**Higher Education**

**Original Article**
The entire original chapter can be found at http://tax.i2i.org/files/2010/11/CB_HigherEd.pdf.

**Overview**
The chapter provides analysis and recommendations about state colleges and universities. It is the second time the topic has been addressed in a Citizen’s Budget.

**Savings**
Total Recommended Savings = $50+ million

**Findings**
We find that the College Opportunity Fund program should be retained because it forms an excellent base on which to build changes. It must be expanded and modified to conform to the real needs.

After a review of how state colleges and universities are operated as independent government enterprises, we conclude that the situation should be extended and made permanent. We address what the real reform would entail and urge reform that does not involve changing ownership to a form of private holdings.

We urge that the institutions reform themselves by initiating audits regarding teaching productivity, and thereby lead the nation in reducing low-priority publication in favor of more direct instruction. We know that the standings of highly-rated institutions, dependent on research dollars, should not be called into question.

**Discussion**
As elected officials grapple with the determination of the best set of priorities for citizens, they must address a fundamental understanding about higher education. Is the system primarily for society’s benefit? If so, then ever higher amounts of support will be justified and students should understand that completing their educations implies that they owe some return to the government. If on the other hand, furthering one’s education is done primarily so that an individual can improve his understanding of the world and his professional production, then subsidy can be justified only for those for whom higher education is otherwise unattainable. The general justification for college subsidies is that successful pursuit of a degree can lift an individual out of perpetual poverty. Is higher education primarily for society’s benefit, or for the individual’s benefit?

**Funding Adequacy**
Critics argue that higher education is underfunded, especially in Colorado, and that the state should allocate more subsidies to higher education.

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**Recommendations/Savings**

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<tr>
<th>Recommendation</th>
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<tr>
<td>• Complete the transition to subsidies through stipends, ending the practice of the State paying fees directly to the institutions</td>
<td>$50+ million</td>
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<tr>
<td>• Expand the stipend program to use at all private, accredited colleges and universities</td>
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<td>• Increase productivity of all faculty</td>
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Colorado’s legislators have allowed colleges and universities to increase tuition to offset the budget cuts in periods of recession. In periods of growth legislators have provided more generous funding for higher education.

There have been efforts to raise taxes earmarked for higher education. In 2008, Initiative 119 would have earmarked severance tax revenues for higher education; but the initiative was withdrawn by the sponsor prior to hearing. Amendment S8, which also earmarked severance tax revenue for higher education, made it to the ballot box, but was rejected by the voters. Amendment S9 would have earmarked TABOR surplus revenue for higher education, and was also defeated at the ballot box. Voters passed a citizen initiative, Amendment S0, earmarking gaming tax revenue for community colleges. House Bill 09-1272 was passed to implement Amendment S0, allocates a modest amount of gaming revenues to the community college system.5

Solving a structural deficit requires fundamental reforms to stabilize higher education funding, and balance the state budget without federal handouts and federal unfunded mandates.

**College Opportunity Fund: Already Begun**

As the funding crisis in Colorado’s higher education system emerged in the early part of this decade, elected officials began to search for alternative ways to fund higher education.4 In 2004 the legislature enacted the College Opportunity Fund (COF). This Fund created a voucher system to replace some direct funding to public higher education institutions. The vouchers, referred to as stipends, were set at $2,400 per year per full-time student to be used to offset tuition. Vouchers were to be portable among Colorado’s public higher education institutions and some private institutions.5

Block grants in the form of direct funding contracts for specific purposes were provided to each institution reflecting their different mission statements. These included graduate-level education, specialized education services, and professional degrees. Performance contracts are negotiated between the administrations in higher education institutions and the Department of Higher Education (DHE).6

Because the vouchers replaced some direct funding to institutions of higher education, the share of state general funds allocated to some institutions fell below 10 percent of their total funding. This change allowed these institutions to acquire enterprise status, which made them exempt from the Taxpayer’s Bill of Rights (TABOR) restrictions. Most importantly, these institutions could raise tuition without triggering the TABOR limit on state revenue and spending. Thus, higher education institutions could raise tuition without requiring cuts in other state programs. The institutions with enterprise status also had greater flexibility in issuing debt. The *quid pro quo* of enterprise status is what motivated administrators in higher education to support the COF plan.

