

**Academic Council of Stanford University
Annual Meeting – April 30, 2009
Kresge Auditorium**

I. Call to Order

President John Hennessy called the meeting of the packed auditorium to order at 3:30 PM. He called attention to the minutes of the annual meeting of the Academic Council, May 15, 2008, which were previously distributed to the faculty electronically and were on the faculty Senate web site.

II. Report of the Chair of the 41st Senate of the Academic Council

The president introduced Professor Karen Cook, Chair of the 41st Senate, to give the annual report of the Senate activities.

Professor Cook commented, “What a difference a year makes! Last year we were concerned about the growth of the endowment because of the interest Congress was showing in it.”

She referred to a handout summarizing the accomplishments of the Senate the past year that was available to those in attendance [available at <http://facultysenate.stanford.edu>].

Among the major reports presented to the Senate was the Accreditation of the University by the NCAA. The Vice Provost for Graduate Education described the efforts of the university to diversify the graduate student population. The Dean of the School of Medicine and two faculty members described new education programs and the cutting edge research that were to be housed in the facilities now under construction of the School of Medicine.

The major focus, however, was on the budget. One Senate meeting was devoted to the provost’s presentation on the effect of the collapse of the economy on the endowment and an explanation of the process by which budget cuts were to be implemented. In a later session the provost and president gave an update on where matters stood. Extensive question and answer periods followed each presentation. Chair Cook commended the provost and president about the clarity and transparency with which they kept the Senate and faculty informed about the budget reductions.

Among the items on three remaining Senate sessions are:

1. The Vice Provost for Undergraduate Education will review the effect of the budget reductions.
2. The Senate will hear the report of the Committee for Evaluation of the Non-academic Appointment Processes, the so-called “Rumsfeld” committee.
3. A survey of the quality of life at Stanford will reviewed.
4. The provost will present the annual budget report.

The mission of the Planning and Policy Board (PPB), a committee composed of the present and recent past Chairs of the Senate, is to review broad issues confronting the university. This year the PPB, Professor Eric Roberts, Chair, will focus on the effect of the decline in the endowment and the administration's response. Members of the PPB and their email addresses were listed on the handout. Chair Cook invited input from the faculty to her or any of the PPB members.

Chair Cook concluded by expressing her thanks to:

- The senators for attending the meetings. The attendance was very good, reflecting the substantive issues on the agenda.
- The Chairs of the Academic Council Committees for their hard work.
- The Academic Secretary Rex Jamison and Assistant Academic Secretary Trish Del Pozzo for their support. She noted that this year marked a quarter century that Trish has been in the Academic Secretary's Office.
- Professor Harvey Cohen, who as Vice Chair had been very supportive and had presided over the Steering Committee and Senate in her absence.

[Applause]

III. **President Hennessy's address, "The State of the University and the Economy"**

The President's talk was divided into two parts, first, a review of some of the accomplishments by the university, its faculty and students, over the past year, and second, the current state of the economy and its effect on the endowment. The university had survived past crises—earthquakes, a crisis over academic freedom, the Depression, the disruption of war, the oil shortages, inflation and a failed merger between two hospitals. As he mentioned the last item, he smiled wanly and said, "I said 'survived, not enjoyed.'"

"Now we face the swine flu. But we had formed a group to deal with just such a possible urgency."

A. **Accomplishments**

1. The students

The president reminded the audience that the university's primary focus is on our students who were enormously productive and successful. This year two students were awarded Marshall Scholarships and an alumnus was awarded a Rhodes Scholarship.

The excellence of our students was manifested outside our campus. Last year the Stanford Symphony Orchestra, Stanford Symphony Chorus, Stanford Chorale and Stanford Taiko and others traveled to Beijing before the Olympics to give a series of concerts, the last in the Great Hall of the People. Forty-eight members of our Stanford family competed in the Olympics—more than that from any other U.S. university—and won eight gold medals, thirteen silver medals and four bronze medals.

Anticipating 25,000 applicants for the Freshman Class of 2013, the Admissions Office was astonished by receiving more than 30,000. Only 7.6% of applicants were tendered offers--the most competitive in our history. Our ProFros [those who were offered admission] are an amazing group.

The economy has put an even greater financial strain on the students' families. To help them, Stanford introduced plans for families with incomes less than \$60,000 and less than \$100,000, which the president acknowledged were ambitious--and designed in very different circumstances, than the present.

“But we will be steadfast in these plans.”

