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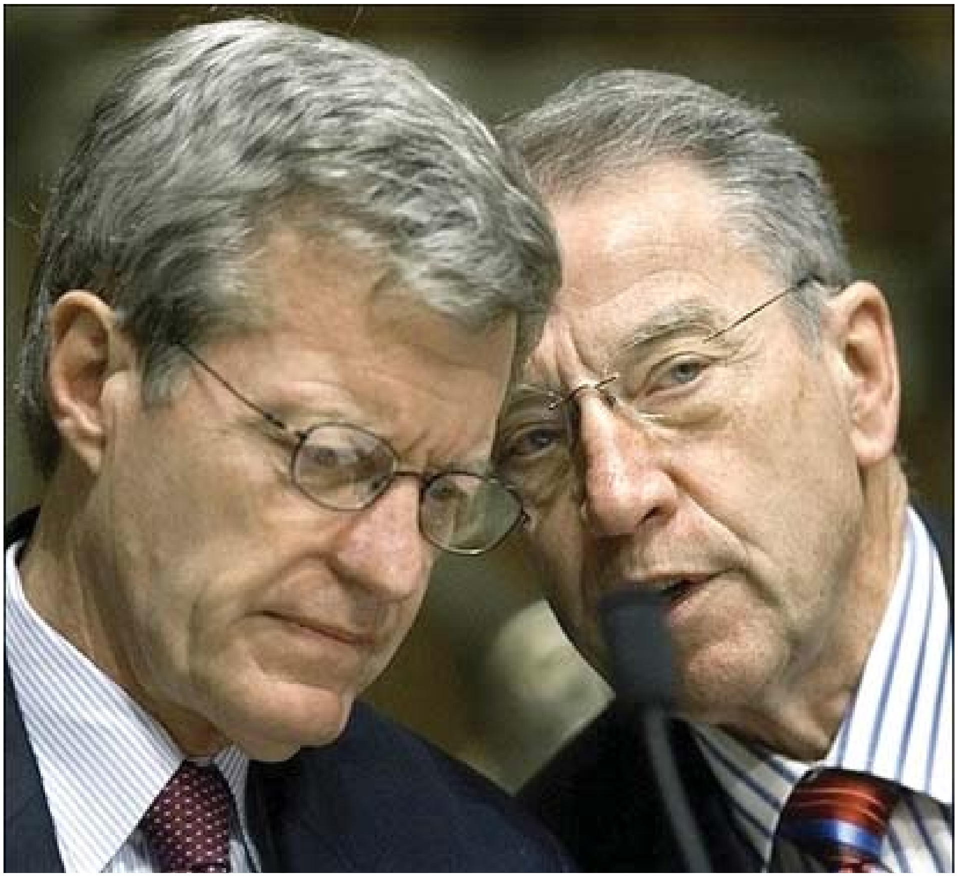
Foundation Watch

# Scrooge U:
# The Illusion of Generosity

**By Lynne Munson**

***Summary**: Even though colleges and universities have become the richest institutions in the history of our nation, tuition continues to skyrocket while institutional spending from tax-free higher education endowments remains meager. Federal lawmakers now question whether college and university endowments should remain unregulated and exempt from taxes, and are considering requiring schools to spend a percentage of their value each year, as private foundations must. Several schools have announced plans to dip into their endowments to defray students' tuition expenses, but are they doing as much as they should in the area of financial aid? And are they violating donor intent by sitting on funds for generations?*



**Senate Finance Committee chairman Max Baucus (at left) and ranking member Charles Grassley (at right) are investigating the hoarding practices of the nation's colleges and universities.**

Columbia University is the most recent institution of higher education to announce that it would be increasing its financial aid to undergraduates. The last four months have seen a string of such announcements, mostly from colleges and universities with sizeable endowments. These announcements have impressed some. But a close look reveals that these schools are doing little different than they have for years, despite the fact that their endowment wealth has increased to a point that would allow some colleges and universities to eliminate—and many to substantially alleviate—the tuition burden for tens of thousands of undergraduates.

Harvard University was the first to say it would be spending more of its treasure. The university expected to be widely applauded just before Christmas for its new financial aid program that promises to discount tuition for students whose families earn $180,000 or less. Harvard's annual aid to undergraduates will now total $120 million—a $22 million increase over last year.

Should America's education consumers really be impressed by this apparent generosity? Harvard is indeed spending more on aid even in comparison to other heavily-endowed institutions such as the University

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of Michigan whose endowment ranks in the top 10 nationwide. This multi-campus system plans to offer its 40,000 undergraduates a mere $61 million in aid next year, or half of what Harvard will give to just 6,600 undergraduates.

