The Regents of the University of California

COMMITTEE ON FINANCE
April 3, 2003

The Committee on Finance met on the above date by teleconference at the following locations: UCSF - Laurel Heights, 3333 California Street, San Francisco; James E. West Alumni Center, Los Angeles Campus; Social Science Tower 122, Irvine Campus; 111-A University Complex, San Diego Campus; Cheadle Hall, Santa Barbara Campus; 1130 K Street, Suite 340, Sacramento; and 4225 N. Hospital Road, Building 1200, Atwater.

Present: Regents Atkinson, Connerly, Hopkinson, Ligot-Gordon, Montoya, Moores, Preuss, and Sayles; Advisory members Murray and Pitts

In attendance: Regents Davies, Johnson, Kozberg, Pattiz, Sainick, and Terrazas, Regent-designate Seigler, Faculty Representative Binion, Secretary Trivette, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice President Hershman, Chancellors Carnesale, Cicerone, Tomlinson-Keasey, and Yang, University Auditor Reed, and Recording Secretary Nietfeld

The meeting convened at 9:58 a.m. with Committee Chair Hopkinson presiding.

1. READING OF NOTICE OF MEETING

For the record, it was confirmed that notice had been served in accordance with the Bylaws and Standing Orders for a Special Meeting of the Committee on Finance, for this date and time, for the purpose of receiving an update on the 2003-04 mid-year budget cuts and the 2003-04 Governor's Budget.

2. UPDATE ON THE 2003-04 MID-YEAR CUTS AND THE 2003-04 GOVERNOR'S BUDGET

Vice President Hershman began his presentation by outlining the steps that will be taken in response to the budget situation. Today's meeting will provide an opportunity for the Regents to offer comments on the State budget. At the May meeting, a recommendation will be made with respect to an increase in student fees; adoption of the budget will occur once the Legislature has taken its final action.

Mr. Hershman recalled that the State is faced with a budget crisis of unprecedented magnitude. The Governor estimates that the shortfall is about $35 billion, part of which is one-time in nature, and part of which is permanent or structural. The Governor's package of solutions proposes both one-time actions to deal with the current-year shortfall as well as permanent reductions to address the ongoing structural imbalance between revenues and expenditures. His basic plan makes significant cuts in all State programs and local government, including K-12, higher education, and health and social services. The

Governor's Budget package includes a combination of program reductions, new revenue, fund shifts, transfers, and other actions to balance the budget. Some of the Governor's proposals were released in December as part of a series of mid-year actions to be taken to help balance the budget. Further actions were announced in January with the release of his overall budget proposal.

The Legislative Analyst recently released her analysis of the 2003-04 budget bill in which she agrees that the Governor's plan, if adopted in total, would address the current-year shortfall and eliminate the structural imbalance, resulting in a balanced budget. Republican members of the Legislature, however, have expressed concern about the tax increases being proposed by the Governor and have indicated that they do not intend to support these increases. A plan proposed by Republicans in the State Senate involves no tax increases, limited cuts to local governments, and deeper cuts to State programs. The University has testified on the effect of an additional 10 percent cut, which would be very difficult to absorb. For example, it is not possible to restrict enrollments for 2003-04 as the students have already been admitted. The University will continue to oppose any additional cuts to its budget. Mr. Hershman continued that many Democratic legislators are also uncomfortable with the Governor's proposal due to its deep cuts in areas they support.

Vice President Hershman reported that a ruling by the State Court of Appeals that the State could not pay out funds from the Treasury without a budget except for those items that were required by federal law is before the California Supreme Court. Depending on the Court's ruling, this could lead to a more expedited resolution of the budget. A reasonable compromise by the Governor and the Legislature, however, could mean that the 2004-05 budget will be even worse because some of the shortfall would be addressed by borrowing. The State also faces permanent problems because of the decrease in stock-option and capital gains revenue.

Vice President Hershman commented that it was unlikely that the University could continue to expect increases in funding above inflation from the federal government. He also acknowledged that the growth in private giving would be difficult to sustain, given the state of the economy.

