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The Boston Globe

Shrouded in secrecy, decision makers gambled and Harvard lost

By Fred Abernathy and Harry Lewis | December 12, 2009

IF AN ORDINARY corporation had the kind of fiscal year Harvard University just had, some of its directors would be gone. Long-term investments down \$11 billion; another \$1.8 billion lost by top management speculating with cash accounts; another half-billion gone in an untimely exit from a debt rate gambit. The institution left so illiquid that it was forced to sell assets and issue bonds at the worst possible time, just to pay the bills. A publicly held company would have experienced a shareholder rebellion - especially after the Globe reported that the chief investment officer had repeatedly warned the president about the risks he was taking with the institution's cash.

But the Harvard Corporation is legally answerable to no one. It consists of six fellows plus the president they hire (and occasionally fire). The fellows serve for unlimited terms, just as they have since 1650. Only they have a voice in appointing their own successors. The much larger, alumni-elected Board of Overseers is powerless; it may hear about important Harvard affairs only days before the rest of us.

Harvard's treasurer acknowledged that in hindsight, the university might have managed its investments differently. Yet, he noted, even with the downturn, the endowment grew over the past decade at a healthy annualized rate of 8.9 percent. True enough, but the Corporation manages not only Harvard's balance sheet, but the expenses of the university as well. The 8.9 percent growth of the endowment wasn't nearly healthy enough to cover the staggering growth in costs.

Professor Caroline Hoxby anticipated the mess nearly three years ago, telling the alumni magazine, "Even if you are very, very rich, you can spend more than you have." The Corporation was negligent not merely in overseeing the investments, but in approving budgets that could be balanced only with consistently fantastic investment returns.

The story goes back to 2001. With much fanfare about President Lawrence Summers's bold vision, Harvard started a building campaign, mostly to grow the size of its science facilities by more than a third. Average yearly expenditures for facilities jumped from under \$150 million in 1995-2000 to \$495 million from 2001-2005, to \$644 million in 2009. The Faculty of Arts and Sciences - about half the university - grew from about 600 professors before 2001 to 700 in 2006 and was projected to reach 750 by 2010. With this growth spurt already underway in 2004, Summers told the faculty not to think small. Its ambitions were limited only by its imagination, he said - Harvard could always come up with more money from its "deeply loyal friends."

All that growth has now come to a crashing halt. The half-finished science lab in Allston has been mothballed; the faculty, only recently expanded, will now have to shrink.

Are these the consequences of a market downturn no one could have predicted? Not in Harvard's case. By January 2006, the faculty itself was warning that Harvard's plans depended on extremely optimistic financial projections.

Hoxby addressed the Faculty of Arts and Sciences on behalf of a committee charged with scrutinizing the administration's plans. The Arts and Sciences budget - roughly \$1 billion - was in balance, but with all the growth that was underway, she said, by 2010 it would be in deficit by at least \$108 million.

The biggest item was interest payments - the buildings were mostly debt-financed, in a sharp departure from Harvard's past practice of raising the money first. Add to that the salaries of the new faculty and the costs of operating those huge new science laboratories. Where would the money come from? The Faculty of Arts and Sciences had saved up \$73 million, but that account would quickly be depleted as it was used to balance the budget. Selling endowment assets wouldn't work either, because almost all those funds had to be used as donors had stipulated, not for building undreamed-of buildings. So there were only two possibilities: a lot more money from donors, and very high investment returns.

Was it wise to borrow so much? The Arts and Sciences dean explained that it was like a homeowner assuming a mortgage. Going into debt was OK, because incomes rise. And President Summers termed the whole borrowing-

to-build plan an “extraordinary investment.”

And what was Plan B, if the endowment did not go up in double-digit increments indefinitely? An English professor questioned the projections, comparing the plan to an exhilarating downhill ski; he wanted reassurance about the chairlift. The president told the faculty that the university would back the projects with its discretionary funds.

There was no Plan B. That is why the would-be Allston campus remains undeveloped. It is why more than 1,600 of Harvard’s staff were offered early retirement last spring (more than 500 accepted, taking invaluable knowledge with them). It is why 275 Harvard workers were terminated last summer. And it is why the magnificent Harvard library will buy fewer books next year.

Loyal alumni have contributed generously to staunch the bleeding, but huge deficits remain in spite of all the reductions. Harvard will be a smaller place when the dust settles, with less educational and scholarly reach. It will employ fewer people and will contribute less to local and national prosperity.

The Harvard Corporation is a dangerous anachronism. It failed its most basic fiduciary and moral responsibilities. Some of its members should resign. But the Corporation’s problems are also structural. It is too small, too closed, and too secretive to be intensely self-critical, as any responsible board must be. Until the board can be restructured, the fellows should voluntarily share their power with the overseers. And Harvard should reveal the risks of its business plans, as would be required if it were a publicly held corporation. That exercise in transparency would surely serve Harvard well.

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