FY 2003-2004 General Fund Operating Budget

July 17, 2003

Introduction

The fiscal challenge faced by the University in FY 2004 is the most difficult that we have seen in over 20 years, with the result that the budget that we propose in this document, and the document itself, are quite different from their immediate predecessors. This budget is based on three organizing principles.

1. The most important principle in this budget is to assure that our students continue to have access to an excellent education—a Michigan education—in an environment where revenues from the State are being reduced by 10% to approximately the same level as in 1998-99. We have increased central financial aid for undergraduates by a total of $3.4 million or 8.3% which is $750,000 more than what would be required to keep up with growth in tuition. It is our policy to meet the demonstrated financial need of all resident undergraduates. Regarding tuition itself, we are recommending an increase of 6.5% for resident undergraduates; a rate of increase that is less than last year's and which is the very lowest in the State and among the lowest in the Big 10. And in a year where many activities are being cut, we are increasing the number of sections in heavily-subscribed courses in LS&A, at a cost of $700,000, in order to be responsive to student demand and to enable students to complete their academic programs in a timely way.
2. Every unit on campus is bearing some of the effect of a $36.4 million cut from the State in conjunction with over $43 million in cost increases. Administrative units, and administrative activities within academic units, will experience a disproportionately large share of the cuts, consistent with our emphasis on education. Every unit has stepped up to the challenge and there are tangible outcomes across the campus.
3. We continue to focus on the long-term essential quality of the institution while managing through our short-term budgetary difficulties. We are committed to emerging from this difficult period with the breadth and depth of academic excellence that has created the foundation for Michigan's greatness for over a century.

The Budgetary Challenge

We face challenges with respect to both revenues and costs.

Two sources of revenue, the State appropriation and interest income, are budgeted to be a total of $38.1 million less in FY 2004 than the budgeted amounts in FY 2003. In addition, the State imposed two mid-year rescissions during FY 2003, which led to our actual revenue from the State coming in at $12.7 million below budget.

On the expenditure side, we continue to be subject to the normal forces of inflation. The cost of doing business in a university rises much as it does in the rest of the economy, but universities face three sources of cost increase that tend to make our costs rise faster than those in the economy as a whole. (1) We are labor-intensive in comparison to the economy overall, and it is generally the case that the costs of labor compensation rise faster than prices economy-wide. (2) The total volume of our activity—in education, in research, and in service—continues to rise. In FY 2004, we will have more students and a higher volume of sponsored research than at any time in our history. While many businesses are seeing reductions in costs that flow directly from reductions in volume, universities in general, and the University of Michigan in particular, are under pressure to reduce costs at the same time that they experience an increase in volume. (3) The sum of human knowledge and creative expression grows every year, and the University, unlike most private enterprises, has an obligation to preserve the past as well as to invent the future. We are both museum and laboratory; the cost of museums grows in part because the collection grows, and the cost of staying on the cutting edge is always high.

For FY 2004, we face a number of special challenges. For example, natural gas prices are rapidly increasing which directly increases the cost of the electricity and steam that we generate in our gas-fired power plant. Utilities will cost us $2.2 million more than last year.

In total, the increases in the costs of supporting the FY 2003 volume of activity and a few essential new activities will be at least $43.7 million. In addition to financial aid and utilities, the cost drivers include a very small salary program, union contracts, increases in staff benefits, insurance, financial aid, inflation on purchased supplies, completion of funding administrative infrastructure, and a small number of essential new commitments, including the commitment to increasing student access to our highest demand courses.

Meeting the Challenge

Combining reductions in revenues and increases in costs, we faced a total budget challenge of some $81.8 million. In order to meet this challenge without placing excessive pressure on tuition, we have cut expenditures relative to the original FY 2003 budget by $37.5 million. The cuts will be effected in part by reductions in 275 regular staff positions and 50 faculty positions. There will also be reductions in overtime, temporary employees, and consultants, as well as reduced maintenance, equipment replacement, travel, printing, and virtually every type of expenditure that we undertake.

