from kindergarten through twelfth grade. In addition, Harvard will contribute about $1 million to fund recreational programs for Cambridge residents. The $2.5 million total in benefits is tied specifically to phase one, the three FAS buildings, which will entail 670,000 square feet of space above and below grade.

Following the procedure established in the Riverside neighborhood, Harvard's contributions are tied to the successful completion of specific steps in the permitting and approval process. The BRI space, which is entirely underground, should be finished in the summer of 2005, with the LISE building following in the summer of 2006. Still in the design phase is the North/West science laboratory. Originally conceived as two separate buildings, the architect's consultations with both neighbors and faculty members led to the proposition that the two buildings be joined and reoriented to run nearly parallel to Oxford Street. The North/West building is slated to house the Center for Systems Neuroscience, and will include teaching laboratory space, classrooms, research laboratory space, and room for collections.

"Extraordinary" Bonuses

During recent years, when returns on endowment assets have been much stronger than the financial markets in general, the performance-based pay system used by Harvard Management Company (HMC) to compensate its investment professionals has annually produced a few outsized paychecks (see "Outperformance Pays," March-April 2003, page 58). But the $17.5-million peak realized by one investment manager for fiscal year 2002 paled in comparison to the $35.1 million and $34.1 million earnings for the top two HMC staff members in fiscal year 2003, ended last June 30. The data, released January 22, attracted more than routine attention, and prompted unusual responses from University officials.

During fiscal year 2003, the foreign fixed-income portfolio returned 52.4 percent, versus 18 percent for the market benchmark; manager Maurice Samuels received $35.1 million in total compensation. David R. Mittelman's domestic fixed-income portfolio earned 31.1 percent, 13.8 percentage points more than its benchmark; he earned $34.1 million. (Mittleman was the top earner the prior year, when Samuels ranked third. A *Barron*'s profile published February 2 called the duo "two of the best fixed-income managers in the business.") Other members of the foreign and domestic fixed-income teams, Elizabeth A. Randall and Shawn Martin, received $7.6 million and $6.5 million, respectively. Jeffrey B. Larson, who oversees foreign-equity and emerging-markets investments, earned $17.3 million, slightly less than in the prior year, when he was the second most highly compensated HMC manager.

According to University data, Samuels and Mittleman directed investments that during the year yielded Harvard more than $700 million in "value added" (returns in excess of the market benchmarks). The return on assets overall was 12.5 percent, raising the value of the endowment to a record $19.3 billion. That performance more than tripled the median return on comparable institutions' investments, and exceeded the market benchmarks used to measure HMC results by 4.2 percentage points—some $800 million (see "Rebounding Returns,"

by those who move to the new facilities.

The former provision would be a boon to any faculty contemplating expansive building plans, not all of which qualify for reimbursement of overhead costs on federally funded research projects. That is certainly the case for FAS. The latter could have particular relevance to Cambridge-based units foreseeing uses for the Graduate School of Education's buildings if it relocates across the Charles River. (FAS, the Kennedy School of Government, the Radcliffe Institute, and Harvard Law School all come to mind.) In Boston, Harvard Medical School could benefit if the adjacent School of Public Health buildings are released by construction of a new Allston complex.

The early reaction was favorable. Florence professor of government Gary King, a member of the FAS resources committee, noted that the faculty had ultimately concluded in 2001 that the endowment-based assessment was "equitable, feasible, and advantageous" to FAS and the University as a whole. Then the chief benefit of Allston for FAS appeared limited to taking over space in Cambridge vacated by other schools. But given the evolution of Allston planning in the years since, the potential now seems much greater: King envisions FAS "participating as an equal partner in a variety of new projects and developments." (The president's October 21 message discussed graduate and undergraduate student housing, laboratories, and performing-arts and museum space.) Indeed, in his annual decanal letter to the faculty (see page 62), William C. Kirby cited "an extraordinary opportunity for continued growth and development for FAS" in Allston.

King's committee colleague, Eckstein professor of applied economics John Y. Campbell, also emphasized that "FAS will be a big part of the new buildings and activities in Allston." The scope and duration of this "enormous project," he said, require long-term planning and a "regular funding source." Another advantage of an "endowment-based fund," he noted, is that it is "able to draw on restricted funds, which are a very large fraction of the endowment," as opposed to drawing down "unrestricted income, which is comparatively scarce and valuable."

