POLICY BRIEF

The Ivory Tower Tax Haven

The state, financialization, and the growth of wealthy college endowments

BY CHARLIE EATON

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TABLE OF CONTENTS

ABSTRACT

Popular anxiety about economic inequality has been compounded by the lavish consumption of the super-rich. In the domain of higher education, there are parallel signs of growing popular resentment towards perceived excesses at the wealthiest private colleges. Consistent with these public perceptions, I argue that private colleges with substantial endowment wealth have increasingly become ivory tower tax havens. I use new college-level data going back to 1976 to show that endowment growth at these colleges has been supported by a three-part federal tax expenditure that I estimate as averaging $19.6 billion per year in 2012. The growth of benefiting endowments contributed to new organizational inequalities in U.S. undergraduate enrolling institutions. For example, private institutions in the 99th percentile for endowment wealth per student increased their annual spending per student from endowments by 751% from $9,724 in 1977 to $92,736 in 2012. At the same time, these wealthiest schools have kept flat the overall number of undergraduates and the share of undergraduates from low-income households. I use the findings to update theories of how the U.S. state supports U.S. higher education in ways that amplify inequality for the new era of finance. This illuminates a new dimension by which the interlocked hands of the state and financialization work together to widen socio-economic divides.

INTRODUTION

Social scientists have only begun to make sense of how inequality and the rising fortunes of the super-rich may have contributed to the social and political tumult of the 21st century (Gitlin 2012; Hacker and Pierson 2016; Hocschild 2016; Skocpol and Williamson 2013). An important piece of the puzzle is that anxiety about stagnant wages has been compounded by the lavish consumption of the superrich. The conspicuous spending of the wealthy raises the bar for maintaining social status and “keeping up with the Joneses” at the same time that household budgets are strained (Fligstein, Hastings, and Goldstein 2015; Frank 2013). Under these pressures, more than 7 in 10 voters in 2016 presidential election agreed that “the American economy is rigged to advantage the rich and powerful” and that the U.S. needs a “strong leader who can take the country back from the rich and powerful” (Kahn 2016). In the domain of higher education, there are parallel signs of growing popular resentment towards perceived excesses at the wealthiest private colleges. Both Democratic and Republican lawmakers, not to mention Malcolm Gladwell, have promoted legislation to tax the endowments of wealthy colleges for overly favoring the well-off (Faler 2015; Fleisher 2015; Gladwell 2015; Lorin 2016).

Consistent with these public perceptions, I argue that private colleges with substantial endowment wealth have increasingly become ivory tower tax havens. The metaphor encapsulates how exponential endowment growth at these colleges has been supported by large tax expenditures that disproportionately benefit a small elite. I build on recent scholarship regarding how the state has long supported and structured U.S. higher education (Loss 2011; Mettler 2005; Stevens and Gebre-Medhin 2016). And I posit that exponential endowment growth benefitted from the interlocked hands of state support and financialization. (Krippner 2011; Quinn 2012; Tomaskovic-Devey and Lin 2011).

Financialization is the increasing wealth and power of investors and financial managers, which has spread through the increasing use of financial markets and new financial strategies and technologies to manage the economy (Davis 2009; Epstein 2005; van der Zwan 2014). When imported to higher education in the 1970s, new strategies for investment asset growth enabled increased endowment investment returns. The rapid growth of endowment assets was also later fueled by increased donations to endowments as financialization contributed to the increasing wealth of the super-rich as potential donors (Tomaskovic-Devey and Lin 2011). As with other expansions of financial markets and financial management strategies, the new endowment investment strategies depended on state policies (Krippner 2011; Quinn 2008, 2012). Namely, endowments have been supported by a triple tax break: 1) a tax deduction for donors to the endowment, 2) a tax exemption for investment income from the endowment, and 3) a tax exemption for interest on municipal bonds used in place of capital expenditures from endowments – a strategy known as indirect tax arbitrage. By existing tax expenditure estimates and a new estimate based on average annual endowment investment returns, I calculate that the triple tax break currently involves a federal tax expenditure of $19.6 billion per year – just $8.6 billion less than the current annual expenditure for the federal Pell Grant financial aid program.

Using new annual college-level data for 800 plus 4-year colleges going back as far as 1977, I also show that large new inequalities have indeed emerged between the wealthiest private schools and the rest of America’s higher education institutions. Rapid increases in endowment wealth are at the center of these new inequalities. Throughout the decades since 1977, but especially since the mid 1990s, endowments provided fast-increasing surpluses to increase annual per student spending on operations and wealthy colleges and universities. For U.S. undergraduate enrolling institutions in the 99th percentile for endowment wealth per student, annual spending per student from endowments increased by 751% from $9,724 in 1977 to $92,736 in 2012. In the 95th to 99th percentiles, spending per student grew by 297 percent from $8,275 in 1977 to $32,868 in 2012. Public universities and less wealthy private schools saw no comparable increase in resources from endowments or other areas of support (Bound and Turner 2007; Eaton, Brady, and Stiles 2016; Quinterno 2012; Weerts, Sanfordeah, and Reinert 2012).