

CFA Research Brief #3: 2003/04 Budget

Summary

- The Governor's Proposed 2003/04 budget includes significant reductions in higher education spending and cuts in other program areas.
- Under the Governor's budget plan, the CSU would suffer a net General Fund reduction of \$123.1 million. However, the CSU anticipates that it will also incur a number of cost increases that would bring the TOTAL CSU budget reduction to **\$260.7 million**.
- The CSU's reduction is comparable to that proposed for the UC.
- In dollar terms, the CSU's net 2003/04 General Fund reduction is comparable to the CSU's 1992/93 budget cut. However, the CSU is currently facing severe cost pressures (i.e. enrollment growth, benefits costs) not present in the early 1990's.

2003/04 Budget Overview

Governor Gray Davis released his 2003/04 budget proposal on Friday, January 10. The spending blueprint employs a mixture of program reductions, tax increases and funding shifts to balance a budget shortfall that could reach \$34.6 billion absent corrective action.

Approximately 60 percent of the budget shortfall, or \$20.7 billion, is solved through program reductions. Virtually all areas of state service would be subject to major spending cuts (see Table 2).

Table 1. Solution to the Budget Shortfall (in millions)

	2002/03 Mid-Year Reductions	2003/04 Governor's Budget	Total Reduction
Spending Reductions	\$ 8,966	\$ 11,762	\$ 20,728
Tax Increases	\$ 192	\$ 7,962	\$ 8,154
Transfers, Fund Shifts, Borrowing	\$ 1,040	\$ 4,660	\$ 5,700
Totals	\$ 10,200	\$ 24,384	\$ 34,583

Tax increases account for nearly one-quarter of the solution. The budget proposes to generate \$8.2 billion in additional revenue through:

- A 1 percent increase in the sales tax (generates \$4.6 billion)
- Imposition of 10 percent and 11 percent income tax rates on higher earners (generates \$2.6 billion)
- A \$1.10 per pack increase in the cigarette tax (generates \$1.2 billion)

The revenue derived from the tax increases will be used to support the shift of several health and social services from the state to local governments.

Table 2. General Fund Expenditures by Program Area: 2002/03 and 2003/04 (in millions)

	2002/03	2003/04	Percent Change
Legislative, Judicial and Executive	\$ 2,477	\$ 2,167	-12.5%
State and Consumer Service	\$ 480	\$ 438	-8.8%
Business, Transportation and Housing	\$ 206	\$ 216	4.9%
Technology, Trade and Commerce	\$ 46	\$ 21	-54.3%
Resources	\$ 1,115	\$ 959	-14.0%
Environmental Protection	\$ 175	\$ 100	-42.9%
Health and Human Services	\$ 23,029	\$ 15,146	-34.2%
Youth and Adult Corrections	\$ 5,674	\$ 5,639	-0.6%
K-12 Education	\$ 29,067	\$ 27,390	-5.8%
Higher Education	\$ 9,447	\$ 8,509	-9.9%
Labor and Workforce Development	\$ 153	\$ 90	-41.2%
General Government	\$ 3,592	\$ 2,094	-41.7%
Total	\$ 75,461	\$ 62,769	-16.8%

The remaining budget gap is filled through a series of transfers, fund shifts and borrowing. Included in this group of proposals is a \$1.5 billion loan from the California Public Employees' Retirement System (CalPERS) and the State Teachers' Retirement System (STRS).

CSU Overview

The Governor's spending plan proposes a \$326.1 million budget reduction for the CSU, a cut that could ultimately threaten student access and instructional quality. The reduction represents a 12.1 percent cut to the CSU 2002/03 General Fund base of \$2.71 billion. The 2003/04 reductions are NOT necessarily in addition to the \$59.6 million in mid-year cuts for 2002/03. If the CSU maintains the 2002/03 mid-year cuts in the budget year, the 2003/04 reductions will decline by \$59.6 million, to \$266.5 million.

