Postsecondary education in Ontario and the recession

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Introduction

Within the 2009-20010 academic year, the economic and political environment for postsecondary education in Ontario was turned upside down.

What had been a collapse in markets for exotic credit derivatives and the institutions that created them before the bankruptcy of Lehman Brothers investment bank quickly spread to every aspect of the financial services industry. What had been a slump in the housing sector in the United States rapidly spread to every sector of every economy in the world. The Canadian government's claims that Canada's healthy banking sector would immunize this country from the worst of the economic and financial turmoil turned to denial, to political crisis and then to virtual panic as hundreds of thousands of jobs disappeared. Ontario's economy actually shrank in the 4th quarter of 2008 (-1.5% growth) and again in the 1st quarter of 2009 (-2%). An Ontario government that headed into the winter season in denial, insisting that business as usual would enable it to maintain close-to-balanced budgets through the economic slowdown headed into spring forecasting budget deficits totaling $19 billion over the next two fiscal years. Within six months, even that depressing forecast was abandoned, with a revised forecast for a deficit of $18.5 billion in 2009-10 alone.

On the political front, the conservative ideas that underpinned economic conventional wisdom for more than a generation were swept aside in a few short months, discredited by financial and economic events that the conservative conventional wisdom insisted were not possible. The claim that market forces would ensure the financial turmoil would be self-limiting made laughable by a financial system spiraling out of control. The assertion that the best role for government in the crisis would be to stay out of the way eclipsed by the parade of business leaders headed to Washington with hands extended and pockets turned inside out. The holy grails of balanced budgets and all purpose tax cut policies replaced by desperate calls for massive economic stimulus packages dominated by increases in public spending and accompanied by equally massive fiscal deficits.

In the battle of ideas, over the course of 2008, Allan Greenspan and Milton Friedman were shuffled to the periphery while John Maynard Keynes was retrieved from the history books to take centre stage.

These sea changes manifested themselves most directly in political changes around the world. In the United States, the most resolutely neo-conservative administration in decades was replaced by the most resolutely liberal administration in decades. In Canada, the political crisis that erupted at the end of 2008 had everything to do with Stephen Harper playing catch-up after having completely missed the signals.

These momentous changes, and the responses of individuals, businesses and governments to those changes affect every aspect of life at Ontario's universities.

The collapse in asset values has a direct impact on university finances through endowment funds and pension plans. The downturn in the economy affects students' and their families' ability to pay; it also affects the school-work decisions of individual students. Governments' responses to the downturn, both here in Canada and in the United States, have the potential for both positive and negative effects on Ontario universities, both short-term and long-term.

