

## POLICY OPTIONS FOR UNIVERSITY OF CALIFORNIA BUDGETING

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### ABSTRACT

Within a quarter century after the end of World War II (1945-1970), largely because of the support and investment it received from the State, the University of California had changed from two modest-size general campuses (Berkeley and Los Angeles) and the medical campus in San Francisco (UCSF), to a system of eight general campuses. California was at the pinnacle of its success—its economy strong and growing. Since then, however, the fiscal and political problems facing California have led to a steady erosion in funding support for the University of California, and now are leading to a debate regarding its future. If UC has in the past been an engine propelling the growth of California's economy, it would appear to be wise policy to place a high priority on repairing the damage which has been done to it, and will weaken its ability to serve students and the people of the State and nation. While most observers acknowledge that this is a desired goal, there is little agreement on how best to achieve it. Setting aside the limited numbers who would opt for the status quo, this paper discusses three scenarios for UC. The first is a return to the *status quo ante*; the second is a full move toward privatization; and the third is a hybrid approach. This last option would mean retaining some of the elements of the past partnership between the state and the university, and could be implemented without unrealistic costs to the State or UC, and allow for the continuing academic health of the university. This last option could be exercised by UC as a whole, by several of the campuses operating through UC, or by several campuses (presumably the same ones as discussed under the "privatization" option) becoming quasi-independent of the current system. It could even be exercised, with the approval of campus and UC officials, by schools, colleges or other intra-campus organizations.

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For most of the time since the end of World War II, California has generally been recognized as the national leader in a large number of important categories. Of course, the growth in the state's population has led the national growth rate, primarily due to the in-migration from other states, and, indeed, around the world. Its economy was the envy of all, growing to become the 6th or 7th largest in the world. Employment was high and it served as the home for many large and growing businesses and industries.

The entertainment industry settled in Hollywood early on and that provided a notoriety that attracted additional immigrants and related business opportunities. Its vast and fertile agricultural areas produced a wealth and variety of products not known elsewhere in the world—citrus in the Los Angeles Basin and the Inland Empire, desert crops in the Coachella Valley, wine in the Napa, Sonoma and Mendocino Valleys, and, of course the greatest agricultural region of them all, the great Central Valleys of San Joaquin and Sacramento.

The war and post war-years saw several additions to those early achievements. Much of the nation's defense, space and aircraft industry found its home in California. The high tech industry, first in computer technology and then in bio-medical expertise, was born and flourished in the state. California's system of higher education, especially following the adoption of the Master Plan for Higher Education, 50 years ago, with its tripartite system was looked to as a model to be followed not only across the U.S. the country but around the world as well.

There are clearly many reasons for California's achieving this level of preeminence: its geography and climate, the openness to new people and new ideas, the availability of land and the opportunities provided by its growing industrial and agricultural base. Even its political system, non-partisan in comparison to those in the states from which the new citizens had come, was welcoming to new arrivals, many of whom played major roles in the politics to the benefit of their adopted state.

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A very important ingredient in the creation of this model state of affairs was the role played by higher education, both public and private, but especially the University of California (UC). California came out of World War II with a number of blessings. Among them was the “Rainy Day Fund” which had been amassed during WWII by Governors Culbert Olson and Earl Warren. A second was the recognition by its political leaders of the role that had been played by the University of California, primarily the Berkeley campus, in the prosecution of WWII and the creation of California’s war related industry, which kick-started the early and strong postwar recovery of the state’s economy.

### **THE UNIVERSITY OF CALIFORNIA**

The interaction of these two factors created the financial and political basis for a growth in the University, which, when further fueled by the GI Bill, resulted in a dramatic increase in the UC system between 1945 and 1960. In a short period, the existing general campuses, Berkeley and UCLA, as well as the medical campus in San Francisco, grew dramatically in size, physical and financial resources and quality. Santa Barbara State College was transformed into a campus of the University. Two new general educational programs were built upon the great general agricultural base at the Davis and the Citrus Experiment Station at Riverside. By 1960, three new general campuses were approved—UC Irvine and UC Santa Cruz—rising from sprawling farmland and redwood forest respectively—and UC San Diego, building upon the world-renowned Scripps Institution of Oceanography.

The University’s role in California’s development was not new. Its graduates had long filled the ranks of the professional scientific and business sectors of California’s economy. As previously noted, the great California agricultural enterprise owed much of its success to the faculty, researchers, and graduates of the agricultural programs at Davis, Berkeley, Riverside, and UCLA. The military research and manufacturing enterprise, developed so quickly as World War II enveloped the nation, was peopled by its graduates and supported by its research capability.

