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The Future of Public Higher Education in Pennsylvania

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Abstract

The goal of this keynote address, as the title suggests, is to confront the question of the future of public higher education in Pennsylvania. Two kinds of information will be presented: 1) data, and 2) interpretations of those data. Based on my careful analysis of those data, I have concluded that, if the funding and policy trends of the past 27 years continue, public higher education in Pennsylvania will disappear and become a thing of the past in just one more generation. I do not mean by this that the campus buildings will disappear, or that our intellectually hungry, but financially needy, students will no longer attend those institutions, but rather that public higher education's historic mission will be rendered unattainable, as public higher education and its students become increasingly marginalized and abandoned by the Commonwealth of Pennsylvania.

Background

Based on a previous (2008) analysis of data that documented the steady decline in public support for public higher education in Pennsylvania between 1984 and 2008, I came to a then shocking conclusion as described by the following assertion:

Assertion 1: **California University of Pennsylvania (Cal U) and all the "public" universities in Pennsylvania are being privatized without a plan.**

The evidence for **Assertion 1** was contained in a paper that I presented at a conference at Baruch College in New York on April 8, 2008, and which later appeared as an Op-ed in the *Chronicle of Higher Education* on October 31, 2008. Since then, I have also looked into some consequences which the combination of the ongoing decline in Commonwealth funding, *plus* current key operating policies, might be having on individual PASSHE **universities** and on individual PASSHE **students**. My interpretation of these data leads me to make two additional assertions, one involving PASSHE *universities,* and a second one involving PASSHE *students*:

Assertion 2: **The "business model" under which PASSHE universities currently operate is financially unsustainable and, without changing key policies that drive that business model, PASSHE universities will face severe financial distress and bankruptcy in the near term.**

Assertion 3: **Although the PASSHE universities were intended to carry out the mission spelled out in Act 188 of 1982: "…to provide *high quality education* at the *lowest possible cost to the* *students*," the rapid decline in Commonwealth funding, compounded by *key operating policies*, portend mission failure, both with regard to providing high quality education, as well as with regard to providing the lowest possible cost to the students.**

The evidence for **Assertions 2** and **3** will be found in the remainder of this presentation.

Because all three assertions are so startling and provocative, the observer is not only free *but strongly encouraged*, to challenge the data and to question the interpretations. It is my hope that this keynote address will spark intense discussion and debate on the relevant issues by all the stakeholders of public higher education in Pennsylvania—because such discussion and debate is needed for, and may in fact help initiate, the conversations with public officials required to forge a consensus on what, in fact, the future of public higher education in Pennsylvania *will be*.

The grave challenges to the future of public higher education in Pennsylvania are seen in Charts 1-6. The decline in Commonwealth funding, whether measured in terms of plummeting budget *percentages* or evaporating purchasing power (as measured by 'constant' *dollars*), reveals the greatest, but not the only, threat to the future of public higher education in Pennsylvania.

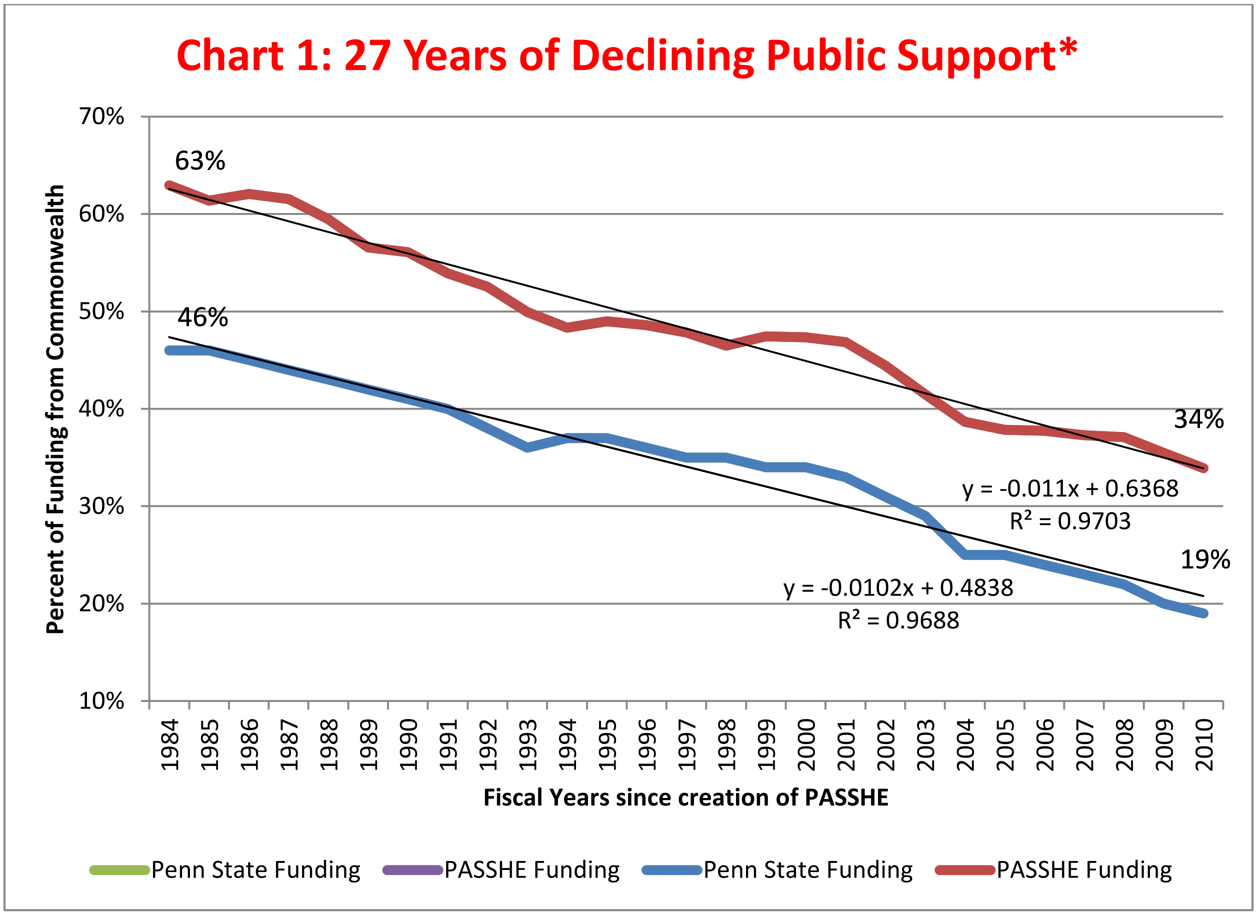
Another measure of the 27-year decline in State funding for 'public' universities is PASSHE's appropriation as a share of the *Commonwealth's budget*. As we see in Chart 2, between 1984 and 2010, PASSHE's share of the State budget fell from 2.9% to 1.9%—a decline of 35%! Clearly, it was the judgment of our elected officials—both Democrat & Republican—in the executive and legislative branches over the last 27 years, that public higher education must fall in priority as other State priorities emerged. We will explore the question of competing State priorities *and* the agreement of both political parties to these funding decisions in what follows.

Although a decline in funding *percentages* makes a compelling case, it is necessary to look at the trends in funding *dollars*, taking inflation into account, in order to get a complete picture. Chart 3 shows that the State appropriation to PASSHE, in constant dollars, fell from a high in 1990 to a low in 2009, resulting in a 19% drop in appropriation purchasing power.

Coupled with that decline in appropriation purchasing power over the last 27 years was a very large increase in PASSHE full-time-equivalent (FTE) enrollments over the same period. As shown in Chart 4, FTE student enrollments grew from about 71,000 students in 1984 to almost 108,000 students in 2010—an increase of 52%!

As shown in Chart 5, the combination of rapidly increasing FTE enrollments and shrinking appropriation purchasing power has resulted in a 39% decline in purchasing power per FTE student between 1987 and 2009, as measured in constant dollars.

It is an interesting fact that the substantial disinvestment in public higher education documented by Charts 1-6 occurred independently of the political affiliation of the governor and/or that of the majority in control of the House or Senate at any given time over the past 27 years; i.e., it happened under *both* Democrats and Republicans!



*Includes ARRA Funding

Chart 1. Nearly parallel twenty-seven year funding trends for PASSHE and Penn State. In FY 2010 Penn State received 19% of its E&G budget from the Commonwealth, while California University and the other PASSHE universities received 34%, similar to what Penn State received just eleven years earlier in 1999. At current trends, Penn State can expect its budget share to fall to zero by 2030, just 20 years from now! Also, if as expected the above trends continue, California University can expect to see its budget share from Commonwealth funding drop to zero by 2041, just 31 years from now. This prompts the question "At what percentage of State funding does a 'State-owned' (i.e., PASSHE) university effectively become private?" The answer would seem to be "Long before the State funding percentage actually hits zero, i.e., long before the next 31 years have elapsed."

An explanation for how this disinvestment could have occurred—independently of whether the Democrats or Republicans were in charge—may be seen in our rapidly changing demographics: In the 50s and 60s a *majority* of households in America had at least one person 18 years of age or younger (i.e., someone who could benefit *directly* from public higher education). Today, only *one out of three* households has someone 18 or younger. It would seem logical then that full funding of public higher education might become a *secondary* priority as soon as elected officials of both parties realized that a majority of voting households could no longer benefit directly from public higher education, and also that a majority of *voting* households may have had (and as the evidence would later show, definitely did have) quite different priorities such as, for example, crime and health care [See Chart 6.]

