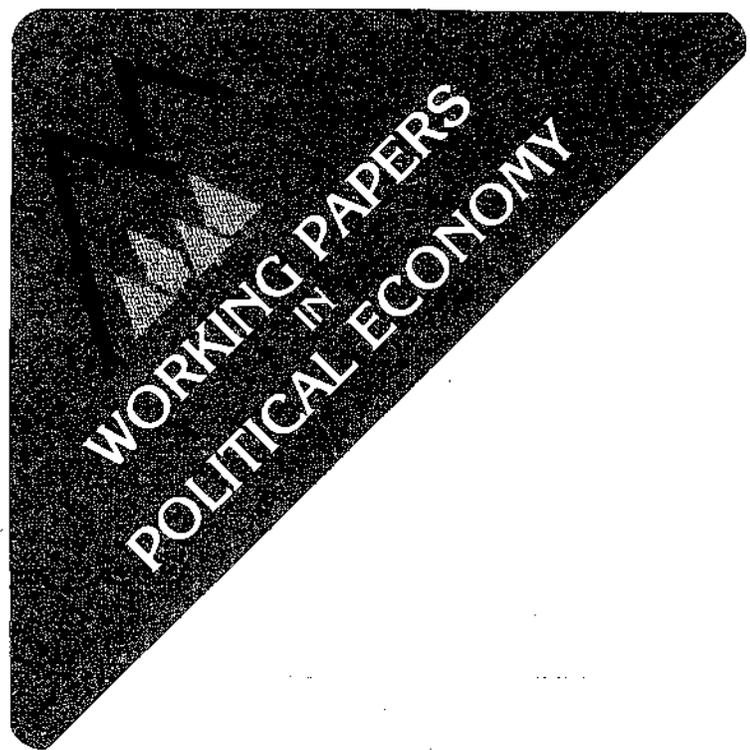


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UNDERGROUND ACADEMICS:
GROWTH IN A DECLINING INDUSTRY

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John Baden

Although the financial plight of universities is well-known, it is also uneven. As expenses increase and federal grants, loans, and fellowships decrease, the traditional university mold is being strained. While many of the proponents of a no-growth or steady-state, sustainable society reside in or on the edges of the university community, the unpleasant consequences of their avowed preferences are providing reality checks on their visions. The nasty realities of no-growth are witnessed in the plight of the gypsy scholar.

University administrators' have responded to this situation in predictable ways; by cutting back programs and by squeezing the revenue generating components of the university. Thus, they foster the academic analog of the subterranean economy.

Universities represent paradigm cases of bureaucracies, institutions are generally most congenial when growing at a 5 percent to 10 percent rate. When growth starts to decline, pain follows; and entrepreneurs emerge. Entrepreneurs provide the only free lunch available to society, and the term bureaucratic entrepreneur appears to be contradiction.

The talents for successfully rising in the administrative ranks of a public university may be inversely related to those that are required for successful private sector entrepreneurship. By definition, public bureaucracies have no place for owners—those who can claim the residual between

costs and return. The structure of public bureaucracies does not permit people in universities to capture benefits of increased productivity or efficiency. Further, public bureaucrats are not personally responsible for deficits.

Individuals who spend their adult lives in such institutions may be disadvantaged in their efforts to be entrepreneurial. University faculties and administrators are burdened by culturally induced rigidity; they are often not programmed to respond while opportunities abound.

For at least a generation, members of the university community have been beneficiaries of the largess provided by politicians who coercively extort revenues from taxpayers and lavish them on the educated elite. From the perspective of the politician, it is probably fortunate that the unemployed steel worker is unaware that he has subsidized the high culture program of his state university. While he might be quite willing to provide this merit good to his self-proclaimed betters, he has had no choice in the matter. While this may be an extreme case, it is directly analogous to the situation in which ranchers and loggers have taxes extracted from them to support the Kennedy Center in Washington D.C. Perhaps they too would willingly support this cultural forum, but we shall never know.

The welfare implications of many university activities are highly regressive. With the possible exception of agricultural colleges, the linkages of control between those who are taxed and those who administer the tax funds range from anemic to non-existent. While organized special interests are almost certain to find their preferences reflected in the missions of the university, aside from course offerings for their children and football games, the general taxpayer is neglected. This is the predictable consequence of a separation of authority from responsibility to the non-voluntary taxpayers.

Living in such an environment seems likely to skew the perceptions of academic administrators. They are likely to be unaware that a significant segment of society operates in accord with the rule of willing consent which governs transactions in the market economy. Under such a rule, all exchanges are voluntary, and both parties to each transaction expect the exchange to improve their welfare. Although errors are sometimes made, even by competent adults, there are strong incentives to learn from one's errors when the decision makers must face the costs. This situation is radically different from that faced by the university official who offers a smorgasbord of of ten non-priced programs whose content is determined by cultural preferences and political currency.

There are, however, mavericks in the university system who can offer products other than classes. Obvious examples are those involved in genetic engineering, numeric analysis, finance, and some specialties within law and economics. These individuals face opportunities radically different from those available to the professor of modern European history, languages, and most social sciences. Essentially, we observe that those with attractive opportunity sets on the outside simply offer products attractive to entrepreneurs and innovators. These scholars, researchers, and suppliers of knowledge valued in the market gain an often intuitive sense of the forces that drive human action.

Consider, for example, the value to society (and to individual entrepreneurs) of an individual who can engineer a gene that will alter the micro-ecology of cow's rumen so that its feed conversion efficiency increases by 20 percent, thereby reducing feeding costs. This individual, quite rightly, may believe that he potentially holds disproportionate power within the university system.

