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CROWDING OUT PRIVATE MONEY: WHY A GROWING GOVERNMENT UNDERCUTS AMERICAN PHILANTHROPY

by

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The dramatic growth of government now underway makes most Americans rather uneasy. Economists in particular fear that higher spending by government causes long-term harm to business investment and economic growth, especially when the country already struggles under heavy public debt.

But another danger must not be overlooked: the harm governmental expansion does to philanthropy. This vital sector of society will see its productivity drained as private dollars that would have been spent by charitable and philanthropic entrepreneurs are channeled instead into the hands of politicians and bureaucrats who may have short-sighted needs.

The danger was detailed in a report on the nonprofit sector issued this past holiday season by the nonpartisan Congressional Research Service (CRS). It warned that government spending “can potentially crowd out private support for charities” and also “cause charities to reduce their fund-raising efforts.” The effect is stark. One study cited by CRS estimated that government largess typically “crowds out” private donations by around 56 percent. That means every \$1,000 in government grant money can reduce private donations by \$560. See Molly F. Sherlock and Jane G. Gravelle, *An Overview of the Nonprofit and Charitable Sector*, Congressional Research Service report, Nov. 17, 2009.

But the immediate cost in dollars is just the beginning of the harm, because \$1,000 guided by private hands isn't the same as \$1,000 doled out by government. Innovation and efficiency are the hallmarks of independent entrepreneurs, not the federal government, and that is especially true in philanthropy.

Yet despite the great potential for harm, few in the political class have raised any alarms. Perhaps that isn't surprising. After all, for two years in a row proposals have been advanced which would take big chunks out of the charitable income tax deduction – that mighty Mississippi of American generosity through which billions flow each year towards those most in need, such as schools, the aged, the arts, and those reeling from economic upheaval.

Nor is the charitable deduction cut the only threat. Indeed, the aforementioned proposal won't even take effect unless Congress enacts it through new legislation, which lawmakers declined to do last year. But two other threats to the charitable sector require no action by Congress to become reality, namely, a jump-up in tax rates for

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the nation's biggest taxpayers and a cut in the same people's ability to claim itemized deductions. Specifically, if congressional inaction allows the 2003 tax cuts to expire at year's end, persons earning more than \$200,000 a year (\$250,000 for married couples) will see their marginal income tax rates rise around 10 percent, and their tax rates on capital gains and dividends rise 33 percent.

This drain on upper-income taxpayers will have a significant effect on philanthropy, because households whose wealth exceeds \$1 million (roughly 7 percent of the population) *provide around half of all charitable donations*. See Arthur C. Brooks, *WHO REALLY CARES: AMERICA'S CHARITY DIVIDE—WHO GIVES, WHO DOESN'T, AND WHY IT MATTERS* (New York: Basic Books, 2006). Taking more money out of these Americans' pockets, in short, means less money for charity. By contrast, a vigorous economy that spins off greater income for all Americans sends more dollars flowing into the philanthropic sector. As researcher Arthur Brooks observes, the booming economy of 1995-2000 saw real income per capita rise by 12 percent, while household giving, spurred by stock market and home value gains, exploded by 54 percent. *Id.*

Too many in Washington seem to have forgotten that America's greatness, and her liberty, are tightly linked to the fact that her citizens are the most charitable on earth. Nearly two centuries ago the French thinker Alexis de Tocqueville observed that while Frenchmen would wait on government to deal with their problems, and Englishmen would await a nobleman's aid and leadership, Americans spontaneously join together in private groups, voluntarily giving time and treasure to respond to the day's most pressing needs.

Hurricane Katrina. This vigorous tradition of private initiative and generosity explains why, for instance, the devastation of Hurricane Katrina brought forth \$6 billion of private aid to persons in need. And as Adam Meyerson of the Philanthropy Roundtable points out, that amazing number equals merely one week's worth of all American giving. Adam Meyerson, *The Generosity of America*, IMPRIMIS, Jan. 2010. The hundreds of billions that our fellow citizens give away each year is nearly double what we spend on cell phones, DVD players, and all other consumer electronics, and ten times as much as we spend on professional sports.

