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ABSTRACT

Pennsylvania State University's early response to declining resources and its current planning and budget process are described. Attention is also directed to the fiscal outcomes of the process over the past 5 years and several of the strategies devised to promote qualitative concerns and respond to variable growth-decline situations. From 1971 to 1976 budget gaps were closed by imposing across-the-board position freezes followed by collapsing vacant positions or reducing their level of funding. Support expenditures also were reduced substantially in such areas as travel, telephones, equipment, and wages. It was determined that future budget reductions must result from careful long-range planning, focusing on the central needs of the university's academic and administrative units. The planning and budget process that was initiated in 1977 used selective reductions and reallocations and evolved into a rolling 5-year process. The key elements of the process include financial projections, recycling assessments, planning questions and data support, responses by individual units, planning and budget hearings, advisory committee deliberations and recommendations to senior officers, and operating budget development. For the program of internal recycling and reallocation (1971-1976), a total of \$11.1 million was pulled back and reallocated primarily for increased costs of operation. Since the rolling 5-year planning and budget process was initiated in 1977, an additional \$14.6 million has been reallocated through 1981. Recommendations and the following funding mechanisms to support quality are considered: the Provost's Revolving Fund, matching concepts for general funds and extramural funds, and private funds. (SW)

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Supporting Quality Through Priority
Setting and Reallocation

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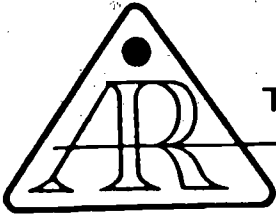
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D. R. Coleman, Chairman
Forum Publication
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ABSTRACT

Following six years of across-the-board internal budget reallocations amounting to \$11.1 million, Penn State initiated a rolling five-year planning and budget process in 1977. The new process, resulting in an additional \$14.5 million in internal reductions and reallocations through 1981-82, was designed to provide for more selective budgetary decisions based on careful analysis of University priorities. As the process has evolved, it has reoriented budget decisions toward University planning issues and qualitative concerns.

SUPPORTING QUALITY THROUGH PRIORITY SETTING AND REALLOCATION

Two recent headlines from The New York Times, calling attention to two extreme circumstances, highlight the financial conditions of higher education in 1982:

"Waves of Economic Change Batter Flagship of Universities in Michigan"

"Texas A & M, Riding a Boom, Seeks Stature to Match its Wealth".

We expect that most participants in this Forum are not strangers to these economic trends, but that more of you are confronted at your institutions by a situation more comparable to the Michigan than the Texas scenario.

The prospect of financial decline did not go unnoticed as the expansion of the 1960s slowed down. Cheit (1971) reported on a survey of financial conditions at 41 institutions and observed that by the late 1960s many of the institutions studied were already experiencing a declining rate of income growth and in some instances an absolute decline in income. A decade later, the financial conditions which may have seemed so limited in scope in 1971 are now prominent in many institutions. Recent publications, for example Surviving the Eighties (Mayhew, 1979), "Management of Decline" (Boulding, 1975), and The Three "R's" of the Eighties: Reduction, Reallocation, and Retrenchment (Mortimer and Tierney, 1979), emphasize the preoccupation with devising mechanisms for dealing with decline.

In his earlier study, Cheit asked administrators to recommend solutions for improving their institution's financial conditions. Administrators at the universities in his sample (17, 8 public) collectively offered the following: 1) increase federal aid; 2) increase student aid; 3) broaden the revenue base for state support; 4) find additional private funds; and 5) improve internal operations. The economic and political

environment of 1982 proffers little encouragement for the first three solutions cited. Many institutions already have reorganized their development offices and substantially increased fund-raising activities. Regardless of the success of these efforts, at least in the case of public universities, private gifts, even in substantial amounts, are not likely to offset declining institutional income for general funds operations. This leaves most institutions with one remaining option--devising effective administrative machinery.

