



**Testimony to the Assembly Select Committee
on the Master Plan for Higher Education in California**

Marc Berman, Chair

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Overview and Status of Higher Education Finance in California

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Elements of Higher Education Finance Reform: A Way Forward

Good afternoon Chair Berman and members of the Committee.

I am Monica Lozano, President of the College Futures Foundation. College Futures Foundation stands for equity of opportunity and outcome for California's diverse students. The vast majority of California's K-12 students are of color and low-income—yet these students face numerous barriers to attaining bachelor's degrees and form a minority of graduates from our public universities. We believe that ensuring their college success is vital to their families, their prospects for a better life, and the health of our state. The Foundation works in partnership with organizations and leaders across California so that the vision of a seamless, student-centered educational path to opportunity becomes a reality.

Introduction

California is justly proud of its public higher education system and all it offers. A high-quality and affordable college education means opportunity and economic mobility for individuals and families, and numerous social and economic benefits for our communities and state. Yet too many qualified students cannot access these opportunities because of systemic problems in how we finance higher education.

Over the past 40 years, shifts in California's economy and demography have led the state to change its approach to paying for health care, K-12 education, community colleges, and social welfare. Yet the state funds the California State University (CSU) and the University of California (UC) basically the same way it traditionally has, through a boom-and-bust cycle that features increasing general fund support during robust economic times and declining or limited funding during difficult economic conditions. A consequence of this approach has been that tuitions tend to increase sharply during economic downturns—at precisely the moments when students and their parents can least afford them. Funding for enrollment has been episodic, and qualified students are being turned away. This is unacceptable—and preventable—by changing California's historic approach to higher education finance and budgeting.

About College Futures

College Futures Foundation began examining college finance because of growing concerns that the system of paying for higher education has become a barrier to increasing bachelor's degree attainment among all students, and has become particularly challenging for low-income and first-generation college students. That led us to work on the topic of higher education finance to better understand the elements of the issue and explore ways to solve it. Our primary focus has been on the CSU and the UC, which educate nearly three-quarters of the state's baccalaureate recipients. Over the past few years, we have convened a series of conversations among individuals with deep experience in public policy and higher education finance, and commissioned significant amounts of research in key areas. My comments and recommendations are a reflection of this analysis and exploration of the issue.

A Growing Concern

The higher education finance problem has worsened over the last 30 years because of a growing structural imbalance between revenues and spending. In flush economic times, the state can pay more, tuitions hold steady, and college enrollment is easier. In bad times the state is forced to make drastic budget cuts, institutions reduce the number of students who can be admitted, and tuitions skyrocket. When good times return, spending increases again, and tuitions are held steady—but nothing fundamentally changes, so when the next recession rolls around, the cycle of budget cuts, tuition increases, and enrollment cutbacks repeats.

No one is well served by this wild ride of highs and lows—not California families, not the state, not the institutions or the people who work for them, and, most of all, not students.

We must find better ways to manage higher education finance, enrollment levels, and tuition by taking on unpredictability of revenues, adopting budget buffering practices, and rigorous cost management.

A Comprehensive Approach

Based on our analysis, we see four aspects to the finance challenges facing California public universities:

1. Volatile revenue patterns, including stretches of declining state general fund revenues linked with growing dependence on tuition;
2. Budgeting practices associated with the fixed cost of employee benefits;
3. Academic or instructional cost structures; and
4. State and institutional decision-making that functions without shared measures, common goals, and mutual accountability.

While the solution may require attention to all four areas, given the limited time we have together this afternoon, I will focus on revenue instability, cost management, and transparency in decision-making. Finally, I will close with a short analysis and description of the problems our public universities face in terms of capital finance, which we must address if we are to accommodate the growing demand for postsecondary education.

Revenue Volatility and Growing Dependence on Tuition

The most widely documented and best understood facet of the higher education finance problem relates to declining or unpredictable state revenue levels linked to increases in tuition by universities.

Sources of revenues to California's general fund have shifted substantially in recent decades, to personal income tax and high-income taxpayers. The income earned by these taxpayers is more dependent on capital gains, making the general fund disproportionately affected by economic booms and busts. This was abundantly clear during the Great Recession, when state economic activity shrank 4% but general fund revenues declined by more than 19%. As general funds have dropped, tuitions charged to students have increased, and are now the largest revenue source for the core program in the UC and half of core revenues in the CSU. Given that major tax reform is highly unlikely, we must seek out ways to buffer against these inevitable precipitous declines.

Budgeting Practices Associated with Fixed Costs

Both state and university budget practices treat employee benefits as fixed costs, which means they are funded ahead of all other priorities. Spending on benefits is increasing faster than any other area and is rising three to five times faster than revenues.

Even as revenues have become less predictable, a larger share is needed to pay for the fixed costs of employee benefits and for pensions and retiree health care.

Benefit levels have improved over time, but the primary cost drivers have been growth in the costs of health care and changes in accounting rules that now require benefits committed to retirees to be shown as institutional liabilities or debt. The consequence is higher percentage increases in spending for employee benefits than any other area of spending in higher education.

Pension benefits are guarantees that cannot be reduced for existing employees and retirees, although they can be adjusted for new employees. Health care benefits to current employees and retirees can be changed, although these changes would be painful to implement.

