—DRAFT EDITED TRANSCRIPT—

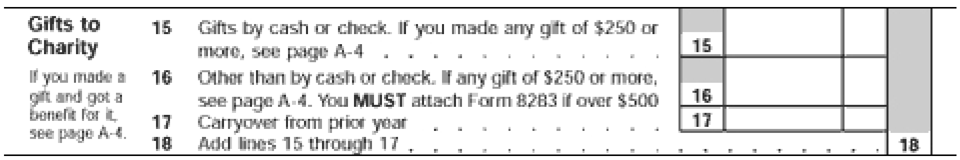
HUDSON INSTITUTE's

BRADLEY CENTER

FOR PHILANTHROPY AND CIVIC RENEWAL

presents

The Deduction Reduction:



Gifts to Charity	15	Gifts by cash or check. If you made any gift of $250 or more, see page A-4	15
If you made a gift and got a benefit for it, see page A-4.	16	Other than by cash or check. If any gift of $250 or more, see page A-4. You **MUST** attach Form 8283 if over $500	16
	17	Carryover from prior year	17
	18	Add lines 15 through 17	18

Threat to American Giving?

Monday, March 30, 2009 ▪ 12:00 to 2:00 p.m.
Hudson Institute ▪ Betsy and Walter Stern Conference Center ▪ 1015 15th Street, NW ▪ Suite 600

President Barack Obama's 2010 budget includes a provision that many charities consider a substantial threat to American giving: a proposal to raise the top personal income tax rates, while reducing the tax benefit from itemized deductions for the top two brackets. But how serious a blow would this be to charitable activity? What does research tell us about the effects of the charitable tax deduction on giving? What about other pressures on giving in today's difficult economic times? And is it fair that the wealthy should benefit disproportionately from the deduction?

On March 30, 2009, Hudson Institute's Bradley Center hosted a panel discussion of these questions and others featuring Stanford University's **ROB REICH**, **DIANA AVIV** of Independent Sector, George Washington University's **JOSEPH CORDES**, and **NAOMI SCHAEFER RILEY** of *The Wall Street Journal*. The Bradley Center's **WILLIAM SCHAMBRA** served as the discussion's moderator.

PROGRAM AND PANEL

11:45 a.m.	Registration, lunch buffet
12:00 p.m.	Welcome by Hudson Institute's **WILLIAM SCHAMBRA**
12:10	Panel discussion
	JOSEPH CORDES, George Washington University
	ROB REICH, Stanford University
	DIANA AVIV, Independent Sector
	NAOMI SCHAEFER RILEY, *The Wall Street Journal*
1:10	Question-and-answer session
2:00	Adjournment

FURTHER INFORMATION

THIS TRANSCRIPT WAS PREPARED FROM AN AUDIO RECORDING and edited by Krista Shaffer. To request further information on this event or the Bradley Center, please visit our web site at http://pcr.hudson.org, contact Hudson Institute at (202) 974-2424, or send an e-mail to Krista Shaffer at Krista@hudson.org.

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Biographies

Diana Aviv is the president and CEO of Independent Sector, the national leadership forum for America's nonprofit organizations. Aviv is a frequent speaker on emerging trends within the nonprofit sector, the financial state of the nonprofit community, public policies affecting charities and foundations, the role of civil society in democracy, and civic engagement. She has testified before Congress and has been featured in print, broadcast, and online media outlets, including *The New York Times*, *The Washington Post*, *The Wall Street Journal*, NPR, and MSNBC.com. Aviv served as executive director of the Panel on the Nonprofit Sector, convened by Independent Sector at the encouragement of the leadership of the Senate Finance Committee. In October 2007 the panel issued its *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*, more than 80,000 copies of which have been distributed. Aviv came to Independent Sector in April 2003 after spending nine years at United Jewish Communities as UJC's vice president for public policy and director of its Washington Action Office.

Joseph Cordes is a professor of economics, public policy and public administration, and international affairs at The George Washington University, and director of the University's Trachtenberg School of Public Policy and Public Administration. He has been on the faculty of The George Washington University since 1975. He is also is an associate scholar at the Urban Institute in the Center on Nonprofits and Philanthropy, and is co-editor of the *Encyclopedia of Taxation and Tax Policy* (Urban Institute Press). Cordes was a Brookings Economic Policy Fellow in the Office of the Assistant Secretary for Tax Policy, US Treasury Department in 1980-81. From 1989-1991 he was deputy assistant director for tax analysis at the Congressional Budget Office. He has published articles on tax policy, government regulation, and government spending in numerous scholarly journals, and has contributed to several books on the subjects.

Rob Reich is associate professor of political science at Stanford University (www.stanford.edu/~reich). He is also faculty co-director of the Philanthropy and Civil Society Center. His main interests are in contemporary political philosophy, and he is working on two projects, the first on the ideals of equality and adequacy as applied to school law and reform, the second about topics in ethics, public policy, and philanthropy. He is the author of *Bridging Liberalism and Multiculturalism in American Education* (University of Chicago Press,) and co-author of *Democracy at Risk: How Political Choices Undermine Citizen Participation and What We Can Do About It* (Brookings Institution Press). Reich is the recipient of the Walter J. Gores Award, Stanford University's highest award for teaching. He has also received fellowships from the Spencer Foundation and the Stanford Humanities Center. In 2004-05, he was a Laurance Rockefeller Visiting Fellow at the Center for Human Values at Princeton University.

Naomi Schaefer Riley is the deputy taste editor of *The Wall Street Journal* and has received grants from the Templeton Foundation, the Randolph Foundation, the Phillips Foundation, and the John M. Olin Foundation for her book, *God on the Quad: How Religious Colleges and the Missionary Generation Are Changing America*. Prior to joining the *Journal*, she was an adjunct fellow at the Ethics and Public Policy Center and is a frequent contributor to *The Wall Street Journal*, the *Boston Globe*, and *National Review*. Riley is a graduate of Harvard University, a recipient of the Phillips Foundation Journalism Fellowship, the Intercollegiate Studies Institute Journalism Fellowship, the Claremont Institute Publius Fellowship, and the Charles G. Koch Fellowship.

Proceedings

WILLIAM SCHAMBRA: My name is Bill Schambra, director of the Bradley Center for Philanthropy and Civic Renewal. My colleague Krista Shaffer and I welcome you to today's panel entitled, "The Deduction Reduction: Threat to American Giving?"

But first, our customary preview of coming attractions: On April 9 we will co-sponsor with Hudson Institute's Center for Global Prosperity a panel on "philanthrocapitalism" featuring two of the leading intellectual lights on the topic, namely Matthew Bishop, co-author of a recent book by that name, and Michael Edwards, a scholar at Demos, whose volume *Just Another Emperor* is probably the best critique thereof. Dennis Whittle of GlobalGiving will also be on the panel, and Hudson's Carol Adelman will moderate the panel.

And on May 28 we are particularly pleased to sponsor a discussion on the new guidelines for philanthropy (*Criteria for Philanthropy at Its Best: Benchmarks to Assess and Enhance Grantmaker Impact*), just published by the National Committee for Responsive Philanthropy (and available for purchase online at http://www.ncrp.org/paib). Those guidelines have generated some controversy, calling as they do for a 50 percent threshold for giving to marginalized communities and 25 percent for advocacy efforts among other suggestions. Aaron Dorfman, who runs the National Committee for Responsive Philanthropy (NCRP), will be on the panel as well as Sherece West, president of the Winthrop Rockefeller Foundation; Adam Meyerson of the Philanthropy Roundtable and Donn Weinberg; recently elected chair at Baltimore's Weinberg Foundation.

Now for today's panel. I must confess that I have been holding my breath until this very moment hoping that the Obama administration wouldn't abandon what has become one of the more controversial elements of its proposed budget, namely a reduction in the charitable tax deduction. As if on cue, however, the president at last week's news conference took a question on this very proposal and he reassured us that today's topic is still very much alive and timely. He maintained that the deduction reduction is "the right thing to do" – and, as if directly answering our panel's question about the threat posed to American giving, he insisted "that there is very little evidence that this has significant impact on charitable giving."

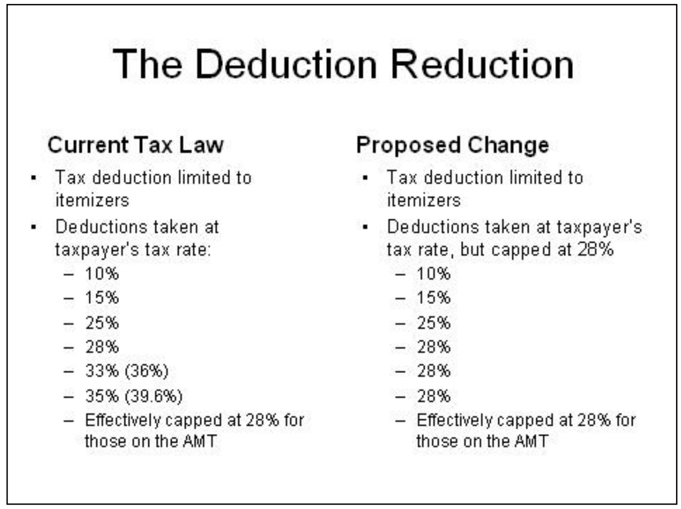
We will no doubt explore both aspects of the president's statements today, namely the empirical question about what effect a deduction reduction would likely have, as well as the moral question of whether it is the right thing to do.