In any event, Berman was at pains to point out, even the extended infrastructure fund will not cover the entire costs of Allston phase one. Gifts, housing rental and parking fees, and the recovery of "indirect costs" (overhead, particularly on scientific research grants) will all play a major role. So too, presumably, will further borrowing by the University. However the specific work is funded, it becomes increasingly apparent that Harvard is embarking on the most ambitious development agenda in its history.

November-December 2003, page 59). In releasing the compensation figures, HMC president Jack R. Meyer reported that for the five years from 1999 through 2003, the five investment managers' portfolios have generated $2.5 billion in above-market returns for the endowment. That sum approaches the $2.65 billion raised by the University Campaign from 1994 to 1999.

Large as those returns are, "Not surprisingly, these compensation figures have attracted significant attention and comment," as University Treasurer and chairman of the HMC board D. Ronald Daniel put it in a letter made available to alumni on the same day as Meyer's news release. Arguing the case that HMC's current pay system stimulates superior investment results at "an overall cost considerably lower than the expense that would be entailed…through external hedge fund management" yielding equivalent returns, Daniel acknowledged the potential for occasional bonus figures of "extraordinary magnitude."

HMC portfolio managers, the letter explained, earn base salaries of less than $400,000; a "neutral bonus" of about $100,000 for meeting their benchmarks; and, thereafter, an incentive bonus, positive or negative, for performance relative to the benchmarks. The latter part of the formula, which produces "extraordinary earnings" linked to "extraordinary performance relative to benchmarks," also makes bonus sums contingent—subject to "clawback" in case of future underperformance. Meyer, in an interview, amplified that bonuses are a percentage of value-added performance, varying by portfolio and weighted by each manager's contribution to the results.

In an interview, Daniel said that bonuses at the current level were never contemplated when the compensation formula was set up in 1990-1991. "We never expected this level of exceptional [investment] performance," he said. "As the economists say, it should revert to the mean," he continued. "For Harvard's sake, we hope it doesn't."

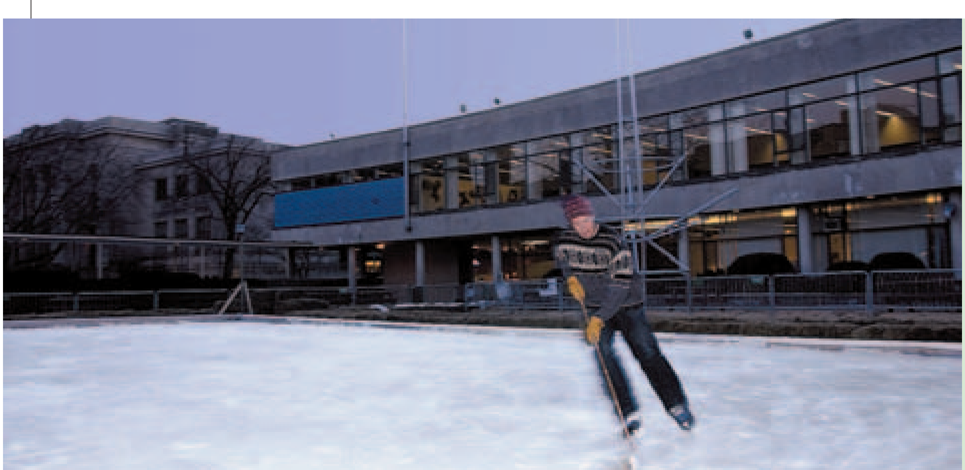
Meanwhile, "We're aware that it creates an awkward situation for the University," Daniel said of the resulting paydays. "We're not immune to the fact that it's upsetting to some significant number of people."

The compensation system has "served the University well when viewed from a financial perspective," the letter noted, so the HMC board, "believing in [its] merits," appears unlikely to alter it. But the board "has taken the opportunity to reexamine the current compensation system" (during meetings in September and December, according to Meyer, which delayed the release of the compensation data beyond the normal date in late November). Within the prevailing system, Daniel wrote, the board "expects to institute changes that would constrain the maximum annual compensation of individual managers." When interviewed, he described specific changes as a work in progress, to be determined in future HMC board meetings.

Another perspective was tendered by a group of alumni. In a letter e-mailed to President (and HMC board member) Lawrence H. Summers dated November 25, William A. Strauss '69, M.P.P.-J.D. '73, and six of his College classmates, contemplating their thirty-fifth reunion gift, took note of the $100 million (plus) paid to the most highly compensated HMC personnel in fiscal years 2001 and 2002—years when the endowment outperformed the market, but declined in absolute value. That became the point of departure for a sweeping overview of University aims and finances, far beyond occasional past criticisms about HMC pay.