Yet given Harvard's spectacular wealth, even its new outlay for aid seems miserly. With a $34.9 billion endowment, Harvard sits on the largest fortune amassed by *any* institution in the history of our nation. It took just eight days last year for Harvard's endowment to earn enough to cover its entire undergraduate aid budget. And this new increase in aid amounts to a mere day and a half of earnings.

Harvard is so wealthy that it would take less than 1% endowment spending for its students to attend tuition-free. But at its current rate of spending, billions of dollars in donations that Harvard promised donors it would spend on aid will just sit unused for generations, serving no purpose. And, all the while the university will keep charging tuition, raising tuition, and even continue to charge an application fee. This amounts to a violation of donor intent. (For information on the issue of donor intent, see *The Great Philanthropists and the Problem of 'Donor Intent,'* by Martin Morse Wooster, Capital Research Center, 2007, and "The Donor Has the Final Say: Martin Morse Wooster on Donors, Foundations and Philanthropy," *Foundation Watch*, October 2007.)

Harvard is not the only school that is sitting on billions. Richer than private foundations, higher education endowments tower over their peers across the non-profit world. There are 136 American colleges and universities with endowments larger than $500 million—74 of which top $1 billion. In 2003 there were only 39 schools with billion dollar-plus endowments, but today such schools span 31 states and enroll 1.4 million undergraduates, 1.1 million of whom are at public institutions.

So the real news out of Harvard, Yale, Stanford, MIT, and others isn't that they are spending a bit more on aid. It is the fact that, despite a paradigm shift in the wealth of our colleges and universities, even the wealthiest among them remain unwilling to freeze tuition or even to entertain the notion of making themselves truly accessible to every deserving student by dropping tuition altogether.

Harvard and Yale and other top schools are trendsetters in many areas, including financial aid. So their refusal to go tuition-free will speak volumes to their peers. Yet it isn't just that these schools could provide free tuition to all of their students and never feel a pinch. It is the fact that in not doing so they are deliberately ignoring the wishes of alumni who have donated billions in the hope that the two elite universities will truly throw open their doors.

Let's look closely at Harvard again. Harvard participated in the annual National Association of College and University Business Officers survey which found that, on average, donors to higher education institutions with endowments exceeding $1 billion restrict 56% of their gifts. According to the Council for Aid to Education's "Voluntary Support of Education" study, more than a third of restricted donations to higher education are designated for financial aid. In fact aid is more favored than support for any other activity including research, faculty salaries, and athletics combined.

Based on these findings, we can estimate that Harvard's endowment includes $7 billion that donors have told the school to spend on financial aid. If Harvard deducts its new $120 million undergraduate aid budget from these funds, the school will still roll over and reinvest nearly $6.9 billion in aid-restricted monies. Conservatively estimating that next year Harvard's endowment doesn't increase the over 20% it has in recent years, but that it goes up just 13.3% (its average annual increase since inception) those aid-restricted funds will earn almost $800 million, or 6.6 times the amount Harvard is now spending on aid.

Even if Harvard gave all of its undergraduates a free ride, the school wouldn't come close to spending even half of the interest it is receiving on the aid-restricted portion of its endowment alone. The full cost of allowing all undergrads to attend without any tuition, fee, or room and board costs would be $306 million. After deducting that amount the remaining $6.7 billion will still earn at least $584 million.

**Saving for a Rainy Day – of Biblical Proportions**

Harvard, Yale, and dozens of their peers are hoarding funds they should have spent years ago. This stockpiling is an affront to the alumni who have given so much to make college more accessible. It is also an expensive habit that economist Jane Gravelle of the Congressional Research Service estimates costs taxpayers $15 billion annually.

The incredible wealth amassed by our colleges and universities should redefine our expectations for many things, including financial aid. Instead of trying to shape those new expectations, the richest schools of all are hoping to be hailed for what amounts to token gifts.

And even as schools grow increasingly affluent, spending from endowment funds is at all-time lows. Recent media reports cite 4.6% as the average endowment payout last year, but this number includes management and custody fees and actually gives an inflated impression of how much schools are spending on education.

Colleges and universities distributed just 3.9% of their endowment last year on activities related to their mission. That's a 0.3% drop from 2006. Either way you look at it colleges and universities are spending less now than they have in decades. And that means that they are hoarding more.