Turning to the University's State-funded budget, Mr. Hershman noted that there has been a steady decline in the University's budget as a share of the State's general fund since the mid-1980s, with a steep decline occurring in the early 1990s. That decline was moderated by the first Compact with the State in 1995-96. Even with the extraordinary support of the State in the late 1990s and early in this decade, the University's share has remained about the same and is still far below what it was before the cuts in the early 1990s. The University is concerned about its ability to maintain quality without sufficient resources, particularly in an era of dramatic enrollment growth. Enrollments are growing at more than triple the rate of the state's population. Therefore, higher education's share of the State's general fund budget should be increasing during this decade. Mr. Hershman recalled that the University coped with a $900 million shortfall from its workload budget in the early 1990s through a combination of actions in order to preserve quality and ensure that all eligible students who wished to attend were admitted and that they had the opportunity to graduate in a timely manner. One-half of the cuts occurred through campus-based budget cuts, while one-quarter of the solution came by not giving employees any cost-of-living adjustments for three consecutive years and by reducing salaries on a temporary basis for one year. The final one-quarter of the solution came through increases in student fees. Mr. Hershman stressed that similar solutions would need to be considered to address the current budget crisis.

Vice President Hershman commented that, by providing basic funding to keep salaries and benefits competitive for faculty and staff, support enrollment growth, address shortfalls in core areas of the budget, and fund the facilities the University needs to accommodate students and faculty, the Partnership with the State provides the minimum amount of funding needed to maintain quality during a period of enrollment growth. Until 2001-02, both the University and the State lived up to and exceeded the goals specified in the Partnership's funding and accountability principles. With the recent budget shortfalls, the University is not receiving the resources it needs to provide sufficient cost-of-living adjustments to faculty and staff to keep pace with faculty salary increases at comparison institutions or market-based increases for staff. With the 2003-04 budget, the Partnership will be underfunded by over $420 million in terms of funding for salary, employee benefit, and other cost increases. In addition, the University will have sustained over $530 million in budget reductions. The combined total shortfall will be nearly $1 billion by 2003-04. This means that while the University would expect to have a $4 billion state-funded budget, it will actually receive only about $3 billion.

Enrollment at the University will have grown by nearly 18 percent between 2000 and 2003, yet the State-funded budget will have declined by almost 6 percent. The University faces the challenge of experiencing one of its most sustained periods of enrollment growth during one of the worst economic downturns in the state's history. The University's long-term enrollment plan, last revised in 1999, called for an annual enrollment growth of about 5,000 FTE over this decade; by 2010-11, with the opening of the Merced campus in 2004 and fully State-supported summer instruction accounted for, the University would reach its planned target of 217,500 FTE. However, enrollment is growing by an average of 8,000 students per year. By 2003-04, total enrollment will be more than 12,000 FTE over the level envisioned in the 1999 plan. In the current year alone, the University has 5,000 students more than budgeted levels, due in part to the success of the Eligibility in the Local Context program. The percentage of admitted students who choose to enroll has grown from 7.3 percent to 7.8 percent. Enrollment of community college transfers is tracking well with the planned growth in the number of these students. In 1999-2000, as the University worked to develop the Partnership Agreement with the Governor, it made a special commitment to increase community college transfers by 6 percent per year. The University has surpassed this goal, with community college transfers increasing by over 21 percent in the last three years. In addition, in the past two years there has been an 80 percent growth of enrollment in summer sessions at the campuses where State funding has been provided.

Mr. Hershman presented details of the 2003-04 Governor's Budget proposal for the University of California. He recalled that, prior to the mid-year cuts, the State had intended to provide the University with $3,220.9 billion in funding as part of the Budget Act that was signed by the Governor in September. The final 2002-03 Budget for Current Operations that was adopted by The Regents in December 2002 remains intact at $3,013 billion. The reductions are spread across every area of the University's budget, although a priority was maintained for protecting instruction. Reductions that otherwise would have been targeted at instructional programs were offset by student fee increases in the current year and are proposed to be offset by further student fee increases in 2003-04. In many other areas of the budget, the cuts range from 10 percent to 50 percent, and in the case of the Subject Matter Projects amount to virtual elimination of the program.

Funding for research is reduced by 10 percent, in addition to the 10 percent these programs were already reduced in the current year. These most recent reductions occur on top of the 20 percent reductions to research programs during the cuts of the early 1990s. The University is very successful at using State funds provided for research to leverage federal dollars. Cuts in State funds of this magnitude put at significant risk the University's ability to maintain a return on the State's investment. Research cuts in particular will have an impact on the state's economic growth.

Cuts in other areas of the budget are also very deep. They will mean closure of some programs and dramatic reductions in others:

- Some Cooperative Extension centers will be closed.
- Services to students will be reduced at the same time student fees are increasing dramatically.
- Administrative functions will be cut back at a time of greater demand associated with enrollment growth.