But the half-century following World War II saw something different in kind. UC was widely recognized as the yeast enabling the state’s other remarkable resources to rise to the levels that propelled California forward. Through the crises of the Civil Rights Movement, the Vietnam War and the resulting era of student unrest, erupting from the Free Speech Movement at Berkeley, the University remained well-supported by California. It grew in size, quality, and its ability to serve the state. During the span of 22 years, three of the older campuses, UCLA, Davis, and Santa Barbara, as well as two of the new, San Diego and Irvine, were admitted to the Association of American Universities, alongside Berkeley, placing all six within the top 60 research universities in the nation as recognized by their peers.

Within a quarter century after the end of World War II (1945-1970), largely because of the support and investment it received from the State, the University of California had changed from two modest-size general campuses (Berkeley and Los Angeles) and the medical campus in San Francisco (UCSF), to a system of eight general campuses. These campuses provided the full span of undergraduate educational programs, a wide variety of high-quality graduate academic programs, and a growing array of nationally recognized professional schools, plus a ninth specialized campus (UCSF). UCSF and the other medical schools comprised an eminent group of medically-related professional institutions with an international reputation for biomedical research.

For its part, California was at the pinnacle of its success—its economy strong and growing, along with its population, beginning to take a leadership in national politics, with one of its native sons (Richard Nixon) occupying the Oval Office.

### **CLOUDS ON THE HORIZON**

Through the late 1970s and into the mid-1980s, the synergism continued, for the most part, to work its magic, propelling both the University and the state to even greater levels. Although there were ups and downs in the levels of support for UC, these were generally the result of temporary aberrations. The slope of the curve was generally upward.

Although the percentage of the University’s total operating expenditures which was funded by the State, steadily declined over that period (from 32% in 1976 to 27% in 1986) this drop was in large part due to growth in the denominator. There was a steady increase in the amount of UC funding from other-than state sources. UC received private support, federal contracts and grants, medical centers’ revenues, and income from operations such as parking and residence halls. The core funding—the money needed for general educational and related administrative expenses— continued to come primarily from the State.

However, beginning with the adoption of the UC and State budgets of 1970 (both created under the strong hand of then-Governor Ronald Reagan), the concept of a tuition-free University of California—a concept that had been one of the premises of the Master Plan adopted just ten years earlier—was dramatically changed. In the ensuing forty years from 1970 to 2010, the so-called “education fee” became, in fact, tuition. It steadily increased at a rate that outpaced the growth of personal income in California during that period. The burden of funding the core undergraduate and graduate educational programs at the

University's campuses is now shared responsibility between the State and the enrolled students. Indeed, with the cuts of the past few years and the fee increases imposed to partially offset those losses, student fees account for about \$4 out of every \$10 of core support. In fiscal year 2010, the income from tuition and fees was greater than the amount provided by the state.

### PROPOSITION 13

Two other seminal events brought difficulty for both the State and its University. One was the passage of two propositions a decade apart, Proposition 13 in 1978 and Proposition 98 in 1988. The first of these is perhaps the most famous or infamous of the many propositions that have been adopted by California voters since the creation of the direct democracy process under Governor Hiram Johnson in 1911. Prop 13 contained a number of provisions. Of these, two were particularly impactful on California's subsequent fall from grace.

The most prominent provision of that proposition amended the State constitution to roll back property taxes to their levels of three years earlier, limited them to 1% of assessed valuation, and restricted increases to the level of inflation, but in no instance more than 2% of the prior year's value. A second (and at the time largely unnoticed) provision of Prop 13 required a two thirds majority in both houses of the legislature for the passage of any measure which increased tax rates or amounts of revenue collected.

While the limits placed on the property tax did not directly affect the state budget or its programs, the subsequent indirect effect was enormous. The effect of Prop 13 on local governments and districts, especially public school and community college districts, was such that the State chose to bail them out by temporarily "State-izing" them. Sacramento could handle the bailout initially because at that particular moment California had an unusually large General Fund reserve. But his action led to a permanent systemic change. Programs previously supported by local revenues became dependent on State support for their basic operations. This sea change resulted in a substantial reduction in the level of support for traditionally state-funded programs—especially UC and the State University System.

The second important provision of Prop 13, requiring a two thirds majority in both houses for the allocation of funds or increases in revenue, guarantees that the budgetary process will be controlled by the minority. Minority control has resulted in increasingly bitter budgetary battles in which it is extremely difficult, if not impossible, to increase taxes to deal with fiscal crises. That means budget cutting in a depressed or stagnant economy is the only possible solution. The annual budget is now routinely adopted many weeks, even months, after the date required by law, occurring only when the majority finally concedes to the minority. In addition to guaranteeing budgets which fall short of meeting the needs of the State, this phenomenon reduces the incentive for cross-aisle cooperation (already badly compromised by the existence of "safe" districts created by the legislative redistricting process). The minority knows that it will eventually accomplish what it wishes without the necessity of compromise.

