JOHN HARVARD'S JOURNAL

AL GORE '69, LL.D. '94, filled Tercentenary Theatre on October 22 when he spoke about sustainability. Noting that the impressive turnout on a raw fall day—free soup, cider, and apple crisp notwithstanding—indicated "deep and broad commitment to addressing this issue," Gore said, "There is an African proverb that says, 'If you want to go quickly, go alone. If you want to go far, go together.' We have to go far, quickly." For more on Gore's visit, see page 58.

Harder Times

Abruptly, the financial challenges facing Harvard—whose programs, people, and physical plant have prospered from the seven-fold-plus appreciation of the endowment in the past 15 years—have attracted urgent attention. Late on December 2, the University posted a memorandum from President Drew Faust and Executive Vice President Ed Forst stating that the endowment's value had declined 22 percent through October 31. Moreover, "even that sobering figure is unlikely to capture the full extent of actual losses for this period, because it does not reflect fully updated valuations" for certain classes of assets, "most notably private equity and real estate." Those assets, managed externally, are valued in pe-

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Photographs by Justin Ide/Harvard News Office riodic reports to Harvard Management Company (HMC); the expectation is that "the endowment will realize further declines in value" there.

The numbers may seem abstract, but their consequences are real. The endowment was valued at $36.9 billion last June 30, at the end of fiscal year 2008; in that year, Harvard's total revenues were about $3.5 billion, with some $1.2 billion (34.5 percent) from endowment-income distributions. Such distributions are much the largest source of operating revenue today, far outstripping tuition and fee revenues (20 percent), sponsored support for research (19 percent), and other income.

The prospective decline in the endowment is unprecedented. In the past 40 years, the memorandum notes, Harvard's worst investment loss was a negative 12.2 percent return in 1974. Given the extraordinary circumstances, the University's planning envisions a scenario with asset values decreasing 30 percent. Accordingly, Faust and Forst advised deans "not merely to contemplate changes at the margins," but to prepare for significant budget reductions.

The community had been prepared for bad news. On November 10, Faust e-mailed a message announcing that Harvard faced "a period of greater financial constraint." She noted several sources of pressure, particularly the impact of plunging financial markets on the endowment. "[E]ven well-diversified portfolios are experiencing major losses," Faust wrote, citing an external projection of "a 30 percent decline in the value of college and university endowments in the current fiscal year."

Later that day, Faculty of Arts and Sciences dean Michael D. Smith wrote to his colleagues: "The FAS is not unfamiliar with proverbial belt-tightening, but given the current crisis we will need to go significantly further….[W]e must consider budgeting scenarios that significantly reduce our annual operating expenses." That was notice enough to attract a standing-room-only audience to the November 18 faculty meeting.

The arithmetic is sobering. Beyond losses in value from negative investment returns, the endowment will be further reduced by current-year distributions for operating and capital purposes—totaling perhaps $1.6 billion. As a hypothetical exercise, that implies a decline in the endowment's value (including both the negative investment returns of 22 percent to 30 percent, and the funds distributed this year) from $36.9 billion to a range of $24 billion to $27 billion by year's end. Using the Corporation's long-term guideline of distributing approximately 5 percent of endowment value annually, such declines imply theoretical reductions in yearly spending power of nearly $500 million to about $635 million (though likely actions, discussed below, would lessen that impact).

Daunting though the University's situation may be, the case is even more so for Harvard entities that are particularly dependent on endowment distributions (see "The Endowment: Each School's Stake," opposite, for each academic unit's share of the endowment, and the related portion of its revenues, for fiscal year 2008, ended last June 30).

FAS is most vulnerable, in sheer dollars. As Smith noted at the faculty meeting, FAS is using approximately $650 million in endowment-income distributions to support operations this year—more than half its roughly $1.2 billion in budgeted expenses—and had planned on about $750 million of such distributions for fiscal 2010, beginning July 1—approaching 60 percent of the preliminary budget. (In mid decade, endowment distributions accounted for about 46 percent of FAS's annual operating revenues.)