Mr. Hershman observed that these cuts will also have serious consequences for University employees. If all of the cuts were to be taken through layoffs, for example, it would be the equivalent of losing about 3,000 FTE employees. Consistent with Executive Orders from the Governor, the University has instituted hiring restrictions, except that, in keeping with the Governor's intent, the University has excluded from the restrictions positions that are needed to meet the University's educational mission and to provide certain specialized skills. Given the magnitude of the proposed reductions, it is anticipated there will be layoffs, although it is difficult to estimate the number this early in the process. In addition, the University is considering a range of other options, including voluntary work furloughs, deferring purchases of equipment, library books, and other materials, and other cost-saving measures in non-personnel-related areas of the budget. As a last resort, pay reductions and mandatory work furloughs may need to be considered. Taking many of these actions to address the cuts is unavoidable.

Funding for the University's outreach programs has been a high priority for the Legislature, and there is some expectation that a portion of these cuts will be restored. The University has committed itself to work with the administration and the Legislature to try to resolve the potential cut in outreach. It is unlikely that any other State funding will be restored. The budget also includes an unallocated reduction for 2003-04 of $43.8 million, which goes against all understandings the University had with the State with respect to protecting instructional programs.

Mr. Hershman noted that funding under the Partnership will provide $117.2 million for the enrollment of an additional 13,000 FTE students at the agreed-upon marginal cost and $11.3 million in start-up funds needed to open the Merced campus by 2004-05. On the other hand, the State did not provide the 4 percent increase to the base budget requested under the Partnership, nor did it provide the 1 percent to the base for core needs.

Vice President Hershman outlined the major budgetary challenges that face the University in 2003-04:

- Deep targeted cuts to the base budget covering nearly every area of the University's budget, on top of $160 million in cuts contained in the 2002-03 Budget Act
- Student fee increases to avoid cuts in instruction
- Unallocated reduction not covered by student fee increases
- No funding provided for faculty merit increases
- Employee health benefit increases
- Other unavoidable costs that are not funded include energy cost increases, maintenance of new space, and price increases on non-salary budgets.

Mr. Hershman stressed that, as a result of these deep cuts, there is no doubt that quality at the University of California will be eroded.

Regent Connerly believed that the assumption should be made that the State's budget problems will not be short lived because State government had grown beyond the capacity of its citizens to sustain it. As a result, the University will have to make permanent, across-the-board cuts to its programs through the reduction of its size and its reach in a variety of areas. The Regents must examine ways in which to adjust the University to this new reality, including the option of admitting fewer students than in the past.

Mr. Hershman recalled that when President Atkinson testified before the Senate Budget Subcommittee, legislators had raised questions similar to those put forward by Regent Connerly. One member of the committee suggested that the University consider a number of options, including directing eligible students to a community college for the first two years of undergraduate education. He stressed that the legislators on the committee have been committed to preserving access to UC; their remarks addressed the State's ability to fund the University. Regent Montoya suggested that it was unrealistic to depend on enrollment at the community colleges when their budgets are being severely curtailed.

Regent Connerly continued that if the University needs to step back from accepting the top 12.5 percent of California's high school graduates, its administration should be supporting the efforts of the community colleges to receive adequate funding from the State. Vice President Hershman responded that the Legislature must address the Governor's request to raise fees at the community colleges from $11 per credit unit to $24. The community colleges have the lowest fees of any system in the country, and they would continue to have the lowest fees even with the proposed increase.

Regent Pattiz observed that falling further behind with respect to faculty salaries would be a serious problem for the University. It was his belief that the only way to address this concern would be to have fewer faculty members making higher salaries and have them teach larger classes. He agreed that, in order to maintain enrollment levels, quality would need to be sacrificed. He asked for comment on the financial impact on the budget of opening the Merced campus. Vice President Hershman recalled that the Governor had provided an extra $11 million to support faculty and staff who are already working at the Merced campus. If the number of faculty were to be frozen for one year as of June 30, 2003, there would be a resultant savings of $4 million. However, if the opening of the campus were delayed until 2005, student housing would be unoccupied, and there would be no way to pay the debt service on these facilities.

In response to a question from Regent Ligot-Gordon, Vice President Hershman explained that a 10 percent budget cut is equivalent to funding for 32,000 students; by contrast, the University enrolls 41,000 new students per year.

Regent Hopkinson requested that the administration provide specific scenarios to respond to the budget crisis. Mr. Hershman observed that any steps that the University takes will have to be done in consultation with the Governor and the Legislature.

In response to a question from Regent Pattiz, Mr. Hershman explained that the marginal cost per student to the State for UC students is about $9,000, while the figure is approximately $7,000 for the California State University and approximately $4,000 for the California Community Colleges.

