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A "Thriving State?"

Reading a Private College Budget

ROBINSON G. HOLLISTER

'Tell me some of your mistakes,'
'I am almost ashamed,' said Sissy, with reluctance. 'But today, for instance, Mr. McChoakumchild was explaining to us about Natural Prosperity.'
'National, I think it must have been,' observed Louisa. . . .
'National Prosperity. And he said, Now, this school room is a Nation. And in the nation, there are fifty millions of money. Isn't this a prosperous nation? Girl number twenty, isn't this a prosperous nation, and an't you in a thriving state?'
'What did you say?' asked Louisa.
'Miss Louisa, I said I didn't know. I thought I couldn't know whether it was a prosperous nation or not, and whether I was in a thriving state or not, unless I know who had got the money, and whether any of it was mine. But that had nothing to do with it. It was not in the figures at all,' said Sissy, wiping her eyes.
Charles Dickens, *Hard Times*

Most faculty members feel like Sissy when first encountering the institutional budget process. The McChoakumchilds of the administration say: "The budget includes a 6 percent increase in faculty salaries. An't you in a thriving state?" Yet when we note that the budget also includes a 9 percent tuition increase (which the president informs parents is required "for salaries to meet the competition for faculty"), we respond: "We don't know whether we're in a thriving state or not, unless we know who gets the money from the tuition increase and why a smaller proportion of it is ours."

Faculty participation in the budget process *can* provide an opportunity to find out who gets the money. Of course, finding out where the money goes is one thing, and changing where it goes is another. But knowledge provides some kind of power, and even the power to raise intelligent questions about resource allocations may be important.

Detailed knowledge of how an institution obtains and expends its resources forces faculty to look at the whole picture of an institution, thereby gaining a better understanding of those persons outside of the faculty who also require increased resources to do their jobs properly. The budget process should be one in which the various institutional interests achieve mutual recognition and consensus about policies, people, and perquisites, rather than a charade in which the faculty appears to endorse largely predetermined administrative decisions.

At Swarthmore College, the budget has primarily been a form of communication between the administration and the governing board; faculty, staff, and student participation began only four years ago. Faculty members are now just beginning to learn what role we can play in the budget process and whether we can make a difference in some way.

To provide a concrete focus for the discussion,

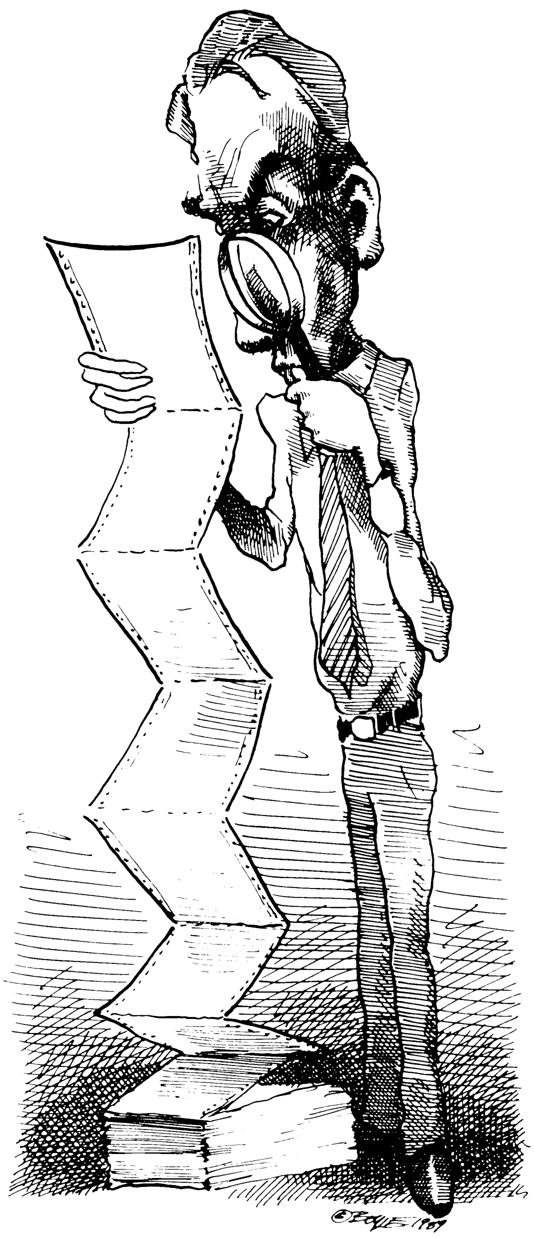

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TABLE 1
Annual Budget Swarthmore College 1987–88