Now, Smith said, FAS found itself facing a much more adverse environment. Using Faust's projection as a guideline, he said that if a 30 percent decline occurred, FAS's endowment would fall by $5 billion (to $11 billion). If the Corporation then hewed to its long-term distribution goal, FAS would receive $550 million in endowment-income distributions for fiscal 2010—$200 million less than planned, and $100 million less than in the *current* year. Moreover, he said, even if FAS received the full $750 million it had anticipated, its core budget (the College, the Graduate School of Arts and Sciences, and the faculty members themselves) would still run a $20-million deficit next year, without *any* new programs or enhancements. (Smith did not note that if *this* year's income distributions are taken into account as well, under that scenario the FAS endowment could drop to $10.3 billion, exacerbating the shortfall.)

The central administration will have to mind expenses, too: its operations are funded in part by assessing schools' budgets and endowment funds. Harvard's funding model thus assures that changes in endowment distributions and schools' budgets directly affect administrative finances, so the same cost-cutting guidelines apply.

(The annual half-percent endowment levy to defray Allston development expenses—the "strategic infrastructure fund," $168 million in fiscal year 2008—is a separate assessment. Although it is a capital item, not an income distribution, FAS members asked at the November 18 meeting if it might be reconsidered, as the pace of work in Allston is recalibrated; Dean Smith indicated that "everything is on the table," not only within FAS but in the council of deans' institution-wide discussions with the administration.)

Important uncertainties surround the University's finances, even as its leaders must prepare future budgets. In extremely volatile markets, endowment-asset values might recover somewhat.

But there are offsetting cost pressures as well. First, in her November 10 message, Faust stated flatly that Harvard "must…affirm our strong commitment to financial aid for our students" at all levels; that substantial part of the budget is off-limits for cutting—and will become *more* costly as aid requests rise during the recession, and as tuition and fees increase. Second, expensive construction projects under way (the first Allston science laboratory, a Law School office complex, and the art museum renovation, totaling an estimated $1.7 billion) will proceed. Third, sources of additional revenue are

For background on fiscal year 2008 results, see the November-December 2008 issue: "Endowment Edges Up in a Down Year," page 60, and "In the Black," page 68. More extensive posts on the financial news appear at http://harvardmagazine.com/categories/breaking-news for November 7, 10, 12, and 19 and December 2.

constrained: Faust noted that donors will be "harder pressed," that sponsored-research funding is subject to "the intensified stress on the federal budget," and that tuition increases will be "moderate" given "economic strain" on households.

How will Harvard respond? The Corporation will determine exactly what budgets it will authorize (and thus how it will spread cutbacks in endowment distributions over time). That decision, usually made around Thanksgiving, has been deferred pending information about the ultimate value of the endowment, and data from the schools and the central administration about savings they might effect. As is its custom, the Corporation would not comment; Faust and Forst did note their expectation that "we will be spending a higher percentage of the endowment next year than we have in the recent past." But she cautioned that the magnitude of the investment losses is clearly too large to cushion against the prospect of significant budget cuts.

Smith told his faculty that Faust had asked deans to reduce budgeted spending by a percent for this fiscal year (more than $10 million for FAS—not simple to effect with half the year already gone). In a November 24 e-mail, he placed "all staff changes and searches on hold"; urged canceling of " any open [professorial] search if the priority…changes" or the applicant quality "is not truly extraordinary"; and solicited recommendations for cuts, to be channeled through a "Priorities Committee" that will operate through March.

Informally, University guidance suggests that recommended wage and salary increases for the next fiscal year will be zero, compared to the 3 percent to 4 percent adjustments recently. With wages and salaries totaling $1.3 billion in fiscal year 2008, and more now, each percentage increase

THE ENDOWMENT: EACH SCHOOL'S STAKE

Harvard's endowment, valued at $36.9 billion as of last June 30, in fact belongs to the separate schools and other academic departments. The large chart shows the share of the endowment owned by each (the Faculty of Arts and Sciences loomed largest, at $15.7 billion—nearly 43 percent of the total). Of crucial importance is each school's dependence on distributions from the endowment for its operating budget, shown in the inset chart. Source: *Harvard University Financial Report, Fiscal Year 2008.*

