South Dakota Legislative Research Council

Issue Memorandum 95-13

A REVIEW OF THE HIGHER EDUCATION FUNDING FORMULA

Like every other state, the amount of resources South Dakota can or should spend on higher education is a perennial controversy. During times of taxpayer unrest, economic uncertainty, and significant increases in the costs of "mandatory" spending (e.g., Medicaid, welfare, and nursing homes), higher education spending is an easy target. In South Dakota, like in other states, higher education is seen as the single biggest pot of "discretionary" spending in the state's budget. For Fiscal Year 1996 (FY96), the Legislature appropriated more than $108 million general, $52 million federal, and $150 million other fund authority for the Board of Regents' system of six universities, two special schools, the medical school, and the various student grant programs. (See Issue Memorandum #95-5.) Roughly 18 percent of the state's general fund budget for FY96 is for higher education. (Postsecondary vocational education, as represented by state appropriations of more than $11.6 million to the four technical institutes, is not included because they are not governed by the Board of Regents.) This paper deals with the mechanism by which the Board of Regents determines how to allocate among its universities money to support the Instruction Program on each campus.

All funding for the Instruction Program comes from the state general fund and student revenue. Suffice it to say, however, that tuition and fees collected on a campus do not necessarily remain there. "Tuition and fees," as used in this paper, means the revenue derived from those rates charged by the universities per credit hour of instruction plus a specific set of fees that are paid across the system by students. There are five fees in particular, the rates for which are set by the Board uniformly across the system, and all the revenue from which goes into the Tuition and Fees Fund[1]: an application fee, a fee for transcripts, a late registration fee, a late payment fee, and a reinstatement fee.

Up until the early 1970s, South Dakota public higher education was budgeted on a base-plus-increment system. Such a system is one wherein a given fiscal year's amount is the base, and additions/subtractions are made to that base for the next period to reflect increased/decreased activity, inflation, increases/decreases in caseloads or the like, the cumulative total resulting in the new total that becomes the next year's budget. Since FY73, the Board of Regents has used an instrument known as the Higher Education Funding Formula (HEFF), also known as the Instructional Formula, to allocate precious tuition and fees revenue back to the public universities. HEFF was written in 1972 as the result of an effort by the Budget Advisory Committee, a team of academic and fiscal personnel representing each of the state's public colleges and universities. This committee studied 15 other states' formula processes and also gathered data from a number of national higher education organizations in the writing of its own. Unfortunately, ever since its inception, HEFF has been controversial, although definitely not to the same degree to the general public

as the formulas for State Aid to Education. Not only have the results (i.e., the amounts of money distributed and the state general fund component therein) been questioned, but HEFF's mechanics, too, have come under fire from various critics, within the Regents System as well as from without. HEFF has remained practically unchanged, though, during its entire two decades, during which time there have been three State Aid to Education formulas. The State Aid to Education formulas are codified (SDCL Chapter 13-13), but HEFF is not. HEFF is operated by the fiscal staff of the Board of Regents Central Office based upon input data gathered from the campuses. It exists strictly as an internal management tool utilized by the Board.

Funding controversy derives from the fact that HEFF has only been regarded as fully funded during the FYs 1990 to 1994, inclusive, when it featured prominently in the budget recommendations of the late Governor Mickelson. Full formula funding (FFF) was part of a bargain the Governor struck with the Board: If they grew their enrollments, which he saw as crucial to the state's economic development, his budget recommendations would include FFF. As he said in his 1989 State of the State Speech, "Last fall, higher education recorded its second consecutive enrollment increase...a goal I asked for and they met. In return, I am requesting we provide full formula funding." As part of his FY95 budget recommendation, Governor Miller, on the other hand, recommended only partial funding of the Board's $3.5 million HEFF request. The Legislature added to his recommended amount somewhat, but still left a shortfall, which the Board of Regents decried as a breaking of the promise.