Financial markets and universities

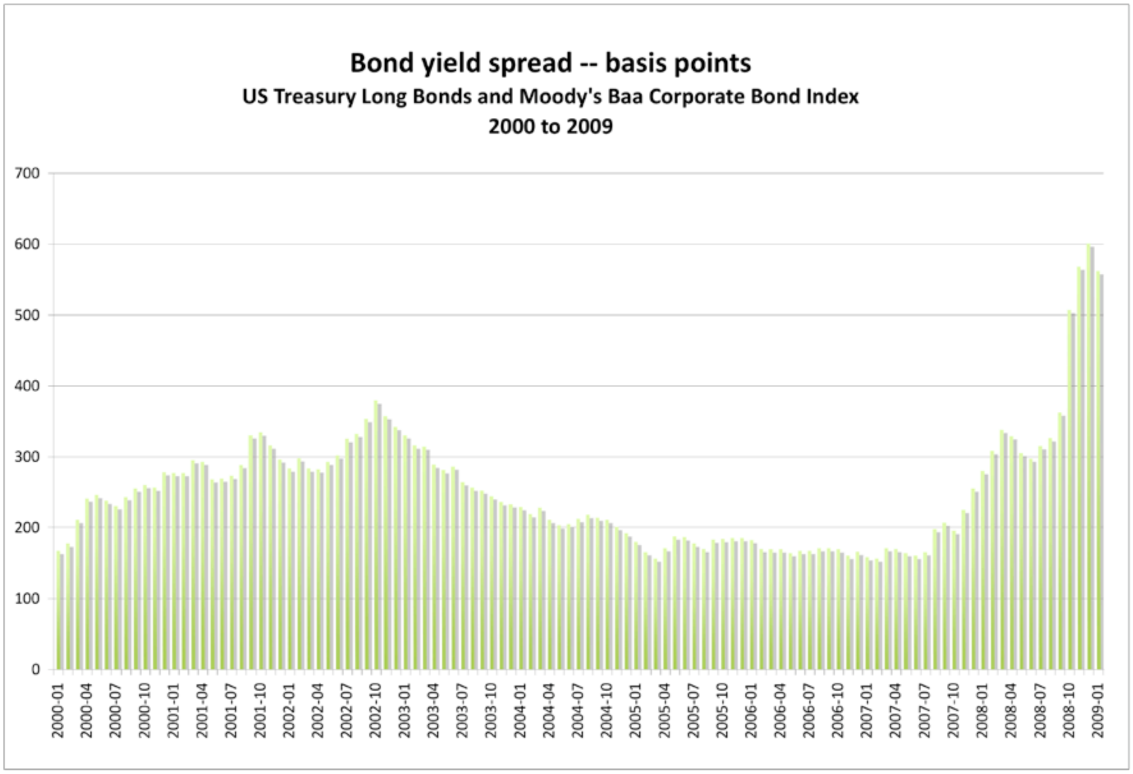
Universities participate in financial markets in several respects. Most universities participate in capital markets as borrowers – normally as issuers of fixed-income securities.

A dramatic widening of yield spreads between national government debt and essentially every other form of credit has been the hallmark of the financial aspects of the current crisis. Securities that carried credit ratings equivalent to those for sovereign debt heading into the credit crunch have seen yield spreads widen to unprecedented levels. For example, the normal 10-to-15 basis point spread between government agency bonds and the government bonds themselves widened in January to more than 100 basis points (1%).

Credit spreads for Baa corporate bonds would be representative of the kinds of credit conditions faced by Ontario universities.

Chart 1 presents the spread between US Baa 10-year corporate bonds and US Treasury 10-year bonds.[1]

[1] US Federal Reserve Statistics, 2009



Yield spreads on high quality investment grade corporate bonds expanded from less than 200 basis points in the run-up to the credit crunch to nearly 600 basis points. With each 100 basis points in yield spreads translating to roughly a 16% increase in total financing costs, these yield spreads add potentially prohibitive premiums to university infrastructure financing costs.

For debt that is already in place, these swings in yield spreads are immaterial. They will affect universities directly only to the extent that they are either required to refinance existing debt or issue new debt to support new projects.

This has direct implications for university involvement in capital spending designed to deliver economic stimulus where cost-sharing is required. To ensure that universities are able to participate in these programs, the provincial government should create a facility through which universities are able to borrow for approved projects on the credit of the Province of Ontario.

Universities also participate heavily in capital markets as asset owners, through pension plans and endowment funds.

The decline in asset values has had a devastating effect on the finances of all pension plans in Canada. The large ($1 billion + assets) pension plans in Canada reported median returns of -18% for 2008.[2] When one considers that pension plan funding generally assumes a nominal return of at least 6%, that translates to

[2] RBC-Dexia

a loss on the asset side of the funding equation of roughly 25%. Since pension plans are effectively prevented from carrying surpluses in excess of 10%, this means that most university pension plans would have faced a funding shortfall of at least 15% as of the end of 2008 if they were required to file a funding valuation as of that date. In Budget 2009, the Government of Ontario responded by proposing measures to provide temporary solvency funding relief to Ontario registered pension plans. In June 2009, Regulation 909 made under the Pension Benefits Act (PBA) was amended and affords temporary solvency relief for deficits reported in the first filed valuation report with a valuation date on or after September 30, 2008 and before September 30, 2011. While the revised General Regulation will allow universities to spread their solvency payments over a longer period, it is anticipated that these institutions will be left with significantly increased funding requirements.