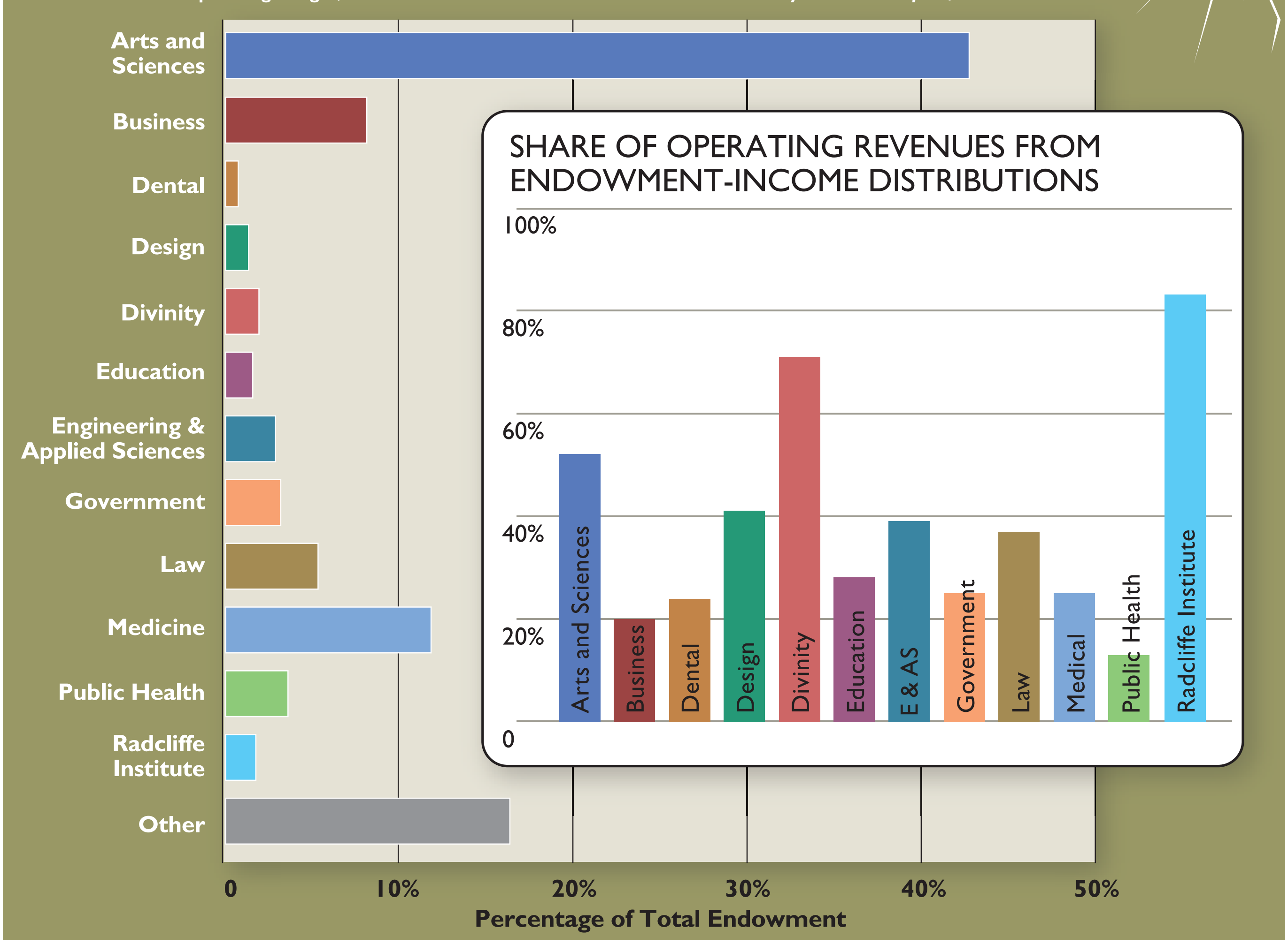


Chart by Stephen Anderson

HARVARD PORTRAIT

Chiara String Quartet

When Julie Yoon joined the Chiara String Quartet in 2000, she not only gave up a spot in a master's program at Juilliard, but also agreed to pull up stakes in New York City and put them down in Grand Forks, North Dakota. The Manhattan-based quartet had won a rural residency grant, but had lost its second violinist to an arm injury. Those left (Rebecca Fischer on violin, Jonah Sirota on viola, and Gregory Beaver on cello) needed a replacement. "The fact that they were going to North Dakota to do this residency," Yoon says, "was a strong indication of what kind of people they were and what kind of group they wanted to be." The players aim to be musical pioneers in both what and where they perform: Haydn to Schoenberg, in concert halls, company cafeterias, schools, and even nightclubs. Now, as the Blodgett Artists-in-Residence, they will spend 12 weeks (spread across three academic years) teaching and performing at Harvard. Group members say they went out West because that afforded so many opportunities to play (albeit sometimes at schools at 7 A.M., with half-frozen fingers). They also had time to settle on ways to resolve disputes. In an orchestra, notes Beaver, "You can play with people you have active lawsuits against. Not so much in a quartet." ("At least [the quartet] won't last," adds Fischer.) They have since spent two years in New York in a residency with the Juilliard String Quartet, and now hold a long-term position at the University of Nebraska that enables them to spend 60 percent of their time traveling and performing. "That's really why we do this," explains Sirota. "We also love to teach, but performance comes first."

worsens the fiscal problem by more than $13 million. Faust and Forst are "taking a hard look at hiring, staffing levels, and compensation"—and "reconsidering the scale and pace of planned capital projects," including Allston.

To maximize financial flexibility during a period of disrupted markets and a recession of uncertain depth and duration, the December 2 memorandum outlines an additional financial strategy.

First, taking advantage of the University's top-tier (Aaa/AAA) credit rating and the historically low interest rates, Harvard will issue "a substantial amount of new taxable fixed-rate debt." Forst said borrowings will depend on the terms and structure of debt that can be sold in the market over time. (According to the 2008 University financial report, taxable bonds and notes outstanding as of last June 30 were $1.3 billion; tax-exempt debt issued at fixed rates totaled $1.1 billion.) The aim is to accumulate cash "to fund ongoing operations and critical academic and research priorities."