STUDENT FEES	
Average Enrollment	1,298
Average Enrollment-R&B	1,193
Tuition and Fees (in $)	12,150
Room and Board	4,600
Total Student Fees	16,570
REVENUES AVAILABLE (in $thousands)	
Gross Student Fees	21,259
Less: Grants (Financial Aid)	–5,400
Net Student Fees	15,859
Endowment Return Used	10,052
Annual Giving	2,000
Other Gifts Used	1,123
Income on Working Cash	786
Other Income	1,283
Sponsored Activities	1,200
Total Resources Available	32,303
EXPENDITURES	
Compensation	
Faculty Salaries	6,951
Staff Salaries	
Instruction and Libraries	1,325
Computing	297
Admissions	330
Student Services	928
Development	855
President	207
Business and Finance	1,348
Subtotal	5,290
Hourly Wages	2,006
Fringe Benefits	3,682
Total Compensation	17,928
Departmental Expenses	
Instruction and Libraries	1,747
Computing	497
Admissions	228
Student Services	631
Development	621
President	82
Business and Finance	1,034
Total Departmental Expenses	4,840
Administrative and Other Expenses	2,497
Plant Projects/R&R Transfers	1,218
Food Service	1,218
Debt Service	1,148
Utilities	1,108
Enrollment Reserve	221
Contingency	534
Sponsored Activities	1,200
Total Expenditures	32,303
Surplus (Deficit)	0

the actual budget for Swarthmore College for the 1987–88 budget year is presented in table 1. Institutionally, Swarthmore may be somewhat atypical because of its relatively low student-faculty ratio (about 9:1) and its relatively high per-student endowment (although these factors counterbalance to some degree on the expenditure and revenue sides).

At its basic level, a college or university budget is an incredibly simple and straightforward document. In contrast to most business or non-profit organizations, the elements of a college budget remain extremely stable from year to year. The level of charges (tuition, room and board) and the size of the student body determine about 55 percent of total revenues.[1] The size of the faculty and its compensation (salary plus benefits), the level of financial aid, and room-and-board costs account for about 55 percent of expenditures.[2] As all of these elements are largely subject to institutional control, a balance of revenues and expenditures would seem to be readily attainable. There would seem little here to engage the inquisitive faculty mind.

But the faculty mind has been shaped by years of training to pick up on the seemingly insignificant detail, to expand upon it, and to find cosmic meaning there. This penchant is readily encouraged in the budget planning process: even though two-thirds of the budget on both the revenue and expenditure sides may have been set, we can spend *months* debating how funds should be allocated for secretarial assistance for both faculty and administration, whether the alumni bulletin should be printed in color, and whether the costs of athletic teams' preseason trips to warmer climes should be carried in the budget or through external fundraising.

This penchant for excessive attention to detail should be resisted, not indulged. Faculty attention should instead be directed to the considerable effort needed to shape the policies that determine the major budget elements, which are fairly simple and controllable. The faculty also needs to learn about the one-third of the budget made up of more uncontrollable elements.

One of the ''uncontrollable'' budget elements is endowment revenue. Table 1 shows that revenue drawn from the endowment at Swarthmore accounts for 31 percent of total resources available. For many institutions, endowment payout is a

"While a budget contains few key elements, considerable analysis can go into the development of the policies that determine them."

