the system simply isn't able at the present time to get them through in a timely fashion. The consequences for students and the state, of course, are the substantial

opportunity costs of those individuals being unable to join the work force with the skills their education is providing.

California must change its finance policies in great part because its current policies no longer meet the needs of the new normal in finance facing all states. It must also change, however, because changes at the national level must be better taken into consideration to maximize the combined effects of changes in federal and state finance policies on student access and success. California higher education has benefitted greatly from federal support for both research and student assistance. With respect to federal research funding, California has been extremely astute in fostering positive federal relations to draw strong research support. This is reflected in the exceptionally high ranking of California institutions in federal research funding, with four University of California institutions among the top ten public universities in receipt of federal funding; California is the only state with more than one institution in this top ten.

On the other hand, California has been woefully benign with respect to the interaction between state and federal higher education funding policy for student financial assistance. As a result, the state and its residents benefit much less from this type of federal funding than do almost all other states. This will become increasingly important as federal budget constraints begin to reign in federal funding for financial assistance, which has already occurred with respect to federally subsidized student loans and will almost certainly also occur with respect to the major federal student grant program known as the Pell Grant program, the costs of which have escalated over the past decade to unsustainable levels.

All of which is to suggest that California must develop a new philosophy to guide its investment in postsecondary education. The state simply can't afford its current "you come, we will pay and provide" philosophy. Truth be told, this philosophy began failing students and institutions before the turn of the century, though the two recessions experienced in the first decade of this century have accelerated and dramatized the gradual reductions in access to and quality of higher education in California, at least in the public sector institutions.

Finding a New Path to Affordable Access & Success

This testimony provides an alternative philosophy for consideration – a concept of *shared responsibility* that would rebalance the way in which higher education is paid for between five partners: students, their families, government (both state and federal), and the institutions they attend. In many ways this proposed philosophy is similar to *the design for shared responsibility* developed recently in Oregon, though the plan presented here has been tailored to meet the unique needs and culture of California.

The Student. As the principal beneficiary of the education, the student would be explicitly expected to contribute significantly to her or his education. This contribution would be expected to come in two ways.

First, the student has a responsibility to prepare herself or himself well for college and for achieving at the highest level possible in college. Both academic and finance policies should reinforce this expectation.

Second, the student has a responsibility to pay a significant, though manageable amount toward her or his education. A portion of this contribution may come from savings for college, working while in college, or scholarships earned for college. Given the realities of higher education finance today, a student should expect to borrow an amount that she or he can reasonably pay from future earnings, as well. Because future earnings represent the principal financial benefit of higher education and those benefits accrue primarily to the students, it is reasonable for students to *pay as they earn,* after they leave school.

Expecting students to provide explicitly such a substantial portion of their costs of attendance is a radical departure from current policy. Yet, it makes both philosophical and practical sense. Philosophically, it better fits a concept of "she/he who benefits should pay." Practically, it reflects what, in truth, is current practice, albeit not current philosophy. Today we simply don't fund our philosophy, so students and their families are left picking up the expenses that current public resources can't cover, and in fact many if not most do so through borrowing and work, too often incurring levels of debt that will prove

exceptionally onerous and/or working at levels that jeopardize their academic success.

To adopt such a significant role for students requires two critical components. First, the concept must be easily understood by students and their parents or guardians. Second, the concept must be perceived by students and their parents as truly achievable and reliably available; that is, they must believe they can afford to meet the level of responsibility established in policy or the entire philosophy goes poof. The Oregon model achieves this in the following way. First, they hold that the student's share should differ, depending upon the type of institution the student attends, contending that there should be a cost of choice albeit an affordable one, for students in selecting a college or university. The presumed student share in Oregon is quite simple and understandable: a student attending a community college should be able to meet her or his financial obligation through reasonable levels of either work or borrowing, whereas a student attending a public university should be able to meet her or his financial obligation through a combination of work and borrowing. In the Oregon model, a student attending a private university receives the same amount they would if they were attending a public university. To determine just what would be reasonable work and borrowing expectations, Oregon establishes the work requirement based on 90 percent of what a student can earn at minimum wage, working 15 hours per week. They selected this because research has demonstrated that students working less than 20 hours per week during their term of enrollment, in general, do not suffer academically. Oregon established its borrowing expectation based on what a student could reasonably manage in debt repayment if they chose to receive their degree in a high social value but moderately paid field, specifically education and social work. Given the proposed "*pay as you earn*" concept mentioned above and discussed in more detail later in this paper, this borrowing component would logically be crafted differently for California.