### PROPOSITION 98

The second initiative that has impacted the ability of the State to provide for funds for UC and to higher education generally is Proposition 98, adopted by the voters ten years after the passage of Prop 13. It requires through a set of formulas that about \$4 out of \$10—and sometimes more—of the State's General Fund revenue be allocated to support K-14 education. While providing some differences for stagnant growth and declining revenue scenarios, the result, in all cases, is a further restriction on the amount of funds which can be allocated to support UC and other programs whose budgets are not tied to specific funding or mandated appropriations. Indeed (as will be spelled out in more detail in a subsequent section) during the recovery period ahead of us, the mandated percentage allocated will undoubtedly increase to an even higher level. <sup>i</sup>

### THE CURRENT REALITY

These and other factors have created a situation in California that is far different from the rosy picture which characterized the fifty years following the end of World War II. The nation, indeed the world, has been mired in a recession, followed by what is at best an extremely slow recovery. But the difficulties facing California now and in the foreseeable future are beyond those of most, if not all, of its sister states. These difficulties are:

- Deficit funding has been the rule for several years. Budget shortfalls have run into many billions of dollars;
- Unemployment reached approximately 12% by 2010, one of the highest in the nation; All state services have been drastically cut; state employees have had salary cuts and/or were placed on mandatory unpaid furloughs;
- Health care, education and all social services have been drastically reduced—even local police and fire protection has not been immune from the budgetary axe as the state's fiscal problem cascaded down to cities and counties. In short, the picture for the immediate future looks as bleak as the present and the immediate past.

The problems facing the State have also severely affected the University of California. While the levels of support in the first 40 years following WWII had their ups and downs, UC's share of the total state budget has declined rather steadily over the past two decades—from 5% in the late nineties to approximately 3% in 2009-10. These reductions have been especially severe during the past decade, culminating in sharp reductions in the past year. In rough terms, state support of UC's average expenditures per student dropped by about 22 percent between 2007-08 and 2008-09 representing a reduction in total state support from approximately \$3.3 billion to \$2.6 billion in that single year.<sup>ii</sup>

### POLICY OPTIONS FOR FUNDING UC'S RECOVERY

If UC has in the past been an engine of propelling the growth of California's economy, it would appear to be wise policy to place a high priority on repairing the damage which has been done to it, and will continue to weaken its ability to serve its students and the people of the State and nation. While most observers acknowledge that this is a desired goal, there is little agreement on how best to achieve it. Setting aside the limited numbers who would opt for the status quo, there are three logical options to consider:

- Return to the *status quo ante*;
- Privatization; and,
- A hybrid approach

### STATUS QUO ANTE OPTION

The first of these options is the most broadly argued proposal. Regents, trustees, presidents, chancellors, alumni and students have testified, editorialized, lobbied, and demonstrated for increases in the funds allocated to UC and the State University System. They want increases which would over time return the State's appropriation to levels comparable to when the state's economy was at its peak in the 2000s—or even more. To be successful, this approach would require that the executive and legislative branches of state government be convinced that:

- The revenues flowing to the General Fund of the State must be increased to a level which would provide sufficient funds to eliminate current deficits, provide for the other high priority needs of the State, and return the level of UC budget appropriations which existed at some earlier target date; or
- UC be provided as large a proportion of funds available from current General Fund levels as would be required to return its public funding to the earlier target date, regardless of the impact of that action on other State-supported services (e.g., health, safety, schools and social services). The amount of additional funding which would be required under either of those scenarios (by an increase in General Fund revenues or reallocations of currently available General Fund sources) would be the same. If the target date were set, say, at fiscal year 1999-00, just accounting for inflation would require a boost in the UC budget of about \$1 billion. Unfunded enrollment growth would add to that figure, as would a variety of other needs, including the necessity to bring the currently underfunded University Retirement System (UCRS) back into a fully funded position. The amount needed to meet UC's core needs during the next decade has been estimated by UC's Office of the President at about \$5 billion—almost double the total funding now provided.<sup>iii</sup>

Whichever of the possible methodologies for meeting the *status quo ante* option were used, this is an enormous amount to expect the state to provide. Under those circumstances, why is this approach so widely supported?