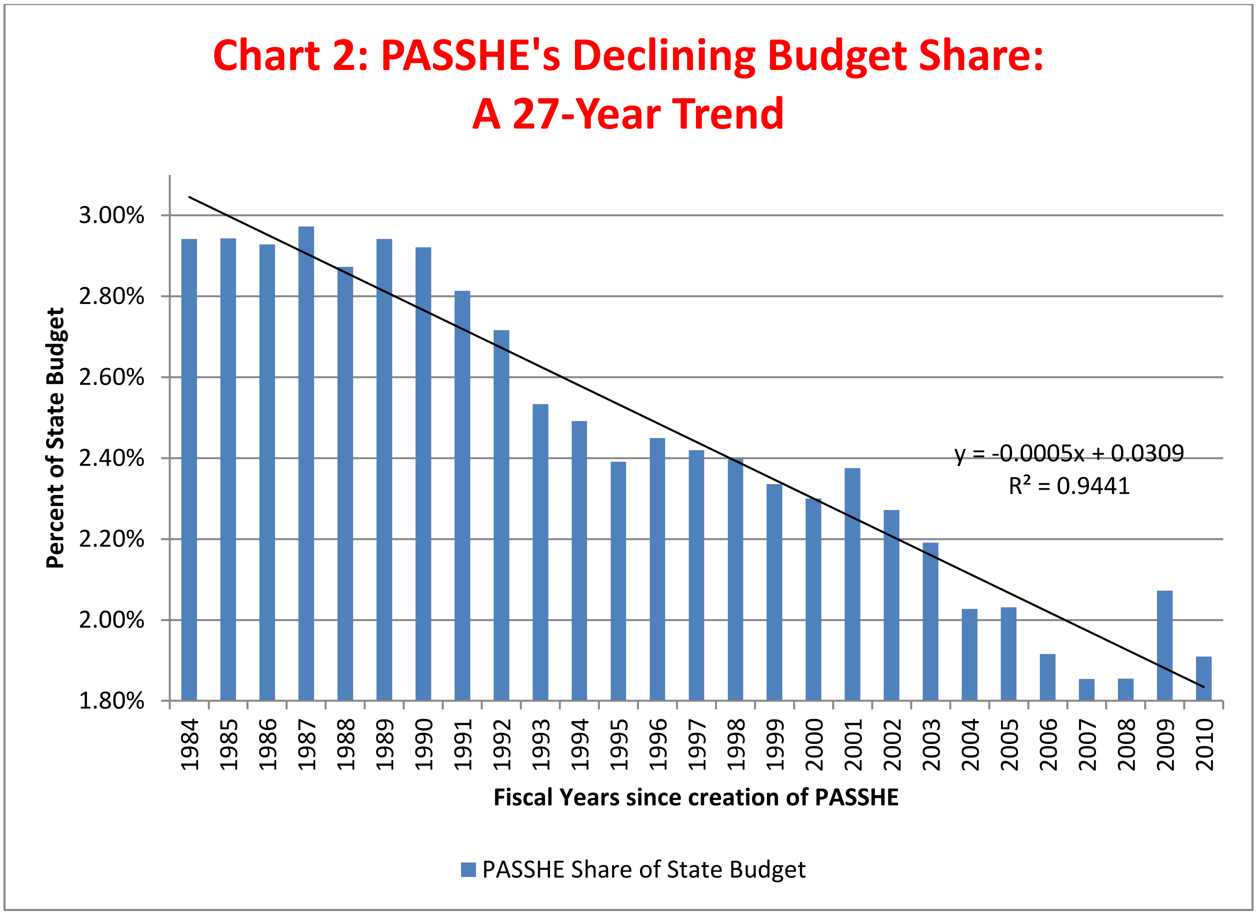


Chart 2. The 27-year Decline in PASSHE's Share of the Commonwealth Budget. Although more volatile than Chart 1 (which tracked the share of *PASSHE university budgets* provided by State appropriation), this chart focuses on PASSHE funding as a percent of the *Commonwealth's Budget*, one whose total value (the denominator in the above percentage calculations) waxes and wanes with variations in taxes collected and, as a result, is very dependent on the overall state of the economy in a particular budget year. Despite volatility, the downward trend is quite stark.

As far as the 27-year decline in funding is concerned, it could have been different, of course, *if* we as a society had decided—despite the changing American demographics—that public higher education was still a public (as opposed to a private) good, and that it was in everyone's best interest to provide an affordable public college education for every son or daughter, not just our own. But as Chart 6 clearly shows, Pennsylvania's elected officials shifted the state's priorities *away* from public higher education in a recent eighteen-year period (between 1990 and 2008) by drastically reducing the share of the Commonwealth's budget devoted to public higher education from 7% to 4%, a reduction of 43%!

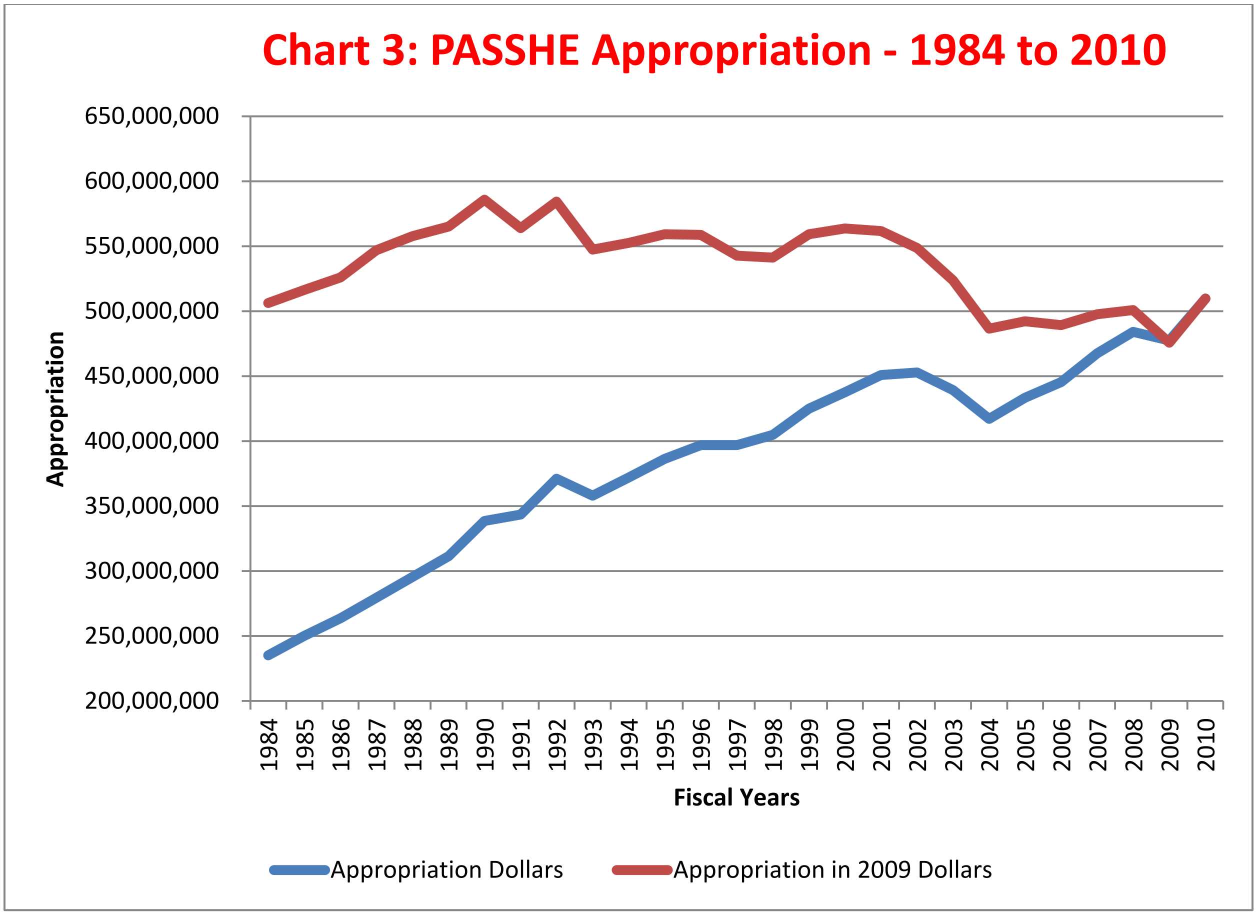


Chart 3. Appropriation to PASSHE in current dollars (blue) and constant (2009) dollars (red). From its high point in FY 1990 to its low point in FY 2009, the purchasing power of PASSHE appropriation dollars fell by 19%.

The data also show that, in the most recent 13-year period between 1997 and 2010, PASSHE FTE enrollment grew by 32% while, at the same time, the annual number of graduates coming out of Pennsylvania high schools grew by only 15%. That PASSHE enrollments grew twice as fast as the number of high school graduates during that period says that PASSHE was suddenly able to garner more than its normal share of "the market" in terms of those additional graduates—during that 13-year period. This means that between 1997 and 2010, PASSHE has been "taking" students from the other sectors of higher education in the state, which include the private and state-related universities. That in turn suggests that something "different" was being done during that period, either by the other sectors, or by PASSHE, or by both.

It is well known that tuition rates at the private and state-related universities, which were already much higher than PASSHE rates, then rose much more rapidly during that 13-year period than PASHE tuition rates did (See Chart 9.) It seems clear that this widening price differential, coupled with increases in the perceived quality of PASSHE universities, contributed to the large increase in PASSHE market share as far as student enrollments are concerned.

