

COMMENTS ON THE BUDGET PROCESS AND MOVING FORWARD

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The primary focus of budget policymaking is the Governor, not the Legislature.

UCOP's strategy for setting the budget has been to cut the best deal that it could with the Governor (through the Department of Finance), then defend this deal in the Legislature. The primary motivation for this strategy is the fact that the Governor has a line item veto, which allows him to cut anything that the Legislature includes in the budget that he does not support. (There are always skirmishes in the Legislature over a few issues that are highly partisan, such as funding for labor research or outreach, but the bulk of the budget is negotiated with the Governor.)

At the same time, UCOP blames the Legislature for budget problems.

This behavior allows them to protect the Governor and the deals cut with the Governor. At the same time, defending the deal with the Governor in the Legislature makes it difficult to argue for increased support in the Legislature (which UCOP thinks that the Governor would line-item veto anyway). This strategy also makes it more difficult to use Legislature mechanisms such as hearings as a way to raise the profile of higher education funding as a public policy issue.

The current deal with the Governor, the 2004 “HIGHER EDUCATION COMPACT: Agreement Between Governor Schwarzenegger, the University of California, and the California State University 2005-06 through 2010-11,” represents a fundamental shift in the model for supporting higher education in California, away from viewing higher education as a public good towards a private good.

While UCOP has a history of reaching multi-year funding plans with the Governor (generally called “compacts”), the agreement with Governor Schwarzenegger contained a commitment to fundamentally shift financing away from the state general fund onto private sources: student fees and other private sources. It states, “In order to help maintain quality and enhance academic and research programs, *UC will continue to seek additional private resources* and maximize other fund sources available to the University *to support basic programs*. CSU will do the same in order to enhance the quality of its academic programs.” (Compact,¹ page 2; emphasis added) Until this point, the state was viewed as the primary source of support for “basic programs” with private sources being used for additional initiatives.

The Compact commits UC and CSU to increasing reliance on (private) student fees for base support.

¹ The full text of the Compact is at <http://budget.ucop.edu/2005-11compactagreement.pdf> . For how UC and CSU presented the Compact to the public, see <http://www.universityofcalifornia.edu/news/compact/factsheet.html> and <http://www.calstate.edu/PA/news/2004/compact.shtml> .

The shift to using fees to finance UC (and CSU) is also explicit: the Compact states, “The student fee policy contained in this Compact assumes that UC and CSU will retain student fee revenue without a corresponding reduction in State funds which, together with State funds provided each year, will be used to help meet their budgetary needs as well as help the segments recover from the current fiscal crisis” (page 3). While, on its face, this statement sounds like an increase in funding for higher education, the Compact linked these fee increases to even larger reductions (about one-third²) in state support for basic operations.

In addition, the Compact committed UC and CSU to increase fees at least as fast as the rise in personal income, which is about twice the rate of inflation. Because incomes have increased most rapidly among the wealthy, this policy made higher education less affordable for most people.

The fee increases, while very large, have not been large enough to compensate for the loss in state support.

The fee increases in the Compact were limited to 10% a year, probably because that was the most that was politically possible. This amount was not related to the size of the cuts that UC and CSU accepted, resulting in a large drop in the money available to finance core functions, which would not be restored over the life of the Compact. The net result has been a substantial drop in quality of the educational experience, which has accelerated over time.

If the Compact was so bad, why did UC and CSU accept it?

The first reason was that Governor Schwarzenegger was threatening even bigger cuts if UC and CSU did not accept the Compact. More important, cognizant UC (and, presumably CSU) budget officials knew that there would be a major budget crisis starting around 2008, and believed that the Compact would protect UC and CSU from large cuts at that time.

Of course, when the budget crisis came in 2008, Governor Schwarzenegger simply walked away from the deal. Other than one comment at the July 2009 Regents’ meeting from Regent Blum, there has been no effort to exact a political price for failing to honor his commitment.