Many of those who argue for the return to the *status quo ante* apparently assume that the cuts absorbed by UC, CSU, K-14 and other vital services have been caused by reduced revenues coming as a result of the effects of the recession, and that, therefore, with the recovery, funds will be available to replace these cuts. However, the state faces a large structural deficit, the combined result of the factors that have been described above (Props 13 and 98, etc.) compounded by state initiation of other social programs. These social programs were initiated on the assumption that revenues would continue, as they had for most of the previous 50 years, to grow at a predictable rate. Unfortunately, California's current tax structure, depending primarily on a highly progressive income tax with a high maximum rate has resulted in a highly erratic revenue stream.<sup>iv</sup> And with the end of the Cold War and the growing antipathy to taxation, the rapid federally-funded growth that once characterized the state is unlikely to resume.

This phenomenon, taken together with the requirements of Prop 98 (as amended in 1990) which require that cuts to the previous levels of funding for K-14 be made up in the following years by disproportionate percentage increases, has created a no-win situation for both UC and the State. Since the state has squeezed the K-14 budget during the Great Recession, funding is likely to be diverted to refunding that segment as revenues increase.<sup>v</sup>

This situation rules out returning to the *status quo ante* through reallocating revenue growth due to economic recovery. It also suggests that increases in state taxes, if that route were followed, would also tend to be eaten up by K-14. So, even if it were possible to get over the maze of hurdles necessary to achieve a tax increase sufficient to substantially increase general fund revenues (which for the reasons set forth in the previous section would not be likely), the revenue increase scenario would not provide major assistance to UC.

### PRIVATIZATION

This potential option is one not often publicly advocated. In its pure form it would mean that the University of California would be turned into a private university. It is inconceivable that this would work for the entire University. Some of the campuses of UC (UC Berkeley, UCLA, UCSF and perhaps UC San Diego and UC Davis) might be able to make such a transition successfully over a reasonable period of time, with declining state support continuing during the transitional period. What would be the positive and negative outcomes of such a change?

The privatization of these four campuses would provide savings of something like \$1.5 billion based on the State funding provided to those campuses in 2009-10. If these campuses were to become "independent," additional State resources now funding the Office of the President might also be freed up on a *pro rata* basis, perhaps something of the order of \$200 million, raising the total to \$1.7 billion—not an inconsequential sum.

There are at least a few *potential* advantages to UC related to this scenario:

- Some or all of the funds saved could be used to make up the deficits at the other campuses created by recent cuts as well as under funding of workload they have assumed.
- A number of restraints and problematic policies which come attached with the State's largess would be removed, allowing the campuses to operate more efficiently, to increase overhead funding from governmental contract and grant sources and increase the level of private giving.

Those benefits, however, would come at substantial costs to the privatized campuses and to UC as a whole. The privatized campuses would not only have to replace the State funds in their current budgets, but also to cover the cuts they have received in the past few years. In addition, they would have to make up for the under funding which has been eating away at their ability to provide the quality of education and research expected of them.

Also, it is not clear how these campuses (or UC on their behalf) would raise the funds for capital outlay which in recent years have come either from State General Obligation bonds or lease revenue bonds. Presumably the newly privatized campuses (or the Regents) would be able to issue the bonds, but this would be a complicated affair. What bond ratings would the newly-privatized campuses receive?

The obvious sources on which the privatizing campuses would have to call to meet these demands for funding would be:

- Increased tuition, perhaps by a combination of across the board increases and differential fees for undergraduates similar to those which have been utilized for some time in several professional schools;
- Increased overhead from governmental and private contracts and grants;
- Increased private giving totals, together with a shift to a greater proportion of gifts being unrestricted; increased income from non-resident tuition, to be achieved by lifting the cap on the number of nonresidents;
- Increased allocations to core funding from service enterprises, and self-sustaining activities such as, for example, executive MBA programs in other professional schools and, even perhaps, in basic undergraduate programs.

Even with these changes and the relaxation or elimination of state imposed restrictions on other options, the sources available to the privatizing campuses under this scenario would likely be insufficient to meet the needs required under a full privatization scheme. Furthermore, a change of that magnitude would likely modify the character of those campuses involved to substantially reduce their contributions to the people and State of California which are even more needed now than in the past.

For all of the reasons cited as well as the political and legal difficulties such a move would generate, pure privatization (even if undertaken only by a few of the campuses) would not seem to be a viable option for funding UC.

### A HYBRID OPTION: MODIFIED SELF-SUFFICIENCY

There is, however, a scenario that, while retaining some of the elements of the past partnership between state and university, might be implemented without unrealistic costs to the State or UC and still allow for the continuing academic health of the university. This option could be exercised by UC as a whole, by several of the campuses operating through UC, or by several campuses (presumably the same ones as discussed under the “privatization” option) becoming quasi-independent of the current system. It could even be exercised, with the approval of campus and UC officials, by schools, colleges or other intra-campus organizations.

