The Effects of Federal Indirect Cost Recovery Policy on Academic Institutions

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Benjamin Franklin once wrote that the Constitution might not last forever, but that death and taxes would forever be with us. To those who have been attentive to the relationship between the federal government and the nation’s universities since the end of World War II, indirect cost recovery deserves a place on that short list. Like the first two, the problem of indirect costs is inherently insoluble, and also like them, it excites extraordinary passions among people who are normally quite peaceable and reasonable (Richard Rosenzweig “The Politics of Indirect Costs” 1998).

About one-third of the of the approximately $30 billion spent annually by US taxpayers on biomedical research is used for indirect cost payments to universities and other grant recipients. These overhead costs are meant to help support infrastructure, utilities, and administration. Institutional indirect cost recovery rates are determined through notoriously complex negotiations between grantees and funding agencies. The arcana of federal indirect cost recovery policy have been the source of significant controversy in science policy for decades. One view is that these rates are too high. This view came into focus during the so-called Stanford scandal in the 1990s (when some private universities were accused of enlarging their indirect cost recovery rates through improper accounting procedures). It is also seen in the long-standing complaints by scientists that higher indirect cost rates mean less funding for actual research, and in more recent concerns that indirect cost policy creates incentives for universities to over-invest in research capacity (including building, and hiring of "soft money" faculty), and proposals to cap indirect costs. On the other hand, universities have long argued that indirect costs rates are too low and under-compensate universities, and that in effect universities lose money on many grants. Are indirect cost recovery rates too high, too low, or just right? How do federal indirect cost rules shape academic institutions’ incentives? How do they affect the productivity of the biomedical research enterprise? Knowing the answers to these questions will help ensure that limited biomedical research funds are used most efficiently and effectively towards advancing knowledge and health.

While debates surrounding these issues are among the oldest and factious ones in science policy, there is little empirical evidence to guide them. This project provides new data on indirect cost rates and estimates of how they affect academic research. The first output is a new open-source dataset on indirect cost rates, and a statistical overview of how and why they differ by institution and over time, and analysis of how these rates influence total funding available for research. (The dataset is accompanied by code to allow researchers, journalists, government officials, and other stakeholders to explore the data independently and link to other sources.) Second, using these data the project examines how changes in indirect cost
rates affect institutional incentives to seek grants, to grow faculty, build, and make other investments. One challenge is to separate the effects of indirect cost rates from other potentially confounding factors. To ameliorate this, the research exploits various natural experiments in indirect cost policy, providing more confidence in the estimates. Finally, the project also considers the effects of historical changes in indirect cost recovery policy. Current policy has its roots in a 1966 decision to allow institution-specific rates and negotiation; before this time there were uniform caps on indirect cost rates. The research examines how this policy change influenced the expansion and productivity of the biomedical research enterprise, and whether it reinforced disparities across research performers.