

FINANCING IN SYNC – POLICY BRIEF

In this Policy Insights, author Dennis Jones presents some of the key concepts from his larger paper “Finance in Sync: Aligning Fiscal Policy with State Objectives,” in WICHE’s report Policies in Sync: Appropriations, Tuition, and Financial Aid for Higher Education. Jones notes that while financing policy is potentially the most powerful policy tool states can utilize to influence how institutions, students, and employers behave in ways consistent with broader public purposes, it is often not wielded effectively. After identifying the elements of financing policy and major issues that relate to those elements, he looks at decision points for state policymakers and suggests some approaches to enhance the decision-making process and its results.

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While the specifics vary from state to state, leaders hold generally common aims for the citizens of their states. They want them to be safe in their homes and on the streets; they want them to breathe clean air and drink pure water; they want them to live healthy lives and to have access to affordable health care when illness or injury does strike. They also seek economic stability and self-sufficiency for the citizens of the state—they want them to have the means to enjoy the benefits of a middle-class lifestyle.

Statistics show that achievement of these desired ends is increasingly dependent on the education levels of the population. It is now nearly impossible to achieve that middle-class lifestyle without the benefit of postsecondary education—not necessarily a baccalaureate degree but some education beyond high school. The importance of some level of postsecondary education is reflected in the increasing commonality of state-level goals concerning higher education—goals designed to ensure that:

- A higher proportion of students graduate from secondary school and achieve proficiency in academic subjects in the process.
- More students attend college and persist to graduation.
- College attendance remains affordable to students from all socioeconomic groups.
- Employment opportunities are created for a highly skilled workforce.

Because higher education is a responsibility of the states in our federal system of government, state policy is the primary tool for ensuring that the many benefits of higher education accrue to the citizens of the state and to the collective society.

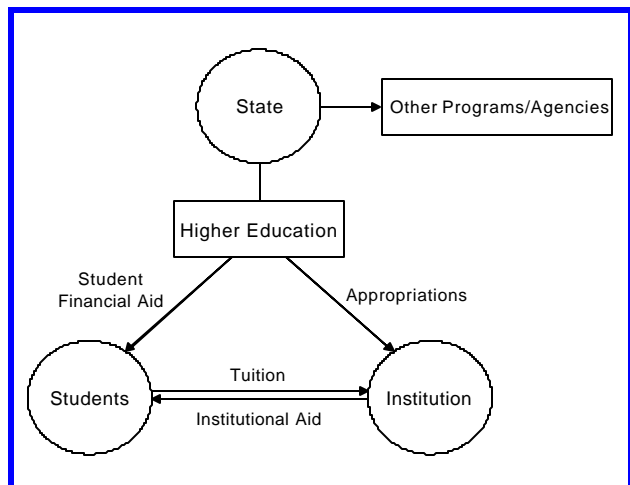
State policy regarding higher education is dominated by considerations of financing and resource allocation—how much will be devoted to higher education and what means are used to distribute these funds to which recipients. Although states have other policy tools available—governance arrangements, regulation, accountability—finance policy is in a preeminent position. It is revisited every year or two, it sends the strongest signals about intent, and it is the one policy tool that can

be construed as more carrot than stick—it can provide incentives for certain behaviors in an environment in which all other tools are viewed as constraining and negative. Given the importance of higher education to the state and its citizens and given the importance of state financing policy in determining the extent (and terms under which) higher education services will be made available to students and other clients, it is imperative that these policies be devised in a thoughtful, coordinated, and comprehensive way.

The Elements of Financing Policy

Figure 1 indicates the essential elements of state higher education finance policy.

Figure 1. Elements of Financing Policy



This figure calls attention to the fact that most public institutions get the vast majority of their unrestricted operating revenues from only two sources—the state and students. Other sources provide funds for specific (restricted) purposes but only states and students underwrite, in any significant way, the ongoing operations of the institutions. Thus, state-level financing policy as it relates to funding higher education must focus on the following components and issues:

1. The total resources to be made available to support higher education students and institutions.

2. The overall level of general operating funds (from all sources) required to ensure that institutions can continue to effectively fulfill their missions. Determining a reasonable benchmark for “adequate” institutional funding is always a contentious issue—institutions inevitably want to raise the bar, funders to lower it. In this context, several points are important:

- Some method is required for establishing benchmarks regarding the minimal level of funding needed to ensure the maintenance of institutional capacity and quality.

- Institutions with different missions require different levels of funding.

- Institutional missions are (or can be) established as a matter of state policy.

- Acceding to institutional and local community aspirations for “upwardly creeping” missions has direct (more expensive) fiscal consequence.

- The sum of institutional desires for their missions seldom equates to a **system** of institutions optionally aligned with the needs of the state.

- Improvements to productivity as opposed to increases in revenues are sometimes—but not always—an appropriate response to fiscal constraint.

