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ABSTRACT

Findings of a Southern Regional Education Board study of management flexibility and state regulation in higher education are discussed in five chapters. James R. Mingle in "Management Flexibility and State Regulation: An Overview" outlines the scope of the study, which focused on administrators' and board members' views on management flexibility, the origins and objectives of state regulation, how much and what kind of state regulation is necessary, fiscal and administrative controls, and changes in budgetary or accountability procedures. It is noted that the conclusions of the study support the movement toward increasing institutional management flexibility, especially in the areas of purchasing, contracting, cash management, and budgeting. The remaining four chapters consider the situations in Maryland, Wisconsin, Kentucky, and Colorado. The chapter titles and authors are as follows: "The Extent of State Controls in Maryland Public Higher Education" (Richard J. Meisinger, Jr., J. Mingle); "Improved Efficiency Through Decreased Government Regulation: The Case of Wisconsin" (Reuben H. Lorenz); "Management Flexibility in Kentucky: The Passage of House Bill 622" (Edward A. Carter, Jack C. Blanton); and "The Adoption of Budget Flexibility in Colorado: Its Consequences for the University of Colorado" (Marilyn McCoy). (SW)

Management Flexibility and State Regulation in Higher Education

James R. Mingle, Editor

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SREB

Southern Regional Education Board

Foreword

The degree of state oversight to which public institutions are subject differs widely among the 50 states and the lines of responsibility between state and institution have changed frequently. While demands for accountability from governors and legislators have increased significantly in recent years, we are now seeing a swing in the other direction in some states. This is occurring for several reasons. Management studies are revealing that state regulations and bureacracy are often substantial barriers to the improvement of institutional efficiency. And, tight resources are demanding greater flexibility at lower levels to facilitate adjustments to changing circumstances and to provide incentives for carrying out such adjustments.

The conclusions of this SREB study support, in general, the movement toward increasing institutional management flexibility, especially in the areas of purchasing, contracting, cash management, and budgeting. The report does not offer a definitive set of recommendations applicable to all states; rather, it presents in four case studies examples of states that are implementing different types of changes. Some of these reforms are being made through governor-appointed special task forces which bring together institutions and state agencies to negotiate incremental changes. Others have occurred through new legislation or memoranda of understanding approved by state legislatures.

This new level of state and institutional cooperation is to be commended and we look forward to reporting on other efforts aimed at increasing both the efficiency and the quality of public higher education.

Winfred L. Godwin
President

Table of Contents

Chapter 1
Management Flexibility and State Regulation: An Overview

James R. Mingle

The relationship between public colleges and universities and the state governments which charter and fund them has been of considerable concern in recent years. Public higher education has argued vigorously for greater freedom, both in establishing educational policy and in controlling the financial and administrative management of its institutions. In many states, higher education does operate with great autonomy relative to other state agencies and functions. But in other states, public colleges operate with a substantial amount of legislative and executive branch oversight.

A number of observers have noted that the degree and scope of this regulation has increased significantly in recent years and that, now, too many agencies may be involved in the administrative, legal, and budgetary review of institutional operations.[1] Multiple reviews of campus budgets, for example, are commonplace—review by the campuses' own system office, by the statewide coordinating board, by multiple committees in the state legislature, and by the governor's budget staff. Campuses also deal with a variety of other state offices in conducting their affairs—departments of budget and planning; departments of general services and purchasing; departments of personnel; the state auditor; the attorney general's office; the department of public works; legislative program audit committees; as well as a variety of special committees, commissions and agencies concerned with narrow issues, such as the purchase of computing equipment, affirmative action, energy policy, or privacy.

All of this oversight, institutions believe, is costly and unproductive, and undermines the authority of both institutional managers and boards of trustees.

At question in this study, however, is not the authority of state government to regulate higher education, but the wisdom and efficacy of particular policies. The cases which follow describe the regulatory policies under which selected public colleges and universities are operating, and highlight specific changes made by states toward increasing efficiency and effectiveness through greater flexibility in institutional management.

James R. Mingle is Research Associate, Southern Regional Education Board.

Most of the cases discussed in this study deal with "procedural controls," a term which Robert Berdahl has used to distinguish these accountability measures from "substantive" controls affecting academic issues. Berdahl, in his 1971 study, dismissed procedural controls as a "hindrance" to good management, but not likely to affect substantive issues in higher education.[2] But Frank Bowen and Lyman Glenny, looking at the issue in 1977, were less sure, and suggested that the cumulative effect of controls on some state institutions was beginning to influence substantive autonomy.[3]

Financial pressures have also added a new dimension to the question of whether or not state regulations are inhibiting the ability of colleges and universities to respond to adversity and changed circumstances. Second to money, "institutional flexibility" is probably the most frequently voiced "need" of presidents of public colleges. Institutions want the ability to control and raise non-state revenue, and they want incentives to make program reductions. If benefits accrue only to the state, there is little motivation among unit managers to search for and undertake such cost-cutting efforts. In some states, these institutional interests have merged with those of state policymakers who are seeking ways to reduce the pressure on state revenues and to stay clear of the politically sensitive issues involved in retrenchment. Increased flexibility is being offered as a solution.

The questions addressed in this study are these:

What do university administrators and board members view as the necessary elements of management flexibility?

How much and what kind of freedom from state regulation is necessary to run cost-effective, high-quality programs?

What are the consequences of current state practices, and what changes would provide incentives for better management?

The cases also address the state perspective to public accountability by asking:

What are the origins and objectives of state regulations?

What changes might provide better public accountability *and* greater management flexibility?

These questions reflect an assumption that has guided this study since its initiation—that few of the parties involved with higher education in highly regulated states are happy with the current state of affairs. On one hand, despite increasing state oversight, governors and legislators are not satisfied with current accountability measures and management practices in higher education; and on the other, administrators and board members are frustrated with rules and regulations which they believe are inhibiting their ability to effectively manage their institutions.

The Growth of State Regulation

State controls of higher education did not emerge from a vacuum—all public functions have come under closer scrutiny by both state and federal governments in recent years. John Folger observed that many of the accountability measures instituted in the 1970s grew out of decreased public confidence with the way public officials were doing their jobs.[4] "Sunshine" and "sunset" laws were passed. State fiscal auditing expanded to include performance and management issues. Legislatures themselves increased the number and qualifications of their professional staff and, in some states, added performance audits to their activities. Governors and legislators hired away staff from governing and coordinating boards to do their analyses of higher education operations; this exchange of staff greatly increased the knowledge of state policymakers about higher education, and broke down the idea that colleges and universities were unique and untouchable.

Much of the increased state control of higher education can be traced to the desire to "coordinate" higher education into a single, rational, more efficient "system" in the states. Glenny, in 1959, argued that the states needed coordinating boards to mediate between the institutions and state government in order to protect their autonomy.[5] Institutions have often resisted this coordination, preferring their traditional, more personal relationships with legislators and state officials. Ironically, the result in many states has been to increase direct state oversight of higher education. Whether this state oversight is any more damaging than heavy-handed regulation from "system" offices is debatable, although most commentators on higher education prefer university system regulation over intervention from the executive and legislative branches of state government.

Coordination of higher education has been a persistent objective of the states for at least the past 20 years (and, as comparative studies have demonstrated, a persistent theme in many countries around the world). The primary aim has been to avoid waste, eliminate duplication, and improve operations by applying the logic of systems-management theory to higher education. This is reflected in the steady reorganization of individual campuses into systems of institutions that occurred in the 1950s and 1960s. While much of this centralization has been aimed at policy rather than management issues, the effect has often been just the opposite. Nell Eurich notes in her study of higher education systems in 12 countries that "... the links between policy and practice (in higher education) have been loose and sometimes lacking altogether. Under these circumstances, details of management and administration have assumed importance, and regulatory rules have proliferated. The lines of control have tightened as hierarchy has grown into systems and enlarged central offices for the execution of policies."[6]

A new type of legislative and gubernatorial discontent with higher education occurred in many states in the late 1960s and early 1970s. Higher education budgets had grown enormously in the 1960s, with no indication from the institutions that requests for expansion would slow. In *The Politics of Higher Education*, James Nowlan, former state legislator, describes how the Illinois legislature reluctantly entered the budget battle over higher education appropriations in 1971, when consensus broke down between the governor, the institutions, and the coordinating board on the need for this continued growth.[7] During the period of student unrest in higher education, regulatory legislation was introduced on such issues as workload and the use of funds, which set a new tone for state involvement. While most of these bills were never enacted, they did "send a message" that the public was dissatisfied with higher education. Although the number of instances of gross mismanagement in public higher education were relatively few, this climate created demands for broad-based regulatory solutions when these instances did occur.[8]

David Adamany, in his study of regulation in California, cites general causes of heightened state government regulation of higher education that can be traced to the origins of the Roosevelt New Deal. More recently, there has been a strong public reaction against government spending and growth, which Adamany notes:

> . . . is oddly coupled with public insistence that no services now provided be abandoned. Regulation is an inevitable, though probably mistaken, attempt by elected officials and their control agencies to save money while providing services.[9]

At the same time that these public attitudes about government have affected state regulation, higher education has added to the problem by approaching state government with issues that the academic community itself has been unable to resolve. Increased competition over programs and resources has required sometimes reluctant legislatures to deal with higher education issues. Adamany notes that the California Master Plan, developed in the 1960s, has been the cause of considerable intersystem conflict in California and has resulted in almost continual state government intervention. Disputes about institutional titles, missions, and degree authority "have often been carried into the legislature by one or another of the contending parties."[10]

Adamany's study catalogs a diverse and interesting set of instruments for state intervention. He notes, for example, that in California the state government regulates the structure and power of governing boards, names the members of those boards, and, in the past, has been directly involved in the appointment and dismissal of chief executives of higher education. In addition to approving the master plan, the legislature regulates higher education policy by statute on such issues as the confidentiality of personnel records and lay-off policies for faculty. In the budget document itself, there is supplementary language which, although not legally binding, "is law, in fact, because of the political consequences that would flow from disregarding it."[11]

A Need for Periodic Review of Fiscal Controls

Some of the states that have been included in this study have recently undertaken a review of the fiscal and administrative controls under which public institutions are operating. Robert Anthony and Regina Herzlinger in their study, *Management Control of Nonprofit Organizations*, note that:

> Some rules. . . may have been devised to deal with situations that no longer exist, or they may unduly restrict the ability of the manager to use good judgment. From time to time, an organization is well-advised to review its rules and to prune out those that no longer serve a useful purpose. Otherwise, frustrations. . . may impede the functioning of the organization.[12]

Fiscal and administrative controls encompass several issues that are discussed in the four cases which follow:

1) the authority of institutions to carry funds forward from one year to the next, to expend excess income, and to invest funds;
2) the procedures imposed on procurement, contracting, disposal of property, and personnel policy;
3) the authority to reallocate funds among categories of appropriations during the budget year;
4) the special review processes established for sensitive areas, such as purchasing data processing equipment and traveling;
5) the monitoring and regulation of hiring through "position control."

Nonprofit organizations do require more controls than profit-oriented organizations because there is no equivalent to "profit" as a measure of performance. Whether colleges need the amount and type of control that exists in many states is the question under consideration. Anthony and

Herzlinger conclude that in any organization, the right balance has to be struck between:

> . . . a) the need for freedom in order to take advantage of the ability of the person on the firing line, to motivate that person, and to reduce paperwork; and b) the need for restraint, in order to ensure that management policies are followed, and to reduce the effect of poor judgment or self-interest decisions by lower-level managers.[13]

Routine procedures are the essence of modern bureaucratic organizations. They allow complex organizations to develop divisions of labor and a predictability of organizational behavior. But the level at which this control is exercised is of critical importance. State-level controls, in some cases, can be replaced with strengthened internal controls.

Fiscal controls have revenue implications as well. Struggles over "institutional flexibility" are often struggles over cash and the revenue it can produce through short-term investments. This issue has become of greater interest to both states and institutions, as state financial problems have increased and the amount of money to be earned from cash management has risen, along with interest rates. States differ substantially in the flexibility allowed public institutions in this regard. In some states, all funds are deposited in the state treasury, with the state earning interest from short-term investments even from those operations that are self-supporting, such as auxiliary enterprises. In other states, some funds are state-controlled, while others are under institutional control; and in a few states, public institutions control and earn interest from virtually all funds, with the state controlling state revenue only through a periodic allotment system during the fiscal year.

Among the most common controls imposed on managers are restrictions on the number of personnel who can be employed. This is done for several reasons. Personnel costs are by far the largest item of expense, and the total number of staff is closely linked to other expenses—for example, telephone, travel, and supplies. Furthermore, personnel decisions in higher education tend to be long-term commitments. While central administrations, at the campus or system level, may impose "position control" on their own sub-units, they oppose such restrictions from the executive budget office and the legislature. In some states, position control is imposed in great detail, preventing flexibility between units and between activities supported by different funds. It is also used by the state to "capture" savings through attrition. Positions which are vacant for a specified period may be lost and revert to the state. Such procedures create substantial paperwork, as states try to reduce the number of positions in the system and institutions work equally hard to monitor their vacancies and shift positions and individuals from slot to slot in order to avoid losing staff.

Position control may be imposed for political as well as economic reasons. The *number* of state employees has come to represent growth in big government rather than the overall size of budgets. Reductions can be accomplished through cutting positions, even if total budgets continue to grow.