To help us in both aspects of that discussion we have a distinguished panel, which I will introduce in order of their appearance. First we will hear from Joseph Cordes, professor of economics, public policy and public administration, and international affairs at The George Washington University; then Diana Aviv, president and CEO of Independent Sector; next Rob Reich, professor of political science at Stanford University; and finally Naomi Schaefer Riley, deputy taste editor of *The Wall Street Journal*.

So, Professor Cordes?

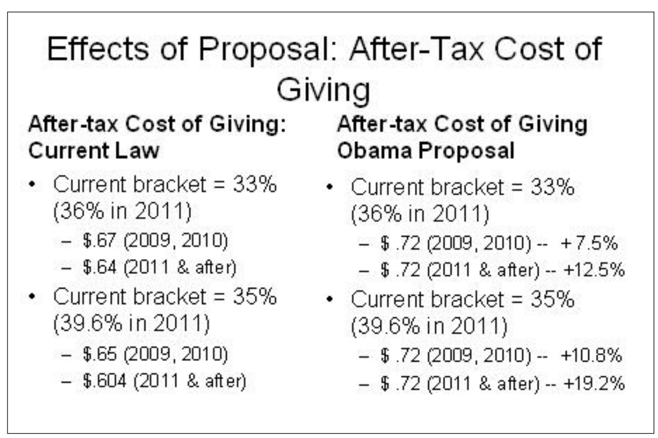
NOTE: Cordes' remarks included a PowerPoint slide presentation. The slides are incorporated below where appropriate.

JOSEPH CORDES: What I'm going to try to do is basically tee off the rest of the panel by giving a policy overview of the proposal. Basically, I'm just going to summarize exactly what the proposal is, say a little bit about the likely impacts, and then raise what I think are some of the policy issues that have come forth as a result of the debate about the proposal.



Building on the very clever title here – I'm going to say you rival my colleague Evelyn Brody, who has some of the most interesting law review titles I know on this and other topics. What is a deduction reduction? Well, it's a very incremental change. As I'm sure many of you know, essentially the effects of this change are going to be confined to those people at the upper end of the income scale, who would face under current law a rate of 33 percent or 35 percent on extra dollars of income. Under current law, which is supposed to expire in 2010, the tax rates are 36 percent and 39.6 percent if the Bush tax cuts go away. The deductions are currently effectively capped for those on the Alternative Minimum Tax (AMT) at 28 percent. What the proposal will do is essentially cap those who would be making charitable deductions at rates above 28 percent at 28 percent.

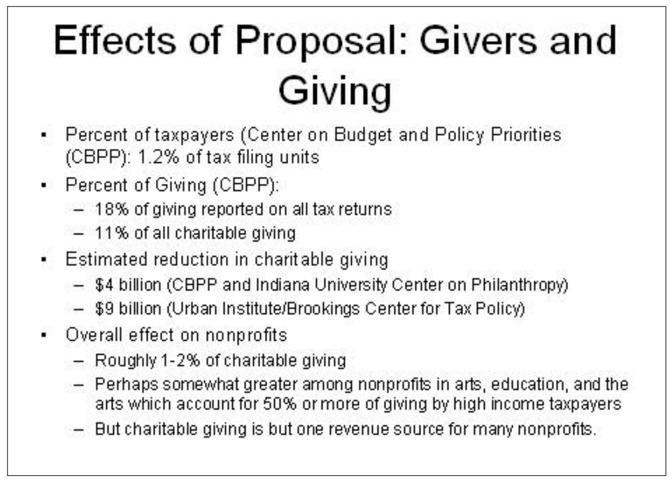
To some degree, how you think about the effects of this proposal depends a little bit on what you think the baseline is. If you think the baseline is the current lower rate, the effect is somewhat smaller. If you benchmark it against the higher rates that are proposed to take into effect in 2011, the effects are somewhat greater, that accounts for some of the variation in estimates of impact that you may have seen.



The way economists tend to think about the effect of something like this is as a change in the after-tax price of giving. Once again, I've got the side-by-side comparison. (See slide, right.) The relevant numbers are the percentages at the end of the slide; because they calculate what the percentage change in the after-tax cost of giving would be if this proposal were to be implemented. The lower numbers, the 7.5 percent and the 12.5 percent, represent the increase in the after-tax cost of giving that would occur relative to the current lower rates of 33 percent and 35 percent. The higher rates of 10.8 percent and 19.2 percent, which is the rate that Martin Feldstein uses in his *Wall Street Journal* article (March 25), would be benchmarked against the higher rates that are scheduled to come into effect in 2011.

This is important – because economists tend to think of charitable giving as a consumption choice that people make. It has a price. And while we do not claim that people would stop giving if we didn't subsidize it, we do think that there is evidence to support that the out-of-pocket cost of giving does affect the amount given. This raises the out-of-pocket cost anywhere from about 8 percent to 20 percent for the top income givers who file itemized deductions.

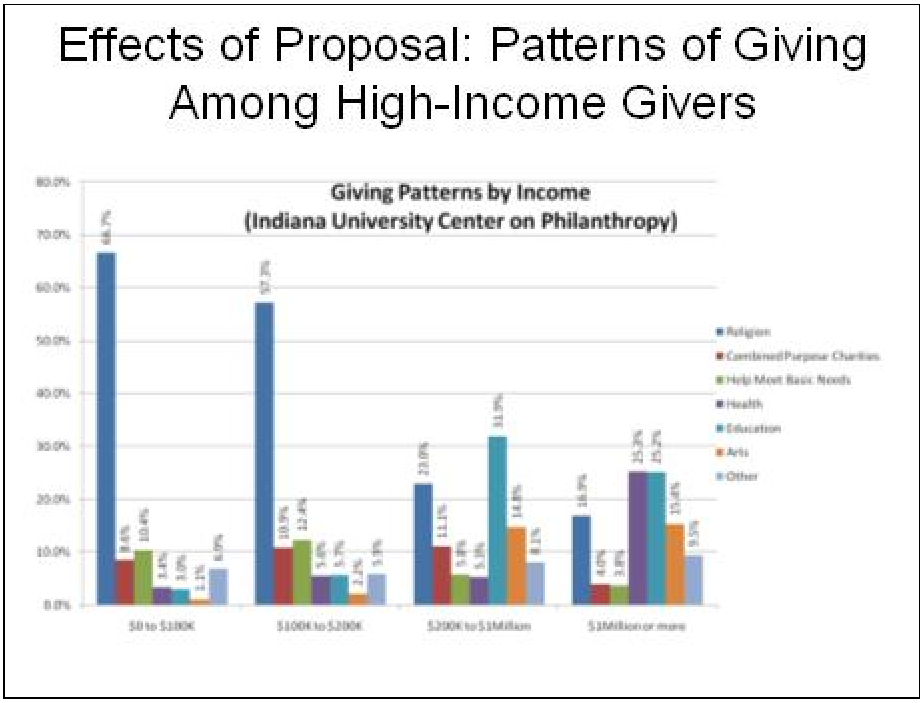
These are some estimates that various organizations have developed of the effect of the proposal. (See slide, right.) The Center on Budget and Policy Priorities (CBPP), estimates it would hit about 1.2 percent of tax filing units. This does hit a fairly narrow range of givers and taxpayers; they account for about 18 percent of the giving that's reported on tax returns. However, not all giving is of the sort that's reported on tax returns, and when we scale it back it's about 11 percent of charitable giving.



The estimates for the reduction in charitable giving range from $4 billion from the Center on Budget and Policy Priorities, which used the lower tax rates and therefore the lower percentage increases in the cost of giving to figure out their response. The Indiana University Center on Philanthropy uses a somewhat different, more macro, econometric approach. The Urban Institute/Brookings Tax Policy Center uses the higher tax rates as its benchmark and therefore gets bigger increases in the after-tax cost of giving; they get a $9 billion reduction in charitable giving. A quick glance at the Martin Feldstein piece that appeared on the 25 March in the *Wall Street Journal*, he comes up with a $6 billion or a $7 billion reduction in giving. Thinking in terms of orders of magnitude, because this is not an exact science to say the least, you would be thinking of something in the order of between $5 billion and $10 billion as the actual impact in terms of charitable giving.

In terms of the overall effect on nonprofits, this is about 1 percent or 2 percent of charitable giving. The effect is probably going to be somewhat greater, because as we will see in a minute it is likely to be experienced a bit more heavily by certain nonprofits than others. We should also keep in mind – and this is something the other panelists will have something to say on – that nonprofits rely on wide sources of revenue for financing them. For many nonprofits, charitable deductions and gifts that they get certainly play a role, but alongside government grants, fees, charges and so forth.

This diagram (see next page) takes a very interesting study done by the Indiana University Center on Philanthropy and tells an interesting story. It says that there are clearly different preferences for giving that vary by income. What we see here is that the types of givers who would be most likely to be affected by the deduction probably give about 50 percent or as much as 60 percent or 70 percent to three types of organizations: health, education, and the arts. This is in contrast with middle-income or lower-income tax payers, who tend to give much more to religious organizations and a bit more to social services and others.



