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A Moderate Alternative to Free College

**PROMOTING COLLEGE AFFORDABILITY
THROUGH A FLEXIBLE MATCHING GRANT**

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Introduction

Higher education is a key driver of economic mobility in the United States. The ballooning cost of college, however, has placed a postsecondary degree increasingly out of reach—particularly for low- and middle-income students. Net prices for tuition, fees, room, and board (TFRB) have grown steadily at public four-year schools, rising 20% since the 2007-2008 academic year, after adjusting for inflation.¹ These rising prices have contributed to soaring levels of student loan debt. Indeed, the size of the federal student loan portfolio has nearly tripled over the same time period, from \$642 billion to \$1.6 trillion in real terms.²

Rising prices in higher education have several causes, but one clear driver is declining state investment in higher education. States used to bear principal responsibility for financing higher education, but state tax cuts, competing priorities, and the compounding impact of recessions on state finances have all eroded state support. Facing shortfalls, colleges and universities hiked tuition to fill the gap, leading students to lean on the federal student loan system to cover the increased cost of attendance.

Some tout free college as a solution to these challenges, but having taxpayers foot the bill for eliminating tuition would fail to adequately address the rising cost of college and continue to leave the system vulnerable to shortfalls during a recession. Rather than a one-size-fits-all model, a flexible matching grant that focuses on affordability and rewards a state's commitment to higher education is a more sustainable approach. This framework would ensure durable investments in higher education that benefit students directly, while also preserving state discretion.

State Funding Challenges Have Consequences for Students and Taxpayers

Historically, states were the primary financiers of public higher education, with the federal government supplying federal student aid in the form of grants and loans to fill funding gaps. Over time, however, states have struggled to maintain consistent funding for higher education, leading institutions to rely more heavily on tuition revenue, driving up tuition prices and thereby increasing student reliance on federal loans.

State support for higher education flows to public university systems in the form of annual or biennial appropriations. Students also receive direct support from states through grant aid that can usually be used at public or private institutions, with states determining eligibility based on need, merit, or some combination thereof.

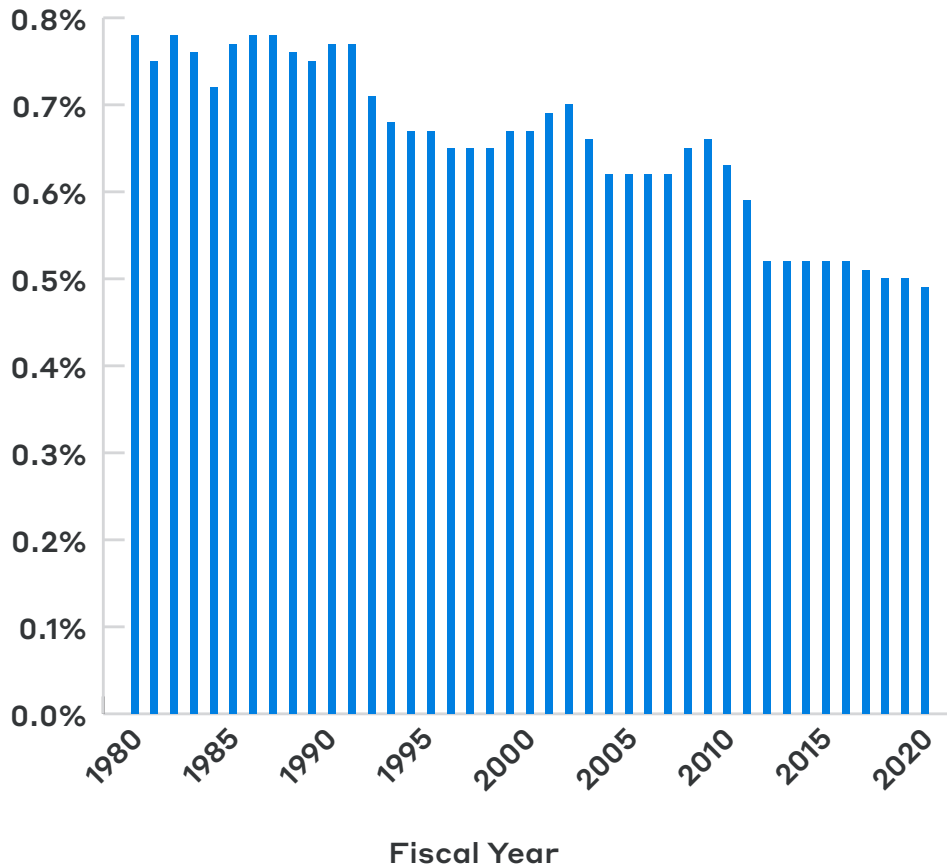
State appropriations remain a major source of revenue for public university systems, accounting for 51% of total institutional revenues available for instruction, but this support has not kept pace in recent years.^{a,3} State appropriations declined in real terms from \$8,817 per full-time equivalent (FTE) student in fiscal year 2000 to \$7,805 in 2020.^{b,4} These figures still fail to tell the full story, however, as personal income—and therefore tax revenue—have increased over time, as has the cost of higher education. As a percentage of personal income, state funding for public higher education has fallen by nearly 30% since 1980 (**Figure 1**).