The COF legislation included specific language that vouchers were designed to make college more affordable to low-income students. In this regard COF has not fulfilled expectations. In the same year that COF became effective, 2005-06, institutions raised tuition significantly. Average tuition for full-time students, after deducting the value of the COF voucher, increased $507 (23.5 percent) at community colleges, and $545 (13.3 percent) at four-year institutions. Much of the benefit of COF has been captured by institutions rather than students.7 Across the nation, public subsidies to higher education have increased very rapidly in
Policy changes to Make a Difference

on General Fund appropriations to higher education. The money for COF vouchers and direct funding contracts for special purposes is reported separately from state appropriations to higher education. Adding that money to state higher education appropriations, Colorado compares more favorably with other states. Further, economists measuring the efficiency of higher education have found that Colorado ranks significantly above the national average, and above other states in the region. A measure of efficiency takes a ratio of the index for graduation rates divided by an index for total higher education revenues per FTE. This is a comprehensive measure because it compares graduation rates with total education resources per FTE. While higher education efficiency in Colorado is about equal to the national average using this measure, it falls below three other states in the region.

Why Has the COF Plan Not Fulfilled Expectations?

Our analysis suggests that while Colorado has a relatively efficient higher education system, room for improvement certainly remains for other measures of performance. Particularly troubling is the evidence of deterioration over the past two decades in measures of access and affordability. The voucher plan has not fulfilled many of the expectations of the higher education system when the plan was enacted. The question is why the voucher plan has not been successful in fulfilling these expectations.

The Western Interstate Commission for Higher Education report explains that vouchers were combined with service contract funding so as to protect the revenue and budgets of higher education institutions. Service contract funding undermines incentive effects of the voucher plan. DHE provides estimates of enrollments that then are used to determine voucher funding each year. When these projections underestimate the use of vouchers, the state covers

recent years; and, recent research suggests that much of this public subsidy has been captured by professors, administrators, and other stakeholders in higher education. There has been a virtual explosion of recent studies critical of the rising cost and diminished quality of public higher education.

With few exceptions, financial aid has not kept pace with published tuition in most states, including Colorado. As a result, net tuition has been increasing more rapidly than published tuition.

The Level of Public Support for Higher Education

Much of the criticism of Colorado’s higher education system is the low level of state and local government support. There is an important qualification to this evidence regarding state and local funding for higher education in Colorado. The observations are based

Figure 1. Average Published Tuition & Fees at COF-Eligible Public Institutions by Sector, 2000-01 to 2008-09

Note: Data reflect the student share of published in-state tuition after applying the COF stipend.
any shortfall from the fee-for-service fund. Money is redistributed from service contract funding to voucher funding so as to leave total state funding to that institution unchanged. Thus, enrollment growth is not actually funded by the state, and institutions have no incentive to increase enrollment. There is no incentive in this funding policy to induce institutions to compete for any students, let alone in-state students or underrepresented populations.

The Western Interstate Commission for Higher Education found that even though the state designed performance contracts for each institution, no penalties or rewards for performance were established. No rewards were created to attract more students, to attract in-state students, or to target underrepresented populations. No penalties were adopted for students who failed to progress or graduate in a timely manner. The performance contracts became another bureaucratic requirement, without impacting decision-making. The result was business as usual in higher education institutions. Universities also correctly anticipated that service contracts combined with the voucher plan would leave their revenues and budgets unharmed. Community colleges that attracted more students did not receive the additional promised voucher money. Some universities that failed to attract the projected number of voucher students nonetheless received the voucher funding for those missing students.

The amount of voucher revenue received by private higher education institutions was a little more than $1 million, equal to a miniscule 0.3 percent of total voucher funds. Therefore, it is not surprising that voucher funding to private institutions has created little competition for public college and universities.

Eligibility limitations on where vouchers can be cashed are too restricted. The legal monopoly held by public colleges and universities will not be broken by the small numbers of students and limited funding impacted by vouchers at two private universities. As long as these constraints are imposed, one should not expect much incentive effect from vouchers through increased competition in the higher education system.

A NEW STIPEND PLAN

Funds currently allocated to higher education from the General Fund, and service contract funding, would be used to fund the stipend plan. Stipends would be extended to students attending all qualified postsecondary institutions, including for-profit as well as nonprofit institutions. The stipend plan would be phased in over five years to give higher education institutions time to adjust to the new system.

