

## In the Pay of the Piper: Governments, Not-for-Profits, and the Burden of Regulation

Peter Kurti

---

EXECUTIVE SUMMARY

No. 139 • 23 April 2013

When enacting the *Australian Charities and Not-for-Profit Commission Act 2012* last year, the Gillard government declared that its reforms of the Australian not-for-profit (NFP) sector were motivated by the need to restore public confidence and trust in charities.

Informed by the 2010 Productivity Commission report *Contribution of the Not-for-Profit Sector*, the legislation introduced a regulatory framework intended to promote partnership between government and the NFP sector as the best way to address pressing social need.

Some degree of regulation is to be welcomed because NFPs manage money donated privately or awarded from public funds. Even in its first few months of work, the Australian Charities and Not-for-Profit Commission, established by the 2012 Act, has been investigating instances of fraud and misleading behaviour on the part of some NFPs.

But in couching its intentions in terms of shared values and responsibilities, the government has only paid lip service to the commission's report. In fact, the new regulatory regime imposes new reporting protocols that are likely to add to the administrative burdens already borne by NFPs and make it harder for them to pursue their work effectively.

In addition, the nature of charity and charitable purpose is changing. Charities used to be largely dependent on private, voluntary action. Dependent as they now are on high levels of public funding, NFPs increasingly work in conjunction with the state and run the risk of becoming lobbyists on behalf of the government.

The new Act introduces a broader statutory definition of *charity* to embrace the expanded range of services now delivered by the NFP sector on behalf of the government. But in setting out to clarify 400 years of common law tradition, the Act threatens to debase the concept of charity.

Dwindling income from voluntary contributions may have provoked fears that the public has lost confidence in charities, but the real problem may be that charities have lost confidence in themselves.

The 'progressive' reforms implemented by the Gillard government impose a regulatory burden weightier than anything proposed by the Productivity Commission. They are couched in concern for promoting public trust and confidence, but the reforms amount to little more than a pretext to extend government control over the NFP sector.

---

**Peter Kurti** is a Research Fellow in the Religion & the Free Society program at The Centre for Independent Studies.

My thanks go to Professors Peter Saunders and Gary Johns, to Robert McLean AM, and in particular, to my colleague Dr Jeremy Sammut.

The creative chaos of private and voluntary action, which lies at the heart of charitable endeavour in a healthy civil society, is in danger of being stifled. This puts at risk not just the discretion of individual donors and philanthropists but also the spirited involvement of individuals freely choosing to associate and act independently of the power of the state.

## Introduction

Regulation has its place, but it is safe to say the country is living through the most intense period of regulatory change in several decades. No matter where you turn, regulation is being heaped on corporations. This is raising costs, distracting directors from their main job, and making projects uneconomic.

— Tony Boyd<sup>1</sup>

The burden of regulation is being imposed not only on the commercial sector of the Australian economy. Australia's first charity regulator, the Australian Charities and Not-for-Profits Commission (ACNC), has now begun its work of imposing a new tax and regulatory regime on the Australian not-for-profit (NFP) sector. At the heart of the reform is a new legislation, the *Australian Charities and Not-for-profits Commission Act 2012* (the Act), which gives expression to the Gillard government's intentions for the NFP sector.

The legislated reforms introduced under the Act will affect all Australian NFPs and have provoked some strenuous debate. Those who support the new regime argue that it will foster a stronger relationship between government, the NFP sector, and business by cultivating what the federal minister for social inclusion, Mark Butler, describes as 'shared value.' It is a concept he has borrowed from Mark Kramer of Harvard's Kennedy School of Government. Kramer argues that the economic value created by corporations is 'shared' when social needs are also addressed.<sup>2</sup>

By contrast, critics of the new regulatory regime, such as Peter Gregory of the Institute of Public Affairs, are uncompromising. They maintain that far from strengthening the NFP sector, the changes being introduced by the Act will impose a financial and administrative burden that many organisations will find impossible to bear. These critics think the ACNC is one of the worst examples of government involving itself where it is not needed or wanted. Gregory says:

Far from making things easier for charities, the ACNC will make things harder and more expensive. Charities should be left to get on with serving those in need, not the government.<sup>3</sup>

There is disagreement, then, about the extent to which government should be involved in the business of NFPs. On the one hand, some argue that regulatory scrutiny will force NFPs to account more completely for the ways they deploy their resources. On the other hand, sceptics of regulatory reform worry that the burden of compliance is little more than a response to political pressure for external accountability rather than being a key driver of charitable mission.<sup>4</sup>

The Centre for Independent Studies is a NFP organisation, and has a keen interest in the ways the reforms are likely to affect the work of all Australian NFP organisations. In addition, I have a personal interest in that impact because my work as a minister of religion for more than 25 years has afforded me considerable practical experience of leading religious NFP community organisations, that is, local church congregations. I understand the importance of administrative and financial accountability for church organisations, whether to diocesan, state or federal authorities. At the same time, accountability must be tempered by autonomy and freedom from undue hierarchical interference so that staff and volunteers in local organisations can respond to local needs as they see fit. One of my principal concerns in this report, as a practitioner, is to evaluate the extent to which the new regulatory reforms might strengthen rather than weaken the Australian NFP sector.

This report will begin by surveying the contemporary Australian NFP landscape and then evaluate the specific changes being introduced under the Act.

**There is disagreement about the extent to which government should be involved in the business of NFPs.**

The conclusion argues that increased regulation of the NFP sector adds a regulatory weight of little intrinsic value, and that increased public funding of the sector will alter the very nature of charity and charitable purpose.

First, though, it is important to define the terms used in a discussion about the NFP sector.

### What is the not-for-profit sector?

The very idea that unpaid amateurs can and should supplement, or substitute for, paid professionals embodies the belief that the nature of the effort provided by volunteers is of a different, sometimes more desirable, character than that of the salaried union worker or social service technocrat.

