How universities became hedge funds

What America can tell Britain about the future of higher education

Bob Samuels

As Britain debates the future of higher education, it might be helpful to understand what has been happening to higher education in the United States. While America is often cited as a model of how to organise universities, a deeper understanding of the American model reveals the destructive effects of the combination of public de-funding with the adoption of a market-based system. In fact, by looking at recent changes at the publicly-funded University of California, we can see how Britain may be heading down a path of inequality, inefficiency, and injustice.

Welcome to the privatised public university

In August 2009, just one month after the state of California cut over a billion dollars from its higher education budget, the University of California (UC) lent the state $200 million (Asimov, 2009). When journalists asked the UC president, Mark Yudof, how the university could lend millions of dollars to the state while the school was raising student tuition fees 32 per cent, furloughing employees, cancelling classes, and laying off teachers, Yudof responded that when the university lends money to the state, it turns a profit, but when it spends money on salaries for teachers, the money is lost.

Welcome to the university as hedge fund. In this strange new world, institutions of higher learning care more about interest rates than educational quality. In fact, Harvard cared so much about reducing the cost of borrowing money that it made several expensive credit default swaps, which resulted in the loss of hundreds of millions of dollars and the halting of an ambitious expansion plan (Groll, 2010). Not only did Harvard gamble on interest rates to support future construction plans, but it moved much of its endowment into high risk investments, and the result is that the world’s wealthiest education institution is now claiming poverty.

Risky business

Like Harvard, the University of California was seduced by the Yale endowment manager, David Swenson, who inspired universities throughout the United States to shift their investments from secure bonds and treasury notes to volatile equities. At first, schools showed high rates of return in their investment and pension portfolios, but when these investments turned south, the universities lost billions of dollars of savings (Humphreys, 2010). In fact, the UC lost over $23 billion dollars in its combined pension and endowment funds, and this loss will take years to recover.
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administrator for every faculty member (UCOP, 2009). Moreover, many administrators pull in huge salaries, and they often bring with them a purely corporate mentality that is in conflict with the stated missions of educational institutions.

Pleasing the bond raters

To support the expansion of research and the increased cost of bureaucracy, universities have to borrow huge sums of money. For example, during its recent financial crisis, the University of California applied for over a billion dollars for construction bonds, and almost all of this debt will go to build new research facilities. In response to these bond applications, Moody’s gave the UC system a high bond rating, which will result in low interest rates, fuelling further borrowing. Moreover, as UC Santa Cruz Professor Bob Meister has revealed, the UC is using student fees and tuition as collateral for its construction bonds (Meister, 2010). In this modified credit swap, students are forced to take out subprime student loans, often charging 6 per cent interest, so that the university can borrow money at a reduced rate.

Not only do the bond raters help to determine the cost of borrowing, but they also tell universities what they should do in order to attain a clean bill of fiscal health. For instance, Moody’s slipped into its bond rating for the UC system the need for the institution to restrain labour costs, increase tuition, diversify revenue streams, feed the money-making sectors, and resist the further unionisation of its employees. Like the IMF or World Bank, the bond raters tie access to credit to the dismantling of the public sector and the adoption of free market fundamentalism.

In the case of the UC system, it appears that President Yudof is taking his marching orders from the bond raters and is doing everything in his expanded powers to feed money into the privatised profitable sectors, while starving the non-revenue generating public areas, like instruction. Yudof’s core values were revealed when he described the fiscal status of the UC system on the PBS News Hour:

Many of our, if I can put it this way, businesses are in good shape. We’re doing very well there. Our hospitals are full, our medical business, our medical research, the patient care. So, we have this core problem: who is going to pay the salary of the English Department? We have to have it. Who’s going to pay it in Sociology, in the humanities? And that’s where we’re running into trouble. (Watson, 2010)

For many people inside and outside of higher education, Yudof’s statement may seem jarring, but for bond raters, his argument makes perfect sense. From a purely financial perspective, there are profitable ventures and unprofitable ones, and only the areas bringing in money should be nourished.