There are two ways you can think about the policy debate here. First, the most immediate and somewhat narrow context of the deduction is as a "pay for." This is a wonderful new word that my budget and tax colleagues have invented in talking about fiscal policy – a "pay for" for other things they want to do in the budget. Roughly speaking, the amount of revenue that one can expect to raise from this is about the same as the reduction in giving that we are getting. We are talking about reductions in giving of $5 billion to $10 billion, increases in tax revenue of $5 billion to $10 billion, which will then presumably support other things, probably healthcare because that is the way in which it has been framed. This is a big budget with lots of stuff, so it is thinking that is focusing the other initiatives that the Obama administration would like to put in the budget.

I'm just going to raise that as a question: How does one think about that in terms of policy? One can think about it in broader terms, and I think this debate has raised some old issues again. Charitable deductions have been around for a long time – since the 1920s; it has generally been unquestioned in many circles as good tax expenditure, as distinct from others. However, people started to raise questions about whether it ought to be retained or whether changes ought to be made to address some issues –

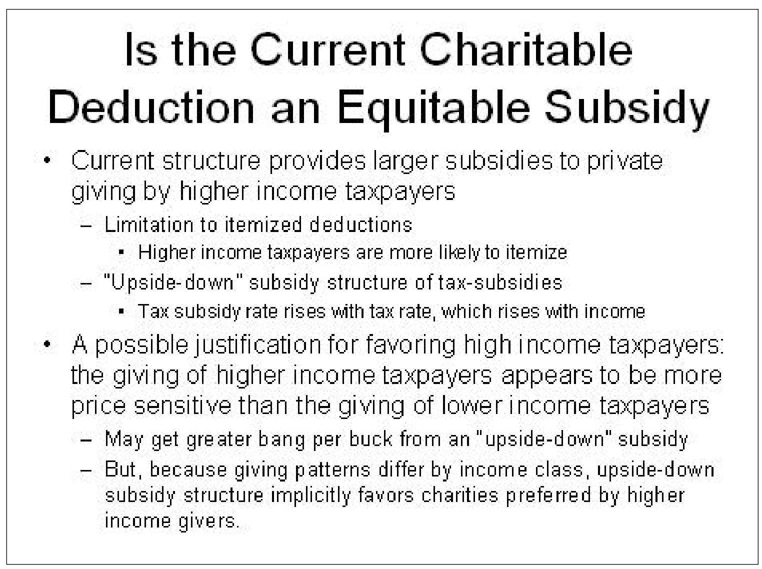
Broader Policy Issues

- **Is the charitable deduction an efficient way of providing public support to charities? (Emmanuel Saez, *J. Pub. Econ* 2004; John Bakija, NBER, 2007).**
  - Are charitable contributions price sensitive?
  - Do activities supported by charitable activities generate "significant externalities?"
  - Do activities supported by charitable activities have desirable distributional effects?
  - Does direct public spending crowd-out private giving?

and some of those, in a way, can be thought of as a more far-reaching variants of what the Obama administration wants to do.

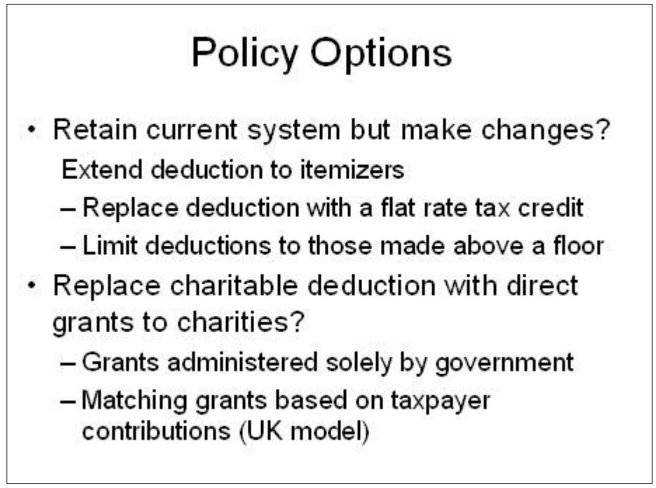
Economists would say there are two ways to look at this. Is this an efficient way of providing public support to charities? What is the bang per buck we get out of it? There are a series of questions here. Are charitable contributions price sensitive? The more price sensitive they are, the more effective a mechanism this is for incenting giving. Do the activities supported by charitable giving generate "significant externalities" that are not captured and fully reflected in the private market place? Do the activities have desirable distributional effects? And does public spending crowd out private spending?

That last question is a unique contribution of micro economic analysis, and the story runs something as follows. Using some very simple consumer choice models you can show, (this is one of those light bulb moments when I teach in class), that if you have a situation where people are previously funding a public good on their own and then the government comes in and says we are going to pay for it, over some range you may get people cutting back their own spending on this dollar for dollar as they say, well the government is doing this so why should I. It turns out that one way you can avoid that happening is if you provide a subsidy for the public good, and one way of doing that would be through something like the charitable deduction. The more you are concerned about this, the more effective this indirect way of supporting what charities do becomes a good idea.



Is the current charitable deduction an equitable subsidy? One of our panelists has written a number of interesting pieces on this. Basically the current structure provides larger subsidies to private giving by higher income taxpayers. The limitation to itemized deduction payments is one aspect of that. The other is the upside down subsidy structure of tax subsidies generally. Tax deductions reduce the after-tax cost of whatever is being deducted in direct proportion to the person's tax rate. This will rise with income. One can criticize the subsidy saying if you want to subsidize charities what exactly is the policy rational for structuring a subsidy that gives different subsidy rates to people at different incomes levels? Shouldn't they all be eligible for the same subsidy?

One response from economics would be that maybe this is justifiable if high-income givers are much more price sensitive than low-income givers, as then you will get more bang for your buck if you give more price-sensitive givers a higher subsidy than to individuals who have lower price sensitivities of giving. The evidence suggests that there is that kind of relationship between the price sensitivity and income. You have to remember, however, that that argument would have the greatest force if patterns of giving were the same across all income classes, but we know they are not. If you want to buy this optimal subsidy argument you have to balance this against the fact that the people who are getting the bigger subsidies also tend to give in different ways than people who don't, and there is a legitimate discussion to have about that.



What are the policy options? The most incremental is, keep what we have but make changes, some of which have been talked about before: Extend the deduction to itemizers. You could replace the deduction with a flat rate tax credit, so that everybody gets the same subsidy. Make it eligible to everybody regardless of whether they itemize or not. If you are looking at getting the maximum bang per buck you could limit the deductions to those who made above a floor; my colleague at the Urban Institute, Eugene Steuerle, and I analyzed a proposal like this about nine years ago. You could replace the charitable deduction with direct grants to charities – two models there that could be directly administered by the government. Alternatively, if you look at the British model, individuals give to charities and then they tell the charity that they have given, and then the charity goes to her Majesty's Treasury and tells them that *x* has given so many dollars to me and effectively the charity gets a rebate, which is structured in the form of a matching grant.

I suppose I left off "get rid of it all together," which would be another alternative that I think one of our panelists is going to talk about. I think I will stop there and turn over to the rest of the panel.

DIANA AVIV: Let me start by saying that I am delighted to be on this panel today with such distinguished speakers. I know that by the end of this you will probably hear every single argument on every side of this and everything in between, and I'm not sure that it will change anybody's mind anyway. I wonder how many people come into this discussion with a very clear idea of what they think, and will simply arm yourselves for better arguments from some of the panelists as you hear all of this.

At Independent Sector we've struggled with this issue for a number of weeks, because within our membership we have public interest organizations who believe that this is the only opportunity that we have had in twenty years plus to enact some serious healthcare legislation. They think that this president did the responsible thing and that is to send an outline of a proposal that also included how he would pay for it. They believe that somebody's ox is going to get gored in changing the system, and so given that this is the time, and that if we miss this opportunity who knows when healthcare reform of the scope and breadth that the president intends will ever have an opportunity to be considered in the serious way that it is likely to be considered now. By putting this point out early and getting the debate going now, this creates that opportunity.

We also have among our members organizations that are looking at their budgets week to week, day to day, almost hour to hour, and are finding that the individual donations are not what they used to be for the most part. That is not true for all nonprofit organizations; there are a number of charities who actually saw higher donations at the end of last year, a subject for another time. Some of our members are looking at foundation assets and reading in the paper that these assets are down between 25 percent and 40 percent, some even higher, and know that even if the promises of last year are kept for this year, that there is no assurance at all that in 2010 it will be any better. They are wondering whether, other than the stimulus package funding, there would be the possibility of funding in the budget which Congress will soon begin to work on, or has begun to work on already. They are thinking that those who receive public funds are not in a good place and believe that any kind of disincentive by government towards individuals of any size and any scope regardless of whether it's big or small, is the wrong way to go and would hurt their ability to fulfill their missions given the economic times that we are in. So for them this is not an academic discussion, this is a serious one.

I think that in some ways Bill (Schambra), I wish we'd had this discussion weeks and weeks ago as it first surfaced, and the reason I say that is because I think there has been a lot of hot-headed responses long before the facts are in about this. I think Joe (Cordes) has begun to describe some of the scope of these issues, but I think beyond that there are still questions about who would be hurt in this process.