Our graduate students are also vulnerable. Long-term funding, at least for some disciplines, is likely to remain challenging. The Stanford Interdisciplinary Fellowship Program is designed to support outstanding scholars; raising endowment for these fellowships, as well as for other fellowships will be critical to graduate student funding.

2. The faculty

Our distinguished faculty received many honors this past year.

Five were inducted into the National Academy of Engineering, five into the National Academy of Sciences, six into the American Philosophical Society and twelve into the American Academy of Arts and Sciences.

[Applause]

The President acknowledged that he was not a fan of the annual rankings of the undergraduate college and universities by US News & World Report but the magazine's ranking of graduate programs were based on peer ratings. All six of our graduate schools were ranked in the top ten and five of the six in the top three. Among the 11 ranked departments in the sciences, social sciences and humanities, all 11 are in the top five and seven are ranked or tied for first. Our six graduate schools in the sciences were ranked first or second. No other university did as well.

The president affirmed that while faculty recruitment will be somewhat limited, we will continue to use our resources and focus on excellence.

3. The Stanford Campaign

The president acknowledged that some alumni have thought Stanford erred in launching the new campaign, but he did not agree. Although we have to reconsider our objectives, we remain committed. Advances in knowledge continued to be critical. For example the complex energy problem requires expanded research efforts. Stanford moved out in front addressing the problem of energy resources with the Precourt Initiative. In a period of seven years Stanford has increased its amount of research funding in energy by ten-fold.

Stanford has also made great progress in stem cell research. We have recruited one of the best group of faculty researchers in the world and they have obtained nearly \$95 million from the California Institute for Regenerative Medicine.

As of today we are half way along in the Stanford Campaign but much further ahead in fund raising. However, we have not met some of our goals and we will have to raise even more funds than our initial goal because of the downturn in the economy.

The key question is—in the present environment how can we continue to innovate and produce the next generation of leaders?

4. The Endowment

The president reviewed in brief the principal sources of revenue for the university.

- 1) Until recently, there had been a spectacular growth in endowment, which has become the largest single source of revenue.
- 2) Sponsored research (e.g. the NIH) the second largest source of revenue, has been substantial but in recent years has been on a plateau. SLAC was recently awarded \$68 million as a stimulus.
- 3) Tuition provides a more modest fraction.
- 4) Gifts are likely to decline.

The president reviewed the recent decline in the endowment. He noted that building the endowment has been a goal of Stanford since the days of Jane and Leland Stanford.

The portfolio of investments is highly diversified. Moreover we have a “smoothing rule”, which is set by the Board of Trustees, designed to blunt the effect of sudden changes in the endowment, up or down, on the payout rate. We thought this plan would be sufficient until the last three months of 2008, when all classes of assets in the portfolio exhibited significant losses that continued through February of this year, with a slight up tick in March. The total decline in the value of the endowment pool was 30%, which is predicted to be the figure at the end of the fiscal year .

A plan to cut the operating budget by 15% was initiated by the provost. The effect of this will be felt throughout the university and affect many dedicated employees.

But the smoothing rule was never designed to deal with a fall in the endowment in one year that exceeded by two standard deviations the mean of historical distributions. To illustrate what he meant the president posed the hypothetical question--What would it take to return the endowment to its highest value in mid-2008? The answer: We would need a 43% increase in the endowment from its value today. Based on reasonable assumptions regarding interest return and inflation rates, it was calculated that it would take more than 30 years for the endowment to

return to its peak value. If one adds the effect of the estimated value of incremental endowment gifts, it will still take more than 15 years.

That meant we would have to reduce the payout rate more than that calculated according to the smoothing rule. It was proposed to the trustees to decrease the payout rate 10% in fiscal year 2010 and 15% in fiscal year 2011. This will require greater sacrifice in the next few years.

The reduced payout rate will affect different parts of the university differently. Those units that depend heavily on endowment will see budget reductions next year and in the academic year 2010-2011.

Another difficulty is that hundreds of recent contributions to the endowment are “under water” [their current value is less than their initial value]. To draw from the initial corpus, we are in the midst of requesting the permission of our donors.

There was some concern about the expendable funds of the endowment (e.g. cash and publicly traded stocks and bonds). For this reason we raised \$1 billion in a bond offering. (Harvard, Princeton, Duke and other universities have done the same thing.) The bonds received an AAA rating (the highest) and the demand exceeded the availability of the bonds by seven fold. But we will have to pay these funds back; they will be kept in a special account to be used only in a true emergency.