A goal of the stipend plan is to create competition among all qualified postsecondary institutions. This stipend-based higher education system would create incentives for these institutions to deliver quality education at lower cost. Replacing the current system of direct state funding to higher education institutions with a stipend plan funding students and families will generate public support, and reverse the downward trend in state support for higher education.

Reservations regarding state funding for higher education are not new. Half a century ago Milton Friedman challenged the rationale for government subsidies to higher education based on ‘social benefits.’ Friedman pointed to potential negative social impacts from public subsidies to higher education. One of those impacts is certainly evident in current government subsidies to higher education, increased government regulation and intervention in higher education.

As Friedman observed, many of the presumed benefits of higher education to a democratic society are difficult to measure,
for many hours in addition to the minimum to earn a degree? Two strong, opposing arguments present themselves:

1. Citizens have already paid the taxes used to fund stipends. To argue that some families who are eligible should receive smaller stipends in order to subsidize other students with higher stipends is an implicit tax. Stipends should be set at the same level for all students eligible for the stipends. The stipend plan should not be used to redistribute income from one Colorado family to another.

2. Our nation is at risk now due to unsustainable entitlement spending. A universal college stipend would entitle a resident to government funds merely by being a resident. To avoid creating yet another broad entitlement program, stipends should be means-tested. Experience shows that entitlements tend to grow over time, and are very difficult to cut during periods of budget pressure. Therefore the legislature will lose even more control over the budget. Finally, some people choose never to pursue a college degree; universal stipends would redistribute income from these people to other people.

For the time being, it is not necessary to resolve this debate in order to start improving Colorado’s stipend system.

A New Stipend Plan for Higher Education

As this chapter has detailed, the flaw is not in stipends per se, but rather in the way in which the COF plan was designed and implemented. We propose a new stipend plan to replace the COF plan, to be implemented over a five-year period. Several provisions in the proposed stipend plan would correct flaws in the COF plan.

Stipends Replace All Direct State Funding to Higher Education

Stipends would replace all direct funding to public higher education institutions. Funds currently allocated directly from the General Fund to these institutions would be allocated instead to the stipend plan. The 2010 Independence Institute paper by Barry Poulson, “Colorado’s College Opportunity Fund: A Critical Appraisal”17 details how to manage a five-year transition period.

The goal should be a stipend voucher system to create competition
among all institutions of higher education. Students should be eligible to apply stipends toward tuition at all postsecondary institutions in the state, including public, private for-profit, and non-profit private institutions. We should then expect improved outcomes from wider incentives as COF is fully enacted.

**Stipends and the Flagship Institutions**

The University of Colorado and Colorado State Systems would no longer receive direct funding from the state. Their students would continue to receive funding in the form of stipends.

These flagship institutions receive “enterprise” status as long as direct state funding is below 10 percent of the institutions’ total budgets. With enterprise status they have had greater flexibility in raising tuition and in issuing debt. They have had greater freedom to design academic programs in response to market forces. These institutions can offset the loss of direct state funding by improving efficiency. While the evidence suggests they have not always taken advantage of this freedom, a stipend system will create more incentives to implement reforms.

The economics literature suggests that in a more competitive environment, in which funding is provided through stipends rather than through direct funding, the flagship institutions of higher education will be the most competitive.18 We can predict that these institutions will increase tuition more rapidly than other public institutions. Further, the tuition of flagship institutions will tend to converge with the tuition at private colleges and universities. In turn, this convergence will create greater calls for merit and need-based scholarships. The flagship institutions will continue to attract students even with higher tuitions, because of the higher quality of their undergraduate programs. The higher tuition revenues will enable the flagship institutions to provide better quality undergraduate education, using tuition revenues to offset the loss in direct funding. The current differential in tuition between private and public colleges and universities would decline.19

The flagship institutions already have adjusted tuitions to target disadvantaged students. Colorado State University funds families with incomes below the poverty line at half tuition; and students eligible for PELL grants pay no tuition. Expect these institutions to continue to target disadvantaged students, even without direct funding from the state.

