**Testimony of**

**Mark Schneider, Ph.D.**

**Before the**

**Subcommittee on Oversight**

**Committee on Ways and Means**

**U.S. House of Representatives**

**September 13, 2016**

## Introduction

Chairman Roskam, Members of the Subcommittee, thank you for inviting me to testify today. My name is Mark Schneider. I am a Vice President at the American Institutes for Research here in Washington DC. Along with Jorge Klor de Alva, President of the Nexus Research and Policy Center, I have been exploring the size of public subsidies to students who attend the best endowed universities in the nation.[1]

America's universities are held up worldwide as models of excellence and are heavily represented in any list of the world's best. However, this high esteem rests on a highly unequal distribution of wealth, dominated by some first-tier public flagships and a group of private not-for-profit universities. Topping the list of the latter are schools with endowments over $10 billion: Harvard ($36 billion), Yale ($26 billion), Princeton ($23 billion), Stanford ($22 billion), and MIT ($13 billion)—joined by another 50 or so with endowments over $1 billion.

Because gifts to these endowments are tax deductible to the donors and the earnings these endowments generate are tax free, the public subsidizes these universities. These subsidies increase with the wealth of the university so students at Harvard or Yale are subsidized to a far greater degree than students at public colleges and universities.

Congress has granted endowments tax-exempt status to promote the public welfare. But because so much wealth has accumulated in so few institutions, questions arise about the degree to which the inequality in taxpayer subsidies serves a public purpose. It is important to note just how large the inequality in endowment wealth is: Of the approximately 1,600 not-for-profit private universities that report endowment data to the federal government, only 102 have endowments over $500 million and only 56 (less than 4%) have endowments more than $1 billion. The concentration of wealth is even greater at the top: only seven private institutions have endowments topping $10 billion. But these seven alone hold well over 40% of the endowment wealth of America's super rich universities.

[1] See for example *Rich Schools, Poor Students: Tapping Large University Endowments to Improve Student Outcomes* (2015, April) available at http://www.air.org/resource/rich-schools-poor-students-tapping-large-university-endowments-improve-student-outcomes or http://nexusresearch.org/wp-content/uploads/2015/11/Rich-Schools-Poor-Students-Revised-November-2015.pdf and *Why Should Rich Universities Get Huge Property Tax Exemptions,* available at https://www.washingtonpost.com/news/grade-point/wp/2016/07/08/why-should-rich-universities-get-huge-property-tax-exemptions/

This highly unequal distribution of endowments has led to arguments that many universities have far more money than they need and that they are not managing their endowments in alignment with the public interest.[2] One factor contributing to this "endowment hoarding" is that university presidents are rewarded for large endowments. Empirically, we found that 2013 compensation levels for a set of almost 400 presidents[3] increased with the size of the endowment but declined with increases in Pell enrollment and was unrelated to six year graduation rates. In short, university boards of trustees, which set presidential compensation levels, are rewarding endowment hoarding far more than they are rewarding presidents who are more attuned to student success or the public interest in seeing them succeed.

These data suggest that a bright light needs to be shined on the size and use of endowments. Below we show the extent to which taxpayers are subsidizing students in rich universities and suggest ways in which the incentives governing the use of tax-free university endowments can be made more compatible with the public interest.

## The Hidden Public Cost of "Private" Not-for-Profit Colleges

Since endowments are not taxed, students at well-endowed private schools enjoy public subsidies that are far greater than those for students at the public two- and four-year schools responsible for educating most working- and middle-class Americans. While these subsidies are all too often hidden from public view, they are nonetheless very real and very expensive.[4]

Table 1 shows that the per-student value of subsidies that flow through tax exemptions can far surpass the level of direct government appropriations to public colleges and universities.[5] The table is based on: (1) the average difference between 2012 and 2013, 2013 and 2014, and 2014 and 2015 endowment data,[6] used as a proxy for investment gains,[7] (2) the average effective

---

[2] See for example http://www.nber.org/papers/w15861.pdf?new_window=1

[3] The compensation data come from the Chronicle of Higher Education's most recent report on presidential compensation. Available at http://chronicle.com/interactives/executive-compensation#id=table_private_2013

[4] These tax exemptions are "off budget"—but they translate into taxpayer subsidies that, from a public policy perspective, should be treated as the equivalent of direct appropriations.

[5] An appendix detailing the calculations is available upon request.

