Testimony of

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Introduction

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, D.C. Along with Jorge Klor de Alva, President of the Nexus Research and Policy Center, we have been exploring the ways in which large endowments intersect with public policy and how the tax code could be modified so that these endowments better serve the public interest.[1]

America's universities are held up worldwide as models of excellence and are well represented in any list of the world's best. This high esteem rests on a highly unequal distribution of wealth, where a small group of private not-for-profit universities disproportionately dominate the rankings through an accumulation of riches, while public four- and two-year schools educate far more students with significantly fewer resources.

As is well known, the list of the richest schools, those with endowments over $10 billion, include Harvard ($35 billion), Yale ($25 billion), Princeton ($22 billion), Stanford ($22 billion), and MIT ($13 billion). They are joined in the upper end of the concentration of wealth by another 50 or so institutions with endowments of over $1 billion. This is both impressive and troublesome.

Because gifts to these endowments are tax deductible to the donors and the earnings these endowments generate are tax free, the general public lavishly subsidizes these universities although few taxpayers have students enrolled in them. Furthermore, these subsidies increase with the wealth of the university so that Harvard or Princeton is subsidized to a far greater degree per student than are the public colleges and universities that educate the majority of the nation's college students and our future workforce.

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 truly serves a public purpose. It is important to note just how large the inequality in endowment wealth is: There are approximately 1,600 not-for-profit private

[1] See for example *Rich Schools, Poor Students: Tapping Large University Endowments to Improve Student Outcomes* (2015, November) available at 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/.

universities that report endowment data to the federal government, but only 98 have endowments over $500 million and of these 53 (fewer than 4%) have endowments of more than $1 billion. As we near the top, the concentration of wealth is even greater: the six private institutions with endowments topping $10 billion hold well over 40% of the total endowment wealth of America's super rich universities.

Another way of seeing just how unequal the distribution of endowment wealth has become is through the "Gini coefficient,"[2] a standard measure of inequality. The Gini coefficient—which ranges from 0 to 1 and rises with inequality—shows that inequality among the distribution of endowment wealth in America's private colleges is close to .90 (approaching its upper limit). By way of comparison, the Gini coefficient measuring income inequality in the United States is less than half that (.40).

This highly unequal distribution of endowments, and the causes behind endowment hoarding, 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.[3] These data further suggest that a bright light needs to be shined on the size and use of endowments and the tax policies that have enabled such a concentration.

We now turn to the public policy effects on endowments of current tax laws and conclude with recommendations regarding how tax incentives governing university endowments can be better aligned with the public interest.

Are Taxpayers Over-Subsidizing Rich Not-for-Profit Colleges?

Since endowments are not taxed, well-endowed private schools enjoy per-student public subsidies that are far greater than those found at the public two- and four-year schools. These subsidies are generated through complex tax laws and are all too often hidden from public view. Yet they are very real and very expensive.

[2] For a general explanation see http://www.bbc.com/news/blogs-magazine-monitor-31847943; for a statistical definition see http://mathworld.wolfram.com/GiniCoefficient.html.
[3] See for example https://itunes.apple.com/us/podcast/revisionist-history/id1119389968?mt=2&i=372836942 and http://www.nber.org/papers/w15861.pdf?new_window=1.

Elsewhere[4] we have documented the differences in the size of taxpayer subsidies to these rich campuses compared to the subsidies received by public institutions. Depending on the year, differences between the per student tax subsidies at Harvard, Princeton or Yale compared to per-student government support at nearby state public flagships can be in the tens of thousands of dollars. As we have shown, in 2013 the ratio of the per-student taxpayer subsidy to these rich schools compared to nearby regional public campuses was as high as $22 to $1; at community colleges it jumped in one case to $44 to $1.

Such a gap in taxpayer subsidies would be more acceptable if these rich campuses were promoting social mobility and helping low-income students rise into more affluent social strata, but unfortunately that is not the case. We can see this by noting both the distribution of Pell students across different types of campuses and by comparing the level of social mobility found among rich and less well funded institutions.