In developing improved internal mechanisms, at least two factors need to be addressed. The first is the need to integrate academic planning and budgeting (Micek, 1980). If decisions are to deal with critical budgetary constraints on the one hand, while responding on the other to qualitative programmatic concerns, planning issues must be addressed along with budgetary considerations. Second, the decision processes must take into account that while the institution may be experiencing overall decline in real income, other factors, e.g., enrollments, may be increasing; the fiscal and enrollment experiences of individual units within the institution may vary still further, so that the institution is responding to dramatic conditions of growth and decline concurrently (Hills and Mahoney, 1978 and Salancik and Pfeffer, 1974).

Response to both of these factors--the affinity of planning and budgeting and the paradox of simultaneous growth and decline--contributed to the structure of the decision-making process which was instituted at Penn State in 1977. The initiation of this process was followed by the development of a long-range planning document (Perspective, 1980) in which three pervasive themes were adopted as Penn State's objectives for the decade of the '80s--maintaining quality through an emphasis on selectivity

and flexibility. Following a brief discussion of Penn State's early response to declining resources, we will describe the University's current planning and budget process, summarize the fiscal outcomes of the process over the past five years, and describe several of the particular strategies devised to promote qualitative concerns and respond to variable growth-decline situations. The paper concludes with an assessment of the process' achievements and shortcomings, with recommendations for others considering implementing a planning and budgeting process.

EARLY RESPONSES

Like many public universities, increases in Penn State's annual state appropriation have not kept pace with inflation over the past ten years. Inflation has increased 92 percent, while appropriations are up only 60 percent. At the same time, Penn State's annual tuition rate, among the highest of all land-grant universities at over \$1800, has increased 116 percent (see Figure 1). State and federally mandated changes in retirement and social security costs have amounted to a 241 percent increase over the same period. Group hospitalization and medical insurance costs have escalated by over 69 percent in the last two years alone. As a result, Penn State has experienced yearly gaps between estimated income and expense too large to cover entirely by increases in tuition.

From 1971 to 1976, these budget gaps were closed by imposing across-the-board position freezes followed by collapsing vacant positions or reducing their level of funding. In accord with responses at many institutions (Melchiori, 1982), support expenditures also were reduced substantially in such areas as travel, telephones, equipment, and wages. These early

reductions were substantial, but they were not based in any systematic way on program considerations.

THE FIVE-YEAR PLANNING AND BUDGET PROCESS

In 1977, the President and his advisors recognized that continuation of across-the-board budget reductions would be detrimental to many of the University's most important programs. While the total enrollments continued to grow moderately during the last half of the 1970's, the phenomenon of simultaneous rapid growth and decline among individual units was well underway, and it simply made no sense to continue to assess the same level of budget reductions, for example, to the College of Engineering and the College of Education. It was determined that future budget reductions must be differentially applied and must come through careful long-range planning, focusing on the central needs of the University's academic and administrative units, in order to minimize any further erosion of quality programs.

Currently, Penn State's two most critical planning problems are:

1) a base level of state support which is not sufficient to provide the breadth and quality of services expected by the citizens of the Commonwealth; and 2) a mismatch between changing student interests and curricular demands on the one hand, and the placement of faculty members, laboratories, and equipment on the other. The planning and budget process that was initiated in 1977 was designed to make the best use of the University's scarce resources through selective reductions and reallocations. What has evolved is a rolling five-year process which today serves as the major programmatic component of Penn State's planning and budgeting cycle. This cycle is diagrammed in Figure 2.

The planning and budget process consists of several highly related stages which are evolving continually as we attempt to improve both the process and the decisions that emerge. The key elements of the process include:

Financial Projections

The first element in the planning and budget process is a projection of the University's financial picture over a five-year time horizon. Estimates of state appropriation support and tuition income levels, including anticipated enrollment and tuition rates, are the primary factors on the income side. Salary and fringe benefit levels, including numbers of personnel and anticipated salary and benefits increases, provide the primary factors on the expense side. Planned program changes and expected cost increases for supplies and services also are considered. From these projections, an estimated "gap" between anticipated income and planned expenditures is identified for each of the next five years.