— Howard Husock<sup>5</sup>

When William Beveridge was laying the foundations of the British welfare state in the 1940s, he stressed the importance of the twin components of private charity and voluntary action. Private action, according to Beveridge, is ‘action not under the directions of any authority wielding the power of the State.’<sup>6</sup>

In today’s Australian economy, the NFP sector—also called the third sector, the voluntary sector, or the social economy—has substantial importance. A *charity* is a distinctive kind of NFP organisation because it has been endorsed by the Australian Taxation Office as having charitable status, and thereby, qualifies for charity tax concessions. The term *charity* itself strikes many as anachronistic because the new term ‘not-for-profit’ reflects the more professional and commercial character of many third sector organisations.<sup>7</sup>

The system of tax concessions available to charities and other NFPs is complex, but the 2010 Productivity Commission report *Contribution of the Not-for-Profit Sector* estimated that in 2008–09, the value of tax concessions given to the NFP sector and donors of deductible gifts was worth around \$4 billion, and may have been substantially more.<sup>8</sup>

The Productivity Commission report identified certain distinctive features of NFPs such as a formal governance structure, independence from government, autonomy in decision-making, and voluntary participation by members.<sup>9</sup> The NFP sector also employs a considerable number of people. According to the Productivity Commission, the sector attracts 4.6 million volunteers who contribute to around 700,000 entities, and their effort generates around \$43 billion for the economy. The sector has around 900,000 paid employees (or about 8% of the Australian workforce). Most Australian NFPs operate in the services market sector of the economy such as sports, education and health, while others operate in community ‘non-market’ areas such as civil rights and religion.<sup>10</sup>

We might think of charity, then, as a social and voluntary responsive impulse to perceived needs in the community. The capacity of society to perceive these needs is a mark of ‘civic capitalism,’ which combines a commitment to open, competitive economic markets and recognises that a free society rests upon ‘an ethos of shared personal responsibility for the well-being of our fellows.’<sup>11</sup>

It is precisely because they encourage volunteers rather than government to achieve their purposes that NFPs add value to civil society. Neither government nor business would undertake many of the activities of NFPs because of the risk involved or because of the nature of client relationships upon which effective service delivery depends. Their close relationship to their community means most NFPs are often better placed than government or business to anticipate the services that might be required to meet social needs.

**Most NFPs are often better placed than government or business to anticipate the services that might be required to meet social needs.**

The breadth of work with which charities are involved (also known as ‘charitable scope’) has continued to expand over the years and this, in turn, has entailed an evolution of what might be appropriately considered a charitable purpose. These changes can be attributed, in part, to the changing social compact between government and community. It is important to understand something of these developments before turning to the specific changes introduced by the new Act.

## Charitable scope

In Britain, the distinction between charity and government has been blurred to the point of eradication by the fact that government, local or national, is often the largest contributor to charities—sometimes, indeed, almost the only one. And he who pays the piper calls the tune.

— Theodore Dalrymple<sup>12</sup>

### **Private and voluntary?**

The idea of charity as an essentially private impulse informed by a community ethos began to be crowded out as the provision of taxpayer-funded relief by government expanded in response to communities’ perceived needs. Increased amounts of funding from public as opposed to private sources meant that charities, which used to largely depend on voluntary action, were now working in conjunction with the state. It was, of course, an understandable development. Christopher Snowdon says:

The state cannot be blamed for seeking partnerships with those who have the passion and experience to deliver services effectively, just as charities cannot be blamed for taking government money when private donations dwindle, but the result has been the creation of ‘insider-outsider’ groups who cloud the definition of civil society.<sup>13</sup>

While charities are unlikely to want to be thought of as ‘agents of the state,’ their cooperative relationship with government has meant that Beveridge’s idea of charity as private, voluntary action has been somewhat diminished. The prospect of much more direct government involvement in the regulation of charitable organisations (couched in terms of ‘partnership’ rather than ‘control’) means that private and voluntary influence is likely to be even more attenuated.

### **The government decides to help**

The Gillard government’s initiative paper, *Strength, Innovation and Growth—The Future of Australia’s Not-for-Profit Sector* (July 2012), which sets out details of its commitment to reform, explicitly states that the relationship between government and the NFP sector needs to be understood in such terms of partnership. The paper calls for the government and the NFP sector to work together to address what it calls one of Australia’s ‘most intractable and complex problems.’<sup>14</sup> One of the attitudes the government could bring to such a relationship is a renewed willingness to understand better how the NFP sector actually functions. Even the Productivity Commission noted that the sector’s participatory, inclusive and community-oriented processes, which are often at odds with the prevailing business culture of efficiency and quality, can make relationships between the NFP sector and government more difficult.<sup>15</sup> An underlying assumption appears to be that government must always be at least part of any attempt to make life better.<sup>16</sup>

As will be discussed later in this report, one of the reforms being implemented by the Act is increased regulation to enforce compliance by NFPs with set

**More direct government involvement in the regulation of charitable organisations means private and voluntary influence is likely to be even more attenuated.**

standards of practice. However, regulation is not the only reform the government is implementing. As foreshadowed in the initiative paper, the government is going further and intends to create a new meaning of the term *charity*.

According to the initiative paper, the Act will introduce a new statutory definition of *charity* from July 2013 to:

‘... clarify 400 years of complex common law, align the definition with the values of modern society and reduce administrative costs for NFPs ... [and] help ensure that any definition of charity adopted by the Government is best suited to the needs and challenges of the sector in the future.’<sup>17</sup>

### **Charitable purpose in common law**

Those 400 years of common law tradition were developed from the preamble to the *Charitable Uses Act 1601*, also known as the *Statute of Elizabeth*, which contained 21 socially beneficial purposes for whose pursuit property might be set aside. Although the Act was repealed in 1888, the preamble has continued to influence the definition of a *charitable* purpose.

For a purpose to be deemed *charitable*, it must:

- be beneficial to the community, and
- fall within the spirit of the 1601 preamble.