Endowment funds are affected by financial markets both directly and indirectly. Generally speaking, one would expect the financial results for large endowment funds to be similar to those for large pension plans – indeed, at some institutions, the endowment funds and the pension funds are managed on the same basis. This means both that the asset base for the endowment funds is likely to be lower and that there will be pressure to reduce the cash flow to operations from these funds. Canadian university endowment funds generally have not experienced anything like the liquidity problems facing the major Ivy League university endowment funds, nor are their finances as heavily dependent on endowments as are those of major US private universities. However, the deterioration in financial markets will create a tension between fund managers desire to protect capital and the requirements of those university activities that are the heaviest users of endowment funds.

Endowment funds have not become significant sources of operating funds for Ontario universities. Other than restricted uses, such as academic chairs, the major use of endowment money seems to be in the area of student financial assistance.

Even the limited pressure that the poor performance of endowment funds is placing on some universities highlights a fundamental problem with the encouragement of endowment funds – along with much higher tuition and other fees -- as a source of funding for universities adopted by the Harris Government in the mid-to-late 1990s. Increased reliance on endowments for operating funding has exposed Ontario universities to financial market risk, thereby putting postsecondary education programming at risk from declining asset values in financial markets.

Endowment funds are also indirectly affected by declining financial asset values, to the extent that these declining values cause potential large donors to reassess the value of their potentially disposable wealth.

Economic downturn and universities

The effect of the economic downturn on universities is felt through its impact on students and their families and decisions to go to or stay in school, and could conceivably be either positive or negative. On the negative side, Canadian data show that family contributions and students' summer and part-time earnings are significant sources of financial resources to fund postsecondary education. With a significant economic contraction accompanied by tens of thousands of layoffs and particular weakness in the retail sector, one would expect both students' and families' financial resources to be strained by the recession. In addition, one would expect a family's assessment of the risks associated with committing to a significant multi-year expenditure to change as the economy weakens and risks to family economic security increase.

Evidence from the labour market in the summer of 2009 suggests that the recession has already had a significant impact on students' finances. Statistics Canada's Labour Force Survey for August 2009 reported as follows:

> From May to August, the Labour Force Survey collects labour market information about young people aged 15 to 24 who were attending school full time in March and intend to return to school in the fall. The published estimates are not seasonally adjusted; therefore, comparisons can only be made on a year-over-year basis.
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> In August, employment was down 128,000 (-9.5%) among students aged 15 to 24 compared with August 2008, the fastest year-over-year rate of decline for a month of August since 1983.
>
> The unemployment rate reached 16.4% for students in August, up 5.0 percentage points compared with the same month last year. This was the highest August unemployment rate for these students since comparable data became available in 1977.
>
> The 2009 summer labour market was one of the most challenging for students. The average unemployment rate for the summer was 19.2%, the second highest rate since comparable data became available in 1977. In addition to a high unemployment rate, the average number of hours worked during the summer by students was the lowest since 1977, at 23.4 hours per week.[3]

On the positive side, it is often suggested that participation in postsecondary is affected by the state of the employment market, as the trade-off between school and work is affected by prospects for secure employment.

As a result of the reduced level of family income, student financial needs will be greater than would otherwise be the case, as will the propensity of students to incur debts in order to stay in school. The Ontario Student Assistance Program

[3] The Daily, Statistics Canada, September 4, 2009

has seen an increase in students turning to financial aid to finance their education for the 2009-10 academic year. Many of these students have never needed financial assistance before because they received support from their families and/or were able to pay for their own tuition.

This issue raises questions about the government's decision to proceed with the planned 5% tuition fee increase for the 2009-10 academic year. Even without considering its impact on student finances, from a fiscal perspective it will have the same effect as a tax increase.

Political responses to the recession and universities

Assessing the impact on universities of political responses to the recession is extremely complex.

Under normal circumstances, one would expect both federal and provincial governments to react to the deteriorating revenue side of their budgets as the recession deepens. That was certainly the case with the Rae government's response to the 1991 recession and the Harris government's response to revenue losses from tax cuts and the brief slowdown of 1996. For universities that meant restrictions on transfer payments and expenditures in the 1990s and substantial cuts in transfer payments in the late 1990s.

