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## **Cumulative Impact:**

How cuts to higher education in the recent past, today and in the near future will affect access and opportunity for California students.

**Report prepared for**

**The Campaign for**  
**College**  
**Opportunity**

by

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## Acknowledgements

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## About the Authors and Sponsors

The Blue Sky Consulting Group was founded by Tim Gage and Matthew Newman in 2005 and specializes in public policy analysis, development of custom forecasting models, and providing insights into high-level budget and fiscal policy issues.

The Campaign for College Opportunity is a coalition of business, labor, and community organizations working to ensure that the next generation of California students has the opportunity to go to college as promised by the 1960 Master Plan for Higher Education.

## **I. Introduction**

This report presents our estimates of the likely cost of higher education in California over the next decade, and explores the capacity of the state General Fund to pay for these costs. The report also assesses the impact of the Governor's 2008-09 Proposed Budget reductions on access to higher education.

Higher education can enhance quality of life for students (long after graduation) and acts as a major engine of economic growth for the state. Nevertheless, during the past several years, the share of higher education costs paid by the state has been declining and the share paid by students and their families has been increasing. These changes come at a time when recent undergraduate enrollment increases are expected to subside slightly, but challenges in terms of access on the part of historically underrepresented communities and providing for the needs of a 21<sup>st</sup> century workforce loom. These financial and demographic factors form the context for the current analysis.

There has been much discussion of the effects of the Governor's proposed budget cuts on higher education next year. This study looks at the past decade, the present, and future years to examine how the proposed budget will affect California's overall investment in higher education.

When we reset the baseline of higher education funding repeatedly, we tend to look at each given year in isolation. What this study shows is that the past several years of increased higher education funding has only partially mitigated the impact of the prior years' cuts. Education funding does not exist in a year-by-year vacuum. The cumulative impact of our education funding policies over years and decades will determine whether we create a college-educated population that can meet California's workforce needs and thus propel the state towards a robust future economy.

This report presents the results of our projections for the costs of state-supported higher education, including projections for the California Community Colleges, California State University, University of California, and Cal Grant program. Our projections span a ten-year period, and results are presented and analyzed under a variety of scenarios and assumptions. Because these higher education expenditures must be paid for, at least in substantial part, with state General Fund resources, we present an analysis of the current General Fund condition and projections of the General Fund operating surplus/deficit over the coming decade as well as the impact of the Proposed 2008-09 Budget. In setting a context for this discussion, we analyze the impact of the reductions in higher education funding from earlier in this decade as well as the recent history of fee increases. We do not, however, attempt to evaluate the adequacy of the current level of per student funding in each segment.

The foundation for the analysis and conclusions presented in this report is provided by a General Fund projection model developed by the Blue Sky Consulting Group.

## ***Organization of the Report***

Following this introduction, we begin the report with a brief description, in Section II, of the context for the analysis presented, in particular describing the importance of publicly supported higher education to the state's economy and recent developments in terms of the level of state support for these institutions. Sections III and IV discuss the 2008-09 Proposed Budget and its impact on higher education. This is followed by a brief description, in Section V, of the projection model we developed to estimate the state's General Fund condition over the next decade. Sections VI and VII present the results of our projections of the General Fund condition and the impact of the budget proposal on the three higher education segments and the Cal Grant program. Conclusions are presented in section VIII.

## **II. Context**

Providing access to affordable higher education is one of the most important investments of public funds made by the state. Indeed, according to research conducted by Henry Brady and others at the University of California at Berkeley, education "is now one of the major engines of progress and opportunity in California."<sup>1</sup> Brady's 2005 report goes on to conclude that "California's declining per-capita personal income relative to the national average can be reversed by setting realistic goals for greater investments in public higher education." The authors further found that "investments [in publicly financed higher education] will pay for themselves in increased tax revenues and decreased expenditures for social welfare, crime control, and other expenditures."<sup>2</sup> The Brady et. al study is one of several recent studies supporting the now well-established conclusion that investments in publicly supported higher education generally pay for themselves.

California can expect to feel the repercussions of lower funding of higher education long into the future. As Bound and Turner (2006) found by studying state responses to increased college age populations:

"Changes in the funding for public colleges and universities have a large impact on both the quantity and the quality of college graduates in the country. Reductions in state appropriations limit the flow of resources to higher education and reduce collegiate attainment, ultimately lowering the long-term supply of college-educated workers in the labor market."<sup>3</sup>

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<sup>1</sup> Brady, Henry, et. el. "Return on Investment: Educational Choices and Demographic Change in California's Future." Report published and funded by the Campaign for College Opportunity.

<sup>2</sup> Brady, et. al, op. cit. p. 6.

<sup>3</sup> Bound, John and Sara Turner. 2006. *Cohort Crowding: How Resources Affect Collegiate Attainment*. National Bureau of Economic Research Working Paper 12424.

The state receives more in taxes and pays less in government programs – such as prisons, health care, and welfare – for citizens with higher education levels. While most analysts are right in cautioning that variation in wage rates and government program usage may not all be directly attributable to education and may reflect unobserved characteristics like drive and skill, they are still confident that the differences in attainment and costs do provide an insight into the types of benefits California would miss out on if higher education rates decline or remain static.

In addition to the general economic and social benefits of higher education, the state's public higher education institutions play an enormously significant role in helping to ensure the supply of highly skilled workers critical to California's economic future. California has a desperate need for college graduates simply to remain on its current economic trajectory, let alone improve upon it. According to the Public Policy Institute of California, the state already faces a future shortage of college-educated employees. With a shift toward service-related industries, such as tourism, restaurants, and financial planning, the California economy faces increasing demand for college-educated workers. Even continued trends in minority graduation improvement and continued attraction of out-of-state educated workers will not be sufficient to provide enough college-educated workers to meet increased demand. By 2020, projected employment demand for college education will be 39 percent, but state levels of bachelor degree holders will only be at 33 percent.<sup>4</sup> Inadequate resources that undercut the higher education segments' ability to expand access and completion rates is detrimental to the state's long term interests.

A 2006 report<sup>5</sup> by Dr. Robert Fountain of the Applied Research Center, College of Continuing Studies, at the California State University, Sacramento, made similar findings:

- *California employers and industries are demanding greater levels of education.* Through 2022, the study finds that demand for higher-educated employment with a college degree will grow by 1,808,000 – 48% growth – while employment requiring less than a higher education degree will grow by 3,575,800 – 33% growth.
- *A major retirement wave of talented, highly-skilled workers with college educations is about to hit California industry.* The largest higher-educated cohort of workers to date – the Baby Boom generation – is approaching retirement. California needs to meet not only the expected growth of industries, but also to replace 1.4 million workers with higher education who will be retiring or otherwise leaving their occupations.
- *The potential lack of workers with a higher education will be felt throughout the economy, but a constrained supply of these workers will hit certain industries hard.* The three top industries in terms of the number of highly educated workers needed in 2022 are professional, scientific and technical services; education; and healthcare. In

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4 Hanak, E. and M. Baldassare (Eds.). 2005. *California 2025: Taking on the Future*. San Francisco: Public Policy Institute of California.

