

# THE CHARITY BALL

Charities chase government money, and governments chase charity approbation. There is a better way, argues **Gary Johns**

Charities do much good. Then again, so do government and business. Each sector has an important role to play in Australian society and each should be judged on its performance. The examples of charity in this essay are not designed to single out failures; rather, they illustrate elements of the charity market that, with improvement, could drive better charity.

Consider this statement about the role of charities: ‘Civil society [for our purposes, charities], sometimes conceived as the third sector, was once held to have stood apart from business and the state.’<sup>1</sup> If charities ever stood apart from government, it has been a long time since many stood on their own feet. Charities’ fears that government would crowd them out have not been realised. Charities grow because they deliver government services that were once the preserve of charities. Charities also grow because some donors are reassured by government support for charities, thus providing confidence to the donor.<sup>2</sup> They also grow because charities spend some of their time and money lobbying government, usually for more money. And why not—it pays handsomely. Governments also seek approbation from charity spokespersons, whose community trust is higher than in politicians.<sup>3</sup> I call the relationship the charity ball—it goes round and round.

Australia’s oldest charity, The Benevolent Society, which this year celebrates its 200th anniversary, has an income of more than \$80 million per annum. Almost 82% of its income comes from government. Only 4% comes from donations. The Benevolent Society may be described as a government sub-contractor. The society is not alone: economically significant not-for-profits (largely charities) in Australia derive

33% of their income from government and only 9% from philanthropic sources.<sup>4</sup> Charities have placed themselves in the hands of government, a predicament that some charity elders have described as a crisis of identity: ‘They do not know who they are and they do not know why they are doing what they are doing.’<sup>5</sup>

As the welfare state has grown so have charities. Not-for-profits grew more than double the real growth rate of the economy in the seven years to 2006–07.<sup>6</sup> In 2007, there were 51,000 tax concession charities, 24,000 of which were eligible deductible gift recipient charities (DGR). In 2005–06, individuals claimed \$1.5 billion in deductible gifts.<sup>7</sup> In 2011, there were 55,000 tax concession charities and 28,000 DGRs. In 2010–11, nearly five million Australians claimed \$2.2 billion in deductible gifts. Nearly 40,000 individuals claimed gifts of more than \$5,000, amounting to \$910 million.<sup>8</sup>

These amounts substantially understate the extent of giving. It is estimated that in 2004, Australians gave \$5.7 billion in donations; about 50% of the population gave another \$2 billion through charitable gambling, charity auctions, dinners and other events where they received a benefit in return for their support. Around 92% of this went to non-for-profit organisations.<sup>9</sup>

## Accountability—regulate or inform for a better market?

As the charity ball bounces along, government and philanthropists (‘large’ or ‘wholesale’ donors) are beginning to ask questions



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about charity performance.<sup>10</sup> Donors believe that their contribution can make a difference,<sup>11</sup> and they are influenced by charities' performance, so it is in the interests of charities that their performance is scrutinised by donors.<sup>12</sup> The problem is that relevant and reliable information is rarely available in Australia.<sup>13</sup> This absence needs to be remedied.

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A recent Productivity Commission report on the sector treated all dollars—donor dollars, tax-assisted donor dollars, and charity-government contract dollars—as charity 'inputs.' This view masks the essential tension in the relationship between government and charities, and between charities and private donors.<sup>14</sup> After all, 'where the money is coming from will impact where the attention is directed. The source of funding will impact to whom charities are accountable.'<sup>15</sup> Currently, private donors, often with tax-assisted donations, are generally not well informed about charity performance.<sup>16</sup> Charity performance is now a product of the charity activist, often without the input of donors. Charity activists sometimes approach every problem with the same set of solutions; they are said to 'problem surf.'<sup>17</sup> Some are also in the business of exaggerating problems for which they have 'the solution.' Anytime you read the headline, '1 in 4 Australians' (... fill in the problem) or some other bold claim, be wary of the accuracy of the data. For example, although the number of homeless people in Australia is reported as 90,000, the actual number of people sleeping rough on the streets is 7,000. The definition of homelessness has been expanded to include, among other things, those who live in supported accommodation, which is the solution for some causes of homelessness. Nevertheless, homelessness charities always report the 90,000, never the 7,000.