[6] NACUBO. (2014). *U.S. and Canadian institutions listed by Fiscal Year 2013 endowment market value and change in endowment market value from FY 2012 to FY 2013*. Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2013NCSEEndowmentMarket%20ValuesRevisedFeb142014.pdf

NACUBO. (2015). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2014 endowment market value and change in endowment market value from FY2013 to FY2014*. Retrieved from combined state and federal long-term capital gains rates for 2013,[8] and (3) the latest three academic years' (AY 2011-12, 2012–13, and 2013-14) enrollment and government appropriations figures.[9]

Table 1 shows the estimated average government subsidy—through direct appropriations and tax exemptions[10]—per full-time equivalent (FTE) student attending 10 not-for-profit universities with the highest endowments in 10 states. It also shows the corresponding government investment in students attending a public institution in each of the following categories: the state flagships, regional campuses, and community colleges located in the same state as the elite private campus.

Across these 10 rich private institutions, using a weighted average of enrollments, taxpayers spent nearly $26,000 per student per year, almost twice the average direct taxpayer subsidies to students attending public flagship campuses in the same state as the private institutions. Table 1 also shows that, on average, the level of per-student support given to the 10 regional campuses in our study is about half what is given to students attending flagships. And while nearly half of students beginning their postsecondary education attend community colleges,[11] taxpayers support these students at the lowest levels. Each receives only about one dollar for every five dollars that taxpayers send per student to the elite private schools we studied.

---

http://www.nacubo.org/Documents/EndowmentFiles/2014_Endowment_Market_Values_Revised.pdf; NACUBO. (2016). U.S. and Canadian institutions listed by Fiscal year (FY) 2015 endowment market value and change in endowment market value from FY2014 to FY2015. Retrieved from http://www.nacubo.org/documents/endowmentfiles/2015_NCSE_Endowment_Market_Values.pdf

[7] Because the IPEDS data on income (for schools that use Government Accounting Standards Board [GASB]) and investment return (for schools using Financial Accounting Standards Board [FASB]) do not distinguish between recognized and unrecognized gains from investments, we searched for the best proxy possible for realized gains. After substantial consultation, we settled on the delta between annual endowment results. This solution is not perfect, but other alternatives we explored—in the absence of the relevant data—were found to be too speculative for this study. *This is why one of our recommendations is for greater transparency in reporting of endowment returns.*

[8] See Table 1 in: Tax Foundation. (2013). *The high burden of state and federal capital gains taxes.* Retrieved from http://taxfoundation.org/article/high-burden-state-and-federal-capital-gains-taxes

[9] National Center for Education Statistics. (n.d.). *IPEDS Data Center*. Retrieved from http://nces.ed.gov/ipeds/datacenter/

[10] Note that property tax exemptions, discussed below, are not included in our sum of taxpayer subsidies.

[11] Community College Research Center. (n.d.). *Community college FAQs*. Retrieved from http://ccrc.tc.columbia.edu/Community-College-FAQs.html. The support per student is lowest at community colleges for several reasons, including lower tuitions and degree attainment rates, and the shorter length of many of their educational programs.

**Table 1: Total Federal, State, and Local Appropriations and Tax Subsidies* per FTE Student, by Institution Type: Three-Year Average**