<sup>5</sup> Fountain, Robert and Cosgrove, Marcia “Keeping California's Edge: The Growing Demand for Highly Educated Workers.” Report published and funded by the Campaign for College Opportunity and the California Business Roundtable.

three additional industries, the highly educated workforce will yield substantial value added economic impacts: finance, manufacturing, and information.

- *The largest part of the demand for a higher educated workforce, both currently and in terms of growth, is at the Bachelor's degree level, while percentage increases are highest at the Associate and graduate levels.*
- *Small changes in the proportion of the workforce with higher education result in substantial economic impacts.* A 1 percent increase in the share of population with a Bachelor's degree, combined with a 2 percent increase with an Associate degree or some college, results in \$20 billion in additional economic output, \$13 billion in value added, \$1.2 billion more in state and local tax revenues annually, and 174,000 new jobs created

Additional studies have illustrated the benefits of the research conducted in California higher education. As the premier public research university in the world, the University of California is one of the engines of the California economy, according to a report<sup>6</sup> by ICF Consulting:

- For every \$1 in state-funded UC expenditures in 2000-01, UC spent an additional \$4 – and for every \$1 in state-funded R&D, UC secured an additional \$3.89 in federal and private research dollars.
- More than 160 companies have been founded on the basis of UC technology licensing agreements. In the biotech field alone, 1 in 4 U.S. companies is located within 35 miles of a UC campus.
- In the last decade, UC campuses reported more than 2,600 inventions that led to new technologies and products. For the past nine consecutive years, UC has been the nation's leading university in the number of patents issued by the U.S. Patent Office.

### ***Recent Developments in Higher Education***

In spite of the well documented returns to increased investment in higher education, during the past decade, state spending on higher education has decreased, when measured as a share of General Fund spending. Because the base on which shares of the budget is calculated can change significantly and for reasons unrelated to the level of support for higher education, this measure may not necessarily indicate a lack of support for higher education, but it raises at least concerns that warrant further examination.

Since 1998-99, fees for students at UC and CSU have increased, by 84 percent and 81 percent, respectively. This represents a 39 percent increase for UC after inflation and 36 percent for CSU. Fees for Community College students have risen and then been partially reduced, reflecting an increase of 82 percent, or 37 percent after inflation. As a result of these fee increases displacing state support, the shares of cost of higher education borne by students and their families has risen from just over 18 percent in 1998-99 to 31 percent for UC and from 17

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<sup>6</sup> ICF Consulting, "California's Future: It Starts Here." Report prepared for the University of California Office of the President.

percent in 1998-99 to 25 percent for CSU. The share of cost for students at the Community Colleges has increased from 8 percent to 10 percent during this period, according to the Legislative Analyst's Office (LAO).

**Table 1: Students' Share of Cost  
for Higher Education**

	1998-99	2007-08
<b>University of California</b>	18%	31%
<b>California State University</b>	17	25
<b>California Community Colleges</b>	8	10

Source: Department of Finance, Legislative Analyst

While it is appropriate for students to bear a share of the cost of their education, and it may be better to target state support to financially needy students rather than the general population of students as a whole, serious policy questions remain: What is the appropriate share for students and families? How will the state ensure that cost is never a barrier for financially needy students? If fees are to be raised, is there a value to having those increases be predictable for students and families? What is the right balance between the state's need for a highly skilled workforce and giving students a stake in their education by charging fees?

### III. 2008-09 Governor's Proposed Budget

Facing a substantial shortfall for the 2008-09 Budget, the Administration proposed a combination of major spending reductions, additional borrowing and accounting changes to close the gap. In many instances, including proposals for UC and CSU, the budget identified the cost of a "workload" budget<sup>7</sup> for 2008-09 and then imposed a roughly 10 percent reduction in funding from this level. For the Community Colleges and the Student Aid Commission, the reductions proposed by the Administration were somewhat smaller than a 10 percent reduction from the workload budget level.<sup>8</sup>

<sup>7</sup> The Department of Finance determines the cost of a workload budget by calculating the budget year cost of currently authorized services, adjusted for changes in enrollment, caseload, population and other adjustments as defined by Section 13308.05 of the California Government Code.

<sup>8</sup> It is important to note that UC, CSU and Community Colleges have different funding sources and the different comparisons shown in this report sometimes reflect this. Notably, Community Colleges are funded largely from a combination of state General Fund monies and local property tax revenues and receive much less of their funding in the form of student fees, while the UC and CSU receive a significant portion of their funding from student fees.

### ***Governor's Proposed Budget for the University of California***

The Administration estimated the General Fund cost of a “workload” budget for UC for 2008-09 at \$3,494 million. This workload budget anticipated a higher funding need over 2007-08 of \$233.4 million, including \$56.4 million for an increase in enrollment of 5,000 students. The Regents also planned to increase most student fees by 7.4 percent.

The Governor's Budget proposed state General Fund support for UC of \$3,162 million, a \$331.9 million reduction from the estimated workload budget. As shown in Table 2 below, the budget's proposed funding level represents a reduction from 2007-08 of \$98.5 million, a 3.0 percent decline in General Fund support. Including estimated revenue from student fees, assuming a 7.4 percent fee increase, yields a 1.5 percent increase in revenue (fees plus General Fund) over 2007-08.

The budget proposes to allocate \$32.3 million of the budget-year reduction to Institutional Support, which includes campus administration and the Office of the President, and permit the Regents to allocate the remainder of the reduction. The budget anticipates that the balance of the reduction will result in a combination of fee increases, limitations on enrollment levels, increased efficiency and reductions to other existing programs.

### ***Governor's Proposed Budget for California State University***

The Administration estimated the General Fund cost of a “workload” budget for CSU for 2008-09 at \$3,186 million. This workload budget projected a higher funding need over 2007-08 of \$215.3 million, including \$70.1 million for an increase in enrollment of 8,572 students. The Trustees also planned to increase most student fees by 10 percent.

The Governor's Budget proposed state General Fund support for CSU of \$2,873 million, a \$312.9 million reduction from the estimated workload budget. As shown in Table 2 below, the budget's proposed funding level represents a reduction from 2007-08 of \$97.6 million, a 3.3 percent decline. Including estimated revenue from student fees assuming a 10 percent fee increase yields a 1.1 percent increase over 2007-08.

The budget proposes to allocate \$43.2 million of budget-year reduction to Institutional Support, which includes campus administration and the Chancellor's Office, and permit the Trustees to allocate the remainder of the reduction. Again, the budget states that the balance of the reduction likely will result in a combination of fee increases, limitations on enrollment levels, increased efficiency and reductions to other existing programs.