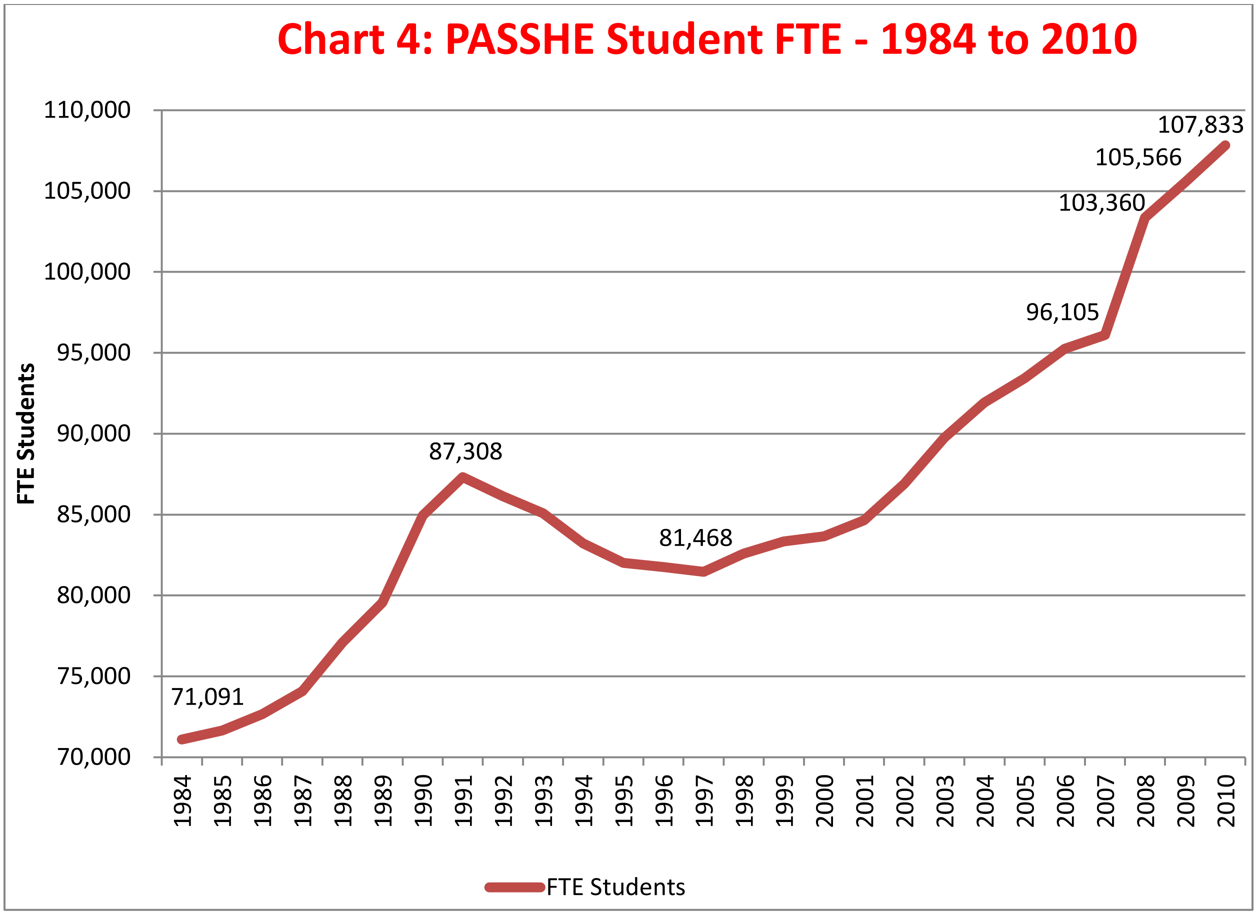


Chart 4. A 52% Increase (over 27 years) in PASSHE FTE Student Enrollment. Except for a brief 7% decline in FTE student enrollment between 1991 and 1997, PASSHE has increased its total FTE student enrollment by 52% between FY 1984 and FY 2010. An enrollment increase of this magnitude raises two obvious questions: 1) Why were the PASSHE universities willing to "impoverish themselves" by accepting such large increases in enrollment without additional funds to cover the cost of educating the additional students?, and 2) How were the PASSHE universities able to attract so many more students when the growth in the number of high school graduates coming out of Pennsylvania high schools was rising so much more slowly? As we will see below, the answers to these two questions bear directly on the validity of **Assertions 2** and **3**.

Soon after the arrival of Chancellor Hample in 2000, the allocation formula was changed in two important ways: 1) Appropriation would subsequently be tied to Pennsylvania residents only, meaning that the universities would receive no appropriation support for out-of-state students; and 2) Individual universities would subsequently retain—and not have to share—any and all "excess" tuition revenue that they might collect through their recruitment efforts.

That these two policy changes would in turn change the recruitment strategies of the PASSHE universities should not be surprising. Because PASSHE tuition increases continued to be kept small, not in absolute terms but, more importantly, in relation to the much larger tuition increases common to two of the other higher education sectors (private and state-related), the only option available to our universities for generating additional tuition funding (in an attempt to make up for rapidly diminishing appropriation funding) was by increasing the number of students, especially Pennsylvania students, who would then be paying tuition.

This encouraged the PASSHE universities to grow, and some of them did just that. And in the absence of any policy discouraging enrollment growth, those institutions that wanted to grow and could grow, either because they had: a) physical space available on campus, and/or b) a favorable geographical location, and/or c) alternative ways to accommodate additional students, such as through off-campus sites and/or internet education, did manage to grow substantially.

That large increases in enrollment, without corresponding increases in appropriation, might benefit individual universities in the short term but impoverish the entire PASSHE system in the long term, has not been discussed extensively, at least in my presence. However, in the 1990s, the Office of the Chancellor enforced strict caps on enrollments (known as "enrollment bands") at the individual universities. The apparent purpose of that strategy was to put pressure on the legislature for "additional funds for additional students," by denying admission to some Pennsylvania residents who would then, presumably, complain to their elected representatives.

The reasons why individual universities might want to increase their enrollments now seem fairly clear. Equally clear are reasons why individual PASSHE universities were in fact able to increase their market share of students, despite what would seem to be a very competitive higher education market in Pennsylvania. It would seem that the single largest reason for PASSHE's stunning enrollment success in recent years is the fact that its tuition—and tuition rate increases—have been kept artificially low, so much so, that the "competition" simply can't compete on the basis of price, especially in view of PASSHE's perceived high quality.

Since Cal U and the other PASSHE universities are *today* functioning at the same level of State financial support as a state related university did just eleven years ago, one can logically ask "At what level of State funding does a 'state-owned' university become 'state related'—in terms of a release from, or at least some gradual reduction in, those State regulations from which state-related universities are currently exempt?" While it is both natural and logical to expect that the relatively high State funding levels of long ago *should* have been accompanied by relatively high levels of State regulation, it is equally natural and logical to expect that the large reductions in State funding over these last many years should have been accompanied by equally large reductions in State regulations, an expectation that not only has not happened; it has not yet even begun to happen; it has not yet even begun to be talked about publicly, perhaps until now.

And since Cal U's budget share from the Commonwealth is projected to reach zero in 31 years, only eleven years after Penn State has done so—provided only that the funding trends of the last 27 years continue—the obvious corollary to the above question is this: "At what level of State funding does a 'state-owned' university become 'private'—in terms of a release from, or gradual reduction in, State regulations from which private universities are currently exempt?"

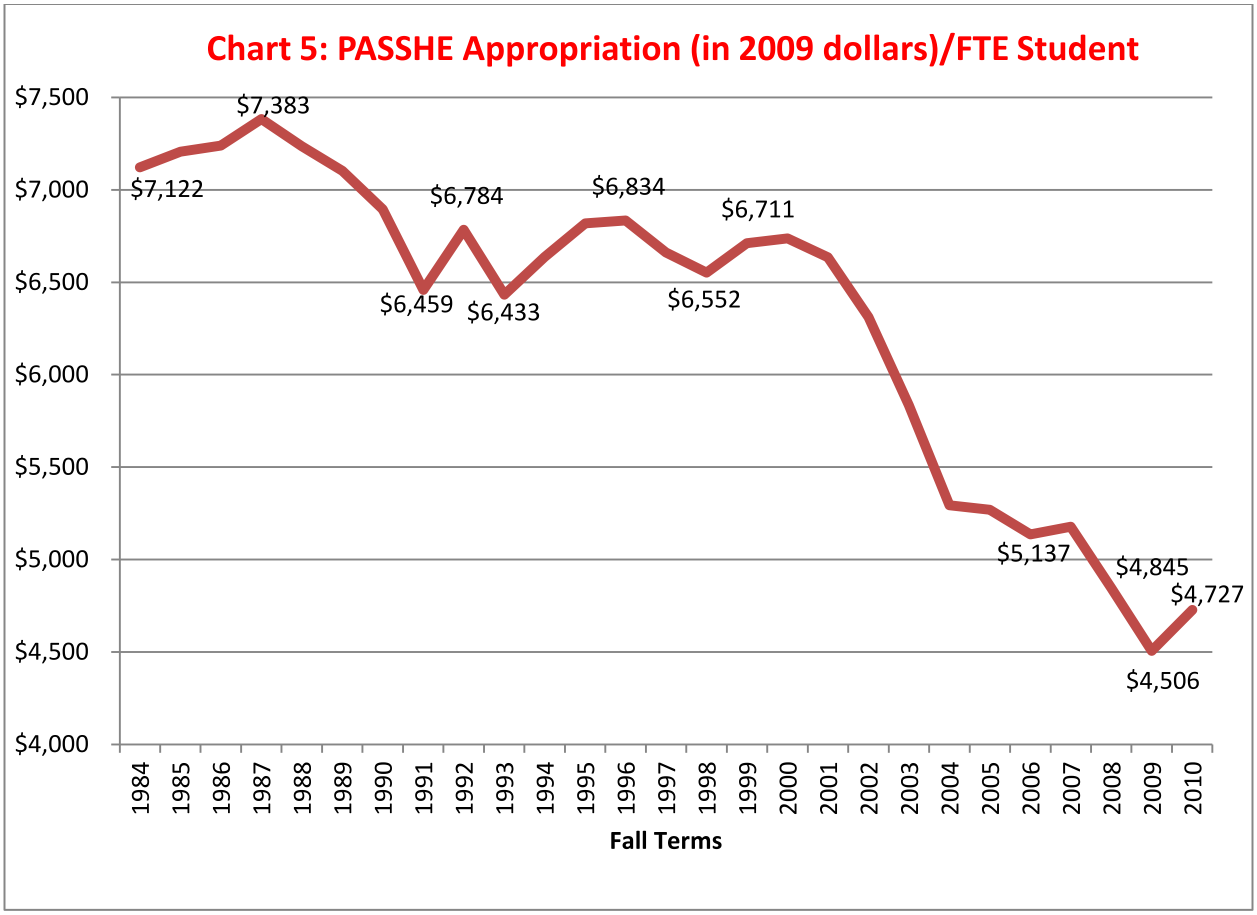
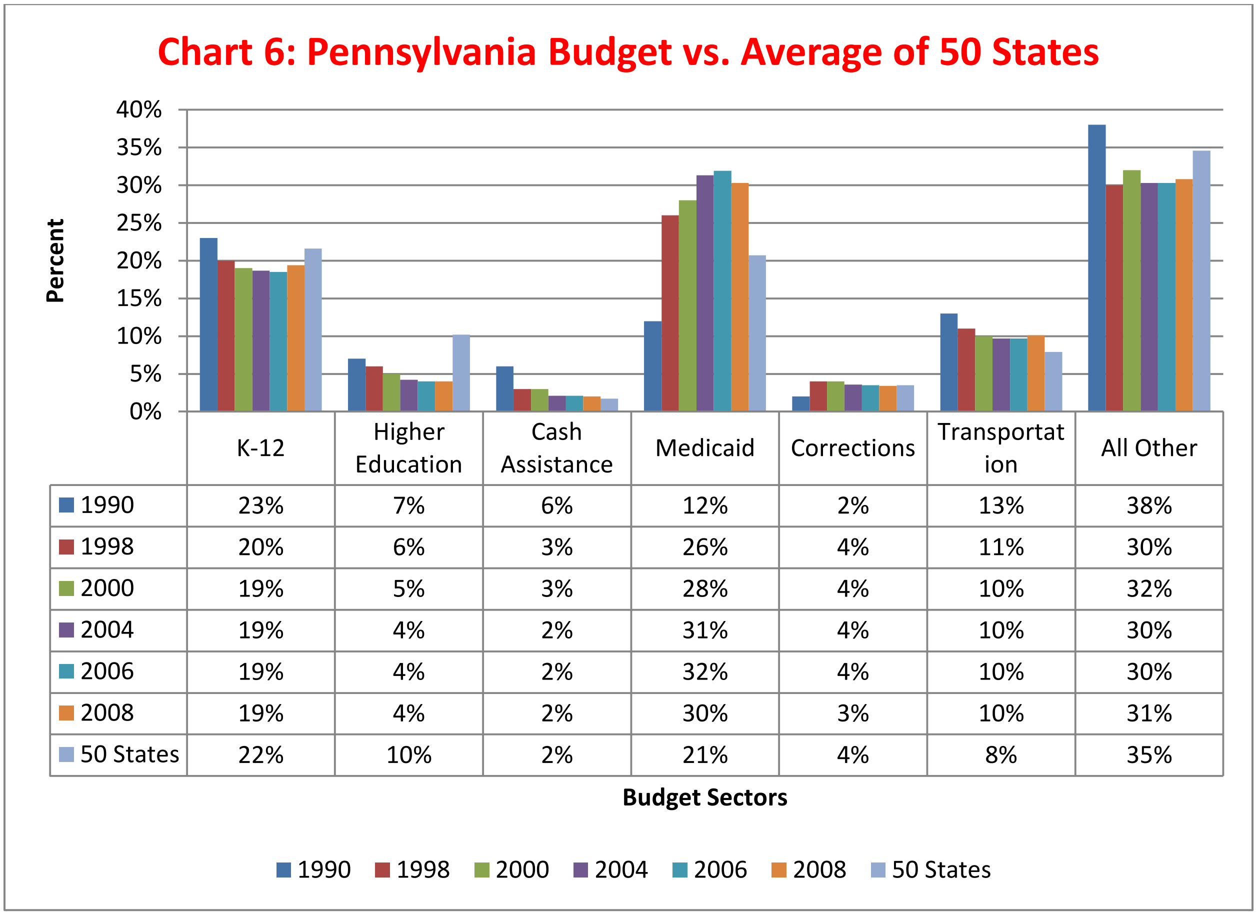


