

Memo

Budget Committee of Academic Senate

To: Policy Committee

From: Budget Committee

Subject: Criteria for Budget Cuts

Date: February 23, 2004

The University is facing serious budget problems as a result of the substantial reductions in State funding. The Budget Committee has formulated proposals, set forth below, for deciding how the necessary cuts should be made. Its goal is to establish criteria for making cuts without going into the merits of particular cuts to particular units or divisions.

(1) The University should hold harmless, to the extent feasible, the core academic functions.

The Budget Committee believes that the core academic functions of the university should be preserved to the extent feasible. It believes that those core function are performed primarily, although by no means exclusively, by the schools and colleges and particularly by the faculty members in those schools and colleges.

Over the past several years, the Budget Committee has argued that the University's past practice of imposing across-the-board cuts on schools and colleges to deal with budget shortfalls was resulting in serious damage to the academic functions and was depleting the ranks of tenured and tenure-track faculty. The committee continues to hold that view and has supported that view with substantial evidence. It believes that further cuts in the budgets of the schools and colleges are unwarranted and would put the core functions of the university at risk.

The University will be able to cover some of the State budget cuts with the unanticipated revenues resulting from the surge this year in undergraduate enrollment. Adding students, however, puts additional demands on the academic units charged with teaching those students. In this situation, cuts to the budgets of the schools and colleges would seem to be particularly inappropriate.

In addition, the Budget Committee is concerned about the lack of any specific provision in the budget plans for providing budget support for those units of the University that are increasing out-of-pocket costs from the expansion of their enrollment. The committee

recognizes that some academic units have been able to absorb the additional student enrollment without incurring significant additional costs. Other units, however, do have additional expenses that need to be addressed. The committee suggests, as a short-term measure, that a reasonable portion of the revenues from increased enrollment be made available to the units that can demonstrate an actual increase in their costs as a result of their enrollment increases. The goal should be to target situations where a real need or hardship has been substantiated. A more permanent system for addressing the proper relationship between enrollment and unit budgets is under review by the ad hoc budget review committee chaired by Professor Cogan.

(2) The administrative side of the budget should be considered for cuts, notwithstanding the cuts made to administrative budgets in recent years.

In the most recent round of budget cutting, the Administration avoided any cuts in faculty lines. Significant cuts were made, however, in support services for the academic side, and even larger cuts were made on the administrative side of the budget. Given the need for additional budget cuts, the question arises as to whether there is scope for significant additional cuts on the administrative side.

The Committee believes that the recent rounds of budget cuts have not been born disproportionately by the Administrative divisions. According to calculations made by the Budget Committee and by the Budget Office of the University, the percentage of the budget going to the schools and colleges remained almost the same for FY year 2004 as it was for FY 2003. The University numbers show no increase or decline, and the Budget Committee calculation shows an inconsequential decline. This tiny difference is due to the way adjustments were made for changes in the organization of the university that occurred in FY 2003 and not to any fundamental differences in how the numbers should be calculated. In addition, it is clear beyond debate that during the years when the University's General Fund Budget was growing, the budget line for "Schools and Colleges" did not increase in proportion to that growth.

As the University goes through a period where the General Fund Budget may actually decline, the Committee fears that funding for the academic side of the house will continue to decline. The Administration's efforts to avoid cutting faculty positions should be praised. Yet, that praise must be tempered by a realization that 118 of the 204 personnel positions (58%) lost in the last round of cuts came from those positions reporting to the Provost. In a General Fund Budget that allocated far less than half of the funds to the Schools and Colleges, having far more than half of the positions affected by the reorganization coming from the Provost's side of the house strikes at the institution's core competence, our academic programs. The administrative infrastructure that did so well during the years of growth must contribute its full share during difficult times.

(3) A proper policy framework for considering cuts in the General Fund subsidies provided to the centers and institutes should be established.

Many centers and institutes receive substantial subsidies from the General Fund. Those subsidies obviously need to be evaluated in any budget process and especially in a process that is likely to result in university-wide budget cuts. There is nothing special about the centers and institutes that should insulate them from budget scrutiny. At the same time, the centers and institutes should not be the objects of some special attack. As with all parts of the university, they should be evaluated in a time of budget shortfalls by reference to their contributions to the core functions of the university.