Take a different example of the need to check whether a donation is put to best use.

The Australian Indigenous Education Foundation (AIEF) claims it 'has found a way to make the best education available to the most marginalised children in [Australia] ... by offering scholarships which cover their school or university fees.'<sup>18</sup> The founder has stated: 'Our program is not about cherry-picking the best and brightest kids, it's about giving opportunity to kids of all walks of life who want to make the most of those opportunities, irrespective of where they come from.'<sup>19</sup> Clearly, the charity is sensitive to the claim that such programs of assistance can appear to be successful by selecting people who would otherwise have succeeded, without such assistance.

According to their own measure, however, their target are 'the most marginalised,' meaning disadvantaged. Selecting those who want to succeed is, of course, an important element in success. The AIEF states that it is looking for students who are 'tapped into the idea they could achieve more,'<sup>20</sup> but it would presumably choose the most marginalised among those who show promise.

The two case studies that the AIEF allowed to be featured in its recent extensive press coverage were students who appeared to be not at all marginalised.<sup>21</sup> The most marginalised students are those who live in remote Aboriginal communities—20,000 children on Aboriginal lands attending Aboriginal schools. 'These students had by far the worst results, with failure rates often exceeding 90 per cent.'<sup>22</sup> The case studies promoted by the AIEF appear to not satisfy its goal. In addition, it is highly likely that scholarships could have been made available at less expensive schools, possibly in the region where students lived.

Charities are susceptible to singing the praises of their own performance and picking easy marks. It is a cheap way to perform, unless someone, perhaps a donor, pulls them up.

### A remedy

Competition among charities for informed donors should overcome the tendencies to problem surf, exaggerate claims and solutions, and overly rely on government. Suggestions of the type of information required range from highly sophisticated, such as a predictive market in charity products, to the mundane, such as minimal

registration information required by the Australian Charities and Not-for-profits Commission (ACNC).<sup>23</sup> The charity sector cannot escape some form of accountability. Currently, governments impose a mild level of accountability because tax dollars are indirectly at risk. Donors, however, should impose a form of accountability as part owners of charitable deeds.

Well-informed donors, especially philanthropists with an investment sufficient to justify inquiring about charity performance, are the best chance of both forestalling government regulation and driving a better charity market. Donors can ask hard questions of charities. Ask a child sponsor charity working in less-developed countries to name the village they have ceased working in because it is functioning well enough to look after its own as a result of charity.

Meanwhile, governments get on with regulation. The ACNC will register charities and require an annual return to be lodged with the commission, details of which will be shared with the public.<sup>24</sup> In 2014, larger charities will have to lodge a financial return, the details of which should enable public scrutiny of charity efficiency.<sup>25</sup> The federal opposition has announced that it will abolish the commission, but continues to ‘support transparency and accountability of public funds,’ presumably through another commission.<sup>26</sup>

The ACNC may well be prompted by Productivity Commission recommendations to improve data collection about sector performance and its availability to the public. One suggestion is for the government to fund the establishment of a Centre for Community Service Effectiveness to promote evaluation.<sup>27</sup> Concentrating on charity effectiveness is a good idea. Although donors are affected by efficiency in charity fundraising and disbursement,<sup>28</sup> these may not indicate an effective charity and are perhaps better suited to internal management purposes.<sup>29</sup> Nevertheless, work on a national standard chart of accounts for charities is well advanced so that comparisons in efficiency will, in time, be possible.<sup>30</sup>

One charity industry insider recently commented that charity tax deductions were ‘chickenfeed’ compared to government contracts.<sup>31</sup> The charity sector may well continue to be a

supplicant and lobbyist to government, but it should seize the opportunity to allow donors to help drive performance. Government need not fund a centre for service effectiveness when the Australian National Audit Office is quite capable of scrutinising government service contracts. Charities and philanthropists should fund evaluations. In this way, the donor market may begin to deepen and mature, perchance once more to become a voice apart from government.