**Table 2: Proposed 2008-09 Funding for Higher Education**  
 (millions)

	2007-08	2008-09	2008-09	Change from 2007-08	
	Estimated <sup>c</sup>	Workload Funding <sup>d</sup>		Proposed <sup>e</sup>	Amount
<b>University of California</b>					
General Fund	\$3,260.7	\$3,494.1	\$3,162.2	-\$98.5	-3.0%
Fees <sup>a</sup>	2,151.5	2,331.3	2,331.3	179.8	8.4%
<b>Total</b>	<b>\$5,412.2</b>	<b>\$5,825.4</b>	<b>\$5,493.5</b>	<b>\$81.3</b>	<b>1.5%</b>
<b>California State University</b>					
General Fund	\$2,970.7	\$3,186.0	\$2,873.1	-\$97.6	-3.3%
Fees <sup>a</sup>	1,376.9	1,521.1	1,521.1	144.2	10.5%
<b>Total</b>	<b>\$4,347.6</b>	<b>\$4,707.1</b>	<b>\$4,394.2</b>	<b>\$46.6</b>	<b>1.1%</b>
<b>California Community Colleges</b>					
General Fund <sup>b</sup>	\$4,146.7	\$4,519.5	\$4,034.9	-\$111.8	-2.7%
Property Tax	2,051.7	2,196.2	2,196.2	144.5	7.0%
Fees	281.4	284.4	284.4	3.0	1.1%
<b>Total</b>	<b>\$6,479.8</b>	<b>\$7,000.1</b>	<b>\$6,515.5</b>	<b>\$35.7</b>	<b>0.6%</b>

<sup>a</sup>Assumes fee increases of 7.4 percent at UC and 10 percent at CSU.

<sup>b</sup>Excludes bond funds and teachers' retirement payments

<sup>c</sup>2007-08 funding level as estimated in the 2008-09 Budget.

<sup>d</sup>2008-09 workload funding level as estimated by the Department of Finance.

<sup>e</sup>2008-09 funding level as proposed in the 2008-09 Governor's Budget

Source: Department of Finance, Legislative Analyst

***Governor's Proposed Budget for California Community Colleges***

The cost of a "workload" budget for the Community Colleges for 2008-09 was estimated by the Administration at \$6,716 million from General Fund support and local property tax revenues pursuant to Proposition 98. This figure projected an increase from these sources of \$517.3 million, including \$171.9 million to increase district apportionment funding by three percent to accommodate 35,000 additional full-time equivalent students. The budget does not currently propose a fee increase for community colleges.

The Governor's Budget proposed combined state General Fund support and local property tax revenue for the Community Colleges of \$6,231 million, a \$484.6 million reduction from the estimated workload budget. As shown in Table 2, the budget's proposed funding level, including revenue from student fees, represents an increase from 2007-08 of \$35.7 million, or 0.6 percent.

The budget proposes to allocate the budget year reduction by (1) reducing apportionments by eliminating the 4.94 percent cost-of-living adjustment (\$291.7 million) and (2) reducing enrollment growth funding to one percent (\$111.8 million), and (3) reducing funding for categorical programs (\$80 million). The budget assumes that districts will implement the reductions by limiting low-volume course offerings and reducing service levels in various categorically funded programs.

### ***The Governor's Proposed Budget for the Cal Grant Program***

The Cal Grant program provides financial aid for students to attend college. The program mainly consists of two grant programs (Cal Grants A and B) that are awarded on an entitlement basis or through a competitive program. (A third, smaller program, Cal Grant C, provides support for tuition, fees and other costs for students preparing for occupational or technical careers.) Entitlement awards are provided to high school graduates and community college transfer students who meet certain financial need, eligibility and age criteria. Competitive awards are provided on a competitive basis to students who meet the eligibility criteria for Cal Grant A or B awards, but do not qualify because of age or time elapsed since high school graduation. Currently, 22,500 competitive awards are made each year.

The Governor's Budget proposes to make two significant changes to funding for Cal Grant A and B. First, pending final decisions on the level of fee increases at UC and CSU, the budget proposed sufficient funding to accommodate increases of 30 percent at UC and 32 percent at CSU so as to fully cover systemwide fees for eligible students. Second, the budget proposes to reduce funding for the competitive program by \$57 million to eliminate new competitive awards for 2008-09. According to a recent report by The Institute for College Access & Success, these cuts represent a loss in 18,500 new grants to Community College students this fall, a loss of 700 new grants for UC students, and 2,000 new grants for CSU students.<sup>9</sup>

## **IV. Impact of the Budget Proposals**

### ***Budget Context***

The 2008-09 Budget proposal operates in a context set by the public higher education segments' treatment under recent prior budgets. As a result of the revenue decline resulting

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<sup>9</sup> The Institute for College Access and Success, "Proposed Cal Grant Cuts Would Hit Community College Students Hardest." March 2008.

from the “dot com” bust of the early part of this decade, numerous state programs suffered significant funding reductions and have experienced varying degrees of recovery from those reductions.

Each of the public higher education segments had one or more years during this period where it experienced reductions in state General Fund support and total revenue. In general, these reductions were accompanied by major increases in student fee revenue, as a result of fee increases. For example, UC had three successive years of declining General Fund support starting in 2002-03. UC significantly raised student fees during this period, partially offsetting the loss of General Fund support. Similarly, CSU experienced somewhat more moderate reductions in General Fund support, but at the same time generated slightly smaller increases in fee revenue. The Community Colleges experienced significant reductions in General Fund support in 2002-03 and 2003-04 and property tax revenues in 2004-05, again followed by increases in fee revenues and General Fund support.

The segments estimate that recent funding increases have not fully offset the budget reductions of the early to mid 2000s. For example, CSU indicates they experienced a cumulative funding shortfall of \$522 million over the three-year period beginning in 2002-03 which has not been restored. UC estimates that the cumulative funding shortfall from the earlier part of this decade is roughly the same at \$520 million.

The segments have at least temporarily accommodated these reductions by pursuing a number of different strategies. Economies have been forced on them, some of which presumably are permanent adjustments. Other strategies, such as hiring lecturers rather than tenured faculty and increasing class sizes, are viewed as temporary measures that, if not reversed, will result in a reduction in educational quality over time. And other measures, such as eliminating classes or class sections, clearly can have an impact on the time it takes students to earn their degree and frustrate students’ educational plans, resulting in lower levels of persistence and success. Because it is difficult to measure the effect of these strategies on educational outcomes in the short term, it is impossible to determine the impact on the reductions of the early 2000s.

*Context: Funding Growth Since 2001-02*

A detailed accounting of the extent to which each of the segments have recovered from the reductions of the early to mid 2000s is beyond the scope of this report. However, an analysis of total revenues available to the segments since 2001-02 indicates that their resources have grown at best modestly over this period. From 2001-02 through the budget’s proposed 2008-09 spending level, total revenues have grown by an average annual rate of 3.7 percent for UC, 4.0 percent for CSU and 4.3 percent for the Community Colleges. These growth rates are not adjusted for inflation, which over this period is estimated to have averaged 3 percent per year. Accounting for inflation means that funding for all three segments has grown slightly more than inflation over this period.