UCLA’s Anderson School of Management has developed a proposal, supported by UCLA’s chancellor (but at this writing not yet considered by UC president Yudof or the Board of Regents). It would trade the small amount of state funds still included in its budget for greater flexibility in a variety of areas. Judy Olian, dean of the Anderson School, has referred to this proposed change as a move toward “self sufficiency” rather than “privatization” (a term which has caused difficulty both at UC and other universities where similar changes have been proposed). Such was the case with the University of Virginia’s Darden School of Business where a similar proposal has been implemented. The proposal by the Anderson School has now been released for review by the UCLA academic senate and others and provides an excellent description of the principles, benefits which it might achieve.<sup>vi</sup>

The benefit of the change from “privatization” to “self-sufficiency” at the Darden School is the subject of an article by David L. Kirp and Patrick S. Rogers in the Summer 2002 issue of *The Public Interest*.<sup>vii</sup> It describes the benefits to the school in much the same manner as those suggested by dean Olian of the UCLA Anderson School in an article entitled, “Giving Up State Funds” which appeared in the online *Inside Higher Ed*.<sup>viii</sup> The problems the authors ascribe to the change are the potential to lose sight of the mission of the school and go to extremes in acting like a private business.

The advantages of dropping the term—privatization— in favor of self-sufficiency appear clear. However, just as there are scenarios that involve differing academic units implementing the option (UC, campuses, schools or colleges), there are differences in the degree of self-sufficiency involved. So the term “modified self-sufficiency” will be used to describe this option.

### IMPLEMENTATION PROCESS

Ideally, the implementation of modified self-sufficiency would involve a change in the perceived status of UC. The current arrangement is one in which it is treated as a publicly funded state agency (although the amount of its funding coming from the state is a small proportion of the total) by the regular appropriation process. To work best, UC should be a quasi-governmental organization, designated to provide certain services for the state with which the State enters into a contractual arrangement to provide education, research and related services. It is possible that this arrangement could be accomplished without a change to the California Constitution, since that document, in Article 9, Section 9, already provides for UC to be essentially independent of the Legislature.<sup>ix</sup>

Theoretically, the negotiations with the state might be conducted by campus, by tier (as described below) or by something like the current system-wide administration. In order to continue to obtain some of the benefits which flow from the combination of the several campuses into a single entity and for the sake of simplicity, these negotiations would probably best be retained by the UC Office of the President. If so, that office should exercise that responsibility with active participation of representatives from several campuses, assuring the maximum benefits at the campus and intra-campus levels.

In operation, the State and the university representatives would negotiate a contract through which the latter would enroll an agreed upon number of students in each of the several undergraduate, graduate academic and professional programs for which a need is determined. A modified self-sufficiency agreement would also provide for research and other activities in areas and levels required.

The negotiation and subsequent accord would provide for qualitative indices on which it would be the University’s responsibility to deliver. One of these, for instance, would be accessibility and diversity of the incoming students and concomitant graduation rates by ethnicity and socioeconomic status. On its part, the State would agree to provide a set payment—a subvention—to the University on a lump sum basis and agree to a rolling five-year contract. There could be an annual review to determine if the conditions of the agreement were being fulfilled. If so, a new year would be added and the contract would roll on from year to year.<sup>x</sup>

The accommodation to this change could not be uniform across all of the campuses for a variety of reasons, primarily because of the differences in the ability of each to accommodate the funding changes which would be required. While a good deal of study

would be required to determine the appropriate differentiation, for discussion purposes, assume the campuses are divided into four tiers, based on ability to replace State with non-State funding:

- UC Berkeley, UCLA, UC San Francisco, UC San Diego, and UC Davis
- UC Irvine and UC Santa Barbara
- UC Riverside, and UC Santa Cruz
- UC Merced

The number and size of the associated benefits would also vary among these tiers and would change along with the relative levels of funding. Of course, the tiers might be constructed differently, e.g., UC Irvine added to the first tier, or UC Santa Cruz included in a fourth tier along with UC Merced. Alternatively, the campuses might be individually categorized, with UCLA or UCSF at one end and UC Merced at the other.

While all of the campuses except UC Merced could probably operate with less state funding under this plan, Merced, which is still in its infancy clearly needs a period of funding beyond its current level if it is ever to become a reasonably sized general research campus in accord with its mandate.