negligible item, but where it is not, the faculty should try to find out precisely how the draw from the endowment is determined. Poorly formulated procedures for endowment payout to the annual budget can introduce instability, not to mention crisis. Endowments heavily invested in equities (the stock market) can fluctuate sharply (as does the stock market, perhaps increasingly).[3] If the endowment payout is not carefully structured to dampen the transmission of market value fluctuations from the endowment to the budget, then the endowment becomes a mixed blessing, providing more resources but in a somewhat chaotic fashion. Because most colleges do not vary their expenditures from year to year, revenue instability can be hard to tolerate. The linking of endowment payout to market value, combined with the post-1972 decline in price-earnings ratios in the stock market, generated a perception of financial crisis at Swarthmore in the late 1970s that led to wrenching deliberations on whether and how to reduce the size of faculty.[4]

Endowment payout formulations need to be carefully watched to assure a proper balance: if payout is too fast, the endowment will shrink; if payout is too slow, the endowment will mushroom. A balance must be found between using endowment resources for current budgets and sustaining the endowment's basic asset value to provide a continuing flow of resources for future budgets. Unfortunately, most faculty members will find endowment payout formulae virtually impenetrable. Furthermore, administrations and boards of trustees—who usually regard the regulation of endowment use as the most concrete manifestation of fiduciary responsibility and their domain of eminence—are often reluctant to listen and respond to faculty views about proper endowment payout procedures. It is probably inappropriate, therefore, to enjoin *all* faculty budget players to police endowment use formulae. Yet, most faculties include a few persons who would enjoy the arcana of endowment use. If those persons will use their expertise to look at the experience of several institutions engaged in refining their formulae, they may be able to help rationalize this area of budget making.

A college budget is, as already suggested, a relatively simple document, with the size of the student body, tuition, and room and board on the expenditure side, and the size of the faculty, its compensation, the level of financial aid to students, and the costs of providing room and board on the expenditure side. While a budget contains few key elements, considerable analysis can go into the development of the policies that determine them. These policies should be reviewed, not every year but in a regular cycle, by the budget committee. What follows are some considerations with respect to the key budget elements that may help faculty think more clearly about them.

Room-and-board charges are generally considered "a wash"—that is, the college provides lodging and food at cost. Aside from these costs, the major portion of most institutional expenditures is compensation (salary plus benefits). At Swarthmore, compensation accounts for 60 percent of expenditures and tuition charges account for 60 percent of revenues (see table 1).[5] This rough correspondence between the tuition charged and the compensation paid to faculty and staff can be used to fashion long-term relationships between the policies that set tuition and those that set faculty compensation.

Over the long term, the growth of faculty compensation should be roughly commensurate with that of similarly skilled and educated workers in the broader economy and, thus, with family income. If tuitions rise at a rate comparable to faculty compensation, then tuitions should remain a relatively constant proportion of family income.[6] This relationship provides a foundation for formulating policies on setting the key parameters of the budget.

Other considerations enter into the determination of compensation and tuition, however. First, faculty compensation must respond to competition in the market. Many institutions have developed comparison groups of similar institutions and have formulated their own faculty compensation in relation to these comparable institutions. Colleges must also take into account what is happening to broader markets for persons with advanced degrees. During the 1960s, the demand for faculty—driven by increasing student enrollment rates and faculty retirement rates—outstripped the supply of new doctorates; demand for faculty caused faculty salaries to rise faster than those of similar workers. In the 1970s, the supply of Ph.D.'s outpaced the demand for faculty, and faculty salaries fell relative to those of other workers (and, in most places, relative to the rate of inflation). The 1980s have been a period of relative balance between de-

"Over the long term, the growth of faculty compensation should be roughly commensurate with that of similarly skilled and educated workers in the broader economy."

mand and supply, and most faculties have pushed hard to regain the economic position they enjoyed in the 1960s. The pattern of the 1990s will be closer to that of the 1960s, driven by large numbers of retirements and a persistently meager supply of new Ph.D.'s. Thus, while long-term faculty compensation should be commensurate with that of similarly skilled workers, faculty compensation will deviate in the short run according to market conditions.

Trustees often question the wisdom of a policy based on keeping up with a comparison group, fearing that it may lead simply to mutual escalation. The underlying relationship to the compensation of other workers in the economy serves as an anchor for compensation policies. Faculty compensation will generally increase at rates comparable to the long-term trend in compensation for similarly skilled workers, and yet deviations will result from explicit needs to meet competition, specific pressures in the academic marketplace, and peculiarities of the faculty age structure.