During the 1994 Interim, the Legislature's Higher Education Funding Study Committee addressed the issue and, as a result of its study, introduced what was eventually passed in the 1995 Legislature as Senate Concurrent Resolution 2 (SCR 2). This resolution encouraged the Board of Regents to conduct its own HEFF study, which they have just begun. SCR 2, which is shown in its entirety as Attachment 1 to this paper, lists a number of aspects of HEFF the Board should study, including: "which students should be included;" "the proper level of state support for each student;" and the various factors that are used within the formula--which have not been changed since the formula was written--to allocate money for costs of instruction, administration, student support services, and the myriad other aspects of higher education. No date specific was mentioned for a report from the Board on its findings, nor did SCR 2 mention to whom the Board should report, or what form the report should take.

Without going into great detail, HEFF is a zero-based formula that begins with a totaling of student credit hours (SCH) by more than three dozen academic disciplines and by four class levels (lower, upper, graduate, and thesis). The sums for each level are divided by predetermined ratios for the disciplines to compute instructional faculty FTEs. These FTE numbers are multiplied by a second set of predetermined factors to yield research FTEs, which when added to instructional FTEs, equal total faculty FTEs. These totals are then divided by an "instructional administrator factor" of 24 across the board to result in FTEs for instructional administration.

FTEs is only part of the output of the HEFF, one of the other parts being salary dollars. Part of the monetary figure for a given FY's FFF results from a net process wherein the

total increases in FTEs generated by the formula are multiplied by the average salary for that type of FTE (instructional or administration) plus the Governor's recommended salary policy. The salary figures are multiplied by the percentage that is employee benefits, then salaries and benefits are totaled for the types of FTEs resulting in the final grand total of personal services and FTEs. Finally, HEFF also yields a monetary component for instructional "O & M," which is supplies, contractual services, capital assets, and travel that support the Instruction Program.

The Board's overall budget request to the Governor for a given fiscal year, which is then followed by the Governor's recommendation and the Legislature's ultimate appropriation, includes a figure that is the incremental difference from the previous fiscal year's formula base but based on actual enrollment data that is two fiscal years old. Thus, FY93 enrollment data was used in 1994 when the Legislature discussed the $3.5 million and 73.2 FTEs the Board wanted for FY95 FFF. That year's FFF discussion assumed as a base the almost $90 million total that comprised the Instruction Program for the Regents System. The total funds requested for FY96 for the Instruction Program were over $100 million, of which more than half was general and almost $30 million was tuition and fees. Only during those five years of FFF during the Mickelson Administration was there both a Governor's recommendation followed by the Legislature's appropriation of that full incremental difference each year.

In making its funding request each year and selling it to the Governor and Legislature, the Board of Regents has traditionally described HEFF as "performance funding," and SCR 2 expresses "legislative support of the instructional formula as a **performance-based** mechanism to fund higher education." Despite the Board's allusions to the challenge by Governor Mickelson, however, saying HEFF and, consequently, the Instruction Program, are performance-based is arguable. True performance-based funding utilizes a process wherein formal objectives or goals are set at the outset of a funding period, then the system or agency's results are assessed at the end of the period. HEFF is really a manipulation of (or series of mathematical operations on) a statistical base from one fiscal year to attempt to allocate proper funding two fiscal years later.

SCR 2 was not the first expression of support for the formula by the Legislature. During the mid-70s, the Letters of Intent written by the Committees on Appropriations also announced support for the formula method of distributing funding for the Instruction Program. Despite these documents and the five years of agreement with Governor Mickelson's recommendations of FFF, the Legislature never promised FFF in so many words; nor could it, however. Clearly, such a concept would entail an obligation of future Legislatures, which is forbidden.

South Dakota is by no means unique in its use of a formula to distribute funds to its universities. According to Mary P. McKeown and Daniel T. Layzell in JOURNAL OF EDUCATION FINANCE (Winter, 1994), 33 states use formulas of some sort to determine amounts of funding for their higher education systems and/or to distribute funds to the colleges and universities. Of those states, only seven use formulas for all sectors of higher education (universities, colleges, junior colleges, vocational schools), but 20 states use them for their universities. Almost all of the 33

states use formulas during the budget request stage, and about half of the states' governors use the formulas to make their budget recommendations. About the same number of states' legislatures use formulas to allocate funding.