Most of the staff reductions, and all of the faculty reductions, will be via attrition and elimination of open positions, but there have already been a number of layoffs associated with our budget planning and there are sure to be more. In total, our administrative units will have smaller budgets in FY 2004 than they did in FY 2003. Academic unit budgets grow slightly, but essentially all of the growth can be attributed to increased costs associated with the growth in research and teaching volume. Overall, academic unit budgets will grow much less than costs.

In short, this budget attempts to provide more with less, and, as we shall discuss in greater detail later in this document, there are inevitable negative consequences for the quality of the student experience, although we have made every effort to limit those consequences.

Perspectives on the Budget

Figures 1 and 2 show a 42-year history of the most important elements of the Ann Arbor General Fund budget—the sum of tuition revenues and revenues from the State appropriation. These two sources are the most important for two reasons. First, these are the two large revenue sources in the General Fund that can be used flexibly by the University. (The third large source—Indirect Cost Recovery—is not as available to use flexibly. It is partial reimbursement to the General Fund for the indirect costs of sponsored research. It is meant to cover costs that are incurred in the General Fund, including space, utilities, research administration and infrastructure, among others, that are not paid for directly by sponsored research, and so comes with the obligation to cover those associated costs of research.) The second reason that tuition and the State appropriation are most important is that these funds come from the people about whom we care most. The citizen taxpayers of Michigan provide funds for the State appropriation, and serving the people of Michigan is at the core of our mission. Our students and their parents provide our tuition revenue, and we have an even more direct and specific obligation to them.

Figures 1 and 2 show how unusual the recommended budget for FY 2004 is. If we do not adjust for inflation, FY 2004 is the worst year in over 40 years, as shown in Figure 1. Adjusting for inflation, Figure 2 shows that FY 2004 is the worst year in over 20 years, and that the actual growth in revenue from tuition and the State appropriation is negative. Were we to use a price index that better reflects the cost pressures facing higher education this result would be even stronger—the reduction in real revenues would be even greater.

Figure 3 relates the two components of revenue that we have been discussing. There is a longstanding historical pattern in which tuition rate increases respond to changes in the State appropriation. In years when the appropriation grows more, tuition rates rise less; when the appropriation growth is stunted, tuition growth is greater. The pattern is quite clear over the recent period. In response to a lower increase in the State appropriation in 1998-99 than in 1997-98, tuition rose more sharply. When the trend reversed in the subsequent two years, tuition rose less. When the State appropriation increase fell to 1.5% in FY 2002 and to zero in FY 2003, tuition rate increases got larger. In this context, the proposed budget for FY 2004 is quite remarkable. In the face of a 10% base cut in the State appropriation—only the second year-over-year cut in over 20 years, and the largest cut ever—we propose to increase resident tuition by 6.5%, almost a full percentage point and a half less than last year's increase. The comparison to the last year in which there was a base State cut—1981-82—is instructive. In that year the budgeted State appropriation declined by a little less than 5%, and tuition was increased by 19%.

This unusual combination is due to the efforts of every unit to find ways to reduce costs while preserving educational offerings. We are determined to find ways to reduce so that our tuition increase can be as small as possible. That we are recommending 6.5% shows the success of both our ongoing efforts to control costs and our response to the specific challenges that we face this year. (A complete schedule of recommended tuition rates can be found in a separate Action Item.)

Expenditure Reductions and Cost Containment

The University of Michigan is highly decentralized, and its decentralization is a source of its academic strength, because it allows those who are most familiar with teaching and research to make decisions about what should be studied and how. Decentralization poses special management challenges in times of expenditure reduction, because expenditure decisions are made in hundreds of departments and programs and in dozens of schools, colleges, institutes, centers, and administrative offices.

Our strategy of cost reduction reflects the organizational structure of the University. For areas where operations are centralized, such as purchasing, utilities, staff benefits, and financial management, we are continually looking for University-wide improvements that can save money. Over the past several years, we have undertaken significant cost reductions in all of these areas, and have been making continual improvements. Compared to what would have occurred had we not undertaken these improvements, the FY 2004 budget saves approximately $7 million in energy costs, $1.3 million in debt service, over $ 1 million in pharmacy benefits, over $7 million in purchasing activity, and $1.3 million in other staff benefits. These savings take years of planning to realize and arise not so much as a result of the specific budgetary challenges of FY 2004, but as a result of ongoing efforts to keep costs down. Such efforts are continuing and will yield more fruit in future years, especially in the areas of travel management and health benefits, where we are currently planning for changes that will lead to significant future reductions in University costs.