A complete analysis of the financial effect of this approach on the State, UC and the several campuses is not easy to accomplish. But looking in detail at UCLA and extrapolating to the other campuses indicates that increases of the following kind, as an example, would be doable without running afoul of the ability to meet the long-term mission of UC. Something like the following scheme might be utilized:

- For the Tier one campuses, increase revenues by implementing the following actions to a level which will, in the aggregate, provide a minimum 20 percent increase in the funds derived from those sources:
  - Increase average student fees across several schools and colleges except for those professional schools which are already at the margin in terms of impact on admissions yield or ability to attract and enroll a sufficient number of highly qualified students;
  - Increase the number and percentage of nonresident and international students, without reducing the number of resident students to such an extent that overall access would be affected;
  - Increase income from contract and grant overhead by adjusting rates to be in line with actual costs and comparable charges from other Universities;
  - Increase income from gifts and endowments by strenuous efforts to increase the percentage of unrestricted giving to a level at or near that of our peer institutions;
  - Increase the funding derived from self-sustaining programs, perhaps by doubling the current amount.
- Increase those rates on Tier 2 campuses sufficiently to provide for the aggregate amount to rise by 10%;
- Increase Tier 3 campus rates sufficiently to increase the yield by 5%; and,
- Leave UC Merced unchanged, until it grows to a level sufficient for it to provide some form of self-sufficiency.

These changes could be accomplished in several ways. For instance, the increase in tuition income could be the result of a change across the board, or selective increases among the several categories of students whose fees are already widely differential. The contract and grant overhead could be increased by raising the rate and/or the number and size of the contracts or grants funded by the agencies involved. Increases in private giving called for would be possible by an increase in the total sum, a shift from restricted to unrestricted giving, or both.

Whatever the combination of actions taken to implement the proposed increases, they should be able to be implemented without negative qualitative consequences, and ought to produce sufficient additional income to cover all of the recent cuts in the current level of State support for the first tier. The second group would need approximately \$155 million in additional state funds, the third \$52 million and Merced \$100 million, for a total of slightly more than \$300 million. Certainly, these appropriations are within the ability of the State to manage, even under the fiscal constraints which have been described above.

The necessity of dealing differently with the several campuses in this matter is valid also for the sub-units of each. For instance, at UCLA, the Anderson School of Management and the Medical School would be at one end of the spectrum with the College of Letters and Sciences at the other.

## ADVANTAGES FOR UC AND CALIFORNIA

The advantages to UC from this arrangement are several:

- Tuition could be increased on a regular basis in line with cost of living or cost of education index, providing more funds over time, greater planning ability and less hardship for students, resulting from huge increases after long periods of “holding the line” for political purposes. Contrary to generally held views, the move to even greater tuition should increase accessibility. The key is to increase it on a predictable basis in accord with appropriate cost of education or cost of living increases. Then a substantial proportion of the funds thereby raised would be returned as financial aid—one third has proven to be an effective percentage to date.
- Funds derived from the state would be fungible. That would considerably simplify UC’s financial management and allow the administrators close to the action to determine how best to use the funds provided in order to meet their obligation to the State. For instance, if faculty salaries were a major problem, they could be raised within some general policy window, as long as appropriate provision was made for ongoing costs. The same would be true for increasing the number of faculty or for other purposes which were deemed to have the highest priority for that campus at that time.
- A five-year contract would allow for long-term planning to occur, while that is now totally impossible.
- A whole range of substantive and procedural controls would be eliminated. For instance, it has long been estimated that the cost of construction would be reduced by as much as 20 percent if the University could use the good practices followed by its private peers.
- One of the major continuing impediments to private fundraising which still exists despite the great success of UCLA and Berkeley in this regard. Potential donors say, “I give my university contribution to the state in taxes.” Under modified self-sufficiency, that problem would be ameliorated. In exchange for the advantages which would accrue to UC from adopting the modified self-sufficiency option, the State would be able to assure the quality of its University without the necessity of restoring all of the cuts, unfunded price increases, and underfunded and unfunded enrollment increases that accrued during the Great Recession and before.

## PROSPECTS FOR IMPLEMENTATION

Getting the approval of all the necessary parties and putting this proposed strategy into effect would not be an easy task. Almost every stakeholder involved would likely find the proposal unsettling, too great a break from tradition, too threatening, or worse. The greatest thing in its favor from a political point of view is that there appears to be no other option which has the possibility of dealing effectively with the problems facing California and UC.