Defenders of minimal endowment spending repeatedly raise two arguments. First, they claim that these funds are needed to protect institutions against fiscal rainy days. This "rainy day" claim is actually an old one, left over from a time when it was impossible to predict donation levels from year-to-year—long before today's non-stop fundraising. With a constant, steady stream of donations that adds around 3% to the endowments' value annually, proponents of low spending have refashioned the rainy-day argument and now claim that it applies to protecting the endowment from market fluctuations.

But it's good management—not miserly spending—that protects endowments from risk, and higher education endowments are among the best-managed pots of money in the country. Because of their size they attract first-rate talent. That's why they weathered the post-911 downturn far better than most—experiencing just a 4.2% average drop in value even as the S&P 500 index plunged 18%. The investment return on Harvard's endowment decreased just 0.5% in 2002 while Princeton's actually increased 2.2%.

There are at least two more reasons the rainy day argument doesn't hold water. First, Yale professor Henry Hansmann found that schools are far more likely to cut educational expenditures than to tap into endowments when the budget doesn't balance. So endowments aren't being used as rainy day funds in that sense. And finally, decades of hoarding has resulted in many endowments growing so large that it would take a rainy day of Biblical proportions to require significantly tapping into these stockpiles.

***Suddenly*, Schools are Interested in Reform**

America's post-secondary institutions have had at least a decade to come up with a strategy for tapping into their not-so-newfound wealth and putting those monies to work for students, families, and taxpayers. These schools were in fact earning slightly better returns on their endowments 10 years ago than they are now. Returns averaged 18.6% in 1998 and 23.8% in 2000. Harvard earned 32.2% on its endowment in 2000 and Princeton earned 35.5%. In 1998 Harvard's endowment was already over $12 billion and Yale's was almost $6 billion. Endowments for all colleges and universities in the nation grew, on average, 23.2% last year while spending from their endowments averaged just 3.9%.

Yet it is only in the last few months—after Congress signaled an interest in the issue—that some schools have announced plans to spend more endowment monies. Specifically, federal lawmakers have begun to wonder why higher education institutions continue to be exempt from taxes while tuitions and endowments continue to balloon. One proposal discussed by Senator Chuck Grassley (R-Iowa) would make colleges and universities, like other foundations, spend at least 5% of their assets each year. Private foundations are required to spend 5% of their value annually in exchange for their tax-free status. Currently, colleges and universities aren't required to spend a cent. (Note: I testified before the Senate Finance Committee last fall. My testimony follows this article.)

**One of the famed gates at wealthy Harvard University**

"Tuition has gone up, college presidents' salaries have gone up, and endowments continue to go up and up. We need to start seeing tuition relief for families go up just as fast," said Grassley, ranking member on the Senate Finance Committee. "It's fair to ask whether a college kid should have to wash dishes in the dining hall to pay his tuition when his college has a billion dollars in the bank."

In late January, the Senate Finance Committee sent 136 schools with endowments larger than $500 million a fact-finding questionnaire. "The questions we put forward in this letter will help Congress better understand how colleges use their endowments to make certain that talented young folks in Montana and across the country aren't left out of the classroom," said Senator Max Baucus (D-Montana), the committee's chairman.

This is a step in the right direction. Until senators wrote to the wealthiest schools, the federal government had never officially requested any significant information from schools about their endowments. Unlike private foundations, colleges and universities aren't required to share almost any information with the public about what they do with their monies. They enjoy tax-free status without many of the responsibilities that normally go along with it.

Grassley aide Jill Kozeny told Newsweek (March 4) that Grassley plans to use the information provided by the schools "to evaluate their endowments' activities in the context of tax-exempt laws and the accompanying obligations to taxpayers and donors."

Historically, Congress has worked to prevent "unreasonable accumulations of income" by tax-exempt foundations, said Roger Colinvaux, legislative counsel to the Congressional Joint Committee on Taxation. This concern gave rise to the requirement that private foundations spend a certain percentage of their assets each year. Some senators now believe today's bloated university endowments constitute an unreasonable accumulation and want those endowments to be subject to the same laws that private foundations have to follow, the Chronicle of Philanthropy reports.

The good news is that endowment funds are now on the table for discussion, no longer locked away in a treasure chest where they languished for so long, helping almost no one. Endowment spending practices may be deeply ingrained, but just as colleges and universities learned to change their longstanding conservative approach to investing, they can update their payout practices, too.

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**Testimony of Lynne Munson before the Committee on Finance of the United States Senate September 26, 2007**

Chairman Baucus, Ranking Member Grassley, and members of the Committee, thank you for inviting me to testify on the topic of higher education endowments.