According to the Australian Taxation Office, the phrase ‘within the spirit’ means the purpose must be ‘within or analogous to purposes set out in the preamble to that Statute, or purposes that the courts have found to be charitable and within the technical legal meaning.’<sup>18</sup>

In a late nineteenth-century English case, *Commissioners for Special Purposes of Income Tax vs Pemsel* [1891], Lord McNaughten established four heads of charitable purposes that are still used by the courts. A purpose is charitable if it is for:

1. the relief of poverty
2. the advancement of education
3. the advancement of religion
4. other purposes beneficial to the community.

McNaughten said these beneficial purposes, which came to be known as the *Pemsel* purposes, had to be within the ‘spirit and intendment’ of the preamble to the *Statute of Elizabeth*. However, as social and economic circumstances have changed, the courts have recognised that what is accepted as a charitable purpose also has had to change.

Charity law in Australia continues to follow English common law closely, and the statute and *Pemsel* continue to influence Australian courts.<sup>19</sup> The Howard government launched the Charity Definition Inquiry (CDI) into the definition of *charity* and submitted a report in 2001. Following this, a draft charities bill, introduced in 2003, took the *Pemsel* purposes and divided them into seven heads, including the advancement of health, education, community welfare, religion, culture and the natural environment. However, further community consultation led to the withdrawal of the draft.

In 2004, the government enacted the *Extension of Charitable Purposes Act 2004*, which extended the definition of charity for *federal* purposes to include child care, self-help groups, and enclosed religious orders. As the Productivity Commission report has noted, these three extensions were relatively uncontroversial and all federal statutes were subsequently modified by this legislation. ‘However, the extension has not been taken up by any state jurisdiction to reform their definition of charity.’<sup>20</sup>

**The government intends to create a new meaning of the term *charity*.**

Australia has been in the forefront of charity law reform among common law jurisdictions. The changes adopted in this country have influenced countries such as England and Wales, where recent charity law reform began with a report from the National Council of Voluntary Organisations in 2001. The report's recommendations resulted in the *Charities Act 2006*, which came into force in early 2007, introducing a revised set of purposes as well as establishing a new regulatory framework that includes a Charities Appeals Tribunal and a Register of Charities.

The United Kingdom's 2006 Act has retained the *Pemsel* purposes and extended them to include such purposes as the advancement of animal welfare. At the same time, the Act identified clusters of new purposes that 'cohere around clear social policy themes, revealing the matters central to government's intended partnership arrangement with charity.'<sup>21</sup> The new clusters are:

- advancement of human rights, conflict resolution or reconciliation, and the promotion of multiculturalism
- advancement of civil society
- efficiency of charities
- advancement of health and related services
- promotion of the welfare of specifically socially disadvantaged groups.

### **Supply or demand?**

The scope of charitable purposes has therefore broadened in recent years, and Australian charity law reforms have been at the vanguard of this development. In the latest Australian formulation of the legal definition of charity, section 25-5(5) of the Act states that a NFP organisation is entitled to be registered under the Act as a charity if the organisation aims to alleviate poverty, sickness or the needs of the aged; advance education and religion; benefit the community; promote disease prevention and control in humans; provide child care services; or act as a public benevolent institution. In early April 2013, the Gillard government launched a public consultation on exposure draft legislation for introducing a new statutory definition of *charity*. This legislation proposes to extend the meaning of charitable purpose even further to allow charities a more activist participation in public debate.<sup>22</sup>

One obvious explanation for the expanding category of charitable purposes could be that the range of charitable purposes has simply grown to fill a gap between what the market delivers and what governments have a mandate to fund. However, the Productivity Commission report dismisses this as too simplistic. Rather, it argues, the scope of charitable purposes has broadened to reflect the breadth of the underlying social contract between citizenry and government.

The scale and scope of the NFP sector depends on the demand for the activities that the sector is well placed to provide, competition for supplying these activities and constraints on the sector's ability to respond to these demands and to compete for resources. Sector development is not a defined pathway, rather it is the response of the sector to changes in the nature and scale of demand. The ability to respond depends on the constraints it faces, including the extent to which NFPs resist change.<sup>23</sup>

Government can exert a considerable influence over the demand faced by NFPs. Indeed, one of the ways it can expand demand is by actively engaging NFPs as providers of services such as health care and disability services, and by giving them large grants of money to do so. However, there is a danger that NFPs can not just be bribed into silence by the promise of public funding but that such funding may actively encourage NFPs to lobby on behalf of the government. Christopher Snowden has noted that this self-perpetuating system—in which politicians fund their

**The scope of charitable purposes has broadened to reflect the breadth of the underlying social contract between citizenry and government.**

**The value of tax exemptions available to the sector has been valued at least at around \$4 billion.**

supporters, who in turn, expand their bureaucracies—has tainted the image of politics. As voters become reluctant to trust politicians, the political elites choose to transmit their message to the public through untainted third parties.<sup>24</sup>

The size of transfers from the government to the NFP sector is substantial. According to the Productivity Commission report, government transfers to Australian NFPs amount to one-third of the sector's income.<sup>25</sup> This funding has grown strongly, rising from 30.2% of sector's income in 1999–2000 to 33.2% in 2006–07. However, Australian social economist Mark Lyons suggests that only some 20,000 NFPs, 2.85% of a possible 700,000 entities, actually receive this funding—although for those 20,000 organisations, government funding amounts to more than half their income.

While Lyons rejects the idea that the sector as a whole is now dependent on government transfers, he concedes that funding arrangements have evolved as particular purposes have arisen rather than as the result of specific, active policy analyses. Whereas government has been keen to promote the idea that it is engaged in partnerships with the NFP sector, this idea of partnership is rather hollow because the funding models themselves have transferred risk from government to recipient organisations.