This long-term trend is partially the result of state tax cuts, as well as the reality that most states face balanced budget requirements.⁵ Higher education is a particularly vulnerable line item in state budgets because institutions have an alternative source of revenue to turn to: tuition. Therefore, when states face competing priorities, higher education tends to get squeezed. Research suggests that increased spending on Medicaid and administrative expenses associated with Supplemental Security Income, Temporary Assistance for Needy Families, and the Supplemental Nutritional Assistance Program account for more than half of the overall decline in higher education funding.⁶

a State appropriations do not include direct operations of research, agriculture, public health care services, and medical schools. They also exclude any federal stimulus.

b FTE is the standard in higher education finance analysis.

Figure 1: State Fiscal Support for Higher Education as a Percentage of Personal Income



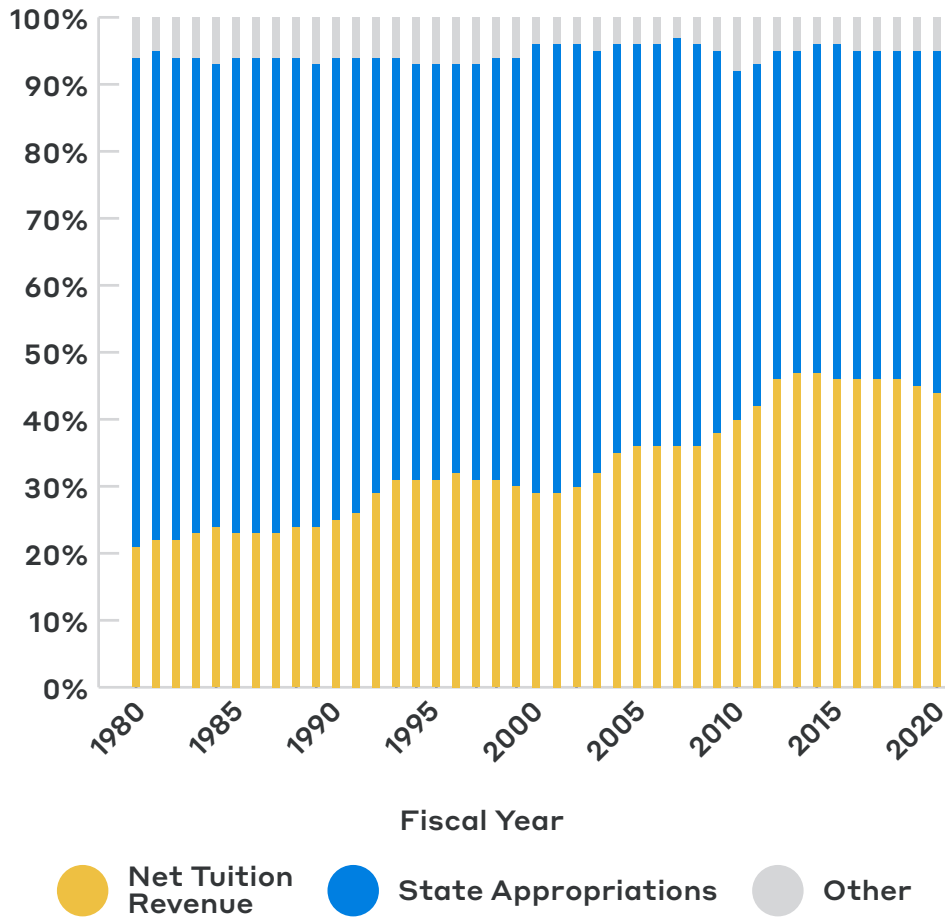
Sources: State Higher Education Executive Officers Association, State Higher Education Finance: FY 2020, 2021; Bureau of Economic Analysis, 2021.