Chart 5. A 39% Drop in Appropriation Purchasing Power/FTE Student. The combination of a 19% decline in PASSHE appropriation in constant (2009) dollars, coupled with a 52% increase in FTE student enrollment, has resulted in a 39% drop in constant appropriation dollars/FTE Student between FY 1987 and FY 2009. Hence, for every constant dollar available to educate a PASSHE student in 1987, only 61 cents is available today!

It is quite clear that 158-year old Cal U and the other PASSHE universities are on a trajectory which, unless drastically altered, will see these universities become *literally* private—in the sense of <u>zero</u> State funding—in just 31 years. That fact alone justifies the assertion that California University of Pennsylvania (and the other public universities) are being privatized.

A second question, whether this privatization is happening *without a plan* is not difficult to establish, even though it is well known that it is impossible to *prove* a negative —i.e., to prove that there is <u>not</u> (in someone's secret files) a plan to privatize Cal U and the other PASSHE universities. One, however, can reasonably infer the *non-existence* of such a plan by some easily verifiable facts, including:

a) No elected official of the Commonwealth, either in the executive or legislative branch, has ever announced the existence of such a plan, or stated that work had begun on such a plan, or stated that a bill had been introduced for such a plan, or hinted that work on a bill was even being contemplated for such a plan; and b) When elected officials speak of funding, their remarks typically focus on the “funding climate” (usually not good) for that particular year, evidence itself that the Commonwealth funding process is seen by our elected officials as an annual event, often referred to by the media as the “annual budget battle.”



	K-12	Higher Education	Cash Assistance	Medicaid	Corrections	Transportation	All Other
1990	23%	7%	6%	12%	2%	13%	38%
1998	20%	6%	3%	26%	4%	11%	30%
2000	19%	5%	3%	28%	4%	10%	32%
2004	19%	4%	2%	31%	4%	10%	30%
2006	19%	4%	2%	32%	4%	10%	30%
2008	19%	4%	2%	30%	3%	10%	31%
50 States	22%	10%	2%	21%	4%	8%	35%

Chart 6. Pennsylvania’s 2008 Budget Priorities as compared to the average of the 50 states. Over the 18-year span (1990 to 2008) covered by the above data, K12 funding in Pennsylvania dropped from 23% to 19% of the budget, and Higher Education funding dropped from 7% to 4% of the budget. Only two budget sectors received an increase over that 18-year span: Corrections, which increased from 2% to 3% of the budget, and Medicaid which increased from 12% to 30% of the budget—an increase of more than 150% in terms of the number of additional dollars directed toward Medicaid funding, a figure which suggests that Pennsylvania (like a number of states in America) is being bankrupted by Medicaid. Pennsylvania’s budget priorities for 2008 are comparable, or roughly so, to the average of the 50 states except in two budget categories: Medicaid funding, where the 50-state average is nine (9) percentage points lower than that of Pennsylvania, and Higher Education funding, where the 50-state average is six (6) percentage points higher (i.e., 2.5 times higher!) than the level in Pennsylvania.

Twenty-seven (27) years of troubling—but non-controversial—annual budget decisions, coupled with key policy decisions and non-decisions, have created unintended consequences that are now clearly focused in the minds of those of us responsible for delivering PASSHE’s historic mission “…to provide *high quality education* at the *lowest possible cost to the student*.” Current circumstances are making that task increasingly difficult, if not impossible, to accomplish.

As long as budget decisions are viewed as *annual* events, it is not likely that there would be any recognition of, much less concern about, the long term effects of a negative 27-year trend (Chart 2) in which occasional "good years" are offset by many more "bad years." One would also expect that, if there were a plan to privatize the 'state owned' universities, part of that plan would have to deal with proposed reductions in State *regulations* (including existing laws that would have to be modified or repealed) to accompany the plan's future "planned reductions" in State *funding*. Such a discussion would involve the Legislature, would be controversial, and would obviously be big news. That has never happened in the past. It is not happening now. It is not even being talked about. There is obviously *no* such plan at the present time.

Having established that California University is being privatized without a plan, let us now consider some of the implications of that fact. First it is important to recognize that there are and always have been significant differences in the ways that private and public universities operate. But the list of those differences has changed drastically over the past 27 years. While private universities have no doubt had to change what they do—at least in *degree*, public universities like ours have been forced to change a great deal—not just in degree, but in *kind* as well.

Twenty-seven years ago, most public university presidents did not need to concern themselves with private fund raising. Today, virtually all do. Twenty seven years ago, the procurement of needed goods and services at public universities was complicated, bureaucratic and slow. Today, it still is. While such bureaucracy may make sense for *true* State agencies whose entire funding comes from the State (and which today's state-owned universities really once were), it doesn't make sense for public, state-owned universities that are today increasingly public in name only, and desperately require the flexibility to be agile in a competitive world.

While most of the charts in this presentation focused on the decline in *operating* percentages and *operating* dollars, there has been a steep decline in State funding for <u>capital</u> projects as well. Twenty-seven (27) years ago, academic buildings at PASSHE universities were paid for *entirely* by the Commonwealth. Eighteen years ago, at the time of my arrival at California University in 1992, presidents were *required* to raise 25% of the cost of *academic* buildings from private sources, in order to leverage the remaining 75% from the State. More recently, the ante was raised to 50-50! As a result, the pressure on PASSHE presidents to raise private funds for capital projects, as well as student scholarships, is immense.

Aside from tuition (i.e., "sticker price") there is the critical question of the "bottom line" cost of public higher education. The failure of the states and the federal government to adequately fund financial aid <u>grants</u> (as opposed to loans) to America's neediest students (many of whom seek out *public* universities) is well documented. Listed below are titles of three National reports that, while dated, nevertheless paint an accurate and compelling picture of what is happening to public higher education in America. While the titles alone tell a shocking story, the actual reports provide devastating indictments of our public policy regarding financial aid:

- Losing Ground: A National Status Report on the Affordability of American Higher Education (National Center for Public Policy and Higher Education; 2002);
- Empty Promises: The Myth of College Access in America (Advisory Committee to Congress on Student Financial Aid; 2002);
- Access Denied: Restoring the Nation's Commitment to Equal Educational Opportunity (Advisory Committee to Congress; 2001).

For those who might wonder if our elected officials are aware of this problem, please note that two of the above three reports were commissioned, and received, by Congress many years ago.

As stated earlier, the Commonwealth's failure to provide adequate funding, combined with certain key operating policies, have seriously complicated our efforts as university presidents to deliver the PASSHE mission outlined in Act 188 of 1982. I believe that most public university presidents, I among them, have increasingly accepted responsibility for "high quality education" as far as educational facilities (i.e., capital projects and equipment) are concerned.

And at the other end of the PASSHE mission statement quoted earlier, more and more public university presidents, I among them, are increasingly accepting responsibility for lowering the effective cost of attendance (i.e., the bottom line) to students through private fund raising for student scholarships, to mitigate the cost of tuition and fees for our neediest students.

Somewhat schizophrenically, PASSHE presidents must operate like *private* university presidents as far as fund raising is concerned while, simultaneously, continuing to employ outdated business practices that, though perhaps appropriate for true State agencies, are totally out of touch with the needs of agile and increasingly privatized public universities today.

As a practical matter, it seems clear that, since we are being privatized without a plan, it behooves us to begin functioning more and more like *private* universities. And that is what we have begun doing at California University of Pennsylvania in recent years. Once the inexorable nature of the decline in State funding became clear, we began to focus on what we *ourselves* might be able to do to support the two ends of the PASSHE mission statement quote cited earlier. A few of our colleagues criticized this approach saying that, by doing so, "We would enable the State to abdicate its responsibility to the students of Pennsylvania."

The gist of our rebuttal was: a) that the decline in state funding began at least twenty years *before* we began our approach; and b) that if *we* didn't act to preserve the high quality of our academic offerings *as well as* to preserve the ability of our students to pay their tuition, through need-based, privately-funded scholarships, who would?