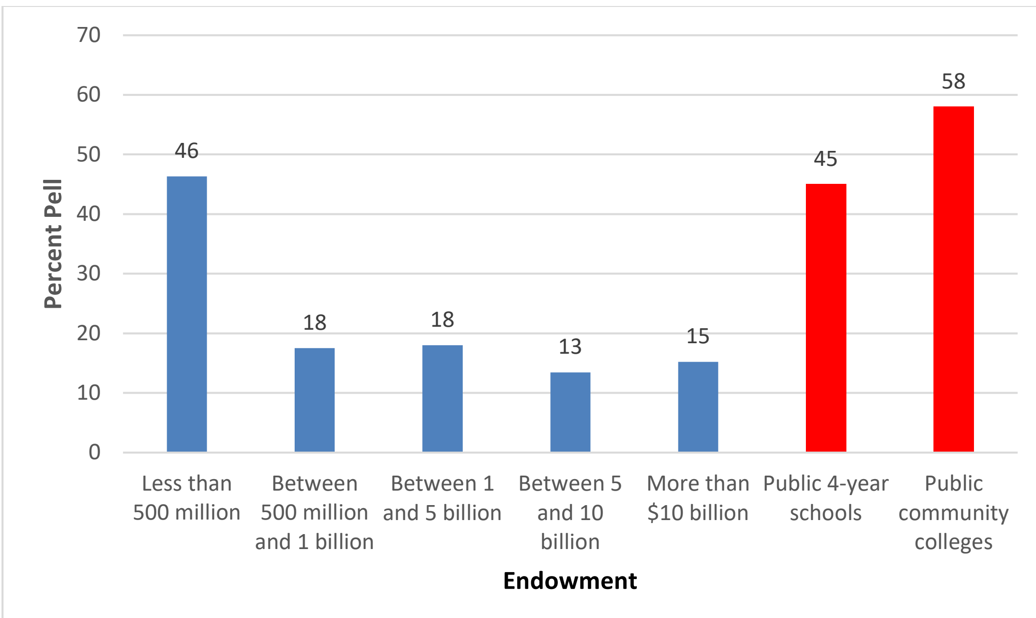
| State | Private Not-for-Profit | Public Flagship | Public Regional | Community College |
|---|---|---|---|---|
| CA | Stanford | UC-Berkeley | CSU Fullerton | Fullerton |
| | $39,600 | $8,800 | $4,200 | $7,500 |
| CT | Yale | U of CT | Central CT | Tunxis |
| | $45,100 | $23,600 | $7,000 | $6,500 |
| IL | U of Chicago | U of IL Urbana | Western IL | Waubonsee |
| | $7,300 | $7,100 | $11,900 | $8,100 |
| IN | Notre Dame | IU Bloomington | IN State | Ivy Tech |
| | $17,100 | $6,100 | $7,100 | $3,200 |
| MA | Harvard | U MA Amherst | Bridgewater | Massasoit |
| | $26,200 | $10,000 | $5,000 | $4,300 |
| NC | Duke | UNC Chapel Hill | UNC Charlotte | Central Piedmont |
| | $11,500 | $23,400 | $8,600 | $5,100 |
| NJ | Princeton | Rutgers | Montclair | Essex County |
| | $72,100 | $13,600 | $4,600 | $2,400 |
| NY | Columbia | Stony Brook | CUNY Queens | Queensborough |
| | $9,600 | $18,100 | $5,400 | $5,500 |
| PA | U of Penn | Penn State | IN U of Penn | Westmoreland |
| | $15,900 | $9,400 | $3,700 | $2,600 |
| TX | Rice | UT Austin | TX State | Austin |
| | $13,700 | $16,900 | $4,400 | $6,500 |
| **AVERAGE** | **$25,800** | **$13,700** | **$6,200** | **$5,200** |

* Does not include subsidies based on property tax exemptions.

## The Size of Endowments and Pell Participation Rates

We noted above that presidential compensation levels were *negatively* related to the concentration of Pell students but positively related to endowment size. The data in Figure 1 shine more light on this relationship, showing that high endowment wealth is associated with low concentrations of low-income Federal Pell grant recipients. Only 13% of the students in universities with endowments between $5 and $10 billion are Pell recipients, and at even wealthier universities only 15% of students receive Pell grants. Meanwhile, only private colleges with endowments below $500 million have concentrations of Pell students comparable to the percentage of Pell recipients at public four-year colleges. And, as could be expected, community colleges, which receive the lowest levels of government or endowment support, serve the highest percentage of Pell students.

**Figure 1: Median Percentage of Federal Pell Grant Participation at Private Colleges and Universities by Endowment Size and at Public Colleges and Universities**




Source: IPEDS and 2015 NACUBO-Commonfund Study of Endowments.[12]

In sum, the unequal distribution of endowment wealth and the unequal enrollment of low-income Federal Pell grant recipients lead to a pattern: the rich schools get more than their less affluent

[12] National Center for Education Statistics. (n.d.). *IPEDS Data Center*. Retrieved from http://nces.ed.gov/ipeds/datacenter/; NACUBO. (2016). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2015 endowment market value and change in endowment market value from FY2014 to FY2015*. Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2015_NCSE_Endowment_Market_Values.pdf .

private and public counterparts, who are educating the lion's share of America's working- and middle-class students.

## What Should Be Done?

### First, Make Hidden Subsidies Public.

The data presented here suggest a domain in need of a bright light. Many of our best-known private colleges are supported by taxpayers to an extent that is far more generous than the support received by the public colleges and universities that most students attend. State and local appropriations, allocated by elected politicians, pale beside the government subsidies to the richest universities made possible by hidden tax policies. Rather than leaving tax-based subsidies hidden, we need to bring to the surface data about the nature and size of these subsidies, the extent of their distribution, and the policies that promote their concentration in the wealthiest schools.