While saluting the strength of HMC's investment performance over time, the correspondents wrote, "If Harvard can afford to pay over $50 million per year to a small number of financial managers, and if it does so because the endowment has recently experienced excellent growth, it is clear that Harvard can afford to reduce more than $50 million per year from the ever-increasing cost burden on current students and debt burdens on recent graduates."

Comparing HMC's reported senior compensation for those two years to other metrics ("half of the annual tuition and living expenses paid by all students at the College," for example), the correspondents called the investment pay packages "inappropriate, indefensible, and corrosive to the values of the University." The compensation system, they wrote, offered an "unwelcome object lesson for the current generation of students" and could only be the result of "a market distortion, especially in a university context." They called on the University to freeze tuition, eliminate the loan component of financial



An Icy Amenity

Dean of the Law School Elena Kagan testified that she decided on the spur of a frozen moment in January to flood the field by Harkness Commons to form a skating rink. Almost at once, it was done, and incipient lawyers and other Harvardians took to the ice, some to practice hockey moves, others to go around in circles sedately, others to twirl and crash. The rink is lighted for use into the night, and tinny, canned music is occasionally provided. Kagan reportedly got her idea from a 1950s photograph showing the field as a rink, with frolickers. The modern rink will remain open, says the dean, "until it melts."

Photograph by Stu Rosner

aid, and forgive loan balances for graduates employed in public service or the arts, at an aggregate cost equal to the compensation of senior HMC professionals. Further, they advocated higher distributions from the endowment to begin reversing the growth in the cost of attending elite schools in recent decades.

Thereafter, the group forwarded its letter to news outlets, including the *Boston Globe* and the *Crimson*. Steve Bailey, AMP '94, a *Globe* business columnist, then interviewed Jack Meyer and was able to calculate, based on published endowment results for fiscal year 2003, that compensation for the most successful portfolio managers would be as much as $30 million to $40 million—news that broke on the front page of the paper on December 11. HMC's January 22 release validated those estimates.

On the same day, vice president for government, community, and public affairs Alan J. Stone sent a letter to Strauss. Writing at the request of President Summers, he acknowledged the November correspondence; shared the correspondents' "commitment to need-blind admissions and need-based aid for Harvard's undergraduates"; linked strong endowment returns to the University's ability to sustain financial aid and reduce College graduates' debt; and referred to Treasurer Daniel's simultaneous letter on all matters pertaining to compensation at HMC.

In a subsequent interview, Strauss—a cofounder and director of the Capitol Steps, the political satire group, who has also been coauthor of several books on issues confronting the current generation—took strong exception to those responses. "No one should require a $35-million bonus to give his best efforts to Harvard," he said.

The larger point, Strauss maintained, is that "Harvard presents itself as a philanthropy." Payments of $107.5 million for fiscal year 2003 (the five portfolio managers' compensation, plus Meyer's $6.9 million) equal about 4 percent of total University spending, he pointed out, and about one-eighth of the sum distributed from the endowment to support all academic operations.

Restating arguments his group had raised before, he said the compensation

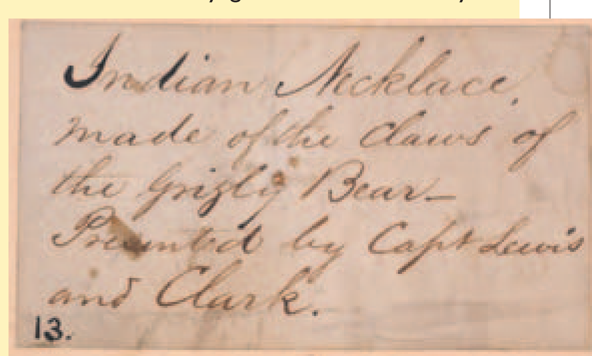
New from Lewis and Clark

Separated from its original Peale Museum label (below), this Native American necklace was lost on a South Sea island.

Two collections assistants at the Peabody Museum of Archaeology and Ethnology were making an inventory of objects in the Oceania storerooms last December when they came upon a necklace that didn't look to them like something from a South Pacific island. They summoned the collections manager. On January 15 museum director William Fash announced the discovery of a Native American bear-claw necklace acquired by Meriwether Lewis and William Clark during their epic trek 200 years ago. It is one of only seven known Indian objects that can be positively linked to Lewis and Clark.