States do use position control to solve immediate financial problems, although institutions would prefer that they be asked to return a certain percentage of funding rather than a specific number of positions. But states believe that, unless institutions are forced to reduce staff, they will not do so, and that only through personnel reductions can the base of funding be reduced. Institutions suggest that state government "lay down the burden" of considering higher education employees as state employees and turn this responsibility over to the institutions. (They note, for example, that states do not count school teachers as state employees.) State officials argue, however, that higher education employees (especially unionized employees) may be expected to petition state government for support if they perceive themselves as poorly paid because of overstaffing.

Financing and Budgeting Systems: The Implications for Institutional Flexibility

While states tend to approach the subject of regulation and institutional flexibility issue by issue, the subject is part of the broader questions relating to funding stategies. David Breneman noted that state policies can be judged by their relative reliance on the market or reliance on central planning. "Because most states are unlikely to adopt either course in the extreme, mixed strategies involving elements of each approach will be most common."[14]

In a study of financing in the state of Washington, the Council for Postsecondary Education outlined four models of funding and described what the major features for financing, budgeting, and accountability were under each model.[15] At one end of the continuum was the "state agency model"—an approach toward which the authors believed many states had moved steadily in recent years. Its major features are:

- All funds, including receipts from auxiliary enterprises and federal research grants and contracts, are deposited in the state treasury and are subject to appropriation control.
- Student tuition and fees are prescribed by the legislature.

- All expenditures are subject to legislative appropriation and allotment control.
- Spending requests are detailed and focus on the objects of expenditures; adherence to these budgets is expected unless conditions change. Deviations must receive prior approval and be reported.
- Unexpended funds are returned to the general fund at the end of the fiscal year.
- Oversight is exercised over changes with long-term fiscal impact, such as salary increases and the acceptance of grants.
- Institutional operations flow through state government—for example, purchasing, personnel, and engineering services. Other activities, including workload, are standardized through statute.
- The focus of oversight is directed at process, with little consideration given to effectiveness.

Washington's Council puts the "corporate," or "free market model," at the other end of the spectrum of financing, noting, however, that although it is not currently used to finance higher education, it is similar to systems used in such service activities as health care and social services. (This model falls short of a full "voucher" system, in which state support is made exclusively to students who then "carry" those dollars to the institution of their choice.)

The primary features of the "free market" system are:

- Institutions of higher education have total control of all funds, including tuition, fees, and charges for services.
- State appropriations are made to a third-party state agency for the purpose of contracting with institutions for particular services, including a designated number of student spaces in particular kinds of institutions. (Role and mission of institutions are constrained by state charter.)
- Contract amounts are determined by using some external index.
- State financial aid is substantial.
- Accountability provisions focus on effectiveness (student performance, for example) rather than on process. The most effective institutions would receive the largest contracts.

State funding systems can be found between these extremes, although the direction of movement has been toward greater state control. Most states take a "total funds" approach to budgeting.[16] Higher education appropriations are determined by accounting for all unrestricted funds coming to institutions, not just the state appropriation. In this way, a state can both control tuition and minimize the state's contribution if it chooses. Budgets are determined by first calculating the amount of revenue available from tuition and other sources, such as indirect cost overhead from research grants; state appropriations then make up the difference. If institutions "overachieve" their budget targets for these non-state revenues, they may have to seek approval for their use, or have excess funds returned to the state at the end of the fiscal year under budget lapse provisions. (Such an approach has advantages for institutions if the state is also willing to provide supplemental appropriations when tuition revenues fall. State officials also claim that institutions know how to use the system to their advantage. They will, for example, consistently underestimate revenue from non-state sources, such as tuition, in order to maximize state appropriations and then have unencumbered revenue after the start of the fiscal year.)

A more "flexible" approach to budgeting is one in which state appropriations are made without reference to tuition and other sources of revenue. State support is granted on the basis of a workload formula that uses historical per student costs to determine appropriations and/or reference to some stated goal (achievement of parity with a reference group of institutions or states, for example). In this budgeting approach, the institutions are free to establish tuition without fear of it directly affecting the level of state support. They remain constrained, however, by competitive factors and by general political support for their actions. During periods of growth, institutions may choose to keep tuition at a minimum, thus attracting more students and maximizing state support. During periods of no-growth or retrenchment in state support, the institutions can make up for shortfalls in state support by raising tuition. Any over-achievement of tuition goals, gifts, or indirect cost recovery revenue can also be saved for future contigencies. Institutions also have greater incentives to institute cost-cutting measures on their own initiative if this money can be saved for reallocation, rather than reverting to state government.

Exempting higher education from state regulations and fiscal controls is far less controversial than this broader issue of "budget flexibility." Few states believe that public institutions should be completely free to determine their own tuition policies. (Even public institutions that have a great deal of budget flexibility are constrained by public objections to inordinately large tuition increases and the building of excessive reserves.) From the institutional perspective, budget flexibility may or may not be of benefit. Less competitive institutions may find that this free market approach to setting tuition puts them at considerable disadvantage. Declines in state support cannot be made up by increasing tuition, because of the likely negative consequences on enrollment. Such an approach also theoretically closes the possibility of state bailouts to make up for enrollment declines. In Colorado, this budgeting approach has been combined with statutory limitations on the growth of state appropriations.

On the other hand, as Marilyn McCoy notes in her case study (see page 52), this type of increased flexibility has had a positive effect on the University of Colorado, by providing the incentives to eliminate unnecessary costs and the authority to raise and retain non-state sources of revenue.

Salary Issues. States may also restrict institutional flexibility through their salary policies. In fact, expressions of legislative intent over the size and distribution of salary increments is quite common. The salaries of chief executives and other top administrators are often of special interest to legislators, and dissatisfaction over "excesses" is one of the more common justifications offered for legislative intervention. Even in states without detailed line-item budgets, legislatures award appropriations by dividing them between personnel and non-personnel (operating) expenditures. A cost-of-living percentage is often specified, with the remaining increment designated as a merit component. Specifying minimum and maximum raises for classes of employees is less common, but not unusual. In some states, the legislative figure used for salary increments is mandatory—that is, the legislature, not the institution, grants the raise. This is most often the case for classified (non-faculty) employees. Legislative expression of a percentage increase for faculty salaries also may act as a mandate by establishing a normative expectation, which administrators violate only at the peril of internal opposition and legislative discontent.

Institutions note that states may mandate salary increases without providing the funds to meet those increases. Institutions are left to find the salary money, either through "productivity" improvements or from other sources of revenue, such as tuition. They also complain that the states seldom provide enough support to offer significant "merit increases," although in recent years state legislatures have been receptive to special appropriations for funds of excellence or supplemental salary payments for faculty in highly competitive areas, such as engineering and computer sciences.

Institutions are of two minds about "salary flexibility." If they are to manage and control their operations, they know salary administration must be included. But if salary increases are going to be low or nonexistent, administrators would be happier attributing the blame to low state funding rather than to internal decisions. And if governors are not going to get the "credit" for raising salaries, they may be less likely to support higher education adequately. Institutional presidents are also happy to have such rapidly increasing costs as social security and fringe benefits outside their budgets, making their annual budget increases appear more modest than they are—and thus strengthening institutional arguments for increased funds. (In recent years, higher education budget increases for "operations" over and above personnel costs have been extremely modest and, in some cases, show declines.)[17]

Decreased Flexibility Is a Reduction in Choice

The theme that unites the various institutional concerns about flexibility is the reduction of options available to institutional leaders in the 1980s. Management is the exercise of choice; without choices, managers become merely administrators. The cases which follow discuss some of the reasons for reduced options—the rules, regulations, and accountability measures imposed on the financial management of public institutions.

State fiscal regulation is by no means the only factor—or even the most important one—contributing to reduced flexibility. A number of studies, including those conducted by SREB, have examined the responses of colleges and universities to enrollment decline and financial cutbacks and have concluded that ineffective planning and poor management decisions regarding programs and staffing have played a role in institutional problems.[18] Other factors, such as changing student interests, unanticipated economic problems, and the lack of planning at the state level, have also contributed to reduced flexibility. But, if these conditions are combined with extensive state regulation of management functions, a climate of total inflexibility may exist.

The cases also address the "money" issue, which is at the heart of reduced flexibility. In expanding organizations, management options are exercised by capturing surplus funds centrally and allocating those dollars to functions of highest priority assigned by central management. During periods of expansion, growing enrollments provided the additional tuition and state support for presidents' "flexibility." Now, college presidents find themselves in a tug of war with governors and budget officers who are searching for their own flexibility by capturing what savings they can from the various state agencies.

This study offers no definitive answers, because the issue is not totally resolvable. It is, as Stephen Bailey expressed it, part of a "persistent human paradox: the simultaneous need for structure and for anti-structure, for dependence and for autonomy, for involvement and for privacy." Bailey concluded that:

> The public interest would not, in my estimation, be served if the academy were to enjoy untroubled immunity. Nor could the public interest be served by the academy's being subjected to an intimate surveillance. Whatever our current discomforts because of a sense that the state is crowding us a bit, the underlying tension is benign.[19]

States are faced with this choice: they can try to force productivity improvements through regulation and control, or they can try to encourage efficiency by providing incentives and delegating authority and responsibility to institutional officers and board members. States that choose to regulate their institutions closely may capture savings in the short term, but they are likely to dampen the initiative, imagination, and motivation of individual managers to make longer-term improvements in productivity. (They may even find institutional managers spending their time searching for ways to circumvent state intent.) This close attention to the details of management also prevents states from focusing on the more important policy questions that affect the size, scope, and distribution of higher education services in the state.

Institutions often argue that states should provide greater incentives for improving efficiency. This usually means allowing them to retain the savings from their cost-cutting measures. But, if the state's objective is to minimize state expenditures in the short term, this is hardly a persuasive argument. However, trying to capture savings through regulatory controls is often ineffective—for every state tactic to capture savings there is a counter-tactic from institutions to retain them. States and institutions would be better off with a more direct approach to expenditure reduction. For short-term problems, this can be handled by formula adjustments or mid-year recisions, which leave the widest flexibility to institutions to determine specific cuts. For longer-term problems, it may mean the reduction of scope through the master-planning and program-review procedures of central coordinating agencies. Whatever the size of required reduction, these "productivity" improvements need to be shared by both the institution and the state. There should be a *quid pro quo* in this retrenchment—with the state receiving some budgetary relief and the institutions being allowed to retain some of the cost-cutting savings for new program development. All too often, states view surpluses as evidence of excessive funding rather than good management, while institutions view *any* reductions in state funding as affecting quality.

Deregulation implies a greater role for institutional boards and greater personal accountability from institutional managers. In some cases, it cannot take place until internal auditing systems have been strengthened and board members are willing to replace staff. Legislators will have to resist the temptation to pass across-the-board legislation to solve a particular case of mismanagement. Board members will have to become more responsive to the needs of the public, so that legislative intervention is minimized. This will involve greater sensitivity and self discipline on the part of colleges, to avoid appearing either too extravagant or too unresponsive to issues with wide public appeal. At the same time, institutions will have to increase the use of self-evaluation methods that can be audited by state agencies. This, David Adamany notes, is "at the heart of any argument for the wide delegation of authority to universities."[20]

Whether board members and administrators want the added responsibilities of flexibility may be uncertain. They will find themselves under new pressure to justify their actions to internal constituents—to explain internal reallocations and salary decisions, for example. There will be more risk involved—the risk of running up deficits or expanding the base of commitments beyond what the state or the students are willing to support. But at the same time, opportunities will present themselves for improving efficiency and quality. Morale and productivity of individuals are likely to improve, providing central administrations learn the lessons of correctly using deregulation and find ways to provide their own units with the incentives for efficient and effective management.

The Four Cases: Maryland, Wisconsin, Kentucky, and Colorado

The cases which follow present the array of issues that define the concept of flexibility. They also illustrate the sources of discontent over state regulation, as well as the rationale for their imposition by state officials. All of these states, in varying degree, have initiated recent changes in their budgetary or accountability procedures.

The Maryland case, by Richard Meisinger and James Mingle, analyzes the extent of state control of public higher education in Maryland, where institutions are subject to relatively detailed budgetary and administrative oversight by both the legislature and executive agencies. The case outlines the origins of state controls, the types of controls imposed, and their perceived consequences on institutional managers. The discussion highlights the points of conflict between the state and the institutional perspectives. In early 1983, as the case was being written, the issue of flexibility began to receive increasing political attention and became the subject of an ad hoc committee of institutional and state representatives to consider new budgeting and accountability policies.

The Wisconsin case, prepared by Reuben Lorenz, is presented as an example in which university and state officials have worked closely together to identify specific ways to "deregulate" higher education. The university system argued effectively with the governor that many state procedures were duplicative of their own auditing of campus activities. In 1981, with the governor's support, the University and the Departments of Administration and Employee Relations formed a joint committee to implement procedural changes in the areas of general purchasing, printing, computer acquisitions, telecommunications, and employee classifications.

Edward Carter and Jack Blanton report on the passage of House Bill 622 in Kentucky, which followed a management study of higher education conducted at the governor's request. The study, using outside consultants, cited state regulation as the primary obstacle to the improvement of institutional management practices. Through this "management flexibility" bill, which was passed in 1982, a wide range of functions formerly controlled by the state has been delegated to the institutions. Institutions now have the authority to do all of their own purchasing (within the guidelines of the state's model procurement code) and to pay vendors and employees directly from institutionally-controlled accounts. At the same time, Kentucky has required the governing boards of each institution to make uniform financial reports to the Council on Higher Education, and to conduct annual financial audits, as well as audits that address the institutions' compliance with the new bill.

