



Dedicated Funding for Higher Education: Alternatives for Tough Economic Times

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In recent years, there has been growing use of dedicated funding sources for higher education, but this practice is still quite limited. In view of economic uncertainty, a history of fluctuating levels of state appropriations to higher education, and the need to keep higher education affordable, we present some facts about dedicated funding practices in the states and encourage policymakers to consider all the possibilities.

Context

When the stock market is booming and state economies are strong, all state agencies and programs benefit. Consumers earn more and spend more, and there are increased tax dollars to go around. Conversely, in times of economic downturn, everyone suffers—but the pain is not shared equally. The state appropriation to public higher education, a discretionary item in most state budgets, is often the first budget item to be cut and the last to recover.

In the minds of many state legislators, the rationale is simple: colleges and universities can find other sources of income to compensate for reduced state

support, an option not available to K-12 education, Medicaid and corrections. Unfortunately, college students and their families become the source of alternative income, by contributing more tuition dollars due to higher tuition rates. The relationship between the ebb and flow of state appropriations and tuition rates has been documented time and time again. To make matters worse, the unpredictability of state support from year to year makes it difficult to manage institutions efficiently, further contributing to higher costs and diminished affordability.

From time to time, the concept of dedicated funding for higher education has been proposed as an antidote to the problems created by the “boom and bust” cycle of higher education funding. For the purposes of this paper, we use the term “dedicated funding” synonymously with “earmarking,” defined by the National Conference of State Legislatures (NCSL) as “designating some or all of the collections from a specific tax or revenue source for a specific expenditure, with the intent that the designation will continue into the future.” On the one hand, dedicated funding provides a steady funding stream for specific purposes, regardless of current

economic conditions. On the other hand, it reduces the flexibility of the state legislature to meet the broad mix of public needs, and dedicated funds may be used to supplant appropriations rather than to augment them. NCSL notes that earmarking is an “important and controversial element in state finance.”

NCSL reports that every state earmarks taxes to some extent—for state highways; local government; education; health, welfare and human services; and the environment—and the average is 24 percent. Five states earmark 50 percent or more of their state tax revenues, and this number ranges from 4 percent in Rhode Island to 84 percent in Alabama. The proportion of state funds earmarked has remained fairly constant over the past two decades, but it has declined since the early 1950s when about half of all tax dollars were earmarked. Currently, 35 states earmark at least some state taxes for education, including K-12 and higher education.

Another significant source of dedicated funds is gaming revenues, and 48 states currently have some form of legalized gambling (Hawaii and Utah are the exceptions). This source is growing as a revenue stream, and *Stateline.org* reports (5/27/08) that 17 states now generate more than 5 percent of their state budgets from all forms of gambling. Since New Hampshire began the first state lottery in 1964, 42 states now operate lotteries, adding \$17.1 billion to state coffers in FY 2006. Thirty years ago, only Nevada and Atlantic City, New Jersey had legal casinos. Today 25 states have commercial casinos, racetrack casinos, card rooms and/or electronic gaming devices, adding more than \$8.0 billion to state and local governments in 2007. The racetrack casino industry is the fastest-growing mode of gambling, experiencing a 55 percent increase in state tax revenues between 2006 and 2007. Currently, at least 30 states dedicate some gaming revenues to education.

A final source of dedicated funding is revenues from state trust lands. This practice started in the 18th century when Congress began to grant lands to newly formed states to support a variety of public

institutions, including K-12 and higher education. Most state trust lands have been sold by now, but 46 million acres remain, spread across 23 states primarily west of the Mississippi. Revenues from these lands are generated from timber production; mining of oil, gas, coal and minerals; grazing; agriculture; commercial leases; and land sales for residential and commercial development. In every state K-12 education generally receives most of the revenues from trust lands.

In recent years, there has been growing use of dedicated funding sources for higher education, but this practice is still quite limited. This paper explores the scope and types of dedicated funding sources for higher education across the states, their uses, pros and cons, and recent issues and debates. It is the intent of this paper to provide some facts about what states are doing, to point out some of the variation among states, and to stimulate thinking on this controversial topic.

Observations

Though the vast majority of state and local support for higher education comes from tax dollars, almost none of these dollars represent dedicated funding streams to higher education.

This conclusion is based on an analysis done by the American Association of State Colleges and Universities (AASCU) of detailed state-by-state tax revenue data provided in an appendix to NCSL's 2008 report *Earmarking State Taxes, FY 2005*.