The accompanying issue of tuition-setting must be approached somewhat gingerly, in light of the recent bold anti-trust initiative by the U.S. Department of Justice. In this area, too, an institution looks at the policies of its "competition," as well as at its costs, when setting tuition. Because of the relationship between tuition and compensation suggested above, tuition-setting can be based on an expectation that tuition will increase at about the same rate as the increase in family incomes. Indeed, throughout the post-World War II period up until the 1980s, tuitions for private liberal arts colleges represented a fairly constant proportion of family income. As with compensation, however, this rough relationship cannot totally determine tuition policy because of the need to respond to special circumstances.

Compensation changes are often reflected in tuition. But the special circumstances may go further. The increases in tuition in the 1980s (which outstripped both the increase in cost of living and family incomes) may have actually reflected in large part an increase in the content of the college experience. Parents are now buying a richer mix of college services for their children. There are now more education-related expenses, such as computing services, better classrooms, and studio and performance facilities, and better student services, such as more spacious rooms and better and more varied food (try to get students to endorse those generalizations!). Campuses have seen increases in special services such as career planning and placement, psychological services, athletic equipment and facilities, and support to other extra-curricular activities such as music, dance, drama, and debate (notice the parallels to international luxury hotels). It is not clear how colleges can contain this mushrooming of extra-educational services, or indeed whether they should, because the competition for students seems to drive them to it. But their tuitions will reflect it.[7]

Financial aid is also involved in the complex budget relationship. For the reasons outlined above, tuition and compensation will rise at about the same rate, which is determined by the rate of increase in the economy of the income of highly skilled workers. Because financial aid is closely related to the demonstrated need of students as determined by family income, financial aid will increase at about the same rate as family incomes within the segment of the economy which sends children to these types of institutions.

Many highly selective private institutions determine virtually all aid on the basis of financial needs and uses through rough use of the formula for determining need outlined by the College Scholarship Service. The resources devoted to financial aid by those institutions committed to a policy of "need blind" admissions (in which students are admitted before the financial aid need and package is determined) are largely determined by the need formulae and the family backgrounds of students who happen to be admitted in a given year.

Not surprisingly, the actual financial aid expenditures can fluctuate substantially from year to year. The sharp changes in demand for financial aid resources periodically cause panic, with administrators and others questioning whether the "need blind admissions" policy can be maintained. But the costs of a constant policy based on fixed formulae will change over the long term only if there is a long-term shift in the mix of incomes of families of those admitted.[8] Policy should be assessed only in terms of longer trends. (Many institutions fix the level of total aid to be given and then adjust the individual awards so that budgeted financial aid is just exhausted, or they manage the admissions process in light of the established need of each applicant so that the allocated aid will approximately be exhausted. For these institutions, finan-

"Trustees often question the wisdom of a policy based on keeping up with a comparison group, fearing that it may lead simply to mutual escalation."

cial aid is a more controllable budget item than it is for Swarthmore.)

The structure of a college budget is simple and its major items readily controllable and susceptible to clear analysis by reference to underlying relationships among the key parameters. At the same time, there is much to engage an active faculty participant. There are also deeper analyses and complex issues to argue about.

An institution can function well when its budget and budget-making process are relatively stable from year to year. On the other hand, one would not wish stability to become transformed into rigidity, with mechanistic policies grinding out the annual budget leaving little room to maneuver. Stability is one of the great virtues of the academic environment but innovation is the element that provides the most fun.

Although the budget is not the place where the character of the college—the curriculum—is determined, it *can* disrupt and constrain curricular developments. Strong faculty participation in the budget-making process can help to minimize these constraints and disruptions by anticipating the consequences of curricular actions for budgets and budget actions for curriculum.

On any campus there is a strong tendency for faculty and administrators to develop their separate cultures, an "us versus them" posturing. Faculty participation in the budget process can help reduce this gap by forcing all to think about our common "natural prosperity." ■

NOTES

1. To get total revenue, one must add to the line entitled Total Resources Available (32,303) the amount of Grants (5,400) taken out above (yielding 37,703). Gross Student Fees, which include tuition, fees, and room and board charges in table I are 21,259, which is 56 percent of total revenues.