The Colorado case, discussed by Marilyn McCoy, describes a fundamentally different approach to budgeting, which was adopted by the Colorado legislature in 1981. Replacing a line-item budget and a "total funds" approach to appropriation, the Colorado legislature is now primarily concerned with only two issues: the number of students to fund at each public institution, and the rate at which those students are to be funded. Institutions are free to establish tuition without affecting the level of state support, and have the authority to carry over savings from year to year. McCoy believes that these changes have added important new incentives for increasing management efficiency. She discusses the changes implemented at the University of Colorado in the areas of tuition policy, reallocation of resources, the development of contingency funds, and other measures aimed at increasing efficiency.

Footnotes

1. See: The Carnegie Council on Policy Studies in Higher Education, *The States and Higher Education: A Proud Past and a Vital Future* (San Francisco: Jossey-Bass Publishers, 1976); the Sloan Commission on Government and Higher Education, *A Program for Renewed Partnership: An Overview* (Cambridge, Massachusetts: Ballinger Publishing Co., 1980); and The Carnegie Foundation for the Advancement of Teaching, *The Control of the Campus: A Report on the Governance of Higher Education* (Princeton, New Jersey: The Carnegie Foundation for the Advancement of Teaching, 1982).
2. Robert O. Berdahl, *Statewide Coordination of Higher Education* (Washington, D.C.: American Council on Education, 1971), p. 10.
3. Lyman A. Glenny and Frank M. Bowen, *State Intervention in Higher Education: A Report for the Sloan Commission on Government and Higher Education*, November 1977. (ED 184 427)
4. John Folger, "Legislative Expectations about the Accountability of Higher Education," a paper presented at the Inservice Education Program of the Education Commission of the States, Tucson, Arizona, December 1977. (ED 202 310)
5. Lyman A. Glenny, *Autonomy of Public Colleges* (New York: McGraw-Hill Book Company, Inc., 1959).
6. See Nell P. Eurich, *Systems of Higher Education in Twelve Countries: A Comparative View* (New York: Praeger Publishers, 1981), pp. 51-52.
7. James D. Nowlan, *The Politics of Higher Education: Lawmakers and the Academy in Illinois* (Urbana: University of Illinois Press, 1976).
8. *Ibid.*, pp. 52-55. See Nowlan's discussion of the "million-dollar house" at Southern Illinois University as an example of the type of abuses which increased legislative control in Illinois.
9. David Adamany, "Government, Quality Programs and Effective Resource Use in Higher Education," a paper prepared for the University of Southern California Annual Academic Planning Conference, June 11, 1979, p. 15 (ED 202 310)
10. *Ibid.*, p. 15
11. *Ibid.*, p. 9
12. Robert N. Anthony and Regina E. Herzlinger, *Management Control in Nonprofit Organizations*, revised edition (Homewood, Illinois: Richard D. Irwin Inc., 1980), p. 442.

13. *Ibid.*, p. 447
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Chapter 2

The Extent of State Controls in Maryland Public Higher Education

Richard J. Meisinger, Jr.
and
James R. Mingle

Within the last decade, the growth of state support for higher education slowed considerably and, in some states, declined as the result of slower national economic growth and changing state priorities. As colleges and universities encountered stiffer competition for scarce resources, decisions about the allocation of these resources often shifted to higher administrative levels, and the amount of state-level regulation increased significantly.

On the surface these tighter controls seemed reasonable. They were imposed to insure that institutional actions were consistent with state policies, legal requirements, and accepted standards of proper management. Often the controls were introduced to correct past institutional or state agency indiscretions. Regulations promulgated to solve a particular problem were then applied universally. Seldom were the costs of such controls weighed carefully against the anticipated benefits.

State-level controls also evolved from the increasing competition between legislative staffs and executive budget offices. As legislative staffs increased in size and sophistication, they offered an analytical capability which was comparable to that of the executive budget office. This adversarial relationship was reflected in increased controls and more detailed analyses of agency activities.

This case study is an examination of the degree to which public four-year institutions in Maryland are subject to state regulation, especially in the use of state-appropriated funds. Interviews were conducted to identify both the formal and informal controls imposed by state-level officials on institutions and the consequences of those controls on a number of routine administrative functions and procedures, including procurement, personnel policies, position control, and travel regulations. To a lesser degree, the interviews were used to examine the effect of the

Richard J. Meisinger, Jr. is Assistant Provost for the Division of Behavioral and Social Sciences, University of Maryland—College Park.

James R. Mingle is Research Associate, Southern Regional Education Board.

budget format on institutional flexibility and the institutions' ability to make changes in budget plans. An attempt was made to estimate qualitatively the cost of controls for both the state and the institutions. Those interviewed were asked to suggest alternatives to expenditure controls which might satisfy state-level concerns for accountability.*

State Control in Maryland

The degree of control imposed by state agencies over Maryland public four-year institutions is substantial, relative to other states. In fact, on many issues the controls exercised over higher education are exactly the same as those imposed on other state agencies. Historically, the exception has been the University of Maryland, which has enjoyed a degree of autonomy recognized in statute that other institutions do not have. The state colleges and universities, six of which are governed by a single Board, are much closer to the "state agency tradition," in large part, because of their more recent history of independent governance. Until the mid-1960s, these institutions were governed by the State Department of Education, which also had responsibility for elementary and secondary education. In contrast, Maryland community colleges, with a tradition of local governance, generally have been exempted from state oversight. (Community colleges receive state funds on the basis of an enrollment formula. There is no requirement to submit a budget to the state to receive those funds.)

The extent of control, according to those interviewed, has created considerable tension and distrust between state officials and higher education administrators in Maryland. State officials seriously question the need to treat institutions of higher education any differently than other state agencies and, in recent years, increases in state control have been justified on this principle of uniformity of treatment. In contrast, institutional officials believe that such policies fail to recognize both the authority of the governing boards and the existence of internal system

*State and institutional officials from the following organizations were interviewed: Department of Budget and Fiscal Planning, Department of State Planning, Department of General Services, Department of Personnel, Department of Legislative Fiscal Services, State Board for Higher Education, University of Maryland Central Administration, University of Maryland at College Park, University of Maryland at Baltimore, Board of Trustees of the State Universities and Colleges System, Towson State University, University of Baltimore, and Morgan State University. The term "state universities and colleges" as used in this case study refers to the six institutions under the Board of Trustees plus Morgan State University and St. Mary's College, which have their own boards. Community colleges were not included as part of the study because the operations of county and local governments are a strong determinant of expenditure behavior for those institutions.

controls. Higher education officials also contend that they oversee operations which are more complex than others in the state and thus need greater flexibility on management and policy issues. (This issue of distrust is not new. In the early 1970s, Lyman Glenny and Thomas Dalglish of the University of California-Berkeley conducted a study of constitutional autonomy in eight states, including Maryland. They observed that state managerial controls were being imposed as a corrective to perceived institutional deficiencies.[1])

Maryland is a "strong governor" state, with the governor traditionally dominating state politics and providing leadership in developing the budget.[2] (The constitution allows the General Assembly the power to make deletions in the Executive Budget—but not additions.) As in other states, the Department of Budget and Fiscal Planning (DBFP) has often been used as an agency of control over the many agencies and bureaus of state government. This was especially true in Maryland prior to the reorganization and consolidation of state agency leadership into a cabinet system in 1969-70. More recently, DBFP has lessened its active role in trying to manage the various agencies of state government, although the relatively low turnover among personnel in DBFP means a slow change of that attitude. According to some of those interviewed, increasing confrontational relationships between higher education administrators and the budget examiners of DBFP led to reassignments among staff in 1982, and statements from the Secretary of DBFP that, in the future, the office would be more concerned with policy issues than day-to-day budgetary matters. The institutions are hopeful that these changes may signal a relaxation of state agency management controls.

For the past five years, higher education's campaign for increased flexibility has taken several directions. The University of Maryland's Central Administration has focused on flexibility in budget preparation rather than budget execution. Accordingly, the University has sought new budget formula guidelines and a change from an object-of-expenditure budget to a full program budget.

The current budget process is directed through the governor's office and DBFP. After agencies indicate their "special" needs to the governor in the spring, the governor issues a "MARC" (maximum agency request ceiling) for state General Funds, based largely on revenue projections for the fiscal year in question. The DBFP examines each agency's budget to distinguish between one-time expenditures and ongoing activities. Various rates of inflation are applied to the ongoing activities to estimate a maintenance budget. New initiatives, program expansions, and other special requests are added to the maintenance budget to the extent that additional resources are projected to be available. Once the MARC is established, institutions determine the appropriate level for tuition and fees (the major component of Special Funds in the instructional program) to generate additional revenue needed. Although institutional boards of trustees and regents have the authority to set tuition and fee levels, the governor and DBFP and the legislature have forced institutions to alter these schedules. Budget requests ("Asking Budgets") for General Funds which are submitted in the fall must be formulated within the MARC. It is possible to seek funds over and above the MARC through the submission of supplemental budget requests, although the probabilities of receiving such funding are slight.

The institutional budget requests are reviewed by both the DBFP and the legislature, using previous appropriation and expenditure data and the State Board for Higher Education (SBHE) guidelines as the basis for making adjustments. Legislative alterations tend to be less significant because the legislature is dependent on the governor to make changes. If, for example, legislators want reallocations, they will ask the governor to submit supplementals to the budget and will search for the money by cutting line items from various programs.

The state's formal plan developed by the State Board for Higher Education calls for the adoption of SBHE guidelines as the basis for allocating funds on a program rather than an object-of-expenditure basis.[3] But legislative staff tend to use the SBHE guidelines only to signal "overfunded" activities and programs rather than to identify program needs. At the same time, University officials have not supported the SBHE formula as a basis for funding because they believe that it fails to sufficiently recognize the University's high-cost programs. In particular, the University believes that the SBHE guidelines, which reflect historical expenditure patterns, need to be "calibrated" by comparison with peer institution expenditure patterns. In contrast, the Board of Trustees of the State Universities and Colleges supports the present guidelines.

In 1982, the University's Central Administration broadened its concern for increased flexibility to include the expenditure side of budgeting. This initiative came primarily from campus officials, who have lobbied for changes through Central Administration during the past several years. The president has stated that flexibility in the use of appropriated funds is almost as important as suitable funding, although he is unwilling to seek greater flexibility at the expense of state support. He also has endorsed the recent Colorado Plan (see page 52) on the grounds that it is less costly to administer than Maryland's present budget system and provides significant incentives for sound management.

Greater "flexibility" has a significantly different meaning for the central staff of the Board of Trustees of the State Universities and Colleges

System. This group of five former state teachers' colleges and one former private university has never received recognition as a "system" of institutions with strong central authority in budget development or reallocation. The Board puts more emphasis on "system" flexibility than "institutional" flexibility. Relations between DBFP staff and the central staff of this system have, in the past, been considerably more strained than with the University and other institutions in the state. This is due to the constant negotiations which must take place over budget changes and the long tradition in which DBFP staff has had direct contact with campus administrators rather than working with the system office. In an effort to strengthen its position, the central staff negotiated an agreement in 1983 with the Secretary of DBFP that limits the direct contact between DBFP staff and campus administrators.

The University of Maryland's considerably greater budgetary flexibility stems from the "University of Maryland Autonomy Act" passed in 1952. But this statutory independence, not available to other state agencies or boards, has been eroded in recent years. The Act was amended in 1976, omitting the previous version's strongest language on independence. The 1976 revision coincided with the legislation which established the Maryland State Board for Higher Education. (Previously, this agency had been a Council with lesser powers than its successor.) State-level officials noted that the University did not effectively challenge the 1976 revisions in the Autonomy Act. Moreover, the University had been unsuccessful in stopping previous infringements of its autonomy. In 1966, for example, legislation was introduced requiring the Department of Budget and Fiscal Planning to review and approve all leases and purchases of automatic data processing equipment and software for all state agencies, including the University of Maryland.

In general, the University's autonomy has been reduced most in matters related to the budget process, especially in (1) the format of budget requests and the amount of detailed justification requested by budget examiners, (2) the inclusion in the appropriations of resources not previously appropriated (prior to FY 1974, "Dedicated and Self-Support" functions were not appropriated), and (3) a more detailed appropriation to lower-level units and programs (within the last 8 to 10 years, the number of appropriations for the University of Maryland, for example, has increased from approximately 8 to 90).

In 1981 and 1982, the issue of institutional flexibility and accountability became the subject of a statewide discussion which evolved from a debate over the governance structure of higher education in Maryland. (Duplication in the greater Baltimore area was of special concern.) Two groups explored alternative governance structures, including various proposals for consclidation. An informal group of institutional board members met during the late summer of 1981 at the request of the governor. But they failed to reach agreement on any one proposal for the reorganization of public higher education. However, the group reviewed and adopted unanimously a statement on the need for additional flexibility.

Also studying the subject of reorganization was the House Subcommittee on Education and Human Resources, chaired by Delegate Nancy K. Kopp. Delegate Kopp believed that it would be difficult to gain legislative support for increased flexibility without a change in statewide governance. But, like the governor's Task Force, the Subcommittee could not reach agreement on an alternative governance arrangement for Maryland. After the Subcommittee ceased deliberations, Delegate Kopp suggested that the issue of institutional flexibility should be considered without governance changes, although she recognized that legislative skepticism would be a formidable obstacle.

