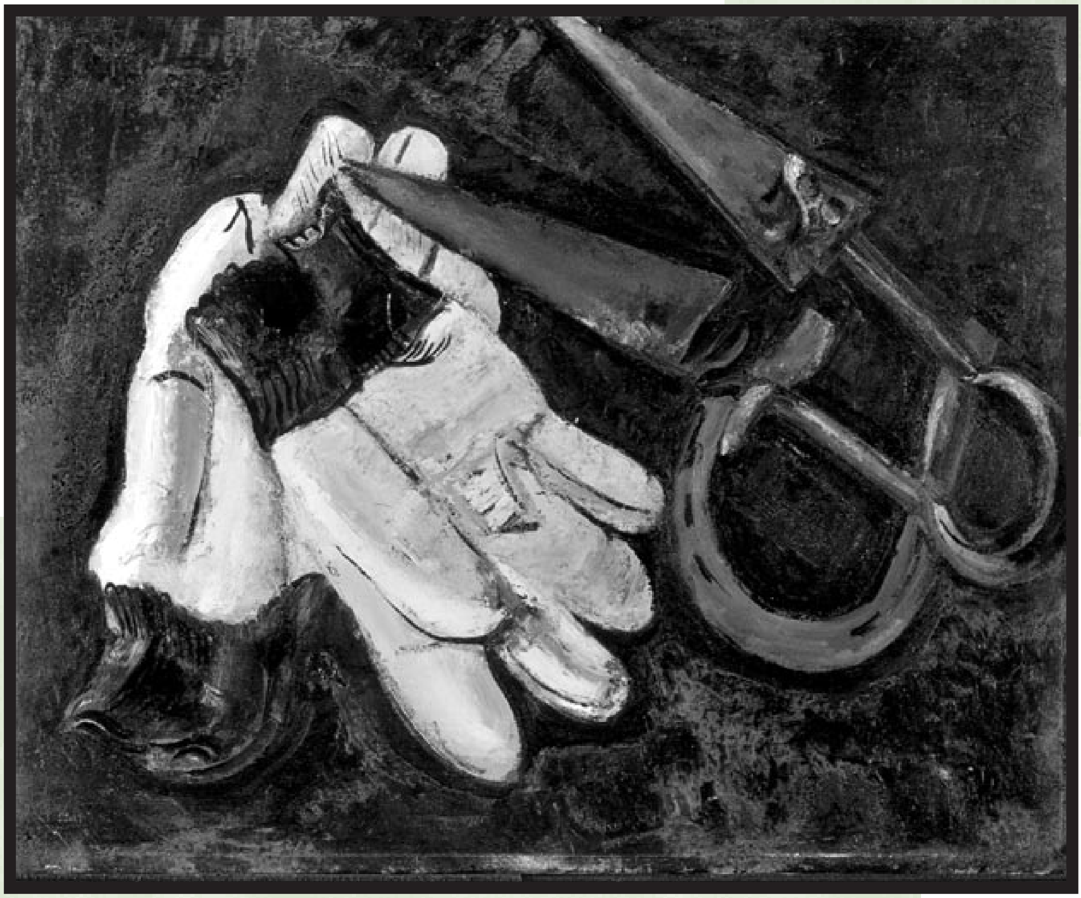
THE NEW DEPRESSION IN



The Ford Policy Forum, under the direction of co-chairs Michael McPherson and Morton O. Schapiro, presidents of Macalester College and Williams College, respectively, identifies emerging economic issues affecting higher education and is designed to develop policy recommendations and initiatives. In early 2001, before recession was a certainty, the focus for the fall symposium of the Ford Policy Forum was narrowed to the possible effects of the anticipated depression in higher education. As we know too well today, that prediction has come to be. After a 10-year run, the longest expansion in the history of the American economy ended in early 2001. Higher education now faces a very different environment than that which prevailed in the mid to late 1990s.