Lurking in the background of this entire discussion is a critical question that we have not yet attempted to address: Is PASSHE tuition too high? Is it too low? Or is it just right?

A careful review of all the data makes it clear that PASSHE tuition is too <u>high</u>—for the neediest students—and too <u>low</u>—for the wealthiest students. Not surprisingly, as the public universities in Pennsylvania become increasingly <u>privatized</u>, the issue of need-based scholarships—or "tuition discounting" as the private universities call it—was bound to come up. We will discuss this topic later in more detail under the banner of "market rates of tuition."

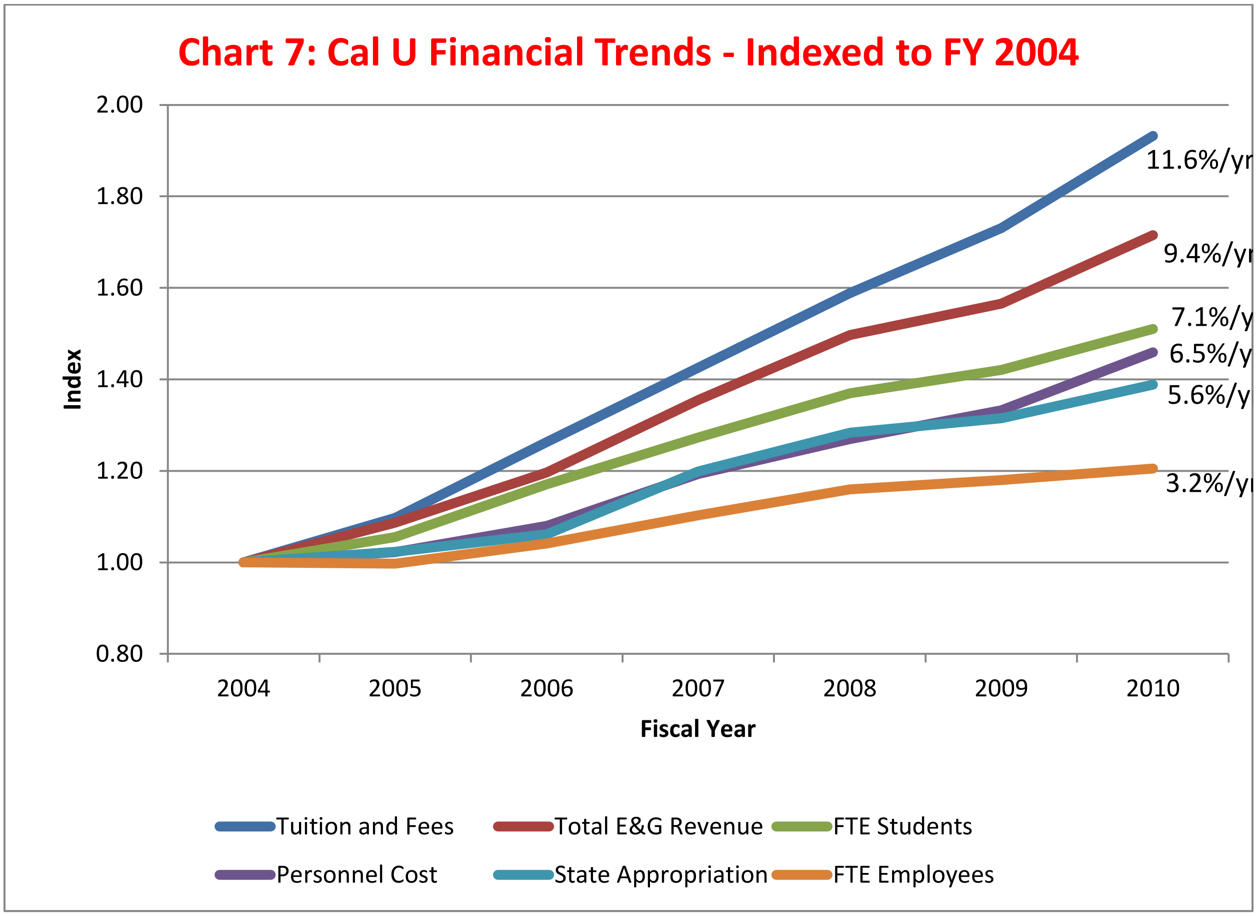
As the effects of declining State funding plus recent tuition rate increases compounded themselves, two cruel choices had to be faced:

1) allow educational quality to suffer <u>or</u> find additional sources of both *operating* revenue and *capital* funding to make up the shortfall; and
2) allow academically qualified but low income students to be denied a college education because of (for them) tuition that is too high, <u>or</u> expand *private* fund raising to support student scholarships, thereby reducing the *effective* tuition (bottom line) they must pay.

Recall that the mission of PASSHE is to provide high quality education as the lowest possible <u>cost</u> to the student. Act 188 does not say that we are to provide high quality education at the lowest possible <u>tuition</u>, a distinction that makes all the difference, not just semantically, but also in regard to the very future of public higher education in Pennsylvania.

The two-tiered policy practiced by virtually all private universities can solve this problem if PASSHE moved to a combination of "market tuition rates" and "scholarships for the neediest students." Those rates would allow scholarships that would reduce the *effective* tuition for needy students to levels they can manage and, at the same time, provide funds to keep the universities financially viable, enabling them to continue to provide "high quality education" to our students.

Although **Assertion 2** appears shocking and provocative on its face, the evidence that it is true is so compelling as to be irrefutable. That evidence is taken from the audited financial statements of California University of Pennsylvania between FY 2003-04 to FY 2009-10.



*In FY 2004, Personnel Costs consumed 83.5% of Total E&G Revenue.

Chart 7. Audited Financial Trends for Cal U – Indexed to FY 2004. The above Index Study enables ready analysis of otherwise cumbersome financial data. The key to reconstructing the entire chart with fidelity to the audited financial statements is to simply multiply each horizontal entry with the actual value of the statistic in FY 2003-04. In other words, the values of 1.00 in the Table below refers to the actual audited values for that year. To get the audited values for FY 2005, the second fiscal year, one must simply multiply the value of the statistic in the Index Year (FY 2004) by the index in the second column. And so on. As one moves from left to right, the indices contained in the Table below provide the <u>cumulative</u> percent change in that statistic up to that fiscal year.

Fiscal Year	2004	2005	2006	2007	2008	2009	2010
Tuition & Fees	1.00	1.10	1.26	1.43	1.59	1.73	1.93
Total E&G Revenue	1.00	1.09	1.20	1.36	1.50	1.57	1.72
FTE Students	1.00	1.06	1.17	1.27	1.37	1.42	1.51
Personnel Cost	1.00	1.02	1.08	1.19	1.27	1.33	1.46
Appropriation	1.00	1.02	1.06	1.20	1.28	1.32	1.39
FTE Employees	1.00	1.00	1.04	1.10	1.16	1.18	1.20

Note that our tuition and fee revenue increased by a total of 93% between FY 2004 and FY 2010! A simple calculation shows that Tuition and Fee revenue increased at an <u>average</u> <u>annual rate</u> of 11.6%/year over seven years. At the same time, Total E&G Revenue increased by a total of 72%, for an average annual increase of 9.4%/year. Similarly, Annualized FTE Student enrollment increased by a total of 51%, for an average annual increase of 7.1%/year; Personnel Costs increased by a total of 46%, for an average annual increase of 6.5%/year; while State Appropriation increased by a total 39% (including ARRA funds), for an average annual increase of 5.6%/year; and finally, Annualized FTE employees increased by a total of 20%, for an average annual increase of 3.2%/year.

A careful look at Chart 7 reveals a number of interesting things that bear on **Assertion 2**:

- Since FY 2004, Tuition and Fee revenue at Cal U has been increasing at an astounding average annual rate of 11.6%/year;
- At the same time, Total E&G Revenue, which is the sum of appropriation, plus tuition & fees, plus "other" revenue has been increasing at a very impressive annual rate of 9.4%/year. ["Other" revenue consists primarily of interest earned on invested funds, plus privately raised dollars, which typically averages about 5% of total E&G revenue.]
- Annualized FTE Student enrollment has been growing at an unsustainable 7.1%/year, a rate that, if continued, would double our current enrollments from 9,500 students to 19,000 students in another 10 years! However, in the short term, that rate of increase in FTE students is fueling our tremendous increase in tuition and fee revenue which, in turn, is fueling the rapid annual increase in Total E&G Revenue. Even State Appropriation funding is positively influenced by our large enrollment increase, since the allocation formula is based to a large degree on each university's enrollment share of Pennsylvania residents.
- There is a very interesting trend in regards to Personnel Costs and State Appropriation. Up until the FY 2010 year, personnel costs and State Appropriation were increasing at largely identical rates! Note that, over the 7-year period shown in Chart 7, Personnel Costs were only increasing slightly faster than State Appropriation (6.5%/year compared to 5.6%/year). But the entire difference between the 5.6% and 6.5% average figures was triggered by a 13% increase in our personnel costs in just one year—FY 2010. Something special happened in that fiscal year as higher negotiated salaries, delayed from earlier contract years, began to be paid out. Also, some of that one-year increase in Personnel Costs was attributed to the 2% increase in the number of employees for that year.
- Note that the <u>average</u> annual increase in Total E&G revenue (9.4%/year) smartly outpaced the <u>average</u> annual increase in Personnel Costs (6.5%/year). *If* that arrangement could be continued indefinitely, neither Cal U nor any other PASSHE university would have to worry about a lack of funds hindering its ability to deliver on the PASSHE mission. That is, as long as the annual increase in Total E&G Revenue outpaces the annual increase in Total Personnel costs (which typically consume some 80% of the E&G Revenue budget), there would be

sufficient funds left over to invest in the "high quality" end of the PASSHE mission statement, once the "mandatory transfers" (debt service, utilities, etc.) had been taken care of.