We know that of the people who earn $250,000 and more, that there are some who are already capped at 28 percent – that's because of the Alternative Minimum Tax (AMT) and other kinds of provisions in the tax code, and therefore this would make no difference to them at all. We know there are other people who earn at that level who don't look at their check book and decide that they are going to give on the basis of the tax benefit, but give because they think it's the right thing to do. So the first thing that we have to ask is who in fact is likely to give less and over what period of time.

One of the arguments that Peter Orszag, the head of the Office of Management and Budget, has said is that in 2002 when the tax cap was changed from 38.6 percent to 35 percent, that year and in the following year there was no decrease in giving. That doesn't mean that over time there wouldn't be a decrease, but in fact at that time when the change happened there wasn't a decrease in giving.

Before we decide on what the outcome should be and what the impact should be, it would probably be a good idea for us to know exactly who is likely not to give as much as they have been giving, to which organizations, and what are the likely consequences. I don't think that we know that data at this particularly point in time.

Let me say a little bit about some of what Joe (Cordes) has mentioned as well. I think that experts disagree on the extent to which tax incentives affect total contributions made by taxpayers. They do agree that overall, even if it is not in the same year or in the next year, this change would reduce charitable giving with estimates ranging from $1.63 billion to over $7 billion in a given year. These contributions, as I have said, are needed more than ever for those organizations because of the economic times. But at the same time, charitable organizations face enormous challenges in paying for the healthcare that they provide to their employees – and I will get back to that in a minute. I'm going to jump over some of the data that Joe (Cordes) has already mentioned that I was going to talk about as well, but let me just say that I think that the question of the degree to which tax incentives impact Americans' decision to make charitable donations and the amount that they give is what is on the table.

It is our view that while there are many reasons why Americans choose to give contributions, the research has shown that tax benefits have an impact on when and how much Americans give, either individual or family contributions to charitable organizations. So, not whether they give but when and how much. There has been a clear correlation between the tax deductions for charitable contributions and the amounts individuals give to support charitable programs. The Internal Revenue Service (IRS) statistics for 2006 show that 49 million Americans who itemized their tax deductions accounted for $196.8 billion in charitable contributions, 88 percent of the total $222.9 billion contributed to charitable organizations by living individuals that year. If somebody is itemizing it means clearly that they are intending to garner some kind of benefit for their giving, otherwise they wouldn't bother to itemize.

I think that it is worth reminding ourselves that the reason that this proposal surfaced is because the president, as part of his package or intent to provide healthcare to all Americans, decided that it was important to pay for it, and included in the trilogy of proposals that he had to pay for it was this particular provision. I would go on to argue, and I think that some of our organizations have said this, that having healthcare reform is essential for this country's citizens and also for this country's nonprofit organizations.

Let me focus momentarily on our 1.4 million charitable, nonprofit organizations. Healthcare costs have become an increasing concern for this community. In 2005, the latest reporting year for which data is available, nonprofits paid over $48 billion for employee healthcare coverage and related benefits. That does not include pension plan contributions or payroll taxes. It is over 4.6 percent of expenditure of the $48 billion, not all of that is included in the cost because we will pay costs no matter what, even if costs went down. There are those who would estimate that the amount that nonprofit organizations would benefit if healthcare costs remained stable or even declined under the president's proposal is much higher than the $1.6 billion that is being estimated by the experts.

Since that time, and this was in 2005, healthcare costs have skyrocketed not only for nonprofit organizations but for everybody else. If you run a nonprofit organization you know that the single cost that you are not able to control at all is healthcare costs, and if you provide that for your employees, it is very difficult. Many nonprofit organizations are now facing difficult decisions about whether to cut benefits or to cut programs. It is not always possible to keep both at this moment in time.

Nonprofit organizations also witness firsthand the costs associated with providing services to the over 43 million Americans who lack health insurance coverage, as well as the millions of other individuals who are postponing important healthcare because they simply don't have enough money to supplement the cost of their meager healthcare plans. Therefore, in this particular time, whether they are providing services or whether they are the recipients of healthcare benefits, nonprofit organizations are in the middle of this discussion, whether they like it or not.

Finally, there is the question about the role of the sector with regard to what kind of society we want. It seems to me that the charitable sector's mission is to improve life for people here in the United States and around the world, and we have various ways in which we try to achieve that goal. One of those ways has been to make sure that people have affordable access to decent healthcare, and if this proposal moves us in the direction of providing that, surely this should be part of our broad responsibility to step in line, to step up and support this.

Now on the other side of that are also the arguments from the research that you have heard that the impact on charitable giving, even though it may not be massive, is still going to have the kind of impact for the organizations that would be affected that would make it an unacceptable proposal. There is reason to believe that individuals, while they may accelerate their charitable giving in 2010 as they brace for this proposal going into effect in January 2011 – God help those organizations who in 2011 are looking for funding and finding that those individual donors say, "Sorry, I did it last year and I am going to take a break in 2011." Even though everybody is expecting, and hoping, and dreaming, for an uptick in the economy by 2011, the fact of the matter is that nonprofit organizations will have to raise the money, and that money just may not be there, particularly for those that receive donations from these particular individuals.

It is also possible, though, that these individuals might dig deeper into their pockets, if they have deep pockets any longer, and may within that year increase giving. Like with 2002 and 2003 when we didn't see an increase over time, and we do believe that there will be erosion in giving, and therein lies the problem. I think that given the fact that charities right now are experiencing trouble meeting their mandates and fulfilling their promises, it is not a big surprise that these organizations have stepped up and said that they are very concerned about this particular proposal.

While many believe in the healthcare proposal that the president is encouraging and supporting, they think that the funding for it should come in a different way. I must say that when I was talking to a very senior advisor to the administration about two weeks ago he seemed to pour on me the blame for killing this proposal, even though Independent Sector was actually, as you can hear, thinking about on the one hand and on the other hand, and that there are merits on both sides of this. I asked him what is sacrosanct about $250,000 being the cut-off point for increasing taxes? What's wrong with $175,000 or $200,000, and looking at people with incomes at that level also increasing their taxes? I was told that was off the table and wouldn't happen, but there is always the Congress to go to, to suggest the same kinds of ideas.

I think that at this point in time we have a situation where it is almost a Solomon-like choice to make, for charitable organizations. Take a look at the healthcare organizations where on the one hand we haven't seen an onslaught of all those healthcare organizations stepping up and saying we need to do healthcare and we need to do it in this way even if we take it on the chin, and at the same time you see those organizations deeply concerned because they have donors who may in fact reduce giving and they are very worried about that.

Let me just raise one last question, and that is the question of fundamental fairness. This is the issue that the public interest organizations on the other side say about this proposal, and I'm sure that Rob (Reich) will get into some of this in more detail. To those who say, yes, we understand that you need the money; we understand that it's a good idea for you to try and incentivize giving in whatever way you can. However, we also think that it's not fair that a person who earns $250,000 a year and upwards of that, should get a tax break of $350 for a thousand dollar gift, when a person who earns $50,000 would only get $150 dollars tax benefit. Those who think this is unfair do not see it to be a terrible move in the wrong direction for the individuals who will go from $350 credit to $280 credit. Added to that argument, these people say that in fact the individual is still getting the credit of $350, and that the extra is being made up by government – and that this is government subsidizing a piece of their charitable donation – and since it is for charitable purposes, what is wrong with that idea.

Independent Sector has long held that within our progressive tax structure it's not unfair to encourage tax payers of more substantial means to make substantial gifts back to the community, and therefore incentivizing them further is not a bad idea, especially if Uncle Sam is making up the difference. In the end the charity is going to get the same thousand dollars, so what difference does it make?

All of this probably leads you to conclude, including me, that we are in a thorough muddle about this. We think that there are arguments on both sides that are important. Protecting the tax incentive for charitable giving is extremely important, and at this moment it is very difficult to ask charities to sacrifice at a time when their purposes are to serve the public good. At the same time we think that healthcare for all Americans is essential and that we ought to work together to find a way to help the president pay for it, though not through this particular vehicle.

ROB REICH: First, thanks to our hosts Bill Schambra and Krista Shaffer for the organization of this panel. I want to begin by saying I'm not in a muddle about the Obama budget proposal and its effect on charitable giving. I am here today to defend it, and to suggest that in certain respects his proposal doesn't go far enough in tinkering with the incentive mechanism for charitable giving. In fact, even after the previous presentations that Joe (Cordes) and Diana (Aviv) gave us, I don't believe we face a Solomon-like choice, and I want to draw what I see as the necessary conclusions from some of the data and arguments that they have already presented. These arguments lead in the direction to favor and in fact endorse and perhaps even go beyond what the Obama budget proposal suggests with respect to charitable giving.

Secondly, I also want to give truth in advertising that I am going to withdraw some of my remarks from a project that I am now working on, on my own, independent of this entire discussion. I'm trained as a political philosopher, so I come at this not as a social scientist in the first instance, but rather as someone who wants to begin in a sense from first principles. The project I am working on now is on ethics, public policy and philanthropy. What I am trying to do is to provide some argument, any argument, to seek the answer to the question, why should we have a system that provides a subsidy to charitable giving in the first place? We have a system of protecting private property, and we have a tax system up and running – pick your favorite tax system. People have been taxed. They have the liberty to do what they want with their property. Why should we have a system which provides a subsidy to exercise individual liberty to give money away? I think the answer to that question is not obvious, and the work that I am doing now seeks to provide, one and I will draw from that in my remarks today.