Fiscal Restrictions and their Consequences

The nature of state control over the institutional use of appropriated funds is illustrated by several categories of budgeta.y flexibility: (1) procurement regulations; (2) automated data processing procurement procedures; (3) authority to carry funds forward from one fiscal year to another; (4) authority to invest funds; (5) authority to expend excess income and to reallocate funds; (6) position control; (7) hiring and reclassification of nonfaculty employees; and (8) level of detail of the budget appropriation.

Procurement Regulations. In 1981, Maryland adopted procurement regulations based upon a model procurement statute used by a number of states. The goal of the Maryland Procurement Regulations ("Article 21") was to standardize purchasing statewide and to subject more purchasing to competitive bidding. Generally, the 1981 Procurement Regulations increased the flexibility of the state universities and colleges (which had none previously), and decreased the flexibility of the University of Maryland (which had substantial flexibility). For all institutions, the new regulations significantly increased the reporting burden. Specifically, the new regulations require institutions to document in more detail the bidding processes followed.

For the state universities and colleges, the new regulations raised the ceiling on the internally-controlled purchase of commodities from $200 to $1,000. Purchases above this ceiling must be approved first by the Department of General Services. This review process can take up to

12 weeks. The ceiling is somewhat higher for commodities for which a statewide purchasing agreement exists. The Board of Public Works must review and approve contractual agreements in excess of $7,500. This review usually requires approximately one month. (Previous procurement guidelines did not set a specific ceiling for contractual agreements, but implied that *all* contractual agreements were to be reviewed by the Department of Budget and Fiscal Planning. The institutions would negotiate with DBFP on a case-by-case basis over which agreements were to be reviewed.) Sole-source contracts in excess of $1,000 must be reviewed and approved by the Department of General Services, unless they are for "delegated purchases," such as library books, for which the limit becomes $7,500. All construction is still handled by the Department of General Services. Service contracts up to $7,500 can be issued by the state universities and colleges without prior approval.

The new procurement regulations require the state universities and colleges to submit monthly, quarterly, and annual reports on actions taken. Also, the new regulations specify more clearly the requirements for the solicitation of bids from minority-owned and small businesses.

The University of Maryland has more flexibility than other Maryland state universities and colleges because it is authorized as one of four state purchasing agents. The University is subject to the following ceilings, provided that a competitive bidding process is followed: commodities—no limit; services—$100,000; construction—$50,000; and maintenance—$25,000. Sole-source purchases in excess of $7,500 must be reviewed and approved by the Board of Public Works. Before the 1981 procurement regulations were introduced, with few exceptions the University of Maryland did not have to go before the Board of Public Works for any purchases. The new regulations also have increased greatly the reporting notification requirements of the University. To solicit competitive bids, for example, the proposed purchases must be announced and posted, sometimes in the *Maryland Register*, often for up to 30 days.

The University of Maryland campuses find the reporting requirements of the new regulations more cumbersome, in part because of the specificity of the process, which eliminated local autonomy on certain kinds of purchases. The mandatory bidding requirements pose problems for some campuses in the procurement of items for which there are few vendors, such as medical supplies. Also, there are some types of commodities and services for which there are few minority-owned or small businesses. In addition, the state has applied pressure on all institutions (and other state agencies) to purchase from "State-Use" industries run by the state prison system. Typical purchases are laundry services and furniture. The pressure to use State-Use industries exists, even when State-Use is not the low bidder. Moreover, when State-Use is the low bidder, institutions claimed that the quality of services or products is inferior to that of higher bidders. State officials noted that provisions of state law provide avenues by which non-low bid vendors may be used if quality, past performance, or ability to meet specifications by the low bidder are not satisfactory. What concerned institutional purchasing officers, however, was not the lack of legal recourse, but the informal pressure exerted by individual state officials.

Purchasing officers reported that new regulations were complex and difficult to interpret initially. One institution had yet to receive an audit of this purchasing activity, while another reported that the auditors themselves did not understand the new law. There were questions, for example, about what constituted an emergency procurement. One purchasing officer asked, "Was a page missing from a newly-printed college catalog an emergency that would allow the institution to contract for a 'rush' replacement printing exempt from the bidding process?"

Institutions used various strategies to cope with delays in the approval of purchases by the Department of General Services. In some cases, contractors went to work without approved contracts with the understanding that eventually they would be compensated for their services. There were limited reports of circumventing intent—for example, typesetting equipment might be categorized as "typewriters" to increase the likelihood of approval.

Representatives of the Department of General Services believed that problems with the new law resulted from a lack of familiarity. From their perspective, Article 21 had done much to liberalize policies for most state agencies by establishing detailed regulations. Posting proposed purchases and bidding were problems only when agencies and institutions failed to plan ahead. "Too often, institutions create their own emergencies because of poor planning," a representative of the Department of General Services noted. (In 1983, the new procurement law became the subject of a special task force chaired by the state treasurer. Some modification of the provisions was expected.)

Automated Data Processing Procurement. Under a 1966 statute, the Department of Budget and Fiscal Planning is empowered to review all proposed purchases of data processing hardware, software, and services for all state agencies. These reviews are required, even if non-state funds are to be used for the purchases. The Department of Budget and Fiscal Planning established a Management Information Systems Division (MISD) to oversee these reviews.

Institutional managers noted the redundancy and substantial oversight built into the state budget process in the area of computer-related purchases. First, the budget requests must include detailed descriptions of computer-related purchases. Second, all institutions are required to submit detailed five-year plans for the acquisition of computers and software. These plans are the basis for the MISD reviews of requests for computer-related purchases. Third, the MISD staff review all requisitions for computer-related purchases—from the most inexpensive computer terminal to complex mainframe computer configurations. The review and approval cycle usually takes a minimum of three to four months. When the MISD staff raise questions about intended purchases, approval is delayed even more.

An informal survey on the University of Maryland, College Park campus indicated that MISD spends approximately 48 days, on average, to review transactions of less than $25,000, and up to four months to review larger transactions or requests for proposals. Another campus study determined that requests to purchase computer-related equipment or services were cycled through MISD an average of 1.36 times, as some requests were returned for further clarification or justification.

The MISD has sought to extend its authority to encompass the review of proposed purchases of word processing equipment. To date, the University of Maryland has successfully retained authority to purchase word processing equipment without state-level review. However, the state universities and colleges must have such proposed purchases reviewed by MISD.

The long review process for computer-related purchases has inconvenienced the institutions considerably. In several instances, researchers were threatened with the loss of their research support from external sources because of delays in purchasing the computer equipment required to conduct their research. In other instances, the review and approval process has dragged on for over a year, causing funds set aside for the purchase of equipment and services to revert to the state treasury.

Authority to Carry Funds Forward from One Year to Another. It is a common practice in state government for budgeted funds to lapse and to revert to the treasury at the end of the budget period. This practice often, but not always, applies to public higher education in the same manner as other state agencies. The Georgia Study Committee on Public Higher Education Finance found that only 11 of 38 states responding to a 1981 survey permitted carryover in public higher education.[4] In Maryland, with few exceptions, institutions are not permitted to carry funds over from one fiscal year to another. No General Funds and virtually no special funds that are earmarked for the instructional program may be carried forward from one fiscal year to another. Exceptions have been negotiated with the Department of Budget and Fiscal Planning on a case-by-case basis. Funds which support auxiliary enterprises and research contracts are carried forward. Also, institutional revolving accounts which are appropriated may be carried across fiscal years. (Revolving accounts are established for certain activities for which income is received throughout the budget period, usually in the form of fees and sales, for example, publications and photocopying services.)

The effect of reversion requirements can be seen most clearly in the spending behavior of departments and other units in the institutions. Year-end spending increases as the units seek to avoid reversion. One strategy is to overspend the unit's budget by submitting requisitions in excess of budgeted amounts. Toward the end of the fiscal year, as the comptroller begins balancing accounts, units will receive notification of what amount of their total encumberances may be purchased. Purchasing at this point is likely to be affected by what can be obtained quickly, conveniently, and for the amount dictated by the budget balancing. Since there is no "savings strategy" this often excludes purchases of expensive items or those which take time to purchase, such as word processing, reproduction, and laboratory equipment. At the institutional level there are no incentives to control this sometimes inappropriate spending or to build reserves for contingencies, such as revenue shortfalls.

Authority to Invest Funds. At present nearly all funds received by institutions must be deposited in the state treasury. Under this arrangement, the state receives the interest income from these deposits. (In many states, public institutions can deposit non-General Fund monies, such as sponsored research and auxiliary enterprise funds, in commercial banks and draw interest. In other states, all funds are managed and controlled by the institutions.)

Institutional representatives especially objected to the fact that institutions do not receive interest income from self-supporting operations, such as dormitories, continuing education programs, and hospitals. For example, University College of the University of Maryland, which is a self-supporting instructional unit with worldwide operations, estimates that the college would have earned $425,000 in interest in FY1981 had it been permitted to invest its own unexpended income. The exception to this constraint for the state universities and colleges is that certain non-budgeted funds can be invested by the institutions. An example would be fees collected from students for the construction of buildings related to student activities. For the University of Maryland generally, only the endowment funds are approved for investment by the University. The dental service plan and part of the medical service plan for dentistry and medical faculty of the University of Maryland at Baltimore campus are conducted outside state appropriations; accordingly, their monies can be invested without state control. Finally, some University funds in the state treasury, for example, some from University College, draw interest which accrues to the University.

Authority to Expend Excess Income and to Reallocate Funds. Because budget requests are constructed almost two years in advance of the fiscal year to which they apply, it is difficult to estimate accurately levels of income from such sources as tuition and fees. If, for example, enrollments exceed those used for budget projections, the tuition income will exceed projections. The University of Maryland must seek approval from the Board of Public Works to spend this excess income. It must also seek approval to spend excess hospital patient revenues. (The requests are submitted to the DBFP, which serves as staff to the Board of Public Works, composed of the governor, treasurer, and comptroller. Ultimate authority for approval of the requests rests with the Board of Public Works.) In contrast, the state universities and colleges need only DBFP approval.

The state universities and colleges are constrained more than the University of Maryland in their ability to reallocate funds among and within institutions. If, for example, the state universities and colleges wish to purchase commodities costing more than $200 that are not contained in the appropriation as line items, the institutions must justify a substitution of resources to the Department of Budget and Fiscal Planning. (The institutions view this as a minor and routine transaction.) Also, the state universities and colleges must submit requests to reallocate all positions among programs and among institutions to Budget and Fiscal Planning for review and approval. All changes in the appropriated budget are processed as "budget amendments."

The University of Maryland is permitted to reallocate funds in program areas, such as instruction and research, within a specific appropriation. To reallocate funds among programs, however, the University must submit budget amendments to the Department of Budget and Fiscal Planning for ultimate approval by the governor. Changes are inevitable, given that the University receives 88 program appropriations, for example, instruction, student services, library, which are in turn subdivided by fund source (general, special, and federal). Budget amendments must explain the sources of funds and how they are to be spent for proposed changes. The DBFP may delay the processing of budget amendments or return them for additional justification, but typically does not deny approval. The first budget amendment submitted by the University of

Maryland for a given fiscal year is usually the "working budget" amendment, which alters the format of the legislative appropriations prior to the beginning of the fiscal year. Subsequent budget amendments can be submitted at any time, although typically the University of Maryland waits until its revenue estimates are sound before processing the amendments that seek authorization to spend excess income. The University of Maryland usually does not submit budget amendments reflecting the transfer of funds from one program to another until the end of the fiscal year, when the amendments are used to balance the University's budget. Thus, approval for these amendements is sought, in essence, after the fact. (The state universities and colleges process amendments throughout the year which, generally, are also accorded approval.)

Budgeters at the institutional level want to have the flexibility to shift funds among programs as the need arises. But they fear that these transfers, as reflected in the budget amendments, are interpreted by state officials to mean that the institutions have excessive funding in some of their programs. There is a general perception among institutional administrators that significant transfers are used by DBFP analysts as justification for future budget-cutting in programs from which funds were transferred.

In addition to being subject to the 1981 Procurement Regulations, institutions in Maryland have some constraints in the expenditure of appropriated funds. In the state universities and colleges, for example, travel expenditures cannot exceed budgeted amounts. Moreover, out-of-state travel by personnel of the state universities and colleges must be approved first by the Department of Personnel. (It may take up to 30 days to process these requests.) Relatedly, the state universities and colleges are required to seek approval of the DBFP prior to the spending of "operating expense" funds authorized in the budget. This approval process, known as the "BB-4 Process," is required of the University of Maryland only during the procurement of computer-related equipment and services.

Finally, the state universities and colleges and the University of Maryland are subject to a requirement to prepare a deviation analysis each year during preparation of the "asking" budget. Institutions must explain for sub-objects-of-expenditure (for example, postage, telephone, office supplies, equipment rental) deviations between the actual expenditure for the previous fiscal year and the budgeted amount, and between the current appropriation and the budgeted amount.

Position Control. The number of personnel lines permitted each institution is approved by the General Assembly and closely monitored by the

Department of Budget and Fiscal Planning to the extent that each personnel position has a unique line number. Thus, an institution may have sufficient funds available to hire additional individuals, but not have sufficient personnel lines available to make the appointments. If, for example, a senior full professor retires and is replaced by a junior assistant professor, the difference in salaries is available to the department to hire temporary faculty, clerical support staff, and graduate teaching and research assistants, and to meet budgetary savings requirements. The funds cannot be used to hire another permanent faculty member unless a vacant line is available.