These are not normal circumstances. The re-emergence of Keynesian economic stimulus as the last remaining viable public policy response to the recession has changed the environment in important respects. No government is prepared to suggest that it will cut its way to a balanced budget, regardless of the economic circumstances. Deficit phobia has evaporated. With the public economy the only source of economic stability and the only potential source of short-term economic stimulus, governments have suddenly become conscious of the need to avoid imposing a fiscal drag on an already weak economy through services cuts. Even when it comes to salaries and benefits, Ontario in particular is not in a particularly strong position to impose restraint on transfer payment agencies having negotiated substantial long-term pay increases with physicians and elementary and secondary teachers.

Indeed, to the extent that universities are in a position to respond, they stand to benefit from government efforts to stimulate the economy through investments in public infrastructure. Universities in Canada got their own specific stimulus program in the January 2009 federal budget, which provided approximately $2 billion to support deferred maintenance and repair projects at post-secondary institutions up to 2010-11. The Ontario Budget 2009 has also committed $780 million in capital funding for colleges and universities. Ontario universities have now received $1.09 billion in combined federal-provincial funding under the Knowledge Infrastructure Program.

As interest grows in the role of education in general and of postsecondary education in particular in building Ontario's competitive advantage for the future, universities have a compelling case to make that investment in postsecondary education is one of those 'foundation for the future' investments that the experts keep saying we have to make, recession or no recession, to prepare for a recovery. The recent report of the Prosperity Institute of the Rotman School of Management at the University of Toronto makes clear the extent to which Ontario's ability to succeed in the future depends on the quality of and participation in postsecondary education.[4]

The wild card in the postsecondary education game in North America is what the impact will be of a new US administration that is committed to rebuilding the United States educational system and academic research capacity. Education features prominently in the Obama Administration's recovery plan. Under the American Recovery and Reinvestment Act of 2009, the United States government will invest $53 billion in education and training. The President has also appointed a science advisor, and has chosen a scientist to head up the US Department of Energy. Research funding is increasing. Equally important, political restrictions on research activities in American universities are being relaxed, most notably the end of the ban on stem cell research.

At the same time, Canada's federal government is allowing funding for basic research to lapse, putting this country potentially in the position of reducing funding for basic research at the same time as the United States is making unprecedented new investments.

Positioning Ontario universities for the future

There is no shortage of advice being offered to the Ontario government and the universities that rely on it for a substantial portion of their revenue. The high-profile report by Richard Florida and Roger Martin for the Prosperity Institute calls for significantly increased investment in postsecondary education. At the same time, the Educational Policy Institute, a US-based conservative educational think tank, has issued a report suggesting that governments will not respond to even the current needs of postsecondary institutions, and suggests that middle-income families can afford to and should pay substantially more for postsecondary education.[5]

[4] Richard Florida and Roger Martin, "Ontario in the Creative Age", Martin Prosperity Institute, Rotman School of Management, University of Toronto, February 2009

[5] Alex Usher and Ryan Dunn "On the Brink: How the Recession of 2009 Will Affect Postsecondary Education", Educational Policy Institute, February 2009.

Offering no references for the claim and using a convenient base year, the EPI report asserts that family incomes have been increasing while tuition fees have been stable over the past decade. Neither of those statements is correct, even for the carefully-selected time period, and certainly

While Premier McGuinty has welcomed the Prosperity Institute report and wisely rejected the recommendation from the Educational Policy Institute to impose substantial increases in university tuition, the government has not yet come to terms either with the implications of the Martin-Florida report or with the reality that the government's current policy with respect to postsecondary education is rooted in ideas about the economy and the government's role that have been among the earliest and most obvious casualties of the recession.

As a result, Ontario's approach to the funding of postsecondary education is a mixture of the unaltered legacy from the Harris years with its emphasis on the privatization of the costs of the system and the constrained vision of student-funded education espoused by conservative think tanks like the Educational Policy Institute and reflected in the report to the McGuinty government by federal Liberal external affairs critic and former NDP premier Bob Rae.