However, a more appropriate measure by which to assess the adequacy of support for the three public higher education segments is growth in funding per full-time student after inflation. On a real per-student basis since 2001-02, funding has declined by 10.4 percent and 5.7 percent for UC and CSU, respectively, and increased for the Community Colleges by 5 percent. Thus, on a per student basis, funding for UC and CSU has not kept up with inflation, and support for the Community Colleges has slightly exceeded inflation over this period. It is important to note, however, that this analysis does not address whether the absolute level of funding per student is appropriate, but rather simply whether per student funding has kept up with inflation over this period. Thus, we do not, address the question whether funding per community college student from these sources of \$5,675 in 2007-08, which is substantially lower than per student funding at UC and CSU, is adequate or appropriate.

*Context: Student Fee Increases*

As noted in the above discussion, fee increases are one of the ways the segments have sought to mitigate recent budget reductions. The LAO has noted that fee increases have tended to fluctuate with growth in state spending. Periods of rapid growth in spending have been accompanied by declining inflation-adjusted fees and periods of slow growth in spending have been accompanied by rapid growth in fees. Following a period of no increases from the mid 1990s through 2001-02, undergraduate student fees at UC and CSU increased by about 94 percent from 2001-02 to 2007-08. This represents a 62 percent increase after adjusting for inflation for UC and 63 percent for CSU. Community College fees increased from \$11 per unit (\$330 per year) in 2001-02 to \$26 per unit (\$780 per year) in 2004-05 and 2005-06 and then were reduced to the current level of \$20 per unit (\$600 per year). This represents a 52 percent after-inflation increase.

The LAO points out that fees are low compared to fees at comparable colleges nationally. However, recent, rapid fee increases create significant challenges to access. The state's higher education institutions must work to combat the perception that fee increases make going to college impossible for low and middle income students and families. News of large, unplanned fee increases can significantly disrupt families financial plans and send a discouraging message even if financial aid is available. Fee increases and current levels of financial aid create pressure on students to work while attending school and/or borrow heavily to stay in school. Because of students' personal circumstances or family or cultural attitudes regarding debt, the willingness of some students to tap these resources may be limited, resulting in a loss of access.

Gradual, predictable fee increases allow students and families to plan and prepare for their education. Ad hoc fee increases that take students and parents by surprise can derail students and families from pursuing their goals. Repeatedly relying on steep, ad hoc fee hikes to fund higher education, as we have in the past decade and risk continuing to do going forward to deal with the proposed budget cuts, undermines access to higher education.

### ***Impact of Budget Proposals on Enrollment***

Typically, the budget provides funding for additional students in recognition of the marginal cost of enrolling new students. However, at both UC and CSU the number of students enrolled in the current year exceeds the amount of funding provided. UC is over enrolled by about 4,200 students; CSU by about 10,000. Because the proposed 2008-09 Budget provides no funding for additional enrollment at UC and CSU for the upcoming academic year, this funding shortfall will be exacerbated.

Over the last several years, UC has planned for annual enrollment growth of 5,000 new students. Combined with the current-year shortfall, the budget's failure to fund enrollment for 2008-09 will leave UC without funding for about 9,200 students – generating a funding shortfall of slightly less than \$100 million. Because UC has only a modest ability to limit enrollment for 2008-09 without significantly disrupting access, it expects to accommodate the bulk of this year's new students. However, it plans to admit fewer new students in future years in order to bring funding into line with the number of enrolled students. Reducing enrollment will result in greater competition for a limited number of slots, likely reducing access for historically underserved communities.

CSU's planned enrollment growth for 2008-09 was 8,572 new students. Combined with the current-year shortfall, the budget's failure to fund enrollment for 2008-09 leaves CSU without funding for over 18,000 students – generating a funding shortfall of more than \$150 million. In the face of the budget proposal, CSU closed applications for impacted campuses for first-time freshmen as of February 1 and remaining campuses as of March 1 of this year. CSU also plans to admit fewer new students in future years in order to bring funding into line with the number of enrolled students. CSU's recent outreach efforts have resulted in double-digit annual increases in student enrollment from underserved communities. Lack of funding for new enrollments likely will reduce the effectiveness of these efforts.

Given anticipated growth in Community College enrollment of 3 percent, the budget's proposal to fund only a 1 percent increase results in a loss of funding for the equivalent of about 23,000 full-time students. In fact, it is likely that enrollment pressures will exceed this level insofar as economic downturns have historically been accompanied by increased enrollment at the state's Community Colleges. Moreover, because the Community Colleges provide open access to all students with an ability to benefit, they cannot directly limit new enrollment. Thus, this \$111.8 million reduction is likely to result a potentially significant loss in class offerings, increased class sizes and a reduction in service to students.

### ***Other Impacts of Budget Proposals***

In addition to the impacts resulting from enrollment underfunding, the lack of inflation adjustments in the budget proposal for UC, CSU and the Community Colleges will have several effects. UC, CSU and local community college boards will need to determine whether they will provide cost-of-living adjustments to faculty and staff. In some instances, they may be bound by contractual obligations. In addition, all three segments will face some unavoidable cost increases, such as utilities and step and column or merit increases for staff and faculty.

In the absence of funding for these costs, the segments will need to identify cost savings that can be achieved or be forced to reduce class offerings or student services or increase class sizes in the manner discussed above. Because of the budget reductions earlier this decade, the ability of the segments to achieve additional savings or economies without affecting the quality of services delivered is extremely limited. The Community Colleges' ability to avoid these reductions is complicated by the fact that property tax revenues are running \$80 million below the systemwide estimate for 2007-08 and, a shortfall in local property taxes is not automatically backfilled by the state General Fund.<sup>10</sup>

As noted earlier, the budget also proposes an \$80 million reduction to Community College categorical programs. These programs provide support for a number of specialized programs or services to students, such as disabled student services and Extended Opportunity Programs and Services. The budget reduction eliminates cost-of-living adjustment and enrollment growth funding for these programs and reduces base funding by 7.4 percent (\$52.5 million). The reductions to individual programs vary from 3.7 to 12.8 percent. These reductions will reduce the level of services provided to students by these various programs. For example, the Community College Chancellor's Office estimates that the proposed 3.7 percent reduction in the Matriculation program, which provides students with orientation, assessment, placement, and counseling services, will result in

- 100,000 fewer students being assessed,
- 46,000 fewer students meeting with counselors, and
- 43,000 fewer students in academic trouble receiving follow-up counseling to help them stay in college.

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<sup>10</sup> Even though Community College General Fund support is based on an estimate of local Community College property revenues, once the budget is enacted, they, unlike K-12 schools, are at risk if property tax revenues fall below the estimated level. Even though the General Fund has to make up for these lost local revenues under Proposition 98, the state does not automatically restore a loss of property tax revenues to district apportionment funding. Because of slowing growth in property tax revenues as a result of the collapse of the housing market, Community Colleges are especially at risk from a missed estimate.