Thus, the debate over higher education should not be framed as a debate over how to allocate scarce state resources during difficult times, but as what it actually is: an ideological debate over the nature of higher education.

² The UC Academic Senate “Futures” report reads: “Budget cuts began mid-year in 2001-02, and continued through 2004-05. Overall the State appropriation to the University of California fell by 15% while enrollment grew by 19%. This means that state funding per UC student fell by approximately one-third in three years.” According the Senate’s later “Cuts” report, the state budgeted \$2.8 billion in 2003-04 and \$2.6 billion in 2004-05 (the budget being discussed at the time the Compact was signed), a 7% reduction. The Futures report is available at <http://www.universityofcalifornia.edu/senate/reports/AC.Futures.Report.0107.pdf> and the Cuts report is available at <http://www.universityofcalifornia.edu/senate/reports/cuts.report.04.08.pdf> .

The central policy document guiding higher education policy in California has been the 1960 Master Plan for Higher Education,³ which specified the coordinated roles of UC, CSU and the community colleges and established the system that guaranteed every California student an affordable (initially free) seat at an appropriate institution of higher education. The Master Plan clearly established higher education as a public good provided by the state for its citizens.

While fees have increased over time since then, the Compact represents the first time that UC accepted the *idea* that the costs of higher education should be shifted from public onto private sources.

The real question is: Should higher education be treated as a public good (as envisioned in the Master Plan for Higher Education) or should it be viewed as a private good to be paid for by its customers (students and their families) and voluntary private donors?

The Master Plan model has served California well.

It led to a large, highly educated population and workforce that supported the development of the knowledge economy. In recent years, the rate of college attendance has dropped in California, making it 18th in the country, below Missouri.

The only way to maintain quality and access is to restore state funding.

As the Futures Report notes, the only alternative to public funding as a way to finance UC (and, presumably, CSU) is student fees. Private philanthropy and sponsored projects finance specific activities, not the core budget. To replace the (reduced) state support with fees in 2008 would have required raising fees to around \$23,000 a year.⁴ To restore the quality (level of funding per student) to 2001 levels would have required fees of over \$27,000. Doing so will continue to price students out of the market.

Increases in fees have reduced the quality of academic graduate programs, contributing to the overall decline in quality of UC.

The top graduate academic programs compete nationally (and internationally) for the best graduate students. An important element of this competition is the support package (payment of fees plus a stipend) UC can offer potential students. As fees have increased, the ability of UC campuses, departments and programs, which have to pay these fees from departmental funds or individual faculty research grants, have not been able to offer competitive stipends, making it more difficult to recruit the highest quality graduate students to UC.⁵

³ The Master Plan is available at <http://www.ucop.edu/acadinit/mastplan/MasterPlan1960.pdf> .

⁴ In 2008 UC received \$3,250,348,000 in state general support (http://www.lao.ca.gov/laoapp/LAOMenus/lao_menu_economics.aspx) divided by 2008 UC FTE enrollment of 220,034 (UCOP 2009-10 Budget Detail) = \$13,958 per student. Student fees in 2008 were \$8,014 (<http://www.ucop.edu/budget/fees/200809/0809genfees.html>) So, total undergraduate fees would rise to about \$22,000. To restore the inflation adjusted per student funding level of 2001-02 would cost an additional \$5,180, yielding a total of over \$27,000.

⁵ Competitive Graduate Student Financial Support Advisory Committee, June 2006. <http://www.ucop.edu/sas/sfs/docs/gradcommittee2006.pdf>.

Grants and partnerships with business cannot replace core state funding and, in the current environment, actually aggravate the problems associated with declining core support.

Extramural funds for research and other projects allow the university to expand specific activities, but these funds are rarely available for general support of core educational activities. More important, because such contracts and grants almost never cover the full (and real) indirect costs associated with the projects that they support, the more extramural funding the university (or a specific campus) receives, the more it has to divert discretionary funds (mostly fees and state general fund support) away from other activities to pay the unreimbursed indirect costs.