I want to begin by reminding us of three facts; I think that it is a helpful reminder to start the discussion. The first thing that it is important to realize is that the proposal to cap the deduction rate at 28 percent is not targeted at charities themselves, so it is not as if the president's budget proposal sought to make charitable organizations a sacrificial lamb for whatever its grander budget purposes. He targets the deduction structure from 35 percent or 39 percent to 28 percent, and that will affect, of course, mortgage deduction and other run-of-the-mill deductions that those in the higher income brackets take as well. It is unfair, I think, and factually incorrect to suggest that this budget proposal has singled out charitable organizations as the "ox to be gored" for the sake of the president's grander budget proposal.

The second fact, as has already been mentioned, the additional tax revenue that is to be raised from the proposal is not just added lump sum to the general budget but is to be set aside in a special fund for healthcare reform. I will come back to that point later.

Thirdly, because as Bill (Schambra) mentioned in his introduction, this has actually become now a topic of discussion within the president's most recent press conference, I want to highlight the fact that President Obama mentioned in his response to the question last week, that this is also a matter of equity. Independent of whatever one thought about the budgetary affects of the proposal – the tax revenue raised and its use for healthcare reform – you can generate arguments in favor of the proposal on equity grounds, grounds that have already been alluded to, both by Joe (Cordes) and by Diana (Aviv).

In my remarks I want to make three different but connected points in favor of President Obama's proposal to cap the deduction rate. Let's start with point number one, what will the effect be on giving? As I already disclosed, I am not a social scientist and I don't think I am in any position whatsoever to referee the debate about the actual affect on giving, but I will of course concede the obvious point that this is ultimately an empirical question, not going to be settled by a philosopher who invokes a bunch of values about how it is we should view the matter. I want to remind us of a few things that Joe (Cordes) has already brought up, and underscore them in certain respects.

Recall that the Obama budget proposals to lower the rate will only affect, in the estimates, perhaps at most 2 percent of all tax payers. The change in incentive for 98 percent of tax filers will be nothing. Of course, the wealthiest give the most as an absolute amount, and so this could still hurt giving significantly – or so it's thought. As I think Joe (Cordes) could give you chapter and verse on, the initial studies on the effect of the incentive on giving, as Martin Feldstein's *Wall Street Journal* piece last week reminded us, showed the effect to be quite strong, but more recent studies show that especially if you look over time with panel data, the effect diminishes. So whereas there was strong consensus at one time that there was a big effect, with the deduction, on the incentive to give, more recent studies show a diminished effect.

I am not going to be able to make any massive conclusions from this. What I suppose I want to remind us in the end is that what most likely will have the greatest effect on charitable giving –

especially when we are talking about the small marginal change that the Obama budget proposal suggests – is a stimulated economy that is back on its right footing.

Second point, I want to now focus on the equality concerns, again I pick up here on President Obama's invocation of this in his answer at the press conference last week. Using tax deductions to stimulate charitable giving has a number of familiar and decidedly inequitable, unfair and arbitrary consequences. President Obama's budget diminishes some, but not all of this inequality. When in response to the question last week he said, why is it fair that if he makes a charitable contribution of $100 to an organization and a bus driver in a much lower tax bracket makes the identical contribution to the identical organization, the government treats that contribution differently by having a different subsidy rate? He thinks that's an equity issue. I think that is an equity issue as well, and both Joe (Cordes) and Diana (Aviv) have agreed, although I don't think they have drawn what I think is the obvious conclusion from it.

What fundamentally the deduction structure gives us is a capricious system for which you can't generate any strong justification in terms of the differentiated incentives. It is built into the very progressivity of the tax code and it is not merely the tax bracket you fall under but of course whether or not you are an itemizer or non-itemizer. If I have the most recent data correct, 70 percent of Americans don't even itemize and so they receive no incentive to give whatsoever compared to those who itemize.

Think of it in its most obvious and, I think, strictly logical terms: Let's make Joe (Cordes) a very wealthy American, and I'll make myself a non-itemizer. He makes a thousand dollar contribution to the same organization to which I make a thousand dollar contribution. He's subsidized at 35 percent for that, so he pays effectively $650. I make the thousand dollar contribution but I don't itemize; I pay the full thousand dollars. From the organization's perspective, that receives our charitable gift, the effect on them is identical. They get $2,000, a thousand dollars from Joe and a thousand dollars from me. The same social good is produced, but the policy structure we have in place treats us capriciously in a very different way. Why? Because the outcome, the social output, is identical and yet the incentive on the input end is very different.

President Obama's proposal only goes one small step towards eliminating this equality. As Joe (Cordes) mentioned very quickly at end of his presentation, one way to correct this in the tax system would be to propose a flat tax credit for all taxpayers rather than use the deduction. That's not on the table in the Obama budget proposal, but I think that's something worth taking seriously.

My final point, I'll grant that the reduced deduction or the reduced rate at which people can claim a deduction will have a material effect on giving. I won't quibble about the social science and just say that it will diminish the charitable dollars that come into the nonprofit universe. Virtually all the commentary about the deduction reduction focuses on the threat to the nation's charitable organizations. Just at a time when we most need charity, so goes the argument, the president proposes to reduce the incentive to give. How could he in good conscience do that? What I want to insist upon here is that we have to say "diminished giving," but compared to what? What is the relevant comparison when we think about a smaller amount of charitable donations going to nonprofit organizations? Diana (Aviv) has already alluded to this in her remarks; I think it is the fundamental source of her ambivalence about the Obama proposal. The tax revenue that will be raised from the smaller deduction does not disappear into a black hole as if the cash is to be burned. The money is supposedly set aside for healthcare reform. Even if we have lower giving and smaller budgets for charitable nonprofits, we have to compare that state of affairs to one in which there are additional dollars available for healthcare reform.

Put yourself in the shoes, as Diana (Aviv) essentially already has in her remarks, of the charitable nonprofit whose primary mission is to assist those without health insurance. If the additional tax revenue that the Obama proposal generates will be used to finance fundamental healthcare reform, something in the interests of the very clients of that nonprofit organization, in whose interest is the nonprofit speaking when they oppose the Obama proposal? It seems to me they are speaking in their own self interests, in the staff's interest, or in their funder's interests – to see the nonprofit thrive rather than to see their clients thrive.

What we have to insist upon here, I think as almost anyone who answers this discussion will, that if the point of the nonprofit universe is to promote the social good, to create a civil society in which citizens' arguments about what is socially valuable get played out and social goods are produced, then the simple fact that smaller amounts of dollars will flow into the nonprofit universe does not conclude a discussion about the desirability of the proposal. We have to view that offset against the increased benefit – if you think there will be one – from the increased tax revenue that will generate healthcare reform.

So unless you are a persistent pessimist – for which there may be some good reason – about the ability of the government to bring about fundamental change in healthcare, and you think that the additional revenue raised will in effect simply disappear into a black hole as if it were burned, then invoking the "likely outcome" that smaller amounts of money will be given to nonprofits and therefore we should oppose this is simply faulty reasoning. You need additional arguments about skepticism, about government as a whole, in order to get you there.

So, very quick conclusion. On the social science evidence, point one, I can't offer any conclusive evidence about this but there are some reasons to be cautiously optimistic that the reduction will not harm giving significantly – especially if you look over time, and especially if you think that what will contribute to charitable giving overall as a healthier economy. For those of you in the room who aren't economists, one suggestive reflection or observation here – I don't offer this up as conclusive evidence – is that Obama's proposal, of course, only goes from the 35 percent or 38.6 percent tax bracket to 28 percent deduction rate. Now, roll the clock back twenty or thirty or forty years to a time when the top tax brackets were much, much higher and therefore the corresponding incentive to give was also different. Think about the fact that over the years, the progressivity of the tax code has diminished, and as a result the incentive to give has been lowered. Has the amount of money given to charities gone down correspondingly? No – just the opposite. You find that relative to twenty or thirty or forty years ago, people are giving more money.

There is a wide variety of ways to explain this; the chief reason usually invoked at this point is that the economy is on a fundamentally different footing and people are much wealthy than they have ever been.

Second point, to remind you about the equity, or equality, issue, Obama's budget proposal increases equity, although only marginally. It treats similar donors who make similar gifts to similar organizations more alike rather than less alike.

Finally, on the output or outcome of what nonprofits produce, I insist to you all that you compare apples to apples. I'll grant that there may be reduced giving – but compared to what? If we get fundamental healthcare reform out of this, as Diana (Aviv) already indicated, stepping into the shoes of any nonprofit executive who worries about paying healthcare costs, won't that be in the fundamental interests not only of the nonprofit organizations but also of the very clients that healthcare nonprofits serve?

I'll conclude with a very modest proposal – but please grant me the liberties that a philosopher usually takes, especially since I don't work here in Washington DC and I don't know the daily ins and outs of the legislative process. I will suggest that one way perhaps to straddle the arguments on offer today is to endorse the Obama proposal of lowering the deduction rate, but then to say that if a citizen wishes to make a charitable contribution to a nonprofit organization that provides exactly the sorts of social services that the country so desperately needs during an economic downturn – basic human needs, basic social services – give them the full deduction. Differentiate the incentive structure so that donations to nonprofit organizations that serve precisely those needs that are greater than ever in an economic crisis get treated with the full deduction rate. Maybe even double it.