"Gardener's Gloves and Shears," Marsden Hartley. The Phillips Collection, Washington, DC

Higher Education

Local, State, and National Views

At the Ford Policy Forum's 2001 symposium, attendees discussed the myriad effects of a recession on colleges and universities, as well as the courses of action those institutions might consider—both in preparation for an economic downturn and in reaction to the current environment. History played an important role in the deliberations, and the recessions of the early 1980s and early 1990s were studied to glean insights into how campus leaders might best cope with the effects of today's recession.

Three perspectives were brought to bear on the issues: first, Craig Aase and Gary Krueger, chief financial officer and economics professor, respectively, at Macalester College, offered a case study of how their campus engaged in a budget and planning exercise to prepare for an institutional response to a recession should one occur. Second, Patrick Callan, president of the National Center for Public Policy and Higher Education, assessed the ramifications of recession from the state level. Given that primary responsibility for education in the United States lies with each of the 50 states, the effect of state budgeting policies and priorities on higher education is profound. Finally, Clayton Spencer, associate vice president for higher education policy at Harvard University, discussed the national political context in which higher education must compete for diminishing revenues and attention in a time of recession and extremely limited focus on domestic issues other than homeland security and the economy.

Presidential Perspectives

We have studied the economics of higher education for many years and have collaborated on much of our research and writing. We began our careers as economists, and our work reflects that perspective. Now, however, we are presidents, not professors, and thus we have a different vantage point from which to consider institutional and economic issues.

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Expenses

In the past, writing as economists, we criticized the prevailing institutional response to the recessions of the early 1980s and early 1990s, namely, to defer maintenance and cut library expenditures. Across the board—public and private institutions, liberal arts colleges, comprehensive universities, and research universities—the components of the operating budget that bore the brunt of those recessions were operations and maintenance and the library. We saw those cuts as the easy way out; despite their long-term consequences, they were unlikely to generate an uproar on campus—unlike faculty salary freezes, staff layoffs, or cutbacks in instruction. Today, as college presidents, we see the merits of this approach, particularly if it is backed by a sound long-range plan such as that undertaken at Macalester. The political value, too, of warding off faculty and student protests should not be underestimated. Depending on the president's agenda for the institution, it may be important to preserve political capital to accomplish other, broader goals, such as refocusing on a core curriculum or encouraging new forms of pedagogy.

In terms of the capital budget, the recession of the early 1990s was reflected by a striking, precipitous decline in capital expenditures. Once again, we opined that cutting the capital budget was an easy way out. In retrospect, though—and with our more recent perspective as college presidents—it could be that a short-term drop in the capital budget was the right course of action. Campus building did, indeed, resurge following the drought of the early 1990s.

Revenues

By far, the single revenue source most adversely affected by prior recessions has been state operating subsidies. The states today are in terrible shape, with a cumulative budgetary shortfall measured early in 2002 of approximately $50 billion. Based on total expected state revenues of $500 billion, the shortfall is 10 percent. Clearly, the most vulnerable institutions are state colleges and universities, where budget cuts are already wreaking havoc. Public institutions have privatized to some extent in that their tuition revenues have risen from an average of 15 percent since the mid-1980s to 25 percent of total revenues today. However, 25 percent is still quite low compared with the more typical 70 to 75 percent of total revenues that tuition represents for many private colleges and some universities. Presidents of public institutions face an enormous and difficult task in periods of recession. James Duderstadt, president of the University of Michigan during that state's difficult economic times from the mid-1980s to the mid-1990s, summed up the situation well when he said that while he was president, the University of Michigan went from being state supported, to state assisted, and finally to state located as Michigan's tuition dependency increased dramatically.

To make matters worse, although it wasn't of great significance during times of tremendous economic growth, the percentage of state appropriations spent on higher education has declined over the last decade as infrastructure, health care, prisons, and K–12 have gained. With a shrinking pie, the smaller percentage translates to cuts in appropriations.