Recycling Assessments

The budget gaps for each of the five years are used to establish overall yearly "recycling targets," or the total amounts to be pulled back from operating budgets for reallocation to areas of greater priority or need. The President begins by breaking these targets down and assigning to the University's senior vice presidents amounts for which their respective units will be held responsible each year. The senior vice presidents, in turn, break down their total targets by assigning "recycling shares" to their respective academic and administrative divisions. These shares are assigned on the basis of judgements on program quality, need, centrality of mission, effectiveness of management, demand, productivity, and costs.

Planning Questions and Data Support

Each year planning questions are developed for each academic and administrative unit. These questions are unit-specific, and range from the use of previously allocated funds to the future program priorities of the administrative officer, and from general concerns about enrollment projections or faculty staffing patterns to very specific questions about individual programs.

At the same time, data packages containing current and historical program and performance indicators are prepared and distributed to all academic units. Included are data on enrollment and degree production trends, research support, credit hours, unit and program costs, and faculty tenure and rank distributions.

Responses by Individual Units

The dean or administrative officer consults extensively with faculty and staff members at the department and division levels in both academic and non-academic units to consider their planning directions and budgetary needs for the ensuing fiscal year and the four "out-years." Each unit is responsible for devising a plan for complying with the budgetary assessments and for developing appropriate responses to the planning questions. Units may also request and justify reduction of the assigned assessments and, in some cases, the infusion of new resources.

Planning and Budget Hearings

The senior vice presidents conduct planning and budget hearings with each academic and non-academic unit reporting to them. Each senior officer has a planning and budget advisory committee which assists in the hearing process. The purpose of these hearings is to review unit five-year plans

for accommodating assigned recycling shares and to discuss the unit's presentation on the specific issues posed in the planning and budget questions. The results increasingly are open and frank discussions on important long-range planning issues.

Advisory Committee Deliberations and Recommendations to Senior Officers

Following the hearings the advisory committees, chaired by the respective senior officers, discuss at length the proposals of each unit to help the senior officer formulate recommendations on planning issues and funding recommendations. Included are evaluative comments and possible direction to be given to the individual unit heads by the senior officers regarding their five-year plans.

Equally important are the discussions on University-wide issues and priorities. Each unit is considered in the context of the whole, with specific recommendations on priorities being the result. These recommendations frequently will transcend organizational boundaries, such as placing a high priority on academic equipment replacement, supporting the University Libraries, promoting graduate education, or upgrading major maintenance activities.

Operating Budget Development

From the advisory committee discussions, the senior officers present their respective planning and budget recommendations to the President and the Budget Task Force (the President's budget advisory committee, chaired by the President and consisting of the four senior officers, the Controller, and the Director of Planning and Budget). With the budgetary recommendations from the senior officers in hand, the President and the Budget Task Force consider priorities and program needs and recycling and reallo-

cations among the major academic and administrative divisions of the University. These are also considered in the context of State appropriation and tuition levels and the ever-competing needs for salaries, benefits, and mandated cost increases such as fuel and utilities and other supplies and services. Final recommendations on the proposed operating budget for the next fiscal year are approved by the President and submitted to the Board of Trustees.

Following the final budget decisions, the senior officers hold follow-up discussions and evaluations with each dean and administrative officer to inform him or her of decisions regarding budgetary allocations, recycling shares, and planning concerns and directions for the next five years.

FISCAL OUTCOMES OF THE PROCESS

For the first five years of our program of internal recycling and reallocation (1971-1976), a total of \$11.1 million was pulled back and reallocated primarily for increased costs of operation such as salary and benefits cost increases and increases in the costs of fuel, utilities, and others supplies and services (see Table 1). Since the rolling five-year planning and budget process was initiated in 1977, an additional \$14.6 million has been reallocated through 1981, bringing the ten-year total to \$25.7 million. An increasing portion of the reallocated funds has been used in direct support of high priority program needs, with mandated cost increases coming from other funds. Of the total reallocated, approximately one-third has come from the budgets of academic units, and two-thirds from academic support and non-academic budgets.