### ***Impact of Budget Proposals on the Competitive Cal Grant Program***

As noted earlier, the competitive program provides financial aid awards on a competitive basis to students who meet the eligibility criteria for Cal Grant A or B awards, but do not qualify because of time elapsed since high school graduation or age. Unlike the Cal Grant entitlement program, which primarily serves students who go directly from high school (or transfer) to college, the competitive program serves non-traditional, older students on average. The LAO notes that both programs serve very low-income students, but that the competitive program actually serves students with a higher average GPA than the entitlement program. Currently, 22,500 competitive awards are made each year and nearly three quarters of students receiving competitive awards attend the Community Colleges. The budget proposes to phase out this program by eliminating new awards for 2008-09. The LAO recommends that the budget proposal be rejected, arguing that, “eliminating the state competitive program undermines a key part of the state’s affordability strategy.”

### ***Conclusion on the Impact of Budget Proposals***

The budget proposes significant reductions from the level of funding needed to provide for enrollment growth, mandatory cost increases and cost-of-living adjustments for faculty and staff. Depending on the level of fee increases the segments ultimately approve (no increase is proposed for Community Colleges), total funding including fee revenue is likely to be in the range of a percent or slightly more over 2007-08, but insufficient to maintain the current level of funding per student after inflation. In the absence of funding for unavoidable cost increases, all three higher education segments will need to identify cost savings that can be achieved or be forced to reduce class offerings or student services or increase class sizes in the manner discussed above. Because of the budget reductions earlier this decade, their ability to achieve additional savings or economies without affecting the quality of services delivered is limited.

Alternatively, the segments could increase student fees to close more of the funding gap. As noted earlier, UC and CSU have planned for increases of 7.4 and 10 percent, respectively. Even at this level students are one of the few groups being asked to shoulder a higher share of costs even though they are not the only beneficiary of higher education’s effort to provide a skilled workforce to meet the state’s future economic needs.

Moreover, both UC and CSU are already underfunded for their current enrollment. Both segments have indicated that over the next several years, they will reduce new enrollment so as to ensure that enrollment is fully funded. Reducing enrollment will result in greater competition for a limited number of slots, likely reducing access for historically underserved communities at a time when we should be investing in higher education in order to meet the growing demand for educated workers.

## **V. General Fund Projection Model**

### ***Overview of the General Fund Projection Model***

To estimate the extent of resources available for higher education and other General Fund supported programs during the coming decade, we developed a model designed to project General Fund revenues and expenditures through 2017-18, under a variety of assumptions.

Previous work by the LAO, Department of Finance, and others provides a foundation from which to build such a projection model. Specifically, the LAO produces a five-year projection of General Fund revenues and expenditures each fall. The Department of Finance prepares the annual Governor's Budget, which contains detailed expenditure and revenue information for state government.

Building on these sources, we extended and refined the projections produced by the LAO, incorporating more current information from the Governor's Budget where appropriate. The resulting projection model presents the expected surplus or deficit for each fiscal year during the period 2007-08 through 2017-18.

With respect to higher education specifically, the model calculates the cost of the higher education segments for a given year based on higher education fee levels, enrollment growth rates, and other parameters.

### ***Starting Point: LAO and Governor's Budget***

As the starting point for our revenue and expenditure forecasts, we relied on the projections prepared by the LAO and published each November in a report entitled *California's Fiscal Outlook*. The LAO report contains detailed projections for major revenue and expenditure categories for a period of five years. In many cases, we simply relied on the LAO projections, and extended each series based on the underlying trend or growth rate. Consequently, our projections incorporate the Analyst's assumptions about economic and demographic factors.<sup>11</sup> The LAO results are based on a projection of a slowing economy followed by moderate economic growth through the balance of the forecast period. Specifically, the LAO projects California personal income growth averaging about 5.4 percent per year through 2013 and employment growth strengthening to 1.6 percent per year by the end of the projection period. Our results are based on this same set of underlying growth projections, which we extend through the end of our projection period, 2017-18.

As an alternative to the "current law" baseline developed by the LAO in their November 2007 report, as modified as discussed below, we included an alternative scenario regarding General Fund expenditure growth based on the 2008-09 Governor's Budget proposals for reductions in

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<sup>11</sup> See, Legislative Analyst's Office, "California's Fiscal Outlook: LAO Projections, 2007-08 Through 2012-13." November 2007. Note that the LAO report generally presents the requirements of current law, and typically does not include policy choices that, however likely, have not yet been enacted into law.

programs (“2008-09 budget scenario”). Using these reductions to establish a new spending baseline, we then applied the LAO’s spending growth rates, extended through 2017-18, to illustrate the impact of the budget proposal on the General Fund condition over that period.

While we have relied on the LAO Fall 2007 projections as the baseline for certain revenue and expenditure categories, in several instances we have departed from the LAO projections and developed our own. First, we updated our projections to include the most current expenditure and revenue numbers and to reflect recent action by the Legislature in the special session. In addition, we refined the LAO projections in the following areas:

- a) **BSA.** The Fall 2007 LAO projections assume no transfers of revenues to the Budget Stabilization Account (BSA) pursuant to Proposition 58 (approved by voters on the March 2004 ballot), other than those made through 2007-08. Consistent with the 2008-09 Budget proposal, we assume a suspension of transfers for 2008-09, but a resumption in subsequent years for both the “current law” baseline and the “2008-09 budget scenario”. This has two impacts. First, we assume half of the funds transferred into the BSA are transferred back to the General Fund each year as needed. Second, consistent with the requirements of the law, we assume that half of the amounts transferred into the BSA are used to help retire the state’s Economic Recovery Bonds (including the additional \$3.3 billion in bonds sold this year).
- b) **Proposition 98.** Our projections are based on the results of our own Proposition 98 simulation model. While our model follows the same rules for calculating the Proposition 98 guarantee and uses similar projections for ADA, personal income growth and other model factors, our model calculates the estimated guarantee (including any maintenance factor owed) based on the revised estimates of revenues contained in our model and recent action by the Legislature in special session. As a consequence, the estimated Proposition 98 guarantee we calculate differs somewhat from the LAO’s forecast because it reflects the Legislature’s recent action.
- c) **Revenues.** Our revenue projections include the same underlying growth rates for each category as the LAO projections, however, in our model these growth rates are applied to the most current revenue estimates as included in the LAO’s *2008-09 Perspectives and Issues*. For years beyond the LAO’s five-year forecast period, we assume that revenues will recover from the current slowdown and grow at the historical trend.

### ***Projecting Higher Education Costs in the Model***

While the General Fund condition provides the context for evaluating higher education costs, it is specifically the analysis of these costs that is the focus of our work. We sought to build a model that can project costs for each of the three publicly financed higher education segments as well as the Cal Grant program under a variety of assumptions.

In preparing our higher education projections, we relied on an analysis of budget documents, discussion with budget staff for each segment, and reports prepared by the LAO and others. It is important to note that in constructing the “current law” baseline for UC and CSU, we have

deviated from the LAO's assumptions slightly by instead assuming the Legislature will continue to fund the segments largely on the basis of the higher education Compact. This agreement between the Administration and the UC and CSU spells out expectations regarding various issues such as fee increases and funding through 20010-11. We have used this agreement as the basis for our assumptions under the "*current law*" baseline.