Additional revenue sources affected by recession are annual giving and endowments. The evidence indicates that philanthropy declines during recessions, and certainly colleges and universities experienced a significant decline after September 11 compared with other non-profit organizations, at least for a couple months. In this climate, presidents need to consider questions such as whether to delay campaigns or to increase their endowment spending rates. Another revenue source is government grants and contracts, which for research universities represent 20 and 30 percent of total revenues for public and private institutions, respectively. Despite the heavy lobbying and often loud complaining, the data show that federal grants and contracts are not very much affected by the business cycle. Thus, we expect that this source of revenues for most research universities will not be seriously affected.

Tuition

The significance of tuition should not be underestimated. For private institutions, tuition is the key to managing revenues. Fifty-five percent of all revenue at the average private research university comes from tuition; at the average private liberal arts college, that figure is 75 percent. Tuition revenues depend on three factors: the number of students, the sticker price, and institutional discounts off that sticker price.

As for numbers, the demographics bode well. The dramatic overall increase in college enrollment expected over the next several years, however, obscures regional differences. In California, for example, the growth from 2000 to 2010 in the number of high school graduates is expected to be 22 percent, in Massachusetts, 11 percent, whereas in Ohio, growth is projected to be flat, or zero percent. The numbers are affected by the enrollment rate as well, which at this point is roughly 67 percent—two-thirds of high school graduates enroll in some college or university within 12 months of graduating from high school. Economists and other observers expect that this rate will not be greatly affected by the recession, even if it turns out to be deeper and more prolonged than most people now anticipate. This view is based on the fact that the economic return to college attendance is at record levels now, and the opportunity costs of attending college

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have declined because well-paying jobs are scarcer for high school graduates.

With regard to sticker price, recessions exert downward pressure from the public as incomes shrink and upward pressure from within the institution as other revenue sources decline. For expensive, selective institutions with unmet demand—that is, long lines of students trying to get in—sticker price generally is keyed to the income levels of the top 5 percent of the population, beginning at about $155,000, above which students usually do not qualify for need-based aid. During the early 1980s and early 1990s recessions, this group fared relatively well—since 1980 the percentage of real disposable income allocated to higher education by the top 5 percent group has not changed significantly. Thus, we do not believe that sticker price is going to be significantly affected by recession, at least for selective institutions.

What will be affected is the neediness of the students. As neediness rises, the discount between sticker price and net tuition revenues rises as well. Many institutions attempt to ameliorate their discount through the strategic award of aid packages and at the same time compete for top students with merit aid. The combination of these strategies heightens the tension between need-based and merit aid. This tension and how presidents and institutions address it will be one of the primary and fundamental issues arising from the effects of a recession in higher education. Where they are still practiced, need-blind admissions and full funding of need are cherished values. The commitment to these values among alumni, faculty, students, and staff often runs deep; as a result, it can be quite painful when financial exigencies force the consideration of alternative approaches to admissions and financial aid.

CONCLUSION

Our attempt to help guide institutions through the current recession shouldn't be interpreted to mean that we're predicting a long and deep recession. We can't predict the business cycle. We do urge, though, that if a period of stringency is expected, campus leaders prepare for it.

First, we suggest that you do everything you can to anticipate challenges by preparing estimates of likely impacts on your institution and by devoting serious thought to contingency plans based on various scenarios. Second, educating your community is key. Talks with faculty and staff groups about possible scenarios can be enormously valuable, both to mobilize community resources to find solutions and to cultivate buy-in for the direction that is ultimately chosen. Finally, we believe that minimal budget cuts year after year are demoralizing and bad for the institution. If possible, target a reduction in the base budget that you believe will be adequate to allow you to return to a growth pattern. In that way, the institution absorbs the financial blow early on and can begin to move forward in a positive way as soon as is realistically possible. Without question, these steps are easier said than done, but they should help your institution successfully weather the new depression in higher education.

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