Probably given to the explorers by an Indian chief in a diplomatic exchange of gifts full of meaning, the necklace consists of 38 claws, each about three inches long, attached with rawhide thongs to a fur foundation, possibly weasel. Red pigment originally covering the claws has largely worn away. Bear-claw necklaces from any period are rare, and according to one expert, this one is probably the earliest surviving example in the world.

Lewis and Clark and President Thomas Jefferson gave about 70 Native American objects obtained on the journey to the Peale Museum in Philadelphia (see "Buckskin Diplomacy," November-December 2003, page 32). A portion of these objects migrated in 1848 to Moses Kimball's Boston Museum, and his heirs gave them to the Peabody in 1899. The Peabody cataloged the necklace and retained a Peale Museum label describing it thus: "Indian Necklace made of the claws of the Grizzly Bear—Presented by Capt. Lewis and Clark." But at the last minute the heirs decided to keep the necklace. When a descendant finally gave it to the Peabody, in 1941, a staff member cataloged it erroneously, and the "whalebone" necklace was lost in Oceania. Peale's label remained with the curators of Native American artifacts, a frustrating reminder of treasure gone missing.



The necklace will be added this spring to the museum's current exhibition "From Nation to Nation: Re-examining Lewis and Clark's Indian Collection."

Photographs courtesy of the Harvard Peabody Museum of Archaeology and Ethnology

Yesterday's News

From the pages of the *Harvard Alumni Bulletin* and *Harvard Magazine*

1919 Alice Hamilton is appointed assistant professor of industrial medicine, becoming the first woman to hold a professorial position at the University.

1934 The mayor of Cambridge orders that fire trucks from the new station near Memorial Hall must not sound their sirens on Thursday nights (when concerts are in progress) until they are two blocks away from Sanders Theatre.

1944 Between matinees at the RKO Theatre in Boston, Duke Ellington visits Harvard to discuss "Negro Music in America" before a crowd in Paine Hall, and then treats the audience to a medley that includes "Don't Get Around Much Anymore" and "Mood Indigo."

1954 A Center for Middle Eastern Studies has been established at Harvard within the Faculty of Arts and Sciences, the third such "area program" in the University; the others focus on East Asia and the Soviet Union. Faculty members from the graduate schools of law, business, public health, and public administration are also involved in the project.

1969 Some 70 students occupy University Hall to protest ROTC and Harvard expansion, precipitating a police bust and student strike.

1974 A $200 increase in tuition and a $125 increase in room-and-board rates raise the cost of a Harvard-Radcliffe education to $5,350—the same price as Yale's.

1979 President Derek C. Bok issues two open letters to the Harvard community, on "the ethical responsibilities of the university in society" and on "divestment of stock," both concerning in large part Harvard's ownership of stock in companies doing business in apartheid South Africa. A *Washington Post* editorial suggests that Bok has "sharpened the issue at least to a point where the opponents can see each other."

1984 Computer-consciousness is on the rise throughout the University. The Business School has announced that incoming M.B.A. students will be required to use portable IBM personal computers as part of regular class preparation, and the Expository Writing program is offering an experimental section in which the papers are written and critiqued on computers on loan from IBM.

system "is *not* a good example for Harvard students." Alluding to the correspondents' views of motivation and employee incentives, he renewed their suggestion that no employee earn more than the University's president (about $450,000, plus benefits). In their November 25 letter, the class of 1969 members wrote, "We reject any suggestion that this limit on financial manager pay would in any way jeopardize the future performance of the endowment. Even if that were true, which we seriously doubt, we believe that the actions we recommend will advance the interests of the Harvard community far more than any additional increment in a University wealth that, by any measure, is already very ample."

Accordingly, in the wake of the January 22 disclosure and letters from Harvard officials, Strauss and the other correspondents reiterated their call for a community forum on investment-manager compensation.

There, for the moment, the matter rests. The University essentially stands by HMC's compensation system for investment professionals. If their performance holds up, the endowment will grow further during the current fiscal year, and significant paychecks will ensue: Meyer's news release disclosed that bonus payments carried forward into 2004 for himself and the five highest-earning professionals last year total $44.8 million— subject to "clawback" if returns trail the relevant portfolio benchmarks. And because HMC is required to disclose certain compensation data annually, those payments, if earned, will be reported next Thanksgiving.