The Family. Before expecting the public purse to pay for a student's education, it remains legitimate to expect that the student's parents will provide what they reasonably can to the education of their children. While many federal policy

analysts, including the author of this paper, believe that the current federal methodology for determining the right amount for a family to contribute is flawed, it probably remains the best proxy available and will hopefully be revised when the Higher Education Access and Affordability Act is reauthorized over the next two years. The federal methodology for assessing the parents' contribution is a fairly complex formula developed over the past fifty years. The formula takes into account income, personal and business assets, family size, exceptional circumstances like unusual health care costs, etc. It protects families living in poverty (approximately $25,000 for a family of four) from any expected parental contribution, and assesses a portion of what is called the adjustable available income (AAI) above the non-discretionary poverty level amount at a progressive rate that begins at 22 percent and rises to 47 percent. Some states have moved to a simpler and perhaps more efficacious model of progressive rates of family contribution based on Adjusted Gross Income from the annual federal tax calculations. Whatever method is used, families should be expected to contribute, just as they are today.

The State of California*.* This shared responsibility proposes a substantial revision in the way in which the State of California would both envision its financial responsibility for higher education and the way in which it would orient its subsidies. While the state would not eliminate either its subsidy for institutional support or its grant assistance to students, it would substantially recast these supports and would develop a new policy support system to allow students to accept the *pay as they earn* component described earlier as part of their financial responsibility.

With respect to supporting the institutions of higher education, this testimony presumes that the state would sustain roughly its current levels of aggregate financial support, but that the overall state finance strategy for financing institutions be changed. Critical to this is understanding that state finance policy for postsecondary education must not separate consideration of state appropriations, tuition, and financial aid policy because the interplay between these three is what assures that resources are balanced to ensure both quality and access. To that end this plan for shared responsibility, while retaining the

current level of overall state appropriation, would propose two fundamental shifts in its policy toward institutional support.

First, it would redirect resources from an enrollment funding basis, which has guided state policy for the last sixty years, but for all practical purposes has not been state practice for at least the last decade. In truth, simple expedience has been the guiding practice in recent years; spread around some new resources, "as fairly as possible" when possible, and cut discriminately when necessary. That is hardly a viable philosophy for pursuing good public policy. Most states with which we work at WICHE are now looking at an outcomes based funding model as a more viable contemporary approach. Done wisely, it can be an effective strategy for rewarding both student access and success and for ensuring that students receive a quality education. I suggest that the state appropriation be constructed around such a philosophy. Second, I propose that most of the expansion in financial resources required by institutions to provide the increase in college educated population necessary for California's future would be generated from the marginal revenues accrued through tuition.

At current tuition rates at the University of California and the California State University, tuition revenues are sufficient, or nearly so, to cover the marginal costs of new students. California universities already charge more, on average, than comparable institutions in other states. The California State Universities, on average, charge 8 percent more than comparable institutions in other states, whereas the University of California has the ninth highest tuition for public research universities among the fifty states. Some upward adjustment of tuition may be possible and necessary, but it is likely that the CSU institutions, in particular, are reaching the upward threshold of tuition rates for institutions with their broad access mission. Without doubt, the University of California could increase its tuition and sustain its current level of enrollment, though whether it would remain affordable for many Californians and able to contribute to the increase in demand to meet California's workforce needs of the future would then become a serious question, and would depend in part on whether the state's financial aid system were recast to ensure financial affordability for those unable to pay higher prices.