According to the State Higher Education Executive Officers (SHEEO), 88 percent of total public support for higher education comes from state tax appropriations. Given that every state earmarks at least some of its tax dollars, one might expect higher education to be a significant recipient of these dedicated funds. However, our analysis of NCSL data indicates that at best, 20 states earmark at least some dollars for higher education, but the earmarks are quite small and generally do not contribute to college and university general operating funds. Just four states have at least one ongoing general earmark for higher education, with dollar amounts that are quite modest. For example,

Arkansas dedicated \$49.4 million in FY 2005 to “state institutions of higher education,” derived from 2.1 percent of its sales and use tax, and \$11.1 million to “Department of Higher Education grants,” derived from 0.5 percent of its sales and use tax, out of a total of \$778.5 million total state tax dollars appropriated to higher education that year. In the same year, Montana dedicated \$11.8 million to “the state university system,” derived from 6.5 percent of its property tax, and another \$1.9 million to its “state universities,” derived from 1.3 percent of its oil and gas production tax, out of a total of \$173.8 million in tax dollars appropriated to higher education.

Eight states have at least one combined earmark for K-12 and higher education. The total dollar amounts of these funding streams are significantly higher than those earmarked for higher education only, but it cannot be inferred that higher education is receiving a large dollar amount. Alabama is unique in earmarking 97 percent of its personal income tax to “public schools and higher education,” equal to 65 percent of its total tax collections, or nearly five billion dollars (on a related note, Utah is unique in earmarking 100 percent of its personal and corporate income taxes for K-12 education, but none to higher education).

Finally, 14 states have at least one special purpose earmark for higher education, typically a quite modest amount that does not support the general operating costs of institutions. These beneficiaries include a veterinary school’s equine research program, medical education and research, a community college job training program, wine and grape research, and other specialized purposes (note that several of these states overlap those counted above, also having either general higher education earmarks or combined K-12-higher education earmarks).

One of the strongest arguments for dedicating tax dollars to higher education is that it lends greater predictability and stability to fiscal planning during economic downturns. However, this funding approach does nothing to add to the total state coffers, and it reduces the flexibility that lawmakers value in allocating state funds, especially in tough

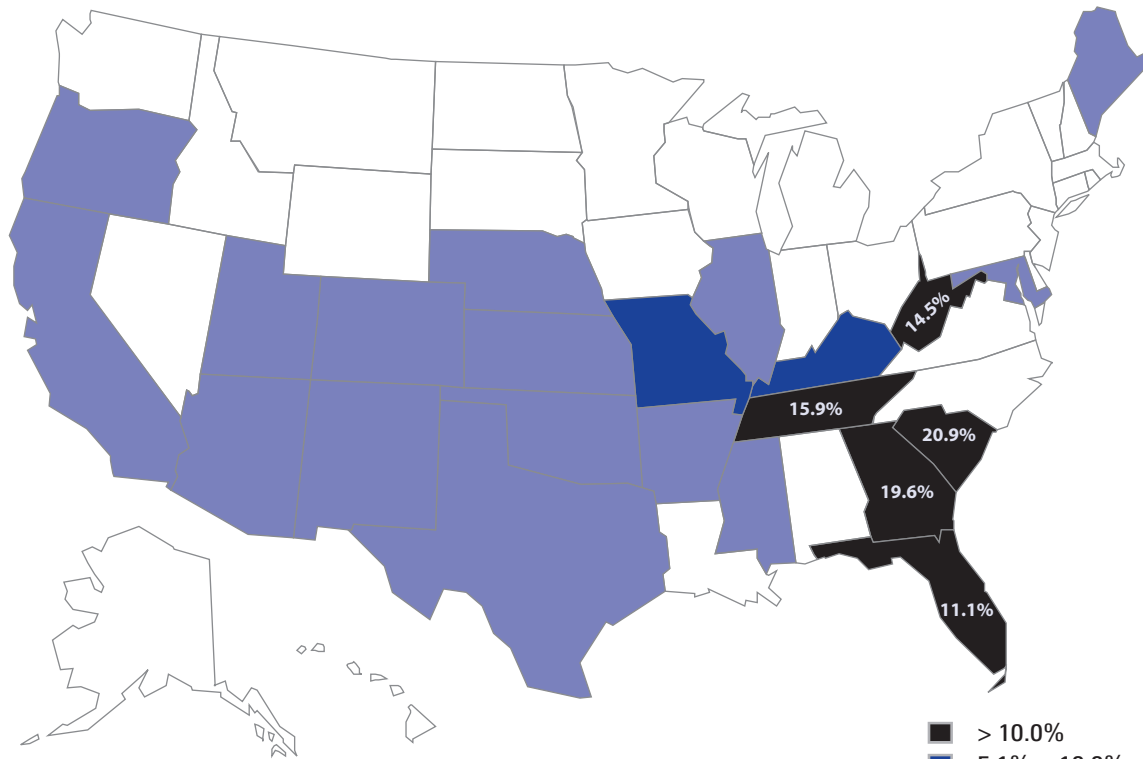
times. Also, assuming that the vast majority of higher education funding would still come from non-dedicated tax dollars, there is little safeguard against legislators using dedicated funds to supplant regular, non-earmarked state appropriations.