I am an Adjunct Research Fellow at the Center for College Affordability and Productivity, which is dedicated to research on the issues of rising costs and stagnant efficiency in higher education. I served from 2001 to 2005 as Deputy Chairman of the National Endowment for the Humanities. And I'm also the mother of a one-year-old whose college education will cost a half million dollars if current tuition trends continue.

Senators, our colleges and universities are sitting on some of the largest fortunes amassed by any institutions in the history of our nation. These riches are proof of America's economic strength and of the boundless generosity of its citizens. But I'm afraid to report that, in too many cases, this wealth is being hoarded instead of shared.

College and university endowment spending practices are stuck in a past when endowments were small, investment gains were marginal, and economic rainy days were frequent. Today higher education endowments are massive and—as we've heard today—aggressively invested. Double-digit returns often exceeding 20% are common year after year. Yet endowment payout rates are miserly—averaging just over 4% last year. The situation begs the question: Is the public benefiting enough? Research indicates the answer is "no."

A study conducted by economist Jane Gravelle of the Congressional Research Service points out that endowment wealth is concentrated in the upper ranks, much of it at 62 institutions that have endowments larger than $1 billion. (*Editor's note*: Gravelle's testimony from the same day is available at the Committee's website at http://www.senate.gov/~finance/hearings/testimony/2007test/092607testjg.pdf.)

**The number of colleges and universities with endowments larger than $1 billion has grown dramatically in recent years:**

| | |
|---|---|
| 2003: | 39 |
| 2004: | 47 |
| 2005: | 56 |
| 2006: | 62 |
| 2007: | 76 |

But it is important to know that just three years ago only 39 schools had billion-plus endowments. That's a 38% increase in just a few years. In 2006, 125 schools had endowments over $500 million—a third more than in 2002. The number of schools that can count themselves as endowment-rich or super-rich is growing rapidly. (See National Association of College and University Business Officers, "2006 NACUBO Endowment Study" at http://www.nacubo.org/documents/research/2006NES_Listing.pdf.)

This wealth no longer resides solely or even primarily in the New England corridor. Twenty-six states including Tennessee, Kansas, Minnesota, and Iowa boast institutions with $1 billion-plus endowments. The University of Pittsburgh, Purdue, Michigan State, and little 1,500-student Grinnell College each have endowments larger than $1 billion. A third of the $1 billion-plus endowments are at public institutions. And four of the top 10 endowments are at public schools.

Some of the most outsized endowments are at elite institutions. Yale has more than $4 million in the bank per undergraduate. But, on average, independent schools with endowments larger than $1 billion have $432,422 in their endowment per full-time student. And plenty of public schools also have impressive endowment-to-student statistics. The University of Virginia and the University of Michigan bank $330,000 and $275,000 per undergraduate, respectively. And even though the nine-campus University of Texas system currently enrolls just under 150,000 undergraduates, its massive $13 billion endowment contains $90,000 for each student.

What the data shows is that endowment wealth is everywhere—except in the hands of the students who need it today. Last year endowments increased 17.7% on average—those larger than $1 billion increased 18.4%. Yet, despite double-digit increases stretching back a decade or more—endowment spending is at a nearly all-time low of 4.2%—down from 5.1% in 1994, 6.5% in 1982, and 5.2% in 1975. And spending on financial aid is shamefully small, with many schools putting just a fraction of a percentage of endowment value toward aid.

Schools often blame low endowment spending on donor restrictions. But 45% of endowment funds are unrestricted at independent institutions—as are 20% at public schools. And financial aid is the number one restriction designated by donors—with 36% of gifts restricted for financial aid use in 2005. (Council for Aid to Education, "2005 Voluntary Support of Education," p. 13, table 12)

Tuition has been going up so rapidly for so long it has reached levels that defy understanding. So let me put today's tuition cost in concrete terms. Senators, what would your constituents say if a gallon of gasoline cost $9.15 a gallon? Or if the price of milk was over $15? I ask because that is how much those items would cost if their price had risen at the same rate as tuition since 1980.

I believe that skyrocketing tuition is in fact the biggest "access" problem in higher education. What can possibly be more discouraging to a capable student whose parents are not wealthy than a school with a $45,000 price tag on the door?