One of the important considerations in modifying previous budget cutting mechanisms and instituting the rolling planning and budget process.

was to differentiate between areas of growth and decline. For the past five years, the average cut for all academic units was about 4.7 percent. However, the range of budget decisions has varied widely from an absolute increase in funds of over 20 percent to a cut of 12.5 percent. Similarly, in the non-academic areas changes have ranged from modest increases to a cut of over 14 percent. (These amounts are independent of permanent allocations for salary and fringe benefits increases.) Genuine differentiations among colleges and among other units are being made through this reallocation process.

The next five years promise to bring even further differentiation among units. The current plan, with tentative recycling targets in place through 1985-86, will add additional recycling shares ranging from 1.4 percent to 13.1 percent to the differential cuts already made. Beginning in 1984-85, the recycling shares for individual units are assigned in the form of ranges to provide even more central planning flexibility. The ranges for a given year will be narrowed as that year approaches to enable the unit head to plan effectively for the budget reduction.

FUNDING MECHANISMS TO SUPPORT QUALITY

The first and perhaps most fundamental of Penn State's three objectives for the '80s is "quality" (Perspective, 1980, pp. 4-6). In an era of increasingly scarce resources, preserving existing quality programs and achieving excellence in others with high potential are formidable tasks indeed. It has become apparent through the evolution of the five-year planning and budget process that innovative funding approaches are required to be sure that qualitative issues are being addressed. Some examples

of the new allocation techniques that have been used during the last several years include:

Provost's Revolving Fund

For many years, the University has maintained a fund ranging from \$200,000 to \$500,000 to respond to short-term teaching workload needs. These needs are identified at or shortly before registration, when student demand for a particular class section exceeds available faculty resources. With the major and rapid shifts in student preferences for programs, however, it was clear that some funding mechanism was needed for medium-range considerations. The Provost's Revolving Fund, currently budgeted at \$1,000,000, was established to permit some flexibility of resources to swing in response to changing needs. Commitments of temporary funds can be made for one to three years. To date, most of these funds have been used to hire faculty members on temporary appointments to respond to heavy enrollment pressures in such areas as engineering, business administration, and computer science. Class sizes in these areas were increasing dramatically and program quality would have been affected adversely without funds to hire additional faculty. After the initial commitment has expired, several options exist: (a) funds can be withdrawn if enrollment pressures have subsided, (b) the commitment can be renewed for an additional period of from one to three years, or (c) the unit can be considered for permanent funding if the enrollment pressures prove to be long-term in nature.

Other qualitative issues have been addressed by the Revolving Fund. For example, funds have been provided to promote curricular reassessment and revision. Courses for a non-major option and the redesign of the core courses for majors was accomplished by the College of Business Administration through Revolving Fund monies provided for this purpose. The fund

also has been used to stimulate research and faculty development in areas where research had suffered from the work-load generated by severe enrollment pressures, i.e., engineering and business administration. Research grants and contracts in the College of Engineering have increased dramatically since these temporary funds were allocated.

The "Matching" Concept - General Funds

The recycling shares assigned to all units provide a unique opportunity for reallocation, even when it is not possible or desirable ultimately to withdraw the funds from the unit. Difficult decision making on the part of the dean or administrative officer can be supported and encouraged by selective reduction of assigned recycling amounts. In the planning and budget response, the unit presents a plan for meeting the recycling target, thereby identifying the weaker programs or softer areas of the budget. Frequently, a unit also will ask for full or partial relief of the target to be reassigned to a higher priority program or purpose within the unit. By agreeing to such a target reduction, the University has accomplished budgetary reallocation within the unit. This can contribute to the overall goal of reallocation of funds to areas of higher priority or need just as much as a transfer of funds among units.