The Productivity Commission emphasised the importance of the NFP sector being accountable for the use of taxpayer dollars. As stated earlier, the value of tax exemptions available to the sector has been valued at least at around \$4 billion. But the commission specifically warned against imposing excessive compliance requirements, other than what was required for the delivery of agreed funding outcomes, as these would amount to an unnecessary burden.<sup>26</sup> The commission argued that the sector should be allowed to retain its independence wherever possible and acknowledged that the link between government interference (through funding, for example) and loss of independence is well recognised.<sup>27</sup>

The Gillard government has paid lip service to the commission's argument by couching its regulatory intentions in terms of shared values and shared responsibilities (see endnote 2), but has nonetheless imposed a burden of compliance that is much weightier than anything the commission proposed. The government claims that the changes introduced by the Act will enhance public confidence in the NFP sector and so drive up levels of charitable giving. However, such claims, especially from governments committed to reforms whether needed or not, are nothing new.

## **The fashion for reform**

### ***The 2012 Act: What's new?***

Reform of the NFP sector has been debated and weighed in Australian government circles for some years. The more significant inquiries into the sector in recent times have included the Inquiry into the Definition of Charities and Related Organisations in 2001, the Henry tax review (Australia's Future Tax System) in 2008, and most recently, the Productivity Commission's 2010 report on the contribution of the NFP sector. The government's stated aim is to improve accountability and boost public confidence because it believes 'increasing transparency and accountability will help build a more sustainable NFP sector for the future.'<sup>28</sup> This apparent need to shore up public confidence in the NFP sector accounts for the key objectives set out in the preamble to the Act.

The Act has three key objectives:

- maintain, protect and enhance public trust and confidence in the NFP sector
- support and sustain a robust, vibrant, independent and innovative NFP sector
- promote the reduction of unnecessary regulatory obligations on the NFP sector.<sup>29</sup>



In Division 15-5 (2), the Act states that these objectives will be achieved by establishing two entities: a national regulatory framework intended to be suited specifically to the structures, goals and funding arrangements of NFPs, and the position of ACNC commissioner who will:

- (2) (b) (i) be responsible for registering entities as not-for-profit entities according to their type and subtypes; and
- (ii) administer the national regulatory framework; and
- (iii) assist registered entities in complying with and understanding this Act, by providing them with guidance and education.

Registration would be mandatory for an entity to enjoy Commonwealth tax concessions and obtain other unspecified benefits and concessions currently available to NFPs under Australian law.<sup>30</sup> An entity will be entitled to be registered if it is a charity or NFP that complies with certain prescribed standards and is not deemed to be involved in terrorist or criminal activities.<sup>31</sup> Furthermore, the Act provides that in order to enjoy ongoing registration with the ACNC, entities will be required to comply with governance and external conduct standards.<sup>32</sup> Clearly, the Act intends registration to be one of the principal means of controlling the NFP sector.

The Act also imposes an extensive reporting protocol. Every registered NFP will have to lodge an annual information statement with the commissioner. In addition, any registered NFP with annual revenue more than \$250,000 will have to lodge an annual financial statement with the commissioner.<sup>33</sup> The idea is to set disclosed costs of fundraising against the income generated to afford some crude metric for assessing performance and efficacy. It is not yet clear whether these new obligations under the Act will replace the existing reporting obligations to the Australian Taxation Office.

Proponents of the reforms argue that part of the social compact, whereby charities enjoy a continuing favourable tax status, is a readiness to accept new regulatory protocols for disclosure. 'Regulation does not imply loss of freedom to speak, nor does it preclude debate about the proper use of charity funds—for example, for advocacy.'<sup>34</sup> Yet some NFP leaders do argue that a comparison of income with the costs of fundraising is not an appropriate metric for assessing either the efficacy or the level of trustworthiness of a NFP organisation. Further, these critics argue that new regulatory burdens, such as additional reporting requirements, will impose significant costs on NFPs that will lead to a reduction in income and a consequent diminution of charitable funding.<sup>35</sup>

### ***Is there a problem with public confidence?***

Although the preamble to the Act asserts the need to promote good governance and accountability, no empirical evidence is adduced to support the claim that funding warrants increased accountability.<sup>36</sup> Nonetheless, this crisis of public confidence is most frequently given as the reason for reforming the sector. So just how big is the crisis? Or rather, how much has the public's confidence in charities really deflated?

In a paper written for the Institute of Public Affairs in 2004, Gary Johns, then head of the IPA's Non-Government Organisation Project, argued that as the scope of charitable work broadened, the public found it increasingly difficult to keep themselves informed of the work NFPs were undertaking. Although charitable status carries with it tax privileges, donors know very little about what goes on behind the NFP scene. Johns argued that public assistance—primarily tax concessions—gives rise to a need to scrutinise the activities of charities and keep donors informed.<sup>37</sup> In particular, donors need to know about three key areas of NFP activity and organisation: first, the efficiency of the charity; second, the nature of the work undertaken in the name of the charity; and third, the achievements of

**Crisis of public confidence is most frequently given as the reason for reforming the sector.**

**'Policy makers  
tend to  
underestimate  
the difficulty  
of evaluating  
impact and  
place too much  
confidence in  
proxy measures  
of performance.'**

the charity. 'Donors may have little voice in the charity, but armed with good information, they would have the power of spending their donor dollar elsewhere.'<sup>38</sup>

Since then, Johns' thinking about the sector has moved from a concern with measures of efficiency to a focus on measures of *effectiveness* or *impact*.<sup>39</sup> It is a shift in focus reflected in the Productivity Commission's report, which called for overhauling the methodology for measuring effectiveness that might lead to the formulation of a common measurement and reporting framework. Such a framework could form the basis of reporting requirements imposed especially on those NFPs involved in delivering government-funded services.<sup>40</sup> Despite being costly to implement, measuring impact is difficult in itself. As Catholic Social Services Australia observed in its submission to the Productivity Commission:

A stronger focus on measurement will inevitably shift attention away from what matters most towards what is easiest to measure. Policy makers tend to underestimate the difficulty of evaluating impact and place too much confidence in proxy measures of performance (usually outputs or outcomes).