One mechanism for increasing transparency is through improving the IRS 990 Form that tax-exempt universities must file annually. The 2016 joint letter to the 56 richest universities identified many areas in which taxpayers should have more information. We suggest that Congress consider revising the 990 form so that this information is reported in a clear manner accessible to both the public and policymakers. Among the areas most in need of being addressed, in light of this hearing, is Schedule D, Part V, which concerns endowment funds. In particular, we suggest the following sections be revised:

> 1.c. Realized earnings and losses must be clearly distinguished from endowment gains (i.e., total increase in the endowment minus contributions).
>
> 1.d. Grants and scholarships should distinguish between cash awards and in-kind contributions (e.g., free tuition).
>
> 1.f. Administrative expenses should detail total cost for the management of the endowment (including fees paid to third parties).
>
> 2. Rather than percentages, exact amounts should be used for the endowment categories (quasi, permanent, and restricted).
>
> 2.a. Board designated quasi-endowment funds should distinguish between those reserved for financial aid (scholarships and grants), those reserved for other educational purposes, and those reserved for other expenditures.
>
> 2.b. Permanent endowment funds and 2.c. temporarily restricted endowment funds should likewise make the same distinctions.

## Second, Encourage Localities and States to Revisit the Property Tax Exemption

Private colleges are also exempt from paying property taxes, which adds, sometimes substantially, to the level of taxpayer subsidy they receive.[13] Since property taxes are set by local governments within the constraints of state laws, the federal government's role is inherently limited. However, because the *low level of information* about the size of property holdings of different campuses and how much these holdings cost taxpayers is something that could be used by local and state governments, the federal government can help by requesting this tax information in the 990 IRS form.

Reliable comparable numbers on the property holdings of tax-exempt colleges and universities would permit all to see exactly how much this tax break is costing local taxpayers. Given the paucity of data in this area, we believe the Congress should also ask the National Center for Education Statistics (NCES) to undertake a systematic study of these property holdings and the payments made in lieu of taxes (the so-called PILOTs).[14]

## Third, Tax Large Endowments.

It is clear from the facts cited here that the current system of tax exemptions granted to large endowments no longer serves the public interest. We suggest that the Congress consider levying a moderate tax on these endowments. The questions are what should that tax look like and how should the revenues generated by the tax be best used to support the success of students and the public interest.

As presented in Table 2, we propose a taxation scheme in which qualifying endowments are very large (more than $500 million) and the proposed excise tax range is small and similar to the tax rate that private foundations are already subject to (0.5 percent to 2.0 percent).

To help minimize the impact of these assessments on the institutions subject to the tax, we recommend that, first, tax deductions for gifts given to these colleges remain in place. Second, to

---

[13] There are other avenues for tax subsidies we have not measured, including exemption from state income and excise taxes, state and local sales tax, and tax-exempt bonds. Researchers at the Tellus Institute have proposed a broad framework for identifying and classifying all these expenditures, but we have chosen a more limited exercise across a wider range of schools. See: Tellus Institute. (2012). *Public investment in private higher education: Estimating the value of nonprofit college and university tax exemptions*. Retrieved from http://tellus.org/publications/files/college-tax-exemption.pdf See also Povich, E. S. (2015). *Should nonprofits have to pay taxes?* Retrieved from http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes

[14] Note, Schneider served as Commissioner of Education Statistics from 2005-2008.

assure the proposed tax does not inadvertently disrupt the amount affected schools set aside for financial aid and to encourage even higher allocations in aid to low- and middle-income students, we suggest the proposed tax be offset annually by the amount the school appropriates for financial aid to its Pell-eligible students.

**Table 2: Proposed Annual Excise Tax Rates, Number of Colleges Affected and Expected Tax Revenue Based on 2015 Endowment Size**

| Size of Endowment | Number of Private Colleges Affected | Tax Rate | Total Endowment (in Millions) | Expected Tax Revenue (in Millions) |
|---|---|---|---|---|
| >$3 Billion | 21 | 2.0% | $222,468 | $4,449 |
| >$2+ Billion | 7 | 1.5% | $15,528 | $233 |
| >$1 Billion | 28 | 1.0% | $39,714 | $397 |
| >$0.5 Billion | 46 | 0.5% | $33,172 | $166 |
| TOTAL | 102 | 1.01% | $310,882 | $5,245 |

Source: 2015 NACUBO-Commonfund Study of Endowments[15]

This excise tax should not only encourage the taxed institutions to allocate a larger share of their endowments to financial aid for their low-income students, but also provide billions of dollars annually for the improvement of the education of hundreds of public institutions serving millions of low-income and middle-class students.