For units which are more reticent to propose internal reallocation, this approach can be extended by use of "matching" sums for target reduction. The target is reduced by some amount if and only if the unit head "matches" it by an agreed upon amount for reallocation for the desired purpose. This has the effect of increasing the recycling share while retaining the original funds for higher priority use within the unit. One dean wrote the Provost in response to this matching approach:

"This method of handling fiscal recycling is one of the most imaginative ways of asking administrators to reduce their budgets that I have encountered. It forces academic focusing when that effort is so clearly necessary. No one likes to cut back, but at least this retrenchment makes academic sense." At the same time, concern has been expressed regarding the timing of the matching concept offer. Sufficient lead time is necessary for the dean to plan for both the further reductions in one area and the infusion of funds in another.

The "Matching" Concept - Extra-mural Funds

Matching funds can be used effectively as an incentive for external fund raising. For example, the Matching Equipment Fund was established to encourage departments, colleges, and research institutes to seek outside sources for research and instructional equipment. Matching sums are guaranteed if contributions are received within an agreed upon period of time, e.g., 24 months.

The matching concept also can provide encouragement for capital fund-raising. Funds from capital accounts can be promised as a partial match for funds raised from outside sources. This provides an incentive for the unit conducting the fund drive, and it also aids fund raising by demonstrating the institution's commitment to the project. Two badly needed facilities at our Behrend College and Capitol Campus are on the drawing boards and nearly funded using this approach. A lesser investment of institutional resources can be successful in other instances. The promise of equipping and operating a facility can provide similar incentives for fund-raising. We now are operating buildings at several of our campuses as the successful result of this approach.

Private Funds to Support Quality

We stated earlier that, in the case of public universities, private gifts are not likely to take up the slack in declining income for general funds operations. The judicious use of gift funds can, however, have a salutary effect on the margin in the institution's attempt to preserve and enhance quality. For example, Penn State has used both committed and undesignated gift funds to establish the Fund for Academic Excellence. Among the most successful activities supported by this fund are selected external program reviews. Several departments in our College of Science, for example, have benefitted substantially from these reviews during the last two years. Instructional improvement grants, which support released time for faculty members to develop new approaches and updated materials for selected lower division courses, will be funded this year. Other activities supported by the Fund are the University's honor programs, interdisciplinary programs, lectures, seminars, and intensive summer language programs.

CONCLUSIONS

At this writing, we have just concluded the sixth year using the rolling five-year planning and budget process. The process has not been static, but rather has evolved continually. The most notable change is embodied in a statement made to the University Faculty Senate by a faculty member who served for three years on the Provost's Advisory Committee for Planning and Budget: "The most interesting evolution of this committee has been its shift from a committee primarily interested in [the details of] budget and budget reallocation to a committee that concerns itself with the widest possible range of planning [and budget] problems."

As this faculty member implied, the first year or two of the process focused mostly on budgetary considerations. As a recognition of fiscal constraints became more uniformly acknowledged, the focus of the process was able to shift toward planning issues which would affect budget decisions. Ultimately, program considerations and changing academic directions must be linked to available resources, and in recent years these priority considerations have benefitted from full and open discussion with deans and administrative officers through hearings with the various advisory committees. Greater efforts have also been made to provide the advisory committees the opportunity to discuss priorities rather explicitly, while providing the University provost and senior vice presidents maximum flexibility to introduce other judgements into their final resource allocation recommendations. The Provost observed to the Board of Trustees that, "We are [now] pulling planning together with the allocation of funds and not making them two different approaches which have no relationship to each other."