In response to a comment by Regent Kozberg, Vice President Hershman confirmed that it would be important for the Regents to affirm their commitment to outreach. The University is working with the Department of Finance and the Legislature to have funding for outreach restored.

Turning to the issue of student fees and financial aid, Mr. Hershman explained that the Governor's Budget anticipates that student fee increases will be a part of the University's solution to address budget cuts. The Regents has already approved a $405 student fee increase of which one-third will be implemented in spring 2003. For 2003-04, the Governor's Budget assumes The Regents will once again act to increase student fees to offset an unallocated reduction, which grows to $179 million in 2003-04. Student fee increases will once again be necessary to protect instruction from budget cuts. These increases will raise undergraduate student fees by $1,200, or 35 percent, over an 18-month period. Fees for graduate and professional school students will also rise by 35 percent over the 18-month period. Financial aid will be increased consistent with the University's policy of returning at least one-third of the revenue derived from fee increases to financial aid to provide grants for the neediest students. The Governor's Budget also includes funding to increase Cal Grants to provide sufficient funds to cover fee increases for eligible students. Any student currently receiving a grant would have his or her fee increase covered, either through Cal Grants or through grants provided by the University. On average, a financially needy student from a family with income up to $60,000 will receive a grant to cover the fee increase.

Mr. Hershman recalled that historically fees were very low for a long period of time because adequate State support allowed fees to remain stable. With the decline in State support in the early 1990s, fees rose sharply. There was no increase in mandatory systemwide fees for seven consecutive years until the mid-year student fee increase was instituted for the spring 2003 term. If the University had adjusted mandatory systemwide fees by the annual increase in California per capita personal income, consistent with the Partnership Agreement, between 1994-95 and 2002-03 the average student charges for UC undergraduate students in 2002-03 would have been $6,202, an increase of $2,185 over the actual average of $4,017, which would have been on par with the average of total tuition and fees charged at the University's public comparison institutions. Vice President Hershman commented that he had testified before the Legislature that, if the University had raised student fees by $100 each year for the past eight years, instead of having fee reductions, the current student fee level would be the equivalent of that proposed in the Governor's Budget. Because fees have been kept low, UC fees continue to be significantly below the average of the comparison public universities. Assuming the fee increase anticipated in the Governor's Budget is implemented, UC's undergraduate fees will still be more than $1,600 below the comparison group average.

Vice President Hershman stressed that financial aid is a major component in the University's ability to maintain access for needy students. When all fund sources are included, UC students received $1.2 billion in financial aid in 2000-01, the most recent year for which actual data are available. Nearly $650 million in financial aid was in the form of scholarships, grants, and fellowships, which was about the same amount of revenue generated by student fee income in that year. State and University funds are used primarily for grants and scholarships; most federal aid is in the form of loans. Nearly 50 percent of UC undergraduates receive grants or scholarships. Mr. Hershman recalled that a study by the Irvine Foundation had found that UC enrolls a higher percentage of low-income students than any other top university in the country, with UCLA first at nearly 35 percent.

Vice President Hershman noted a desire on the part of the University to assist middle-income students who normally would not receive financial aid due to work and loan expectations.

Because of the high fee increase, the University will provide significant assistance to these students, which is a change from normal procedures.

Mr. Hershman recalled that the Legislative Analyst had proposed that, instead of a $1,200 fee increase over a two-year period, the amount be reduced to $980; in order to fund this reduction, the University would provide no institutional financial aid related to the fee increase. The University opposes this proposal because it would be particularly difficult for low-income students.

Regent Connerly recalled that at the December meeting Regent Sayles had alluded to the concept of charging fees based upon the ability to pay. Vice President Hershman recalled that the California Postsecondary Education Commission had studied this issue several years ago. At the time, concerns were raised about what effect this would have on the financial aid system. He believed that, if the University's financial aid system were kept intact, Regent Sayles' suggestion could be taken into consideration, given the fact that all students receive a substantial subsidy from the State, regardless of income level. Regent Hopkinson suggested that a fee policy should be created in the context of the University's response to its budget situation.

Chairman Moores asked whether any revenue opportunities might be found in raising nonresident tuition and admitting a higher percentage of out-of-state students. Mr. Hershman agreed that the Regents might wish to consider this suggestion, given the State's financial condition. Additional, substantial increases in fees for professional students should also be a subject of consideration.

Regent Davies believed that when the administration comes back with options for addressing the University's long-term structural problems, it should consider restricting enrollment in the years following 2003-04. Mr. Hershman recalled that one approach would be that suggested in meetings with the Senate of directing lower-division students to the community colleges.