2. Once again, the Grants must be added back into the line Total Expenditures to get the correct Total Expenditure (37,707). To get faculty compensation add 25 percent of salaries to the faculty salary line (8,689). Then add the Grants line (5,400) and use the Room and Board charge (1,298 students × 4,600 room and board charge = 5,970) to get the total of 20,059 which is 53 percent of total expenditures. That leaves us 3 percent short of 56 percent so we can throw in about 20 percent of staff (administration) compensation (salaries plus benefits) to make it up to 56 percent of total expenditures—many faculty tell me that about 20 percent of current staff is all we need anyway.

3. Heavy weighting of endowments toward fixed nominal value assets, e.g., bonds, have other drawbacks.

4. Since 1978 Swarthmore has revised and refined its endowment payout rule. Presently the amount paid to the annual budget increases by an index made up of the increase in the annual increase in the Consumer Price Index (CPI) plus 1 percent, weighted by 0.8 and the total market return on the endowment weighted by 0.2, both calculated over the December-to-December period of the previous year. For example, for the 1987–88 budget the CPI was 3.2 percent and the total market return was 3 percent, so the index increase was .8(3.2 + 1) + .2(3.0) = 3.96 percent. In addition, record is kept of the amounts by which the rate of payout from the endowment rises above 4.75 percent of the market value, or falls below 3.75 percent of market value. These accumulations are used as flags to indicate when, over the longer term, some corrective action might be needed. For example, if there are continued accumulations over 4.75 percent, the payout might be held constant for a number of years; if there are continued accumulations under 3.75 percent, the payout would be increased to create a higher base for future payout calculations. The latter step was taken for the current budget year. These procedures provide a fairly reliable contribution to the annual budget, helping to insulate it from inflation but giving some weight to the changes in market value of the endowment. The 3.75 to 4.75 percent bounds over the longer term provide safeguards for longer term adjustments.

5. Room and board costs are taken at the room and board charge (4,600) times the number of students paying room and board (1,193), 5,488. Subtracting the total expenditures gives non-residential expenditures of 26,815. From total compensation remove hourly wages to get 15,922, which is 60 percent of non-residential expenditures.

6. Here I have implicitly assumed that student's family incomes track compensation per worker fairly closely. This would be the case if family composition and the number of earners per family remained steady for college-going students. In the last decade, this has not been the case. I pass over these considerations to keep the discussion relatively simple.

7. A couple of other points about tuition bear mentioning. First, the public, and often many faculty members, seem insufficiently aware that, even at private institutions, tuition and fees cover considerably less than the full cost of the services rendered. For example, working from the budget represented in table I, the per-student cost, obtained by dividing the total resources used by the number of students, was $24,887, and the total charge of tuition room and board was $16,570; full-paying students paid only two thirds of the per-student cost. And, of course, those receiving financial aid grants paid a considerably smaller proportion of per-student costs. As long as charges are below full costs then tuition setting is really an extension of financial aid policy because all the students, including those not "on financial aid," are receiving a grant of the difference between per-student costs and the charges they pay. Thus, for a period of time, raising tuitions faster than costs rise can be seen as a redistribution of financial aid from students with higher income to those with lower incomes (as long as official financial aid rises commensurate with tuition increases).

Second, I am surprised at the number of faculty members who will endorse the general public view that tuitions at private colleges are rising too fast while at the same time lamenting the inadequacies of their own compensation—not making the very simple connection outlined above between the rate of increase in tuition and the increases in compensation. Participation in the budget-making process can force faculty to make those connections and try to work out ways to reconcile those conflicting concerns.

8. Here again I have implicitly assumed that family incomes are determined by the traditional family structure with a constant number of earners. One of the most difficult problems to be faced currently in determination of financial aid is, in the course of estimating financial need for a given student, how to determine that family contribution when there has been a divorce or one of the parents refuses to provide support and information about his/her income. The equity problems in this increasingly frequent case are not easy to resolve, and it threatens to undermine the conceptual foundations of current financial aid practices.