DECLINING APPROPRIATIONS CONTRIBUTE TO RISING STUDENT LOAN DEBT

When state funding for higher education falls, institutions must increasingly rely on tuition revenue to maintain consistent resources. This means state budget cuts are effectively passed on through tuition hikes, with students gradually taking on a greater share of the responsibility for funding higher education. Research suggests that for every \$1,000 reduction in state appropriations per FTE, the average student can expect to pay \$257 more per year to attend a public institution.⁷ From the 1979-1980 to the 2019-2020 academic year, average published in-state public four-year TFRB rose from \$8,260 to \$22,170 in real terms.⁸ At the same time, net tuition revenue increased from 21% of total institutional revenue to 44% (**Figure 2**).⁹

Enrollment increases following recessions enable this dynamic, as a tough labor market drives workers to pursue additional training. While the influx

Figure 2: Share of Total Educational Revenue at Public Institutions by Source

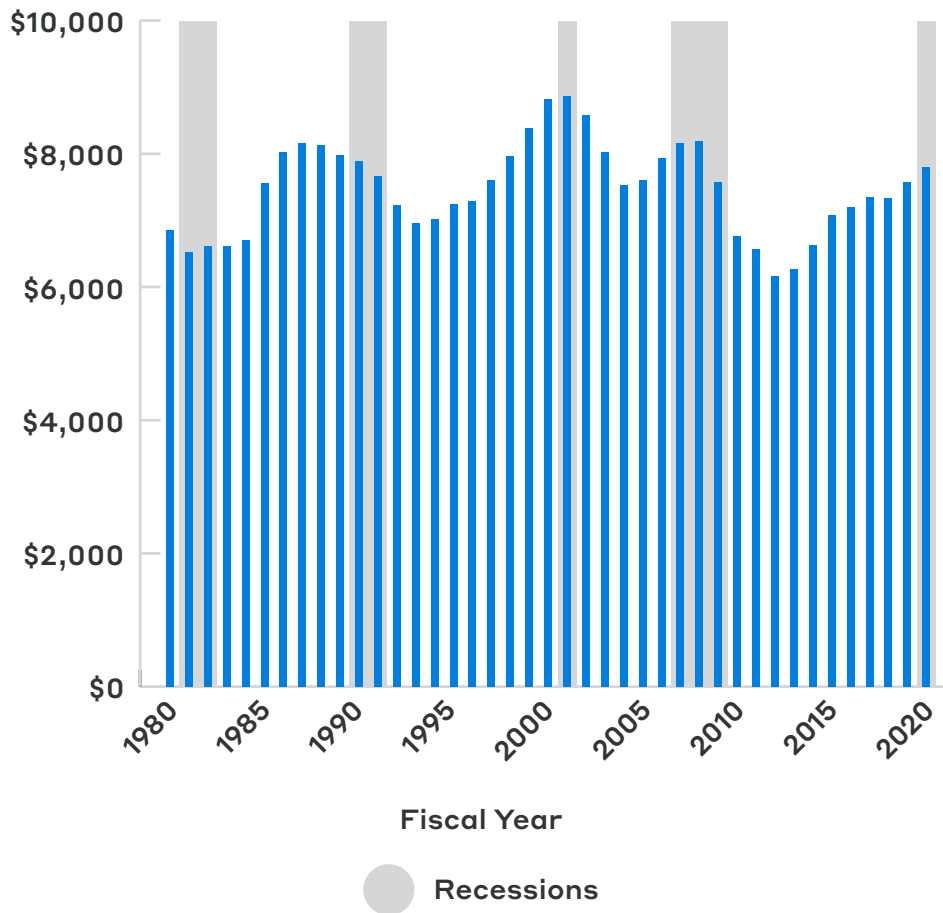