Let me provide one more concrete comparison—this one to remind us all exactly how much money we're talking about when we're discussing higher education endowments. The total worth of the top 25 college and university endowments is $11 billion greater than the combined assets of the 25 largest private foundations — including the Gates Foundation, Ford, and Rockefeller. (Foundation Center, "Foundation Growth and Giving Estimates," 2007 edition, p. 7. http://foundationcenter.org/gainknowledge/research/pdf/fgge07.pdf)

Private foundations have fewer assets and, in part because they give away more of their money, are growing far less. Yet they are spending more—their payout averaged 7% in 2005 even though they are legally required to spend just 5%. (Foundation Center, "Foundation Growth and Giving Estimates," 2007 edition, table at p. 4). (Source: Foundation Center,)Yale law professor Henry Hansmann has said that, "A stranger from Mars who looks at private universities would probably say they are institutions whose business is to manage large pools of investment assets and that they run educational institutions on the side…to act as buffers for the investment pools." (Hansmann was quoted by Peter Brimelow in "Professor Scrooge," Forbes, October 19, 1998, p. 60)

Senators, our colleges and universities need to be reminded that they are education institutions first and foremost—and that that is why they receive the enormous tax breaks they do. Their practices, including their handling of endowment monies, should reflect their priorities as educators.

Payout information and other basic higher education endowment statistics must be brought out of hiding—made available, for example, via the Department of Education's website in addition to making permanent the proposed endowment-related revisions to IRS Form 990 (the tax return used by nonprofits). Should this sunshine prove insufficient motivation, Congress should not hesitate to consider a minimum payout requirement—and 5% should only be considered a starting point. Making sure any newly directed monies actually go toward aid or tuition reduction and don't become part of an elaborate shell game will be a significant challenge.

**Question from Senator Pat Roberts (R-Kansas)**
I understand that a university endowment is usually comprised of thousands of donations that are often restricted for certain purposes. These restricted donations are important to funding scholarships, attracting and retaining top-flight professors, and promoting cutting-edge research. How would you structure a payout requirement that would respect the restrictions placed on a good portion of donations made to endowments? Would it be possible to create a payout requirement that would recognize the intent of the donor and ensure trustees do not breach their duties to their endowment?

**Answer by Munson**
Many of the associations that are fighting any mandatory annual endowment spending requirement argue that it would interfere with institutions' ability to abide by the restrictions donors put on their gifts. But colleges and universities themselves have provided information that proves this claim to be false. And research suggests that a spending requirement might actually compel institutions to be more responsive to donor wishes than they are now.

Every year hundreds of endowed institutions of higher education participate in a voluntary survey conducted by the National Association of College and University Business Officers (NACUBO). Because no agency of the federal government currently collects information on higher education endowments, this survey is the most definitive source of information about them. The most recent edition of the NACUBO survey included data from 765 institutions and was published in February 2007.

Private institutions reported that just 32% of their endowment funds are permanently restricted. And only 23% are restricted temporarily. Nearly half of endowment funds at private institutions (44.6% to be precise) are entirely <u>un</u>restricted. A larger proportion of endowment funds are restricted at public institutions, yet still not enough to interfere with any reasonable spending requirement. The NACUBO survey made no distinction between permanent and temporary restrictions at public institutions. Participating public institutions reported that 20% of their endowment funds are <u>un</u>restricted. The percentage of unrestricted funds rose to 25% for public institutions with endowments greater than $1 billion.

Keeping in mind also that higher education endowments have enjoyed double-digit gains for more than a decade, there clearly is no threat that a reasonable spending requirement—even one as high as 8%—will interfere or conflict with donor restrictions. In fact an annual payout requirement might better assure that schools are respecting donor intent by compelling institutions to stop hoarding endowment funds and instead spend gifts as donors wish. Let me illustrate this point by looking a bit more closely both at the proportion of donations restricted for financial aid and at actual institutional spending in that area.

A donor who restricts their gift is more likely to earmark it for financial aid than for any other purpose. According to the Council for Aid to Education's 2005 Voluntary Support of Education report, donors earmarked 36% of restricted donations for aid, vastly outpacing any other area including academic divisions (19%), faculty and staff compensation (18%), research (6%), and athletics (2%). If the percentage of donations earmarked for aid is added to the percentage of unrestricted funds the result is a total pool of 64% of endowment funds available for financial aid use at private institutions. Similarly, 48.5% of endowment funds could be used for financial aid at public institutions. Yet in some cases including the University of Michigan, Stanford, and elsewhere, schools are spending less than 1% of the value of their endowment on aid. Almost none of the most heavily endowed schools (which now total more than 125) are spending a truly significant sum on aid, a fact made clear by looking at college and university financial aid outlays as a percentage of their endowment.