Were HMC spun off, the disclosures would not have to be made, but Harvard would pay a heavy price, Meyer

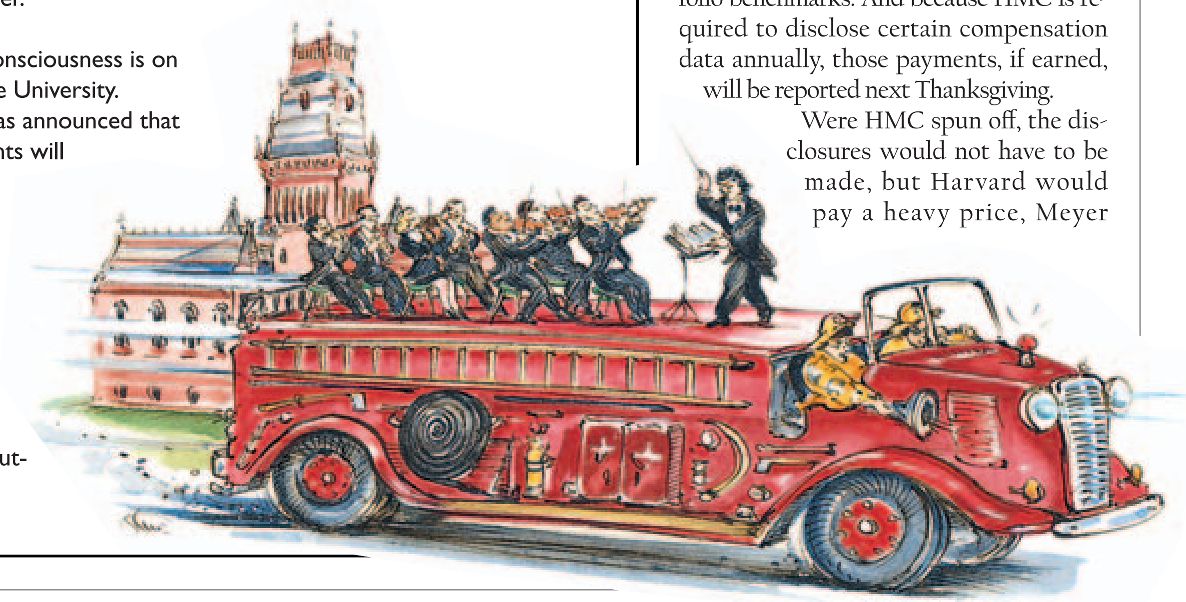


Illustration by Mark Steele

maintains. Based on experience with externally managed portions of the endowment and the investment fees charged by hedge funds whose strategies most closely approach HMC's internal funds, he said, "Fees will go up, returns will go down, and we will underperform our peers, because of our size." The current system, which he introduced when he became HMC's president, has proven itself in economic terms. The resulting release of managers' pay to comply with tax-reporting requirements "is certainly our least favorite time of the year." Daniel's letter noted that "Other universities, which rely on external investment managers…do not face comparable scrutiny." Strauss said that if other universities are paying comparable fees to external money managers, their alumni ought to object.

Indeed, the discussion begun at Harvard may resonate. Leading institutions from MIT to Stanford to Yale have implemented cuts in staffing and expenses, or announced their intent to do so. Harvard had been buffered, in part because of relatively strong returns on the endowment. But even here, as the University has noted, absolute returns were negative in fiscal years 2001 and 2002, so the recent gains have recouped only part of the loss in the endowment's actual purchasing power since 2000.

As a result, belts are being tightened in Cambridge and Boston, too. Harvard College Library has been reducing staff. The central administration has set a goal of level or reduced administrative expenses in the year beginning July 1 (see "Barer-Bones Budgets," November-December 2003, page 58). Harvard Business School intends no increase "for spending on campus operations," according to the most recent annual letter from chief financial officer Richard P. Melnick. Given surging employee benefits and building costs, those budgets suggest reductions in the work force.

Thus, in a very real sense, the issues buffeting the larger society since the economy cooled at the end of the twentieth century—concerns over jobs and the distribution of economic rewards—have found an echo at twenty-first-century Harvard.

HARVARD BY THE NUMBERS

The University is an increasingly international community. For the 2002-2003 academic year, according to the *Harvard University Fact Book,* 19,600 students were enrolled in degree programs; international students numbered 3,459—17.6 percent of the total—with particular concentrations in some of the professional schools. Asia and Europe send the largest number of international students to Harvard.