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Extend the Exemption for the Endowment Tax

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The Tax Cuts and Jobs Act places an explicit emphasis on unleashing the potential of the private sector. Proponents argue that slashing tax rates will lead to greater private business investment, capital formation and improved productivity -- resulting in more jobs and higher wages for American workers.

Some have argued that the cuts don't go far enough. Wisconsin Senator Ron Johnson initially balked, arguing that the legislation favors corporations over so-called pass-through companies. He worried that differential treatment would skew investment decisions and worsen the competitive position of small businesses and business partnerships.

Johnson is right on this point. It is bad public policy to have the tax code favor one form of organization over another. But there is another class of private enterprise getting even worse treatment: America's small colleges, particularly private liberal arts colleges. There are hundreds of these institutions across the country, typically with 500 to 2,500 students, offering distinctive alternatives to the big university settings.

Many are located in small communities, contributing to the local economy and often helping to shape the area's cultural life. These colleges have thrived not through public handouts, but by meeting budgets through a combination of tuition revenues, alumni and donor contributions, and a draw from the institutional endowment. However, as the higher education marketplace has become increasingly competitive, many institutions are struggling. The pending legislation has fiscal implications for many of them, and might well be the final nail in the coffin for those struggling to survive.

The legislation is clearly antagonistic to the higher education status quo, with provisions such as eliminating the deductibility of interest on student loans and limiting deductions for charitable contributions, which will almost certainly affect gifts from less affluent donors. Perhaps most egregious: placing a 1.4 percent excise tax on investment income from college and university endowments. The House bill originally applied to private institutions with endowments over \$100,000 per student and was amended upward to \$250,000, while the Senate version relaxed this to \$500,000 in endowment per student.

The tax affects so few and raises so little revenue that the Cato Institute's Neal McCluskey says it essentially amounts to Republicans saying, "Take that, Harvard!"

In response, representatives from Harvard University and other institutions are speaking up in opposition to the tax. George Will dedicated a recent column to defending his alma mater Princeton's use of its \$20 billion endowment to support its "need-blind" admissions and generous need-based financial aid. On a smaller scale, Grinnell College President Raynard Kington appeared on National Public Radio to talk about the revenue stream from its \$1.8 billion endowment that allows more than one-quarter of its 1,700 students to attend tuition-free. As a Grinnell alumnus and a beneficiary of its generous aid packages, I found a lot to agree with in President Kington's assessment.

But many of the colleges subject to the House bill's endowment tax have much different economic profiles than Princeton and Grinnell and are located in rural communities, such as Wabash College and Earlham College, both in Indiana. Senator Johnson might consider why an institution such as Ripon College, in a small community in his home state, with an endowment of under \$100 million, would potentially have been treated like Harvard, Yale, Stanford and Princeton -- each with endowments in excess of \$20 billion.

The case against the tax isn't really about survival, though clearly that is of concern, but about principles of the proposal itself. Small colleges survive because amid the greatest university systems in the world, they offer students attractive curricular and co-curricular offerings. I am a professor of economics at Lawrence University, one of a handful of small institutions that offer a liberal arts curriculum alongside a conservatory of music. Many of our students enroll because we deliberately foster interaction between the college and the fine arts. One of our recent economics graduates performed in operas during his time here, and he now runs a company that manufactures and distributes LED lighting. Another economics major had leading roles in campus plays and is now earning her graduate business degree at Duke. These stories are not unusual. They represent a central reason why students choose to attend a small college.

There are similarities across many institutions, but each offers something that distinguishes it and allows it to thrive in a competitive market for higher education. Some colleges have preprofessional programs, others have distinctive curricular offerings or pedagogic approaches, while some follow distinct religious precepts. The Milwaukee School of Engineering and Rose-Hulman Institute of Technology offer engineering education. Colorado College and Cornell College offer a single course at a time in several-week blocks. Wheaton College in Illinois offers a liberal education "deeply rooted within a Christian worldview."

And then there is Hillsdale College, the small Michigan institution that is a darling of conservatives for its emphasis on the Western canon and its eschewal of all federal funding. The Senate plan would have exempted Hillsdale from the tax had four Republicans not broken ranks to defeat the exemption.

The near-unanimous support among Republicans for the proposed Hillsdale exemption is clear evidence that the endowment tax is expected to be detrimental to the operations of even well-heeled organizations. If the Republicans want to target the largest endowments, they should do it

directly rather than pushing forward this charade that will undermine small American colleges and their communities.