— Catholic Social Services Australia<sup>41</sup>

Meanwhile, some NFP leaders, such as the Rev. Harry Herbert, executive director of UnitingCare NSW/ACT, have pursued the idea of a crisis of public confidence. Herbert believes the drop in public confidence has been due to a collapse in public faith in the ability of NFPs to manage their own affairs effectively and efficiently, especially in regard to the disbursement of funds to meet overhead costs. His hope is that the regulatory framework to be administered by the ACNC will increase transparency and restore public confidence in charitable giving, and so reverse this trend.

Herbert, whose organisation, UnitingCare, has lobbied for greater independence for the NFP sector, sees the creation of the ACNC as a significant development because it removes the opportunity for government to interfere with the work undertaken by NFPs.<sup>42</sup> It seems counterintuitive to argue that the best way to reduce government interference in the activities of NFPs is to actively increase government regulation of them; yet this is precisely what NFP leaders such as Herbert do argue when they use the fashionable term 'progressive reform' to describe the new regulatory regime.

Whereas NFP leaders like Herbert have praised the ACNC regulatory schedule, others from within the sector, such as the Anglican Diocese of Sydney, have been more critical. These critics have been concerned that the problems the reforms are intended to fix remain largely unidentified.

This report has already noted that while proponents of reform assert a decline in public confidence, very little evidence has been presented to substantiate that assertion. They have also observed that levels of public trust and confidence in the NFP sector have not been of particular concern before now and that there have been few significant breaches of that trust. Indeed, the Productivity Commission cites findings of the *Giving Australia* report on levels of philanthropic support for NFPs:

- the annual real growth rate in individual philanthropic donations for the period 1997–2005 was 8.3%
- data from tax concessions suggest individual giving increased in real terms by 6% per annum in 1992–2001 and by 11% per annum in 2001–07
- corporate support for NFPs (including financial donations) rose from \$1.4 billion in 2001 to \$3.3 billion in 2004.<sup>43</sup>

Individual and corporate giving were strong when the Productivity Commission reported them in 2010. Since then, public donations have weakened somewhat

although it is too early to tell whether this is simply a dip or the beginning of a downward trend. According to the Australian Taxation Office, individual tax deductible donations to charities and NFPs decreased by 6.3% in 2009–10. Reasons for declining philanthropic giving to NFPs are not hard to find (see below) and hardly warrant the kind of regulatory requirements introduced under the Act.

### ***An over-engineered approach***

In the era of economic constraint that began with the global financial crisis, when money has been tight and job security low, people have fewer spare dollars to donate to charities. Governments themselves too can discourage public giving. After all, regulation is not the only way governments can interfere with the NFP sector.

Arthur C. Brooks, president of the American Enterprise Institute, says government ‘gets in the way of giving behaviour all the time, sometimes making it difficult or even impossible to behave charitably.’<sup>44</sup> Brooks would prefer dismantling all partnership between government and NFPs, and, addressing more specifically an American context, he gives a stringent and classically liberal example of the subtle ways in which government can stifle public donations to charities:

When governments fund nonprofits, this tends to displace private donations. This effect is most pronounced in assistance to the poor and other kinds of social welfare services: When the government gives your local soup kitchen \$1, it drives off up to 40 cents in private donations. When the state gives \$1 to your favourite theater company, it lowers private giving to the theater by about 30 cents—and so on. The reason for this may have something to do with the behaviour of donors—there is less perceived need when a nonprofit gets a government grant. But even more, it is related to the behaviour of nonprofits themselves, which tend to put less effort into fundraising when they receive government subsidies.<sup>45</sup>

Critics of the new ACNC regulatory framework argue that the Act’s continuing focus on trust has yielded an over-engineered legislation. Had there been evidence of problems in the NFP sector that needed reform, the need for the Act would have been understandable. As it is, research for this report discovered no cases of non-compliance by charitable entities that could justify the regulatory reforms.

Enthusiasm about the likely impact of the regulatory legislation has not been widespread within the NFP sector. A survey of NFP directors carried out for the Australian Institute of Company Directors (AICD) by Curtin University showed that 80% of respondents were worried that the ACNC would not reduce red tape, improve financial planning and standards of compliance, or help with recruiting directors.

Chief executive and managing director of the AICD, John Colvin, said:

Although there is widespread support in the sector, and across the director community, for the ACNC, the study findings confirm that there is doubt among the NFP community that the legislation establishing the new regulatory regime, in its current form, will achieve the Government’s commitment to strengthen the NFP sector.<sup>46</sup>

Until the new ACNC machinery was established, the regulation of charities was managed by the Australian Taxation Office, the states, and by voluntary codes of practice adopted by NFP sector peak bodies. The government intends the legislation to reduce red tape, but it is likely that the tape will proliferate, at least for a time. According to Rob Edwards, CEO of Fundraising Institute of Australia, until the states agree to defer their powers to the ACNC, the ACNC represents even more red tape. Edwards says the notion of a singular regulator has ‘some attraction,’ but thinks the creation of the ACNC has been ‘rushed’ and the ACNC needs the support

**Research for this report discovered no cases of non-compliance by charitable entities that could justify the regulatory reforms.**

**If voluntary associations are removed, crowded out, or stifled by over-regulation, the health of civil society will almost certainly suffer.**

of the states to be effective.<sup>47</sup> So far, only South Australia has agreed to amend its legislation to take up provisions of the new Act—setting a precedence for other states and territories to follow.<sup>48</sup>

One might reasonably conclude that government ought not to embark upon a regime of reform without evidence of acknowledged and investigated regulatory failures. The onerous regulatory provisions of the Act led critics to conclude that the concern with promoting public trust and confidence is little more than a pretext for extending government control over the NFP sector.

### **The value of creative chaos**

So what is government's duty when it comes to the institutions of civil society? Basically, it is to secure their rights, respect their purposes, and preserve their freedom. Nothing undermines the essential and honorable work these groups do quite like the abuse of government power.