Source: State Higher Education Executive Officers Association, State Higher Education Finance: FY 2020, 2021.

of new students blunts the financial blow to colleges and universities, it also compounds the challenge states face in ensuring their higher education systems have enough funding to serve their students effectively (**Figure 3**).

As tuition rises, many students take on additional debt to pay for their education. Bachelor’s degree recipients in 2019 took out an average of \$27,000 in student loans to attend a public four-year institution and \$33,700 for private nonprofit schools.¹⁰ This increased reliance on debt puts students at risk of not being able to pay back their loans—often with serious consequences for borrowers and for taxpayers, who are ultimately on the hook for the \$1.6 trillion in outstanding federal student debt.¹¹

Figure 3: State Support for Higher Education per FTE



Source: State Higher Education Executive Officers Association, State Higher Education Finance: FY 2020, 2021.

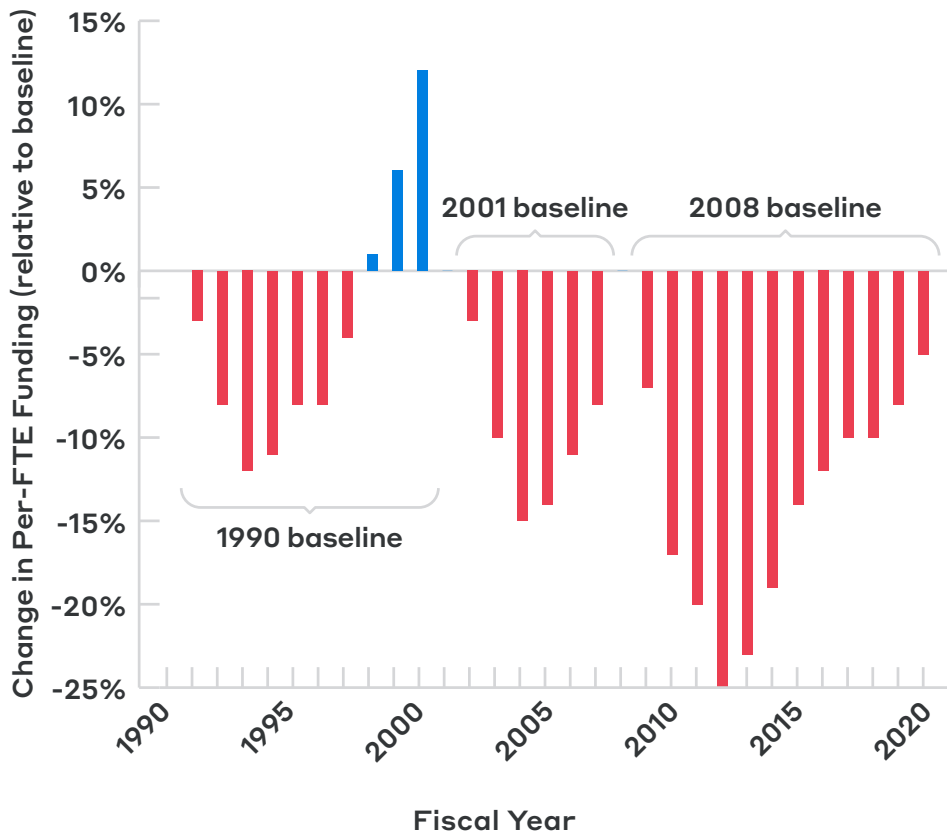
Note: All figures in constant 2020 dollars.