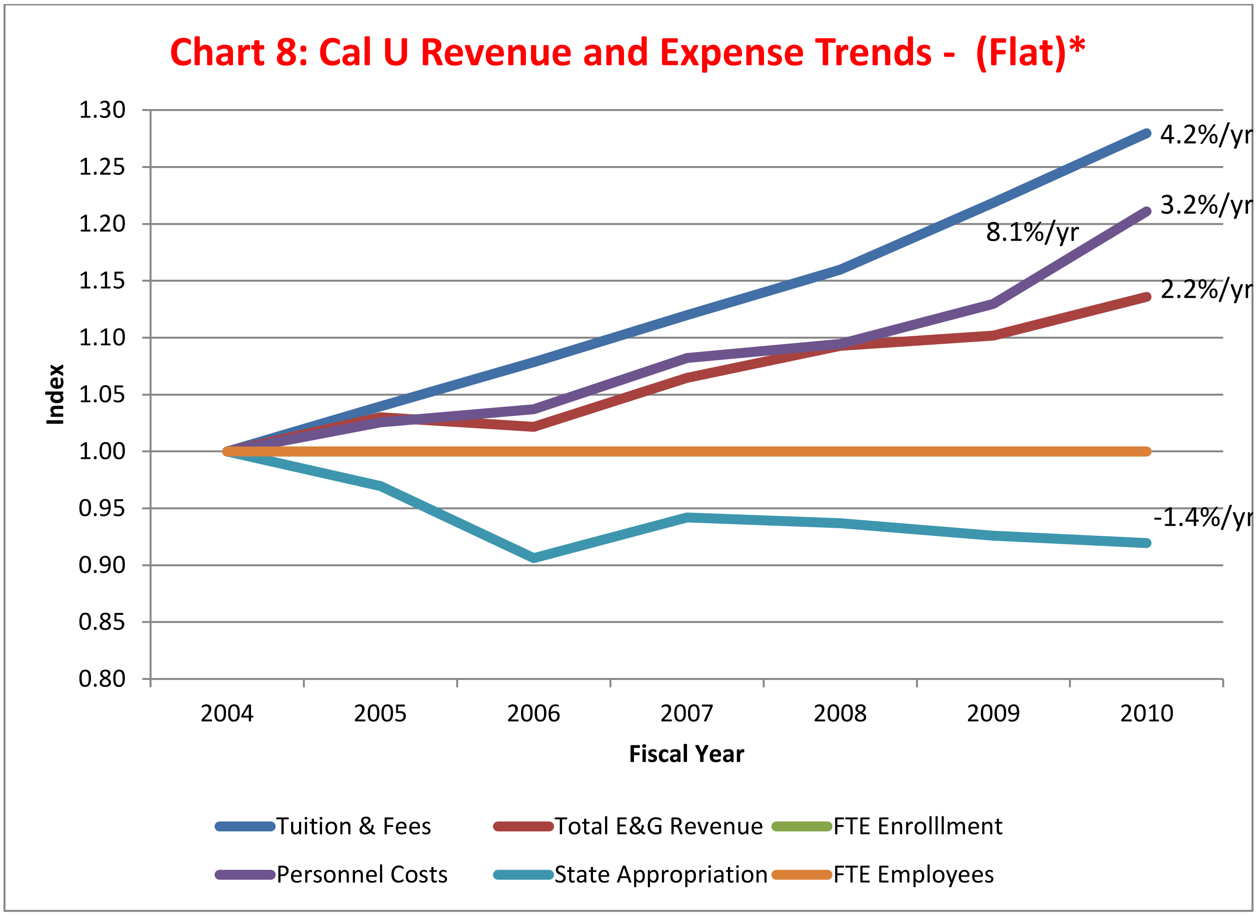
- As E&G Revenue was smartly outpacing Total Personnel Costs in Chart 7, another positive result was manifesting itself. The "Personnel Percentage," which may be defined as the ratio of Personnel Costs to Total E&G Revenue, fell substantially. In fact, our Personnel Percentage, which was 83.5% in FY 2004, dropped to 71.1% by FY 2010, thereby freeing up surplus funds which could be, and were, invested in the "high quality" end of the PASSHE mission statement as it applies to Cal U.
- Chart 7 can clearly be used as an "early warning system." Note that it has already begun to send signals that there may be financial trouble ahead—despite the enormous enrollment increases (7.1%/year) and our growing average productivity (3.9%/year), which results from the difference between our average annual FTE Student growth rate (7.1%) and our much smaller average annual FTE Personnel growth rate (3.2%).
- In FY 2010, Personnel Costs, for just that one year, shot up by 13%, which is much larger than the 9.4% average increase in Total E&G, but still smaller than the 15% one-year increase in E&G Revenue that year. In the short term, we can no doubt handle an occasional personnel cost increase of that magnitude, assuming that our revenues spurt to cover those added costs, but once the average annual Personnel Cost increase begins to exceed the average annual Total E&G Revenue increase, the "cushion" between Personnel Costs and Total E&G Revenue will quickly evaporate and severe financial distress and bankruptcy will soon follow, as stated in **Assertion 2**.

Chart 8 portrays an even more drastic scenario in which there is neither enrollment growth to generate additional tuition revenue, nor economies of scale to generate marginal revenue. Basically, Chart 8 simulates what would have happened to Cal U if, instead of growing our FTE student enrollments at 7.1%/year and our FTE Personnel numbers by 3.2%/year, we had kept both of those statistics constant at FY 2004 levels.

As we can see clearly from Chart 8, had FTE Enrollments and FTE Personnel numbers remained constant at FY 2004 levels, Personnel Cost increases would have exceeded Total E&G Revenue increases at Cal U in FY 2006, just two years later! Such a situation would eat into and quickly erode the slim budgetary "cushion" reflected by our 83.5% personnel ratio in FY 2004. With just 16.5% of our budget available for mandatory transfers such as debt service, utilities and similar unavoidable costs, we would have quickly become insolvent had we not increased our enrollments and our productivity as rapidly as we did.

Since the enrollment growth strategy would seem to be sustainable only in the short term, and the level enrollment strategy leads quickly to bankruptcy, there is no need to simulate what happens when enrollments are falling. Such institutions cannot survive financially because of the following **Structural Imbalance: PASSHE tuition rate increases have been wholly insufficient to cover the costs of our mandated personnel increases in a sustainable way.**

Having said that, it is important to note that average faculty salaries are, and have been, a highly regarded proxy for academic quality for many years now. In other words, faculty salaries are intimately connected to the PASSHE mission of providing the "high quality education" called for in Act 188 of 1982. The solution, therefore, is not to lower salaries but, instead, to provide sufficient tuition rates to generate the funds needed to make up for the loss in State appropriation while, at the same time, preserving PASSHE's mission indefinitely into the future with stable, as opposed to rapidly growing student, enrollments.



*Assumes Flat FTE Student Enrollment & Flat FTE Personnel Numbers at FY 2004 Values. In FY 2004, Personnel Costs consumed 83.5% of Total E&G Revenue.

Chart 8. Revenue and Expense Trends Assuming Steady Enrollment and Steady Personnel Numbers. In this chart, the previous values for Tuition and Fees, Total E&G Revenue, Personnel Costs and State Appropriation have all been "normalized" to remove the effects of either increasing student enrollment or increasing personnel numbers. This is a simulation of "what would have happened" at Cal U had FTE enrollments and FTE Employees not increased over the years but had, instead, remained fixed at their respective FY 2004 values.

The rapid (8.1%) increase in Personnel Costs in FY 2010 alone suggests that whatever budgetary cushion we had in FY 2004 would not last long since the average annual Total E&G Revenue increase (2.2%) was too small to "hold off" the personnel cost increases, and even the larger one-year increase for FY 2010 (4%) was barely half of the personnel cost increase. There can be no other conclusion but that severe financial distress and looming bankruptcy would have soon followed the decision to keep enrollments flat after FY 2004.

Fiscal Year	2004	2005	2006	2007	2008	2009	2010
Tuition & Fees (flat)	1.00	1.04	1.08	1.12	1.16	1.22	1.28
Total E&G Revenue (flat)	1.00	1.03	1.02	1.06	1.09	1.10	1.14
FTE Enrollment (flat)	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Personnel Costs (flat)	1.00	1.03	1.04	1.08	1.09	1.13	1.21
Appropriation (flat)	1.00	0.97	0.91	0.94	0.94	0.93	0.92
FTE Employees (flat)	1.00	1.00	1.00	1.00	1.00	1.00	1.00

The blunt truth is that the PASSHE universities are being starved for funds. They do have four (4) different financial means at their disposal to deliver their mission while balancing their budgets: State Appropriation; Tuition, Fee and Other revenue; Productivity increases; and Privately Raised funds. Unfortunately, the formerly largest means—State Appropriation—has fallen from 63% to 34% of the PASSHE E&G budget while, in the last 27 years, Appropriation purchasing power has dropped by 39% as measured by constant dollars per FTE student.

The amount of Tuition, Fee and Other revenue depends on two different factors: a) tuition and fee rates, and b) the number of students attending. Unfortunately, because tuition and fee rates have been artificially constrained for many years, the only strategy available to increase the revenue is to increase the numbers of students attending—a strategy which is not sustainable in the long term. **The only sustainable tuition strategy capable of a) keeping the PASSHE universities out of bankruptcy, while b) preserving the PASSHE mission of high quality education at the lowest possible cost to the students, is one where tuition rates are set high enough to offset personnel cost increases with constant, not growing, student enrollments.**

Cal U's productivity figures are the highest in PASSHE. This productivity strategy was invoked years ago to save money, and it saves millions of dollars each year. Similarly, private fund raising has grown exponentially in recent years—it is the most rapidly growing (percentage wise) segment of our funding pie—from 1% to 5% in less than 15 years. But while private funding clearly represents the wave of the future, it will be many years before private funds could begin to make up for the lost State Appropriation, and the forgone Tuition Revenue.

For political as opposed to financial viability reasons, tuition *and* tuition rate increases have been kept artificially low, compared to the tuitions *and* tuition rate increases at both the private university sector and the state-related sector. Chart 9 documents the fact that PASSHE tuitions *and* tuition rate increases have not kept pace with the "market." This fact is the most significant reason—as State appropriation continues its inexorable decline—why the current business model is financially unsustainable, while forcing the PASSHE universities into severe financial distress and looming bankruptcy in the short term, validating **Assertion 2**.