As with the General Fund as a whole, we used the 2008-09 Proposed Budget to define an alternative baseline for higher education spending, which is projected through 2017-18. The resulting output can help in understanding the long-term impact of the Governor's proposals, within the context of the assumptions we have made about future expenditure growth.

### ***Major Assumptions in the Model***

While our results reflect our best assessment with respect to likely future outcomes and events, and are in most cases similar to the LAO projections, the results are nevertheless subject to uncertainty. In addition to the potential for programmatic changes that may influence costs and the possibility of revenue growth higher or lower than our projections, the results are sensitive to several major assumptions.

First, our results present the General Fund condition on a year-by-year basis. In other words, we do not show the cumulative effect of either surpluses or deficits, but instead present the annual operating surplus/deficit for each year in the projection time horizon. Embedded in this approach is the assumption that the state will adopt a balanced budget each year, using either expenditure reductions or revenue increases or a combination thereof. (Note that the same is true of surpluses: we assume that all available money will be spent in some fashion each year, except for the balance of the Budget Stabilization Account.)

Second, our results are based on a specific set of economic assumptions. To the extent that economic growth is lower than anticipated, the result will be lower revenues and increased expenditure obligations for some period, placing increased fiscal pressure on the General Fund.<sup>12</sup>

Third, we do not include any provision for the state's unfunded health care cost liability for retirees. These costs are estimated to be about \$1 billion more annually than the state is currently spending if prefunded. While there is a requirement that the state estimate and report these costs, there is no requirement that the state set aside money to pay these costs (which will not become due for many years). Given the uncertainty regarding this issue, we have not made provision for it in the model.

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<sup>12</sup> The converse is true as well: to the extent that growth is more rapid than anticipated, revenues will be higher and cost pressures lower.

## **VI. General Fund Condition**

Based on our “*current law*” *baseline* projections for revenues and expenditures, we anticipate that expenditures would exceed available revenues for nearly the duration of the forecast period. The annual operating deficits under the “*current law*” *baseline* scenario start at about the same level in 2007-08 due to the Legislature’s action in the special session, but then jump significantly higher for several years and then gradually decline, bring the budget into balance by about 2015-16.

Alternatively, the proposed “*2008-09 budget scenario*” achieves an operating surplus by about 2012-13, but accumulates a cumulative deficit prior to that point of about \$8 billion. General Fund supported programs that are expected to grow the fastest over the forecast period are debt service, in-home supportive services and services for the developmental disabled.

Thus, under both scenarios, the state faces a significant period of operating deficits that will continue to put pressure on General Fund-supported programs, including higher education.

## **VII. Projections for Each Higher Education Segment and Cal Grant**

Enrollment rates are a significant cost driver for all three publicly financed higher education segments. However, providing access to higher education implies increasing enrollment, notwithstanding the corresponding costs.

There are differing opinions about the likely rate of increase in enrollment for the segments over the coming decade. Most observers expect the rate of growth of the population of graduating high school students to slow, although this effect may be offset to some extent by the goal of increasing participation rates. Because we cannot know with certainty what will occur in the future, we have included in this report projections based on a variety of enrollment rates. Under the “*current law*” *baseline* scenario and “*2008-09 budget scenario*” based on the Governor’s proposed cuts (presented below), we show projected funding assuming enrollment growth starts at 2.3 percent and declines to roughly 1.5 percent toward the end of the forecast period for UC and CSU and 2.5 percent for the Community Colleges. These rates reflect the impact of the projected declining growth in the number of high school graduates over the next decade.

### ***Two Projection Scenarios for University of California and California State University***

The basic projection methodology for the University of California and the California State University is the same as for the Community Colleges. A description of this method is presented below, followed by results for each segment.

Projections for each segment were made to reflect the two different scenarios described above: the “*current law*” *baseline* scenario and the “*2008-08 budget scenario*” based on the Governor’s proposed reductions. In both cases, the first methodology is the same as currently

used by the Department of Finance, the LAO, and the segments themselves. This approach starts with the current General Fund allocation. This allocation is increased for enrollment growth (number of new students multiplied times the appropriate marginal cost per student) and the prior year base is increased by an inflation factor. Under this approach, increases in fee revenue are available to the segments without a corresponding reduction in General Fund revenues, but one-third of the revenue from fee increases is set aside for financial aid.

Under both approaches, adjustable model parameters were included for the following:

- a) Enrollment growth
- b) Inflation
- c) Growth in student fees

*“Current Law” Baseline Scenario for UC and CSU<sup>13</sup>*

Under our “current law” baseline scenario, costs are increased according to the terms of the higher education Compact agreed to by the university systems and the Governor. Under this agreement, enrollment growth is initially assumed to be 2.5 percent per year, declining slightly thereafter as the population of high school graduates declines, and the prior-year spending base is increased at a rate of 5 percent until the end of the current higher education Compact in 2010-11. After the end of the Compact, we assume costs will increase at 4 percent per year through the forecast period.

Fee are estimated to grow at the projected rate of per capita personal income growth. While fee revenue is not treated as an offset to General Fund support, it is recognized as a resource in terms of funding per student.

Under our “current law” baseline scenario, General Fund costs for UC are projected to increase from \$3.3 billion in 2007-08 to \$5.6 billion in 2017-18. General Fund costs for CSU are projected to increase from \$3 billion in FY 2007-08 to \$5.3 billion in 2017-18. Funding per student from the General Fund and fees rises from about \$22,700 to \$33,000 by 2017-18 for UC, an increase of about 11 percent after inflation. Funding per student rises from about \$11,400 to \$17,100 by 2017-18 for CSU, or about 15 percent after inflation.

*“2008-09 Budget Scenario” Based on the Governor’s Proposed Reductions for UC and CSU*

Under this scenario, the 2008-09 Governor’s Budget reductions are imposed as a baseline for 2008-09. Thereafter, costs are increased according to the terms of the higher education Compact agreed to by the university systems and the Governor. Under this agreement, enrollment growth is initially assumed to be 2.5 percent per year, declining slightly thereafter as the population of high school graduates declines. However, because UC and CSU are already over-enrolled and because the proposed budget does not fund additional enrollment,

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<sup>13</sup> As noted above, we have largely reflected the current higher education Compact in the “current law” baseline scenario.

we assume that UC and CSU will constrain enrollment growth until current enrollment is fully funded. After the reduction proposed for 2008-09 is applied, the prior-year spending base is increased at a rate of 5 percent until the end of the current higher education Compact in 2010-11. After the end of the Compact, we assume the prior-year spending base is increase at 4 percent per year through the forecast period. In effect, the 2008-09 reductions are reflected as permanent reductions to UC and CSU spending.

Again, fees are estimated to grow at the projected rate of per capita personal income growth.