Specifically, the Governor proposes:

- Unallocated base budget reduction (approx. 5.3%) \$142.8 million
- Reduction in student service funding \$ 53.2 million
- Reduction in academic and institutional support \$ 58.1 million
- Reduction in outreach funding \$ 12.6 million
- Reduction in CalTeach funding \$ 2.0 million
- Reduction in Bilingual Teacher Recruitment \$ 2.0 million
- Increase student-to faculty ratio from 18.9:1 to 19.9:1 \$ 53.4 million
- Reduction in Student Fellow Program \$ 0.5 million
- Reduction in Center for California Studies \$ 1.4 million

- Total \$326.1 million

While all of these reductions are significant, CFA is particularly concerned with three items. First, and most important, the increase in the student-to-faculty ratio (SFR) represents a direct threat to the CSU's instruction program and overall educational mission. Increasing the SFR, either through increased faculty workloads or through a reduction in the CSU faculty, will result in fewer opportunities for teacher-learner contact. Students will be less able to find the individual attention that is often times necessary to cultivate academic excellence and encourage persistence. It is estimated that 850 faculty positions would be lost if increasing the SFR is achieved solely through workforce reduction (NOTE: This DOES NOT necessarily mean that the Governor's proposal will result in layoffs).

Second, the unallocated base reduction of \$142.8 million could potentially have a significant impact on teaching and learning in the CSU. The extent to which this reduction affects the CSU's instruction program is largely contingent on exactly how the CSU administration would implement this proposal. The CSU administration could choose to target administrative costs and overhead, in large part protecting key areas central to the university's core educational mission. Conversely, CSU campuses could choose to continue operating in a highly decentralized manner, spreading the reduction evenly across all academic departments and administrative units. The decentralized approach could result in painful reductions.

Finally, the \$53.2 million cut in student service funding (20 percent according to the CSU) will significantly reduce the breadth of cultural, social and developmental programs offered by CSU campuses. These programs greatly enhance the CSU's regular instruction program by encouraging persistence, contributing to students' emotional and physical well-being, and integrating students into the university community.

In addition to the cuts listed above, the Governor's proposal makes permanent the one-time \$43.0 million reduction included in the 2002/03 budget. Campuses will need to take no additional action if they are able to sustain the cuts taken in 2002/03. However, further cuts will be necessary if campuses used one-time funds to accommodate the reductions.

While the CSU did suffer a series of painful cuts, the Governor's proposal is not all bad. The Governor maintained his commitment to student access by providing \$105.9 million to fund 16,000 additional full-time equivalent students (FTES) in 2003-04 and \$45.0 million to backfill for 8,000 unfunded over-enrollments in 2002-03. The additional enrollment growth revenue should be sufficient to hire up to 1,200 full-time equivalent faculty members (assuming a student-to-faculty ratio of 19.9 to 1) and meet other costs associated with enrollment growth. The provision of enrollment growth money should offset layoff pressures due to the proposed increase in SFR.

It is important to remember that the additional enrollment anticipated in 2003/04 (16,000 FTES) represents a significant cost pressure. In other words, the \$105.9 million provided for 2003/04 enrollment increases CANNOT be treated as an offset to the \$326.1 million reduction proposed by the Governor. Rather, \$105.9 million needs to be used to cover the new costs associated with enrolling additional students (i.e. hiring faculty and staff).

Additional Cost Pressures

In addition to the budget reductions proposed in the 2003/04 Governor's budget, the CSU is facing approximately \$78.6 million in mandatory cost increases. These cost pressures (mainly employee compensation and health care contribution costs that must be met) have the net affect of an additional budget cut. The CSU did not receive funding for these items and, therefore, must reduce funding in other areas in order to fit the additional mandatory costs into its budget. The CSU could offset these cost increases with a portion of the enrollment growth money it receives under the Governor's proposal. This strategy would prevent additional reductions but would obviously result in fewer funds being available to meet the anticipated enrollment demand.

CSU Student Fees

The Governor's Budget assumes the CSU Trustees will partially offset the \$326 million reduction through a student fee increase. The Board of Trustees would have to increase undergraduate fees by 25 percent and graduate fees by 20 percent in order to meet the Governor's revenue assumption. Doing so would generate \$212.2 million, \$70.9 million of which would be devoted to the State University Grant program (the CSU's primary institutional aid program). The remaining \$141.8 million would be used to counteract the budget reductions.