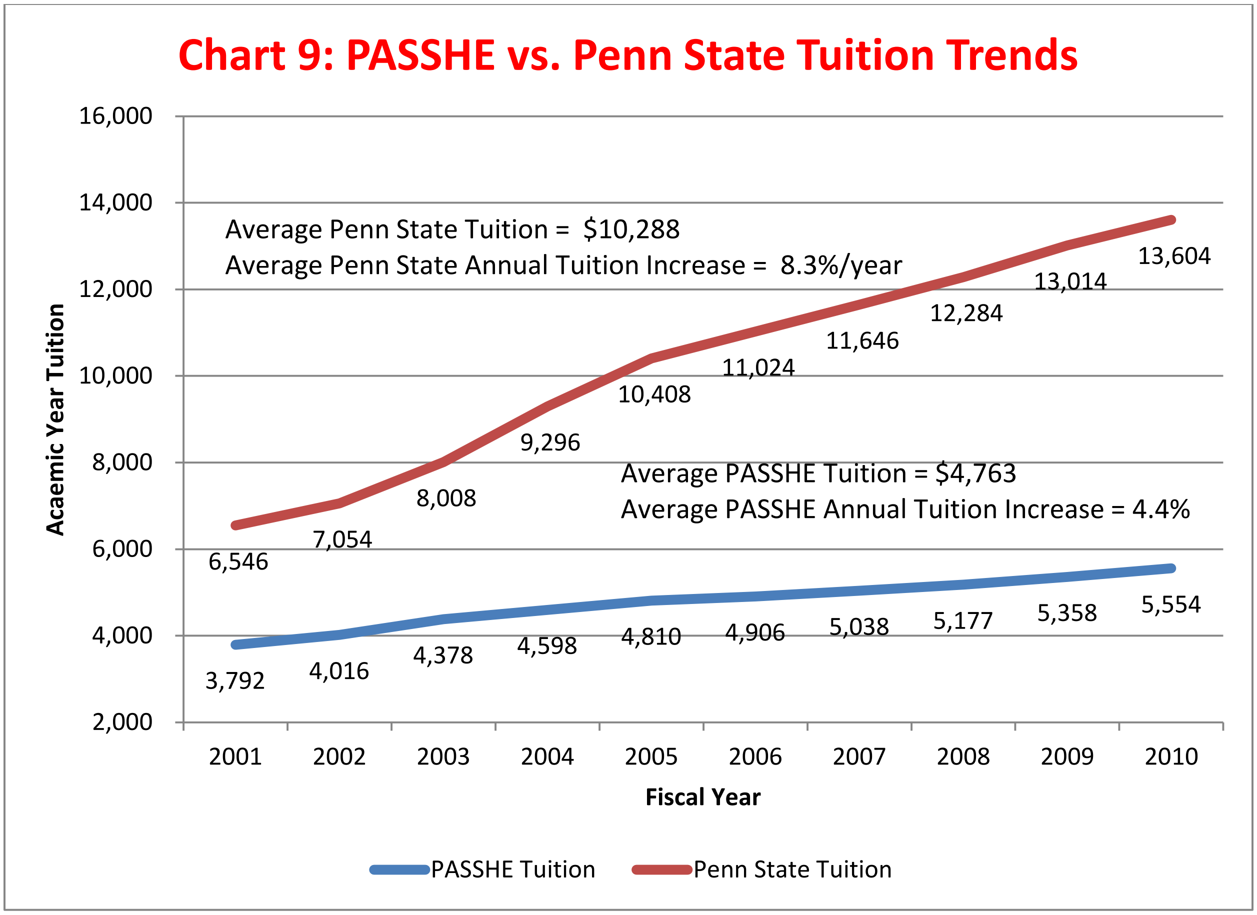


Chart 9. 10-year Tuition and Tuition Rate Increase Trends for PASSHE and Penn State. Between FY 2001 and FY 2010, PASSHE's tuition rose by a total of 46%, with an average annual increase of 4.4% while, over the same time span, Penn State's tuition rose by a total of 108%, with an average annual increase of 8.3%/year.

Chart 9 provides an illuminating comparison between PASSHE and Penn State tuition trends over the last ten years. The data show that Penn State's average tuition over that time span is more than double (2.2) PASSHE's average tuition over the same time period. As well, Penn State's average annual tuition increase is also almost double (1.9) that of PASSHE, meaning that in another ten years, if tuition rate patterns don't change, we can expect that Penn State tuition rates to be almost four (3.5) times as high as PASSHE tuition rates.

PASSHE cannot afford to forgo the millions of dollars of tuition revenue that will be "left on the table" if it continues the destructive practice of maintaining artificially low tuition rates in a time of rapidly declining State appropriation. Not only will the financial viability of the individual universities be compromised, as they face severe financial distress and imminent bankruptcy, but the noble PASSHE mission statement—high quality education at the lowest possible cost to the students—will have been be reduced to empty words. That would be a tragedy that those who care about the PASSHE mission and the PASSHE students cannot allow to happen. Having presented the case for the validity of **Assertion 2**, we will consider the fate of PASSHE students as we present compelling evidence for the validity of **Assertion 3**.

Twenty-seven (27) years of declining public support for public higher education, as documented in Charts 1-6, has affected both PASSHE *universities* and PASSHE *students* in financially negative ways. With only two major sources of available revenue—appropriation and tuition—the first of which has fallen steadily for a generation largely for demographic reasons, and the second which has failed to compensate for the first, largely for political reasons, the financial pressures on the universities *and* our students are enormous and growing. The financial challenges of the universities were discussed earlier in this presentation. We now focus our attention on the financial challenges our students face as a result of the funding decline.

Although we refer to the PASSHE "student" and the effects that 27 years of funding and policy decisions are having on that "student," we actually have many students—from vastly different financial backgrounds—on whom the current tuition rates and financial aid and other policies have quite different consequences.

There has been an enormous shift recently in State and Federal financial aid policy in regard to grants and loans. In the ten-year period between 2000 and 2009, the percentage of grants in a typical financial aid package at Cal U fell from 29% to 21% (-8%) while the percentage of loans in a typical package increased from 61% to 69% (+8%). Basically, PASSHE students are being told that their education is no longer viewed as a <u>public</u> good but a <u>private</u> good. This shift is still one more manifestation that the PASSHE schools are being privatized.

To put the PASSHE financial aid situation into some context, we can look at what our students face on average, compared to what students attending public universities face on average nationally. In the most recent year for which we have data, FY 2009, a typical financial aid package (nationally) consisted of 49% grants and 48% loans. For Cal U students that same year, the breakdown was 72% loans and 19% grants!

In Chart 11, we see the average loan debt for Cal U graduating seniors in FY 2009. Loan debt ranged from about $3,000 on the low end to over $60,000 on the high end, with an average of $22,400, about 25% higher than the average loan debt of graduating seniors nationally.

We have also seen in Cal U financial aid data a large demographic shift in the income distribution of our student families between FY 2000 and FY 2009. The most rapidly *increasing* demographic now for students at Cal U is for family incomes over $100,000/year. That segment increased almost five-fold, from 3.4% of our student population to 15.3% in just ten years. The second most rapidly *increasing* demographic is for family incomes between $70,000 and $99,999. It has increased from 11.2% of our student population to 19.2% in just ten years.

The most rapidly *decreasing* demographic now for Cal U students is for family incomes less than $40,000. It has decreased from 58.2% of our student population to 42.7% in just ten years. The second most rapidly *decreasing* demographic for Cal U students is for family incomes between $40,000 and $69,999.

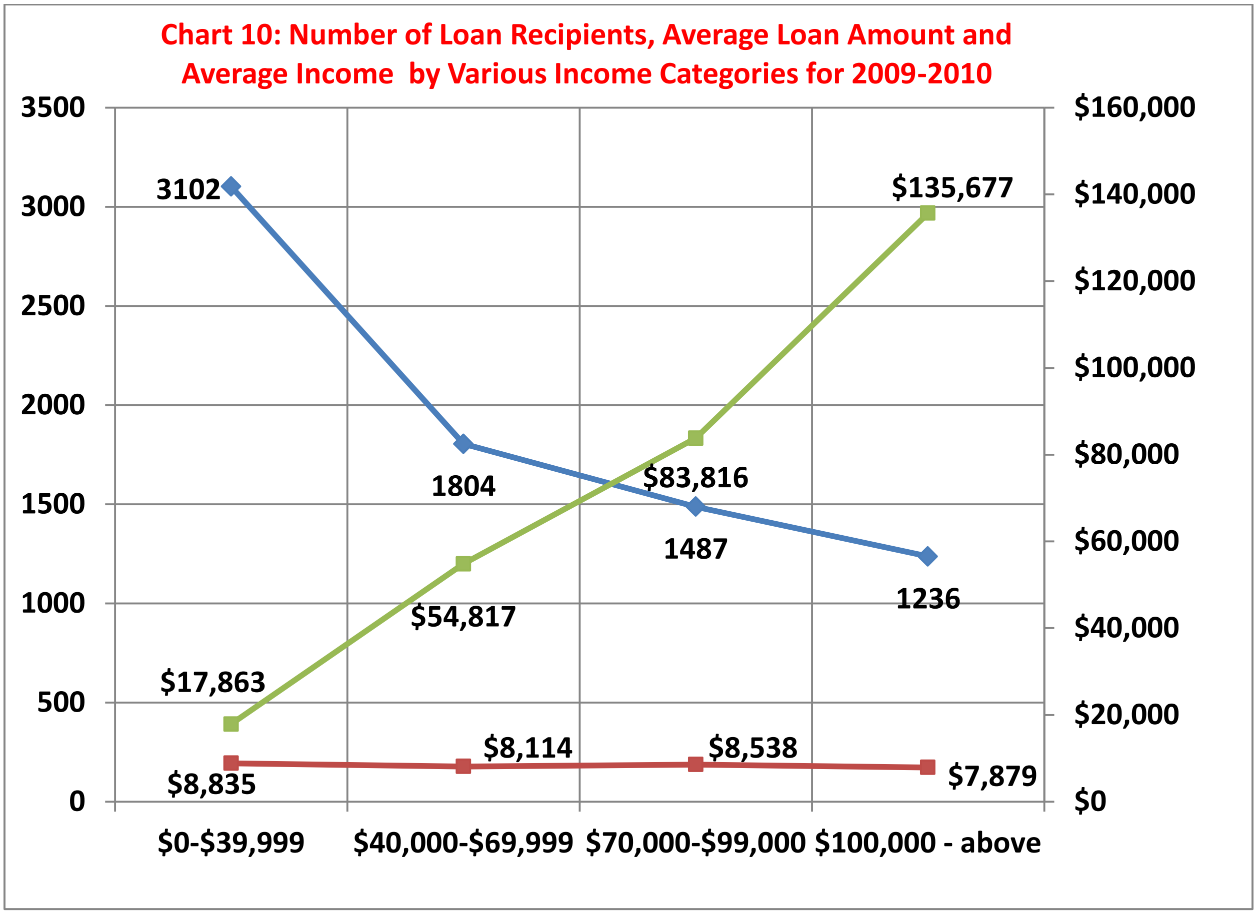


Chart 10. A Comparison of Loan Trends by Various Income Categories. Despite the wide span of family income figures, the average loan amount for Cal U students is, surprisingly, fairly constant over all income ranges.