Position control is employed for purposes of both politics and economics. Positions represent an image of the government. Legislators often view an increase in positions as an increase in the scope of state government; to number individual positions and to limit the expansion of the total number of positions demonstrates to the public that the growth of state government is under control (even if total budgets continue to grow). In Maryland, the state cannot create positions between legislative sessions except to the extent specified in the appropriations bill, which grants such authority to the Board of Public Works. The economic reason for position control is tied to personnel benefits. Currently, the budgets for personnel benefits are contained in the Department of Personnel appropriation rather than in individual agency appropriations. Because the magnitude of some benefits, for example, medical insurance, depends upon the number of employees, position control enables the state to manage the size of its benefits packages.

Position totals for the University of Maryland are controlled by four major categories—state-supported programs, self-supported activities, dedicated programs, and non-budgeted programs (state government contracts and grants, student activities). Position totals at the University are controlled for teaching faculty, non-teaching faculty, associate staff, and classified staff. For the state universities and colleges, the movement of lines from one major program to another must be approved by the Department of Budget and Fiscal Planning. The University of Maryland has more flexibility in this area. Positions in the state-supported programs and self-supported activities categories are controlled by individual line numbers. Dedicated programs and non-budgeted programs each are assigned a block of positions without line items. By agreement with DBFP, the University of Maryland will not shift positions between block categories and line-item categories without the concurrence of DBFP. Also, the University will not shift positions between campuses without the concurrence of DBFP. The University is not legally bound to seek approval from DBFP, but does so as an informal working agreement.

The constraints of state-level position control force the institution, for exampl , to establish and monitor position vacancy pools. By using these pools, institutions can reallocate vacant positions temporarily within fiscal years to insure the maximum use of free positions and to avoid losing the positions to the state. (DBFP and legislative staff examine periodic reports of position vacancies to determine whether positions are needed and used. On several occasions in its review of budgets, the legislature has taken specific action to withdraw positions.) However, the monitoring mechanisms needed to manage these vacancy pools are cumbersome and expensive to maintain. And, institutions are not above manipulating the system. One institution reported that the Director of the Physical Plant, for example, had been temporarily appointed as an "Assistant Dean" in order to avoid losing the position.

Hiring and Reclassification of Non-faculty Employees. The state universities and colleges are under the purview of the state personnel system. The hiring of all non-faculty employees is done through the Department of Personnel. When filling vacant classified positions, for example, these institutions must use a state-approved list of candidates. Some institutions complain that the state lists of candidates contain individuals who are not interested in the listed positions—individuals laid off from other state agencies and waiting for unemployment benefits to end, or those unwilling to relocate or commute the sometimes considerable distance to work at a state institution. The institutions' request for lists of candidates who are more local has been responded to by the Department of Personnel.

The reclassification of non-teaching positions in the state universities and colleges must first be reviewed and approved by the Department of Personnel. Staff in the Department of Personnel indicate that a review typically takes one month. Institution officials complained that the review and approval process sometimes has taken up to four months.

In the state universities and colleges, governing boards establish the salary scales for teaching and non-teaching faculty. But in the past, the Department of Budget and Fiscal Planning has established scales for salaries of top- and mid-level administrators, and the Department of Personnel for mid- and lower-level administrators and staff.

Under the Autonomy Act, the University of Maryland is exempt from the state personnel system. However, the University has adopted a personnel system for classified employees which in many ways mirrors the state classified system. The University's system is more responsive than the state's system in that candidate screening and reclassification reviews are conducted locally. Administrators on the University's campuses argue, however, that the personnel system could be streamlined significantly.

The University has considerable flexibility in setting faculty and administrative salaries. Unlike the state colleges and universities, which have adopted scales indicating minimum and maximum salaries for faculty, the University does not have established scales. (The University has published guidelines for faculty and associate staff; these guidelines are used in preparing the University's budget request for merit adjustment funds.) The University has the flexibility to set faculty and administrator salaries according to the marketplace, and to base a portion of salary adjustments on merit.

Level of Detail of Budget-Supporting Documentation and Budget Appropriation. The DBFP prescribes the level of detail and the budget format for institutional budget requests. One of the most frequent institutional criticisms was that the amount of information and the level of detail requested place unreasonable demands on institutional staff. For example, DBFP requires budget requests to be broken into approximately 250 sub-objects-of-expenditure.

The governor's budget includes recommendations for each campus and program within the campus according to the 14 state objects-of-expenditure (salaries and wages; technical and special fees; communications; travel; food; fuel and utilities; motor vehicle operation and maintenance; contractual services; supplies and materials; equipment—replacement; equipment—additional; grants, subsidies, and contributions; fixed charges; and land and structure). The governor's budget message also gives an informational context for the budget recommendations, including workload measures for certain programs.

Although the appropriations statement is very brief, the appropriations are very detailed. The University of Maryland, for example, receives appropriations in 88 programs subdivided by as many as four fund sources. Although the General Assembly terms the budget a "program budget," it is in fact an object-of-expenditure budget.

The extremely detailed budget requests required by the DBFP lead to a situation whereby the targets of fiscal analysis tend to be line-item expenditures rather than programmatic objectives. The detail also hinders the General Assembly and budget examiners from focusing on the broad programmatic goals of higher education. In addition, it discourages institutions from setting program priorities.

The budget format also inherently limits the flexibility of central administrations. Expectations concerning funding levels for individual units which arise during the budget process must be recognized after appropriations are made. These expectations constrain administrators from reallocating resources and changing spending plans after they are developed.

The Future

Flexibility is a major concern of public higher education in Maryland. But state regulation affects institutions differently and also affects individuals within institutions differently, according to their function and level. Despite the substantial degree of state oversight of both budgets and expenditures, Maryland institutions, for the most part, remain more concerned with the level of support than with the strings attached to support. To the University of Maryland's Central Administration, flexibility means largely a fundamentally different method of building the budget—one which is based upon a formula sensitive to the University's mix of expensive programs and one which produces a state appropriation independent of other sources of revenue. Flexibility also means greater control over those other sources of revenue, and the ability to benefit from money management, especially in auxiliary enterprises and other operations that are self-supporting.

In contrast, the staff of the Board of Trustees of the State Universities and Colleges system is less concerned with achieving a change in the budget process than in gaining recognition as a "system" and negotiating specific changes with the Department of Budget and Fiscal Planning, for example, the ability to offer higher administrative salaries. Both systems believe "a change in attitude" on the part of state officials is as important as changes in legislation or budget format.

Among middle-level administrators in the institutions, the issue of flexibility looks significantly different. Here the concerns turn to the day-to-day frustrations of seeking approval, dealing with personalities, interpreting regulations, filling out reports, and finding ways to relieve the burden of controls. The MISD review process for the purchase of computer-related equipment and services was singled out as especially cumbersome and inefficient. The amount of dissatisfaction with hiring and reclassification procedures varies from campus to campus, although the contrast is marked between the positive attitude of University of Maryland personnel officers (who operate outside the state personnel system) and the negative attitudes of those in some of the state universities and colleges. Some personnel officers in the state colleges and universities believed that a state-managed personnel system for their campuses could never be run efficiently and would not attract and retain highly motivated employees. Other administrators, however, were reluctant to take on this substantial task, hoping instead that the efficiency of the Department of Personnel and its sensitivity to the special needs of higher education could be increased.

Deviation analysis, budget amendments, and the paperwork associated with reallocation are also sources of inefficiency and aggravation. These accountability measures are not, however, a significant restraint on institutional action, at least in the University of Maryland system. In the six-institution State Universities and Colleges system, relations between institutions and the analysts in the Department of Budget and Fiscal Planning are improving, and administrators seem comfortable with negotiating changes in budgets on a case-by-case basis. But a great deal of time and energy is spent at both the state and institutional levels in preparing and reviewing reports, seeking and offering approval. This takes its toll in both morale and organizational efficiency.

Flexibility is clearly an institutional priority not a state one. State officials remain concerned principally with the objectives of equal treatment, consistency of policy, and the protection of the public from malfeasance.

It is the varying emphasis which the parties in Maryland place on these different conceptions of flexibility and accountability that is the source of tension between the state and the institutions.

At the state level, the practical question must be asked: Are the extensive and redundant budget reviews and expenditure controls worth the costs? Much of the state oversight appears to have evolved from concerns over specific cases of mismanagement in a few institutions, which the state is attempting to solve through centralized control. Ironically, such an approach can further undermine the authority and initiative of the governing boards and administrators and thus lead to continued poor management. There is a certain degree of comfortable accommodation to state regulation among some institutional administrators in Maryland, which is strong evidence that the initiative and sense of responsibility in these institutions has been reduced by state oversight. A more flexible and autonomous higher education system and a more genuine form of accountability from the state level will put added, and often unwanted, responsibilities on boards and administrators. It will now be board, system and campus administrators who must say "no" to unit managers and take responsibility for such issues as salary, program reallocations, tuition, and auditing controls. At the same time, less concern about the details of institutional spending will put added pressure on state officials to deal with policy issues that are far more politically sensitive than line-item budget cutting.

Many of those interviewed, at both the state and institutional levels, agreed that a more programmatic budget review process would be a step in the right direction. Such a review would focus on projected and actual accomplishments of broad clusters of activities rather than individual objects-of-expenditure.

For their part, institutions will have to strengthen their own internal auditing functions and provide the public with a better sense of their accomplishments. A shift to a program emphasis at the state level will likely increase the amount of post auditing and put added pressure on solving some of the overarching problems of program duplication and productivity. It may also put added emphasis on the coordinating function of the State Board for Higher Education and give new importance to the SBHE funding guidelines.

Postscript. With support from executive agencies and SBHE, there were a number of legislative and gubernatorial initiatives on institutional flexibility in 1983. While the governor would not endorse the University of Maryland's sweeping proposal for budgeting and accountability changes statewide (similiar to those initiated in Colorado), he did support more limited increases in flexibility within the University system. The legislature passed a bill which allowed the University to carry forward special (largely tuition) and federal funds from one year to the next. The University must still submit budget amendments to the Board of Public Works, however, to spend these savings in subsequent years. Another bill passed which allowed University College (the University's totally self-supporting continuing education program) to receive credit for interest earned on fund balances. Funds will remain with the state and be invested by the state treasurer. The legislature also adopted legislation sponsored by the Department of Budget and Fiscal Planning allowing that agency, within certain limits, to delegate to agencies responsibility for the procurement of computer-related equipment and services, so long as the proposed purchases conform to a previously-approved plan. Authority for the approval of such plans remains with MISD of DBFP. Implementation regulations were being developed in the spring of 1983. In addition, the governor established a task force committee to study the flexibility issue further. Chaired by the lieutenant governor, the committee consisted of eight legislators, two representatives from the University of Maryland, and one representative from each of the other governing boards and the State Board for Higher Education.

Footnotes

1. Lyman A. Glenny and Thomas K. Dalglish, *Public Universities, State Agencies, and the Law: Constitutional Autonomy in Decline* (Berkeley, California: Center for Research and Development in Higher Education, University of California, Berkeley, 1973).
2. In a study of gubernatorial influence on the operations of state departments, administrative heads were asked about the relative influence exercised by the governor, the legislature, and federal officials. The level of influence of the Maryland governor on state operations was ranked highest in the nation. See Glenn Abney and Thomas P. Lauth, "The Governor as Chief Administrator," *Public Administration Review*, Vol. 43, No. 1 (January/February, 1983), p. 40-49.
3. State Board for Higher Education. *Maryland Statewide Plan for Postsecondary Education*, July, 1978 (Annapolis: State Board for Higher Education, 1978).
4. Georgia Study Committee on Public Higher Education Finance, unpublished memorandum, September 16, 1981.

Chapter 3
Improved Efficiency Through Decreased Government Regulation: The Case of Wisconsin

Reuben H. Lorenz

In the budget instructions for 1981-83 issued by the Wisconsin Department of Administration, one of the major themes is "deregulation." The precise language is as follows:

> As an overall budget theme in 1981-83, every agency will be asked to examine ways in which it can decrease the degree of regulation imposed on activities of private enterprise and private citizens. Proposals may be large-scale, such as ending all regulation in some area, or minor, such as simplifying operating procedures or forms to be completed. Deregulation proposals should be identified, along with any statutory modifications needed to accomplish them, as a separate component of the budget request.

The institutions of the University of Wisconsin (UW) System are not regulatory agencies, but they are subject to numerous regulations and administrative controls at the federal, state, and local levels. Directly or indirectly, the costs and educational consequences of these regulations and controls are assumed by private citizens throughout Wisconsin—taxpayers and students, as well as faculty and staff. Like inflation, these costs represent a hidden but steadily increasing draw on the limited resources available to institutions of higher education. Moreover, in an era of limited budgets, external requirements and controls may build rigidities into institutional management that prohibit responsible efforts to introduce innovation or contract programs.

The combination of sustained high inflation in the United States without a corresponding increase in productivity has made the cost of government regulations—particularly as they affect private enterprise—a major national concern in recent years. The importance which the Wisconsin Department of Administration has given to the question of deregulation and to examination of some of the policies and procedures

Reuben H. Lorenz is Vice President and Trust Officer, The University of Wisconsin System.

developed within the bureau has, therefore, been both timely and constructive. The focus of this paper is on actions which a state government may take to lessen the burden of regulation on public institutions, without retreating from the purposes and concerns behind those regulations and controls.

