Recessions Past and Present

Higher education struggles with state cuts, rising tuitions and a climate of uncertainty

By David W. Breneman

THERE IS A TENDENCY, when discussing the impact of recessions on higher education, to treat recessions as largely similar in kind, and thus not to pay much attention to factors that may differentiate among them. What we are seeing, however, in the financial crisis and decline of 2007–09 is a very different sort of event than, for example, the recession of the early 1980s. Few have asked whether different types of recession affect higher education differentially, but this is a topic that the current downturn renders worth considering.

Differences in Recessions

Since the early 1970s, the United States has experienced five recessions: 1973–75, 1980–82, 1990–91, 2001–03, and 2007 to the present. Today, given the severity of the current situation, the word "Depression" has crept back into the conversation, as certain similarities to the dire experience of the 1930s are evident. A brief commentary on economic thinking about depressions and recessions is a good place to start.

The great intellectual advance coming out of the 1930s was the work of John Maynard Keynes, who in his classic 1936 book, "The General Theory of Employment, Interest and Money," established the framework that guided macroeconomic thinking for several decades. The Great Depression witnessed hundreds of bank failures, a severe contraction of the money supply, and the collapse of aggregate demand in the economy.

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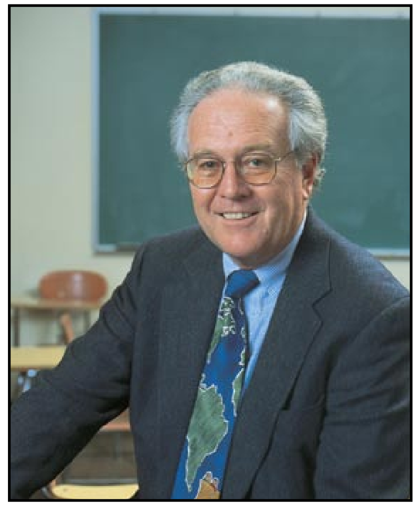
Keynes focused his efforts on rejuvenating demand, and with consumers and investors on the sidelines, he saw government as the sole remaining source of new demand, which through the multiplier effect of subsequent rounds of spending could re-start the economy. At a time when monetary policy was ineffective (people and businesses were hoarding cash for liquidity purposes), Keynes emphasized the necessity of aggressive fiscal policy. In fact, it took World War II to generate the demand necessary to pull the U.S. economy out of depression.

Keynesian economics held sway into the early 1970s, when the comment "We are all Keynesians now" was attributed to Richard Nixon. But the 1973 oil shock and the subsequent years of slow economic growth and accelerating inflation, known as stagflation, began to undercut the logic of the Keynesian system, focusing increased attention onto monetary policy, as inflation is a monetary phenomenon.



Paul Volcker, in his role as chairman of the Federal Reserve Board, broke the back of inflation in the early 1980s by sharply raising interest rates, and thereby squeezing out private investment demand. The result was the recession of 1980–82. The success of this effort, in wringing high inflation out of the economy, enshrined monetary policy as the key instrument for guiding the economy, overshadowing fiscal policy as a tool. But the economic cost was high, with the unemployment rate reaching 10.8 percent.

The 1980s also saw the rise of "supply-side economics," so called to differentiate it from Keynesian "demand-side economics." This new focus lionized the market, entrepreneurship, innovation, and incentives for private production and demand, primarily in the form of tax cuts. Keynesian policies and the productive role of government were dismissed as stodgy and old-fashioned, brushed aside by the drive and vigor of the "supply-side actors," the entrepreneurs and producers. The recession of the early 1990s was brought on as these new actors confronted global competitors, such as the Japanese and the other Asian "tigers," who were outstripping the U.S. in manufacturing productivity and cost efficiency.

Inflation also surged again in the late 1980s, and tight monetary policy had its effect in slowing the economy. In order to regain some measure of competitiveness, the early 1990s featured downsizing, re-engineering, and restructuring of the work force, with sizable reductions in the middle-management sector of the white-collar labor force. Bill Clinton won the White House in 1992 in the sluggish aftermath of recession by never forgetting that "It's the economy, stupid."

The recession of 2001–03 was triggered by the collapse of the high-tech, Internet boom of the late 1990s, as this disruptive new technology burst on the scene and promised to redo the way we conduct business. Speculation on virtually any new "dot-com" company drove the stock market to new highs, and when the bubble burst, much of the economy went with it. The September 11, 2001, terrorist attacks added to the fear and uncertainty, and contributed to the stock market plunge. This recession turned out, however, to be relatively short and shallow, as monetary policy was dramatically loosened so that interest rates hit historic lows and stayed low, and vast sums of liquidity were pumped into the system. Unfortunately, loose monetary policy, coupled with new financial instruments such as derivatives, collateralized debt obligations, credit default swaps and other arcana, set the stage for the financial collapse through which we are currently living.

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Highlights of this brief summary are that the causes of recession are many and varied, and that the cause matters in determining both the cure and the likely duration of the problem. Until recently, consumer demand tended to remain strong even when other economic indicators were not, and thus could be counted on to help pull the economy back to capacity. Monetary policy was broadly effective in stimulating investment, and often helped the economy to rebound in a V-shaped way, rather than the slower U-shaped pattern.

But the current recession is significantly different from those that have preceded it, and in that sense, parallels to the depression of the 1930s are apt. The current problem has its roots in the financial sector—banks are failing, credit has been much reduced, monetary policy is ineffective, consumers are not spending as freely as before, retail businesses are closing, investment projects are put on hold, and demand for liquidity is so strong that in recent weeks short-term Treasury bills, presumably the most secure financial asset, were actually paying a negative interest rate as people clamored for safety, regardless of return.

