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It is widely agreed that the American federal tax system violates most of the basic principles of taxation relating to simplicity, efficiency, and fairness, and that tax reform should lead to lower marginal rates, and an expanded tax base with fewer exemptions, credits, and special interest loopholes. Higher education tax policies contribute somewhat to this problem. People can lower their tax liability by making gifts to non-academic aspects of university life, such as building fancy stadium sky boxes or luxurious resort-like housing facilities. Tax treatment of some collegiate compensation arrangements deserves scrutiny. But today I want to focus on university endowments.

About one half trillion dollars is invested in university endowment funds. The distribution is extremely unequal –the top one percent of measured endowments has nearly 30 percent of all funds. There are several schools with over one million dollars in funds for every student, enough to provide $50,000 per student in annual investment *income* using a five percent payout rate. The vast majority of institutions, however, have well under $100,000 of *endowment* per student. While endowments are particularly critical to private institutions, four of the 15 largest ones are held by state universities.

My student associate Justin Strehle and I have used econometric techniques to examine the relationship between endowment spending and several key variables, looking at a sample of nearly 500 schools, including most of the largest and most prestigious American colleges and universities. The basic question asked is: are endowments used for useful public purposes? Let me share four conclusions:

First, endowments are *not* generally used to lower the stated tuition fees of colleges. There is *no* statistically significant relationship between endowment size and tuition fees. There *are* exceptions –Berea College in Kentucky, the College of the Ozarks in Missouri, and, historically, Cooper Union in New York City have used investments to essentially eliminate student fees. But that is rare.

Second, endowments are used some to provide scholarships, effectively lowering the actual or net tuition fee paid by students. However, assuming a four or five percent payout rate, the evidence suggests typically that less than 20 cents out of every dollar of endowment income goes for this purpose –making college more affordable is not the dominant use of endowed resources.

Third, because of inherent measurement issues, it is difficult to assess the relationship between endowments and institutional quality. *Forbes* Magazine ranks schools mainly on how they satisfy student needs –do students like their professors, excel after graduation, avoid much debt, or graduate in a timely manner? Controlling for other factors, there is *no* statistically significant relationship between the quality of the institution and endowment size.

Fourth, there is some indication that some endowment funds go to increase staff compensation at institutions. In some cases, this might lead to higher quality teachers and researchers, but it might also lead to an excessive bureaucracy, or unjustified pay increases, rather than meeting student needs. The evidence is somewhat murky, but raises real questions about whether endowment funds mainly serve social objectives justifying special tax treatment.

The quality gap between public and private schools has widened over time, partly because of federal student loan policies, and increasingly parents believe success depends on their children getting into highly endowed academic gated communities such as Ivy League schools. This trend is arguably inconsistent with basic American equalitarian ideals, and special tax preference of endowments, especially for extremely wealthy schools, may be of questionable social value.

Thank you.