Of course, bond raters have lately been proven to be questionable experts when it comes to predicting the financial health of institutions, and in the case of judging universities, not only do the raters seem to have the wrong values, but they also have the wrong numbers. In contrast to Yudof’s statement, the reality is that it is the humanities and the social sciences that actually subsidise the research centres and not the other way around. Studies have shown that the humanities often educate most of the undergraduate students, and they do this with relatively inexpensive teachers and low overheads (Watson, 2010). In fact, most humanities departments turn a huge profit that is then distributed to support the supposedly profit-making sectors. Since federal and corporate-sponsored grants often fail to cover the full cost of buildings, administration, labs, staff, maintenance,
and utilities, money has to be taken from undergraduates and humanities programmes to subsidise the research sectors.

Marketing academic labour

The twin engines of increased debt and an emphasis on research have fuelled a third new market force, which is the academic free agent system. In order for universities to remain highly ranked, they feel that they must compete for the best faculty, and the best faculty are often defined by how much other schools are willing to pay them. In the UC system, for example, there is an official salary scale, but over 85 per cent of the faculty are now off the scale, and this means that many of them have negotiated private deals with a dean (Simmons, 2006). Not only does this system turn everyone into competitive individualists, but it also circumvents the peer review process that is supposed to be at the heart of the modern democratic university.

In elite private and public universities, many faculty members search for outside offers from competing institutions every year so that they can renegotiate their deals, and these deals not only include higher compensation but also less time in the classroom. One of the results of this system is that the more universities pay star professors, the less teaching they do, and the less loyal they are to the institution. In turn, star faculty, administrators, and coaches hold universities hostage by threatening to go to a competitor. This compensation system has gotten so out-of-hand that, in 2008, there were over 3,600 employees in the UC system making more than $200,000 (Sacramento Bee, 2010).

Marketing enrolment

Mirroring the free market star economy is the market-based enrolment system. Universities now believe that to get the ‘best’ students, they have to offer the best aid packages, and what has happened is that many top universities have moved much of their financial aid from need to merit. One of the problems with this structure is that merit is often based on SAT scores, and SAT scores have been shown to be heavily correlated with wealth. The end result of switching from a need-based to a merit-based financial aid system is that lower- and middle-class students end up subsidising the wealthiest students because in order to give the top students large aid packages, the universities have to raise the tuition on everyone else.

In his book *Tearing Down the Gates*, Peter Sacks has shown that not only do SAT scores predict the wealth of the students’ parents, and not the success the students will have in college, but SAT scores also determine a school’s ranking in the all-powerful *U.S. News & World Report* college guidebook (Sacks, 2009). By accepting students with high SAT scores, universities not only increase their rankings, but they also bring in wealthy students who will help build the schools’ endowments in the future.

The speculative market-based system that universities use to recruit students is coupled with the way these institutions spend lavishly on new facilities to attract potential enrolees. It seems that universities believe that it is easier to please students outside of the classroom rather than inside, so they pour money into new fitness centres, entertainment complexes, sports arenas, restaurants, and shopping malls. Of course, all of these extracurricular activities require expensive new buildings, which require more debt, and more efforts to please the bond raters.

The expansion and revenue diversification of American universities has gotten so out of hand that research universities, like UCLA, now spend less than 5 per cent of their total
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budget on undergraduate instruction (Samuels, 2009). No wonder universities feel free to expand class sizes and hire people off of the street to teach required courses; instruction is just a small part of what these institutions now do. Since there are no accepted methods to judge the quality of undergraduate instruction or learning, there is no incentive for schools to put their resources into educational activities.