The Consequences of Regulation

The UW System is affected by government regulations and controls in a variety of ways: as an employer, as an intermediary in grants and loans, as custodian of hundreds of thousands of personnel records, as a manager of buildings and grounds, as a purchaser of supplies and services, as a research center, and in many other ways. Any multi-billion dollar enterprise, public or private, which has an impact on as many lives as the UW System does, cannot expect to be exempted from such requirements. Pollution does not change its composition when it comes out of a publicly-owned smokestack. Discrimination by public employers against women or minorities or the handicapped is no less onerous than that of private employers—and may be more offensive. The same is true for misuse of wetlands, unsafe working conditions, and invasions of privacy. With or without explicit regulations compelling compliance, public institutions should lead by the example they set. The special privilege of taxpayer support carries with it special responsibilities.

Unfortunately, and too frequently, the costs associated with meeting those special responsibilities are not recognized. These costs take two forms:

Direct expenditures for new staffing, new equipment, paperwork, postage, and the like, to implement regulatory requirements and monitor compliance with them. Business firms can frequently "pass on" such costs in higher product and service prices. Public universities often cannot, because they are subject to a variety of legislative and executive budget and position controls, as well as taxpayer scrutiny. To the extent that these costs *are* passed on, students (and taxpayers) pay more. To the extent that they are "absorbed," students get less.

Indirect costs and the distortion of educational mission which may accompany them. Faculty members who are filling out forms are not conducting research or "keeping up with their discipline." The cost of their displaced efforts does not show up on the balance sheet, but it does affect the overall "productivity" of the enterprise. Of greater long-range concern are the cumulative distortions which may occur in the nature of the educational enterprise. The bureaucratization of the academy and an accompanying decline in the quality of the various academic "products" are the almost inevitable result of over-regulation. Bureaucratic structures are necessary to assure uniformity and compliance to external requirements within organizations. But, as artists and arts managers and business firms engaging in research and development activities have long known, innovation, creativity, and solid scholarship are rarely fostered in bureaucratic environments. The standards of accountability which prevail in the marketplace of ideas are real and stringent, but they are also different from bureaucratic norms, and must be, if conformity and mediocrity are not to become the rule.

Federal Concerns

The cost of compliance with federal regulations by institutions of higher education is substantial, and both the cost burden and the scope of regulations have grown rapidly over the past decade. As many as 34 Congressional committees and at least 70 subcommittees have jurisdiction over 439 separate laws affecting postsecondary education. Furthermore, educational regulations are only one of many ways, ranging from Social Security to pension regulation to environmental safeguards to occupational safety measures, that the federal government affects the cost of doing university business.

This is not to dispute the need or value of most of the federal laws and regulations. Some are the "stick" that goes with a federal funding "carrot"; others press policies and principles which most university officials would agree are long overdue. What *may* be frequently disputed are the level of detail within the regulations and the lack of flexibility and sensitivity in their administration. Because of such unneccessarily burdensome approaches, which serve few constructive purposes in terms of compliance and accountability, millions of dollars are wasted. There are other costs as well. As UW-Madison's Emeritus Professor William Sewell, who headed the National Commission on Research, put it, the most critical problem facing the nation's research enterprise is "increasing distrust between the federal government and universities as far as the handling of research money. We have very frequently heard the argument that a scientist has to lay out what he is going to do and stick to protocol or he is going to get in trouble with the accounting process. Scientists asked us, 'Doesn't that inhibit highly creative people from doing the most creative work—turn scientists into very controlled bookkeepers?' "

State Relationship

The relationship of state government with the UW System differs both in degree and in kind from that of the federal government. Between 40 and 50 percent of the UW System budget is state taxpayer support (the federal share is about 17 percent). In contrast to its position as a mere "beneficiary" of federal grants, the University System is part of Wisconsin state government. Its budgets go through the same political process as those of other state services, and it is subject to many of the same fiscal and personnel controls and policies as the cabinet agencies headed by gubernatorial appointees. Yet within state government, the University System is also unique in many respects—in its history, mission, and capabilities—and recognition is given to this fact in state law and executive and legislative policy judgments.

Perhaps the most important area of uniqueness lies in the size of the UW System. With physical facilities valued at nearly $3 billion, 27,000 employees, and an annual budget of $1 billion, the internal management of the UW System requires budgetary controls and managerial capabilities analogous to those found in the largest corporations. No other state agency faces a similar circumstance. What is special about the internal mechanisms of accountability developed within the UW System is their applicability to the nature of this particular large organization—that is, to the effective management of a university system with two doctoral institutions, 11 universities, the UW Center System, and statewide Extension services. Not surprisingly, given the role of state tax dollars in the financing of the UW System, the major area of friction between the UW System and state government—and, in particular, the Department of Administration—is the extent to which the UW System should be viewed like other state agencies, subject to various state controls in personnel, purchasing, travel, and fiscal management, and the extent to which it should be allowed to "manage itself."

At issue is not the principle of accountability, but rather, the methods being used to bring about accountability—the timing and the nature of who and what is involved. In some cases, as with various reports that are mandated at both the state and federal levels, the problem is duplication—Why must a report be prepared for state government which substantially (but not totally) repeats the information submitted to the federal government? In some cases, such as with state purchasing criteria which have not kept up with inflation, the problem is meaningless paperwork and needless, costly delay—Why should the volume of paperwork increase, just because the purchasing power of the dollar is decreasing? In other cases, as with the need to obtain approvals for employee absences greater than six days, the problem is what might be called the "Captain, may I?" syndrome—Why should professionals be treated like children, when ample protection against abuses can be had through post-audit review procedures?

Above all, the purpose of most state controls and regulations—to avoid waste—must be kept in mind. In a time of extremely limited resources, there should be no divergence of purpose; it is in the interest of managers at every level to save every penny they can. The alternative to controls by the Department of Administration is not waste. All of the internal incentives within the UW System go the other way. Institutions cannot afford to pursue inefficient and costly alternatives.

In the preparation of their 1981-83 biennial budget proposals, all UW System chancellors and institutions were asked by Central Administration to identify areas where "deregulation" or improved regulation by the state would lead to educational dividends, better management, and administrative savings. Institutions were allowed to be as brief or as detailed as appropriate. Some submissions were over 20 pages, and virtually all contained information of value. The vehemence of the institutional responses suggested the need for an ongoing mechanism to work with the state and federal governments in targeting areas for improvement. A vice chancellors' Committee on Deregulation was established to serve as that vehicle.

In reviewing the institutional submissions, reference to federal problems were set aside for more detailed analysis later. Also postponed were considerations of issues, such as financial aid, teacher certification, and building safety, which involved state agencies other than the Department of Administration and the Department of Employment Relations and could best be dealt with in direct communication with those agencies. In addition, concerns in approvals of program-revenue funded positions and concurrence on an acceptable approach to personnel management information systems were not on the agenda of the Committee because progress had already been achieved with the Department of Administration in the development of procedures dealing with these areas. Once this was done, it became apparent that there were three areas of paramount concern among the institutions—purchasing, personnel, and travel—in addition to a variety of problems that did not fit into a specific category.

In contrast to many of the issues of federal regulation, most of the concerns in the three areas related not to external requirements (applicable to all employers, all polluters, etc.) but rather to internal control mechanisms within state government. Some of the UW System's problems with these control mechanisms might be unique, some might appear minor; but taken together, they add up to a cumulative burden of significant consequence, and many would be echoed by other large agencies of state government.

Following is a summary of the issues raised during the first survey of system administrators, and presented to the governor and the legislature as an information paper accompanying the 1981-83 Biennial Budget Request.[1]

Procurement, Purchasing, Printing

In 1979-80, the University of Wisconsin System made General Purpose Revenue (GPR) expenditures of over $90 million for supplies and services (and double this amount in non-GPR purchases). The breadth and magnitude of the System's operations, and the need to make maximum effective use of the funds available in a time of tight budget constraints, require both expertise in management and extensive internal controls. As a result, external controls may frequently be redundant or unnecessary. In many cases, the Department of Administration (DOA) has given recognition to the unique circumstances and capabilities of the UW System. In other areas, there is room for significant progress.

General Purchasing. The statutory limit on sealed bids in Wisconsin is $10,000. This limit was raised by the legislature in 1976 in recognition of the impact of inflation on prices of state-purchased goods. Under the statute, all purchasing below this figure could be delegated to the UW System, subject to post-audit by DOA. Currently, however, DOA regulations preclude a simplified UW System approach to purchasing. The same sealed bid limitation which has been in effect since 1979 ($3,000) is kept in place by administrative regulation. Written requests for prices are required on purchases of $500 or more, and documentation of price comparisons is required down to purchases of $50. An inordinate amount of time and money is being spent on transactions that have absolutely no payback.

Printing. For many years, the sorting out of responsibilities for printing between the Department of Administration and the state agencies has been a subject of continual friction, relating to the quality, timing, and cost of jobs printed under DOA procedures. One goal should be the delegation of greater authority over the bidding of printing to individual institutions.

Emergency Repair Orders. Rather than go through costly delays, the UW System should be delegated "waiver of bid" authority in clearly defined emergency situations, subject to DOA post-audit.

Computer Acquisition. Under state statute, the Department of Administration has authority to regulate computer purchases by the UW System and state agencies. Although, for the most part, the UW System has had an effective review relationship with DOA, the pace of change in computer technology, DOA rules and procedures, and the statute itself may inhibit the most effective purchasing procedures, in an area where delays can be extremely costly. The UW System should develop and propose to DOA appropriate changes which would allow greater flexibility, delegation, and responsiveness.

Communications. Under Wisconsin statute and DOA rules, the institutions of the UW System must annually submit a five-year telecommunications plan and equipment inventory to DOA. There is serious doubt among the UW institutions about the usefulness of some of this activity, and a number of alternatives have been proposed.

Surplus Property Disposal. Current reporting procedures on disposal of surplus property should be simplified.

Minor Project Review. Local construction projects of the UW System are reviewed by DOA if they exceed $2,500 in cost. Inflation has given this limitation an unintended, and burdensome, impact. The limit should be raised.

Personnel

Affirmative Action. The State Department of Employee Relations (DER) requires an annual report, which takes substantial time to prepare and has a somewhat different format and time frame from a similar report required by the federal government. If the federal report were allowed for state purposes, considerable effort could be saved.

Leave Policy. The UW System is presently limited by statute in the number of faculty members who may go on sabbatical leave. As a practical matter, fiscal constraints and workload pressures limit such leaves to a handful throughout the system, and they are all funded without seeking new state dollars. But the statutory restriction is onerous in that it suggests that the UW System will never be able to do better in meeting this educational priority. Looking ahead to a time of enrollment decline, investments by institutions in academic revitalization will take on a new significance. For this reason, the statutory limitation ought to be raised from the current 1.5 percent of eligible faculty positions (those who have completed 6 or more years of service), or eliminated entirely.

General Personnel Process. As a major employer of individuals in the classified civil service, the institutions of the UW System are delegated substantial responsibility in recruiting and hiring by the Department of Employee Relations. Nevertheless, institutions express a variety of concerns about existing procedures.

Salary and Reclassification Surveys. Reclassification surveys of a group of employees can be costly in three senses: (1) the employee time it takes to complete them; (2) the employees who are lost to competing employers if salary levels are not kept up to date; (3) the cost of funding new salary classes once the surveys are completed. Major surveys should be accompanied by a "fiscal note," with state funding sought to alleviate disproportionate burdens.

Travel

Prior (and Post) Approval Procedures. Under current DOA procedures, the UW System must obtain approval for applicant interview expenses, moving expenses, and out-of-state travel exceeding six working days. Fiscal and internal UW System management constraints make these requirements redundant and they should be eliminated, with UW practices subject to DOA post-audit as necessary.

85 Percent Mileage Requirement. Under Wisconsin statutes, the UW System and all state agencies are required to reduce the miles driven or gasoline consumed by 15 percent from 1978-79 levels. The purpose of this requirement—to conserve energy—is commendable, but the paperwork associated with assuring that it is implemented is not. The skyrocketing cost of gasoline and diesel fuel, coupled with the general fiscal constraints on chancellors and campuses, now make this requirement redundant (that is, there is not enough money in the budget to drive more miles). The requirement should be eliminated.

General Travel Requirements. Institutions have pointed out a number of problems with current travel reimbursement procedures. Given recent air fare increases, the state's 107 percent limitation on out-of-state travel (that is, that costs cannot be more than 107 percent of the previous year) has become unrealistic. The UW System should review with DOA the costs and benefits of simpler reimbursement procedures, the 107 percent limitation, and related concerns.

Conclusion

The history of state administrative controls and regulations is generally one of good men and women seeking to deal with real or perceived problems through statutory changes and administrative rules. It is difficult to quarrel with the motives of state policymakers, or the purposes—such as avoiding dishonesty, assuring fair competition, or preserving energy—behind their actions. Nor can the internal bureaucracy of the University System approach the question of deregulation as if it has not at times been a part of the problem (rather than the solution).

In Wisconsin, 1981 proved to be a good year for constructive dialogue and change, given the willingness—perhaps even eagerness—within the legislative and executive branches of state government to re-examine the need for existing regulations and controls.

Following endorsement of the concept of state deregulation by the governor, the president of the University appointed a committee of four vice chancellors, with appropriate support from System administration offices, to address the issues. State government assigned six individuals from the Departments of Administration and Employee Relations to work with the University representatives. By the end of 1982, nine meetings in which the issues were discussed in depth had been held. Significant improvements have been implemented; probably the most important being the attitudinal changes which have evolved through the extensive interaction of the respective staffs.

