After the Boom

After a decade of explosive expansion for Harvard’s two fastest-growing schools, one faces a deficit and is cutting costs, while the other has hired a consulting firm to analyze its finances.

The Kennedy School of Government (KSG), whose revenues grew at a 9.4 percent annual rate from 1991 through 2001, began trimming its budget for the 2001-2002 fiscal year to avoid a projected $2.9-million shortfall—an amount equal to 2.6 percent of its planned spending. In the last five years, the KSG has increased the size of its faculty by 38 percent, and the number of citations of faculty members’ work in scholarly journals—a common measure of academic excellence—tripled: both achievements that Dean Joseph S. Nye Jr. cites proudly. He has nevertheless had to institute a number of “belt-tightening measures,” including the closing of the school’s Washington, D.C., offices, which had been used for research by students and faculty, for alumni gatherings, and as a “way to get our ideas into Washington policy circles,” says Nye. “This was too expensive. We are going to have to find other ways to accomplish the same goal.”

Like the Kennedy School, the School of Public Health (SPH) has more than doubled in size in the last decade, with 78 percent annual revenue growth. But the school relies on outside revenue for most of its income, and so, given the high probability of a funding slowdown, SPH has hired Boston Consulting Group (BCG) to develop strategies for handling such an event.

Both schools have relatively small endowments, and must therefore lean heavily on so-called “soft money”—sponsored revenue and gifts—to support their research activities (SPH relies on sponsored revenue for a staggering 73 percent of its income).

Beyond the unpredictability of such funds lies a further risk: soft money that comes from nonfederal sources often restricts recovery of “indirect costs”—the price of laboratory or office space and administrative overhead. Whenever a school accepts a gift that doesn’t allow full recovery of indirect costs, that drains other sources of income, such as endowment.

Federally sponsored research, on the other hand, allows recovery of most indirect costs. Of every federal dollar, says vice president for finance Elizabeth C. Huidekoper, “about 70 cents goes to direct research, 20 cents pays for space (laboratories or offices), and 10 percent pays for administrative costs.”

The volume of nonfederal sponsored research has almost quintupled at the KSG, rising from $5 million in 1991 to $23 million in 2001, while federally sponsored research has little more than doubled, from $3.1 million to $7 million. “We have two missions,” says Nye. “One is to train public leaders, and the other is to do research that contributes to the solution of public problems. Since we are in the business of providing public goods, if somebody offers us a grant for research that is directly on the mission, we feel a strong desire to do it—but we can only subsidize what fits within our budget.” He cites as an example accepting a gift that brought Russian generals to the school. “Getting these people to have a broader view of the world was very much in accordance with our mission,” says Nye, “and we decided we would do it even if we couldn’t fully recover all the overheads from the foundation grant.”

But such subsidization must slow, because growth in Harvard’s distributions of endowment income will soon drop dramatically. University-wide, the payout has risen as much as 28 percent in a recent year, but for the fiscal year beginning July 1, it will increase a mere 2 percent.

Because the School of Public Health receives a smaller proportion of its revenue from endowment distribution than any other school (12 percent versus 41 percent for Arts and Sciences and up to 62 percent for the Divinity School), it has real concerns about covering the actual costs, including overhead, of carrying out its expansive research activities. Incredibly, until last year, SPH had no endowed professorships in either of its two core disciplines, epidemiology and biostatistics. (There is now the newly endowed Robin and Mitchell Dong chair in epidemiology.) Any limits on its already meager discretionary funds have a tremendous impact on the ability to take on new initiatives and meet new health needs, says Dean Barry R. Bloom. He credits the large volume of grants secured by SPH—which are awarded on a competitive basis—to the “entrepreneurship of the faculty” and “their excellence in their fields.” But Bloom is concerned because most of the funds comes from the National Institutes of Health (NIH)—and a period of bipartisan congressional support for doubling the NIH budget may be coming to an end. The Office of Management and Budget’s recommended increase for 2004 itself is just 2 percent—less than inflation. BCG’s analysis of the school’s finances showed that income from endowment and gifts was vital to the research and teaching mission, and critical for keeping its budget in balance, but confirmed that the school actually loses money on gifts that don’t pay the full cost of research.

Noting the excellence of its students, and the fact that the director-general of the World Health Organization and four of the last five directors of the Centers for Disease Control are alumni, Bloom is nevertheless concerned about the school’s inability to compete for some students due to limited financial-aid funds. “It may come as a surprise to those who take pride in need-blind admissions at Harvard College to learn that fewer than 50 percent of the school’s students get scholarships, and those scholarships pay for only 55 percent of tuition costs on average, and nothing for living expenses in Boston,” he notes. “If we want to attract the best students, particularly from disadvantaged backgrounds and developing countries where the needs are enormous, raising more endowment will be a high priority.” Bloom is blunt about the challenge. “Without resources for retaining our best young faculty and training future leaders in international health, we will not fulfill our goal of being the public health school to the nation and the world.”