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### Lobbying

There is something unsatisfactory about taxpayers’ money being used to fund charities that are campaigning for things that we may disagree with.<sup>32</sup>

As well as seizing the opportunity to drive a more effective market, charities should seriously review lobbying. The Benevolent Society lobbied government for better provision as early as 1862 when the NSW government took responsibility for those once housed by the society in the Benevolent Asylum. The society proudly boasts that its president was a leading voice in the campaign for the old age pension introduced in 1901.<sup>33</sup> The Benevolent Society spends \$2 million per year on charitable activities from its endowment fund, which comes from donations, \$700,000 of which is spent on ‘influencing social change by advocating for policy reform.’<sup>34</sup> The ‘reform’ aims to create a ‘fairer’ Australia and bewails ‘growing disparity in income and job opportunities,’ an all-too-familiar cry among those disposed towards big government and redistribution. Such policies do not necessarily result in public benefit.

International studies suggest that ‘political activity’ or lobbying increases donations.<sup>35</sup> The same may hold in Australia. Australia’s foreign aid charities, for example, raise \$1 billion per annum but it is unknown how much lobbying has

expanded its coffers. But the bigger prize is official foreign aid for which charities lobby. Official aid is \$5 billion per annum and rising, and Australian charities receive \$289 million of it.<sup>36</sup> It is clear where the best return on effort lies. A recent advertisement signed by 17 charities urged the federal government to spend more on foreign aid. The charities purported to represent ‘more than two million Australian households who generously support international aid organisations each year.’<sup>37</sup> The two million presumably agreed to donate their private funds to charities. Perhaps they were aware that the Australian government also makes donations on taxpayers’ behalf, but it is doubtful they gave charities permission to press government to spend more on foreign aid.

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Charities in Australia have always been free to lobby, so long as they maintained charity work as their dominant purpose. Thanks to a decision of the High Court in *Aid/Watch Incorporated v. Commissioner of Taxation* in 2010, charities are now free to lobby and do no charity work whatsoever.<sup>38</sup> The High Court decided that a charity engaged in ‘lawful means of public debate concerning the efficiency of foreign aid directed to the relief of poverty is a purpose beneficial to the community.’<sup>39</sup> Justice Heydon, in the minority judgment, found that ‘Aid/Watch did not have the goal of relieving poverty. It provided no funds, goods or services to the poor.’<sup>40</sup> Justice Kiefel in the minority decided that Aid/Watch’s ‘pursuit of a freedom to communicate its views does not qualify as being for the public benefit.’<sup>41</sup> If the tax office had challenged a charity set up to cut foreign aid, arguably a public benefit, the High Court would have run a mile.

The federal government has written the substance of the High Court decision into law to legitimise ‘promoting or opposing a change to any matter established by law, policy or practice in the Commonwealth, a state, a territory or another country.’<sup>42</sup> Advocacy and lobbying will

become charitable purposes. Charities will be less constrained to lobby and less constrained to do less charity.

Given that common law has been changed to accommodate lobbying, a statute disallowing lobbying may be the only way to constrain this use of funds, as is the case in most other common law jurisdictions. The opposition has agreed to abolish the Act, although not necessarily to legislatively undo the High Court decision, if indeed that is possible. Of course, there are organisations such as The Centre for Independent Studies (CIS) and the Institute of Public Affairs (IPA) (where I was a senior fellow for some years) that have charity and DGR status. They are deemed research institutions and their purpose is to further public discourse, which includes promoting or opposing changes to law. Research institutions that rail against government provision and its debilitating effect on liberty—IPA and CIS—should be especially wary of promoting a culture of paid lobbying among charities. No charities I know lobby for less government.

Political parties have been publicly funded since 1984, and the idea that government should pay organisations to play politics has entered the Australian culture. It is important, though, that subsidised lobbying should never be able to displace charity. There is indeed something unsatisfactory about using the power of government to do charities’ bidding. The law privileges one group of voters who, having covered the costs of organising their ‘voice’ on the basis of charity reputation and government privilege, proceed to lobby government, placing them and their views ahead of other citizens’ voices.