When the process was begun, it effectively applied only to the academic areas. Although substantial sums were being withdrawn from non-academic budgets, these decisions were being made almost solely at the executive level. Hearings are now conducted by the senior vice presidents for finance and operations and for administration and the provost of the medical center, as well as the provost of the University, with planning questions developed by the senior officers in conjunction with the Office of Planning and Budget for each major administrative unit. It is at these hearings that the impact of reduced funding for non-academic units is discussed. Proposals for cutting services or for instituting new charges for services are evaluated carefully before concrete recommendations are

made to the President and the Budget Task Force. Extension of the hearing process to all administrative areas has improved internal recognition of the process and promoted a better understanding of the planning issues confronting all units of the University.

The five-year planning and budget process by no means offers easy answers to real decline in resources. Over the past ten years, 10 percent of the University's general funds operating budget has been reallocated. The "fat" has been removed from the budget, and further cuts would likely lead to a real erosion of quality if decisions about eliminating entire programs are not considered. In many respects, the amounts which have been reallocated to date have been on the margin. We have been able to meet the recycling of positions largely through attrition.

Enrollment decline is more difficult to respond to than enrollment growth. Hence, budgets and corresponding faculty FTE's have not declined at the same rate as enrollments. Although permanent allocations and creative use of the Provost's Revolving Funds have permitted timely and substantial infusions of funds for responding to dramatic enrollment increases in some areas, funds from declining areas have not been made available as rapidly as might be desirable.

It is ironic that we find ourselves in a position similar to that which begat the current planning and budget process in 1977. There is a strong perception that we cannot continue indefinitely to recycle funds, even on a differential basis, without unacceptable erosion of program quality. There is a critical need for dramatic program reassessment and change involving both substantial reductions and closures. We seem to be at a crossroads in our planning activities. The process has served us well, and the current recycling approach will continue to be effective for a few

more years. We recognize, however, that we will need a slightly different approach to our long range planning for the second half of the '80s, and we are actively seeking these new directions. We believe that the planning process that has evolved over the last six years will accommodate future modifications, and that the necessary planning mechanisms are in place and working effectively. A more significant budgetary crisis precipitated by a statewide revenue shortfall also could provide the impetus for determining our new direction. Nevertheless, the information gleaned from our current process will be invaluable in meeting any crisis. The University's decision makers are confident that as a result of six years of planning, they are in a much better position to make rational and informed decisions.

RECOMMENDATIONS

Penn State's planning and budget process is a reflection of the University's organizational structure and the people who function within it. We do not suggest that it be lifted and superimposed on another college or university. It is also not the definitive solution to resolving the difficult financial issues confronting university presidents and other administrators during the 1980s. Our primary recommendation to other institutions is, however, that if one does not already exist, a formal process should be devised and institutionalized. Decisions are more acceptable when there is a perception that they are based on structured proposals, extensive consultation and deliberation, and integrated judgments.

There are other benefits to be derived from a formal process:

- 1) It can provide an effective mechanism for the planned, orderly reallocation of resources. This can be extremely important in solving problems of simultaneous enrollment growth and decline as well as helping to meet anticipated income shortfalls.
- 2) It can encourage and stimulate the integration of planning into the budgeting cycle. A desirable result is that administrators, academic administrators, faculty and staff members become part of the planning process. Be sure that your president and senior officers support the process both intellectually and practically. This does not imply that other judgements should not be brought to bear as decisions are reached, but without an executive commitment, the correlation between process and decisions will be low.
- 3) It can produce decisions that will be forward looking, not based solely on current conditions, but also supportive of the institution's long-range strategic plan. The process can provide benchmarks for assessing and monitoring progress toward meeting the desired goals and objectives.
- 4) The process can be used to promote a greater institutional self-awareness. This does not mean solely numerically based information systems, although such systems are essential. We are also talking about a greater understanding of unit and program strengths and weaknesses, and identification of desirable directions for selectively promoting those areas of the University for which continued strong commitment must be made. The process increases substantially the number of persons aware of what these directions should be. K

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Table 1
The Pennsylvania State University
Summary of Internal Reallocations
1971-72 Through 1981-82