The Budget Committee believes that the centers and institutes should not receive long-term subsidies from the General Fund unless they can demonstrate, through solid evidence, that they are contributing significantly to the core academic mission of the University in a cost-effective manner. In many cases, they should be required to become financially self-sufficient over some reasonable period, such as five years. A General Fund subsidy should be continued only if that continuation has been justified by specific evidence of past contributions to the core academic functions of the university, and the amount of the subsidies should be reviewed periodically and rigorously. Rather than relying on General Fund subsidies, centers and institutes should be encouraged to obtain external grant funding or development monies.

The General Fund subsidies to centers and institutes for FY 2004 presently stand at well over \$10 million. If these subsidies were to be phased out completely over a five-year period beginning in FY 2005, the nominal savings for FY 2005 would be well over \$2 million. The actual savings, however, would be considerably less because much of the budget in many centers and institutes goes towards the salaries of faculty members who have retreat rights in some department. In such situations, the cut in the budget of a center or institute would simply result in an additional burden on the department where the retreat rights exist.

In the current budget climate, the centers and institutes are likely targets for budget cuts. Unless some mechanisms are put into place for evaluating them on their respective merits, the cuts are likely to be made across the board. A suggestion has been made, for example, to cut the General Fund subsidy of all centers and institutes by 20 percent a year, with the subsidy eliminated entirely after five years. The Budget Committee believes that across-the-board cuts, despite their political advantages, can have serious adverse effects on the University. The goal should be to cut the budgets of those units that are underperforming and to hold harmless or even increase the budgets of those units that are performing exceptionally well. To avoid across-the-board cuts, however, the University needs to have in place some mechanism for measuring past performance. The current system of evaluating the centers and institutes is not suitable for that purpose.

To avoid across-the-board cuts in the General Fund subsidies provided to the centers and institutes, the University needs to develop an effective mechanism for evaluating them. One of the keys to effective evaluation is the adoption of appropriate criteria for determining the contribution of centers and institutes to the core academic functions of the University. The Budget Committee recommends that the following criteria be utilized for that purpose:

- **Research productivity**, as measured primarily but not exclusively by external grant funds. Research productivity, as measured by grant funds, is a particularly important criterion for centers and institutes that are heavily involved in scientific research. The General Fund subsidies provided to these research centers should be considered, in part, as seed money that will be used in obtaining additional grant funds. Research publication is another measure of productivity that may be appropriate for some centers. The research productivity of a center or institute should be measured by the funding or publications specifically generated by the center or institute rather than by a faculty member who happens to be associated with the research center in some capacity.
- **Teaching productivity**, as measured by the number of credit hours generated by courses offered by the center or institute or by the number of degrees or certificates awarded. In general, a center or institute may be viewed as serving a core function of the university if it is offering interdisciplinary courses not offered by any department or college.
- **Development success**, as measured by donor gifts made specifically to the center or institute and also recruited by the center or institute. Credit should not be given for amounts that a center or institute presently receives if it is not engaging in ongoing development activities. It should receive little or no credit for merely being associated with gifts given to other units.
- **Student recruitment success**, as measured by the documented recruitment of undergraduate or graduate students into the program of the center or institute or into other academic programs. Recruitment success is best determined by computing the actual cost to the General Fund of each student recruited. Little or no credit should be given for the recruitment of particular students unless the center or institute can demonstrate that its efforts were critical to the enrollment of those students in the University. Merely promoting good will among prospective students is not sufficient to justify a General Fund subsidy.
- **Academic program success**, as measured by seminars, workshops, academic conferences, speaker programs, and the like conducted or organized by the center or institute. An important measure of success is the publication of papers presented at a program. A center or institute claiming credit for an academic program must be able to

demonstrate that its programs are well attended by faculty and/or students. Little or no credit should be given for programs that are essentially social in nature.

- **Community service success**, as measured by programs that advance the core service goals of the university in a cost-effective manner. Service activities that serve useful purposes but do not advance the core goals of the University should receive little or no credit because these services should be financed by grants or other external sources and not by the General Fund. Programs that merely promote good will in the community without providing a tangible benefit to the University should be given little or no credit. The same may be said of conferences and similar activities that are linked to the core functions of the University only by having a global or urban theme. In sum, a center or institute should obtain credit for community service success only if it has demonstrated that it achieved tangible and valuable outcomes enhancing the core service mission of the University and that it did so in a cost-effective manner.