The number of states that use formulas has not increased for many years, however, and, in fact, may actually begin to decline. Formulas are not perfect, as researchers are beginning to learn. According to a study of the methods used by the 15 member states of the Southern Regional Education Board (SREB), there is legitimate question of the adequacy of current funding processes because "comparative data . . . in one state may yield very different funding levels than another [which is] of particular interest and deserves further study. . ."[2]

It is interesting to note that South Dakota is adjacent to three non-formula states, Wyoming, Nebraska, and Iowa. Washington does not use formulas, nor do Michigan or the states of the New England region. As an example of a state that has discontinued use of budget-building by formula, Wisconsin dropped the use of its enrollment-based funding formula in the early 1980s. They "abandoned the formula when it resulted in unfundably large figures. Instead, the university system submits a program budget just like any other state agency, asking for standard costs-to-continue...then justifies other specific needs such as library-acquisitions funding, laboratory-modernization costs and **additional faculty** [emphasis added]."[3] (While Governor Mickelson recommended FFF in five consecutive years, his budgets only included the general fund dollars component, not the FTEs for it. During the years when FTEs were increased, it was because the Legislature actually appropriated more FTEs to the Board than would have otherwise happened if they had just adhered to the Governor's budget recommendations.)

In effect, this is what has happened in South Dakota, except that general fund support for the Instruction Program has been frozen, supposedly meaning a halt in the growth of the numbers of system faculty, regardless of large enrollment increases. In a study of the Wisconsin experience, the resulting recommendations include advice not to base "state-funding results on enrollment formulas. States never can fully fund rapid growth. The approach encourages overcrowding and diminished quality as institutions admit too many students in pursuit of marginal funding increases.[4]

As mentioned earlier, the Regents' budget request for FY95 included $3.5 million and 73.2 FTEs for FFF, and the eventual appropriation was far short of that amount. For FY96, their request was $4.8 million and 98.7 FTEs, part of which was to make up the shortfall from FY95. None of the FY96 request was recommended by either Governor Miller or Governor Janklow, nor was it appropriated by the Legislature. Thus, South Dakota, so far as recent actions by the two most recent Governors--and the Legislature--would illustrate, is effectively back to the funding method employed prior to HEFF, that being a base-budget-plus-increment style of funding recommendation and appropriation.[5]

NOTES:

[1] The Tuition and Fees Fund in the state treasury is created in SDCL 13-53-15 and continuously appropriated to the Board of Regents. To this fund is deposited 80 percent of the total revenue collected at the universities from tuition and the five fees. The continuous appropriation means the Board is entitled to spend whatever revenue is collected, legislative appropriations notwithstanding. The other 20 percent of revenue is deposited in the Higher Education Facilities Fund, which pays for construction, maintenance, and repair of higher education facilities. The Legislature appropriates expenditure authority to spend from that fund.

[2] Caruthers, J. Kent and Joseph L. Marks. FUNDING METHODS FOR PUBLIC HIGHER EDUCATION IN THE SREB STATES, Southern Regional Education Board (1994), p. 4.

[3] Sell, Kathleen R. "Linking Budgeting to Academic Planning: The Wisconsin Case," from FOCUS ON THE BUDGET: RETHINKING CURRENT PRACTICE, State Higher Education Executive Officers and the Education Commission of the States (May, 1994), p. 23.

[4] Ibid., p. 38.

[5] The System was budgeted at $102 million general for FY95 (which was $105.3 prior to the Video Lottery Special Sessions), and the Legislature appropriated $106.7 million for FY96. Of the Regents' $4.7 million general fund increase over post-Special Session FY95, $2.6 million was for salary policy, $100,000 was for the Animal Disease Research and Diagnostic Laboratory, and the rest was partial reinstatement of Special Session budget cuts. The Regents have enacted certain controversial measures to curb enrollments.

This issue memorandum was written by Mark Zickrick, Principal Fiscal Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.