Year	TOTAL	ACADEMIC BUDGETS		NON-ACADEMIC BUDGETS			
	Amount	Amount	%	Operating Budgets	Central Budgets	Total Non-Academic	%
1971-72	\$ 2 489 000	\$ 1 468 000	59.0	\$ 1 021 000	\$ -	\$ 1 021 000	41.0
1973-74	2 914 000	1 467 000	50.3	1 447 000	-	1 447 000	49.7
1974-75	1 761 000	122 000	6.9	962 000	677 000	1 639 000	93.1
1975-76	2 547 000	1 180 000	46.3	1 367 000	-	1 367 000	53.7
1976-77	1 388 000	-	-	-	1 388 000	1 388 000	100.0
Sub-Total	11 099 000	4 237 000	38.2	4 797 000	2 065 000	6 862 000	61.8
1977-78	5 423 000	968 000	17.9	2 593 000	1 862 000	4 455 000	82.1
1978-79	2 188 000	668 000	30.5	1 017 000	503 000	1 520 000	69.5
1979-80	2 559 000	871 000	34.0	1 073 000	615 000	1 688 000	66.0
1980-81	2 194 000	659 000	30.0	725 000	810 000	1 535 000	70.0
1981-82	2 236 000	1 137 000	50.9	731 000	368 000	1 099 000	49.1
Sub-Total	14 600 000	4 303 000	29.5	6 139 000	4 158 000	10 297 000	70.5
TOTAL	\$25 699 000	\$ 8 540 000	33.2	\$10 936 000	\$ 6 223 000	\$17 159 000	66.8

