Minutes*

Senate Committee on Finance and Planning
Tuesday, March 4, 2008
2:00 – 3:45
238A Morrill Hall

Present: Judith Martin (chair), Rose Blixt, David Chapman, V. V. Chari, Adam Faitek, Thomas Klein, Russell Luepker, Kathryn Olson, Terry Roe, Michael Rollefson, Gwen Rudney, Thomas Stinson, Aks Zaheer

Absent: Jon Binks, Ruonan Ding, Steve Fitzgerald, Lincoln Kallsen, Mikael Moseley, Kathleen O'Brien, Joseph Konstan, Richard Pfutzenreuter, Justin Revenaugh, Michael Volna, Warren Warwick, George Wilcox

Guests: Julie Tonneson (Office of Budget and Finance)

[In these minutes: (1) budget-model subcommittee recommendations; (2) State of Minnesota economic update; (3) update on the budget instructions]

1. Budget-Model Subcommittee "Recommendations"

Professor Martin convened the meeting at 2:00 and turned to Mr. Klein to lead a discussion of the "recommendations" of the budget-model subcommittee. Mr. Klein began by noting that the report from the subcommittee that had already been presented to the Committee represented the consensus report of the group. Some members of the subcommittee, however, believed that there should be recommendations as well, and it is those recommendations that he was asked to bring to the Committee today for discussion. Professor Martin reported that she had sent the original report to the President, the Provost, Senior Vice President Cerra, and Vice President Pfutzenreuter; to date she's only received acknowledgement from Senior Vice President Cerra. She later observed that while the final report of the subcommittee was the work of the entire group (composed of representatives of both this Committee and the Senate Research Committee), it would be appropriate for the representatives from this Committee to make recommendations that this Committee could adopt.

Mr. Klein said that some of the important recommendations with respect to the cost pools are these; the Committee could forward them with a request they be adopted.

"5. Mechanisms must be implemented to provide faculty input on the setting of priorities for the nine cost pools, for setting rates for these pools, for allocating costs to RRCs, and for monitoring their performance." [RRCs are Resource Responsibility Centers, colleges on the academic side and administrative units on the other.] In other words, RRCs should be able to influence the price and service of the cost pools and there should be metrics for service.

"6. Quality standards for the constituents of the cost pools must be established and evaluated, with a mechanism in place to protect RRCs in case a service provider underperforms."

"7. Cost pools changes should reflect last minute changes in budgets to RRCs."

* These minutes reflect discussion and debate at a meeting of a committee of the University of Minnesota Senate; none of the comments, conclusions, or actions reported in these minutes represents the views of, nor are they binding on, the Senate, the Administration, or the Board of Regents.

Professor Martin recalled that Ms. Olson has asked if savings could not be tracked and attributed to the units. She referred to recommendation 8: "A system needs to be put in place by which units directly benefit if they reduce operating and administrative costs. Without such a system, there is little incentive to control or reduce costs."

In the case of compacts, Mr. Klein said, the subcommittee inquired who decides on priorities. It appeared from the subcommittee's interviews that there is great interest in seeing the connection between strategic priorities and budget decisions.

The major thrust of strategic positioning is interdisciplinary work, Professor Zaheer said (he was a member of the subcommittee). He noted recommendation 11: "Interdisciplinary research and centers that cross RRC boundaries are not directly addressed in the new budget model. A faculty committee could be formed to formulate basic rules that could simplify the operation of interdisciplinary research." The subcommittee asked what mechanisms are place to encourage it and who pays for it. Is there a system by which interdisciplinary activities are encouraged in RRCs? Are there ways to encourage it at the unit level?

Professor Zaheer also noted recommendation 4: "We recommend that the Vice President for Research should be an integral part of the process by which decisions are made to allocated resources to all aspects of the University mission." If research is to be an even more critical part of the University mission to be among the top three, then the Vice President for Research should be part of the resource-allocation process, he said.

The question is, where do they go from here, Mr. Klein asked. The budget model is now only in its second year, Professor Martin said, and it may be time for course corrections.

Professor Zaheer observed that the new budget model is not perceived well by the units, but that could be because it was adopted at the same time there were budget cuts, which may be conflated with the budget model. People tended to blame the budget model for everything that went wrong but the two things may not be related.

What is the Committee view of the recommendations, Professor Martin asked?

Professor Roe said he was concerned about how the RRCs implement the budget model. There may not be constraints at that level but there may be at the central level. The budget model limits discretion and applies a rule to heterogeneous units. Did that come up in the discussions? It did, Mr. Klein said. The budget office confirmed that the budget model only reaches to RRCs; it is up to the colleges to decide how to apply it to units. If a college decides the budget model does not allow something, that is consistent with the budget model. Colleges may or may not like that the budget model is silent with respect to departments and units below the college level, but the Office of Budget and Finance explained that it works with the colleges and does not communicate with individual departments.