## Taxation

The key element of charitable activity or enterprise is the simple mechanism of a person being motivated by the need of another or a cause, and responding to it.<sup>43</sup>

So why do charities need taxpayers’ help? After all, charities would survive on after-tax dollars and would not be beholden to government, or subject to scrutiny if they got off the drip. The cost of



foregoing tax advantages, however, is that the cost of philanthropy may rise and less of it would flow to charities. By lowering the price of giving, tax incentives potentially increase the amount donated and the number of individuals donating. The same, of course, could be said of any industry. There is, after all, an opportunity cost of philanthropy and charity.<sup>44</sup> There are alternative beneficial uses for these resources.

The critical taxation question is whether additional giving induced by taxation deductions is greater or less than the value of the tax deductions provided. Best estimates suggest that ‘a one per cent decrease in the cost of giving [as a result of the taxation deduction] results in a 0.51 to 1.26 permanent rise in the amount of giving.’<sup>45</sup> At the low end, this means individual giving rises by less than the value of the tax subsidy, so that there is some ‘crowding out’ and only a minor increase overall. At the high end, giving rises by more than the value of the tax subsidy, resulting in a higher level of giving by the individual and a major increase overall. There is evidence to suggest that high-income individuals are more likely to give more than the value of a tax deduction.<sup>46</sup>

Regardless, in political terms, no government is about to remove tax assistance for all or most charities. They may, however, look at changing the ‘incentive’ target and the nature of the assistance. Putting to one side debate about the efficacy of grants or rebates as opposed to deductions,<sup>47</sup> two questions need to be addressed—whether some charities deserve assistance and whether the balance between the donor and the charity (or charity employees) is right.

Some charity activities such as lobbying are of doubtful public benefit but profitable for the charity. Some charitable purposes are doubtful on other grounds. There are almost 5,000 school or college building funds that are DGR status charities. A case could be made that these are self-regarding, rather than for the public benefit. Since when is giving to one’s child’s school a charity? The same could be said for public hospitals and Technical and Further Education (TAFE) institutions and universities. These are, to all intents and purposes, commercial activities with paying clients and

considerable direct government assistance. The benefits accrue to individuals and only indirectly to the public. Why throw in an extra subsidy? Again, politics, not logic, decides these matters. No government will disturb these constituencies, but in failing to do so they weaken the case for ‘other-regarding’ and public benefit charity.

Charities and donors receive taxation benefits. The balance of these is worth investigating. A range of taxation advantages such as payroll tax and stamp duty concessions from state government assists charities.<sup>48</sup> The Commonwealth government provides fringe benefits tax (FBT) exemptions for employees of eligible institutions and deductible gift exemptions for donors to charities with DGR status. The value of reportable fringe benefits in 2009–10 was \$5.6 billion and the value of individual gifts (including distributions from private ancillary funds) in 2009–10 was \$2.2 billion.<sup>49</sup> Some in the charity sector would like to have fewer funds used in FBT and more access to DGR.<sup>50</sup> They do so to rebalance support for large rather than small charities. They also argue that most FBT benefits accrue to well-paid employees. These arguments are strange. There is little reason to suspect that small charities are better than large charities or that higher paid workers are not worth their benefits. In broad terms, however, taxation should assist the donor, not the charity worker.

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### **Accountability and its limits**

A key part of the charity ball is that government has rarely been prepared to ask what charities do with donated money and charity is keen to remain free of regulation. But every dollar misspent is a dollar that has little or no public benefit. Well-informed donors could drive a better charity market. The Productivity Commission has charted a path to a better charity market, but with a significant weakness: the omission of the donor.

The commission's formulation suggests that apart from access to capital, there are several main constraints to improving productivity in the charity market: a danger of excessive regulation;<sup>51</sup> lack of information and evidence on outcomes; and weak mechanisms to reallocate resources to more productive charities.<sup>52</sup> There is one other. Although the commission argued that competition plays 'at best a weak role as an incentive for productivity improvement in charities,' charities nevertheless compete.<sup>53</sup> Charities compete for government contracts—their major source of income—and for donors.