On the other hand, the exceptionally low tuition levels in the California community colleges do not generate enough revenue to cover the marginal costs of expansion and thus must be increased. The tuition at California community colleges, if tripled, would still be below the national average of tuition for community colleges, and there is no evidence that higher prices in other states have eroded access; in fact, access is generally broader in other states because they can generate the marginal resources necessary from tuition to accommodate growth in demand. While the historical tradition and "low or no tuition" culture of California will make it extremely difficult to accomplish, the only viable and reasonable choice for the state is to implement a moderate tuition policy for the community colleges. The state must do so not only because it is the only way to adequately resource these institutions for the difficult job they face in educating the most at-risk students, but also because not doing so leaves a huge amount of federal funding unavailable to California. Raising community college students' tuition may seem like it would erode financial access, but in truth it would have no impact for many students because the increased tuition would essentially be passed on to the federal government through receipt of larger Pell Grants and/or tuition tax credits. If the California community colleges raised tuition by $1,000, although this would roughly double the current rate, it would generate enough revenue for the colleges to serve the 300,000 students currently estimated not to be served, and few students would see much of a change in the net price they face because they would cover the full increase either via the federal Pell Grant or tax credit programs.

If California wants adequately resourced community colleges it simply has to bite this bullet and join the modern world. The new normal of public finance makes it clear that substantially more state resources aren't going to be available but more revenue is essential to serve the increased number of students that California needs to remain economically competitive. Tuition has got to be the answer, and done smartly can be done so as not to erode financial opportunity.

Perhaps the most significant change that this shared responsibility concept envisions for the state, though, is in the way in which it would distribute its financial aid. While not abandoning the concept of state grants currently

reflected in the Cal-Grants A, B, & C, it would focus these resources on those students demonstrating both the greatest commitment to completing their education and from the most financially needy families. It would eliminate tuition waivers for community college students and make them eligible for the Cal Grants. It would establish the Cal Grant as a Pell Grant supplement, matching the Pell Grant on the basis of a simple formula that takes into account: (1) the average student budget in the three tiers of public institutions (with private institutions factored in at the budget of the tier they most resemble), and (2) the number of hours completed by the student in the previous term attended (or hours enrolled for a first-time student), with a significant premium for enrolling for a full fifteen hour load. The dilemma, of course, is that this approach to distributing Cal Grants would eliminate eligibility for many middle and upper middle income students who receive Cal grants under the State's current exceptionally generous grant eligibility criteria. Research has demonstrated clearly that grants to middle income students don't affect whether they attend college or not; in economic terms, the price elasticity of demand for middle income students is exceptionally low. So, in essence, many of today's Cal Grants don't eliminate barriers to access but rather ease the burden for students already intent on receiving an education. There's nothing wrong with easing the burden, but in an era of limited funds eliminating barriers must trump reducing burdens. What is being suggested is a realignment of limited grant dollars to focus on the neediest students for whom financial aid does make a difference on whether they go to college.

To help middle income students, however, a new and novel concept is put forward that builds on the federal student loan programs. The *pay as they earn* concept built into the students' share discussed earlier must be accompanied by a capacity for students to be assured that they will be able to afford to repay what they borrow. Until recently, that was not assured because students were expected to enter standard repayment schedules once they left school. The risk for a student in borrowing, therefore, was that they may not be able to repay immediately because: they may not complete their education and receive the income they anticipate, they may not get a job immediately upon leaving school,

they may enter a job after graduation that doesn't pay what they anticipated, etc. To alleviate this risk the federal government has created a program that allows student borrows to enter into a repayment plan based on the amount they earn upon leaving school. Alternatively called Income-contingent or Income-based repayment, this concept is intended as a win/win, with the student achieving a manageable debt repayment and the federal government receiving greater assurance of student loan repayments in full. The dilemma to date, is that few student borrowers are taking advantage of this program, presumably either because they are unaware of this opportunity or because the program has been difficult to join. The current administration has indicated strong interest in expanding the use of these income based repayment plans.