So we have to think differently about things.

Other budget adjustments include:

- Hiring freeze for staff;
- Faculty searches cancelled or reduced;
- Salary reductions for senior administration officials that were voluntary;
- Salary freezes for faculty;
- Enhancements to faculty retirement incentive programs;
- Encouraging employees to take a vacation in the year it was earned to reduce the vacation days that can be accrued.

In the next years, salary and benefits increases will be very modest.

Construction projects: We will not halt current projects underway; that would be a waste of money. Construction of new projects, however, has been cancelled or delayed.

In his concluding remarks, the president said that the process we are now going through should be viewed as we are resetting our budget base rather than a series of budget cuts that might some day be restored, meaning the budget will be \$300 million less than the budget of the present year. As our financial state improves and we receive gifts from alumni and friends, the budget will increase and we will have additional funds to address new opportunities.

The president reiterated that our goal remains to lead in research and to educate the next generation for leadership.

“I am confident that—through our collective efforts, talents and dedication—Stanford University will thrive and will remain a leader in this century and those ahead.”

The president thanked everyone for their support and their attention.

[Applause]

IV. **Panel**

The president introduced the members of the panel:

John Shoven, the Charles Schwab Professor in Economics and Director of the Stanford Institute for Economic Policy Research, who served as moderator;

John Taylor, the Mary and Robert Raymond Professor in Economics and a Senior Fellow at the Hoover Institution;

Darrell Duffie, the Dean Witter Distinguished Professor in Finance at the Graduate School of Business; and

Kathryn Hall, Chief Executive Officer and Chief Investment Officer at Hall Capital Partners.

Professor Shoven, referring to a panel convened on October 10, 2008, on the same subject, said that the president thought it would be a good idea to have an encore. But Professor Shoven cautioned that the federal government in the interim has taken unprecedented actions so we can't be confident that we know what's going to happen; we can only provide educated guesses.

In October, he continued, the economy was falling apart at its seams. The 'D' word was being used. Since then there have been two quarters of bad economic performance. Unemployment has increased from 6.2% to 8.5% and is likely to rise further. The stock market, which fell dramatically in February, has recovered and is now roughly back to where it was on October 10th.

What's going to happen? Professor Shoven said the consensus of those in Washington DC (and he agreed with them) was that the “second derivative” of the economy is turning positive, that is, the *rate* at which the economy is getting worse now is less than the previous rate. And by the 4th quarter there may be a little growth in the GDP (Gross Domestic Product). There should be growth throughout 2010.

He turned to Professor Duffie to ask what he thought was going to happen.

Professor Duffie reminded everyone that as an economist he was supposed to think about all possibilities. The government and the Federal Reserve Bank have demonstrated a willingness to take any and all actions. If it comes to a need for another large bailout, it is likely to be expensive and the question is--will the large banks have sufficient capital? A low probability--but not a negligible one--is that a very expensive additional bailout may be needed.

Professor Shoven asked Professor Taylor about the employment picture.

Professor Taylor noted that changes in employment always lag behind changes in the economy. The unemployment rate looks like it will reach 10%. He posed the question--how did we get here? In 2003-2005 because of the action of the Federal Reserve Bank, the interest rate on mortgages decreased to such low levels that it encouraged excess housing construction. As the demand for houses declined, values fell and panic ensued, which bottomed out in December.

Professor Shoven commented that although we are in a deep hole he thinks that in 2010 and 2011 we will see a robust growth in the economy.

He asked Chief Executive Officer (CEO) Kathryn Hall to comment about the stock market, which had decreased to approximately half its value at its 2007 peak.

CEO Hall replied that we have to recognize that price-to-earning ratios have been artificially high. Now we are starting to see some stabilization and should see a higher equity return over the next 5 years, perhaps more than 10%. But she warned us to expect volatility. As for real estate, the picture is still unclear.

Professor Shoven noted that Stanford's endowment investments are very diversified. But have things gotten so "globalized", that there is little payoff from having an internationally diversified portfolio?

CEO Hall answered that it's still important to remain diversified. She thought Stanford's investment strategy in the past has been effective and should be continued.

Professor Shoven asked, "How concerned are you about inflation five to ten years from now?"

Professor Taylor said he was quite concerned. He quoted from a song, "Inflation or Deflation?", by country and western singer, Merle Hazard: "Are we going to be Zimbabwe (hyperinflation) or Japan (deflation)?" Professor Taylor said that the Federal Reserve has increased money in the form of excess reserve balances by one hundred fold. This excess eventually has to be pulled out of circulation to prevent inflation, but we don't know how to do it. The national debt has increased from 40% to 80% of the GDP.