3. The mechanisms that, taken together, yield appropriate levels of funding. The four elements of such mechanisms include:

a. Appropriations made directly to institutions for support of general operations. Such appropriations may be made in two categories:

- Base institutional funding for creation and maintenance of the educational capacity of the institutions.

- Special purpose funding intended to leverage this capacity in ways designed to achieve state priorities (performance or incentive funds).

b. Tuition and fees policies—establishing “sticker prices” for different categories of students. This category also includes establishing charges for a variety of special purpose fees.

c. State student financial aid—policies regarding funds made available to students meeting certain criteria. These criteria may include the economic circumstances of the student (need-based aid), demonstrated excellence in academics, athletics, music or other field or endeavor (merit-based aid), or some combination of the two.

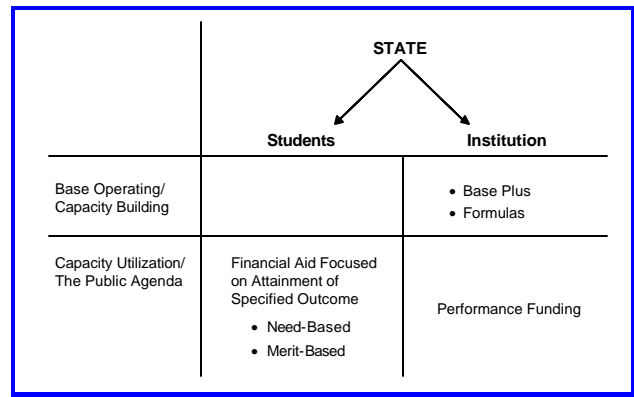
d. Institutional student financial aid—institutional support to students for the purpose of reducing price of attendance. As with state student financial aid, allocations can be based on either need or merit or a combination of the two.

The decisions that **only** the state can make are summarized in Figure 2.

The political leadership of the state necessarily makes decisions regarding:

- The total amount of funding to be provided to higher education.

Figure 2. State Decisions



- The division of these funds between students and institutions—how much for student financial aid and how much directly to institutions for support of general operations.

- The mechanisms by which funds will be distributed to individual students and institutions.

In addition, they must make decisions regarding:

- Allocation of decision authority regarding the setting of tuition rates. Are these decisions to be devolved to institutions and their boards or retained by the legislature and/or governor? If retained, what will the rates be?

- The extent to which they will impose mandates or constraints on the use of institutional student aid. As examples, some states mandate that fee waivers be granted to certain categories of students (National Guard, children of police or fire officers killed in the line of duty, etc.). Other states constrain the ability of institutions to freely grant waivers (for example, by prohibiting waivers for out-of-state students). These decisions, taken collectively, define financing policy for higher education at the state level. There is no recipe that establishes a set of “right” answers to these policy questions. There are some good practices that should be recognized, however.

Some Dos and Don'ts

In formulating state higher education finance policy, there may not be uniformly applied right answers, but there are right approaches. They include:

- Ensuring that these policies and decisions be made as a coherent package, not as unconnected independent actions.

- Recognizing that the economy that leaves states with revenue shortfalls also negatively affects students and their families—if individuals were all financially well-off, state tax revenues would be less of a concern. With this in mind, states should not foster policies that allow institutions to substantially raise tuition in order to offset declines in state appropriations unless a safety net of student financial aid is provided to ensure that affordability for students is sustained. In short, affordability must be preserved simultaneously for both taxpayers **and** students.

3. Don't undertake to establish financing policy in the absence of some understanding of funding adequacy for institutions. Is there a firm basis for determining whether institutions are adequately funded currently? Overfunded relative to mission? Underfunded? Just as point two indicates the dangers of increasing tuition without adequate financial aid as a safety net, this point indicates the dangers that can accrue from constraining tuition if institutions are not adequately funded with state appropriations. While holding tuition down is politically attractive and certainly helps "affordable access," to the extent that low tuition leads to underfunding institutions, both quality and "available access" are jeopardized.

4. Don't make student financial aid policy a solely institutional responsibility. Institutional priorities and objectives are likely to be very different from those that might be developed at the state level. Perhaps more importantly, the income profiles of students enrolled in different institutions can vary markedly—stereotypically students from relatively wealthy families attend the flagship universities while less wealthy students attend community colleges. Charging institutions with maintaining affordability through sole use of institutional financial aid is very likely to result in interinstitutional inequities. In this same vein, it is likely that common tuition levels for similar institutions in different parts of the state will make some institutions more affordable than others—almost all institutions draw from a regional catchment area and per capita incomes can vary greatly from one part of the state to another (by factors of four or five times). This set of considerations argues strongly for having state-based (not institutional) financial aid programs be the device for ensuring affordability.

