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Taxing Yale

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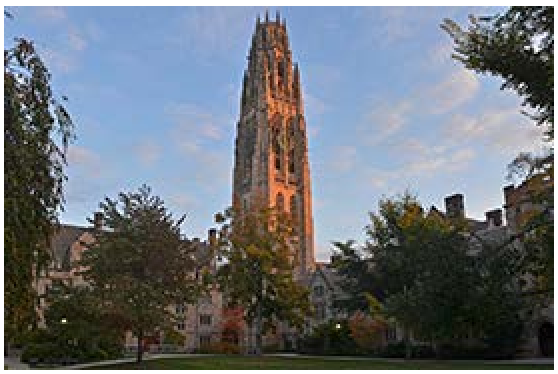
Photo: Michael Marsland, Yale University

In a probably apocryphal story, famous bank robber Willie Sutton was asked by a reporter why he robbed banks. He allegedly replied, "Because that's where the money is."

Following this philosophy, some legislators are covetously eyeing college endowments as a source of revenue. There is scrutiny at the national level from Congress, but recent attention has focused on Connecticut where a bill has come before the legislature that would specifically target Yale.

> *Schools with*

[endowment] funds of $10 billion or more — affecting Yale only — could face a tax on endowment income, according to legislation introduced this month. Yale's record $25.6 billion fund is the second largest in U.S. higher education, behind Harvard University's $37.6 billion.

Connecticut has a deficit of $266 million for FY16, while Yale's endowment earned a cool $2.6 billion in FY15. Richard Jacob, the school's associate vice president for federal and state relations, said in written testimony that the bill and a second one that would tax college property are a "specific attack on higher education."

> *The proposed taxes on Yale would diminish the university's ability to carry out its charitable mission and to enable and support growth in New Haven," Jacob wrote. "Yale's generous financial aid policies, which enable Yale college students to avoid any loans, and which waive any parent contribution for low-income students, exist because of the endowment.*

While the Yale spokesman naturally focuses on students and the "charitable mission" of Yale, he might well have emphasized that the University's $3.2B operating budget and 13,000 employees provide significant revenues to New Haven and

Connecticut. In addition, the mission of Yale includes research focused on generating new knowledge, whose value is hard to assess in the short run.

As a college president it will not be a shock the discover that I think this is a very bad idea, though Saint John's endowment is a couple zeros away from the proposed threshold. But I also think it is a bad idea as an economist and donor.

Photo: Michael Marsland, Yale University

First, as an economist, education plays a huge role in generating economic growth by raising the level of human capital at the macro level and improving the lives of citizens at the micro level. Policies that potentially decrease investments in human capital, even at the very richest institutions, will likely have a negative impact on long run growth. Presumably this benefit to society is one of the reasons colleges and universities are typically non-profits and are tax exempt. One can debate the appropriate level of investment in higher education, but policies based on the deficit of the moment by legislatures that are unable or unwilling to balance their revenues and expenditures are hardly likely to generate optimal long run outcomes.

Second, as a charitable donor, my philanthropic decisions are based, in part, on tax law and my understanding of how those gifts are to be used. I give to Saint John's knowing I get a tax deduction and understanding that my gift will be used in one of three ways: to cover current operating expenses or to be spent on a capital project or put into the endowment.

Every college's endowment is built on such gifts, with the expectation that the dollars will be invested wisely and that the institution will take an annual draw on the endowment to be spent carefully on the educational mission of the institution. Further, there is an understanding that the earnings will be untaxed, making my endowment gift go farther, and that the draw will be managed conservatively to allow the institution to pursue its mission in perpetuity. These expectations are implicit in charitable giving to higher education and are built on the incentives codified in current tax law.

Of course legislatures have every right to modify tax laws as economic circumstances change, but what is objectionable here is changing the law after the fact–an *ex post* decision that would have certainly changed the behavior of generations of donors had a they known that in 2016 part of their gifts would be used to pay for the state of Connecticut's bills, in addition to their intended goal of providing for the educational and research mission of Yale University.

If the Connecticut legislature wants to change the rules, let them state that, henceforth, any endowment gift to Yale will have its earnings taxed. It will take a long time to generate $266m in tax revenue, but at least it would be an ethically defensible way of addressing their deficit.

The other interesting aspect of this case is the potential incentives it provides for institutions. Most colleges and universities are not very mobile, given their histories and significant physical capital investment in dorms, labs and classrooms. This challenge notwithstanding, Governor Rick Scott invited Yale to move to Florida, promising not to tax the institution. Yale politely declined.

The tongue-in-cheek invitation from a governor apparently interested in educational investment had a certain irony to it. Scott was the same governor who drew sharp criticism from educators a couple years ago for taking a slap at the liberal arts, and anthropologists in particular, saying:

> *We don't need a lot more anthropologists in the state. It's a great degree if people want to get it, but we don't need them here. I want to spend our dollars giving people science, technology, engineering, and math degrees. That's what our kids need to focus all their time and attention on, those types of degrees, so when they get out of school, they can get a job.*

Yale's undergraduate curriculum is well-known to focus on the arts and sciences with no majors that would typically be considered vocational. Apparently Yale anthropologists are cut from different cloth.

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