While this use of discretionary funds to subsidize such specific projects makes sense when the University is in good financial health – because it allows expansion of research and other academic and service activities that create opportunities for students and faculty – extramural funds are not a way to replace declining general fund support when it is inadequate to support core University functions.

This situation is unlikely to change because almost all funding agencies expect some level of cost sharing from the University on the grounds that the extramural funding supports the University’s mission. The subsidy through unreimbursed indirect costs is generally much larger for private sources (both foundations and business) than the federal government because they provide no or very low indirect cost support.

In other words, seeking to replace lost core funding with extramural funding is like a business trying to make up for the fact that it loses money on every unit by increasing volume.

Transforming UC based on the University of Michigan model will result in fragmentation of the system and a substantial decline in quality.

The Futures report discusses this option in detail:

The 1980s “deindustrialization” of the Michigan economy forced major cuts in state funding on universities in that state. The University of Michigan at Ann Arbor responded by deciding it would have to increase non-state funding sources. UM deliberately turned itself into what one of its presidents called a “privately-supported public university.” In addition to major fundraising efforts, effective use of its very large and venerable alumni base and of its professional schools, UM was also able to take advantage of its perennial top-5 position in federal contracts and grants to develop that important revenue stream.

It pioneered the pursuit of non-resident tuition income: by 2005-06, UM charged non-residents about \$27,500 per year (exclusive of other fees, housing, etc.), or \$18,000 more than residents⁶; 40% of its 2006 entering freshmen class are nonresidents.

⁶ Kenneth Pomeranz noted that the tuition figures in the Futures report were wrong. We have corrected them here.

Student fees constitute 59% of UM's "core" operating budget. Although the University of Michigan remains one of the world's great universities, this shift to private funds has had its costs. The university's quality has declined, at least judging by U.S. News & World Report rankings, where it fell from 8th to 25th between 1987 and 2003. Its dependence on tuition revenue has not helped its selectivity: over 50% of all undergraduate applicants were admitted, which would put UM in the middle range of selectivity among UC campuses. UM's high proportion of out-of-state students is not the reason why Michigan remains well below the national average in the percentage of the state's population that receives bachelors or advanced degrees, but it has not helped. While UM has done an effective job of protecting its one major campus at Ann Arbor, it has not done the same for the UM system, for Michigan higher education overall, or for the residents of the state.

Something similar can be said about the composition of UM's student body. It lost African-American enrollments during the first wave of fiscal crises in the 1980s, and has only slowly gotten most of them back (African American enrollments in the freshman class of 2005 comprise 7.2% of the total). After strenuous efforts in the 1990s, the University of Michigan still has a Pell Grant rate half that of UC Santa Barbara's; at the other end of the income spectrum, over half of Michigan's 2003 freshman class came from families with six-figure incomes in a state where only 13% of families earn that much.⁷

Those advocating this model have not addressed these realities.

No one in UC's leadership is effectively advocating for restoring the Master Plan and state funding.

The unspoken policy at UCOP and the Regents has been that state funding will continue to fall. (This is not an unreasonable assumption if one passively accepts the current environment in which UCOP budget planning focuses on keeping the Governor happy, a governor who sees higher education as a private good and opposes new taxes and where there is additionally a requirement for a 2/3 vote to pass tax increases.) The problem is that no one has even raised the issue in a consistent and powerful way, which is the necessary first step in changing the political environment.

Indeed, indications are that the policy focus of the Regents and other leaders is to accommodate UC to a privatized model, which, as experienced in Michigan, will probably mean continuing declines in quality and fragmentation of the system.

What about UCOP's public relations activities about the value of UC to the people of California?

UCOP is accelerating public relations activities directed at informing the public about UC's contribution to California. While the details are not known, it is unlikely that this campaign will starkly highlight the policy choice made by the Governor to shift from the Master Plan to a privatized model for higher education.