Most of the specific improvements have been in the delegation of authority to the University in the areas of general purchasing, printing, computer acquisitions, telecommunications, and employee classifications:

A sealed bid limitation of $3,000 was raised to $10,000 in accordance with the statutory limit.

An extensive purchasing delegation agreement became effective February 26, 1982.

A delegation of authority agreement relating to printing became effective August 1, 1982.

A delegation of authority agreement relating to classification of employees became effective June 13, 1982.

The requirement to submit an annual telecommunications inventory was rescinded.

Statutory language raising the sabbatical leave limitation has been drafted and has received favorable reaction from the governor.

Statutory language revising current travel reporting requirements will be submitted as part of the 1983-85 biennial budget.

The joint University-state government efforts to deregulate and provide more cost-effective administration of public funds have produced cost savings and an improved work environment. A continuation of this interaction is expected in the years ahead.

References

1. The University of Wisconsin System, "1981-83 Biennial Budget Information Paper: Administrative Savings and Improved Efficiency Through Decreased Government Regulation," unpublished memorandum, November 26, 1980.

Chapter 4
Management Flexibility in Kentucky: The Passage of House Bill 622

Edward A. Carter and Jack C. Blanton

In a retrenchment, a typical reaction at both the campus and the state levels is to centralize decision making that pertains to the expenditure of public funds. This tendency toward central fiscal oversight seems to be a natural evolutionary process for large organizations experiencing scarcity. An exception to this administrative tendency was manifested in the 1982 session of the Kentucky General Assembly, when that legislative body enacted House Bill 622—a landmark statute that reversed four decades of movement toward state centralization and a steady growth of bureaucratic rules and procedures applying to the Commonwealth's 8 universities and 13 community colleges.

In 1936, Kentucky state government had gone through a comprehensive reorganization in which hundreds of bureaus, departments, and advisory bodies were eliminated. A streamlined organization emerged and was put into place by an omnibus reorganization bill enacted by the legislature. This reorganization greatly reduced the number of governmental units—and also provided for a strong finance department in a "strong governor state."[1] Another equally prominent aspect of the 1936 reorganization was the establishment of centralized accounting and procurement functions for the restructured state units.

The 1936 Kentucky reorganization was not originally intended to encompass the state colleges and universities. However, state appropriations to the higher education institutions were to be kept in the state treasury, and payment documents against state appropriations were to be paid on a state check through the new centralized accounting system. The 1936 reorganization did not contemplate that the state colleges and universities would be enmeshed in the new structure, but anticipated that they would function at its fringe. In retrospect, this presumption did not prove accurate.

Over the next four decades, higher education became mired deeper and deeper in the state bureaucracy. By the mid-1970s, all procurement for

Edward A. Carter is Deputy Executive Director for Finance, Kentucky Council on Higher Education.

Jack C. Blanton is Vice Chancellor for Administration, University of Kentucky.

higher education, including capital projects, was under the central direction and control of state government in the state Department of Finance. Virtually all university funds, including student fees, were accounted for centrally, and the majority of checks—to pay employees as well as vendors—were written centrally. The time required to process documents through the state capitol in Frankfort became a major complaint of university administrators. Over time, a costly administrative structure grew up on each campus whose prime responsibility was to "push paper" through the state bureaucracy.

The Governor's Management Study

In 1982, a series of unlikely events worked to free Kentucky's public colleges and universities from most of the costly oversight of their business affairs by the state Department of Finance and other state agencies. This noteworthy achievement was surprising, considering the state revenue shortfalls that year. (Shortfalls in 1980-81 required that appropriations for all of state government be reduced by approximately $125 million; higher education's share was set at $30 million. The following year, the higher education budget was reduced from original plans by approximately $44 million.)

The road to enactment of House Bill 622 began with the election of John Y. Brown, Jr., as governor of Kentucky in November of 1979. Mr. Brown was, in many ways, unique among gubernatorial candidates. He was a wealthy businessman who had made a fortune in the fast-food business and had never stood for public office before. He pledged to rid state government of "politics," or at least such questionable aspects as job patronage and contractual favors.

Mr. Brown's term as governor has been unconventional. He ignored the old-time politicans in leading his administration, and launched a national industrial development campaign that advertised Kentucky as "the state that is run like a business." Most of his top cabinet appointees came from the ranks of business and, true to his promise and inclination, he was oblivious to political considerations in many of his day-to-day decisions.

Early in his administration, Governor Brown "challenged" higher education to improve its management practices. As a means of demonstrating his concern for the existing management practices in higher education, the governor put $400,000 into his 1980-82 budget for an assessment by an "outside" consulting firm of management practices and funding levels of the colleges and universities—which all of the presidents said were too low in comparison with similar institutions in other states. This tactic concerned many university administrators who were fearful that the governor's concept of management for colleges and universities might be harmful to the higher education process.

Responsibility for implementing the "outside" management assessment was assigned to the state's Council on Higher Education. The Council staff identified six areas for review: (1) organizational structure of the institutions; (2) adequacy and utilization of resources; (3) personnel utilization, evaluation, and promotional practices; (4) fiscal management practices; (5) costs which might be inconsistent with mission or not educationally related; and (6) external management barriers to the operation of the institutions.

The Council sought proposals for conducting the impending management review and received a large number of responses. The accounting firm of Price Waterhouse and Company was selected, along with MGT of America, Inc. of Tallahassee, Florida, to carry out this important study in the summer of 1981. Soon after the state legislature convened in January of 1982, the consultants released the first phase of their report, *A Study of the Management Practices and Procedures of Kentucky's Public Universities and Colleges*, which dealt with the question of external management barriers and funding comparisons.[2]

The principal conclusion of the outside consultants was that state rules and regulations and the trappings of state bureaucracy posed the biggest obstacles to the improvement of management at the colleges and universities. The findings contained in the report included many examples of duplicative state procedures that were costly to higher education and the state.

These findings astonished a number of state officials, several of whom believed that the governor would never allow the universities to be cut free from central state controls. If the governor had harbored such thoughts—and there is no evidence that he did—his role in initiating the study may have constrained his criticism. But there was never any public or private indication that he disagreed with the Price Waterhouse—MGT recommendations.

The consultants recommended changes in several areas—purchasing, personal service contracts, printing, computer purchases, out-of-state travel, payroll, suplus property, the selection of architects and engineers, the oversight of capital construction, and the treatment of claims. Many of these recommendations, which were presented with more than one alternative, were incorporated in House Bill 622, which passed during the 1982 session.

Passing House Bill 622

The role of the Kentucky Council on Higher Education in bringing about the passage of House Bill 622 was contrary to what many have come to expect of coordinating boards. These boards frequently have been accused of invading campus turf, pre-empting the powers of governing boards, and grabbing off the functions of university administrators. Throughout the management study and the enactment of House Bill 622, the Council and its staff supported the decentralization thrust. To the surprise of some in higher education, the Council did not seek to be named as a replacement for the Kentucky Finance Department as "central overseer" of university business affairs. Rather, the Council promoted the universities' efforts to take the lead, and provided assistance when appropriate.

Following the release of the consultant's report in January 1982, the executive director of the Council encouraged the introduction of a bill that would separate the public colleges and universities from the centralized state administrative apparatus.

The topics addressed in the draft legislation were complicated and difficult to understand for those not familiar with the Department of Finance procedures. After extended discussions with legislators and numerous alterations in the draft, 23 sponsors for the bill were found in the 100-member House of Representatives. The bill was dropped in the hopper on February 26, which was late in the session.

Support for the bill by representatives and senators from the home districts of all the colleges and universities was virtually unanimous. The higher education institutions had recently battled over a formula for allocating state appropriations, and House Bill 622—which came to be known as the "Universities' Management Bill"—was just the medicine needed to heal some of the scars of that budget battle. So, in uncharacteristic fashion, all of the colleges and universities were advocates for the legislation. This rare unanimity became widely known throughout the legislative halls, and it eventually paid off.

Several state officials whose "turf" was threatened by the bill were less supportive. The Secretary of Finance, however, stated that he had no objection to the enactment of the bill. This position surprised many old-line bureaucrats who were sure the finance department would work secretly against the bill. One employee in the Department of Finance unwittingly protested that enactment of this legislation would require him to cut his work force in half. This confession was welcomed by the legislative committee reviewing the bill, and it was reported favorably with several committee amendments on March 16. The bill was passed in the House by a vote of 75 to 14 on March 25. The bill was received in the Senate, assigned to committee, and reported out on the same day it passed the House. This urgent timing was crucial, since the General Assembly was set for adjournment on March 31.

The bill came close to being lost in the Senate when it appeared to be at odds with a centralized investment program for state funds, which was strongly supported by the governor. However, a compromise was reached for the handling of state monies that satisfied the governor's aides. On March 29, two days before adjournment, the bill passed the Senate by a vote of 36 to 0, with the investment amendment attached. On March 30, the House concurred with the Senate amendment by a vote of 79 to 6. Despite continued rumors that the governor was going to veto it, House Bill 622 became law with his signature on April 11.

The Effects of House Bill 622

The changes for business management at Kentucky's colleges and universities, that House Bill 622 provides are in the following areas.

Purchasing. Responsibility for commodity procurement is vested with the colleges and universities. Before House Bill 622, the institutions were delegated responsibility for the purchase of certain items, while the state purchasing division procured other items. Now, all purchasing may be accomplished at the campus level. The university purchasing director is bound by the terms of the state's Model Procurement Code, as were the state officials. The universities are no longer required to buy from state central stores certain items that were in great demand, but carried a surcharge to cover the administrative costs of the centralized unit. Universities and colleges may now initiate or enhance their own stores' operations.

Capital Construction. State universities may now select and contract with architects and other consultants; heretofore, the state government selected and employed architects for capital projects on university campuses. Universities also may advertise projects for construction and award contracts for them. This prerogative formerly was vested in the state Department of Finance. The provisions of the state's Model Procurement Code must be followed in accomplishing this objective.

Real Estate. Governing boards may employ appraisers, and acquire and dispose of real property. The acquisition of property still requires the approval of the state Secretary of Finance, but all of the paperwork essential to buying or selling real estate (or other surplus equipment) may now be fully completed by university personnel. All state laws applicable to the sale or purchase of real estate must be adhered to by colleges and universities.

Fiscal Agents. Many of the capital improvements at Kentucky's colleges and universities are financed from the proceeds of revenue bond issues. Formerly, the employment of a fiscal agent, whose job it was to prepare and sell bond issues in behalf of colleges and universities, was the prerogative of state government; now this function may be assumed by the institutions' governing boards.

Accounting and Auditing. The central payment of documents through state government has been discontinued. Under a compromise reached during the enactment of the bill, certain state appropriations must be maintained centrally for investment purposes, but funds are transferred on a daily basis to each university to cover the prior day's checks. All accounting on an accrual basis, as prescribed in the legislation, is now accomplished at the campus level. The bill requires the governing board of each institution to make an annual report to the Council on Higher Education, in a format which meets the existing requirements of the Council's system of uniform financial reporting. The law further prescribes that the colleges and universities must employ a qualified public accounting firm to conduct a thorough annual financial audit that speaks to the institution's compliance with House Bill 622. The Secretary of Finance may prescribe the minimum scope of any such audit.

Payroll. The state treasurer formerly wrote all university payroll checks. Electronic data processing tapes were prepared at the campus level, and then taken to the state capitol in Frankfort every other week. The tapes were put into the treasurer's computer; the checks were written and returned to the campus for distribution. Under the new law, all payroll checks may now be written at each campus by the university treasurer.

Affiliated Corporations and Foundation. The bill authorizes colleges and universities to have affiliated corporations and foundations and to operate them under the provision of House Bill 622. An affiliated corporation (which is not a public agency) is a corporate entity over which an institution exercises effective control by means of appointments to its board of directors, for example, a research and development center.

Institutional Option. The institutions have the flexibility to elect all or any number of the provisions of House Bill 622.

Personnel Administration. House Bill 622 had no influence on personnel administration in higher education, since the Kentucky Revised Statutes already give full authority for personnel matters to the institutional governing bodies.

Summary

The Kentucky experience in the 1982 session of the General Assembly was unique. It was the product of a series of events that, in retrospect, were unlikely and were certainly in violation of any "universal laws of bureaucracy." The following events coalesced to produce House Bill 622: the surprise election of an unconventional governor; the study of management practices of Kentucky's public institutions; the benevolent posture of the state coordinating board; the rare unanimous support for this action by the colleges and universities, which followed a grim fight among the institutions over the biennial budget; and the unlikely support of top officials of the finance department. In the absence of any single event described above, the bill could have failed: the governor could have killed it; the Council on Higher Education could have done the same; failure of any single institution to support the bill could have put it in jeopardy. Old-timers at the campus level and at the state level are still shaking their heads in wonderment.

Footnotes

1. Herbert Jacob and Kenneth N. Vines, *Politics in the American States*, 2nd edition (Boston: Little, Brown and Company, 1971); Donald P. Sprengel, ed., *Comparative State Politics* (Columbus, Ohio: Charles E. Merrill Publishing Company, 1971).

2. Price Waterhouse and Company and MGT of America, *A Study of the Management Practices and Procedures of Kentucky's Public Universities and Colleges, Phase 1* (Frankfort, Kentucky: Commonwealth of Kentucky, Council on Higher Education, September, 1981).