Ironically, the lack of educational quality control in higher education results in a continual increase in tuition costs because universities have no incentive to concentrate their efforts and budgets on instruction. Since no one is rating or ranking these schools on what students are learning or how effective the professors are at teaching, these institutions feel free to spend student tuition dollars and state funding on expensive research and bloated bureaucracy. In fact, while most schools insist that students are not paying the full cost of their education, UC Berkeley professor Charles Schwartz has shown that virtually every university inflates the advertised cost of education so that they can constantly raise tuition and use the added income to support profit-making ventures and risky financial investments (Schwartz, 2010).

The Browne response

Given the questionable record of higher education in the United States, it is strange that Britain appears headed to emulate some of the worst aspects of the American model.

For instance, the Browne Report posits that universities need to focus on the student as the consumer of education: ‘students are best placed to make the judgment about what they want to get from participating in higher education’ (Browne, 2010, 25). This consumer-oriented approach appears to be highly democratic, but what it really calls for is a privatisation of a public function. In other words, not only should the student as a private individual be able to decide his or her own education, but the student should also shoulder the burden of most of the cost. Furthermore, in order to attract the best individual students, British universities will likely adopt the free market approach to admissions and financial aid described above.

As the British government continues to reduce its support for HE, students will be asked to pay more, and class divisions will be increased. As students are repositioned as consumers, they will insist on using faulty instruments, like student evaluations, to judge instructors, and this will force faculty members to teach in a defensive manner in fear of hurting the feelings of the student-consumer.

Another likely by-product of this stress on the student-consumer will be the development of popular ranking books that will create an arms race between competing universities. Since universities will have to compete for the best students in order to make sure they stay highly rated, they will be motivated to shift financial aid to the wealthiest students, while they spend more of their money on providing attractive amenities. In turn, by concentrating on pleasing students as consumers, universities will downsize their instructional budgets and increase their spending on extra-curricular activities. Finally, as a cost-cutting measure, online instruction will be embraced under the banner of catering to students and their schedules.

Defending the public

The end result of all of these predictable changes will be an increased public distaste for spending public funds on universities. After all, once a school has been privatised, why should the public pay taxes to support a private good? However, there is an answer to this question, and it involves defending the notion of a public good supported by public funds.
In other words, instead of celebrating the student-consumer and the de-funding of public education, politicians and public officials must redouble their efforts to defend the value of public institutions serving public purposes.

As educators, we must remind the public that the cause of the global fiscal meltdown was the deregulation of the financial markets and the unleashing of private greed. Not only did bankers sell fraudulent mortgages to uninformed homebuyers, but investment banks also gambled huge sums of money on these faulty loans. Now that the bets have not paid off, not only have the big banks and insurers asked governments to pay off their huge gambling debts, but big businesses and corporate-sponsored governments are calling for the reduction of public services and a global decrease in support for education. In response to these calls for the privatisation of the public realm, we should demand that the private realm pay for its de-funding of the public.

Educators should not only defend the public realm. They also need to show that a public education in endangered areas of the humanities and social sciences is essential in order to prevent another global financial meltdown. We need a public that is trained to ask questions and not be suckered into bad loans and manipulative political rhetoric. We also need to educate students to think not only about their own private gain but instead to see the value of shared resources and common values. Yet it is precisely this type of education that is being threatened by a Tory government dedicated to following the worst examples of the American model. By forcing students to pay for their education by deducting part of their salaries after they graduate, students will tend to gravitate towards highly lucrative jobs. It will become less attractive for students to follow careers in essential areas such as education, social welfare, and public advocacy.

Furthermore, if universities can decide how much to charge for tuition, a few elite schools will attract the most prepared and wealthiest students, while the other schools will fight over the rest. In this free market context, the non-elite universities will have to set a low fee rate to attract more students. This will put them on a downward fiscal spiral where the only solution will be to cut costs by reducing the number of full-time faculty and increasing class size and distance learning. Ultimately, if Britain does not reverse course and increase its public funding for public education, it will develop a highly stratified university system mirroring the worst aspects of the US system.

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**References**


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