The Keynesian model is highly relevant again, as we confront sharply declining aggregate demand from consumers, investors, and from abroad for our exports. Government is once more the force being called upon to get the economy moving, and hence the Troubled Assets Relief Program (TARP), enacted in the waning days of the Bush administration, and the new fiscal stimulus package of the Obama administration. As this essay is being written, the future of the economy is strikingly uncertain, for we have not experienced conditions like this in the recessions of the ’70s, ’80s, ’90s or early 2000s.

Few think that the economy will rebound rapidly, as consumers and investors are nervous and cautious, and the fiscal stimulus will be slow in working. Unfortunately, the recession that began in the U.S. has spread throughout the globe, and no other major country seems poised to pull the rest of us out of the swamp. Some argue that much of the “wealth” created in the last decade was little more than paper wealth floated on a sea of new and unfathomable financial instruments; thus, the air going out of this bubble is just that—air—not substance.

Perhaps the greatest source of optimism is that we have experienced the Great Depression before and have learned from it, and thus will not repeat the policy mistakes of that era, such as initial timidity in stimulating demand, that made the problem worse. But one does have the sense that the psychology of debt—of buying on credit and overextending, whether as a household or as a company—may be changing in ways that will mark this time as one of national, even international, cultural change.

Significance for Higher Education

A review of the past four recessions prior to the current one reveals that, on balance, higher education in the United States weathered each of these economic storms reasonably well (the *Chronicle of Higher Education*, October 10, 2008). But most observers agree that the current recession, officially announced as having begun in December 2007, is a different breed of recession, with disconcerting similarities to the Great Depression of the 1930s, as noted above. After years of neglect, Keynesian economic policy is being reintroduced in the form of aggressive fiscal actions designed to increase aggregate demand in the economy. While it seems unlikely that the world will slump into prolonged depression, the economic outlook is cloudy at best, with conditions likely to be more severe, and depressed longer, than in other post World War II recessions. What might this situation mean for higher education in the United States?

We have no definitive evidence yet, but early warning signs abound. Most state governments are experiencing a sharp drop in tax receipts, and because states have to operate with balanced budgets, expenditure cuts are being reported daily. In recent days, for example, the states of Washington, Nevada, Texas, Oregon, Idaho, California and South Carolina have announced cuts in state appropriations to public colleges and universities, ranging from ten to 36 percent. And few states, if any, will avoid such cuts.

While it is true that state support for public higher education has been declining as a share of institutional revenues for more than two decades, the severity of the current cuts might push public institution leaders to reduce enrollments, something they are normally reluctant to do. For example, the California State University and University of California systems have announced plans to reduce the number of entering undergraduates by several thousands of students. The new round of state cuts will also prompt yet higher public tuitions, further dampening demand.

It has been common in past recessions for enrollments to actually jump, as the opportunity cost of forgone earnings for the newly unemployed declines. While not yet definite, there are early signs that such an enrollment surge might not be happening this time around, in part because institutions are reluctant to keep expanding when revenues drop, but also because of the rising student charges and general uncertainty about the economy. The United States has been on a borrowing binge fueled by low interest rates for several years, and much of what is happening now is an unwinding of unsustainable debt levels, both in families and in businesses. Higher education has become increasingly dependent on student and family debt to cover student bills, but not only is the credit market harder to tap now, but increasing numbers of would-be students may be reluctant to borrow more for higher education.

This phenomenon may be particularly true for potential graduate and professional students, including those who might otherwise embark on Ph.D. programs. One effect of both the drop in state support and falling endowment levels has been a sharp reduction in the number of new tenure-track positions being filled this year. Adding to the costs of college and university budgets will also be a likely reduction in retirements, as many academics have experienced a 40 percent drop or more in the value of their defined contribution retirement plans. Rather than retire and open up positions for new Ph.D.s at lower salary costs, many relatively highly paid academics will now stay on into their 70s.

Both public and private universities have emphasized private fundraising and the building of sizable endowments in recent years as a way to diversify revenues. Numerous universities have reported endowment losses of 25 percent or more in 2008, as virtually all asset classes have fallen in value. The logic of limiting spending from endowments to roughly five percent annually means that drawing from this source must decline, or spending will increase to unsustainable long-term levels. It is also unclear whether major donors will be able or willing to continue to provide substantial new gifts at previous rates in the current climate.

Much depends on what happens in 2009, and whether the fiscal stimulus developed by the Obama administration will recharge the economy. It may also be the case, however, that a prolonged recession and slow recovery will provide the context in which institutions will re-examine their policies and practices and bring an end to some of the extravagances that critics of higher education have railed against for years. Many outlays have been driven by competition for status and prestige, as well as to provide students with accommodations, services and facilities approaching a luxury level in some schools. If families are forced to scale back in their spending and expectations (or do so of their own volition), this pressure will surely be brought to bear on the colleges and universities where their children enroll. Just as cultural change is bringing pressure to bear for "green" campuses and worksites, so might pressure for a leaner, more austere academic experience, at a lesser charge to students, come to pass.

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Institutional leaders, board members and government educational officials face the following challenge: There is no evidence that the needs for a highly skilled and well-educated work force are going to diminish, given the technologically driven, competitive global economy, whatever course the economy takes toward recovery. At the same time, the conditions that provide access and opportunity to complete various forms of postsecondary education and training are languishing in this country, with performance over the past quarter century in improving degree output per capita essentially flat.

Furthermore, other developed countries are surpassing the United States now in the percentage of the younger population with degrees and certificates, so the benefits of our first-mover status toward mass higher education have been eroded. Finding the will and the way to use the educational resources we have most effectively is now both a moral and an economic obligation. ◆

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