Universities are hungry, and university administrators have ambitions. The successful execution of these ambitions almost uniformly requires greater discretionary control over assets, a condition that normally correlates with increased budgets. Thus, there is a strong but naive incentive to exploit the creative potential of these relatively highly valued faculty members. This, of course, is the precursor to the emergence of the underground academic.

Academics and their administrators are continually engaged in a resource-capturing game with Boards of Regents and legislatures. Legislatures often view universities not only as recipients of largess, but also, on the margins, as providers of revenue. Thus, the overhead or indirect costs associated with university grants and contracts are often assigned to the state general fund to be redistributed among the various units of the state's educational system. This is partially an egalitarian move designed to reduce the discrepancy among the units of the state's system. Obviously, junior colleges, upgraded normal schools, and those that emphasize the humanities are at a competitive disadvantage in the grants economy when measured against schools whose emphasis is on engineering, business, and agriculture.

To reduce this financial hemorrhage that "rightly" belongs to their research-oriented universities, administrators have creatively set up "independent" foundations, research institutes, and similar organizations technically separate from their universities. Such institutions are chartered under state and federal law and serve to "further the interests of research and enhance the welfare of the citizens of the state." Grants and contracts assigned to these organizations bypass the sharing requirements imposed by state law and, of course, dramatically enhance the incentives for the institution to encourage grant producing research. Normally, these

institutions do in fact represent a significant asset to their home universities; and, discounting the envy factor, they probably make members of the university community better off. Unfortunately, most administrators seem unable to generalize from their own experience. Perhaps they think they have a monopoly on evasive organizational creativity. They do not.

Those professors who are capable of and interested in producing useful information sometimes learn that their services are valued by those outside the university. Thus, the foundations are laid for the development of the underground academic. To the buyer of the researcher's or analyst's services, the university "overhead rate," which sometimes exceeds 60 percent of the project's budget, represents a tax. This tax, and the traditional tax wedge that results in less productivity than would be desired, cries for evasion. This evasion can take many forms.

Overhead supposedly accounts for such services as utilities, office space, security, maintenance, and like expenses. Masters of creative accounting, however, are able to demonstrate to the federal auditors' satisfaction that for federal purposes more than 60 percent of salaries and benefits is justified. Since the federal auditors are monitoring other people's money, perhaps they are easy game. Empirically, however, private sources are more skeptical. Even if they were not more gullible, they face real incentives to reduce the overhead charge to an absolute minimum. Thus, creativity is fostered.

University administrators commonly delude themselves into believing that they are the single buyers of researchers' products; that is, that they are Eonopsonists. While this naivete may be ego enhancing, it is grossly dysfunctional for their organizations. The less well-known monopsony is nearly as overrated as monopoly. There are alternative buyers for

most valued products; and if the incentives are high enough, these alternatives are likely to be found. A 60 percent overhead rate creates such incentives. What emerges is the academic equivalent of the subterranean economy.

The United States has thousands of research foundations. These non-profit institutes, commonly directed by rent-seeking bureaucratic entrepreneurs, are incorporated to provide "public service" and are eligible for charitable contributions from individuals and corporations. Given that nearly all bureaucrats have a penchant for growth, since growth leads to more discretionary control over resources, these foundations are eager recipients of funds which they can manage. Thus, while the university may demand a 20, 30, or even 60 percent overhead rate, such foundations as the Institute for the Study of X is often pleased to serve as a broker between the university affiliated researcher and the grantor. The fee for this service is often no more and sometimes less than the privilege of collecting the interest on the research grant until it is expended.

As a tax exempt, public service, charitable organization, grants to the Foundation for X constitute tax deductible contributions. Thus, both the grantor and the recipient gain significantly from the arrangement. While the same tax advantages would accrue if the grant were made directly to the university, the overhead "tax" is nearly tax deductible expense rather than a productivity enhancing investment. Since no one in the United States is yet above the 100 percent marginal tax rate, this constitutes a strong negative incentive.

Given 12 hours, an alert academic could probably find a dozen foundations eager to cooperate with him. This is precisely the point ignored or missed by university administrators. In the private arena, unlike the public, individuals are usually in tune with their self-interests. When a

grant is administered by a private foundation, several advantages accrue to the principal investigator. These advantages are explained by three variables, grossly underestimated in explaining motivations: (1) money, (2) morality, and (3) variety. Each variable is enhanced by diverting the grant from the university to a foundation.

As mentioned above, control of money is a good proxy for increased discretionary control over resources. Thus, whether one wants to do good or merely do well, money is a highly relevant variable. Morality is also important. While it is difficult to test this hypothesis, I believe that most academics feel that their work provides a benefit to mankind. While it is most obvious in the area of medical research, this can clearly be extended to work in agrinomics, economics, genetics, and surface physics, among others. Given that grant funds can be employed more efficiently from outside the university than from inside, morally positive outcomes are enhanced by taking grants to foundations outside the university. locational variety is also important. Given that many university funded travel budgets are \$100 per year per faculty member, research projects have obvious benefits. Any innovative academic can "justify" a trip to any conference, so potentials for travel are vast.

The Political Economy Research Center is an unusual organization. Our research orientation and level of commitment provide PERC associates with an important opportunity to analyze and make recommendations on economic and natural resource issues in both the governmental and private sectors. Approximately 50 percent of our efforts have been devoted to natural resource economics and policy, while the balance of our work deals with taxation, regulation, entrepreneurship, economic history, and a sprinkling of other topics. To the best of our knowledge, we are the only research organization with this orientation.

Since its founding in 1980, the Center has maintained a principled commitment to the development of a society of free and responsible individuals in their relations with one another and their environment. On the basis of considerable study and research, we expect these values to be fostered by social and political organizations relying on private property rights, the rule of willing consent, and the market process. Although we are sensitive to the problems of market failure, we recognize that there is an analogous set of problems with governmental management.

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