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VOLUNTARISM AND THE REAGAN ECONOMIC PROGRAM

INTRODUCTION

In recent speeches, President Reagan has stressed the voluntary sector as a crucial element in his strategy to alter the balance between the government and the people in American society. "Voluntarism is an essential part of our plan to give government back to the people," Mr. Reagan declared October 5 before the National Alliance of Business. He then announced the formation of a Presidential Task Force on Private Sector Initiatives, to be headed by Armco Inc. chairman William Verity, which will examine ways of stimulating voluntarism.

Considerable attention has been given to the feasibility of employing the voluntary sector as an alternative source of funding to offset the 1981 budget cuts in welfare and other programs, but Reagan has made it clear that he views the sector as far more than a new source of finance for reduced federal programs. It is a key part of the Administration's policy of moving the provision of services as close as possible to their intended recipients, so that local needs and sources of assistance can be blended. Strengthening the "mediating structures" between government and the individual -- voluntary associations, churches, foundations, neighborhood groups, etc. -- is seen as important in reinvigorating the bonds of community. The growth of the voluntary sector is also viewed by the Administration as necessary to the effective rebuilding of notions of social obligation and "good neighborliness" -- fundamental features of American society that have been eroded by the growth of government.

Many representatives of the voluntary sector, however, seem to doubt that it can respond fully to its challenge and opportunity. Some analysts have argued, for instance, that tax law changes in 1969, together with the explosion of state and federal regulations concerning fundraising and other charitable activities, have caused stagnation in the sector. If this trend is not reversed, it will be impossible for philanthropy to reach its full potential.[1] Others go even further, by maintaining that at the very time the Reagan Administration is advocating an expansion of voluntarism, its 1981 tax and budget package actually will discourage charitable giving. A controversial Urban Institute study commissioned by the Independent Sector, an umbrella group of non-profit organizations, maintains that the budget and tax portions of the 1981 Economic Recovery Program will cost charities at least $45 billion during the 1981-1984 period, compared with what would have been available without the changes.[2] Independent Sector President Brian O'Connell claims that the Reagan Administration has delivered the voluntary sector a:

> triple whammy....Federal program support has already been cut, contributions are now projected to go down, and all this at a time when everyone is looking to these same organizations to expand their services.

Yet the assumptions on which the Urban Institute study are based are open to serious challenge. When the assumptions are examined carefully, it becomes evident that much of the extreme pessimism of the charitable organizations is unwarranted. While there are tax and regulatory obstacles to philanthropy which could be removed, there are also good reasons to suppose that the "gap" left by the budget cuts is smaller than the critics believe, and that charitable giving will expand more rapidly than is generally expected.

The size and nature of the impending "gap," and the ability of the voluntary sector to fill it, is a critical issue in the Administration's policy of encouraging voluntarism. The Urban Institute study is the only comprehensive examination to date of this issue, and it has widely been used as the definitive analysis of the impact of the Economic Recovery Act. It is necessary, therefore, to scrutinize the study carefully.

Yet there is another important element in the debate on voluntarism -- an element that is as much philosophical as practical in nature. Increasingly, the argument is raised that foundations and corporations should expand considerably their charitable activities to alleviate the burden on other segments of philan-

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1 See Stuart Butler, Philanthropy in America (Washington, D.C.: The Heritage Foundation, 1980); Bruce Hopkins, Charity Under Siege: Government Regulations of Fundraising (New York: John Wiley and Sons, 1980).

2 Lester Salamon and Alan Abramson, The Federal Government and the Nonprofit Sector: Implications of the Reagan Budget Proposals (Washington, D.C.: The Urban Institute, May 1981); Charles Clotfelter and Lester Salamon, The Federal Government and the Nonprofit Sector: The Implications of the 1981 Tax on Individual Charitable Giving (Washington, D.C.: The Urban Institute, August 1981).

thropy. Not only is there doubt that foundations and corporations will increase their contributions significantly, given the existing regulations and tax law, but it is by no means obvious that corporations should be major sponsors of charity. A discussion of the appropriate role of corporations and foundations in philanthropy must therefore accompany an assessment of the outlook for voluntarism.