Second, to reduce risk in the cost of renewing its short-term debt in volatile markets, the University intends now to replace such borrowings with longer-term tax-exempt debt instruments. Variable-rate notes and commercial paper outstanding totaled about $1.6 billion as of last June 30; the exact amount now is presumably somewhat greater.

These steps, if effected, may help alleviate other challenges, including those facing the endowment managers. Although HMC declined to comment, it—like other long-term investors with similar strategies— likely has substantial contractual commitments to deliver funds in the future to investment-management firms (which in turn make distributions of funds from successful investments to their limited-partner clients, such as HMC). That is the norm for private-equity, venture-capital, and hedge funds, and for various kinds of real-estate and commodities assets; such assets collectively make up perhaps half or even more of Harvard's endowment holdings.

(One institution that discloses such issues, the University of Virginia Investment Management Company—UVIMC—revealed that as of September 20, it has "un-

Courtesy of the Chiara String Quartet

called commitments of $1.8 billion to private funds" during the next five years. Under "normal circumstances," expected investment distributions would exceed the capital calls, but few distributions were expected through 2009. In a November 26 letter, UVIMC's chief executive, Chris Brightman, put investment losses at $1 billion, or 21 percent, for the 12 months ended October 31, and explained how his team expected to meet such calls through its liquid assets, bonds, and redemption of hedge-fund investments.)

Harvard clearly is not alone. Universities and colleges nationwide have reported losses and taken action: Stanford intends to reduce its $800-million "general funds budget" for faculty and staff salaries, administrative operations, and non-research expenses by $45 million in each of the next two fiscal years. MIT projected 5 percent to 15 percent cuts, on a $1-billion base, in the same period. (To date, among the few peer institutions that have indicated they do not now anticipate similar reductions are Princeton, with the highest endowment per student; Yale, which said its spending rule will likely "buffer the operating budget from any dramatic short-term losses"; and Duke, where endowment distributions contribute less than one-fifth of operating revenues.)

At Harvard, if the most adverse scenarios become reality, hiring freezes and wage restraints will not be sufficient. FAS will have to reduce programs, Smith told the faculty—"not something we typically do." The University's decentralized structure and the schools' differing revenue streams mean that such work will unfold case by case. Much of it will have to be directed by a relatively new group of deans (half appointed during Faust's first 15 months) and by an administration that was still filling senior positions last fall.