Support for higher education from gaming revenue follows a different pattern than support from state tax dollars. With few exceptions, revenues from state lotteries and casino gambling provide only a very small proportion of total state support for higher education, but this is by far the largest source of dedicated funding to higher education.

Though we were unable to find a data source that precisely captures all dedicated gaming revenues to higher education, SHEEO’s 2008 report based on their State Higher Education Finance (SHEF) survey offers a reasonable proxy. According to SHEEO, higher education institutions in 22 states receive money in their operating funds that is set aside from “appropriated non-tax state support,” including lotteries, casinos and other types of gambling; tobacco settlements; and any other appropriated non-tax support. Importantly, these figures include all dedicated gaming revenues, but may overestimate this number in some states to the extent that other sources are included. Fifteen of these states provide less than 5 percent of their total state support to higher education from appropriated non-tax state support, and two states provide 5 to 10 percent of their state support to higher education from these sources [see map]. Five states (Florida, Georgia, South Carolina, Tennessee and West Virginia) allocate a more substantial 10 percent or more of their total state support to higher education from these sources. These figures include contributions to state student financial aid programs.

Though lottery support is generally modest, it can have a significant impact, depending on how the revenues are earmarked. Most notably, the state of Georgia passed a lottery referendum in 1992 designed specifically to fund Helping Outstanding Pupils Educationally (HOPE), a broad-based merit scholarship program. Created to increase access, keep students in state, and ensure a more highly qualified workforce, this program has grown

Proportion of State Support for Higher Education from Gaming and Other Appropriated Non-Tax Support



Source: State Higher Education Executive Officers. State Higher Education Finance, FY 2007, 2008. Based on Supplemental Table "Total Revenue from State and Local Governments," but calculated as percent of state revenue only.

dramatically over the years, enjoys widespread public support, and has served as a model for merit-based aid programs in other states and for the federal government.

Beyond merit scholarships, states have earmarked lottery funds for other higher education uses.

- In Nebraska, 44 percent of lottery proceeds are dedicated to educational purposes, and half of this goes to a need-based scholarship program.
- In Florida, 100 percent of the lottery's proceeds go to education, both K-12 and postsecondary. In FY 2008, 60 percent of lottery proceeds went to higher education. Although the Bright Future scholarship program received the largest proportion (\$346.3 million), another \$297.2 million

went to state universities and \$175.0 million to community colleges.

- In Missouri, the state lottery funds college and university salaries, equipment and library purchases, and institutional-based student financial aid. The lottery also provides institution-specific allocations, and on average, lottery funds cover 8 to 9 percent of total state funding to most four-year public institutions and 5 percent of total state funding to community colleges.
- In South Carolina, 72 percent of lottery profits go to higher education, about three-fourths to several scholarship and loan programs, mostly merit-based, and the remainder to endowed chairs, technology and other programs.

Arguments in favor of state lotteries center on the fact that they provide a new source of additional revenues that support public purposes and provide benefits for individuals. Proponents argue that as a “voluntary tax,” it is a sound alternative to less popular increases in sales, personal income and other taxes, and adds a buffer against budget shortfalls that would otherwise lead to cuts in state programs and services. Opponents maintain that it is a regressive approach in which lower income groups tend to pay a larger share of costs and receive a smaller share of benefits. They argue that merit scholarships, a common beneficiary of lottery funds, are not an efficient way to increase college access, may not increase student retention or completion, and may lead to grade inflation. Opponents also note that states become dependent on lottery funds, but that they are not a reliable source of revenue. Finally, some argue that lottery funding may be used to supplant existing state appropriations to education. If policymakers feel that higher education (or any beneficiary) is receiving enough already, they can use tax dollars for other purposes or even cut taxes.