Chapter 5

The Adoption of Budget Flexibility in Colorado: Its Consequences for the University of Colorado

Marilyn McCoy

In spring 1981, the Colorado legislature ratified an agreement between the Joint Budget Committee of the legislature and all public institutions of higher education in Colorado. At its heart, that agreement, termed the Memorandum of Understanding (MOU), transferred responsibility for financial management from the legislature to the institutional governing boards. This change created new incentives for the institutions to generate non-state revenue and gave institutional boards the authority to set revenue targets and expenditures. In principle, the agreement removed major elements of state control and instituted a new level of institutional autonomy that, in essence, blends concepts of private sector management with responsibilities to serve public sector needs. Major features of this agreement are as follows:

Expenditure-setting authority was conveyed to the institutional boards. Previously, the general fund budget (including revenues from state appropriations, tuition, indirect cost recoveries, and other cash funds) was set by the legislature, but the MOU gave the authority to set budgets to the governing boards. In the past, any revenues in excess of these preset levels could not be spent, since the allowed expenditure levels had been prescribed by the legislature. With the MOU, the institutional boards were given control of revenues. Tuition and sponsored programs no longer were appropriated separately; 52 line items were reduced to a lump sum at the University's general campuses; intercampus transfers within systems, except those involving the Health Science Center, were permitted; and budget levels for faculty compensation, capital outlay, operating expense, and other expenditure categories became the prerogative of the boards. Limits on the number of FTE faculty and selected administrative appointments were continued, but at 100 percent of state formula instead of the previous policy of 98 percent, effectively providing room for staffing expansion if so desired by the boards.

Marilyn McCoy is Director of Planning and Policy Development, The University of Colorado.

Enrollment-setting policy was not changed. In general, except for the previously existing state enrollment limits at the University of Colorado (CU), Boulder campus, and Colorado State University, enrollment levels continue to be demand-based and defined by institutional policy regarding academic admissions standards. (However, the enrollment caps for CU-Boulder and Colorado State University were changed to apply only to residents, thereby uncapping non-resident enrollment.) Supplemental appropriation adjustments, both positive and negative, are made based on variances from original enrollment targets.

Incentives for non-state revenue generation were created by this agreement. Previously, any non-state revenues in excess of targets had to be returned to the state treasury. These included added funds from tuition, indirect cost recoveries, and other cash funds. With the new agreement, institutions could retain these funds, and either spend them or roll them forward into ensuing budgets. This change is one of the key incentive features of the MOU.

Pricing authority was given to the boards. Previously such items as tuition, student fees, hospital charges, and room and board fees were set by the legislature, primarily on a cost-based procedure. The agreement gave authority in these areas to the boards.

Special requests to the legislature were, in effect, eliminated by this agreement. After the initial year of operation, utility supplementals were eliminated, and other separate special requests were placed outside the legislative agenda. Except for capital construction funding, which is continued as a separate item, all other requests have been placed outside the higher education appropriation process.

Consequences of Flexibility on the University

The discussion which follows relates to the consequences and changed management practices carried out at the University of Colorado as a result of the Memorandum of Understanding. (The University is a four-campus system with units in Boulder, Denver, Colorado Springs, and a Health Science Center in Denver. It is governed by a nine-member elected Board of Regents.)

The decision-making discretion afforded by this agreement and the set of management incentives it created are considered key supports in the institution's efforts to improve. (It should be noted, however, that there is some discontent in other public institutions in the state tied to the narrowing of the negotiating agenda with the legislature and the removal of the capacity to strike independent accords with the legislature.) The major effects of these changes include: (1) an enlarged resource base at the

University; (2) differentiated pricing policies that reflect a wider range of needs (academic, access, market, competitive) than were accommodated by the singular cost focus of the legislature; (3) reallocation of resources to areas of higher need and priority; (4) development of fund pools for unexpected contingencies and support of innovation and program enhancement; (5) incentives for management efficiency; and (6) greater involvement and assumption of responsibility by operating managers. An elaboration on these changes follows.

Enlargement of the Resource Base

Although the state did provide a significant boost in state support during the first year of the flexibility agreement, the major focus has been on the incentives which now exist for increasing non-state funding. Flexibility has clearly led to an increase in total funds available to higher education. The removal of the requirement to return "excess" or unanticipated additions to tuition revenues and other cash sources represents one avenue of added support. Before the flexibility agreement, the University returned about 3 percent of its state appropriations, or approximately $3 million, to the state at year's end because historically the institution has overachieved on tuition and other cash fund targets set by the legislature as part of the original budget. Since the legislature set and approved expenditures, the University was not authorized to spend any added revenue from tuition, indirect cost recoveries, or interest earnings. These funds now remain with the institution and can be expended under University authorization as desired. Added gift revenues are another source of funds. In the first year of flexibility, additions to gift funds doubled over the preceding year, in part because donors recognized that gift funds would not be replacing state funds—a common misunderstanding confronted by public institutions.

A series of incentives for changes to pricing policy and for greater management efficiencies also contributes to an expanded base of funds. For example, the application of tuition differentials has netted an additional one to two percent of tuition revenues to the base. Improvements in cash management, in purchasing/inventory control, and the reduction of receivables have similarly increased the base. The acceleration of tuition collections netted approximately $400,000 at the University in added interest income. In addition, earlier tuition collections had a side benefit of reducing uncollectibles from an original level of one percent to its current level of .45 percent, for a combined benefit of over $1 million additional funds annually. At the Health Sciences Center of the University, the time period for receivables has been cut in half.

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port initial research efforts by young and promising tenure-track faculty, to reward excellent teaching through bonuses, to improve capital outlay support, to provide computer resources for faculty, and to stimulate further research in selected disciplines, such as the humanities foundation now being established by the University.

Management Efficiency

Prior to the MOU, there was little incentive to introduce practices that might improve efficiency but would involve some expenditure for implementation. Such expenditures would have replaced the operating needs of the University and any added income would return to the state. Under the flexibility agreement, these incentives now exist. For example, retrofitting facilities to gain energy savings, installing new computing systems for billing and cost-tracking, publicizing changes in tuition collection procedures, and allocating management staff to identify and implement these policies represent examples of practices which involve costs for the University but which are justified by greater savings/income and are encouraged within the flexibility agreement. Whereas the requirement to return "excess" cash to the state treasury provided clear incentives to build inventories, current interest earnings on cash provide the opposite incentive—leading to an improved management of purchasing and inventory control. Similarly, the potential for greater interest earnings led to an acceleration in collections of tuition and patient receivables. Faculty and other unit managers now face clear incentives to save monies in one area and devote them to other uses. So, for example, 9-month versus 12-month secretarial support may be preferred, if the savings can be used to purchase needed capital equipment. In general, cash management, collections, and spending allocations have all improved with the MOU.

Responsibilities of Operating Managers

One of the key benefits of management flexibility is that once it is fully in place it provides incentives at the operating level to control staffing, save funds, and reallocate resources according to unit needs. Since any centralized definition of these needs is unlikely to accurately forecast unit needs, the capacity for units to reallocate makes flexibility a reality at the local level. Local managers also carry the responsibility to meet budgets. Both reserve funds or deficits can, and are, carried over if a unit under- or overspends its budget—thereby ensuring unit accountability. It should be noted, however, that the "theory" of flexibility takes time to materialize; many operating managers schooled in the prior system have been slow to adjust. Until trust and confidence in the new system can be developed, some managers are reluctant to embrace these changes.

Needs for Revisions

Although there is widespread support for these changes in the relationships between higher education and the legislature, selected revisions in the MOU agreement have been suggested.

Inclusion in the State Personnel System

One of the key areas of concern stems from the inclusion of the bulk of staff (exclusive of faculty and top administrators) within the state personnel system. Including staff in the state system deprives the University of the flexibility to establish pay scales and appointment terms, and the capacity to mandate selected furloughs and leaves. The University is responsible for paying state-mandated wage scales without the state facing a comparable mandate to cover these costs—an uneasy position at best.

Inclusion in the State Purchasing System

Although this area is of much lesser concern than the inclusion in the state personnel system, it is not clear that the University has benefited by forced participation in the state purchasing system. In many cases the University could acquire materials more efficiently and less expensively outside this system.

Re-examination of Adequacy of State Support

Another revision relates to the adequacy of support provided by the state in the current formula to each institutional sector. The state government in Colorado operates under spending limitations which restrict the rate of annual growth in the state budget to seven percent, regardless of other considerations, such as the level of demographic or economic growth in the state or the level of inflation. The potential budget strains created by this limitation in times of high growth or inflation are clear.

The level of state support for the University was initially established at the existing per *resident* student average, with subsequent adjustments for inflation (as determined by the state's capacity to meet these price changes) and enrollment growth. Comparisons of per student expenditures at Colorado's public institutions with similar institutions elsewhere show major deficiencies in operating support—in most cases, funding is 20-40 percent less. In addition, since program changes do not affect the level of state support, greater emphasis on graduate education or capital intensive forms of education, such as engineering or the sciences, is *not* encouraged by the current formula. Instead, incentives for greater enrollments in low cost disciplines and at the lower division level are encouraged. Some adjustment is needed to redress these incentives and thereby ensure that state priorities are met.

Average Versus Marginal Funding

As currently practiced, enrollment increases or decreases result in support changes based on average FTE student allocations rather than marginal increments (decrements). The disadvantages of such funding strategies, particularly to institutions which are losing enrollment, have been widely discussed in the higher education community. Although the University of Colorado continues to experience high and growing demand, other institutions in the state have not been as fortunate.

Addressing Special Needs

The MOU explicitly excluded the option of special requests, with the exception of capital construction projects, which continue to be considered on an individual basis by the legislature. (Since the state has a seven percent statutory limit on spending, both the operating budget and capital construction budgets must be financed within this limit.) Although some needs can probably be accommodated through the reallocations permitted by flexibility, others may be too large to address successfully and, at the same time, too important to ignore. For example, the depreciation of physical assets was not adequately addressed before flexibility, nor has it been dealt with effectively since the MOU. Selected members of the legislature are proposing support for special needs, such as one effort to create an Electronics Institute to encourage further economic development of related industries in the state.

Politically Sensitive Issues

The Memorandum of Understanding is an agreement which has to be renewed annually with the legislature in Colorado. Because this agreement is not a permanent arrangement (as in some states), a number of specific "sensitive" issues could endanger or alter the agreement.

The delegation of tuition-setting authority to the institutions has been a source of subsequent legislative concern. Tuition operates as the key incentive lever for greater state appropriations, with the institutions explicity identifying larger tuition increases as the tradeoff when state appropriation increases of a specific level are not forthcoming. Some legislators feel that tuition increases have been too great. Because tuition-setting has a wide range of consequences for the institutions—academic, fiscal, market—a return of this authority to the state would be a major loss, particularly at this time when the demographics are shifting dramatically.

A second area of sensitivity relates to the disposition of the legislature to ignore important cost developments in establishing the level of state support—thereby raising the general issue of the *quid pro quo* for flexibility. A prominent example is the salaries for classified staff, which are established by state statute and are outside the purview of institutional decision making. Utilities' charges also fall into this category. The institutions are concerned that state appropriation increases will not reflect changes in these basic cost components. The legislature, however, is in no way mandated to recognize these cost developments.

A third area of sensitivity is that confronted by the University of Colorado in its role as resource allocator among the campuses within its system. The responsibility for budget decisions related to faculty salaries, tuition levels, and intercampus allocation of funds now clearly resides with the University's Board of Regents and its chief administrative officers. The intercampus issues have been highly charged to date, and continue to present difficult management choices as two developing campuses attempt to make claims against funds at the more established campuses.

A final area of vulnerability relates to the united posture of higher education institutions, both in support of flexibility and the successful carrying out of responsibilities for balanced budgets. To date, this posture has been intact. If enrollment shortfalls are particularly difficult at a set of institutions, or if management practices do not show fiscal returns, this balance may be undercut.

Concluding Comments

The initial year of "flexibility" in state-institutional financing practices in Colorado was one of high inflation and constrained state finances. Still, a range of cost-saving and income-increasing changes in the first year of its operation produced a number of program enhancements, such as funds for junior faculty research, teaching bonuses, and equipment improvement. And, during the second year, when state revenue shortfalls were encountered, flexibility proved a valuable "smoothing" mechanism to ameliorate these downward adjustments in state appropriations. The major effects of this change in responsibility have been a selected number of program enhancements and improved efficiency in the operation of the university; greater sensitivity in pricing mechanisms to a variety of academic, market, and other needs; key incentives for income generation; and the opportunity for operating managers (deans, directors, department chairs, and faculty) to use their funds for the highest priority needs. Although the timing of these changes dovetails with difficult economic times, administrators at the University of Colorado would clearly endorse these changes and attribute a greater capacity to deal with these economic difficulties in ways that are less damaging to the academic program and objectives of the University. The adoption of flexibility has led to the coupling of conservative budgeting/financing procedures with the introduction of new academic policies to improve the quality of the University.

At the same time, it is important to recognize that changes in budgetary procedures can go only so far in contributing to improvements at an institution. A series of non-financial developments is a necessary and important complement to such financial shifts, and clearly have been more significant in creating a basis for change within the institution. This University has underway a concerted effort of significant program review, recently has made major revisions to its tenure procedures, is developing a more sophisticated and consultative process of academic and financial policy-setting, and has experienced a number of important management changes. Combined, these factors are more significant in defining the future of the University than the introduction of flexibility alone can accomplish. Budget flexibility, however, has been essential in contributing to the University's ability to implement changes identified through academic review and policy development.