— Paul Ryan<sup>49</sup>

In an essay published recently in the *Independent Review*, Kenneth Minogue argued that freedom and individualism diminish the more individuals are inclined to depend upon government for provision and protection. Minogue defines individualism as 'the practice that accords to some personal acts, beliefs and utterances a legitimacy that may conflict with the dictates of custom or authority.'<sup>50</sup> Whereas a strong spirit of individualism fosters social association, Minogue argues, 'the unconditional status of entitlements,' which is such a prominent feature of contemporary society, 'does precisely the opposite' by removing from individuals any responsibility for marshalling their resources with prudence and thrift.

In our contemporary world, choice certainly abounds, but it is a choice of the trivial, disconnected from the moral commitments of earlier times, the commitments that alone made individual choice the essence of freedom. Instead of responding to rational desires about the management of life, contemporary choice degenerates into a twitch responding to the hedonistic beckonings of impulse.<sup>51</sup>

Voluntary associations such as charities and NFPs have an important part to play in such responses to those rational desires. Those responses will not necessarily always be especially ordered or even efficient—but if such associations are removed, crowded out, or stifled by over-regulation, the health of civil society will almost certainly suffer.

In the course of debates in the UK House of Lords during the passage of the bill that became the *Charities Act 2006*, Lord Dahrendorf said, 'A thriving civil society is the basis of a liberal order and a thriving civil society consists of a creative chaos of voluntary and essentially private activities by individuals and their associations.' Dahrendorf argued that it was important to recognise this creative chaos and that this was best done by encouraging a lighter regulatory approach for smaller charities while imposing the discipline of consumer choice on those larger charities that accept government contracts for the delivery of public services.<sup>52</sup>

The fashion for 'progressive' reform that has led to the imposition of this new regulatory framework is characterised by an instrumentalist approach to the areas of social life with which NFPs are usually concerned. Whereas at one time NFPs might have described their work in terms of providing social or community support to those in need of it, they now tend to think of their roles in terms of 'service delivery.' It is a change of worldview accompanied by an increasing willingness to rely on public funding rather than on efforts to generate private funds or commercial income.

One of the consequences of this changing worldview is that organisations that were once voluntary and private now tend to be seen by policymakers as a means to achieve public policy objectives. After that, it did not take long for the social priorities of the NFP sector to align more with closely those of the funding departments of government. As those priorities have shifted in this process of policy instrumentalism, the value of social capital, understood as the capacity of people to voluntarily associate with each other for mutual benefit or service to others, has been debased.<sup>53</sup>

Perhaps it is this eclipse of social capital at the heart of charitable ventures that has given rise to doubt about the likely effectiveness of the Act—for the very nature of charity and charitable purpose appears to be changing.

### **Conclusion: The force of *should*?**

Charities spend too little time being charitable. Too much of the taxpayer dollar flows to the charity, too little to the donor and the recipient ... Charities should inform donors how their money is spent.

— Gary Johns<sup>54</sup>

The charitable impulse whereby private resources are allocated to public need is deeply ingrained in history. In the earliest days of the Christian era, caring for those in need was expressed as *caritas*, a form of Christian love from which the word ‘charity’ is derived, and was directed in particular to the needs of the poor and the sick. St Augustine helped elevate charity to the pinnacle of the theological virtues when he argued that God’s universal love is expressed in charitable actions.<sup>55</sup>

Charitable action continues to contribute to the well-being of contemporary Australian society, and government appears to be committed to stimulating that contribution. When announcing that the Productivity Commission had been asked to review the contribution of the NFP sector, Chris Bowen, the then assistant treasurer, said the resulting report would help the government understand better the work done by NFPs and the breadth of services they offered.<sup>56</sup>

Certainly, the size and diversity of the Australian NFP sector indicate the important place it occupies in the economy. The number of volunteers is growing slowly although because the 4.6 million volunteers who contribute to the sector have been volunteering fewer hours, the total number of hours has grown by only 2% over the seven years to 2007. The overall economic value of volunteering remains significant with the wage equivalent of those 4.6 million volunteers who work in NFPs estimated at \$15 billion.<sup>57</sup> Of course, as outlined earlier in this report, the value that the NFP sector contributes to society is not simply economic but also social and civic.

The regulatory changes introduced by the 2012 Act threaten the very vitality and independence of NFPs by imposing upon them costly standards of conduct and governance. At one stage in the life of the legislation, it appeared that reporting requirements might proliferate. However, in response to submissions to the exposure drafts, the government made some significant revisions that included allowing the ACNC to accept financial reports already provided by registered charities to agencies such as the Australian Taxation Office during the transitional period up to 2015. Nonetheless, compliance with the standards imposed by the Act is obligatory if a NFP wants to retain its status as a registered entity, as required by Division 15-5 of the Act. Registration, in turn, determines eligibility for tax concessions and is therefore an important tool of control.

While the creation of a national regulatory framework has enjoyed general support from most NFP groups and their advocates, such a broad-based approach to registration is difficult to justify. An alternative approach might be to follow the

**The size and diversity of the Australian NFP sector indicate the important place it occupies in the economy.**

suggestion Dahrendorf made in the British parliament and free well-established NFPs funded largely from, for example, income from bequests and endowments rather than donations or grants of taxpayers' money, from the compulsory statutory burden of registration and accountability. Where fundraising costs are low, NFPs should be spared the requirement of meeting the expectations of the regulator. In such cases, registration could (and should) be voluntary allowing NFPs to opt in if their boards wish to do so.

As NFP leaders such as CIS board member Robert McClean AM have indicated, one of the unintended consequences of income reporting requirements can be a marked drop in levels of income.<sup>58</sup> McClean argues that comparison of the cost of fundraising with income generated is not even an appropriate metric for the NFP sector. The appropriate metric is not the cost of fundraising but the return on investment (ROI) of the funds raised. Although examining the economics of fundraising is beyond the scope of this report, it is important to note that if critics such as McClean are correct, the regulatory burden created by the Act is based on a wrong premise.