Herein lays the potential for a new partnership between the federal government and the State of California. The State of California could establish a two part *pay as you earn* program.

The first part of the program would be to help the federal government better inform students about the advantages of this program, and to provide a state guarantee of access to the program, if the federal government cannot do so. A package of information for students could be developed by the state and provided through all high schools and college and university financial aid offices, for when middle and high school students and their parents begin considering college, when the students apply for financial aid, when they take out a loan, when they leave school, and when they enter repayment. Furthermore, the financial aid offices of all institutions whose students are eligible for state financial aid could be held responsible for sharing this new concept of *shared responsibility* with students, particularly those first generation and low income students most at risk of foregoing college for financial reasons, so they would understand that they are expected to borrow but to do so within reasonable bounds. A personal finance curriculum for students in middle- or early-high school could be developed to educate participants on the availability of these resources and to assure students that this program would be available to them, assuring them that they can afford college.

Implicit in this is the responsibility of the state to establish the expected share of costs to be borne by each of the five partners, such that the sum of the parts will equal the total cost of financing higher education. Additionally, any guarantees offered to the student would have to be insured by the state up front in order to assure students that future federal policy changes wouldn't abrogate the state's promise of affordability to them.

The second part of this program would be to help students who stay and work in California with the repayment of their debt. This back-end subsidy would be for student borrowers akin to performance funding for institutions; that is, they would be rewarded for achieving what they and the state originally invested in. The amount of subsidy could be determined based on various factors: what the state can afford, the amount a student has borrowed so the debt is retired more rapidly, the perceived value to the state of the area of work in which the student is engaged, the value of the state co-signing for the loan, etc.

In practical terms, what would this require of the State of California? First, it would require continued institutional support from the state at least at present levels. Second, it would require recognition of tuition as a significant revenue source and major changes in tuition policy within the California Community Colleges. Third, it would require a total revamp of the Cal Grant program. And finally, it would require California to develop an intentional relationship with the federal government on the use of federal income based loans to fit the new state *pay as you earn* philosophy. This partnership would need to involve harmonizing current federal and state policy to accommodate this concept and engagement in the upcoming reauthorization of the higher education access and affordability act to enhance the capabilities of this partnership.

The Federal Government. While the State of California cannot dictate what federal policy will be, it can act much more like a partner with the federal government than it has in the past. Some federal policy explicitly presumes a partnership with the states. The federal tuition tax credit, for example, presumes that states will charge a reasonable tuition to students, but limits the credit so that there is no incentive for states to garner additional tax credit benefits from

increasing tuition. California community colleges are some of the very few institutions in the country that don't take full advantage of this federal partnership; obviously students who don't pay tuition can't receive a tuition tax credit. The other two major federal student aid programs – Pell Grants and Student Loans – aren't intentionally developed as state partnerships by the federal government but they do lend themselves nicely to such partnership.

The Institutions. The responsibilities of the institutions in this *shared responsibility* concept fall into two types of institutional behavior. First, it is the responsibility of the institutions to keep tuition as affordable as possible. Despite the current ruckus in California about tuition increases, tuitions in California remain within reason compared to elsewhere in the country. The challenge will be to keep them reasonable, particularly if the state is unable or unlikely to provide additional funding for additional students. Which brings in the secondary area of institutional responsibility; California institutions must work hard to contain their costs by adopting new proven methods for improving teaching and learning at lower costs. Greater use of technology enhanced learning, including blending learning techniques, on-line delivery, prior learning assessment, and use of predictive analytics to enhance student success must be incorporated much more readily than they have been in California to date. Evidence indicates that there is substantial room for productivity improvement in California higher education. Not so much in the California State Universities, which the National Center for Higher Education Management Systems (NCHEMS) ranks as second in the nation and 23 percent above the national average in productivity (where productivity is defined as the number of awards per $100,000 of state and local appropriations and tuition and fees revenue). While the University of California compares reasonably well on national averages on this measure of productivity for research universities, ranking right on the national average, it ranks 40 percent below the top ranked state, Colorado, suggesting there certainly remains room for improvement in this system. And, the California community colleges rank second to last nationally in this measure of productivity, suggesting substantial room for improvement. Thus improved productivity has to be a significant part of

the institutional responsibility in whatever funding approach for the future of higher education in California.