Are Rich Not-for-Profit Colleges Educating Their Share of Pell Grant Recipients and Promoting Social Mobility?

Pell grants represent the nation's most enduring commitment to helping low income students attend institutions of higher education and embody our nation's commitment to helping students achieve the American dream of upward social mobility. Two pieces of data suggest that these rich universities are not doing their share.

First, high endowment wealth is associated with lower concentrations of low-income Federal Pell grant recipients. Only 12% of the students in universities with endowments between $5 and $10 billion are Pell recipients, and at even wealthier universities a mere 15% of students receive Pell grants. And the problem is neither financial nor is it the result of few qualified Pell-eligible students. As recently reported by the Georgetown University Center on Education and the Workforce, "69 of the most selective private colleges ran average annual budget surpluses of $139 million over the last four years, yet admitted fewer than 20 percent" Pell student. However,

[4] Klor de Alva, J. and Schneider, M. (2015, November), *Rich Schools, Poor Students: Tapping Large University Endowments to Improve Student Outcomes*. Available at http://nexusresearch.org/wp-content/uploads/2015/06/Rich_Schools_Poor_Students.pdf.

nearly 90,000 Pell Grant recipients, who enrolled elsewhere, could have enrolled in selective colleges given their scores on standardized tests. [5]

Meanwhile, only a few private colleges with endowments below $500 million have concentrations of Pell students that approximate the percentage of Pell recipients at public four-year colleges (36%). And, as could be expected, community colleges, which receive the lowest levels of government or endowment support, serve the highest percentage of Pell students (53%).[6]

Second, recent data from the Equality of Opportunity Project[7] suggest that the many taxpayer dollars invested in America's most affluent universities support the social mobility of only a very small number of middle- and low-income students, while disproportionately assisting even more upward mobility for the already well-heeled. Consider this: students from families in the top 1 percent of the income distribution are *77 times more likely* to attend the most elite universities (the eight Ivy League colleges, plus four others) than are students from families in the bottom 20 percent of the income distribution.

When all campuses with endowments over $1 billion are considered, less than 4 percent of the students in these universities come from families who fall within the lowest 20 percent of America's income distribution. These lucky few have a pretty good shot at moving from the bottom to the top 20 percent–historically, over half have done so. But because so few poor students have won admission to these elite schools, less than 2 percent of all the students in these schools have moved from the bottom to the top.

In contrast, the vast majority of American students enrolled in four-year schools attend regional state universities. Yet compared to the level of taxpayer subsidies received by their rich private brethren, students attending these regional campuses are grossly disadvantaged.

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[5] Carnevale , A. P. and Van Der Werf, M. (2017) The 20% Solution: Selective Colleges Can Afford to Admit More Pell Grant Recipients. Georgetown University Center on Education and the Workforce, Washington, D.C. Retrieved from https://cew.georgetown.edu/wp-content/uploads/The-20-Percent-Solution-web.pdf.

[6] See the Appendix for more details.

[7] See http://www.equality-of-opportunity.org/documents/.

Among the 242 public four-year schools with endowments reported to the government in 2016, we calculate that over the last three years these public colleges and universities received taxpayer support averaging just over $9,000 per student annually, a fraction of that received by campuses with endowments of over $1 billion. One consequence of that disproportionate flow of taxpayer dollars to the elite private universities is that last year, according to federal statistics, the billion-dollar-plus campuses were able to spend over $41,000 on instructional services for each student. In contrast, regional campuses spent only about a quarter as much ($10,700) on instruction per student.

Yet regional campuses contribute more to social mobility than the heavily subsidized private elite schools. We estimate that over 96,000 current students at public four-year schools will move from the bottom to the top 20 percent of the income distribution by the time they are in their 30s. In contrast, only about 7,000 current students in the billion-dollar-plus universities will get that far. In short, the contribution of regional campuses to making the American dream of social mobility a reality is nearly 14 times greater than that of the elite private campuses.

Should Restricted Gifts to Endowments be Taxed at a Different Rate?