In common with most associations (including political parties), activists, not donors, are the driving force. Political parties that seek to maximise votes, however, must balance the desires of active members with the desires of voters. Businesses that seek to maximise profits must balance the desires of owners with the desires of consumers. It is not clear-cut what charities seek to maximise,<sup>54</sup> but ideally, charity should maximise 'impact.' Impact is such a contestable idea, however, that it is likely only to emerge out of the struggle for control between the organisation which runs the charity and those who support its causes through donations (of time and money). The political essence of the well-informed donor theory is that the donor can act to offset the enthusiasms of charity activists, and the fear that governments hold of program evaluations.<sup>55</sup>

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The economic essence of the theory is that donors can drive an effective market by choosing which charity to support. Donors can strengthen the reallocation of resources to more efficient charities, and improve allocations across charitable causes. Evidence suggests that charity ratings do affect donor behaviour.<sup>56</sup> At present, information about charitable works is held by charities and it is not easy to convey to others. To achieve greater

'symmetry' of information in the charity market, ways must be found to allow reporting good information. The burden of information should not, however, be so great as to divert large resources from charitable works or prove a disincentive to donate.<sup>57</sup>

### Big donors

Most donors are insufficiently organised or have insufficient investment to demand scrutiny of charity performance. Fortunately, big philanthropy has arrived and attention is turning to market function. There are few measures of charity market function, where ideally a major portion of monies flows to the most needy via competition between charities for donations. There is little concept, for example, of the optimum number of charities or whether more charities results in greater public benefit.<sup>58</sup> There are few measures of charity performance, although the costs of fundraising and disbursement as well as impact are beginning to be counted. Nevertheless, it is worthwhile observing that well-informed consumers and investors drive markets. While consumers of charity services are not likely to be in a position to choose their 'product,' donors should be in a position to choose which charity to support, or at the very least, to ask pertinent questions.

Who are the donors likely to drive a better charity market? Twiggy Forrest, Bill Gates, Warren Buffett, and others, for example, have pledged to donate half their wealth to charity through the Giving Pledge.<sup>59</sup> The public benefit of these generous actions is welcome but not obvious. There are opportunity costs, because it means their money will no longer be available for wealth creation. When a donor of the resources of those mentioned above steps into the charity arena they could overwhelm the charity. In essence, they become the charity. They could, however, drive sophisticated cost-benefit analysis to guide charitable priorities and highest impact philanthropy.<sup>60</sup>

In Australia, fewer than 15,000 individuals gift \$15,000 or more a year to charities. In addition, there are 900 private ancillary funds that distribute about \$200 million per year.<sup>61</sup> In time, these donors would probably constitute the informed market.

Large trust companies are beginning to ‘engage’ with philanthropists to maximise the social impact of their clients’ investment in charity.<sup>62</sup> These changes could not only drive existing charities to respond, but also stimulate greater competition among charities or the growth of new charities.

The issue is the limitations to reporting. It is not sufficient, for example, to have charities report in a narrow band of financial ratios. There is no reason to assume that charities with higher fundraising costs are ‘worse buys.’<sup>63</sup> Just because a charity may be an efficient fundraiser does not mean it is effective in directing resources to the causes it serves.<sup>64</sup> But while donors need not consider fundraising costs as the determining factor in their decision to invest, there is no need to have an ‘empty policy locker’ either. The donor needs to know about fundraising costs in conjunction with program delivery. Together, these provide powerful information for improving performance.

A recent senate inquiry recommended that the [then foreshadowed] ACNC investigate the costs and benefits of a GuideStar-type system in Australia to encompass all not-for-profit organisations.<sup>65</sup> GuideStar UK is an information repository that provides information about all registered charities in England and Wales.<sup>66</sup> Unfortunately, the quality of the information is not sufficient to inform donors in a way that would have them decide how their monies will be best used. A 2006 survey of 73 of the United Kingdom’s largest charities reporting on GuideStar concluded:

Charities more readily provide descriptive information ... about organizational motives ... stakeholders have little indication of the effectiveness and efficiency with which charities are operating.<sup>67</sup>

The sector, as a whole, has resisted performance monitoring. There are, however, signs that performance monitoring by other agencies is possible. For example, the private company GiveWell Australia believes that a ‘more informed and generous giving will lead to a more accountable, efficient and effective charitable sector.’<sup>68</sup> GiveWell was formed in 1997 to ‘foster a

better culture of giving in Australia.’ It researches charities and generates ideas on better ways to give. Unfortunately, GiveWell Australia has ceased to operate as an information site.