The state level performance funding strategy recommended earlier would provide incentives for the institutions to focus on these productivity improvements. Unfortunately, California lacks the capacity for state government to work with higher education to collectively address this issue. Most of the Western States are addressing the issue of productivity through statewide efforts driven by state level governing or coordination boards. California, however, no longer has such an entity, and the absence of state level planning and coordination makes it difficult if not impossible to pursue such efforts in the state.

One final state responsibility is to find policy handles to assure that higher education remains affordable in California. It is difficult for a state to find the right balance between institutional autonomy to set tuitions and to assure that these costs don't get out of control. This will be particularly difficult in California because of the need to rely on tuition revenue to fund much of the expansion in educational opportunity needed within the system. The state of Washington has found a reasonable tool for state policy in this regard. Washington, like California, has generous need based aid. Like California, Washington has had difficulty increasing financial aid sufficiently to cover increased tuition levels. To address this through public policy, Washington now requires institutions to keep price neutral for students with assessed need when they increase tuitions.

The Sum of The Parts

This paper has presented a case for change. It has described why the exceptional higher education master plan and finance structure of the twentieth century won't work/isn't working in the new normal of the twenty-first century. But it also puts forth a way in which broader access to high levels of student success in a system of high quality can be achieved, despite the financial constraints that the State of California faces today.

It is quite common in the current environment to try and place blame for the problems we face in the public finance of higher education.

Some like to blame the states for their lack of continued support for higher education. At least until very recently, however, that was not the case in California. Yes, the funding per student was declining. That wasn't because overall state funding was declining, however, but rather because the demand for higher education was increasing at a pace with which the state couldn't keep up. This collision of demand with supply is facing our nation as a whole. We could afford a pretty healthy subsidy for every student when many folks never went to college and when many who did go to college stayed only a short time. Furthermore, the high subsidy was partly justifiable because we needed to provide incentives for people to attend college. That old level of subsidy, however, is unsustainable given the disconnect between the realities of limited public funds and an economy that demands that most people get a postsecondary credential, resulting in more young and not so young people going to college and staying to completion. So, we have no choice but to revise the subsidy structure. And such adjustments are now possible. In part, this is because the individual returns on investment for individuals investing in higher education have grown so substantially and are so well recognized by a large share of the population that we no longer need to incentivize their participation at the same level we did in the past; folks know they must continue their education to have future economic security. And, in part this is because reforms and innovations within higher education are making it possible for us to do more with less.

Some like to blame the institutions, either for escalating costs of providing the education or increasing tuition to cover those costs. And, while there may have been some legitimacy to the cost escalation arguments in the last century, the last decade has been one of reigning in costs in higher education. Furthermore, the return on investment in California of higher education to both students and the state has been well worth the investment.

Some like to blame the polity for its unwillingness to pay taxes for the public good, a harder argument to make since passage of Proposition 30. Others argue that Prop 30 negates the need for radical change. Neither of these positions holds much credence. California is not a low tax state; in fact, it remains slightly above the nation in overall tax levels. Part of the dilemma facing the state is that

its appetite for public goods exceeds its current capacity to provide those, but that is not the same as an unwillingness to pay for the public good. And Prop 30 is not the answer to the finance woes of California higher education. Passage of the proposition certainly did ward off an impending disaster, but the finances of the system remain perilous and the need for substantial reform remains imperative. California can sustain a high quality system of higher education, dedicated and capable of providing broad access to student success. One way to do so would be through a new philosophy and strategy for financing California higher education; a philosophy of *shared responsibility* in which students *pay as they earn.*