While the flagship institutions would have five years to adapt to a full stipend system, some of their programs could adjust immediately. Because COF voucher funding is not available to fund graduate programs, the graduate programs in Medicine, Law, Engineering, and Business should immediately begin funding themselves entirely from tuition, and, of course, from donations provided by alumni, corporations, and foundations. Students in the graduate programs capture the benefits of their graduate degree in higher lifetime earnings. Tuition charges for these graduate programs already have been adjusted to reflect their greater cost, but graduate program rates would likely increase to closer to the full cost of the programs. This increase would not preclude graduate students from continuing to receive financial support from sources other than state funding.

At the other end of the spectrum are the institutions’ undergraduate, such as Arts and Sciences, which depend heavily on public subsidy. Some have argued that CU and CSU shortchange undergraduate programs in order to fund expensive graduate programs and to pursue other agendas. To the extent this argument is true, it will be

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more difficult for the undergraduate programs to compete in a stipend system, and they will likely need more time to adjust.

Some other public higher education institutions could adapt quickly to a stipend system. The Colorado School of Mines already has received enterprise status with a great deal of autonomy from state regulations. It shares some of the characteristics of the flagship institutions, such as a reputation for quality undergraduate programs that attract students. The School of Mines also could raise tuition and continue to attract students.

State support has enabled other public higher education institutions to set tuition levels below that at flagship institutions, and well below tuition levels at private institutions. Students are attracted to these other public institutions by the low cost, even when they receive an inferior quality of education. The other institutions may raise tuition, but not to the extent of flagship institutions. It is more difficult for the other public institutions to raise tuition to offset the loss of direct funding. They are more likely to expand enrollments to sustain revenues.

A stipend system may change the composition of enrollments within public higher education. If flagship institutions increase tuition more rapidly than other public higher education institutions, it could result in an expansion of enrollments at community colleges and other public institutions relative to enrollments at flagship institutions. Such a shift would not be a bad option from an economic standpoint, because the cost of educating students at the other public higher education institutions tends to be significantly lower than at flagship institutions.20

Other public higher education institutions also should have greater freedom to design academic programs in response to market forces. These institutions can offset the loss of direct state funding by improving efficiency.

The response of low-income students to the tuition changes under a stipend system is predicted to be far greater than that for middle- and higher-income students. Thus, an important result of this stipend system would be to expand postsecondary education to a broader group of students, including low-income students.21

With expansion of the stipend system to all postsecondary institutions the incentive effects of stipends will lead to more efficient delivery of education services. Students will be able to make more rational choices in postsecondary education based on the quality of education relative to price. Their decisions will not be biased by the ability to capture subsidy at public institutions but not private institutions. In order to attract students all postsecondary institutions will need to enact reforms to deliver better quality education at lower cost.

Reforming Public Higher Education

The new system of postsecondary education will drive public institutions that have depended on direct subsidies as well as stipends to enact reforms to compete with their private counterparts. Each public institution should be allowed to design the reforms; the last thing the state should do is be prescriptive. However, a number of reforms have proven to be successful when public higher education institutions are subject to greater competition. The following is not a prescription, but rather a menu of potential reforms institutions should consider. Some of the reforms already have been enacted in Colorado public higher education institutions, but the imperative for reform will be greater with a full stipend system.
Improve productivity

Almost all college and university teachers are hired with the explicit expectation to do more work than just give lectures. As used in this section, “teacher” is a generic term that is meant to include all tenured and tenure-track faculty at all levels. Professors, associate professors, lecturers, and some instructors all fall within this definition.

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If the experience on only one campus is correct, a formal change at all the state institutions of higher education would improve productivity by 15 to 20 percent and would save between $50 million and $67 million per year in faculty salaries. The steps to accomplish these savings are likely to be different for each level of institution. The Board of Regents, for example, could alter the University of Colorado system, while statutory change might be necessary for state colleges.

For many decades, expectations placed upon college teachers were stable. The former rule of thumb was that professors taught 15 credit-hours per semester. But more recently, the accepted guidelines for faculty employment have been eroded. The current rule of thumb for time distribution is that 40 percent goes to instruction, 30 percent for service (which is usually poorly defined or not defined at all), and 30 percent (internally-funded) research.