There followed a discussion about “financial engineering”. What is it? Some experts thought that it was responsible at least in part for our present dire situation. Professor Duffie defined the term by giving an example of financial engineering: moving losses to investors that most can afford them. However, in this crisis it got turned upside down. The banks instead of spreading the risk around narrowed it. The method itself was not responsible; it is that it was misused.

The question then turned to personal management of financial funds. Should people treat the events of the past six months as short-term aberrations or not; should they “reprogram” their budgets?

CEO Hall advised to start with a “harsh personal assessment” of your funds. The shorter the horizon [that is, until you need to use your retirement funds] the more you have to adjust your portfolio accordingly. If your horizon is longer, say 5 or 10, years, ride it out.

Professor Taylor noted that many people didn’t move to more conservative investments as they neared retirement, as they should have.

The final question asked by Professor Shoven was about lessons from history; although history does not really repeat itself, it can be instructive. He asked, “Which episode in history provides the most insight to our present situation?” He listed the largest setbacks in the financial history of the US since 1900.

Professor Taylor thought it was hard to say. The magnitude of the present downturn is nowhere near like that of the Depression. Then it was cash; now it was real estate. He thought the closest analogy was the 1981-1982 recession. Credit controls were put into effect to control inflation in 1980.

Professor Shoven invited President Hennessy to join the panel and opened the floor for questions from the audience.

1. Don’t we need legislative control of personal greed/incentives?

Professor Duffie said yes we do.

2. How was it possible that many assets were rated so high, such as AAA?

Professor Duffie replied that the raters made a mistake; no one thought the housing prices would go down. Professor Taylor agreed, noting that foreclosure rates had been remarkably low. Professor Shoven summed it up by saying a lot of the problem was the failure to realize that we were in a housing bubble.

3. The bad assets have not yet gone away. When and how are they going away?

Professor Duffie replied that the assets won’t go away until they are purchased. The government plan to help may or may not work.

What about inflation?

Professor Shoven replied that if you are worried about inflation, put your assets in TIPS [Treasure Inflation-Protected Securities]. Professor Duffie said, "I have all my Stanford pension investments in TIPS." CEO Hall added that another good investment would be in "hard" assets such as timber and energy assets. Professor Shoven added that TIPS are good for retirement accounts, but not for other purposes since they are tax inefficient.

4. We can't just think about what our Fed is doing because of the global economy can we?

Professor Taylor replied, "You have to be optimistic about long term growth in the world economy because the economies of so many countries are likely to grow fast." Later Professor Shoven commented in answer to another question that one of the advantages of globalization is that countries that are behind can catch up faster.

5. This question was directed to President Hennessy. What about Stanford's international students?

The president replied that we haven't been able to support our international students quite as well as universities in the eastern U.S. have supported them. In part this may be due to their longer experience of having international students; another was that while the budget of a university like Princeton is the same as Stanford's, it is a much smaller university.

6. Returning to the AAA raters--what about the systematic incentive to raters to overrate assets?

Professor Duffie agreed that a fundamental problem is the conflict of interest when people are paying you to rate the securities that they issue. No one has come up with a satisfactory scheme to reduce conflicts of interest for raters. But he didn't think that conflicts of interest explained the excessively high ratings of the current crisis. "They just blew it because they didn't include all the scenarios."

7. Why was the financial crisis worldwide?

Professor Taylor replied that it was because banks in other countries purchased the same securities.

8. A question was asked about the value of the price-earnings ratio.

Professor Shoven replied that price ratios did get out of whack for housing. Right now stocks are quite reasonable in terms of earnings multiples.

9. Another question was for President Hennessy: You made a tremendous effort to protect the undergraduates [from the effect of the decrease in the economy]. What about graduate students?

The president replied that he expected we will have slightly fewer funds, which will reduce the number of graduate fellowships that are dependent on university funds. But we are determined to protect the present graduate students. For those whose support depends on external support, the stimulus package is not an answer for this problem because it is short term. How the government is going to deal with the growing deficit is the big question. “As I said to our alumni, we are focusing on raising money for people, people, people.”

V. **Adjournment**

There being no further questions, the President thanked the audience for their questions, and the panel members, and adjourned the meeting at 5:10 PM.

[Applause]

Respectfully submitted,

Rex L. Jamison, MD
Academic Secretary to the University