Those centers and institutes that cannot justify their current subsidy under these criteria should have that subsidy eliminated under an orderly procedure. In general, the subsidies should be phased out over some reasonable period, such as five years. A five-year grace period should allow those centers that are making useful contributions to the University and/or community to develop alternative funding sources. The threat of termination will also provide a desirable incentive to the centers and institutes to seek alternative funding. The Budget Committee recognizes, nevertheless, that centers and institutes are not all equal in their ability to find replacement funds. It suggests, therefore, that any phase-out plan allow for some flexibility to deal with special circumstances.

Drawing on its considerable experience over the years in evaluating centers and institutes for the purpose of recharting them, the Budget Committee has concluded that the existing mechanisms for evaluating centers and institutes are flawed and are not adequate for making refined judgments about budget allocations. It recommends, therefore, that the University develop some new procedure for evaluating centers and institutes. Under the current arrangement, centers and institutes are evaluated by the Centers and Institutes Advisory Committee (CIAC). That committee is not an appropriate body for doing annual budget reviews for the following reasons:

- The committee is too large to operate effectively as a budget committee;
- Its chair would have a conflict of interest in evaluating centers and institutes for budget purposes because some centers and institutes report to the chair and some do not;
- Some members of the CIAC would have a conflict of interest because they also serve as a director of a center or institute;

- Most of the current members of the CIAC do not have much experience dealing with budget issues.

Some alternative to the CIAC needs to be established to evaluate the productivity of the centers and institutes for purposes of determining their claim to a General Fund subsidy. In the short term, the Budget Committee assumes that some type of ad hoc faculty committee would be the appropriate review mechanism. In the longer run, however, the Budget Committee believes that the CIAC should be reformed so that it is capable of determining whether the performance of centers and institutes justifies their General Fund subsidy.

The Budget Committee suggests that the following principles be followed in establishing a procedure for reviewing the costs and benefits of centers and institutes:

- **Centralized control.** Some central authority should have overall control of the General Fund subsidies going to centers/institutes. Under the current institutional arrangements, centers and institutes report to a variety of units or divisions. As a result, no one is in a position to evaluate the relative merits of all of the centers. Such an evaluation is critical, however, to an effective budget process. The Budget Committee believes that budget control over the General Fund subsidy can be arranged without altering the current reporting lines.
- **Fixed Cap on General Fund Subsidy.** Centers and institutes seeking to obtain a General Fund subsidy should compete among themselves for a share of a fixed pool of funds. That is, as part of the budget process, the Administration should determine the total amount of the General Fund subsidy to be given to the centers and institutes and then should devise a mechanism that would allow the centers and institutes to compete for a share of that total amount. In the view of the committee, such a competition is necessary to have an effective system for monitoring the contribution of the centers and institutes to the core academic functions of the university.
- **Overhead.** All, or virtually all, centers receive an indirect subsidy from the General Fund through the provision of office space, utilities, and so forth. The budgets of centers and institutes should include a fair estimate of the General Fund overhead subsidy provided indirectly to them. The point of including overhead in the budget of centers and institutes is to measure accurately the costs incurred by the University in supporting the centers and institutes.

Finally, several centers and institutes play a significant role in generating research grants, as is evidenced by the amount of indirect cost recovery (ICR) amounts received by them. To the extent that they are instrumental in generating such grants, they serve one of the core functions of the university, as indicated in the criteria set forth above. The Budget Committee believes that the University ought to revise the current system for providing

General Fund subsidies to these centers and institutes by creating a link between the amount of the subsidy and the amount of research grants that the centers and institutes actually generate. One way of forging that link would be to convert some portion of their General Fund subsidy into a supplement to the ICR amount assigned to them under current arrangements. The amount of the subsidy would increase if a center or institute increased its ICR amount and would decrease if its ICR amount went down. This change would have no immediate impact on the budget of centers and institutes but would create some incentive to the centers and institutes to increase their funded research in the future.