Research is an integral and central aspect of an academic career, and nothing in this section would suggest otherwise. It becomes more central to the job description, the closer a teacher moves from the community college system to the flagship research universities. An important distinction emerges as we look closer at the way research is initiated and paid for. The “internally-funded” research is part and parcel of the salary paid to have the teacher on campus. It manifests itself in staying current on developments within the individual’s field of study, in writing, and in collaborating and reviewing others’ works.

The second type is the externally-funded research. In that circumstance, the contract brings in new funding to finance the many resources that might be required. Beyond covering materials and research assistants, it includes a salary for the teacher that is meant to fund the portion of the time the professor otherwise would be engaged in instruction and internal research. We urge that the legislature and the Department of Higher Education do nothing to interfere or impact externally funded research performed by those faculty members. Compute the productivity measures after removing the externally funded research from the equation.

Freedom to Set Tuition Rates

All postsecondary institutions should have the freedom to set their own tuition rates. Economic research predicts a convergence of tuitions when all public funding is provided to students through stipends rather than allocated directly to public institutions. Tuition at public institutions will tend to rise, while at private institutions it will tend to fall.

All postsecondary institutions, including public colleges and universities, should set tuitions to reflect supply and demand. Thus, the more costly programs, in business and engineering, should have higher tuition charges than other programs, such as Arts and Sciences. The net effect will be for students to use their stipends more efficiently.

As noted earlier in this study some public institutions have adjusted tuition levels to reflect family income, and they should have the freedom to do so in a privatized system. Privatizing postsecondary education will open up more opportunities for low-income families to have access to vouchers they can use at private as well as public institutions. These students will continue to be eligible for other means-
Create Incentives for Higher Education to Provided High Quality Education at Lower Cost

Reform will create incentives for institutions to engage in entrepreneurial activities to generate other sources of revenue, including research grants, private donations, and ancillary activities. Given the limited resources that likely will be available from the state for the foreseeable future, higher education institutions must look for other sources of revenue. Some of the institutions with less than 10 percent funding from the state are already well on their way toward privatization. With enterprise status these institutions should be free to aggressively pursue other sources of revenue, without constraints or interference from the state.

More efficient utilization of facilities, improved management of assets, and reallocation of resources to academic activities from non-academic activities such as sports, recreation, food, and housing, would generate net income. Other innovation would make better use of new technologies in teaching and administration, increase the ease with which students can transfer between institutions, and create incentives for students to complete a degree in a timely manner. If stipends would not be available to fund tuition costs of remedial courses, demand would grow for high school students to obtain at least a valid diploma, and opportunities would grow to take an accelerated college preparation program.

Acknowledgements

Barry W. Poulson, Ph.D. was primarily responsible for the content of this chapter. Dr. Poulson is retired Professor of Economics at the University of Colorado. He has been a Visiting Professor at universities in Mexico, United Kingdom, Japan and Spain.

He is the author of numerous books and articles in the fields of economic development and economic history. His current research focuses on fiscal policies and fiscal constitutions. Professor Poulson is currently Americans for Prosperity Foundation’s Distinguished Scholar. His studies and articles for AFPF include research and analysis of the Taxpayer’s Bill of Rights.

He has served on the Colorado Tax Commission and as Vice Chair of the State Treasurer’s Advisory Group on Constitutional Amendments in Colorado. Professor Poulson is Past President of the North American Economics and Finance Association. He is an Adjunct Scholar of the Heritage Foundation, advises the Task Force on Tax and Fiscal Policy of the American Legislative Exchange Council and serves as a consultant on fiscal policy and fiscal constitutions to a number of state and national think tanks, including Colorado’s Independence Institute.

Endnotes

3 Colorado House Bill 09-1272, 67th General Assembly, 1st regular session, 2009.
5 Ibid.
7 Ibid.
11 Western Interstate Commission on Higher Education, COF Status Report FY 07-08.
13 Ibid.


18 Poulson, Reforming Higher Education in Colorado.

19 Ibid.

20 Ibid.

21 Ibid.

22 Information collected in 2010 from Metro State College. With permission from the Associate Vice President of Communications and Advancement, Catherine Lucas, we obtained from Ellen Boswell at Metro State’s Institutional Research Office average classroom hours worked by teachers. See the 2010 edition of the Citizens’ Budget for a full analysis and discussion of the findings.