In a sense, each of these arguments is partially correct, and states have options as to how they structure their lottery systems. When targeted effectively and balanced appropriately, lotteries can be less regressive. For example, in addition to merit aid, the Georgia lottery provides significant support for a voluntary pre-kindergarten program. In Tennessee, lottery revenues are split among lottery scholarships, pre-kindergarten and after-school programs. And in many states, lotteries fund a mix of programs that include environmental, mass transit, economic development, property tax relief, and other public benefits. Also, even merit-based scholarships can be more or less “regressive,” depending on the stringency of the eligibility requirements, the mix of merit- and need-based aid available, and other factors. However, the very success of lottery scholarships, leading to a growth in demand for scholarship dollars, can be a major problem when accompanied by flat or decreasing lottery revenues. In the words of Florida state representative Ray Sansom (R): “Gambling is risky. It’s stagnant. It’s unpredictable, and it’s not the best

way to balance the budget.” Over the years, Georgia, New Mexico, Oklahoma and West Virginia are among the states that have had to adjust their lottery-funded college scholarship eligibility requirements, along with the amount of scholarship funds offered, the time period covered and other factors, to save money when demand for the scholarships outpaced the available dollars.

Like lotteries, on the plus side, casinos provide additional revenues for host communities and states without raising taxes; on the negative side, communities and states can become dependent on the revenue these casinos generate, which may decline in tough economic times. However, casinos have slightly different pros and cons than do lotteries. Those in favor argue that casinos create jobs, attract visitors and have multiplier effects in the economy; they point to success in transforming the economies of Nevada after 1931 and New Jersey after 1978. They note that gambling has become more socially acceptable than it once was and argue that casino revenues are less regressive than lottery revenues. Further, opening new casinos helps to keep residents’ dollars from flowing out of state, and opening them has become somewhat of a defensive move, particularly in the northeast corridor of the U.S. In contrast, opponents argue that casinos carry hidden costs in terms of infrastructure, regulation, gambling addictions, personal bankruptcies and increased crime. Further, they suggest states will eventually reach a saturation point in number of casinos that can be supported. Finally, even though they are generally taxed at a high rate, casino revenues ultimately provide only a modest source of income in most states.

Revenues from public land trusts are small as well, though again there are exceptions.

SHEEO also tracks higher education support from non-appropriated sources, which may include, but are not limited to, “monies from receipt of lease income, cattle-grazing rights fees, and oil/mineral extraction fees on land set aside by the state for higher education,” as a proportion of total state support for higher education. Only nine states have this as a dedicated revenue source for higher education, and six of these states provide less than 1.0 percent of

total state support for higher education from this revenue category. Wyoming is a notable exception, leading the states with 18.1 percent of total state support for higher education in FY 2007 coming from non-appropriated sources, followed by New Mexico at 5.3 percent, and Oklahoma at 1.6 percent. However, the SHEEO data track only those revenues going into general operating funds, and do not take into account revenues from these sources that are earmarked for capital projects. For example, in Texas, mineral and oil rights revenues go into the Permanent University Fund, which generates, in part, about \$400 million annually for new construction, renovation and infrastructure projects, as well as debt service for higher education capital projects.

The potential contribution of this revenue category is clearly limited to those states that still maintain public land trusts, and more narrowly to those rich in natural resources. Colorado, New Mexico, Utah and Wyoming, for example, are among the states that receive revenues from oil, gas, coal and other mineral extraction. Idaho, Montana, Oregon and Washington receive revenues from timber management. K-12 education generally receives the bulk of trust revenues in each state, but higher education selectively benefits as well.

At almost any given time, at least some states are embroiled in heated discussions and debates about dedicated funding, some related to higher education. Often motivated by conditions in the economy, governors, legislators and citizens' groups seek to address fiscal challenges by adding new dedicated funding sources or adjusting existing ones. In November 2008, voters in Arkansas passed a measure that would create a state lottery to fund college scholarships for students attending higher education institutions in the state. The measure was supported by Lt. Gov. Bill Halter (D), who estimated that the lottery would generate \$100 million annually; opponents estimated the revenues at not more than \$60 million. A major point of contention was whether the proposed lottery amendment would open the doors to casino gambling in the state as well.