As Joe (Cordes) showed you, those contributions don't account for a very large percentage of all charitable giving in the US – I think at most 20 percent. If you were really generous in how you counted what class nonprofit organizations belong to, you might get a slightly higher percentage. If a citizen wants to contribute to the James Beard Foundation or to help search for a cure for baldness, cap their deduction, or perhaps even eliminate it.

Thank you.

NAOMI RILEY: Thank you all for having me! I am not an academic. When I was preparing my remarks, I was trying to figure out how to describe myself to you; first I was going to say that I'm here to provide the pundit's perspective, but now I realize I am going to provide the persistent pessimist's perspective, which I think is sorely lacking around here. (Laughter.) As Rob (Reich) said, we need additional arguments about skepticism of government as a whole. I probably can't get into all of those this afternoon, but if you read the *Wall Street Journal* editorial page, I'm sure you will find plenty to suit you.

The first thing that interests me about the three distinguished panelists who have spoken before me is that Bill (Schambra), for all of his efforts here, could not find somebody to defend *all* of what President Obama said last week. Obama said, "Now, if it's really a charitable contribution, I'm assuming that that shouldn't be the determining factor as to whether you're giving that $100 to the homeless shelter down the street." Everyone seems to have concluded that people's bottom lines do affect their charitable giving – and that is certainly my perspective as well. In fact, I think it is actually the Obama family's perspective; as we were informed during the election in

2005 and 2006, the Obamas gave $27,500 to charity, and in 2007 they gave $240,000 to charity. Now, assuming that they did not do this just because – I know what you're thinking – Obama was running for president, but rather because his bottom line changed – he got a lot of royalties from his good book – then I think that we can draw a conclusion about how people's wealth and ultimately their bottom lines affect how they spend their money. Charity is a form of consumption, and I think that charitable giving is affected by tax structure. I am not also a social scientist, but I think that everybody here has concluded that it is affected at least to some degree.

Given that Bill (Schambra) didn't find anyone here to defend the position that it's not really affected, I think we then have to go on to what the real arguments are for Obama doing this. Obviously, as Obama says, he thinks this is going to help pay for the healthcare costs. As I said before, I am very skeptical about the effectiveness of government; I am skeptical about the healthcare plan in general; and I do think that money is going to go into a giant black hole.

I want to take on some of the arguments that have been made here – the fairness discussion, first of all, and also whether the government essentially could do charity's job better than charity. As for the fairness argument, I am not going to defend our current tax structure. I am actually hoping that as we all leave today we will have a very interesting coalition of people supporting a flat tax – but maybe you (the other panelists) are skeptical. That is my perspective on the progressive tax system – the whole thing is fundamentally unfair. People who have more wealth should not be paying a higher tax rate; I also think that they shouldn't get a different rate of tax exemption from middle class people. So like I said, I'm not going to defend our current tax structure in terms of fairness.

I do think that we need to think about this question of where people's charitable giving is going. I thought that Joe (Cordes)'s graph that he borrowed from Indiana University Center on Philanthropy (see page ________) was very interesting. He suggested that the wealthiest people in this country are giving to higher education, the arts and healthcare. Healthcare gets lumped in there as a bad thing that wealthy people give to, right? I'm not really sure. I understand the argument – although I don't agree with it – that maybe we could do without so much giving to higher education; certainly I think that we could do without so much giving to higher education. Maybe people think the arts are expendable too. But the argument that two people here have made is that healthcare is not expendable. In fact, the Obama administration and Congress would like to spend a lot more on healthcare. So I am not sure how that fits in here.

That being said, I would like to offer my own modest proposal. If we would really like to equalize things here and make sure that the basic needs are being met – much more than these things which might be a little more expendable, like the arts and education spending – I would be happy to have the government cut a lot of its donations to shovel-ready projects on college campuses. I think that the government does not need to be making up, in any sense, for people's not giving to their alma maters by funding more buildings on college campuses. In fact, as somebody pointed out to me recently, buildings on college campuses are some of the most under-used facilities you will ever see; if you have ever walked onto a college campus at, say, two o'clock in the afternoon, you will never find so much empty space, particularly on a Friday.

I want to conclude by saying that obviously we have some very fundamental differences here on first principles. I think that the money people give to charity is their own; they do have liberty to give it. I don't think the government should be in the business of giving tax exemptions at all. I don't think it should be in the business of giving charitable tax exemptions. I think generally Americans are a charitable sort, and I think that they will give to charity in one way or another. But I don't think that the government needs to be in the position of mandating that.

I do worry, with regard to Rob (Reich)'s proposal about giving to fund basic needs, that that's somehow going to be determined by God knows how many pages of congressional literature and commentary. Right now we have a system where people in this room would disagree about a lot of the things that fall under the charitable deductions; they would say, that's really not charity. Leona Helmsley gave $8 billion to fund the welfare of dogs. There are a lot of people who say that's not charity, and the government shouldn't be in the position of subsidizing that. I think that once you start unpacking this question of the charitable deduction, you will find a great deal of disagreement especially as to what basic human needs are – which seems like something we could agree on, but I don't think it is. That is why I retreat to the perspective that I hope we can all agree on, which is a flat tax with no deductions at all.

WILLIAM SCHAMBRA: Thank you all very much! On the Leona Helmsley question, incidentally, just for the record, we had a conversation about that last September,[1] and indeed we raised the very questions that you suggested, Naomi (Riley), i.e. what is charity in that situation, and is this a legitimate charitable expenditure?

I am intrigued by Professor Reich's suggestion that we allow the full deduction – maybe even an increased deduction – for groups that provide basic services. I am intrigued by it not because I think it is possible to do that; it has been proposed a number of times – including, incidentally, under conservative Republican administrations; this was something that Marvin Olasky had suggested. But it does get to this question, what is the charitable sector? In some of your writings, Professor Reich, you have suggested that there is something questionable about wealthy people funding institutions of higher education, art, museums and that sort of thing; it may not merit the label "charity." Diana (Aviv), Joe (Cordes), and Naomi (Riley), do we in fact get to this question of what is charity, or what is the voluntary sector, what is civil society, through this question? Are we in fact raising some very fundamental questions through Professor Reich's proposal?

JOSEPH CORDES: From the vantage point of economics and public economics, I think a major argument for providing subsidies to charitable giving would have to do with the fact that charitable organizations provide a range of public goods that the public sector either doesn't provide, or doesn't provide in a way that matches the pace of the population. If you take that perspective, there is a distinction to be made between subsidizing activities that are public goods and those that are not. It doesn't break down to basic needs versus everything else. If you think that educational institutions generate external benefits – and I'm not defending this, by the way; I'm talking about general economic principles – there is an argument for doing that. To the extent that you think that the arts have certain kinds of external benefits, there is an argument for

[1] "Is Philanthropy Going to the Dogs?" September 5, 2008. Co-sponsored by *The Chronicle of Philanthropy*. Transcript available online at http://www.hudson.org/index.cfm?fuseaction=hudson_upcoming_events&id=600.

doing that. That would be an argument that would try and get at this community benefit idea, which by the way local governments try to get at insofar as they try to limit the property tax exemptions – something I have written about. It's a hard nut to crack.

I have come down to the view that there is a general set of arguments for having a fairly lively and strong third sector. The Europeans are trying to broaden theirs in some ways, and something like a charitable contribution – although perhaps redesigned from what we have – would be the best way to do that. I think it would be very difficult to get into the business of specifying which types of organizations qualify, beyond some broad criteria, versus those that would not. It wouldn't be the Congressional record that would get full; it would be the Internal Revenue code in terms of how you would actually try to write administrative rules that would distinguish among these kinds of activities. Local governments have found this; it's not easy for them to figure out what a community benefit organization is and what's not. In principle you would like to do that; in practice I'm not sure that you can.

DIANA AVIV: Bill (Schambra), a couple of things. I think the questions you were raising were: What is a charitable purpose? Are some charitable purposes more worthy than others? If Congress and our public policy instrumentality are going to benefit organizations through our tax code, should some organizations be more deserving, or more worthy than others? In fact somebody whom you know so well, Congressman Xavier Becerra (D–CA), has suggested exactly so – that funding should flow to organizations in his district that are serving the poorest of the poor, and so on.

There are two problems with that. I think that there is merit in that question; I think in the end we are saying that as a society we think that we have some public responsibilities towards people, and that people who are the poorest and the most disadvantaged should have some benefit. How we decide which organizations provide those kinds of services is where this becomes thorny even for people who are sympathetic towards this. Paul Brest, president of the Hewlett Foundation, testified in California on a piece of legislation that began to move in this direction. He described how the foundation's commitment is to removing pollution; they funded programs at Stanford University to reduce pollution. He testified that is their belief – and they can show through evidence – that pollution in disadvantaged communities is much greater, but when you track that back to funding research at Stanford University, it doesn't exactly look like the food bank or the soup kitchen.