Professor Martin recalled that the Faculty Consultative Committee had several meetings last year with department chairs; there was a lot of discussion about the relationship between colleges and departments and the tensions in that relationship.

Mr. Rollefson (from the Graduate School, one of the cost pools) reported that they did set up a mechanism, as recommended in #5, and they assumed others did as well. Are they the only ones that did? They survey faculty and units before the compact process and set priorities accordingly. They also have a faculty committee that provides advice, which does shape what the Graduate School does. Mr. Klein said there are a number of instances where there was consultation around the compact and budget but it is not clear if customers had a say if there should be increases or decreases in the amount of money spent and, therefore, whether the charges to them increase or decrease.

The question is on what bases are increases decided, Professor Zaheer said. How are the rates set and should users have a say in them? Some of the decisions seem to be made via mechanisms that do not include the customers. Do other central units not offer mechanisms, Mr. Rollefson inquired? Some do more, some are not as helpful, Professor Martin replied. One of the ideas underlying the cost pools was to have a market-like mechanism, Mr. Klein said, which implies there would be input on charges and customers could influence the prices they are paying. The statements the subcommittee heard indicate that most deans do not believe there is an effective system for shaping cost pool budget decisions. It may be that because the Graduate School is a different kind of provider and more used to dealing with its constituents, it more quickly established a mechanism, Professor Martin surmised. If it provides a model that could be used elsewhere, that should be made known.

In response to a discussion about whether some cost pools are transparent in their allocation of resources and whether some use metrics that may not be meaningful, Professor Martin asked Ms. Blixt and Ms. Olson to develop questions they would like to see asked; she will forward them.

Ms. Blixt said that her concerns have more to do with income than expenses. Colleges have very complex tuition revenues, and are provided information by central administration, but there is no way to figure out how they forecast the revenues. It is difficult for a college to say whether or not it agrees with the forecast, especially for Wave 1 colleges, because they do not know how the forecasts were developed. It would be helpful if there were more transparency, such as indicating how many students they project.

Mr. Klein commented that transparency means different things to different people, depending on their role. Transparency should mean that people can get the information they need to do their jobs. Not all the details need to go to everyone, but the right details need to go to the right groups—and that means more than just putting everything on a website.

Ms. Olson said she has observed that the RRCs are asked to provide reports but are not given guidelines on how to build the models. If the budget office is asking questions but there are no standards on how to provide the information, units do things in different ways and report in different ways. The administration should develop reporting tools that will be consistent so that all of the units are not re-creating the wheel.

Mr. Rollefson asked about recommendation 10: "We recommend that central administration devise rules and procedures by which necessary college reserves can be protected, and their importance communicated to legislators." How does that relate to the charge to the subcommittee, he asked? That is dangerous turf—there are fund balances and there are reserves, some of which are protected. The majority of universities do not allow units keep balances—they are swept each year—so one sees odd purchases. The University should be given credit for allowing units to plan for the longer term.

Professor Zaheer said that is a good point. What the subcommittee heard was that the administration was changing the policy on reserves and sweeping them more. The issue is that reserves are maintained by units to cover shortfalls; by not allowing units to keep reserves without also agreeing to make up shortfalls when problems arise, the administration makes problems for unit budgeting. Budgeting is an inexact process and units must have funds to cover shortfalls. They also have reserves for start-ups and so on, Professor Martin added. They do, Professor Zaheer said, yet those reserves are treated the same way. He said he was not being critical of the way the University is handling money, but without assurance that it will step in when there are shortfalls, it creates problems for units.

Professor Chari asked if there was any discussion about moving to a multi-year budget system. Reserves would play a secondary role if the budget model were to cover several years. Professor Zaheer said they had not discussed it and had limited their inquiries to the subcommittee's charter, which was to evaluate the existing budget model.

Professor Chari then said the commentary that accompanied recommendation 7 was instructive ("Cost pools should reflect last minute changes in budgets to RRCs"): "In 2006-07, RRCs faced budget decreases shortly before the beginning of the academic year, but RRCs were not permitted proportional decreases in their cost pool allocations. Thus RRCs cut funding to academic programs, while the cost pools appeared to be protected. This seems to be contrary to the aspirational goals of the University." One purpose of the budget model was to decentralize decisions, but #7 seems to run in the opposite direction. What is the administration's defense of that position? They provided more of an explanation of the timing and the flow of funds rather than a defense, Mr. Klein said. The cost-pool budgets were set and then the cuts to RRCs were made, and RRCs were not allowed to make proportional cuts in their cost-pool charges. The timing is difficult for the Budget Office and all of the University when state funding is lowered in April or May. It is very difficult to revisit earlier budget steps and complete the process on time. The point is on the mark; is this problem is built into the budget model or can the situation be handled differently if it happens again? Given the change in the state funding picture this could be an important recommendation this year.