While the problem of spending on benefits and is well-recognized within California and nationally, changes will have to happen slowly over many years.

State and Institutional Decision-Making

State and institutional decision makers too often are working at cross purposes, without common goals, shared language, and mutual accountability. State government and higher education are complex systems that rely on multiple decision makers at various levels of authority. The absence of shared goals, common fiscal benchmarks, and accountability systems hampers attempts to adequately plan for and manage resources in a way to advance student success.

The Way Forward

The public may be willing to support increased revenues for higher education, but not without some assurances about how those funds will be used. Given the complexity of the challenge, we think a comprehensive approach that includes revenue buffering, tuition stabilization and predictability, cost management, and productivity improvements are required to address them.

Revenue and Tuition Predictability

The state and higher education systems should address revenue smoothing to reduce volatility from year to year and build better predictability for institutional leaders, the state, and students and their families. This should occur through a combination of moderate and predictable increases in general fund support from the state, moderate and predictable increases in tuition by cohort accompanied by need-based aid to protect college affordability for low-income students, and increases in contingency reserves dedicated to higher education. The state share of core funding of public higher education should be maintained at least at current levels. The long-standing habit of buying out tuition increases in good times and letting the levels spike in recessions needs to end; students, the institutions, and the state are better served through modest and predictable annual increases in tuition matched with same sized growth in state funding.

Budgeting Practices Associated with the Fixed Costs of Employee Benefits

The decision-making process for employee benefits should be revised to increase transparency and to illuminate tradeoffs between spending on benefits and other options, including salaries, new faculty positions, or lower increases in student tuitions. Legislators and trustees should have readily available survey information about benefits and salaries in comparison institutions.

Improved Public Accountability and Better Transparency for Fiscal Decisions

The Department of Finance, the state legislature, and both university systems must identify and agree upon key indicators focused on resource use and performance. Addressing the gaps in understanding of the basic facts about revenues and spending that now exist between state and institutional leaders and illuminating cost levers will improve public dialogue, legislative decision-making, and shared governance between the state and the institutions working to fund higher education in the future.

A Note on Capital Finance

Let me turn now quickly to capital finance of higher education.

We have just discussed important elements of California's public higher education systems like revenue volatility, employee salaries, benefits, and other operating costs. However, there is another massive expense looming on the horizon: an immense and pressing need to repair, improve, and expand facilities in our public colleges and universities.

We need a systematic approach to paying for renovations, repairs, and deferred maintenance, beginning with decisions about revenue sources and ways to establish funding priorities.

This requirement is made even more apparent by the fact that our colleges are unable to meet the demand of graduating high school students for college slots, especially because graduation rates have shown improvement. The proportion of high school graduates who have completed the courses required for admission to UC and CSU campuses has increased by nearly half. Here in California, we have made a bargain with our high school students: If you work hard in high school, there will be a place for you in our public colleges and universities. We must keep our end of the bargain.

It will be challenging, but it is both necessary and doable—and there is no time to waste.

The needs for capital funding in higher education are enormous and growing. The California Community Colleges, the UC, and the CSU have estimated that they will need a combined \$47.2 billion to construct new facilities and modernize existing facilities *in the next five years alone*.

1. *Undergraduate enrollments will grow, with no plan as to how they will be accommodated, or whether new capacity space should even be an option.* The state has no explicit plans for accommodating these students, including guidelines for determining whether new capacity space will be needed, or where it might be needed.
2. *Fund allocations for capital outlay are inconsistent, uneven, and unclear.* The state's planning and policy process for funding capital projects is ad hoc and dependent on short-term revenue availability instead of long-term planning.
3. *The historic separation of operating and capital budgets may be contributing to the funding problems.* Experts argue that separating operating and capital budgets understates the cost of higher education by 15–25%.
4. *Deferred maintenance needs are growing as ongoing maintenance is being cut.* There is currently no reliable or sufficient source of revenue to meet the huge backlog of deferred maintenance needs.

While these are significant challenges, there are ways to address the problem. California needs to move away from the current approach to higher education capital finance and toward a policy-defined, systematic approach. In order to do that, we must first clarify the issue, then honestly assess need, and finally develop a policy framework that sets ground rules for priorities and revenues.

The College Futures Foundation is currently involved in a research project to determine the capacity challenge in higher education through 2030. This includes assessing contributors to demand and supply along with ideas for better utilization of facilities across higher education segments—including community colleges and public and private universities, and other

innovative ways to maximize space and coordinate between educational institutions. We look forward to sharing the data once it is available.

Conclusion

The future of our state and our students hinges on our California's ability to provide a quality education to every student who is qualified and motivated to seek a college degree. California's economic future and the future of our civil society is in jeopardy because we have not come up with sustainable ways to pay for our public university systems.

Solutions must include a focus on affordability and total cost of attendance, which I know our next panel is prepared to address. But achieving solutions posed by the current system of higher education finance requires a systematic and thoughtful approach that takes the long view and which understands that these are investments in our state and our students that will pay dividends for generations to come. It is heartening to see the legislature and other leaders across the state taking the issue of higher education finance seriously and exploring thoughtful solutions to reaffirm our state and the Master Plan's commitment to access of opportunity.

Thank you for your time.