⁷ <http://www.universityofcalifornia.edu/senate/reports/AC.Futures.Report.0107.pdf> , Pages 31-32. Citations are deleted from quote.

It is also possible that this campaign could even be counterproductive, if the public comes away with a feeling that UC is continuing to make important contributions to California despite reductions in funding (which would mean that the reductions did not actually create serious problems).

Another problem has been the fragmented response of people concerned about the future of public higher education in California.

There has been little coordination between UC and CSU (much less the community colleges) in an integrated campaign to reinstate the Master Plan. UC faculty response has been largely through the Academic Senate, which has generally supported the Administration and not been an independent public voice. Students have been largely concerned with annual fee increases, without considering the long-term policy change embodied in the Compact. UC has not sought to make common cause with the unions representing its employees. CUCFA has not yet become an effective central advocate on these issues.

The requirement for a 2/3 vote to pass the state budget and tax increases makes it more difficult to fund public programs, including higher education, but public higher education could be restored even with the 2/3 rule.

There is no question that the requirement of a 2/3 vote for passing tax increases gives the anti-tax, anti-public sector Republicans in the Legislature tremendous power in budget decisions in California and has strengthened the Governor's ability to pursue his vision of privatized higher education. Indeed, the 2/3 rule makes California a blue state with red state budgeting policies and priorities being enforced by the Republican minority. Supporting repeal of the 2/3 rule should be a priority for anyone concerned about restoring quality and access to higher education (and the quality of California's state infrastructure generally).

As noted below, however, the amount of money it would take to restore higher education to 2001 levels of funding is small compared to the entire state budget and within what would be possible to accommodate if the political will was there. If the public demanded it, the governor could propose and push a budget that restored higher education if it was a priority for him or her even with the 2/3 rule.

What are the key strategic steps to change the public debate?

Because of the central role of the governor in setting higher education policy and the need for a high profile public debate on the future of the Master Plan and higher education in California, we need to find a way to inject the issue into the political campaign for governor.

UC and CSU leadership also need to be honest with the public and public policy makers about the true nature of the choice before California in terms of the future of higher education, rather than continuing to allow the system to slide into an inadequately funded privatized model without any explicit decision being made to do so.

Doing so would require presenting a direct contrast of three possible outcomes:

1. ***The status quo:*** There are continuing declines in quality with continuing rapid fee increases that are not adequate to replace state funds that have been cut because of the view that higher education should be a private not a public good. This situation will probably result in a fracturing of the UC system into a few high quality (and probably more expensive) campuses with a strong research base with the others coming to represent CSU. Except for a few centers that attract substantial private funding, high quality faculty and students will abandon the system. This is probably the worst outcome.
2. ***Privatization while maintaining quality:*** Priority is given to providing a quality educational experience for substantially fewer students that UC (and CSU) can afford to educate while maintaining the system as a whole. Implementing this model would require substantial reductions in enrollment (probably around 30%) tied with very large fee increases.
3. ***Reinstatement of California's historic commitment to the Master Plan:*** Such an option should be framed as restoring UC, CSU and the community colleges to levels of funding per student that were available in 2001 at the same real fees students and their families paid in 2001, the last year that the systems were in reasonable health financially and in terms of quality (see Futures Report). Doing so would only cost \$2.7 billion,⁸ which is only a few percent of the state budget and only about half the forgone revenues due to cutting the Vehicle License Fee.⁹ It is not impossible to obtain these funds (despite such assumptions by the Regents and UC leadership), but it would require a change in fiscal (and probably tax) policy by the state, which would represent a major shift away from the current ideological positions.

⁸ To return real UC per student funding to 2001 levels would require an additional \$1.2 billion in state support; doing so and also returning fees to 2001 levels would cost \$1.8 billion. The comparable numbers for CSU are \$390 and \$940 million.

⁹ There were \$5 billion in forgone revenues for the Vehicle License Fee in 2007; see <http://www.californiacityfinance.com/VLFfacts06.pdf>.