Smoothing the State University Hiring Cycle

By William R. Johnson

To no-one’s surprise, given the deteriorating Virginia state budget situation, University of Virginia budget officials recently warned deans and department heads to prepare for a 7% reduction in their state funding in the current fiscal year, continuing a pattern of cyclical funding that has been a part of University life for decades. Similar actions have and will be taken by administrators at other state universities as state tax revenues continue to falter. Somehow, state universities must do their best with a cyclical revenue stream. But are they doing the best they can? Short of ending the cycles altogether, could state universities and their states handle this revenue cycle in a way that causes less damage to higher education? To focus solely on the issue of the variation in funding, I abstract from the important, but fundamentally distinct, question of the appropriate long-term level of state funding of higher education.

Why are cycles harmful? Can’t universities use the fat years to hire faculty and staff for the lean years, just as a farmer might save some of his extra revenue from good harvest years to tide him over the bad harvest years? Unfortunately, the answer is no; the boom and bust funding cycle is particularly harmful to the operation of a high quality university. It’s like driving a car by alternately slamming on the brake and then flooring the accelerator. Yes, you might get to your destination but both car and passengers would have fared much better had the car been driven steadily at a moderate rate of speed.

A prime example of the costs of this boom-bust funding is faculty hiring. For a department that over the long run will need to hire two or three new faculty members a year (as is the situation in my department, economics, because of faculty turnover and retirements), hiring at a steady pace is far more successful than alternating hiring freezes and hiring frenzies. A perhaps underappreciated fact is how difficult it is to hire good faculty members, and it is especially difficult to hire many new faculty members quickly. A hiring frenzy, when a department tries to hire, say, five or six faculty members in a year, is not only costly in money and faculty time and effort, but the results are often disappointing because it is difficult to find and attract that many high quality scholars in a single year. Our department leaves vacancies unfilled, or hires temporary faculty, rather than compromise on quality but then we are penalized when the inevitable hiring freeze arrives because those temporary hires are the first victims of budget cuts. We could avoid the pain of being severely understaffed in the bad times by compromising on faculty quality and filling every line in the good times. The incentives are not conducive to building an exceptional faculty.

Exacerbating the problem is the fact that our hiring frenzies typically occur when many other state universities are also hiring madly, competing for the same desirable faculty members. So, we are allowed to hire just when it is the most difficult to hire, and we are not allowed to hire in those years when we could be the most successful, because the market is slack. This suggests that a university that could run countercyclically – hire the most when others are hiring the least—would have a great advantage. In fact, many
private universities are able to do this because their revenues are not tied to state budget cycles.

Short of eliminating the revenue cycle, what can states and universities do to soften its effects? First, states can make it possible for state universities to build their own rainy day funds by allowing them to save state funding from one fiscal year to the next. In many states, the political rules now strongly discourage this kind of prudent behavior; state funding must be spent now or it will be lost and next year’s allocation may be cut. Universities might similarly allow their subdivisions, like schools or colleges, to save state funds from one year to the next.

Second, universities should try to build endowment funds that can be used to cushion the state revenue cycle by funding faculty positions with private funds in the bad years and shifting them to state funds in the good years. This is, admittedly, a formidable task. Our university has a substantial ($1.7 billion) endowment, yet very little of that money can be used to compensate for variations in state funding because it has been donated for other purposes. Donors, and the deans and administrators who court them, want to start new programs, build new buildings and make their mark by funding something the university does not have. Universities need to convince donors of the value of unrestricted funds that could be used to temper the state funding cycles in order to preserve what the university already has. The argument is simple: spending steadily over the long run will buy much more quality than the same amount of money spent in fits and starts, buffeted by the state funding cycle. And states need to cooperate too by not penalizing universities that use private funds by reducing their state support. Our administrators are always worried that if we use our own resources to survive a state budget squeeze, the state will reduce the long-run level of funding because we’ve shown we don’t need it.

A third possibility might be to introduce some flexibility into faculty compensation. One reason for hiring freezes is that a large part of a university’s budget is inviolate – irreducible compensation for faculty whose jobs are secure. In private firms, devices like bonuses are used to make compensation more flexible. In the lean years, the bonuses disappear and the cost of employee compensation falls. The more flexible is employee compensation, the less severe is the hiring cycle. A university could introduce some compensation flexibility without terminating faculty or altering salaries by varying its contributions over the cycle to TIAA-CREF, the faculty retirement plan. Reducing the contribution in bad years, while increasing it in good years would give the university a cushion of funds in the lean years to maintain hiring. And a cushion of approximately 10% of faculty payroll could go a long way toward easing the pain of the funding cycle.

Of course, many of my faculty colleagues would be up in arms about any tampering with faculty compensation. Faculty would need safeguards to insure that underpayments in the bad years were indeed made up in the good years. One way to do this is never to let a university be in debt to the faculty. That is, start the system in the good years with an overpayment to TIAA-CREF that can be drawn against in the subsequent bad years by underpayments, but only until the overpayment is “spent”.

However it is accomplished, smoothing the hiring cycle will not only allow state universities to build the quality faculties they aspire to, it should also have a beneficial effect on undergraduate education especially. The boom-bust cycle means overcrowded classes due to understaffing in the lean years and classes taught by temporary faculty or
adjuncts in the fat years. On top of that, a stable hiring regime should help the academic labor market, especially for new PhDs. In the current boom-bust labor market, there is a substantial difference in the career paths of essentially similar PhDs who happen to go “on the market” in different years. Go on the market in a bust year and you are likely to spend the beginning of your academic career in temporary jobs or at a place that is “wrong” for you. While you may eventually get established in a suitable tenure track job, your career has been derailed by the labor market cycle. This uncertainty, in turn, makes pursuit of an academic career even less appealing to bright young adults, depriving academia of the talent it needs to flourish.

The main benefit of reducing hiring cyclicality, however, is efficiency. The taxpayer’s money will buy a substantially better university (whether measured by quality of undergraduate education or research accomplishments), for the same amount of money if that money can be spent more steadily.