Figure 1

PERCENT CHANGE IN TUITION,
INFLATION, AND APPROPRIATION
SINCE 1972-73

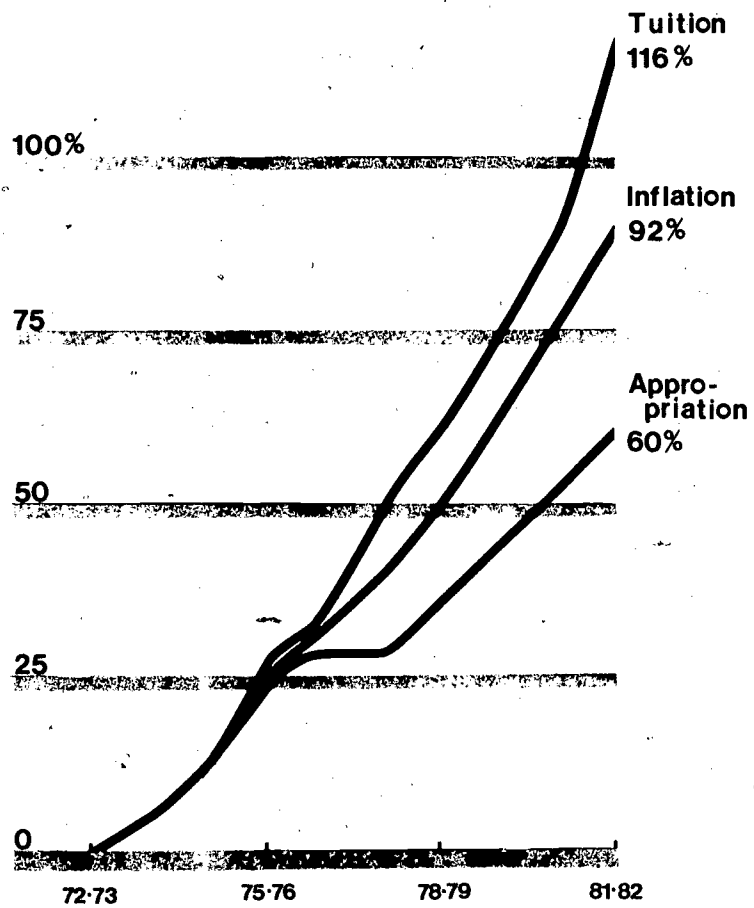
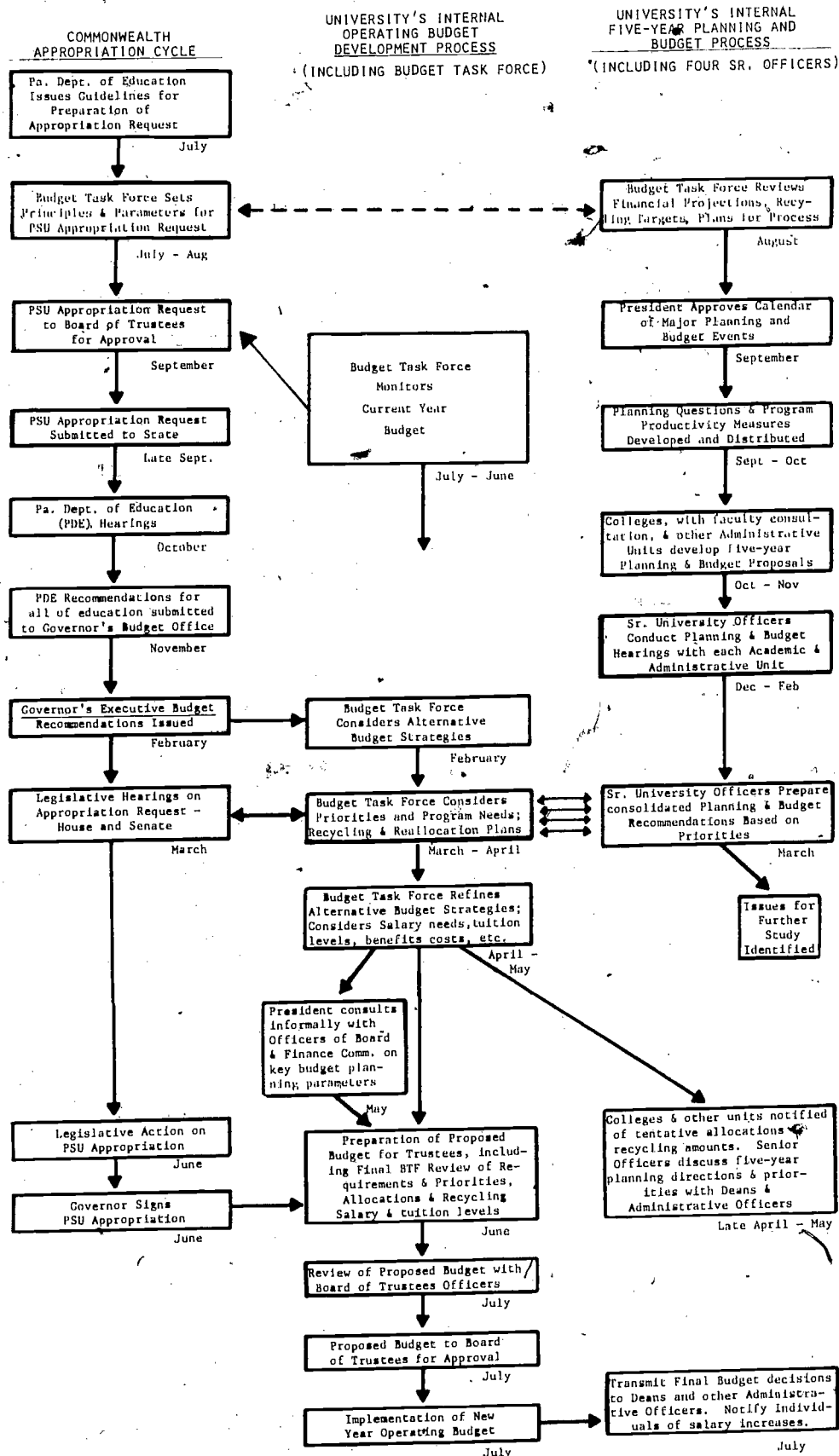


Figure 2

PENN STATE'S PLANNING AND BUDGETING PROCESS



OPB/Budget
7/1/81