Another positive factor in obtaining acceptance for the modified self-sufficiency strategy is that in one way or another, other state universities or parts thereof are moving with varying rates of speed to similar solutions. Some, such as the Universities of Michigan and Virginia, are doing so consciously and with transparency. Others are doing so out of necessity without having worked at the changed arrangements with their state governments which are suggested here. <sup>xi</sup>

Undoubtedly the most compelling argument in obtaining acceptance by the state is not only the depth of the fiscal problems it *now* faces, but the fact that—short of major changes in tax policy—it will continue to face those problems due to the structural deficit. In essence, the state cannot afford the University of California at its current level of quality and service.

This same set of facts may also be the motivation for moving the UC community to support such a change. Although UC has faced budgetary crises before there has never been anything to compare the current problems. There appears to be an increasing understanding within UC that the *status quo ante* is not a viable option, although—as will be noted below— there may be some slippage due to the unrealistic elements in the 2010-11 budget.

## THE 2010-11 BUDGET

The California Legislature finally adopted a budget for 2010-11 in October of last year, over three months after the beginning of the fiscal year, and signed by Governor Schwarzenegger amid much hoopla that it eliminated the state deficit, and restored the reserve in the general fund. In fact, as reported in the *Los Angeles Times*, the budget adopted would:

- Deal with the deficit problem by cutting state worker pay, by trimming public school funding, and by relying heavily on handouts from Washington. It would likely fall out of balance almost the moment the ink dried.

- to remaining The spending proposal, which would not necessarily stave off the eventual need for IOUs, also included the sale of state buildings to generate money, rosy revenue assumptions, and a relative “windfall” for higher education, one of the few areas that would see increased funding, in part due federal stimulus funding.

In short, the 2010-11 budget—like most of its recent predecessors—was created with smoke and mirrors. It is a sham in every respect, including the miniscule appropriations for UC and CSU that the *Times* characterized as a windfall. It is difficult, if not impossible, to imagine how that windfall can be sustained, given the way in which the appropriation became possible. One of the major tricks used in reaching a budget accord and providing for the increase for higher education was, once again to suspend the Prop 98 mandated allocation for K-14. As shown earlier, future budgets will have to make up the amount lost by that piece of legerdemain.

The increased UC funding the budget provides is certainly welcome in that it eliminates some of the unfunded enrollment increases of the past few years; in addition, it covers other unfunded expenditures such as retiree medical insurance costs. But the budget does *not* address the huge costs that will occur during the next few years to bring the University of California Retirement System (UCRS) back towards a fully-funded position. The budget staved off some otherwise necessary cuts and fee increases. However, the prospect of a future dip in funding resulting from the artificial elements in the budget is a real and compelling concern.

Perhaps the greatest problem it creates is reviving expectations that UC can once again expect the same kind of support that it received prior to the 1990s, therefore rekindling support for the *status quo ante* option. Although falling short of taking that position, President Yudof, in an internet message to UC Faculty and Staff on October 13, 2010, gave the impression that good, hard lobbying with the Governor and the Legislature may in the future resolve the problem, “UC still remains 10 percent below the level of 2007-08. So we must continue our efforts in the next budget cycle. But for now we should celebrate the fact that we’re moving in the right direction.”

A look back at the comments set forth above from the prospective of late winter 2011, proves that celebration was to be short lived. The newly inaugurated Governor Brown, starting his third term 28 years after completing his second, proposed a budget which cut UC’s funding by \$500M for next year, turning the windfall appropriation in this years budget into a one year blip followed by a further reduction the next. This budget proposal, which has yet to be acted upon by the Legislature, contains its own version of slight-of-hand that may make the proposed cuts for higher education much worse than suggested. The budget, even with its substantial cuts depends on revenue increases which can only go into effect if the legislature agrees to place several revenue-enhancing proposals on the ballot in the form of a referendum . At present the prospects of the first step being taken, let alone an affirmative vote by the people to increase and/or extend taxes are, at best, problematic

## FINAL THOUGHTS

Even if UC fails to succumb to the call of the status quo ante sirens and continues to respond to the pressure of fiscal disaster staring all of the stakeholders within state government and UC in the face, there are many issues that will have to be resolved. For the academic community, the review of the UCLA Anderson School proposal will be important. It may give a good indication of what lies ahead.

One of the more important issues to be dealt with on all sides will have to be creation of an understanding that increased tuition, if associated with the appropriate amount of financial aid, would not be a detriment to access. Indeed, it would be a boon. Experience both at UC and other universities, as well as a substantial body of research has shown that moderate to reasonably high tuition with a high level of student aid is a better way to provide access than a low tuition approach.

In defending its proposal for tuition increases the Commission on the Future concluded that with the strong financial support program that has been provided, “...UC has been largely successful in remaining financially accessible to students at every income level, as demonstrated by the percentage of low income students we enroll, ...student graduation rates and levels of student employment and borrowing.” Another very interesting argument for high tuition and high fees is made by the president of Cal State University, San Bernardino. He argued for higher tuition in order to be able to maintain the diversity of the campus.