To do so, we recommend that the revenue raised from the excise tax be used solely for the benefit of students attending community colleges—institutions that are seriously under-resourced yet responsible for training much of the nation's workforce. Our proposal thus resembles the bill Senators Chris Coons (D-Del) and Johnny Isakson (R-Georgia) plan to introduce this fall, one holding four-year colleges more accountable for graduating students, especially those from low-income families. The bill, according to *Politico*,[16] would take some federal money away from

[15] NACUBO. (2016). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2015 endowment market value and change in endowment market value from FY2014 to FY2015*. Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2015_NCSE_Endowment_Market_Values.pdf

[16] Stratford, M. (2016, July 26) *Sanders, Clinton eye unity over debt-free college*. Retrieved from http://www.politico.com/tipsheets/morning-education/2016/07/sanders-clinton-eye-unity-over-debt-free-college-215526#ixzz4H7pusVhH.

“wealthy and high performing colleges” that do not “serve a minimum number of qualified low-income students” and target it to “under-resourced colleges that are great on access but are struggling to succeed with completion.” Do note that this proposed bill differs from proposals that would target additional revenues solely to students *within* the same school.[17]

We believe that this tax can be implemented in a revenue-neutral manner that incentivizes corporations to strengthen their support of local community colleges. To accomplish this, we propose that you consider a new charitable tax credit that builds on the tax legislation that created several types of tax credit bonds under the Internal Revenue Code.

The proposed taxing arrangement is revenue neutral because the revenue from the excise tax would match the amount offset by the tax credit gained by participating individuals or corporations. In effect, a taxpayer giving, say, $1 million to a community college could get an extra percentage of credit against taxes owed. The total amount of extra tax credit allowed by the program would offset the amount of revenue raised by the excise tax on large endowments. In turn, the value of the tax credits would match the annual flow of money to be made available to community colleges for qualified purposes. A competitive grant process could be used to assure that selected community colleges applied the funds to support practices proven effective in promoting student success.

As was the case with previous qualified tax credit bonds administered by the Treasury Department and used to support various educational and energy initiatives, these charitable tax credits could provide an attractive opportunity for corporations or others seeking to reduce their tax burden in a socially responsible manner.

Just as Treasury issued tax credit bonds to support only activities that met criteria set by rules, regulations or legislation, this tax credit would not be available to all. A panel of experts could be established to judge the applications and make awards based on the application’s conformance to the established criteria.

[17] The Education Trust’s recent proposal that wealthy schools be required to spend 5% of their endowment annually in order to increase financial aid for their students would benefit, by their calculations, fewer than 2,500 students across all the schools with endowments above $500 million. Our proposal could affect hundreds of thousands of low-income students (on numbers of students and percentages of low-income enrollees at community colleges see http://ccrc.tc.columbia.edu/Community-College-FAQs.html).

In effect, the proposed tax credits can build on these past procedures to support the implementation of practices proven to benefit community college students. The following outlines possible implementation steps:

- First, Treasury would estimate the annual yield of the excise tax on endowments over $500 million.
- Second, Treasury would fix the amount to be offset through the tax credits to equal that yield.
- Third, the U.S. Department of Education would establish a panel of experts to determine the qualifying criteria and evaluate the proposals from community colleges. The Education Department would then publicize a request for proposals from community colleges. The call would specify that only activities with evidence that they are associated with student success—measured by indicators such as increased student progression, retention, completion, or job placement—would qualify for financial support.
- Fourth, interested community colleges would help identify taxpayers interested in the tax credits. This effort would promote links between colleges and corporations that are critical to resolving the current gaps between what is taught and the workplace skills and competencies industries need.

Periodic evaluation of the effectiveness of the program would assure that it would be continually improved for continuous success.

The problems faced by higher education, such as low completion rates, cannot be ignored, and fixing them is expensive. In response to these challenges, and with the hope bipartisan support will make some version of it a reality, we hope you consider this excise tax—a tax whose time has come.