In most areas we are much less centralized, and cost containment and expenditure reduction are achieved unit by unit, person by person, course by course, and program by program. Here, the best way to characterize the savings, that add up to over $26 million in academic programs and academic support and over $11 million in administrative areas, is to provide examples – the full list would run to hundreds of items. These examples are roughly ordered—from least consequential to most—by the severity of impact on students and their educational programs, and on faculty quality. It is our judgment that these cuts do not put the essentials of the Michigan educational experience at risk, but we are frankly concerned that some of these reductions may prove to be difficult to sustain. We pledge to monitor them and their consequences carefully.

- North Campus lawn mowing will be reduced, as will the refinishing of hardwood floors in student recreational facilities
- Property Disposition is eliminating one regular sales position and temporary staff by reducing the number of hours per week that they are open for business
- Information Technology Central Services (ITCS) will reduce the number of hours that the campus computing site in the School of Education Building is open
- ITCS will raise the price per page for printing at campus community sites and labs and may need to reduce the printing allocation for faculty, staff and students
- Office of Academic and Multicultural Affairs will reduce printing, publicity, committee support and speaker costs for the annual Martin Luther King Symposium
- The Office of New Student Programs will outsource the production of the "M-Planner: Insider's Guide to the University of Michigan"
- UM-TV will reduce funds for programming that captures campus lectures and special events
- Custodial Services will reduce trash pickup frequency from daily to weekly
- Social Work completed a significant reorganization of its administrative structure, eliminating several positions
- LS&A has streamlined operations to handle increased workload with 20 fewer staff and is reducing funding for replacement teaching for faculty who are on leave
- The Law School will increase the size of its entering class
- Political Science is increasing class size in several upper division courses—from 45 to 80 students in some and from 80 to 130 in others
- Engineering will extend computing hardware purchasing cycles for 900 public site machines
- Engineering will eliminate three courses that enroll approximately 550 students per year
- Kinesiology will severely limit the number of external speakers invited to campus
- Public Policy and the Law School will reduce the number of courses taught by adjunct and/or visiting faculty

- Office of the Vice President for Research is reducing the annual Faculty Grants & Awards program by $200,000 (17%)
- Office of Financial Aid will not hire temporary staff during peak periods of activity, which will result in longer processing time for applications and for requests to review and adjust aid awards due to special and/or unforeseen circumstances experienced by students and their families
- LS&A's elimination of 20 faculty lines will affect areas such as undergraduate research opportunities and graduate student mentoring, as well as the ability of the College to build research strength in areas of critical needs
- LS&A will eliminate 5 first-year seminars
- Engineering is reducing funds available for cost sharing on major new research initiatives, for technology transfer, and for the development of new inventions to the point where they can be commercialized
- Engineering is deferring technological infrastructure upgrades to its teaching labs (currently on a 9-year cycle)
- Business Administration will reduce or eliminate the Dean's Fellows program for highly qualified new students and will reduce placement-related activities for current students and alumni
- The School of Information's highly successful Internet Public Library project will not be sustainable and may be eliminated
- Most schools and colleges will reduce course offerings, which will result in larger class sizes, reduced scope of the curriculum, disruptions in some students' academic progress, and reduced student-faculty contact

The elements on this list are by no means exhaustive. They cover a wide range of impacts. Reducing hours at Property Disposition, for example, is unlikely to pose many difficulties. Property will continue to be disposed of properly, and units will become accustomed to the new hours, although there may be some congestion and inconvenience. At the other end of the spectrum of effect, reductions in course offerings and increases in class sizes, which are inevitable consequences of increasing the size of the student body while reducing the size of the faculty, put at risk essential elements of the Michigan educational experience.

The breadth of our offerings is one of our greatest strengths, both in what we can accomplish and in how we are perceived by students. Michigan is one of the few places in the world where a student can be assured of having access to faculty and courses, at the highest level of expertise, in virtually any area of inquiry. We have been less well-regarded in our ability to provide opportunities for students—especially lower-division undergraduates—to have small-group interactions with faculty. Over the past decade we have made great improvements in this area, and LS&A has developed a freshman seminar program that provides an opportunity for every first-year student to take a small course with a regular faculty member. The proposed cuts eliminate several of these seminars, and also eliminate a number of other small and medium-sized courses.