'So what do you think's behind it all?' someone asked me towards the end of my research for this report. My questioner, mindful of the generous tax-exempt status enjoyed by NFPs, raised the possibility of other motives for introducing a new regulatory framework.

Since NFPs receive generous tax exemptions to assist them in their work (see endnote 7), government has an ongoing interest in knowing more about the relationship between a NFP's exemption status and its organisational efficiencies. This explains why the Productivity Commission's terms of reference included examining the impact of the tax system on the ability of NFPs to raise funds and the extent to which tax treatment of the sector affects competitive neutrality. However, given that the taxpayers are donating the money awarded to NFPs through tax concessions, government has a pressing interest in the ways NFPs conduct themselves.

Employees may appear to be among the principal beneficiaries of NFPs, particularly when considering the benefits of fringe benefit tax exemptions. However, even with modest tax concessions, the Productivity Commission found that wages in the sector have tended to be low compared to equivalent positions in the public sector.<sup>59</sup> Even so, employment growth in the sector is strong. According to the Productivity Commission, sector growth averaged 5.7% in 2009 compared to 2.3% for the rest of the economy.<sup>60</sup>

Earlier in the year, it was reported that ACNC investigators were looking into instances of fraud and misleading behaviour in some NFPs.<sup>61</sup> Andrew Sealey, director of strategic intelligence and compliance with the ACNC, said the ACNC had received 62 referrals from the public and other regulatory bodies and that 25 investigations were still open. According to Sealey, up to 30% of the referrals related to allegations that NFP employees had received private benefits from donated funds. Although it has been difficult to discover a deeper political motivation for the reforms, aside from ministerial public statements, it might well be that fraud and financial misconduct were, at least in part, the stimulus for change.

Overall, the reforms introduced by the Act are far-reaching and can be expected to have a significant impact on the culture of NFP organisations. There are reasonable concerns that the costs associated with complying with the new regulatory regime will prove to outweigh any benefit for the sector or for the public that supports and is served by the sector. In particular, smaller NFPs such as churches and faith-based NFPs who support the principles of openness and accountability, do fear that a primary focus on transparency needs to be accompanied by a focus on educating the public about the costs associated with delivering services so as to avoid the emergence of league tables or other forms of misinformed comparison.<sup>62</sup>

**Given that the taxpayers are donating the money awarded to NFPs through tax concessions, government has a pressing interest in the ways NFPs conduct themselves.**

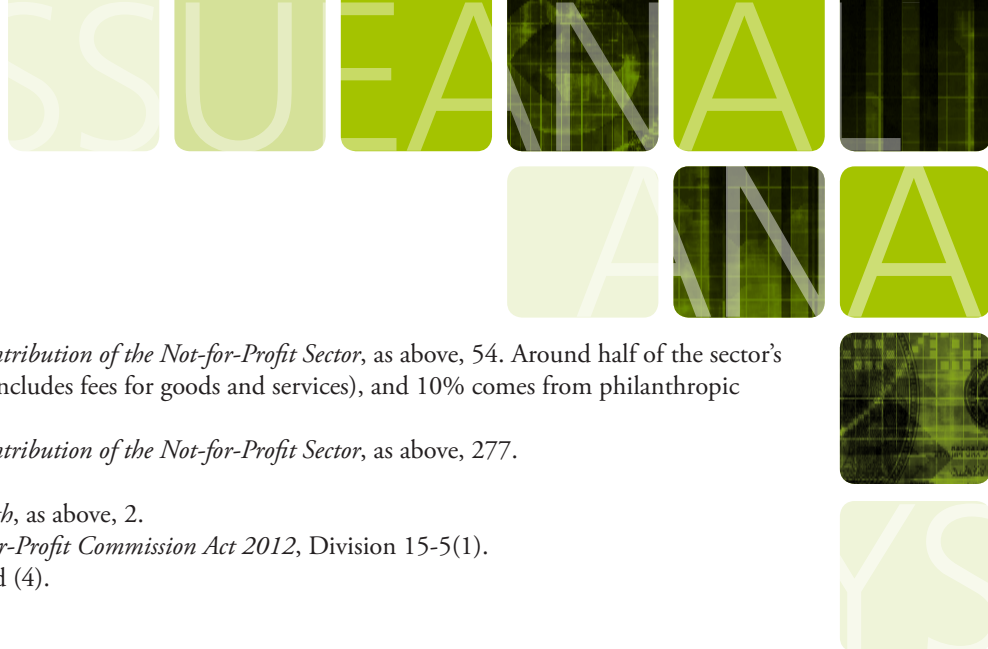
The culture of NFP organisations has already been influenced by governments' increased use of NFPs in recent years for service delivery; this, in turn, has seen a substantial transfer of risk from government to recipient organisations. Faced with a heightened loss of independence, NFPs risk developing into the 'sock puppet' organisations identified and criticised by writers such as Christopher Snowdon. This threatens to accelerate the changing scope of charity and charitable purpose.

The consequences of these changes are likely to be widespread, far-reaching and quite possibly damaging to the work undertaken by the NFP sector. First, the diminution of charitable endeavour because of reduced income, escalating costs, and dispiriting administrative burdens will mean opportunities for addressing social disadvantage, encouraging excellence in the arts, advancing medical research, and fostering education could all be missed in Australia. But second, there is likely to be a more subtle social consequence that is harder to calibrate. As Howard Husock observed, when the integrity of charitable purpose is threatened, it's not just the discretion of donors that is put at risk but also the happy accidents that have often resulted when an individual philanthropist gambles on a visionary new organisation.<sup>63</sup>