PART I: CAN THE GAP BE FILLED?

The Budget Cuts

Although the Urban Institute analysis of the budget changes was completed before the budget bill passed Congress, the difference between the Administration's proposals and the final outcome are not large enough to materially affect the study's claim that charitable non-profit organizations will lose approximately $27 billion in government funding during 1981-1984. This would constitute almost one-third of their direct government support. In addition, the study claims, reductions in federal outlays in areas of interest to non-profit groups will result in pressure on such groups to increase their public services. For the non-profit organizations to finance existing services previously funded by government -- without regard to new demands -- private giving allegedly would have to increase at three times the rate of previous years.

The Independent Sector and others who cite these conclusions as proof that an impossible task faces the voluntary sector seem to ignore an important caveat in the study:

> This report makes no effort to assess the merits of the budget proposals advanced by the current Administration, either with respect to particular proposals or with respect to the package as a whole. The focus of attention is on what the proposals are and what they will mean for non-profit organizations, not on whether they are desirable or undesirable.[3]

In other words, the study includes no assessment of the worth of programs cut in the budget. In calculating the gap, the assumption is that for every dollar reduction in government support to a non-profit organization, a private dollar must be found to replace it. This may be a necessary assumption to make in order to arrive at a "neutral" conclusion, but it weakens the study as a guide to future needs. Although the budget cuts were generally intended to reduce the level of federal spending, the Administration did not cut at random, but sought to concentrate the reductions in areas where government funding was of questionable efficiency, such as:

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3 Salamon, Budget Proposals, p. 4.

a) Reductions in waste, fraud, and ineffective programs

Several of the programs cut or eliminated were wasteful and unnecessarily bureaucratic. As Senator Proxmire often has pointed out, many research awards and other expenditures finance activities of highly questionable value. And many "service" organizations seem to be more interested in obtaining and consuming government grants than in providing tangible assistance to anyone. Must waste of this kind now be financed by the private sector?

Many government-supported programs have been of marginal use, while others arguably have been counterproductive. Certain community development programs, for example, seem to have done little to develop communities, and some may even have exacerbated the problems of depressed neighborhoods. The public-sector CETA program, for instance, has often been accused of providing little real training and of inculcating negative attitudes about private sector employment. In addition, many welfare programs have trapped their recipients in a state of dependency, rather than providing a ladder out of poverty.

Although there would be considerable debate over the value of the particular programs cut, it is clearly not valid to view all the cuts as necessarily requiring some alternative sources of support. In some cases, programs cut should be reduced and even allowed to die; in many other cases, enormous waste can be reduced without impairing the quality of services provided.

b) Activities to be financed directly by recipients

Part of the budget cutbacks for the arts and education, such as the new needs test for student loans, rests on the contention that users of some service should pay directly for the cost. While this involves trimming federal support of certain non-profit organizations, it does not mean that there is a gap to be filled by private donations. The gap, such as it is, is to be covered by the beneficiaries.

In addition to an analysis of the degree to which non-profit organizations would lose federal funding, the Urban Institute study also examined the effect of the 1981 Tax Act on the incentives for charitable donations.

The Tax Act -- Individual Income Tax Rates

Spokesmen for the voluntary sector have expressed considerable concern over the effect that the reduction in individual income tax rates will have on charitable giving. Stated simply, the argument is that the higher a taxpayer's marginal tax rate, the more a charitable deduction is worth and thus the lower is the "price" of a gift. A taxpayer in the top 70 percent bracket (prior to the new law), for instance, would pay only $30 "out-of-pocket" for a $100 donation. The new law raises this net cost of giving. Because the top rate in 1982 will be 50 percent, the after-tax cost of the $100 gift will be $50. The 25 percent cut in rates for the other brackets will have a similar effect. In every case, the new law will make charitable contributions more expensive compared with other ways of spending one's income.