And these new leaders must cope with the whiplash sensation of pivoting from ambitious planning for future academic growth to the possibility of swift, sharp expense reductions. As recently as October 9, Smith's fall FAS letter mentioned a nagging "structural deficit"—with no inkling of the possibly draconian cuts now figuring into budget plans.

But Harvard's leaders sought to balance the disruptive present with a longer-term perspective. Faust's initial message observed that "we are fortunate to be part of an institution remarkable for its resilience....Harvard has weathered many storms and sustained its strength through difficult times. We have done so by staying true to our academic values and our long-term ambitions, by carefully stewarding our resources and thoughtfully adapting to change. We will do so again."

And Smith told his colleagues, "business continues" as they teach students and meet research deadlines—though he added a new priority, bluntly asking them to "save cash." His most lingering message, perhaps, was that "everything we do has merit," underscoring "how hard it is going to be to make these changes." The worst possible solution, he stressed, was a wholesale, fixed-percentage cut: a formula for doing everything FAS does now, but less well. A better solution is possible, Smith said, but, "It has to come from you."

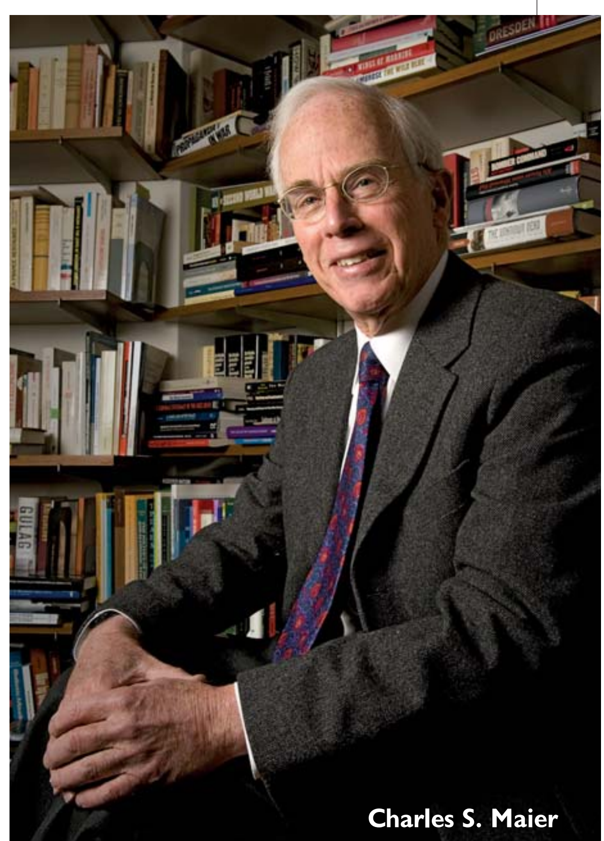
Educating Students for Life

On a Wednesday afternoon in a Sever Hall classroom, students are discussing the Nuremberg Trials. The point of the trials—to punish those responsible for Nazi atrocities—is well known. But Saltonstall professor of history Charles S. Maier tries to push students beyond a simplistic understanding that crimes were committed and justice delivered.

Why did the charges in these cases not emphasize the targeted effort to wipe out the Jewish people? Maier notes that genocide had not yet been codified as a crime by any state or transnational body (the term had only recently been coined) so the prosecutors had to work within the existing framework of international law.

A student raises his hand and expresses the opinion that there are some actions that are universally morally offensive, whether they violate the letter of some law or not. "If somebody has done something wrong," he says, "there should be a way of trying them."

Suddenly, the class has made a leap from analyzing one concrete example to discussing whether universal moral principles exist—or whether, on the contrary, these principles arise from cultural context. In such moments, the new general-education curriculum approaches its goal: to introduce undergraduates to ways of thinking about the world that will shape their lives beyond college. This stands in opposition to the Core curriculum now being phased out, which placed more emphasis on introducing students to approaches used by academic disciplines or sets of disciplines. Maier's course, Ethical Reasoning 12: "Political Justice and Political Trials," begins with Socrates (who was tried and sentenced to death for allegedly corrupting the minds of Athenian youths) and progresses through cases from the French Revolution, the Soviet purges, South Africa, Rwanda,


Charles S. Maier

Photograph by Stu Rosner