President Atkinson pointed out that the University's previous enrollment projections had been made on the assumption that 7.3 percent of the state's high school graduates would enroll at the University; the actual figure has climbed to 7.8 percent. He emphasized that the University had committed to admitting the top 12.5 percent of the high school population. In the absence of a policy on affirmative action, restricting access would result in a dramatic drop in the percentage of underrepresented minority students.

In response to these comments, Regent Connerly observed that the President had seemed to imply that the University had increased its enrollments in order to accommodate underrepresented students who otherwise would not be admitted. Regent Terrazas disagreed with this interpretation; he believed that if the University were to abandon its commitment to admitting the top 12.5 percent of students, there would be a domino effect on the California State University and the community college system.

Mr. Stephen Klass, chair of the University of California Student Association, observed that the failure of the State to fund education and its consequences cannot be blamed on The Regents. The choice for students is whether to lobby the Board or the Legislature on their own behalf. He pointed out that over 50 percent of students must take out loans to pay for their education, and nearly 60 percent must work part time while attending the University. The average unmet financial need of a UC student is $2,500. California students accumulated more than $3 billion in federal student loan debt to attend college. Mr. Klass observed that fees are not the only cost of attending college; many of the University's campuses are in some of the most expensive cities in the country. These facts must be considered in the context of the proposed 35 percent increase in student fees. He reported that, as students increase the number of hours they work per week, the probability that they will drop out also increases. These trends disproportionately affect underrepresented minority students. Turning to the benefits provided by the University of California, he reported that a recent study had found that each dollar spent at the University of California translates into $4 for the state's economy. The University turns research dollars into technological and medical innovations that put California on the cutting edge of many industries. The communities that surround the University's campuses benefit from the direct business of students, faculty, and staff. Mr. Klass believed that a vote to raise student fees was a vote for less-educated Californians who will earn less money in the future. In concluding his remarks, he urged the Board to hold its May meeting at the Los Angeles campus in order to provide students with access to The Regents.

Returning to his presentation, Vice President Hershman observed that the most worrisome problem facing the University for the long term is an inability to pay competitive salaries as a result of the budget shortfalls. Paying competitive salaries is absolutely critical to the University's ability to accommodate students. The promise of accessibility is an empty one if the University is unable hire the high-quality faculty needed to teach the students who are admitted. Funding for salary increases for UC employees in the 2001-02 and 2002-03 budgets fell short of what was needed to stay competitive; for the 2003-04 budget, there is no funding provided for salary increases. Because one-third of all faculty members are eligible for merit increases in a single year, the inability to fund these merits will raise issues of equity.

Based on the CPEC methodology for comparing UC salaries with faculty from comparison institutions, it is estimated that University salaries are about 5 percent behind in the current year; that gap will grow to about 9 percent in the budget year and will be greater if faculty merits are not provided. The gap in competitive salary levels is of deep concern to the University. While there is no single measure for quality of an institution, the excellence of its faculty is surely a primary indicator, and the key to attracting excellent faculty is offering competitive salaries. In a survey conducted by the University spanning the last half of the 1990s, the reason most often cited by first-offer candidates for not accepting a UC appointment was that they had received a better salary offer elsewhere. Nothing is more certain to undermine quality than a persistent inability to offer competitive salaries. The University must be able to compete for the best faculty if its quality is to be maintained.

This is particularly important during a time of unprecedented enrollment growth when campuses must hire thousands of new faculty over this decade.

With respect to staff salaries, the administration is looking at ways to address the inability to provide salary increases through adjustments to healthcare costs for lower-paid employees, with little or no relief for those with higher incomes.

Regent Ligot-Gordon asked about the authority of the Governor and the Legislature to redirect funds that are generated by the University. Vice President Hershman recalled that for the past seven years the State had provided the University with funding for Registration Fee funded programs to buy out student fee increases. The State is no longer providing this money, which is clearly within its discretion. On the issue of cuts to outreach programs, the University has continued to remind the Department of Finance that it does not have the authority to make these cuts because the money was generated by raising nonresident tuition.

Regent Hopkinson pointed out that it was a cooperative process; the State may take the position that it will make cuts where it has the ability to do so.

In response to a question from Regent Connerly, Vice President Hershman explained that the University would be responding to the Legislative Analyst's criticisms of its outreach program in hearings before the Legislature. He stated the intention to distribute Vice President Doby's testimony to the Regents.

In concluding his presentation, Vice President Hershman reiterated the need to coordinate the University's response to the budget crisis with the State. The University will continue to oppose any deeper cuts as its speaks before the Legislature.

The meeting adjourned at 11:35 a.m.

Attest:

Secretary