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Financial Affairs: Why the Endowment-Spending Debate Matters Now More Than Ever

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U.S. Sen. Charles E. Grassley hasn't forgotten about college endowments.



Sen. Charles E. Grassley, an Iowa Republican, says that while health care and jobs preoccupy Congress, his fervor for the endowment debate remains.

And he's not alone.

Despite plunging endowment values, colleges continue to face big questions over whether they spend enough of their endowments for society's benefit to justify the tax exemption they get. The events of the past two years are also raising a crop of provocative new endowment questions that deserve center stage in campus boardrooms and faculty senates.

On the "big question" front, one intriguing idea comes from the chancellor of the California State University system, Charles B. Reed, who has been pushing a proposal

to reward institutions that enroll higher numbers of Pell Grant students with more federal money and withhold support from colleges whose Pell enrollments fall below 15 percent. Rich institutions should use their endowments to meet those thresholds, Mr. Reed argues, and the tax exemption on their endowments should be yanked or restricted if they fall short.

Mr. Reed says this kind of endowment rule, more than the 2007 proposal by Senator Grassley, Republican of Iowa, and others to require colleges to spend at least 5 percent of their endowments' value annually, could actually bring more needy students into the most richly endowed colleges.

They'll claim "the sky will fall," says Mr. Reed. "It won't." (Mr. Reed's 433,000-student system, with about 35 percent of undergraduates receiving Pell Grants, would fare quite well under such a plan.)

In a similar vein, a leading figure in global health, Peter Hotez of George Washington University, recently published an editorial faulting the 50-plus universities with endowments worth more than \$1-billion—most of them major research universities with international profiles—for spending meagerly on research and education in the developing world. "The pharmaceutical companies are doing more for the poorest people than most of our wealthiest universities," Dr. Hotez told me.

Of course, squeezing more money from wealthy endowments wouldn't heal the world's health problems any more than it would make college truly affordable for millions of struggling students. (It will take a true economic recovery and renewed commitment from the states to begin to tackle that.)

But when thoughtful people continue to question how universities are using their endowments—even after they fell an average of 23 percent last year—it's clear the endowment debate isn't going to fade quietly away, however much it can sometimes seem to be a political sideshow.

In Washington, the issue is clearly alive and well. Although health care and jobs now preoccupy Congress, Senator Grassley says his fervor for the issue remains. It's shared by the Internal Revenue Service, whose "interim report" on a broad inquiry into colleges and universities is expected to be made public any day now. (That inquiry is separate from the in-depth audits of 40 or so universities that the IRS is also conducting.)

A national poll released last month found that 60 percent of Americans think colleges are more concerned with their own financial well-being than with giving students a "quality education." That and a spate of attempts by cities like Pittsburgh and Providence to exact property taxes and other payments from colleges suggest colleges aren't exactly in the public's favor, even accounting for expected resentments in tough economic times.

Colleges may not be helping themselves. In January, the Education Trust reported that public flagship universities continue to direct most of their financial aid to wealthier students. And an analysis last summer by the Pell Institute for the Study of Opportunity in Higher Education found that 52 of the 245 *U.S. News & World Report* "best" national universities and liberal-arts colleges actually reduced their proportion of Pell Grant enrollments between 1992-94 and 2006-8—a period when overall enrollment of Pell Grant students nationally grew by 38 percent. More than a third of those 52 were among the most likely to be able to afford to serve such students since they had recently reported having an endowment worth at least \$500-million.

Maybe Mr. Reed has a point.

Flawed Strategies

Several other questions about endowments also continue to stir debate.

Heading into the recession, were some funds invested inappropriately? Paul Jansen, a director emeritus with McKinsey & Company and an oft-quoted expert on the topic, says unequivocally yes. Approaches that relied on volatile and illiquid investments to cover fixed costs were "inherently flawed," he says.

Mr. Jansen has long argued that universities aren't creative enough in using their endowments for "strategic repositioning" so that they can compete based on distinctive strengths, rather than fancier student centers. As many institutions now struggle to redefine themselves for an era of financial limits, that's a lesson that might finally strike a chord.

Did a focus on building and preserving endowment wealth—what the Barnard College economics professor Perry G. Mehrling calls "the 'mine is bigger than yours' thing,"—distort the college mission? No surprise where Mr. Mehrling, for one, stands on that one. Colleges that cut programs and people to preserve the endowment are undermining the very reason for an endowment at all, he asserts: "The point of the endowment is to protect the core, not to endanger the core." Otherwise, "it's not a resource, it's a constraint."

Has the financial crisis shown that the thousands of institutions with small or no endowments are actually better off without them because they weren't suddenly forced to make the kinds of cuts that endowment-dependent institutions like Brown and Dartmouth have recently made? A number of colleges have made that argument over the past year, and the virtues of such a self-reliant approach are undeniable. But Geoffrey R. Woglom, a professor of economics at Amherst College, says it's hard to imagine situations where having more money is worse than having less. Having an endowment is only a problem, he says, "if the endowment becomes the be-all and end-all."

Like Mr. Jansen and Mr. Mehrling, he's an advocate for higher levels of endowment spending than the 4- to 5-percent range that most colleges now spend. (His own institution leads the way on this front, recently agreeing to spend more than 6 percent until 2018, and then stay at 5 percent after that.)

In 2009, 54 percent of colleges spent more from their endowments than in 2008, even as most endowment values fell. But that statistic, from the latest survey of 842 institutions by the National Association of College and University Business Officers and the Commonfund Institute, may give more credit than is due. Some institutions spent more because they stuck with their spending formula, which was based in part on the higher endowment values of previous years.

Only 152 institutions, about 18 percent, went further by taking a special appropriation from their endowment to pay for things like student aid and campus improvements. (Interestingly, quite a few also used it to spend more on fund raising.) And only 22 of the 152 were institutions with endowments valued at \$500-million or greater—the ones Senator Grassley and others have focused on for questions about endowment hoarding.

Colleges rightly argue that endowments are not simply rainy-day funds. But this apparent reluctance to use them during an undeniably rainy period, either to stave off cuts or to make strategic investments, can only add weight to the questions that so many already have.

Financial Affairs is a column about the business of the academic enterprise. Send comments to goldie@chronicle.com.