Current tax laws do not differentiate between restricted and unrestricted gifts to universities. By permitting an institution to have greater flexibility to meet its mission-centered needs, unrestricted gifts can be of far greater value to these campuses and ultimately to the public. Restricted gifts frequently lead to the creation of physical spaces, research projects, and non-critical ventures whose upkeep or continuation can escalate an institution's costs while reducing university funds needed to address core needs, such as financial aid, instructional support, or student counseling. Because such inefficiencies are underwritten by the American taxpayer through the tax code, the public interest may be better served by giving preferential tax treatment to unrestricted gifts relative to restricted ones.

This debate is not limited to gifts to universities. Consider the case of gifts to museums. Michael O'Hare, a professor of public policy at the University of California-Berkeley, argues that "unrestricted money gifts are more valuable than gifts with strings attached." Turning to how the tax code could incentivize the donation of unrestricted gifts and using the example of art gifts, O'Hare argues that the tax code should be amended to "reduce the appraised value of donated art to reflect any restrictions." This would nudge donors to avoid placing restrictions on their giving.[8]

This argument has clear parallels to giving to universities. Indeed, at a 2017 Clark Kerr Lecture, Lawrence Bacow, President Emeritus of Tufts University, agreed that "unrestricted gifts or budget relieving gifts were certainly more valuable to an institution than highly restricted gifts."[9] While Bacow expressed hesitation about differential taxation, the recognition of the different value of unrestricted and restricted gifts clearly opens up that policy option for exploration—an opening explored in depth by Roger Colinvaux, a law professor at the Catholic University of America.

Colinvaux argues[10] that restricted gifts "turn public charities into vehicles for implementing private intent, and undermine institutional independence." In doing so, restricted gifts are not only inefficient but undermine the charitable purpose behind the tax laws. According to Colinvaux, "[a]s a general matter the charitable transfer system is based on the premise that institutions, not individuals, are and should be the locus for determining public benefit." Therefore, he concludes that the tax laws need to be revisited so as to encourage unrestricted giving and discourage restricted gifts.

In short, there are fundamental differences in the effect and the value of restricted and unrestricted gifts to universities—and to the ability of universities to serve the public interest. In the next few pages we recommend concrete steps that can be undertaken to better align the tax deductions Congress has granted to rich universities with the public interest that justifies that tax exempt status in the first place.

[8] O'Hare, M. Museums Can Change—Will They." *Democracy: A Journal of Ideas*. Spring, 2015, No. 36. Retrieved from http://democracyjournal.org/magazine/36/museums-can-changewill-they/.
[9] Bacow, L.S. "The Political Economy of Cost Control on a University Campus." 2017 Clark Kerr Lecture Series, University of California-Berkeley, April 20, 2017.
[10] Colinvaux, R. "Using Tax Law to Discourage Donor-Imposed Restrictions on Charitable Gifts." This draft was prepared for the National Center on Philanthropy and the Law's Annual Conference, Wrestling with Donor Intent: Strategies for Enforcement or Relaxation, October 27-28, 2016.

What Should Be Done?

First, Make Hidden Subsidies Public

The data presented here suggest a domain in need of a bright light. 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 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 universities must file annually. The 2016 letter that Congressional committees sent to the 56 richest universities identified many areas in which taxpayers should have more information.[11] We suggest that Congress study closely the responses from the colleges and universities and consider changing the 990 form as appropriate so that critical information on uses and management of endowments is asked for and that results be reported on an annual basis in a manner accessible to the public.

Second, Apply Differential Tax Rates to Restricted Versus Unrestricted Gifts

Today, donors deduct restricted and unrestricted donations from their taxes at the same rate. But the value of these donations to institutions can be substantially different. And, as just noted, restricted gifts are, at best, second-class gifts that may, in fact, turn into substantial liabilities depending on the donor's intent.