One word summarizes the recommendations, Professor Chari said: transparency. That is what the subcommittee is calling for and it needs to be emphasized. The current budget model is opaque. That is the one word to keep in mind. Professor Zaheer agreed but said that accountability and responsibility, which go hand in hand, are also central to their recommendations.

Ms. Blixt asked if the subcommittee found anyone who liked the new budget model and who saw it as more transparent than the IRS tax imposed in the previous system. They did, Mr. Klein said, because units now know what they are being charged for; before, that was even less visible as central costs were paid off the top with little or no information reaching the colleges on those costs. It is not yet clear, however, whether there has been progress or if this is just another clumsy model.

Professor Martin asked what disposition the Committee wished to make of the recommendations. After brief discussion, she suggested that she and Mr. Klein craft a statement that they would share with the Committee for reaction, with the assumption that it would be presented to the Faculty Senate for action.

2. State of Minnesota Economic Update

Professor Martin turned to Professor Stinson for a report on the economy of the State of Minnesota.

Professor Stinson distributed copies of a set of slides he used as the briefing packet with the Governor, the legislature, and the press, and said he would provide highlights and cautions.

-- The projected deficit in the state budget was \$373 million in November; the most recent forecast puts the deficit at \$935 million. The change is almost entirely from changes in projected revenues.

-- He now expects a recession for the first half of 2008; there was no recession forecast in November. Revenues are down $530 million from the November forecast and down $1.27 billion from the forecast made at the close of the last legislative session. (That sounds like a lot of money, but it is about 3% of the state budget.) Meantime, spending has increased little; it is up $64 million from November. A $1.1 billion shortfall is officially projected for FY 2010-11. However, that projected shortfall makes no allowance for inflation. If inflation is added, the projected shortfall exceeds $2 billion.

-- There is a surprisingly large decline in expected corporate income tax receipts, $456 million (20.6%); the other revenue sources declined by much smaller amounts and smaller percentages. Professor Martin asked if that decline reflected a decline in sales or a loss of corporations in Minnesota. It is mostly lower corporate income, Professor Stinson said. Most corporate income tax is paid by multi-state corporations. The portion of their income taxable in Minnesota depends on Minnesota's proportion of sales, property values, and payroll for each firm. The weights assigned to the payroll and property factors are small compared to sales. That means that even a company like Exxon-Mobil, which has very limited payroll and property value in the state, could pay significant amount of corporate income taxes.

In recessions corporate profits typically slump, and the recession-related slump in corporate profits explains much of the reduction in corporate tax revenue. Corporations also appear to be pursuing tax-minimization strategies more aggressively in recent years, particularly in the use of foreign subsidiaries. Minnesota paid more than $50 million in corporate tax refunds between mid January and mid-February, significantly more than is typical for that period.

There is a relatively small percentage change in individual income-tax revenues (down 1.8%). About 75% of the decline was due to a reduction in portfolio income (particularly capital gains, interest, and dividend income.) Sales tax revenues benefit from the federal stimulus package and changed only slightly from November's forecast. It is interesting to note that FY2008-09 growth from FY2006-07 will be 0.6%: revenue growth has not kept up with inflation.

-- The state's macro-economic consultant Global Insight is predicting recession during the first two quarters of 2008. The federal stimulus package, however, makes it unlikely that the recession will extend beyond June or July. Forecasters are concerned, however, that the economy could slump once again after the federal rebates have been spent. Global Insight expects economic growth to slow noticeably again in the first quarter of 2009 and then rebound.

This forecast assumes oil prices will fall to $75 per barrel this spring—something that looks increasingly unlikely. If oil prices are $10 per barrel higher than assumed, it reduces the GDP growth rate by 0.2% or 0.3%. That will not cause the recession to extend into the third and fourth quarter of 2008 but it could produce a downturn in the first quarter of 2009. The current forecast is for a very mild recession, although Global Insight is expected to lower their forecasts over the next couple of months if national data weaken further.

-- It is hard to appreciate how severe the problems faced by the residential-construction industry are. In the fourth quarter of 2005 in Minnesota single-family housing permits averaged 2400 per month on a seasonally adjusted basis. In the fourth quarter of 2006 permits fell to about 1200. The forecast for the fourth quarter of 2007 was for 1000 permits per month; actual permits are now reported to be 800. Construction employment has fallen significantly in the past year and construction employment is projected to fall by an additional 15,000 this year. This year the skilled trades are likely to be hit especially hard since alternatives in non-residential projects are limited. The capital budget bill of the Minnesota House of Representatives contains significant maintenance and repair money and efforts are being made to make the money available quickly. If the state can act quickly on the maintenance and repair front, it could make a difference in the outlook.