Under this scenario, General Fund costs for UC are projected to increase from \$3.3 billion in 2007-08 to \$5.1 billion in 2017-18. General Fund costs for CSU are projected to increase from \$3 billion in FY 2007-08 to \$4.8 billion in 2017-18. Funding per student from the General Fund and fees rises from about \$22,700 to \$31,200 by 2017-18 for UC, an increase of a little more than 5 percent after inflation. Funding per student rises from about \$11,400 to \$16,000 by 2017-18 for CSU, or about 7.5 percent after inflation. Thus, the proposed funding reductions cut the funding increase per student by more than half for both UC and CSU after adjusting for inflation.

Table 3 presents estimated General Fund support and spending per student for each of the scenarios presented for UC, CSU and the Community Colleges (see discussion below).

**Table 3: Projected Funding for Higher Education**

	2017-18		
	2007-08	Current Law	Budget Cuts
<b>University of California</b>			
General Fund Support (billions)	\$3.3	\$5.6	\$5.1
Funding per Student <sup>a</sup>	\$ 22,700	\$ 33,000	\$ 31,200
Real % Change		11.1%	5.1%
<b>California State University</b>			
General Fund Support (billions)	\$3.0	\$5.3	\$4.8
Funding per Student <sup>a</sup>	\$ 11,400	\$ 17,100	\$ 16,000
Real % Change		15.0%	7.5%
<b>California Community Colleges</b>			
General Fund Support (billions)	\$4.2	\$7.4	\$7.4
Funding per Student <sup>a</sup>	\$ 5,700	\$ 7,900	\$ 7,900
Real % Change		5.2%	5.2%

<sup>a</sup>For UC and CSU includes General Fund and student fee income. Community Colleges includes General Fund, property taxes and student fees.

*Impact of the Budget's Proposed Reductions on UC and CSU Based on the Two Projection Scenarios*

As the above table illustrates, by the end of the forecast period, applying the reductions in the 2008-09 Proposed Budget has the effect of reducing per-student funding at UC by about \$1,800 in 2017-18, and by \$1,100 for CSU. This lower level of funding per student could be addressed by increasing student fees, reducing university costs or a combination of both. If fee increases above the level assumed in the above scenario were used to cover the entire difference in per student spending, fees would have to increase by about 6 percent every year for UC and 6.5 percent every year for CSU as contrasted with a rate of about 4 percent per year. Increasing fees by this amount would increase the share of cost borne by UC students from 31 percent to 36 percent and for CSU students from 26 percent to 31 percent.

If instead, fees were not raised, this funding gap would need to be made up by increasing class sizes, reducing class sections, reducing pay increases for faculty and staff or reducing various

services to students. We do not know which of these strategies would be pursued in advance, but it is likely that most of these strategies, if pursued over the course of the decade, would have an adverse impact on educational success.

In addition, given that both UC and CSU are already overenrolled, if both segments were to keep total enrollment at the current level over the next several years until their student load was fully supported by future funding increases, they would have to stop taking new students above the current level for a minimum of two years in the case of UC and nearly two and a half years for CSU in order to catch up.<sup>14</sup> This scenario assumes that UC and CSU would get “catch up” funding equal to the amount provided for a year’s quota of new students in addition to whatever funding is provided for new enrollment. It also assumes that the state’s fiscal position has improved enough by 2009-10 that this additional funding could be provided. The amount of additional funding required amounts to about \$200 million each annually for UC and CSU.

Even under this optimistic set of assumptions, this would mean denying access to over 9,000 students at UC and over 18,000 students at CSU. If the state’s fiscal situation does not improve as dramatically as assumed under this scenario, either additional students would need to be denied enrollment or additional reductions in class sections and student services would need to be pursued. As discussed above, given the important role both UC and CSU play in terms of providing skilled workers for California’s economy, denying these many students access would have a potentially significant negative impact on the state’s economy. In addition, fewer slots in the state’s public colleges would reduce access to higher education by historically underserved communities.

### ***Two Projection Scenarios for California Community Colleges***

To project likely costs for the Community Colleges, we started with the adopted 2007-08 Community College budget. From this starting point, we increased the total expenditure level for growth in enrollment and cost increases due to inflation.

Specifically, we took the total apportionment to community college districts and divided by current (2007-08) enrollment to arrive at an average expenditure per full-time equivalent (FTE) student. We then increased this amount by an estimate of inflation over the projection period and multiplied by the projected number of FTE students.

In addition to the adjustments described above, we also increased categorical programs by inflation plus one-half of the projected enrollment increase rate for FTEs overall.

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<sup>14</sup> A simple, hypothetical illustration may make this more clear. Say UC is funded for 100 students, but currently has 110 students enrolled. Assume also that the budget expects they will take an additional 5 students for a total of 115, but provides no additional funding for those new students. Finally, assume that the budget typically provides funding for 5 additional students each year. If UC holds enrollment constant at 115 students, and funding is provided for 5 new students each year even though UC would not be taking the new students, it would take three years for funding to be sufficient to support 115 students.

Using this basic methodology, we projected total Community College expenditures under a variety of scenarios. Our model includes adjustable parameters for the following:

- (1) Enrollment growth rate
- (2) Inflation/cost of living adjustment rate
- (3) Fee levels
- (4) Expenditures per FTE

By selecting alternative values for different combinations of these values, we developed a series of projections for Community College costs.

*“Current Law” Baseline Scenario for California Community Colleges*

Under our “*current law*” *baseline* scenario, enrollment growth is assumed to be 2.5 percent per year, fees grow at the projected rate of per capita personal income growth, and funding per FTE rises to the extent permitted by growth in the Proposition 98 guarantee, assuming the Community College share stays at the current level. Under the “*current law*” *baseline scenario*’s set of assumptions, the total Community College budget is projected to increase from \$6.7 billion in 2007-08 to \$11.8 billion in 2017-18. Funding per student increases from about \$5,700 in 2007-08 to \$7,900 in 2017-18, slightly more than 5 percent after adjusting for inflation.

*“2008-09 Budget Scenario” Based on the Governor’s Proposed Reductions for California Community Colleges*

Under this scenario, because the Community Colleges cannot directly restrict enrollment, enrollment growth is assumed to be 2.5 percent per year, fees grow at the projected rate of per capita personal income growth, and funding per FTE is initially reduced to reflect the 2008-09 Budget’s proposal to reduce funding under Proposition 98. Following that, funding per FTE rises to the extent of growth under Proposition 98, again assuming the Community College share stays at the current level. Under the “*2008-09 budget scenario*” set of assumptions, total Community College funding is projected to increase to the same \$11.8 billion level and per student funding is also the same at \$7,900.

This occurs because even with the reduction proposed by the Governor for 2008-09, Proposition 98 requires that the minimum guarantee funding level return to the long-term “Test 2” amount.<sup>15</sup> Even with this result, however, the Community Colleges would experience several years during the interim of declining or flat per student funding. How long this would

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<sup>15</sup> Proposition 98 establishes a minimum funding guarantee for K-12 schools and the Community Colleges based on several “tests” that specify different funding levels depending on growth in General Fund revenues and other factors. Under “Test 2,” Proposition 98 requires schools to be funded based on the prior-year funding level adjusted for changes in enrollment and economic growth.

last depends on the pace of the General Fund's recovery and whether there are repeated efforts over the next several years to suspend Proposition 98's minimum funding requirements.