5. Do align some part of institutional funding specifically around state priorities (using performance or investment approaches). This is the surest way of ensuring that the signals sent through the budget process are not only strong, but clear. In the absence of clear signals about priorities being reflected in the budget process, institutions can legitimately choose to follow their own predilections. Further, priorities with no funding behind them are unlikely to be pursued. As an extension of this point, this component of institutional funding should be sustained in good times and bad; it should not be disproportionately affected in bad economic times.

6. Do make funding distinctions among institutions; protect funding for those institutions making the greatest contributions to the state priorities. If access and affordability, for example, are key priorities, then those institutions that are expected to absorb the greatest share of growth should be treated preferentially in the funding process. This is not to suggest "underfunding" those public institutions that are less aligned with the highest priorities. Rather, it suggests that these institutions should have a reduced claim on public subsidy, be expected to secure more funding from other sources, and be given the latitude to do so.

7. Recognize that the **methods of allocation** of whatever funds are distributed are the key elements of policy. Funds allocated on the basis of course enrollments elicit different institutional behaviors than those allocated on the basis of course or program completions. Student aid funds distributed solely on the basis of high school performance tend to go to students who need it least, not those who need it most.

Jones identifies several examples of how different objectives and different roles in the decision process may lead to decisions that have counterproductive results:

- In an effort to constrain expenses, states reduce student aid funding as well as institutional support at a time when institutions are rapidly raising tuitions in order to maintain revenue streams.
- Student financial aid is administered as fee waivers, and as a consequence makes the recipients ineligible for federal tax credits.
- States fail to intentionally integrate federal Pell grants into the state need formula.
- The design of many state merit-based student aid programs is such that they reduce the price of attendance for a set of students who would enroll in (and pay for) college anyway and often do not contribute to the broader agenda the states are pursuing (i.e., they do not yield improved participation, retention, or graduation rates or employ students in the state after they graduate).
- Tuition levels are held well below what most students could afford, and in this process, institutions are deprived of the resources they need to provide students with a high-quality education.
- Absent good tuition policy, changes in tuition tend to be countercyclical, with tuition increasing when students can least afford it and decreasing when they can most afford it. This has the potential of leading to political interference—pressure to hold tuition down in both good times and bad because there is no publicly understood rationale for not doing so.
- Conversely, participation and retention rates can be negatively affected when the price exceeds the ability (or willingness) of students to pay the bills.

Dennis Jones, "Financing in Sync: Aligning Fiscal Policy with State Objectives," in *Policies in Sync: Appropriations, Tuition, and Financial Aid for Higher Education* (Boulder, CO: Western Interstate Commission for Higher Education, 2003), 9.

This *Policy Insights* is one of several publications produced through WICHE's project *Changing Direction: Integrating Higher Education Financial Aid and Financing Policy*. The initiative examines how to structure financial aid and financing policies and practices to maximize participation, access, and success for all students. Supported by Lumina Foundation for Education, the multiyear project's overarching goal is better, more informed decision-making on issues surrounding financial aid and financing in higher education.

Changing Direction is designed around an integrated approach to restructuring appropriations, tuition, and financial aid policies and practices and examines the socioeconomic-political environment in order to foster the kinds of major changes needed in the near future at multiple levels—campus, system, state, and national—and to initiate and promote those changes through public policy. *Changing Direction* addresses current practices and policies, with an emphasis on exploring innovative, creative, perhaps untested approaches to national- and state-level challenges. WICHE's partners are the State Higher Education Executive Officers (SHEEO), the American Council on Education (ACE), and the National Conference of State Legislatures (NCSL). *Changing Direction* also has these complementary publications available online:

■ ***Policies in Sync: Appropriations, Tuition, and Financial Aid for Higher Education*** – A set of four commissioned papers that look into a system comprised of integrated financial aid and financing policies.

■ ***Integrating Financial Aid and Financing Policies: Case Studies from Five States*** – A collection of case study reports from Arizona, Connecticut, Florida, Missouri, and Oregon as they have tried to align state higher education policies related to financial aid and financing.

■ ***Linking Tuition and Financial Aid Policy: The State Legislative Perspective*** – A summary of survey responses from legislative leaders in the U.S. on the degree of alignment between tuition and financial aid policymaking, their role in the policymaking process, and their degree of satisfaction with the process.

■ ***Informing Public Policy: Financial Aid and Student Persistence*** by Dr. Donald Heller, Penn State University – A study of trends in the awarding of institutional and state-funded financial aid to undergraduates in public institutions, including an analysis of the relationship between institutionally awarded and state-funded financial aid and persistence with policy implications.

■ ***Tuition and Fees Policies in the Nation's Public Community Colleges*** – An analysis of tuition and fees policies among public community colleges in the U.S. with implications for public policy.

For these reports and additional information about the *Changing Direction* project, visit our Web pages at http://wiche.edu/Policy/Changing_Direction/index.htm or contact Cheryl Blanco, director of policy analysis and research (303.541.0221 or cblanco@wiche.edu) or Demaree Michelau, project coordinator (303.541.0223 or dmichelau@wiche.edu).