If approved by the Trustees, undergraduates would begin paying fees of \$1,968 per year in 2003/04 while graduate student would pay \$2,082. The 2003/04 fee increases would be in addition to the double-digit mid-year fee increase approved by the Trustees in December 2002 (10 percent undergraduate and 15 percent graduate).

Table 3. CSU Student Fees: 2001/02 through 2003/04 (proposed)

	Undergraduate Fee	Percent Increase	Graduate Fee	Percent Increase
2001/02	\$ 1,428	--	\$ 1,506	--
2002/03	\$ 1,572	10.0%	\$ 1,734	15.0%
2003/04 Proposed	\$ 1,968	25.0%	\$ 2,082	20.0%
Cumulative	\$ 540	37.8%	\$ 576	38.2%

The proposed 2003/04 fee increase is the largest ever in terms of dollars (\$396 per year) and the second largest percent increase since 1990.

Net Impact on CSU

There are two ways to examine the net impact of the Governor's budget on the CSU. The first is through a simple assessment of the bottom line General Fund expenditures included in the Governor's proposal. This method allows us to see the decline in the state's financial commitment to the CSU. The bottom line General Fund change does not account for additional revenue the CSU will derive through student fees.

In total, General Fund expenditures devoted to the CSU decline by \$123.1 million, a net decline of 4.5 percent from 2002/03 levels. It must be remembered that while funding for the CSU drops by a total of \$123.1 million, the CSU is simultaneously being asked to accommodate an additional 16,000 FTES (and the accompanying costs). This figure could be reduced if the campuses are able to sustain the cuts suffered in 2002/03 (\$43 million one-time reduction and \$59.6 million mid-year cut).

The second method is an evaluation of the CSU's overall budgetary outlook for 2003/04. Here we account for changes in General Fund revenue, increases in student fees and various unfunded mandatory cost increases the CSU is facing (i.e. growing employee health care contributions). According to the CSU, the net impact of the budget reductions, revenue enhancements and fee increases is a 2003/04 budget cut of \$260.7 million, or approximately 10 percent of the CSU total General Fund revenue. This figure could be reduced if the campuses are able to sustain the cuts suffered in 2002/03 (\$43 million one-time reduction and \$59.6 million mid-year cut).

Table 4. Total 2003/04 Budget Reductions

	Campuses Sustain NO 2002/03 Cuts
<i>Budget Reductions and New Costs</i>	
2003/04 Governor's budget—reductions (see above for detail)	\$ 326.1 million
2003/04 unfunded mandatory costs	\$ 78.6 million
Cost associated with 16,000 additional FTES	\$ 105.9 million
Permanent reduction in long-term needs	\$ 43.0 million
Sub-total	\$ 553.6 million
<i>Revenue Increases</i>	
2003/04 student fee increase (less \$70.9 million devoted to SUG)	\$ 142.0 million
2003/04 enrollment growth funding (16,000 FTES)	\$ 105.9 million
Enrollment growth funding for 2002/03 over-enrollments (8,000 FTES)	\$ 45.0 million
Sub-total	\$ 292.7 million
Total budget reductions necessary	\$ 260.7 million

CSU Reduction Compared to UC and CCCs

When comparing the CSU to the UC and CCC's we are limited to examining only the bottom line changes in the Governor's budget proposal. Unfortunately, at this point, we don't have enough information about the UC and CCC budgets to compare the systems' overall budget outlooks (e.g. information on mandatory cost pressures is not available).

The Governor proposes to reduce General Fund higher education spending by 9.9%, with the CSU and UC receiving similar cuts and the Community Colleges receiving a much more significant reduction. Under the Governor's plan, the UC would suffer a General Fund reduction of \$373 million, or 11.9 percent. This is on par with the CSU reduction of 12.1 percent. Revenue from a student fee increase of 24 percent would partially offset the proposed UC budget reduction. As with the CSU, the Governor provides enrollment growth funding for the UC in the form of a \$117 million General Fund increase. In all, the Governor's budget contains a net General Fund reduction of

\$133.7 million, or 4.2 percent, for the UC. Again, this is comparable to the 4.5 percent net decrease for the CSU.