-- Capital-gains revenue remains a big concern. Realizations typically fall during recessions and they can create substantial deficits. In 2001 and 2002 realizations fell by 45% and then 22%, and those declines were a major contributor to the state's budget problems. In this forecast net capital gains are assumed to fall by 5% in 2008. While there are good reasons to expect only a small decline in realizations, experience in1990 and 2002 suggest that a 5% decline could be overly optimistic.

-- The uncertainty in the capital gains forecast creates a difficult budgeting problem. They will not know whether the capital-gains forecast is too optimistic until late April or early May of 2009. If receipts are noticeably below forecast there will be only limited amounts remaining unspent. This argues for retaining a substantial proportion of the reserve. Should the state exhausts its reserves, the only place it can look to deal with a budget deficit is to reducing big end-of–fiscal year payments. The University's budget planning could also be given trouble by the potential $2.1 billion (including inflation) gap in the budget for 2010-11. To the extent that the current budget solution includes cuts in ongoing programs, budget problems for next biennium become less severe; to the extent the state uses reserves and one-time money, the structural problem for 2010-11 will remain.

Will the University again get to the position it faced in 2003, Professor Martin asked? [When the University had to absorb a budget cut of $185 million.] Professor Stinson said he did not expect the deficit to reach the $4.5 billion that occurred following the last recession. While the economy is in a recession, we appear to be about half-way through that recession, he said. And while they do not know what 2007 individual income tax revenues will be, in 2002 receipts were nearly $300 million less than forecast, and he would be very surprised if this year's forecast were off by a similar amount. It is not impossible, he added, but such a drop would require the economy to be a lot worse than it appears at present. The federal stimulus package was approved on a timely basis and it should stop the economic downturn. The effect on the first two quarters of 2008 is unclear, but the third quarter should be good.

Professor Roe inquired if there is any evidence that people are spending in anticipation of the income-stimulus package. There is not, Professor Stinson said; January sales did not contain such evidence. The assumption is that about 20% of the stimulus package will be spent in the first quarter the stimulus funds are distributed, 20% in the second quarter, and half never spent at all. But even 20% of a big number is a lot of money; for Minnesota, it amounts to about $2.5 billion.

Professor Zaheer asked if corporate tax revenues should roughly follow individual income-tax revenues or if there is a more aggressive downturn in corporate taxes. The corporate taxes are a lot more volatile than individual income-tax revenues, Professor Stinson said; he does not expect to see great change in the latter. It appears that corporations have become more aggressive in tax planning (that does not mean they are doing anything illegal) and the major financial institutions have losses they can write off against income. There are legitimate reasons corporations are not paying as much. It is also the case that while in some years when people over-pay taxes, they just have the balance credited to taxes due the following year; this year they are asking for the money back.

Professor Martin thanked Professor Stinson for the report.

3. Update on the Budget Instructions

Professor Martin next welcomed Ms. Tonneson from the Office of Budget and Finance to provide an update on budget instructions.

The budget instructions to academic units went out in December, Ms. Tonneson said, and were very much like support-unit budget instructions. They use the same process and contain the same assumptions about salaries, compact investments, and so on, and had the same three categories for potential investments (for legal/safety issues, to continue funding from a prior year, and compelling needs). Additional elements of the instructions to academic units were tuition revenues, indirect-cost revenues, and cost-pool increases (which were up 5% overall). Academic units were NOT given reallocation targets.

They have met with each academic unit over the last six weeks; now the senior vice presidents, Vice President Pfutzenreuter, and she are making the first pass at allocations they can help with and where reallocations can be made. They continue to work on the assumption that the state appropriation increase of $16.5 million and the other projected revenue increases for FY2008-09 will be available. [Whether the assumption about the state increase will continue to hold, with the state budget situation, is not likely.] Given what is happening at the state, they are also doing contingency planning. If the University receives a cut from the state, they will look at the cost-pool allocations (and the assessments to academic units).

They have also changed the timeline for budget recommendations to the Regents, Ms. Tonneson reported; it will now be May and June (for information/action). They cannot finish the budget until they know what decisions will be made by the state. They are also considering various scenarios, depending on what happens with the economy, and at the potential problems with the 2010-11 budget (highlighted earlier by Professor Stinson).

Ms. Blixt asked if they are thinking about balancing the budget with tuition estimates. That depends on the college, Ms. Tonneson said, but they have not built in increases to deal with potential budget problems. The projected increase is 7.5% with no change in enrollment. Tuition rates are not locked in, however, she said, because the administration told the Board of Regents the recommendation could change, depending on state funding.

Professor Martin thanked Ms. Tonneson for the report and adjourned the meeting at 3:25.

-- Gary Engstrand

University of Minnesota