

great deference to the institution. Without a clear legal definition of academic freedom by the Supreme Court, faculty are hesitant to subject themselves to the expense and time to challenge an institution.

The most recent decision by the Supreme Court has created further ambiguity that some courts have used to reduce academic freedom protection. In *Garcetti v. Ceballos* (2006), the Supreme Court held that speech made by a public employee pursuant to that employee's official duties is not protected by the First Amendment. Justice Souter stated in his dissent that he hoped "that today's majority does not mean to imperil First Amendment protection of academic freedom in public colleges and universities, whose teachers necessarily speak and write "pursuant to official duties." In response, the majority opinion of the Court reserved the issue of whether this decision would apply in the same manner to a case involving speech related to scholarship and teaching by faculty at public universities. The result is that lower courts have the discretion as to whether to apply *Garcetti* to faculty speech cases or not.

Some courts have already applied *Garcetti's* holding to college faculty. In *Renken v. Gregory* (2008), a professor alleged that the university had reduced his pay and terminated his grant in retaliation for his criticism about the university's handling of a grant. The US Court of Appeals for the Seventh Circuit ruled that the situation in the case was pursuant to his job duties and not protected speech. In *Hong v. Grant* (2007), a professor alleged that he was denied a merit-salary increase because of his critical statements regarding hiring and promotion policies. US District Court for the Central District of

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California ruled that the case involved his job duties as a faculty member and not protected speech. Because faculty duties generally encompass more than teaching and research, this expansive definition of "official duties" threatens to make much faculty speech unprotected under the First Amendment, thereby causing important ramification for academic freedom.

The deterioration of academic freedom is not inevitable, and this trend can be reversed. Nevertheless, this approach has been supported by factors affecting the academy, which must be addressed. The Supreme Court could go far to restore the traditional protections afforded by academic freedom for the benefit of higher education and society. ■

Is Greater Financial Independence Ahead for Universities?

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Moody's Investors Service is a leading credit-rating agency, providing credit and financial strength analysis of a wide range of organizations and securities. Moody's rates the credit quality and financial strength of over 500 universities and 250 other not-for-profit organizations. Our analysis of public universities is driven both by the structural policy environment of the country or locality the university works within as well as the particular market position, management and governance structure, operating performance, and balance-sheet strength of the university.

The financial effects of recessions are typically not felt immediately by leading global public universities because tough fiscal policy decisions often must funnel through a lengthy government budget process before impacting university funding. The government budgeting process, therefore, often renders university financial performance a lagging indicator of economic activity. This delayed impact is even more pronounced in the current recession due to the prevalence of short-term government stimulus spending, which often may postpone or soften funding reductions for universities. However, when stimulus spending expires and governments seek to achieve better budget balance, many universities are likely to experience substantial funding reductions or, at best, an extended period of limited funding growth. At the same time, universities face demand to enroll additional students as alternatives to education (i.e., employment) are weakened by economic contraction, forcing many people to seek opportunities in higher education to enhance skills and credentials. With policies of limiting enrollment places and tuition fees, market pressure to add capacity, and government funding unlikely to increase, Moody's expects unprecedented pressure on the current financial model of public universities.

WILL THE FINANCIAL MODEL OF UNIVERSITIES EVOLVE?

For many nations, resolution of these countervailing fiscal and policy choices will be among the more significant public policy developments in the next decade, given the importance of creating a skilled labor force. One solution, with obvious economic and policy implications, would be for universities and policymakers to simply manage within the existing constraints of the system by scaling back enrollments, delaying access for underserved populations, seeking out cost efficiencies, and

limiting capital investment in the hopes of improved funding environments in the future. Clearly, room exists for improved efficiency and different teaching models to enhance access and availability of tertiary education without additional funding. However, the gap between any realistic view of future government funding and the level of demand and policy goals is likely to be substantial in many nations. It is difficult to imagine that efficiency measures such as expanding online education and developing new teaching models could fully alleviate the need for funding in the sector. Government policy that restricted the flow of capital into an industry despite that industry's favorable social and economic impacts on other sectors of the economy would appear to be suboptimal.

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Another possibility is for the model of funding for higher education to evolve toward a public-market-based funding mix. The capacity for most higher education institutions to raise tuition and other fees to generate revenue is substantial, given the large remaining implicit subsidy provided to middle- and upper-income students in most nations. The potential is especially large in systems where government policy has effectively eliminated or capped tuition levels. In some countries, we have already seen signs of rising independence of universities through reformed governance structures and introduction of nongovernmental revenue streams such as tuition deregulation or expanded capacity for nondomestic students. While nuances of how tuition fees are implemented and managed can have serious social-policy consequences, financial aid strategies exist to ensure that access for the weakest economic groups is protected from increased tuition.

CAPITAL FINANCING AND DEBT CAPACITY

Evolution is also possible for capital investment. As existing facilities age and the demand for cutting-edge research facilities grow, capital funding will be a particularly challenging area for university management.

Prior to the current recession, capital investment by universities was funded by one of several sources: direct government allocation, operating cash flow, philanthropy and corporate employer grants, or borrowing of various types. While it is difficult to estimate with any precision the balance of funding sources used in all nations, for institutions outside the United States, capital funding was heavily weighted toward government funding, either through direct allocations for capital or

by the fact that the majority of operating revenues were from government and therefore funding large portions of operating cash flow. US public and private institutions tend to rely on diversified sources, including government, private donors, employers, and capital-market borrowing to fund new investments. Government tax incentives to reduce borrowing costs have also encouraged substantial borrowing by US universities. For US public universities rated by Moody's, the median debt to revenue was 48 percent and the amount of outstanding debt has grown from \$101 million in fiscal year 2003 to nearly \$162 million in fiscal year 2007. For universities in Australia, median debt to revenue was just 7 percent.

While debt and leverage are viewed with a great deal of skepticism after the credit crisis, long-term financing of capital assets remains a rational strategy for policymakers and universities. Added borrowing by sovereigns at a time when their balance sheets are already stretched may be challenging to accomplish and could limit traditional sources of capital funding. However, most universities currently have very low debt levels and retain capacity to utilize borrowing to finance strategic projects on their own.

CONCLUSION

Universities play a unique role in the economies and public policy of their countries. Many face conflicting pressures of rising demand for their services, especially during recessions, while also needing to adjust to a weaker outlook for operating

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and capital funding from their traditional state sponsors. Student enrollment levels are likely generally to rise as the need for an educated workforce continues to expand around the world. Policymakers will continue to seek competitive societal and economic gains through expanded student participation rates, as well as research and development investments, even as they face more limited funding capacity. University relationships with sponsoring governments are likely to remain strong but possibly evolve gradually toward more independent university funding sources, including increased financing for capital purposes. ■

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