This begs numerous questions, including: With so many donors asking for their gifts to be used for aid, why are schools spending so little on it? After all, if a donor gives a gift to an institution and asks that it be spent on financial aid are his wishes really being honored if his gift remains unspent for generations?

***FW***

# **Philanthropy**Notes

Senator **Barack Obama**'s presidential campaign is demanding that Senator **Hillary Clinton** release her tax returns and that the **William J. Clinton Foundation** disclose its donors. The Clintons have refused to release the list of donors, which they are not required by law to do. They promise to do so when Mrs. Clinton becomes U.S. president. (For more, see "The Clinton Foundation: Substance or Style?" *Foundation Watch*, February 2008, by Deborah Corey Barnes and Matthew Vadum.)

**Harvard Law School** plans to provide the third year of education free to students who promise to work at least five years at a nonprofit or for the government, the New York Times reports. The program will waive more than $40,000 in tuition per student. Students typically graduate from law school with more than $100,000 in student loan debt, which discourages them from taking lower-paying jobs in public service. ("Scrooge U: The Illusion of Generosity," by **Lynne Munson**, in the current issue of *Foundation Watch*, examines endowment hoarding by America's tightfisted colleges and universities.)

The **Wikimedia Foundation**, which operates various "wiki" projects including the nonprofit **Wikipedia –**its popular online encyclopedia that anyone can edit— is experiencing growing pains, the New York Times reports. (A *wiki* is software that allows users to easily create, edit, and link web pages together.) Co-creator **Jimmy Wales** has been criticized for betraying the idealism supposedly inherent in Wikipedia by relying on the fundraising efforts of a Silicon Valley venture capital firm. Wales has also been criticized for forming his own business, **Wikia**, to make money from wikis and create a search engine run by volunteers. Wikipedia's budget rose to $4.6 million this year from $2.2 million in 2007.

Young heirs are giving away their fortunes in the name of "social justice philanthropy," the International Herald Tribune reports. **Jamie Schweser** donated three-fourths of his $1 million inheritance, received at age 27, to groups such as **Critical Resistance**, which opposes the building of new prisons. "When the money was suddenly in my name and I really came to grips with my privilege and class background, the denial came apart," said Schweser. "I realized: I am literally the Man."

Proving that liberation theology is alive and well, **Jim Wallis**, president of **Sojourners**, writes in an op-ed that a new movement of "progressive evangelicals" is emerging. He says they are concerned with "both global and domestic poverty, pandemic diseases that ravage the developing world, extreme violations of human rights in places like Darfur, the alarming threats of climate change and the imperatives of 'creation care,' the need for a more ethical response to the genuine threats of terrorism, and a foreign policy more consistent with our best moral values." Wallis, who wrote *The Great Awakening: Reviving Faith & Politics in a Post-Religious Right America* (HarperOne, 2008) also claims "evangelicals are leaving the Religious Right in droves…[and] the Left is starting to get the idea that politics should be about values and that religion has much to contribute to progressive politics."

Participants at the annual summit of the **Social Enterprise Alliance** last month proposed the creation a new legal category of corporate organization, the low-profit, limited liability company, or L3C, to allow nonprofits greater flexibility to pursue profit-making activities, the Chronicle of Philanthropy reports. Its corporate charter would state that charity is its primary mission, while generating profits is secondary. When foundations want to spending money on poverty-fighting enterprises, "there's no list you can go to," says charity consultant **Marc Owens**, who previously headed the IRS office on tax-exempt groups. "You've got to do a lot of research upfront to make that program-related investment, far more than it would cost you to make a grant." Supporters are promoting L3C legislation in Georgia, Michigan, Montana, North Carolina, and Vermont.

Two years after **Abercrombie & Fitch** gave the **Nationwide Children's Hospital** system in Ohio $10 million in exchange for naming a new emergency department and trauma center after the clothier, activists are trying to stop the planned facility from taking the company's name. "It is troubling that a children's hospital would name its emergency room after a company that routinely relies on highly sexualized marketing to target teens and preteens," said the coalition, which includes the **Campaign for a Commercial-Free Childhood**. The system itself was renamed to acknowledge a $50 million donation from the Nationwide insurance company.

Civil engineer **G. Wayne Clough**, president of the **Georgia Institute of Technology**, will become the new secretary of the **Smithsonian Institution**. He will replace former banker **Lawrence Small** who was ousted following allegations of extravagant spending and excessive executive pay.