There is strong evidence for the contention that the "price effect" tends to reduce charitable giving -- but only if all other things are equal.[4] The evidence further suggests that price sensitivity is more pronounced at higher income levels than at lower. High income donors tend to give more heavily to educational and health organizations than to welfare or religious groups, and so the across-the-board tax cut can be expected to affect health and educational bodies to a greater degree than other non-profit organizations.

Complicating the calculation of the aggregate effects of the tax cut, however, are a number of factors:

a) Deductions for non-itemizers

Only taxpayers who itemize deductions are influenced by the price effect under normal circumstances. For the more than 60 percent of taxpayers (concentrated in the lower and middle income ranges) who take the standard deduction, the price of giving has been the full amount contributed. The 1981 Tax Act, however, contains a provision allowing non-itemizers a special deduction on the short tax form. This effectively reduces the price of donations by the amount of the taxpayer's marginal rate. If a taxpayer is in the 30 percent bracket and does not itemize his deductions, a $100 gift to charity has meant an out-of-pocket cost of $100. But under the new law, the donor will be able to deduct charitable gifts from his taxable income, and then take the standard deduction. So a future $100 donation by a non-itemizing taxpayer in the 30 percent bracket will cost him only $70. Until 1985, a ceiling will restrict this special deduction; after that, there will be no limit.

Although contributions by lower income donors tend to be less price sensitive than those by high income taxpayers, the special deduction should stimulate gifts to organizations supported by non-itemizers, in particular churches and social welfare organizations. Martin Feldstein and Lawrence Lindsey, of the National Bureau of Economic Research, estimate that the special

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4 See, for example, Martin Feldstein, "Tax Incentives and Charitable Contributions," National Tax Journal, 1975; Martin Feldstein and Amy Taylor, "The Income Tax and Charitable Contributions," Econometrica, 1976; Feldstein, Testimony before the Subcommittee on Taxation, Senate Finance Committee, January 31, 1980; Charles Clotfelter and Eugene Steuerle, "Charitable Contributions," in Henry Aaron and Joseph Pechman (eds.), How Taxes Affect Economic Behavior (Washington, D.C.: The Brookings Institution, 1981).

deduction will increase total philanthropy by 12 percent.[5] This will offset at least part of the price effect stemming from the tax cut.

b) Income Effects

The negative effect of a reduction in marginal tax rates will also be offset by changes in the income of donors, both as a direct result of the tax cut, and because of future growth in the economy. The more money people earn, the more generous their giving. Central to any projection of giving in the future must be a set of assumptions regarding the growth of the economy, but there is no consensus on what that level of growth will be.

c) Switching

A third, albeit minor, complication involves the manner in which gifts are made. The Tax Act is so sweeping in its scope that it is likely to prompt changes in the pattern of giving. The reduction in estate taxes, for example, may reduce the level of bequests to charity, but donors could simply switch all or part of their intended contributions to gifts during their lifetime, thus swelling the aggregate of gifts by living individuals. This would depend on whether a donor wished to defer a contribution until his death, or simply wanted to give under the most favorable tax treatment. There are several other similar tax changes which will be summarized later. The interaction of these changes makes the net effect of the Tax Act very difficult to project accurately if the analysis is confined to only one form of giving, even if that method is the most common.

The Urban Institute Study[6]

The recent Urban Institute study on the implications of the Tax Act for philanthropy has been widely quoted as concluding that individual contributions to churches, colleges, hospitals, and other non-profit organizations will fall by a total of over $18 billion during the next four years. If this is added to their earlier estimates of the losses to be suffered from the budget cuts, the combined shortfall could be $45 billion between 1981-1984. The study concluded that three-quarters of this "loss" would be from reduced giving by individuals in the top seven tax brackets, and so the greatest impact would be felt by organizations supported by higher income donors.

Like the earlier assessment of the budget cuts, the tax study rests on certain assumptions critical to its conclusions.

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5 Martin Feldstein and Lawrence Lindsey, Stimulating Nonlinear Tax Rules and and Nonstandard Behavior: An Application to the Tax Treatment of Charitable Contributions (Cambridge, Massachusetts: National Bureau of Economic Research, 1981).

6 See note 2.