By changing the tax code so that unrestricted charitable gifts can be deductible at, say, twice the rate of restricted gifts, donors will continue to be incentivized to donate to the school of their choice. Meanwhile, university presidents and their development offices will be incentivized to increase endowments that actually help institutions by giving administrators the flexibility they

[11] Blumenstyk, G. Congress Again Scrutinizes Colleges With Big Endowments. *The Chronicle of Higher Education*, February 9, 2016. Available at http://chronicle.com/article/Congress-Again-Scrutinizes/235238?cid=at&utm_source=at&utm_medium=en&elq=19fdec74defe46f2a1d9b96513256109&elqCampaignId=2398&elqaid=7830&elqat=1&elqTrackId=90f248f1dbb943d69f520e210a92ab95 .

need to address critical, mission-related operations and programs that promote a sound financial structure, increase financial aid, and reduce tuition growth.

We believe that as the bottom line of endowment spreadsheets shift toward unrestricted gifts, the balance in favor of the public interest will likewise increase.

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 as well as it should. We suggest that Congress consider levying a moderate tax on these endowments. Two questions follow: 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.

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 with unrestricted gifts being deductible at twice the rate of restricted gifts. Second, to 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.

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 public 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 re-introduce this year, one holding four-year colleges more accountable for graduating students, especially those from low-income families. The bill, according to *Politico*,[12] would take some federal money away from "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." As is evident, this proposed bill differs from proposals that would target additional revenues solely to students *within* the same school.[13]

We believe that this tax can be implemented in a revenue-neutral manner that incentivizes corporations to strengthen their support of local colleges. To accomplish this, we propose that, besides differential deductions for restricted and unrestricted donations, you also 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 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.

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[12] 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.

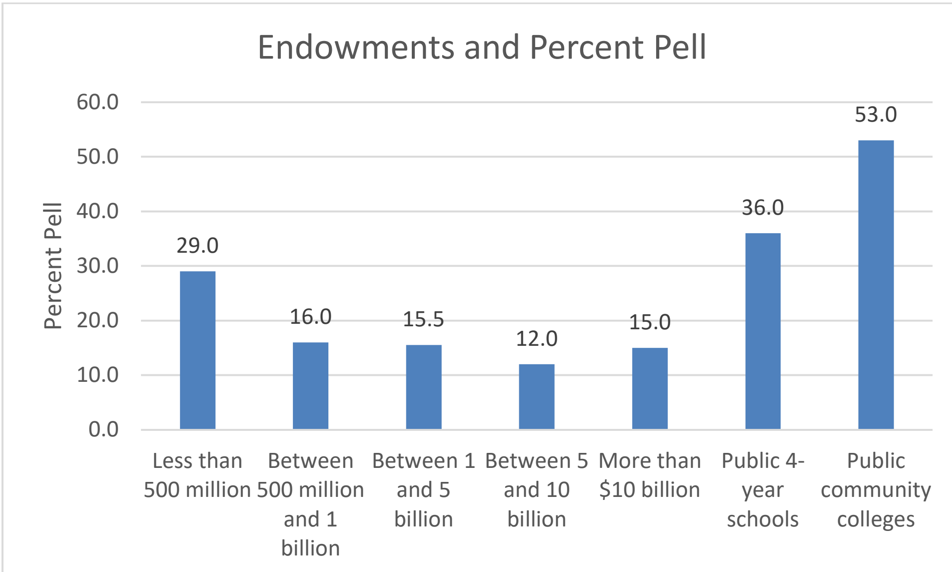
[13] The Education Trust's proposal that wealthy schools be required to spend 5% of their endowment annually in order to increase financial aid for their students would benefit, by their calculations, fewer than 2,500 students across all the schools with endowments above $500 million. Our proposal could 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).

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 by the U.S. Department of Education to judge the applications and make awards based on the application's conformance to the established criteria. In effect, the proposed tax credits can build on these past procedures to support the implementation of practices proven to benefit college students.

To conclude, the problems faced by higher education, such as high costs and 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 modifying the 990 form to increase transparency, applying the differential deduction approach to free the hands of administrators in pursuing the public interest, and enacting this excise tax—a tax whose time has come.

APPENDIX

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 2016 NACUBO-Commonfund Study of Endowments.