The viability of continuing increases in tuition is, of course, dependent on increasing financial aid from all sources sufficiently to offset the effect of higher tuition on accessibility. Cal Grants at the state level and Pell Grants at the federal level need to continue to be funded at the highest possible levels. Above all, however, UC must commit itself to provide institutionally-based aid at a level and type that allows all who are eligible for admission to receive support to enable attendance and graduation without incurring unreasonable amounts of debt.

This vital issue, along with the other elements involved in the move to a modified self-sufficiency option, will require thoughtful and persuasive arguments if it is to be given a chance. Without something like what is being proposed in this chapter, it is difficult to see how the serious problem of funding UC at a level commensurate with its past quality can be resolved. Absent such funding, quality will erode.

However, even with all of the factors pointing toward this approach as the best chance for a continuing high quality university serving the state and nation, nothing can be accomplished without a strong leader willing to think “out of the box” at the top levels of the state and UC. Perhaps the 2010 gubernatorial election produced such a leader. Only time will tell. However, even if that miracle came to pass, the University of California, with the built in conservative approach to its governance and change, will likely be a more difficult matter. We can only hope the extreme pressures on funding faced by California and its University will result in coalescence around an achievable strategy.

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## ENDNOTES

<sup>i</sup> Legislative Analyst's Office, *Proposition 98 Primer*, February 2005. Available at [http://www.lao.ca.gov/2005/prop\\_98\\_primer/prop\\_98\\_primer\\_020805.htm](http://www.lao.ca.gov/2005/prop_98_primer/prop_98_primer_020805.htm)

<sup>ii</sup> University of California Commission for the Future, *Draft Final Report*, October 2010, pp. 4-5. Available at <http://www.dailyca.org/data/files/cotfdraftfinal.pdf>

<sup>iii</sup> University of California Commission, *op. cit.*, p. 4.

<sup>iv</sup> Nickelsburg, Jerry, “California’s Volatile Taxes: Healing a Self-Inflicted Wound,” *California Policy Options 2010*, pp. 163-179.

<sup>v</sup> Legislative Analyst's Office, *Proposition 98 Primer*, *op. cit.*

<sup>vi</sup> Letter to Chancellor Gene Block from Dean Judy Olian, September 12, 2010.

<sup>vii</sup> Kirp, David L. and Rogers, Patrick S., “Mr. Jefferson’s University Breaks Up,” *The Public Interest*, Summer 2002, pp. 70-84.

<sup>viii</sup> Interview with Dean Olian of the UCLA Anderson School of Management in Scott Jaschik, “Giving Up State Funds,” *Inside Higher Ed.*, September 7, 2010. Available at <http://www.insidehighered.com/news/2010/09/07/ucla>

<sup>ix</sup> The University of California shall constitute a public trust, to be administered by the existing corporation known as “The Regents of the University of California,” with full powers of organization and government, subject only to such legislative control as may be necessary to insure the security of its funds and compliance with the terms of the endowments of the university and such competitive bidding procedures as may be made applicable to the university by statute for the letting of construction contracts, sales of real property, and purchasing of materials, goods and services. California Constitution, Article 9, Section 9.

<sup>x</sup> To be fully effective, this fungibility should include not only operating funds but those provided for capital outlay. Since much of that support from the state is currently made possible through complicated revenue funding programs, further attention would have to be given to the method of effecting this change.

<sup>xi</sup> The University of California Commission on the Future, in its *Draft Final Report*, commented on the validity and possible outcomes of initiating all these measures: • Commenting on page 23 on the tuition issue, it stated that, “there still exists substantial headroom on each campus for across-the-board increases without impacting enrollments. However, at some point consideration of a differential tuition model will come into play.

- On page 16, it reports that, “indirect cost recovery (ICR) rates on federally funded research at UC campuses do not fully recover the cost of research, falling 5-10 percentage points behind some of our competitor institutions and an average of 25 percent short of full recovery.”
- On page 22 the report comments that while UC campuses collectively have risen over \$1 billion annually for the past few years. The percentage of those funds that are unrestricted as to purpose is only 5%, compared with averages of 20% at other public and 45% at private universities.
- Again on page 14, the authors state that UC’s percentage of nonresident students (approximately 6%) is very low compared with peer institutions and that each increase of 10 basis points would yield approximately \$20 million added net income. And finally, the amount contributed at the present time from income producing activities such as executive MBA programs at the present amounts to approximately \$100, an amount which could probably be substantially increased.