When comparing the CSU to the UC, it is important to remember that the UC is much less reliant on General Fund resources than the CSU. The UC derives only about 28 percent of its operating budget from the state General Fund. On the other hand, General Fund resources represent 75 percent of the CSU budget. In other words, all else being equal, declines in General Fund spending will impact the CSU to a much greater extent than the UC.

Table 5. Elements of Governor’s 2003/04 Budget Proposal

	General Fund Budget Reduction	Major General Fund Budget Increases	Net General Fund Change	Fee Increase
CSU	\$ 326.5 million (12.1%)	\$150.9 million (enrollment)	\$ -123.1 million (-4.5%)	Undergraduate—25% Graduate—20%
UC	\$ 373.4 million (11.9%)	\$117.2 million (enrollment)	\$ -133.7 million (-4.2%)	All Students—24%

The Community College system would be subject to a General Fund reduction of \$727.3 million, or 26.2 percent. The budget proposal assumes that a portion of this reduction will be offset by raising community college fees from \$11 per unit to \$24 per unit, a 118% increase. It is anticipated that the fee increase would generate \$149.5 million to partially offset the General Fund reduction.

CSU Reduction Compared to Earlier Periods (1992/93)

It is very difficult to draw specific conclusions about the how the CSU fared during the recession of the early 1990’s versus how it would fare under the current proposal. This is due to a number of reasons, including differences in enrollment demands, uncommon CSU budget methodologies and the overall lack of specificity in the Governor’s budget. That being said, we can draw some very broad comparisons between the two periods.

In 1992/93 net General Fund spending on the CSU declined by \$123.3 million or 7.5 percent. In dollars, the earlier reduction is almost exactly the same as the proposed 2003/04 General Fund reduction (\$123.1 million). The 1992/93 cuts were more drastic in percentage terms due to the significantly smaller General Fund base. However, the CSU did not need to contend with a large enrollment increase, and the associated costs, in the early 1990’s. Given today’s enrollment demand and increasing mandatory costs, the proposed reductions may actually be more severe than the cuts suffered in any single year during the early 1990’s

The vast majority of the 1992/93 reduction was unallocated in nature, allowing university administrators maximum flexibility in implementing the budget reductions. The Legislature did specifically request that the CSU achieve savings by delaying instructional equipment purchases, deferring maintenance costs and creating other cost savings in operational overhead. Much of the current reduction is also discretionary in nature.

In 1992/93, the Legislature included several pieces of budget control language requesting the CSU implement certain legislative priorities. Among the most significant was language requiring the CSU to defer implementation of the workload reduction plan negotiated with CFA. There are obvious similarities between the 1992/93 language and the Governor's current proposal to increase the student-to-faculty ratio.

During both periods, students are asked (through fee increases) to finance a larger portion of their education. In 1992/93 fees increased by 40 percent, a \$396 jump. The Governor's 2003/04 budget proposes an increase of 25 percent for undergraduates and 20 percent for graduate students.

Conclusion

The Governor's budget is akin to the first pitch in what will undoubtedly be an extra innings ballgame. Many changes will occur as the budget winds its way through Legislative committees in the spring and summer of this year. Unfortunately, CSU administrators view the Governor's proposal as a "best case scenario" and many policymakers believe the CSU's exposure to additional cuts is significant. While this may be the case, there is little doubt that the CSU will be unable to provide high quality instruction and maintain student access if it suffers deeper reductions. Additional cuts to the CSU budget will further threaten the CSU's education mission and will leave thousands, if not tens of thousands, of promising California students on the outside looking in.

For additional information, or for copies of CFA Research Brief #1 (Teaching Associates) and CFA Research Brief #2 (Student Fees), please contact: Andrew Lyons, CFA Research Specialist
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