Table 3, above, shows estimated spending per student and General Fund support for both of the scenarios presented for the Community Colleges.

*Impact of the Budget's Proposed Reductions on the Community Colleges Based on the Two Projection Scenarios*

Higher revenues from fees are treated as an offset against basic district apportionment funding for the Community colleges, even though fee revenues do not offset Proposition 98 General Fund support. Because fees make up a relatively modest share of total Community College funding, fee increases would have a relatively small impact on per student funding. For example, if instead of increasing at the rate of per capita personal income growth (about 4 percent per year), Community College fees were to be increased by 10 percent per year (about two dollars per unit at the beginning), per student funding would only increase by \$200 by 2017-18. Targeted carefully, such an increase could provide funding to improve student assessment or counseling services that could make a positive difference for students.

Thus, to accommodate the funding reduction the Community Colleges would experience over the next several years under the budget proposal, they would need to increase class sizes, reduce class sections, reduce pay increases for faculty and staff or reduce various services to students. Underfunding enrollment growth is particularly problematic given the increase in demand for Community College classes likely to result from the state's economic downturn. The elimination of classes and loss of services to students as a result of underfunding generally and the specific reductions proposed for categorical programs likely would have an adverse impact on educational success and access.

As discussed above, given the key role the Community Colleges play in terms of providing skilled workers for California's economy, these reductions likely would have a potentially significant negative impact and likely adversely affect educational success on the part of historically underserved communities.

*A Note on Projections for the Cal Grant Program*

Costs for the Cal Grant program are projected based on enrollment and fee levels at each segment. Because Cal Grant costs rise as enrollments increase and to account for increases in fees per student, our assumptions regarding enrollment growth and the pace of fee increases drive higher Cal Grant costs. Under current law, by 2017-18, the cost of the Cal Grant program rises to \$1.3 billion compared to the \$790 million cost of the program in 2007-08.

### ***Higher Education's Share of General Fund Spending***

As noted at the beginning of this report, during the past decade state spending on higher education has decreased as a share of General Fund spending. Because total General Fund spending (which is the base used to make this calculation) changes for reasons unrelated to support for spending programs (e.g. property tax shifts between schools and local governments, the "VLF Swap,"<sup>16</sup> etc.), this measure may not necessarily indicate a lack of support for higher education. Nevertheless, it is one indicator of the trend of state support for higher education. Since 1998-99, the share of General Fund spending devoted to higher education has fallen from 12.8 percent to about 11 percent in 2007-08.

This shortcoming is less concerning going forward since the structure of state responsibilities is largely static looking ahead. Under the two scenarios explored using our model, the share of General Fund spending devoted to higher education increases very slightly under both scenarios, but probably within the margin of estimating error for the model. Thus, looking forward, higher education's share of the General Fund stays largely the same as the current share. At the same time, because under both scenarios, the General Fund has large operating deficits for a significant period of time, all General Fund supported programs will come under significant pressure.

## **VIII. Conclusions**

Based on our analysis, we made the following findings and conclusions:

Regarding the recent history of higher education funding:

- On a per-student basis after adjusting for inflation, since 2001-02 funding has declined by 10.4 percent and 5.7 percent for UC and CSU, respectively, and increased for the Community Colleges by 5 percent. Thus, per student funding for UC and CSU has not kept up with inflation, and support for the Community Colleges has slightly exceeded inflation over this period. This study focused on changes to higher education funding over time rather than whether the absolute level of funding per student is appropriate. In particular, Community College students were funded at \$5,675 in 2007-08, a rate substantially below funding for UC, CSU and K-12 students.
- Following a period of no increases from the mid 1990s through 2001-02, undergraduate student fees at UC and CSU increased by about 94 percent from 2001-02 to 2007-08.

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<sup>16</sup> Under the Vehicle License Fee swap, in 2004 cities and counties received property tax revenues instead of payments directly from the state to compensate them for their losses due to the reduction in vehicle license fees. These property tax revenues were shifted away from school districts and, in turn, this property tax revenue loss to schools was made up by providing them with more state General Fund revenues. This transaction has the effect of changing the share of total General Fund spending going to schools without changing the total amount of money they receive.

This represents a 75 percent increase after adjusting for inflation. Community College fees increased from \$11 per unit (\$330 per year) in 2001-02 to \$26 per unit (\$780 per year) in 2004-05 and 2005-06 and then were reduced to the current level of \$20 per unit (\$600 per year).

Regarding the impact of the proposed 2008-09 budget:

- The budget proposes significant reductions from the level of funding needed to provide for enrollment growth, mandatory cost increases and cost-of-living adjustments for faculty and staff. Depending on the level of fee increases the segments ultimately approve (no increase is proposed for Community Colleges), total funding including fee revenue is likely to be in the range of a percent or slightly more over 2007-08, but insufficient to maintain the current level of funding per student after inflation. In the absence of funding for unavoidable cost increases, all three higher education segments will need to identify cost savings that can be achieved or be forced to reduce class offerings or student services or increase class sizes. Because of the budget reductions earlier this decade, their ability to achieve additional savings or economies without affecting the quality of services delivered is limited.
- The budget's proposed phase out of the competitive award Cal Grant program would adversely affect non-traditional, very low-income students and as pointed out by the Legislative Analyst, "eliminating the state competitive program undermines a key part of the state's affordability strategy."
- The UC, CSU and Community Colleges are significantly underfunded for their current enrollment. Because the Governor's 2008-09 Budget proposes not to provide funding for additional enrollment, both the UC and CSU have indicated that over the next several years, the segments plan to reduce new enrollment so as to ensure that existing enrollment is fully funded. Reducing enrollment will result in greater competition for a limited number of slots, likely reducing access for historically underserved communities. At the Community Colleges, only 1 percent enrollment growth is proposed, versus the 3 percent growth in enrollment demand expected by the system.

Regarding the results of our projection model:

- Under our model, by the end of the forecast period, applying the reductions to higher education in the Governor's Budget scenario has the effect of reducing per-student funding in 2017-18 at UC by about \$1,800 and by \$1,100 for CSU.
- According to the results of our analysis, the state General Fund condition is likely in the red for the next four to seven years. By about 2012-13 (or a couple years later under

the “current law” scenario, we anticipate that available revenues will exceed the projected cost of current expenditure commitments (assuming no recession and no significant new expenditure programs).

- During the projection period, we anticipate that costs for UC, CSU and the Community Colleges will remain roughly the same share of overall GF spending at about 11 percent under both of the scenarios explored.

What this report has shown is that publicly funded higher education in California has not fully recovered from the reductions of the early part of this decade and that a significant share of the effort to make up for these reductions has been borne by students in the form of dramatic increases in student fees. The proposed 2008-09 state budget will exacerbate this situation by providing little if any funding for new enrollments, at a time when the state needs to invest in preparing a college educated workforce to meet the state’s future demand for high-skilled workers. Looking forward, the General Fund financial condition will continue to put pressure on resources for higher education.