Preoccupied with ensuring that students who benefit from postsecondary education pay for the privilege, high-tuition advocates have missed the fact that, through our progressive income tax system, Canada already recovers about 40% of the income gained by students from their university education. Obsessed with demonstrating that higher tuition has not reduced enrolment, advocates of the current high-tuition model have lost sight of the big picture. Rather than take comfort in the fact that higher tuition has not led to any reduction in enrolment, we should be concerned that overall participation in postsecondary education has not kept pace with needs. Wedded to the assertion that issues of access can be addressed through needs-based financial assistance, advocates of the high-tuition model of university finance have resolutely ignored the mounting evidence that lower- and middle-income students are being squeezed out of higher-cost professional programs, that university completion rates are disturbingly low and that students graduating from university do so carrying crippling levels of debt.

This approach has put Ontario firmly at or near the bottom in support for postsecondary education among Canadian provinces. Ontario ranks second-highest in undergraduate tuition, highest in graduate tuition, highest in tuition as a percentage of university expenditures on education and lowest in provincial funding as a percentage of total university income.

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not over a more meaningful longer time period. The choice of the most recent decade for the comparison captures the period in which middle-income families began to recover from their real income losses in the early 1990s but conveniently misses the period during which tuition increased most rapidly. Over the more representative period of 1990 to 2008, average undergraduate tuition, adjusted for inflation, increased by 120%; median incomes of families with children adjusted for inflation actually declined.

Table 1: Ontario's university funding report card[6]

	2008 tuition				2008 Funding			
	Undergraduate		Graduate		Tuition % of education		Provincial grants % revenue	
Province	$	Rank	$	Rank	%	Rank	%	Rank
Newfoundland and Labrador	2,632	9	3,686	7	28%	9	54%	2
Prince Edward Island	4,530	7	2,954	9	45%	6	39%	8
Nova Scotia	5,932	1	7,242	2	56%	3	39%	7
New Brunswick	5,590	3	5,119	5	60%	1	38%	9
Quebec	2,167	10	2,488	10	18%	10	58%	1
Ontario	5,643	2	8,797	1	58%	2	38%	10
Manitoba	3,276	8	4,602	6	35%	8	50%	4
Saskatchewan	5,015	6	3,535	8	38%	7	53%	3
Alberta	5,361	4	6,399	4	50%	4	45%	6
British Columbia	5,040	5	6,580	3	46%	5	45%	5

Total spending on universities, on a per-student basis, is the lowest in the country. The current track of government policy will not change that. And with education moving to centre stage in the economic plans of the United States, Ontario risks being left behind.

Responding to the recession – an opportunity to re-think our approach to postsecondary education

If we have learned anything from the recession, it is that we cannot rely on market forces alone to produce the economic outcomes we need as a society, and that it is the responsibility of government to make the long-term investments whose benefits accrue to society as a whole.

[6] Sources:
Tuition: Statistics Canada Daily, October 9, 2008, September 1, 2006
Funding: CANSIM table # 385-0007

Whether we look at the current state of our educational institutions, measures of educational quality, student participation rates, the positioning of our universities for Ontario's future needs or the financial position of students and their families, the obvious response is a substantial increase in public investment in postsecondary education. Just as Ontario visionaries in the 19^{th} century made elementary education universal and in the 20^{th} century extended universal public education to the secondary level, positioning Ontario to succeed in the 21^{st} century demands that we extend that vision of universality to education at the postsecondary level, including universities, colleges and post-employment adult education.

The recession will inevitably limit our ability to realize a new vision for postsecondary education in the short term. Ontario can, however, take the appropriate first steps.

- Recognize that a 5% tuition increase is equivalent to a tax increase in a recession, rescind it, and provide the equivalent in lost revenue to colleges and universities in the form of increased operating grants.
- Set out a program of increased public support aimed at moving Ontario from last to first among Canadian provinces in its support for postsecondary education over a five-year period.
- Lead a federal-provincial dialogue on student financial assistance to shift assistance from the current distribution, in which much of the assistance is distributed in inverse proportion to need, to a new system that consolidates existing support in a purely needs-based system.
- Over a ten-year period, constrain college and university tuition to 25% of the education cost component of university and college finances.
- Take a leadership role in the funding of basic research in Ontario universities.