(4) Additional withdrawals from the Rainy Day Fund are appropriate during these difficult times.

The University currently has \$7.8 million in its Rainy Day Fund. In face of first a freeze and then cutbacks in State funding, the University has drawn modestly on this fund but has reserved most of it as a safeguard against the possibility of a more devastating downturn in General Fund revenues. The policy probably has been prudent. It is certainly more advantageous to have the fund than not to have it. However, the Budget Committee believes that the time has come to use some of the amounts available in that fund to mitigate the damage otherwise done to core academic functions by cutbacks in State funding.

Although there is little reason to expect any increase in State funding in the immediate future, there are indications that the State's economy may be beginning to recover. Such a recovery will mitigate the State's budgetary problems and, in all likelihood, those of the University. Because Michigan tends to recover more slowly from economic downturns than the country as a whole, it would not be prudent to use up the entire Rainy Day Fund on the hope that significant relief will soon be forthcoming from the State. Orderly withdrawals from the fund over the next three or four years, however, do seem in order. This approach would allow necessary budgetary adjustments to be made while minimizing their negative effects. Moreover, it would relieve the University of what is likely to be a growing political and public relations liability.

Members of the State legislature and the press have been highly critical of intermediate school districts that are holding rainy day funds in reserve in the face of cutbacks in State funding. The critics argue that the fiscal weather is rainy and that it is unconscionable for school administrators not to draw on these funds to support their educational mission. In a recent editorial, the *Detroit Free Press* has called on the legislature to launch a formal investigation into the matter. Members of the legislature and the Governor's Office undoubtedly know of Wayne State's Rainy Day Fund. They are unlikely to be very sympathetic to our financial situation as the University is sitting on those reserve amounts.

The Budget Committee recommends that some funds be withdrawn from the Rainy Day Fund to cover General Fund shortfalls occasioned by the recent cutbacks in State funding. This recommendation is grounded on sound budget policy, although we suspect it is buttressed by

strategic political considerations. Withdrawals from the fund are appropriate to help balance the budget for FY 2004 if the alternative is further cuts in academic programs. The committee also recommends that withdrawals from the fund be a significant part of the strategy for balancing the FY 2005 General Fund budget.

(5) The practice of earmarking surpluses in Auxiliary accounts and in plant accounts should be revised so that these surpluses are included in the General Fund.

The issue of earmarking is an important one for the University's budget processes. In general, the Budget Committee believes that the earmarking of revenue streams for particular uses is an inappropriate budget technique. It is far better that all of those with a claim for support from the General Fund compete for that support through the budget process. The effect of earmarking generally is to insulate the beneficiaries of the earmarked funds from the appropriate competition with other units in the University.

In some cases, certain activities, such as the operation of the book store and the operation of parking facilities, are funded through the Auxiliary Budget and not through the General Fund. The point of that separation is to require the auxiliary functions to finance their operations through user fees and similar charges. The Budget Committee recognizes the benefits of this market approach in many circumstances. It also recognizes that these auxiliary units may need to maintain some working capital as part of their normal operations.

The Budget Committee believes that it is inappropriate to spend surplus amounts generated by auxiliary units outside of the normal budget process. To avoid the earmarking of these surplus funds for special purposes, the Budget Committee recommends that all surpluses in auxiliary funds be placed in the General Fund for allocation in accordance with overall budget priorities.

In addition, the Budget Committee suggests that the University be cautious in allowing units that have not been designated as auxiliary units to impose new fees for services provided to other units within the University. The committee recognizes the potential benefits of using market mechanisms to determine the demand for certain services in some cases. It also recognizes, however, that some units may be tempted to shift the impact of budget cuts from themselves to other units by instituting user fees. The Budget Committee recommends, therefore, that units not be permitted to institute new fees on academic units or to make significant changes in existing fees without prior authorization from the Provost's office. The general expectation would be that any unit introducing a new fee would have its budget reduced by the amount of the anticipated revenue generated by the fee, with those budget savings reallocated to the units expected to pay the fees. Such a general rule would permit the use of user fees in appropriate cases without allowing fee-charging units to avoid the sting of budget cuts by shifting the burden of those cuts to other units.