RECESSIONARY CUTS HEIGHTEN FUNDING CHALLENGES

Prior to COVID-19, recessions produced a predictable response for state higher education systems: State funding would fall, while tuition and enrollment increased. Yet these budget cuts have deepened over time, such that states have struggled to recover their prerecession levels of higher education investment before the next crisis hits (**Figure 4**). For example, in the aftermath of the Great Recession, state higher education funding per FTE fell by a staggering 25%, and it remained 5% below its prerecession level at the onset of the COVID-19 pandemic.¹²

COVID-19 created a perfect storm for higher education. Schools incurred significant unexpected costs associated with virus management and the abrupt transition to remote learning.¹³ At the same time, institutional revenue declined by an estimated 14%, driven in large part by a decline in auxiliary revenues from campus housing,

Figure 4: Change in Per-FTE Funding from Most Recent Recession



Source: State Higher Education Executive Officers, State Higher Education Finance: FY 2020, 2021.

dining operations, and facility rentals.¹⁴ The impact of COVID-19 on state funding is mixed, although some state budgets are determined on a biennial basis, so the full response has yet to be realized. By February 2021, at least 27 states had cut higher education funding for the 2020 or 2021 fiscal years, although some states have since restored funding—aided in part by federal stimulus.^{15, 16}

What makes this recession different, however, is that enrollment actually declined in the fall of 2020, undercutting the tuition revenue that institutions have come to rely on during crises. Compared to fall 2019, overall enrollment was down 3% in the fall of 2020. Public two-year schools saw the most dramatic impact, with enrollment falling 10%.¹⁷ These declines persisted through the spring semester, where overall enrollment was down 4% from the prior year.¹⁸ Tuition at public four-year universities also grew at its lowest rate in three decades, as institutions forwent increases—or opted for more modest ones—in light of the economic situation and the move to online instruction.¹⁹ Without the ability to rely on tuition revenue to fill funding gaps, schools needed federal assistance to alleviate some of the pressure.

GOVERN-BY-CRISIS APPROACH IS NOT A LONG-TERM SOLUTION

During periods of economic crisis, the federal government has stepped in to provide emergency support for higher education. This relief helps the higher education system weather storms, but it is often hastily enacted, and it leaves the system—and students—vulnerable to the political winds in Congress.

Moreover, emergency support is challenging to calibrate in the moment. In response to the Great Recession, higher education received \$9.8 billion through the State Fiscal Stabilization Fund in the American Recovery and Reinvestment Act (ARRA).²⁰ While this funding helped keep the lights on, it amounted to only 15% of the aggregate per-FTE shortfall from 2009 to 2012. These shortfalls also persisted long after the ARRA funding dried up.

In contrast, Congress was exceedingly generous in the wake of COVID-19. In less than 12 months, higher education received \$14 billion in the CARES Act and \$40 billion in the American Rescue Plan. This funding provided emergency grant aid to students and stabilized institutional finances amid the unprecedented economic uncertainty, but there are valid concerns about the generosity of this level of stimulus. The Congressional Budget Office estimates that it will take colleges until 2028 to spend down these funds.²¹

To date, when the higher education system has faced a severe shortfall, Congress has rightly stepped in. But governing-by-crisis is not a sustainable—or reliable—solution. Further, the COVID-19 pandemic demonstrated that increased enrollment and tuition revenue may not always be there to cushion the impact. A long-term strategy to support consistent state investment in higher education is needed to break the cycle of recessionary cuts and expensive emergency spending.