**Faced with a heightened loss of independence, NFPs risk developing into the 'sock puppet' organisations.**

## Endnotes

- 1 Tony Boyd, 'Overregulated and ... over it,' *The Australian Financial Review* (5 December 2012), 48.
- 2 Mark Butler, 'Government's role in creating "shared value",' *Pro Bono Australia* (15 January 2013).
- 3 Peter Gregory, 'Destroy! Gillard government goes all Dalek on charities,' *The Punch* (29 October 2012).
- 4 Peter Shergold, 'Social Enterprises and Public Policy,' in Peter Saunders and Martin Stewart-Weeks (eds), *Supping With the Devil? Government Contracts and the Non-Profit Sector*, Policy Forum 16 (Sydney: The Centre for Independent Studies, 2009), 30.
- 5 Howard Husock, 'Obama's inaugural address and the limits of government,' *Forbes* (23 January 2013).
- 6 William Beveridge, *Voluntary Action* (London: Allen & Unwin, 1948), 8, quoted in Christopher Snowdon, *Sock Puppets: How the Government Lobbies Itself and Why* (London: Institute of Economic Affairs, 2012), 16.
- 7 Peter Saunders, 'Supping with the Devil? Government Contracts and the Non-Profit Sector' in Peter Saunders and Martin Stewart-Weeks (eds), *Supping With the Devil?* as above, 1.
- 8 Productivity Commission, *Contribution of the Not-for-Profit Sector* (Canberra: 2010), 163.
- 9 As above, 4.
- 10 As above, xxv.
- 11 David G. Green, *Reinventing Civil Society: The Rediscovery of Welfare Without Politics* (London: Civitas, 1993), 4.
- 12 Theodore Dalrymple, 'Sharks in the Water and Out,' *City Journal* 23:1 (Winter 2013).
- 13 Christopher Snowdon, *Sock Puppets*, as above, 16.
- 14 *Strength, Innovation and Growth—The Future of Australia's Not-for-Profit Sector* (Commonwealth of Australia: Department of Prime Minister and Cabinet, 2012), 4.
- 15 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, 14–15.
- 16 *Strength, Innovation and Growth*, as above, 4.
- 17 As above, 9.
- 18 ATO (Australian Taxation Office), *Draft Taxation Ruling, Income Tax and Fringe Benefits Tax: Charities*, TR 1999/D21 (1999), paragraph 10.
- 19 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, Appendix F.2.
- 20 As above, Appendix F.3.
- 21 As above, Appendix F.5.
- 22 David Bradbury MP, 'Public consultation on a statutory definition of charity,' media release (8 April 2013).
- 23 As above, 24.
- 24 Quoted in Christopher Snowdon, *Sock Puppets*, as above, 13.



- 25 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, 54. Around half of the sector's income is self-generated (this includes fees for goods and services), and 10% comes from philanthropic sources.
- 26 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, 277.
- 27 As above, 296.
- 28 *Strength, Innovation and Growth*, as above, 2.
- 29 *Australian Charities and Not-for-Profit Commission Act 2012*, Division 15-5(1).
- 30 As above, Division 15-5(3) and (4).
- 31 As above, Division 25-5(1).
- 32 As above, Division 35-10(1).
- 33 The ACNC sets different reporting schedules for charities depending on their size, the more onerous obligations being imposed on those charities with a revenue of more than than \$1 million per year.
- 34 Gary Johns, 'Informed Giving: Ensuring Charities Inform Donors,' *IPA Backgrounder* 16:3 (2004), 9.
- 35 I am grateful to CIS Board Member Robert McLean AM for bringing to my attention this unpublished submission about charitable fundraising regulation reform.
- 36 Preamble, *Australian Charities and Not-for-profits Commission Act 2012*.
- 37 Gary Johns, *Informed Giving: Ensuring Charities Inform Donors*, as above, 2.
- 38 As above, 4.
- 39 Personal email correspondence with Gary Johns (April 2013).
- 40 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, 87.
- 41 As above, 102.
- 42 'Christians Welcome Passage of [ACNC] Legislation,' *Christian Today* (1 November 2012).
- 43 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, 76–78.
- 44 Arthur C. Brooks, *Gross National Happiness: Why Happiness Matters for America—And How We Can Get More of It* (New York: Basic Books, 2008), 186.
- 45 As above, 187.
- 46 'NFP directors sceptical about impact of ACNC,' *Pro Bono Australia* (17 September 2012).
- 47 Alex Burgess, 'New commission to follow the money trail in charities,' *Crikey Daily Mail* (19 December 2012).
- 48 As above.
- 49 Senator Paul Ryan, Republican vice-presidential nominee, address on upward economic mobility to Cleveland State University (Ohio: 24 October 2012).
- 50 Kenneth Minogue, 'Individualism and its Contemporary Fate,' *The Independent Review* 17:2 (2012), 257.
- 51 As above, 268.
- 52 House of Lords Hansard (20 January 2005), Column 938.
- 53 Vern Hughes, 'The Third Sector, Civil Society and Government: Beginning Afresh,' in Peter Saunders and Martin Stewart-Weeks (eds), *Supping With the Devil?* as above, 49.
- 54 Gary Johns, 'It's time to return to some core values,' *The Australian* (29 January 2013).
- 55 Bruce R. Sievers, *Civil Society, Philanthropy, and the Fate of the Commons* (New England: Tufts University Press, 2010), Kindle edition, 13.
- 56 Chris Bowen, 'Productivity Commission to review the contribution of the not-for-profit sector,' media release (2009).
- 57 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, xiii.
- 58 See endnote 33.
- 59 Productivity Commission, *Contribution of the Not-for-Profit Sector*, as above, 264.
- 60 As above, 68.
- 61 Adam Shand, 'Some churches "run more like cults",' *The Australian* (21 March 2013).
- 62 *Briefing on Various Reforms to the Charities and NFP Sector*, Anglican Diocese of Sydney (March 2012), paragraphs 11–12.
- 63 Howard Husock, 'Politicizing Philanthropy,' *City Journal* 23:1 (Winter 2013), 7.



**Issue Analysis** (ISSN:1440 6306) is a regular series published by The Centre for Independent Studies, evaluating public issues and Government policies and offering proposals for reform. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers. Issue Analysis papers (including back issues) can be purchased from CIS or can be downloaded free from [www.cis.org.au](http://www.cis.org.au).