Fortunately, there is a great deal of experience in charity performance measurement, mostly in the United States. GiveWell USA, for example, claims: ‘Unlike other charity evaluators, which focus solely on ... assessing administrative or fundraising costs, it focuses on how well programs actually work.’<sup>69</sup> GiveWell only recommends those charities that can *make a strong case* that they are significantly improving lives in a *cost-effective way* and can use additional donations to expand their proven programs.

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Another independent operator, Charity Navigator (CN), serves more than three million unique visitors and informs approximately \$10 billion of charitable donations each year. CN rates charities by financial health and accountability and transparency.<sup>70</sup> Evaluations on financial health are based on information each charity provides in its tax returns. From the data, CN generates measures of financial efficiency; it also intends to rate results and drive change by rewarding charities that publish rigorously collected feedback from their beneficiaries with rating points.

Providing metrics for results is the most difficult part of the performance exercise. Fortunately, there are signs of development. There is a professional body and international association supporting social impact analysts.<sup>71</sup> These indications of movement towards rigorous external scrutiny to drive competition between charities in the name of better use of donor monies are to be applauded.

### A donor guide

The idea that Australia should have a national register of charities to better inform donors is well established and the ACNC has embarked on

that journey. What information such a register should contain is, however, still some way from being settled.

The contention is that donors should drive the charity market with their choices. Rating charities by means of objective performance is a worthy goal, but it can be resource intensive and may not answer the donors' questions. Rather than establish a charity rating agency and website, it may be more feasible and preferable, at least as a start, to establish a donor guide on a website.

People give to what they know. If they know more or different, they may give differently.

Donors want a warm inner glow from giving and they have biases as to the cause to which they may give. A donor's preferences may, to some extent, be shaped by the frequency of events or distorted by the prevalence and emotional intensity of the messages to which we are exposed.<sup>72</sup> Charities want to find and solve problems; they identify needs, sometimes with attitude. They have their agendas and they sell their cause. Satisfying donors and perhaps correcting their biases may be achieved by creating tools to allow donors to work out to whom they want to give and why. A charity rating will not answer the most fundamental questions about which cause is most important to the donor, unless they are first exposed to a wider set of data about the relative merits of causes. The latter would be one purpose of the donor guide.

According to the most recent large survey of donor attitudes in Australia, undertaken in 2004, 87% of Australians gave to charity; most of the money went to charitable organisations.<sup>73</sup> Almost half the donors gave because they identified with the cause and the people whose assistance is the object of the cause. Close to a third said they gave because of a sense of reciprocation for services already provided, or anticipation that help might be needed in future. For just under one-eighth, the main reason was a desire to strengthen

the community or, more generally, to make the world a better place. Identifying with a cause may be a shallow basis on which to decide to spend money. Charities work on simple messages of hope, messages that assume a great deal of knowledge. For example, whether sponsoring a child in Africa is the best way to assist a child, and why in Africa?

Overall, 34% of givers claimed some sort of direct affiliation with the organisation to which they were donating. For 25%, this affiliation was that they (or members of their family) used the service it provided (some of these were also members of the organisation or volunteered for it). Affiliation could be held to be self-serving, a form of insurance for the future.

People give to what they know. If they know more or different, they may give differently. Those in the survey who answered that they did not give were doubtful about the money's use or that too much would be soaked up in administration, or that too little would reach those in need. These doubts displayed a lack of trust in charities, although they may have been convenient reasons to not give. Nevertheless, they were factors that may have been overcome with better information.

Matching the desires of donors and charities is something to which markets are well suited. Markets are at their best when donors and charities freely interact, and where donors are well informed of the most important aspects of the operation of charities and the policy context in which they work.

## Conclusion

The charity sector in Australia is characterised by the charity ball syndrome. Charities chase government money, and governments chase charity approbation. There is a way to deflate the charity ball and relieve, to some extent, the burden of government regulation on charities. Some proportion of the charity dollar is also misallocated or misspent. Throwing open the market to better-informed donors can help solve these weaknesses in the present market. The beneficiaries of charity have the most to gain.



## Endnotes

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