Proposal: A Flexible Matching Grant to Improve College Affordability

To address the concerns raised above, BPC's Task Force on Higher Education Financing and Student Outcomes endorsed an annual \$5 billion flexible matching grant program to incentivize states to reinvest in their higher education systems and accommodate state funding challenges during recessions.²² This model would promote affordability and success for low- and middle-income students, while also preserving state discretion.

To access the federal grant, states would be required to increase their funding for higher education. Every dollar a state invests in its higher education system above the three-year rolling average would be quadrupled through a federal match—up to a maximum potential allocation. These maximum allocations would be based on a formula that rewards states that increase affordability for low- and middle-income students, demonstrate high completion rates relative to their investment, and provide significant support to their higher education systems relative to their tax base. Allocations would also be adjusted based on state gross domestic product (GDP) and population to ensure a proportional distribution of resources.

Participation by states would be optional, and governors would have a high degree of flexibility for how to use their matching funds to improve affordability or outcomes for low- or middle-income students. For example, states could increase direct aid to public institutions to reduce tuition prices, expand state need-based aid, invest in well-designed College Promise programs, or support evidence-based interventions that improve student outcomes. This type of flexibility would also allow private institutions to benefit from the increased investment.

PROPOSED ALLOCATION FORMULA

BPC's formula would determine a state's maximum potential allocation based on the following metrics:

Affordability

States that reduce net prices for their students or invest significantly in need-based aid would be awarded a higher maximum grant allocation.

Tax Effort

States that spend more on higher education relative to their tax base would receive a greater allocation. This would encourage states to increase funding, while also recognizing that each state has a different capacity to invest in higher education.

Efficiency

To promote strong outcomes for students and ensure resources are used efficiently, it is important that allocations also be scaled by the number of degrees produced at public institutions per \$100,000 in institutional revenues.

State Wealth

States with lower GDP per capita would receive a somewhat outsized share of the resources, recognizing that poorer states need additional capacity to reduce unmet need.

Allocations would also be scaled by the population of people ages 16-54 in a state—meant to represent both current and future potential enrollment—to ensure that resources are distributed equitably on a per-capita basis.

BPC partnered with the National Center for Higher Education Management Systems to model the impact of this proposal.²³ The model projects that one year of the grant would yield 220,000 additional enrollments and 56,000 completions. Over a decade, this one cohort would generate \$14 billion in additional personal income. After 10 years of implementation, the program would generate between \$10 billion and \$30 billion in gross federal revenues (and an additional \$10 billion to \$30 billion in gross state revenues), which would partially offset the \$5 billion annual cost of the initiative, assuming every state receives their maximum possible allocation.

COLLEGE PROMISE PROGRAMS

College Promise programs promote universal access for the first two years or more of college. In 2019, there were 330 College Promise programs in 47 states.²⁴ Eligibility requirements differ across states, influenced by budget constraints and stakeholder priorities, although the ultimate goal of a Promise program is to increase access to postsecondary education.

College Promise programs have improved enrollment and completion rates. One such program, Tennessee Promise, increased the state's college-going rate by nearly four percentage points since its inception in 2015.²⁵ Other states show similarly positive outcomes. Nationally, completion rates for students at schools with Promise programs are 45% higher than for students at schools without Promise programs.²⁶

A MODERATE APPROACH TO IMPROVING AFFORDABILITY

The Biden Administration's American Families Plan proposes a similar partnership approach to BPC's model, but the funds must be used to provide free tuition at community colleges and for two years of subsidized tuition at select minority-serving institutions.²⁷ The aims of this proposal—to provide a mechanism for states to reinvest in higher education and improve affordability—are well-intentioned. This plan, however, represents an overly prescriptive and expensive approach that also fails to address the affordability challenges at four-year institutions.

BPC's proposal emphasizes federalism and represents a more practical approach, providing clear incentives for states to target resources toward activities that impact students directly—broadening access, improving outcomes, and bridging equity gaps. Under this grant program, states would retain control over how best to achieve these goals. This flexibility is key, as governors best understand the needs of their states and could use the funds to address their most pressing affordability challenges. This could include eliminating tuition for certain groups of students through a College Promise program, with states structuring the program and eligibility requirements based on the unique needs of their population.