Although the annual student loan amount for Cal U students—i.e., the average amount borrowed in a given year—is fairly level over all family income ranges, the amount borrowed has a much bigger impact regarding repayment for those families at the low end of the income distribution. For family incomes below $40,000, the average annual amount borrowed represents 32% of the average family income for that year, while for family incomes over $100,000, the annual amount borrowed represents only 7% of family income for that year.

It is clear from the financial aid statistics for Cal U students, as compared to students graduating from four-year public universities nationally, that students attending our PASSHE universities are placed in an unfair position—financially speaking. And yet, under the current PASSHE policy of holding tuition rates low for all students, we are already failing the neediest students who attend our universities. The last part of the PASSHE mission "…at the lowest possible cost to the students" has already become empty words for them, because their education is clearly not being provided at the lowest possible cost to them—witness the almost equal proportion of grants to loans (49% to 48%) for students nationally, while our students receive 72% in loans and only 19% in grants! That fact alone portends mission failure and, as a result, directly validates **Assertion 3**.

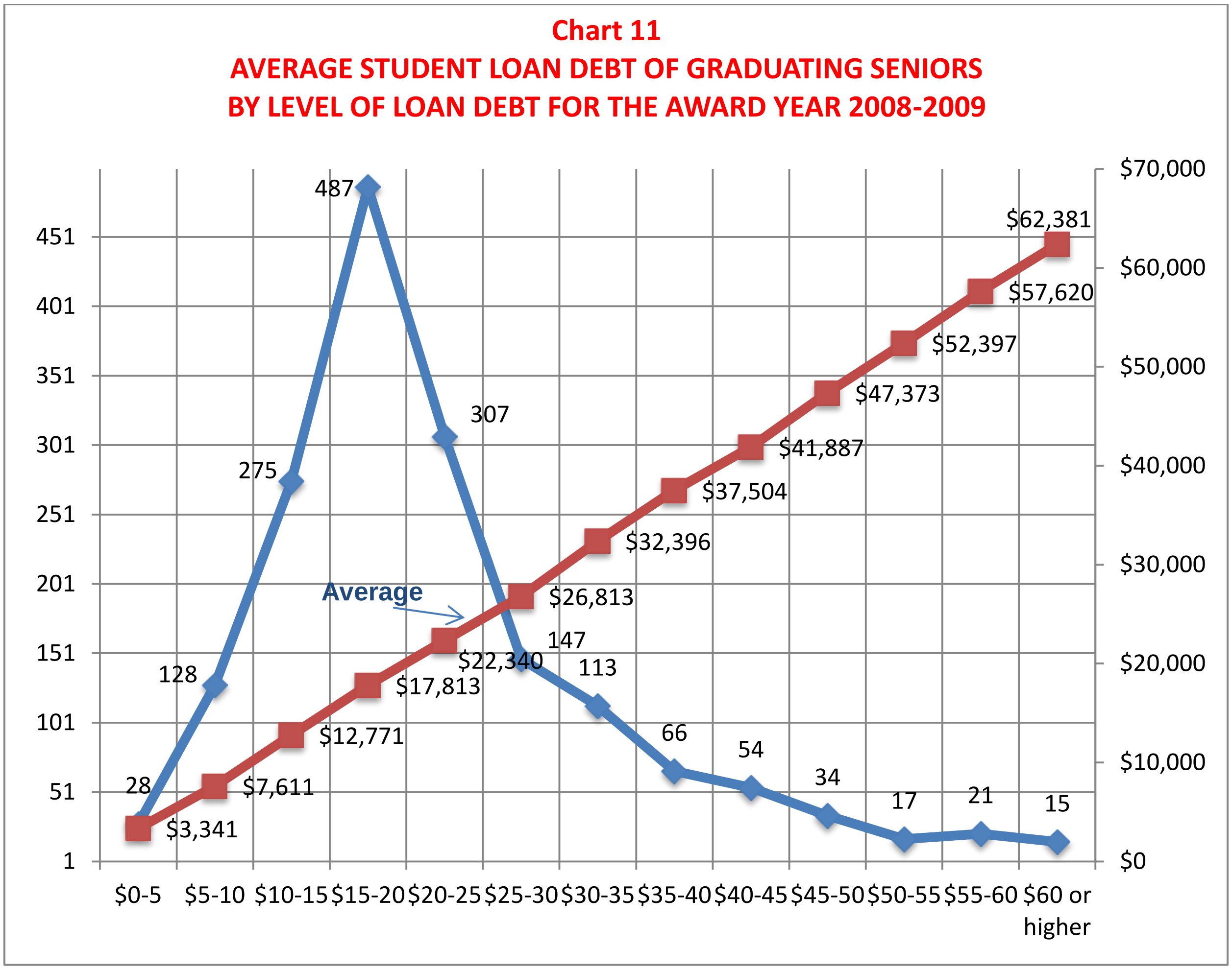


Chart 11. Average Student Loan Debt for Graduating Cal U Seniors in FY 2009.   This chart shows the wide range of total student loan debt for graduating seniors—from about $3,000 on the low end to more than $60,000 on the high end. Most students graduate with debt in the range of $15,000 to $20,000, with the average debt at $22,418.

Conclusion

This presentation began with three troubling assertions which, to my mind, have been clearly validated by very compelling evidence. The obvious next question then would be, what can, or should, we to do about it?   The answer to that question, I think, is fairly obvious.

As it happens, the financial challenges faced by our *universities* and our *students,* although different, are connected by at least two things: tuition rates and the PASSHE mission to provide high quality education at the lowest possible cost to the students.

On the surface it seems that higher tuition rates *and* higher annual tuition rate increases, while helping to keep the universities financially viable and hence able to deliver the first part of the PASSHE mission—"to provide high quality education"—would disadvantage the students by imposing higher costs on them, therefore defeating the second part of the PASSHE mission—"at the lowest possible cost to the students." However, there is a fallacy in that argument based on the false assumption that there is only one kind of student that we deal with.

As Charts 10 and 11 clearly show, there is now a wide and growing range of student family incomes and, despite the fact that students tend to borrow roughly similar amounts each year, independent of family income, the ability to pay those loans back varies greatly from one family to the next. This very disparity in family incomes is the basis for the way in which private colleges and universities, both currently and historically, have always dealt with the income disparity of students—through tuition discounting, or what we might call need-based scholarships. Regardless of what it is called, it is clearly the fairest way in which to proceed.

When we look at the enormous debt that our graduating seniors incur, compared with the much lower debt levels for students nationally, it becomes painfully clear that we are failing the very PASSHE students <u>who are least able to pay</u>. The difference in the ratio of grants to loans for national students (49/48) as opposed to PASSHE students (72/19) cries out for a remedy that would give our neediest students a fair opportunity, rather than a lifetime of loan payments.

<u>The great shift toward greater affluence in the financial demographics of our students means that some affluent Pennsylvania families may be getting an unnecessary subsidy from the Commonwealth under PASSHE's current "Low-Tuition-for-All" policy</u>. For these families, our tuition is clearly *too low*. At the same time Cal U students, as we know, graduate with an *average* student loan debt of $23,418, with some borrowing more than $60,000! For these, our neediest students, our tuition is clearly *too high*. <u>Taken together, it is clear that the current policy is failing at both ends of the financial need spectrum</u>.

The political calculus now speaks in favor of low tuition <u>rates</u> for all families—including affluent ones—while the financial calculus at the universities speaks to the fact that we currently have only two major sources of <u>revenue</u> with which to pay our bills: appropriation and tuition. One source—appropriation—is declining rapidly in real terms. The other—tuition revenue —can only be increased if enrollments grow fast enough to compensate for revenue <u>dollars</u> lost because of below-market tuition <u>rates</u>.

"Market rates" are the norm in every successful enterprise and should be adopted by public higher education if it is to serve all the citizens of the Commonwealth. If rates are too low, the optimal revenue opportunity is missed. Ultimately, such an organization either foolishly shortchanges its stakeholders or fails for lack of operating funds. On the other hand, if rates are too high, the organization loses clients to other providers—assuming they exist—having similar quality but lower costs. Ultimately the organization with rates too-high suffers the same fate as the organization whose rates are too low.

For many years now, PASSHE tuition rates have been kept artificially low with two obvious results: 1) rapidly increasing enrollments—itself a market signal that our tuitions are lower than optimal, and 2) wealthier student families—a signal that our quality is high enough to warrant higher tuition rates.

The most effective and efficient organizations set their rates so as to optimize their revenues. PASSHE's failure to do this has produced tragic if unintended consequences for our revenues, and our students—especially the neediest students who could benefit from a new policy linking market rates of tuition with scholarships for those having the greatest need.

I suggest that PASSHE's "Low-Tuition-for-All" policy be replaced with a "Market-Rate" tuition policy, and that the current policy of providing limited need-based scholarship assistance be expanded and funded by means of those rates, so that the neediest Pennsylvania students can receive larger grants, thereby living up to the second part of the PASSHE mission "…at the lowest possible cost to the students."

The expected higher revenue generated by market-rate tuitions would be sufficient both to preserve the quality and viability of the PASSHE universities themselves by offsetting the loss in state appropriation, and to ensure that Pennsylvania's neediest students secure a high-quality PASSHE university education at the lowest possible cost to them.

I say to every person who believes in public higher education, its mission and its students, that we must do everything in our power to preserve these wonderful institutions—these great places of opportunity that many of us, myself included, have benefitted from. As a first generation college student who received graduate degrees from Temple University, I am grateful for what public higher education did for me so long ago, at a time when it was well funded by the State. I owe my entire career to the education I received there, and it grieves me that young people today are increasingly being denied the same opportunity that I received.

Finally, I would like to salute and thank Chancellor Cavanaugh and my colleague presidents. I know how hard they work, and how much they care. And while we sometimes struggle to deliver the PASSHE mission of providing high quality education at the lowest possible cost to the students, I don't know anyone anywhere who is more committed to achieving that mission than they are.

I thank you for your kind attention.

AA: 13-Oct-2010