In Maryland, voters authorized the installation of 15,000 video-lottery slot machines in five locations, a measure designed in part to protect education funding. Supported by Gov. Martin O'Malley (D), the plan is projected to generate \$600 million annually for education. This outcome followed many years of debate, and supporters argued the action was long overdue, given that neighboring states Delaware, Pennsylvania and West Virginia have gotten a solid jump on the competition for gambling dollars.

Also in November, Maine voters rejected a measure to approve a casino in Oxford County. Ten percent of the proceeds would have gone to higher education programs, including a prepaid-tuition plan, a college-savings plan, money for the Community College System and a program to help residents repay student loans.

In the midst of an oil and gas boom, voters in Colorado rejected an amendment that would have eliminated a tax credit for oil and gas producers in the state. This would have generated about \$200 million a year, 60 percent of which would have financed a new Colorado Promise Scholarship program for low- and middle-income students.

Earlier in 2008, the Kentucky legislature defeated Governor Steve Beshear's (D) attempt to pass a constitutional amendment to legalize casino gambling to help fund higher education. Gov. Beshear argued that without money from gambling or higher taxes, higher education would suffer a 12 percent budget cut. The measure would have added slot machines to racetracks, and was also designed to boost Kentucky's horse industry. In response to the amendment's failure, the Kentucky Equine Education Project commented: "This is no doubt a very good day for Indiana, Illinois and West Virginia—as hundreds of millions of Kentucky dollars will continue to flow into their education, health care and transportation systems."

Conclusion

Dedicated funding as a source of support for higher education is something that has not taken off in the U.S. Though there are many examples of small revenue streams that support higher education, dedicated funding has not provided a significant source of monies for the operating budgets of institutions, particularly when compared to the volume of state tax dollars that serve as the largest source of state support for higher education. An oft-cited objection to dedicated funding is a reluctance by legislators to decrease the flexibility they desire in dealing with a broad set of public services by tying up funds for just one area.

No state-generated revenue source is without its drawbacks or critics. We encourage policymakers to consider dedicated funding for higher education, in view of economic uncertainty, a history of fluctuating levels of state appropriations to higher education, and the state and national imperative of keeping higher education affordable. Such consideration should include discussion of:

- Successful models or best practices from other states that might be replicable.
- The state's particular mix of taxes and non-tax revenue sources, and ways that economic fluctuations—both positive and negative—affect various potential funding streams.
- State and regional variation in public opinion and support for various options.
- Broader state educational and other goals, such as seamless P-20 educational systems and state economic development.

In sum, strategies to generate state revenues and allocate funds must be implemented in a manner that meets state policy goals, is politically viable, and would be effective in improving the financing of higher education in the state. And most importantly, the presence of dedicated funds must not be used as an excuse to reduce the state appropriation for higher education.

Resources

National

American Gaming Association (AGA). Provides information and data on the casino entertainment industry, including the annual report *State of the States: The AGA Survey of Casino Entertainment*. americangaming.org/

Lincoln Institute of Land Policy and the Sonoran Institute. *State Trust Lands in the West: Fiduciary Duty in a Changing Landscape*, 2006. sonoran.org/index.php?option=com_content&task=view&id=149&Itemid=27

National Association of State Budget Officers (NASBO). Produces several reports annually pertaining to state budget practices, including *Budget Processes in the States*, *Fiscal Survey of the States*, and *State Expenditure Report*. nasbo.org/

National Conference of State Legislatures (NCSL). A resource on state budget and tax issues, including the report *Earmarking State Taxes*, FY 2005, 2008 (available for purchase). ncsl.org/programs/fiscal/index.htm

Nelson A. Rockefeller Institute of Government. Produces the *State Revenues Report* and other resources related to state and local government finance. rockinst.org/

North American Association of State and Provincial Lotteries (NASPL). Provides information on member lotteries' histories, sales, profits, beneficiaries and other data. naspl.org/Contacts/index.cfm?fuseaction=home&PageID=45&PageCategory=17

State Higher Education Executive Officers (SHEEO). Produces the annual *State Higher Education Finance (SHEF)* report. <http://sheeo.org/finance/shef-home.htm>

State

University of Georgia's Carl Vinson Institute of Government. *HOPE Scholarship Joint Study Commission Report*, 2003 cviog.uga.edu/hope/report.pdf

Tennessee Independent Colleges and Universities Association. *Securing Tennessee's Future—Changing Lives: Supporting Opportunity in Tennessee Higher Education*, 2005 and *Overview of the 2007-2008 Tennessee Education Lottery Scholarship Recipients*, 2008. ticua.org/