Looking back at Katrina, Americans find much to criticize in the response of government. While the Federal Emergency Management Agency struggled to function, corporations like Wal-Mart, FedEx, and Home Depot performed miraculous feats; charities like the Red Cross, Salvation Army, and Southern Baptist Disaster Relief surged supplies and staff; and funders like the Baton Rouge Area Foundation, the Greater New Orleans Foundation, and the Foundation for the Mid-South quickly established relief funds.

One of the most profound legacies of Katrina and the outpouring of private assistance it elicited is the New Orleans public school system, which was entirely remade after the storm wiped it out. The city's public schools were notorious for being among the nation's worst, but now, to the delight of residents and thanks to massive philanthropic support, the Big Easy has the nation's first majority-charter school system and sees test scores rising "in every subject across every grade, charter and non-charter alike," the Thomas B. Fordham Foundation reports.

These dramatic improvements in the public schools were heartening, and the bounce-back of privately supported religious schools was still more amazing. Within weeks, the Archdiocese of New Orleans had 37 schools re-opened and was serving tens of thousands of students, more than half their pre-storm enrollment. Months later, the public school system was only able to serve 12,000 students, less than 20 percent of its previous capacity. The private Catholic schools were taking in students whose families couldn't pay and even former public school students. One high school even ran two "shifts" a day to double its capacity.

Similarly, private giving, not government, pioneered America's system of higher education and also our unrivalled health care system. Indeed, to see what's at stake in the continued thriving of the charitable sector, consider two of today's most pressing concerns, jobs and health care.

The Detroit Example. Few places in the nation are in more dire need of jobs than Detroit. In response, ten national and local foundations have committed \$100 million to the New Economy Initiative of Southeast Michigan (NEI), an eight-year project to "accelerate the transition of metro Detroit to an innovation-based economy." Last year the initiative partnered with the Ewing Marion Kauffman Foundation, a philanthropic organization based in Kansas City, Missouri, that focuses on spreading entrepreneurship to spur the business

success and job growth needed for a growing economy. Kauffman is bringing to Detroit its premier entrepreneurial learning programs, FastTrac and Urban Entrepreneur Partnership.

FastTrac is a hands-on program “designed to help entrepreneurs hone the skills needed to create, manage, and grow a successful business.” It has specific training tracks for persons who want to start home-based businesses, grow an existing business, or launch high-tech ventures. The Urban Entrepreneur Partnership targets displaced minority workers and helps them adapt their skills to new opportunities while offering one-to-one coaching in business education. One administration official has lauded this Kauffman-NEI effort, declaring the President “is committed to building partnerships with and engaging foundations, NGOs, and the public in ways that leverage federal efforts and will strengthen our economy and society for generations to come.” <http://www.kauffman.org/newsroom/white-house-expresses-support-for-kauffman-new-economy-initiative-to-revitalize-detroit.aspx>. The nearly \$10 million collaboration between Kauffman and NEI is expected to create 1,200 new companies and nearly 5,000 new jobs in the next three years, in addition to saving 20,000 existing jobs in minority-owned companies that supply products and services to local industries.

Health Care. Then there is health care, a top concern of both Washington and the average American family. Although the federal government is a lumbering giant in this field, no one can count all the ways that far-seeing donors and fast-acting charities have achieved breakthroughs in research, sped up medical progress, and otherwise solved health care problems. That irreplaceable work translates directly into saved lives and also saved dollars – public and private.

Before we allow government growth to crowd out the philanthropic sector – or government regulations to hamstring its work – we should ponder whether anyone would want to endanger the following kinds of triumphs:

- ▶ The National Kidney Registry is on the way to saving tens of billions in healthcare costs and dramatically increasing kidney transplants for thousands of Americans in desperate need of a new organ. It exists because a businessman and his wife donated \$250,000, enticed 300 other small private funders to give, and found a software engineer who could invent a new way to match organ recipients to organ donors.
- ▶ When gene therapy triumphed at reversing blindness, it was hailed as the equivalent of the first heart transplant. But the first critical step was a seven-figure grant by a foundation that prides itself on funding research at the earliest stages, when neither the federal government nor commercial firms will underwrite it.
- ▶ An \$80 million state-of-the-art center for treating brain-injured veterans is being built next to Walter Reed National Military Medical Center. It exists thanks to private donors, one of whom also uses the family foundation to build houses for wounded service members' families so they can be near treatment facilities. Well over 110,000 military families have collectively received millions of days of lodging.
- ▶ One man started a small nonprofit that now operates in roughly half of all states and provides home-visit nurses to pregnant low-income mothers at high risk. The results for mothers and children? A RAND study showed that for each dollar the program receives, the government saves four dollars, thanks to higher tax revenues from the mothers' employment and reduced burdens on public assistance and criminal justice systems.
- ▶ When the federal government decided to support better systems to track patients' electronic medical information – a badly needed advance the government estimates could cut about 10 percent of all annual health care spending – it looked to the amazing success story of Indiana's efforts, which sprang from a five-figure grant by an Indianapolis foundation that specializes in projects that “provide market-based solutions to social problems.”
- ▶ A rancher and foundation head in Montana who was upset with the state's epidemic of methamphetamine addiction launched an innovative campaign that has achieved drastic reductions in drug abuse, crime, and health care costs. Government leaders in other states, including Arizona and Illinois, are working feverishly to duplicate the program.

► Hundreds of millions of dollars from one large foundation has been committed to tackling the problem of childhood obesity, a condition that triples health care costs among children and also greatly raises the costs of care as the children become adults. The same foundation, which was created from wealth earned by a major medical supply firm, revolutionized emergency medicine in the 1970s.

How do philanthropic donations achieve such breakthroughs, even though dwarfed by government and corporate health care funding? The answer is found in a recent feature story in *Philanthropy* magazine. Author Adam Keiper observes that private donors, un beholden to voters or shareholders, “are free to innovate, to experiment, to take risks, and to find and occupy their own distinctive niche.” Adam Keiper, *Breakthrough*, PHILANTHROPY, winter 2010. In fact, the first hospital in America was founded in the 1750s by none other than Benjamin Franklin, who arranged for it to receive funds from both the state assembly and private donors – perhaps the first “matching grant” in history. Later years saw Johns Hopkins establish his famous hospital, nursing school, and medical school, and John D. Rockefeller create the nation’s first medical research institute.

As health care gained in scientific precision during the twentieth century, the Rockefeller Foundation launched global campaigns to end the suffering of millions from hookworm, yellow fever, and malaria. The Carnegie and Rockefeller Foundations were also responsible for a complete overhaul of medical education in America, and the latter almost invented molecular biology. At the century’s end, the Whitaker Foundation performed a similar service by establishing biomedical engineering centers around the country, a service that bears fruit in, among other things, prosthetic aids for wounded military men and women.

Keiper notes that these breakthroughs arise from private donors’ unique role:

They are focusing on unconventional hypotheses, enlarging our understanding of human health by asking questions that nobody else is thinking about. They are creating ways for researchers around the globe to share information, working to speed up the process by which cures move out of the lab and into the market, and offering early career support for promising researchers. They are calling attention to diseases that would otherwise be neglected. And they are drilling down on rare and neglected diseases, tackling the problems that neither private enterprise nor public funding has the incentive to confront.

One irony in health care is that corporations are often stymied in their work by the onerous government approval process required to bring new drugs and medical devices to market, a process grimly nicknamed “the valley of death.” The costs entailed in time and dollars often prevent for-profit entities from investing in early research whose pay-off is uncertain.

The good news is that this situation allows donors, with relatively small investments, to leverage breakthroughs otherwise unobtainable by government and industry. The bad news is that government’s failure to appreciate the value of the philanthropic sector may bring significant harm to a critical pillar of American civil society.

How ironic that philanthropy, which gladly partners with governments and businesses and would never deny their vital roles in American prosperity, may be overlooked and squeezed by the rapid growth and intrusive interventions of government. For victims of disaster, as well as students, the sick, and the needy, that would be disaster indeed.