Under a universal free college mandate, however, families who would otherwise be able to pay also receive the benefit of free tuition. This is an inefficient use of limited resources, and such models also fail to address the back-end costs that are driving up the price of college. The flexibility offered by BPC's proposal would advance the same aims of increased affordability, while the inclusion of an efficiency metric in the allocation formula promotes cost savings.

A RAINY DAY FUND TO ENSURE CONSISTENT STATE INVESTMENT

Incentivizing state investment in college affordability must be coupled with mechanisms to ensure states can maintain their support during economic crises. That is why BPC recommends states be required to set aside a portion of their matching funds to draw upon in the event of a recession. When drawn, these funds would count toward the requirement that states increase their funding over a three-year average, ensuring states can continue to qualify for their federal match during difficult economic times. The rainy day fund would also reduce the need for Congress to intervene during periods of crisis and create more predictable levels of long-term federal investment in higher education.

Building Momentum for State Reinvestment

There is already bipartisan momentum behind implementing a federal incentive to promote renewed state investment in higher education. The Partnerships for Affordability and Student Success (PASS) Act, introduced by Sens. Susan Collins (R-ME) and Jack Reed (D-RI), would provide a federal match to states that maintain or increase their higher education funding. These funds could be used to increase need-based aid or otherwise improve student outcomes. Other advocates have put forth similar proposals, some with alternative countercyclical stabilizers or a greater focus on expanding College Promise programs.^c

A common feature of these proposals is a maintenance of effort provision: To qualify for federal support, states must maintain their higher education funding. The relief spending on higher education in the last two recessions also included sustained investment as a condition to receive federal funding. BPC's proposal goes one step further—requiring states to increase their spending to qualify for a match—so that only states demonstrating a long-term commitment to increasing funding for higher education benefit from federal support. Under any approach, safeguards are needed to ensure states make a long-term commitment to funding their higher education systems and promoting affordability.

MEASURING PUBLIC SUPPORT

Public support is strong for this type of flexible funding model. BPC partnered with Morning Consult to measure public opinion on how the federal government should act to improve college affordability.²⁸ While the poll revealed that 65% of respondents support the federal government giving states money to provide students with free tuition at public colleges—indeed, “free” is often popular—there is opposition to this approach among many Republicans (48%) and adults age 65 and over (46%).^d

Instead, alternative arrangements between states and the federal government to improve affordability resonated more broadly. Sixty-nine percent of adults support the federal government providing additional money to states to reduce tuition, with only 33% of Republicans and 29% of those age 65 and over opposed to the idea. Even more (72%) support the federal government and states acting as “financial partners” to achieve this goal, with only 24% of Republicans and 17% of those age 65 and over opposed.

^c The Institute for College Access & Success and the College Promise Program have particularly robust proposals that echo BPC's approach. For additional information, see: <https://ticas.org/affordability-2/student-aid/federal-state-partnerships/better-together/> and <https://static1.squarespace.com/static/5e44327a52b88927aaecabd/t/607993ddb890075c12c378c/1618580461929/College+Promise+for+All+Policy+Proposal.pdf>.

^d In this context, while tuition may be marketed as “free,” the costs of higher education still exist—here, it is U.S. federal taxpayers footing the bill.

Conclusion

“Free college” will not solve the complex affordability challenges that plague the U.S. higher education system. A flexible matching grant that incentivizes state reinvestment in higher education is a more pragmatic and comprehensive approach. The dependable funding that results would allow states to reassume responsibility for financing their higher education systems, reduce reliance on student loan debt, and eliminate the need for pricey federal band-aids in the event of a recession. Finally, creating a new financing relationship between the federal government and states would allow for meaningful, long-term investment that improves access and affordability throughout the higher education system.

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