I remember serving on the board of the Emergency Food and Shelter Program, which is a government-funded program administered by seven national religious and secular organizations. In that particular program we provided services to people who were at risk of being poor, who were about to not be able to pay rent. So where does one draw the line? It is not only if we were to agree. As Naomi (Riley) said, it's difficult to say who would be included and who wouldn't. If we were to agree – and I doubt that we would come to agreement on that – where would we draw the line if we also want to *prevent*?

Finally, I would say that it would give lots of people the heebeegeebees to think that members of Congress or the IRS would be deciding on that issue. Lots of those people who work at the IRS have never worked in a nonprofit organization or done this kind of work, and wouldn't understand. And the American Association of Museums and all those arts groups tell me that if you look at the substance of their programs, they have community orchestras and local programs, and they help lower income people move into these higher spheres of engagement in more meaningful spiritual, emotional and cultural ways. To say that the only kind of good service is one that provides for food and shelter and not for these spiritual and larger issues is to miss an important part of what we do.

WILLIAM SCHAMBRA: Just to pick up on a point that Diana (Aviv) made, one of the great motifs of modern philanthropy in America,of course, is a distinction between the implicit "mere" charity and philanthropy, which gets to root causes. This is a favorite topic of mine for another time. But the point is that it would fly directly in the face of everything modern American philanthropy has tried to achieve to cut it off from some of these grand projects that claim ultimately to benefit the poor.

ROB REICH: Just a few thoughts. When we think about differentiating an incentive structure in such a way as to give a greater incentive to nonprofit organizations – or to give people a greater incentive to give to nonprofit organizations – that provide for basic needs, and then object that either a political fracas will ensue, or too much administrative minutia will be necessary, or argue that the charitable sector is really about ensuring a pluralism of voices to define what public goods are, and shouldn't be left to the whims of our elected representatives at any one point in time – althought it is a very, very important point – and I want to just give us a couple of things to keep in mind.

First, it's not as if we haven't had a version of this discussion already. Setting up the 501(c)(3) sector and identifying which organizations are in and which are out is a version of the conversation I'm proposing to have. And it has already been had over the course of time. Perhaps some rough consensus might emerge – and if you say it's too easy for a philosopher to say that, you're right. But it's not as if a conversation of this sort has never happened before. That is fundamentally untrue.

Now, what Joe (Cordes) mentioned I think gets to the heart of what charity's role is in a flourishing democratic society. In a certain respect, to ask that question or wonder whether or not we should have persistent skepticism or pessimism about what the government can carry out is to reorient the conversation around terrain that I am quite comfortable and familiar on; we are now talking about first principles, political philosophy, political theory about how we set up our society in such a way as to allocate certain roles to the state, certain roles to charity and certain roles to the market.

As a shorthand way of advancing that discussion a little bit, I want to start from what Joe (Cordes) suggested: If you think that the reason to have a subsidy is that we are going to produce public goods through the charitable universe – goods that either the state will not be able to supply or that it will undersupply – it seems to me that you already have to have a lot of concerns about the boundary drawing, about which what organizations are in and what organizations are out. So, for instance, our health club memberships – going to the YMCA: There are all kinds of really great positive externalities from having a healthy body, but we don't deduct our membership fees to the YMCA. It has identically structured positive externalities as religious attendance does, for example, and yet those Sunday afternoon contributions *are* indeed deductable. Why are churches in, and health clubs out? On the public good explanation it seems to me that it's hard to give you a good explanation for that.

Often, people who make those arguments retreat, as Martin Feldstein does at the very end of his op-ed piece, to saying that what is really important here is diversity and pluralism of voice, that civil society is all about promoting and celebrating diversity of civil society, pluralism of civil society, getting all of our voices engaged so that we can test with each other over time what public goods are. If *that's* your justification for civil society, then it seems to me that you ought to worry even more about the current mechanism, which gives a plutocratic megaphone to wealthy people and a whisper to those who are poor. That's not a pluralistic voice; that's plutocratic voice.

WILLIAM SCHAMBRA: Naomi (Riley), is that plutocratic voice?

(Light laughter)

NAOMI RILEY: I speak for the plutocracy! (Laughter.)

ROB REICH: Yes, please!

NAOMI RILEY: Well, I said it half seriously, but I really do think that if government services and the charitable sector are interchangeable in this way – if we can substitute one for the other – then I really think there are a whole lot of things the government should get out of the business of doing. If we think that the charitable sector is overfunding higher education and the arts, then I think the government needs to get out of those businesses. Rob, if you would agree to that, then I might agree to a lot of what you are saying! A significant portion of the budget is going to just the kinds of programs that you say that we should not be giving charitable deductions for, so it seems to me to be inconsistent. Now, Rob, I realize that you are not responsible for all those parts of the budget. (Laughter.) But it does seem to be a little bit inconsistent.

The other point that I wanted to get at is this question of diversity. My case for allowing a thousand flowers to bloom in the charitable sector – although as I said I still don't think the deduction in and of itself is something that I would like to defend – is that the private sector does a lot of this better. It's not just that there are different things that pop up, and we have to celebrate all of our diversity. I just think that in a lot of what the charitable sector does, it comes up with better ideas than government does. And involving all of these different, individual people is not just because we love diversity for its own sake; it turns out that a thousand people thinking about a problem in different ways often come up with better solutions than Congress does. I think that there is a lot of evidence to prove that case.

ROB REICH: Just very quick, the footnote on that. I agree very strongly with the diversity rationale for civil society – that we have it for innovation reasons. It's a type of John Stuart Mill, marketplace-of-ideas argument. We're providing incentives for that. But then it seems to me that you ought to worry about the fact that in terms of the public policy structure we have in place that motivates giving and voice into that sector, it provides a megaphone for those who have deeper pockets and not much amplitude for those who don't have deep pockets. And so we have a distortion; public policy distorts the "marketplace of ideas" of innovation because it systematically favors the wealthy in the current mechanism.

NAOMI RILEY: Are you saying charitable deduction favors the wealthy?

ROB REICH: Correct.

NAOMI RILEY: Or are you just saying that the wealthy have too much money and thereby a disproportionate voice in our society?

ROB REICH: No, I'm saying that the deduction favors the wealthy. The subsidy rates to the wealthy are significantly greater than the subsidy rates to the poor.

DIANA AVIV: Independent Sector has looked at the government's contribution to all of this, the funding that they give that makes it possible for the sector to do its work. And I just want to say that we know that about a third of the sector's funding comes from public financing – whether it is federal, state or local. It's not that the government is running those programs. We also know that about 2 percent of the sector's funding comes from philanthropy and about 17 percent or 18 percent comes from individual donors, not through foundations per se – that is what I mean by philanthropy in this context. Then there is about 38 percent that comes from fees for services. Whether it's museums, or whether someone's going to a conference or something like that, the fees are where the organizations receive the service.

I don't think that this discussion has been about whether government should provide the services or the nonprofit sector. It is a question of what kind of funding we have available. And when government incentivizes people to give more, and people who have more to give more, is that a bad thing? At this moment in time when government wants to pay for other kinds of programs and some nonprofits will benefit from those programs for sure, is it a good idea to limit giving, or disincentivize it in such a way?

Part of the argument on the table has been, will it make a difference or not? I would want to warn the folks who say that decreasing that incentive will not make any difference; you are supporting the argument that you shouldn't have any incentivized giving to begin with. I think that is a dangerous direction. I think the problem that we've had is that we don't know the amount at stake here, and over what period of time. We don't know how many of the other factors work. That's what's at play right now. Moreover, it is in the context of a period in time where people are desperate for money in order to fulfill their purposes.

JOSEPH CORDES: If I can just add a couple of other comments. One is that I think it is important to distinguish between whether one is concerned about the structure of the current subsidy or the concept of a subsidy at all. The argument that one in effect creates a plutocracy, or basically reinforces the giving preferences of the wealthy, is a direct consequence of linking it to the itemized deductions and the fact that we have a graduated rate structure. If you had a flat tax and you still allowed a charitable deduction, that particular concern would go away. Or if you kept what we have but essentially got rid of the charitable deduction and replaced it with a flat rate tax credit set, say, at 20 percent, or 25 percent – pick your number – then you would be providing the same subsidy rate to everyone without regard to income. That still doesn't address the issue of whether you would want to do that. And that gets to the more fundamental question of in fact whether you want to have a subsidy for financial support of the nonprofit sector at all run through the tax system.

WILLIAM SCHAMBRA: Good. Well let's go to our audience for questions. I'm going to ask John Walters to ask the first question –and this gives me the opportunity to introduce him as the newly appointed vice president here at the Hudson Institute. John was formerly president of the Philanthropy Roundtable, so he knows a bit about this topic.

JOHN WALTERS: Thanks, Bill (Schambra). I have apples-to-apples question in two dimensions, because, Rob (Reich), I am kind of surprised at the apples you chose in two regards. Let me start first of all with the deduction and the voice – because despite Naomi Riley's argument about flat tax, I know a lot of conservatives thought – and I certainly thought – that reducing the tax burden on lower income people was a way of doing what they thought was more broad, which was to allow them to become *not* lower income people by reducing the amount of their money the government takes, and creating an upward churning between the (inaudible) and other things – for good.

Given that effort to reduce the overall burden on them, and also the amount of overall tax revenue that is returned in a progressive way even under the current system to those less fortunate, I am confused about what the apples-to-apples argument is about. Why does their individual charitable giving have to have the same treatment in the overall system? What is the proper denominator in the benefits that people in different income brackets have?