We have built this budget placing the highest priority on minimizing negative effects on our educational programs. Even so, there certainly will be an impact, both direct and indirect, and we will pay close attention to this in the coming year.

The General Fund Budget Recommendation

The attached Table 1 summarizes the General Fund Budget Recommendation for FY 2004. The most striking element of Table 1 is the difference between the academic units and the administrative units. Even after making cuts in activities and so reducing costs, the academic units on average experience a modest increase in their General Fund budgets (most of which is accounted for by increased numbers of students and the tuition they pay and increased volume of indirect cost recovery from sponsored research) reflecting our emphasis on supporting, as far as possible, the direct educational offerings. Administrative units, on the other hand, experience an actual reduction in their General Fund budgets year to year. The apparent magnitude of these reductions is understated by approximately $4 million—nearly two percentage points—because we are adding $4 million to the EVP/CFO budget to complete our overhaul of administrative management systems. Without this addition, the change in budget in the EVP/CFO's area would be a reduction of over 2%.

There is considerable variation in the rates of growth of General Fund budgets in the academic units. In most cases, units that are growing rapidly (e.g., the Medical School, the Law School, the College of Engineering, the School of Nursing) are doing so because they are experiencing rapidly growing volumes of research or instruction or both. It is a feature of our budgeting system that General Fund resources wax and wane with the volume of activity. Of course, changes in activity bring with them changes in costs. For example, the substantial increase in budget for the Medical School derives in large part from a robust research volume that has led to increased indirect cost recovery, and the added resources are essential to support the indirect costs of the research itself. The School of Nursing and the College of Pharmacy are both showing substantial increases in research and student volumes, following fairly lean periods.

The growth in expenditure on University Items is driven by one policy choice—financial aid—and two sets of unavoidable cost increases—utilities and insurance. The growth in central financial aid results from an increase for undergraduate aid of 8.3% and one for graduate student aid of 6%.

This budget is decidedly tighter than in years past, but the shape of the priorities is unchanged. We have a longstanding policy to meet the financial need of all resident undergraduates, and our first priority has been to assure that financial aid rises at least as rapidly as tuition. In this budget, we have deliberately allocated an additional $750,000 in recognition of the consequences of the weak economy for our students and their families. We then make every effort to devote resources to our various academic missions while realizing savings in administrative areas. In each of the past seven years, this has been reflected in the fact that academic budgets in total have risen faster than administrative budgets. This year continues the trend but with a new twist—the administrative budgets are actually falling, notwithstanding the fact that both costs and the volume of activity continue to rise. And, of course, we continue to meet our contractual obligations such as utilities, insurance, and collective bargaining agreements.

Conclusion

We end this discussion as we began it. In the face of budgetary challenges, our primary obligation is to maintain the excellence of this University in the coming year and in the years to follow. Our focus is on academic programs, which means that it is first and foremost on the women and men, faculty and staff who enable the teaching, learning, and discovering by our students, as well as the economic growth, patient care, and other vital contributions that the University makes to the State, to the region, and to the world.

The size of the faculty and staff will be reduced in the coming fiscal year; some of the elements of the Michigan experience will be leaner, and will be experienced as such by our students. But the essential breadth and depth of excellence in our academic offerings will be maintained. We are grateful for the efforts of thousands of faculty and staff across the University who have stepped up to the challenge of finding innovative ways to eliminate tens of millions of dollars of recurring expenditures with minimum impact on teaching, learning and tuition rates.

The value of higher education has never been greater. In straightforward economic terms, the return on investment in a college education continues to grow and is at its highest level since economists started making such calculations. Less tangibly, but at least as important, education is the key instrument for understanding, engaging with, and negotiating in an increasingly complicated and interesting world. The best universities, such as the University of Michigan, return the greatest value to their students and to society as a whole.

Our missions of teaching, research, and service continue to be deeply significant. The budget we recommend here allows us to accomplish those missions, relying on the dedication and support of our faculty, staff and students, the people of the State, and the Board of Regents.