It is the same question that brings about the crisis of conscience for Independent Sector – and equity came up here, too. The funds raised by this change will be applied to healthcare. Would it be different to you if they were being used to re-equip the military after several years of war, or just reduce the deficit? It does seem to me that all of those things are equally arguable, since the budget of the United States and its deficit is kind of fungible. So the fact that this is being linked is an artifact more than a profound issue about the spending of government and the direction of public revenue and private revenue. So I guess, Rob (Reich), I am picking a fight with you over whether you are really apples-to-apples, or whether you are not allowing a virtual apple to be an argument about virtue rather than an argument about equity.

ROB REICH: I have quick responses to the two points. I would agree with the first point of comparison. When we look at the denominator of benefits that citizens receive – all things considered, from the government – changing the deduction rate or subsidy rate and insisting for equity purposes on treating different donors to identical organizations in exactly the same way misses the relevant – as you put it, denominator – picture of the sum total of benefits that are received. And that's true, but the reason I want to insist upon following through with that question in the way that I put – the apples-to-apples comparison – is that it seems to me nevertheless still a question of first principle that any state has to answer, any political theory has to have an answer for, if we are going to protect the liberty of people to do what they want with their private property. We've got a system of taxation up and running; people have been taxed –

pick your favorite tax system; they have stuff left; they want to give it away. What's the policy structure the state will have when they want to do so?

One default position you might think, as I think Naomi (Riley) believes, is no incentive, no subsidy whatsoever. The incentive constitutes a distortion of our liberty, and regardless of the denominator picture as you described it, John, you still have to have an answer to that question. And I want to build in an equity argument for first principle reasons. If we are going to provide a subsidy to giving, it seems to me that however we define the eligibility of recipients, if we have different people giving identical amounts to the same organization, there is at least a very strong reason to think that we ought to treat them, public-policy standpoint-wise, identically.

Second, with respect to the Obama budget proposal that says it is setting this aside for healthcare reform, the budget is all fungible, so what does that really mean? It's just window dressing.

I'm not wholly knowledgeable enough about how the actual state of affairs in Washington DC works to know enough to agree with you or disagree with you on that very point, but let me grant it for the sake of argument. As I understand the proposal, this is going to be additional revenue. It is revenue that absent of the proposal the state would not have. And they are simply earmarking the revenue, perhaps just for cosmetic, window-dressing reasons, for healthcare reform. It could come out of some other portion of the budget, and then they wouldn't have to have this conversation about off-scoring. If that were more politically saleable or feasible, then maybe I would be in favor of that. But now we are on terrain with which I am much less familiar, so I'll leave it as, I'm not sure what to think about that.

DIANA AVIV: John (Walters), I love that "crisis of conscience" phrase. I am going to walk around saying, "I am in crisis because my conscience is troubled." I didn't put these two together; it was President Obama who put them together.

A conversation has been going on privately within the charitable sector for a little while now about what kind of role we should play with regard to healthcare. At Independent Sector we don't tend to usually get involved in those particular issues because we are a broad coalition. But when you look at the fact that in the charitable sector there are twelve million full-time employees to whom the sector as a whole generally provides healthcare benefits, and you consider the rapid increase in healthcare costs over the last ten to fifteen years, the sector as a group of organizations – small- and medium-sized businesses and a few large ones – would have a vested interest in figuring out a way to control those costs so that they can continue to provide healthcare to their employees.

The sector also has a portion of those organizations that provide services to people who don't have healthcare. They bear the burdens themselves or they see firsthand the impact of the ravages. In both of those instances the sector has a direct benefit by seeing an improved system, and has a direct obligation because of the services that they provide – on the one side.

On the other side, we also have an obligation, I think, and a commitment to making sure that there is every opportunity to see that the revenues are there to provide the services to the various and sundry causes whether we agree or not – to me that is a subject for another day – but within this current structure. By President Obama putting these two together in this way, it does create a crisis – because we believe in both. And so we came to the conclusion that we should have both, and we should find another way to pay for healthcare. That disconnects me from the question of whether we pay for military or for everything else – because should that happen, it would be an easier argument; in that case, it is not as conflated about the intense belief in both.

JOSEPH CORDES: Two comments: First, at least from a public finance perspective, there is absolutely no reason in principle to link a subsidy for charitable deductions to the current deduction structure. You could in fact structure it – as the current administration began to do, by the way – as a separate credit at fixed rate, with whatever you wanted to put in there, available to individuals regardless of whether they itemized or not. Quite frankly, I think that is maybe a conversation worth having again, because it makes it very explicit that what you are trying to do there is provide a certain kind of financial incentive.

The second point, I do understand why, from the perspective of tax politics, the effort is being made to link the $9 billion that "is raised by capping" – by the way, it is closer to $30 billion when you add in the mortgage deduction – to financing something like healthcare. It is very much like what happens at the state level when they make arguments for either lotteries or higher cigarette taxes, and then they say that they are using them to pay for education. That somehow makes progressive taxes a good thing. It's not clear that it does, but politically it is very clear why you do that. The Obama people are really smart; they are really good public finance people; and they understand the principle behind this. But they also understand the politics. If you put vinegar together with wine, whatever you want to call it, it is still vinegar.

The other thing you can say is, simply as a pragmatic matter you have to come up with revenue. The most direct way to come up with revenue is to raise rates. For example, if the alternative were financing healthcare by raising top marginal tax rates to 40 percent or 50 percent, we wouldn't be having this panel! From a public finance perspective that might be more justified, but politically that isn't going to go anywhere. So then what do you do? With a complex tax system, as Naomi (Riley) would say, you tinker with deductions, exemption phase-outs and all kinds of things, and then try to justify them as raising revenue.

NAOMI RILEY: I am hoping that maybe the Obama administration will start applying these arguments about equity to the actual tax rates. If Rob (Reich) and I are doing the exact same job and I happen to be married to somebody who also has an income and Rob does not, I am going to be taxed at a higher rate for doing the exact same job. In other words, I am going to get to keep less of that money than Rob is. This seems like an argument against progressive taxation! It seems to me that dragging this argument about equity out of nowhere when it comes to charitable exemptions but ignoring it the rest of the time is baffling. I hope that it enters our public policy more often.

JOSEPH CORDES: A small bit of clarification; it's an argument against graduated rates, not progressive taxation as we normally understand it.

NAOMI RILEY: Yes.

WILLIAM SCHAMBRA: More questions?

KEITH GREEN, BoardSource: My question is really a two part question. If we were to lock the five of you in a room with bottles of water and some of the wonderful rugula that you served today, do you think you could make a decision on how to go forward on this? And part two, putting on your prognosticator caps, what do you think the outcome of this discussion is going to be?

DIANA AVIV: Well, I'm going to start off with number two. Number one, I think I don't know my fellow panelists well enough to know whether we would come out with agreement. I think that there are some fundamental differences in views that I have with some of what has been said on this panel. So, on the question of where this is heading: If you look at what Senators Baucus, Grassley, and Schumann have said in the Senate, and then also what has been said in the House, there are enough people on both sides of the aisle who jumped up very quickly – Senator Thune from South Dakota – and said that this is a terrible idea. I think that for any entrepreneurial, nonprofit person, they should quickly go to those same senators and say, let's take the IRS charitable rollover and expand it and extend it right now and make sure that "in perpetuity" exists. I have never seen so many senators jump up so quickly to defend the charitable sector, not in the five years that I have been in the Independent Sector. So, very enterprising people should do that!

My opinion is that this is dead on arrival as a proposal. I think, though, that the issues that have been raised by this are really important ones.

JOSEPH CORDES: I think I would agree with Naomi (Riley) in principle about the desirability of having a flat tax, although it would be progressive because you would have a generous exemption to begin with. I don't know that I agree, if I understand it correctly, with not then also having some kind of charitable tax credit. I think there is a good intellectual argument for that. The flat tax would take care of Rob (Reich)'s objection because it would be at a constant tax rate.

WILLIAM SCHAMBRA: And your prognostication, coming from the Urban Institute?

JOSEPH CORDES: The day the proposal was announced – both parts of the proposal, this one and the one with the mortgage interest deduction – I said, yes, and the California delegation is going to stand up and support capping itemized deductions on home mortgages?! Give me a bleeping break! And of course, they immediately had lots of concerns. And you can't very well then go after that and not talk about the whole thing. So I'm not sure why it was in there. Was it a trial balloon? Was it part of a broader discussion? I don't know. But I agree with those who say it is dead on arrival.

WILLIAM SCHAMBRA: And Obama defended it. I really was surprised at the news conference that he defended it both in empirical terms and in moral terms which is –

DIANA AVIV: I also think that as smart as this administration is – and I think they are plenty smart – they didn't do their homework on this one. I think that they didn't in advance bring the kinds of folks in to talk to, to discuss what the impact would be. I think that they are genuinely surprised at the intensity of the reaction. I have had more email traffic on this issue than I have seen in the last five years. I find it very surprising.

WILLIAM SCHAMBRA: But Rob (Reich), they surely consulted you, right, before they introduced this? (Sarcastically.)

ROB REICH: I'm in the ivory tower out there (at Stanford), so I'm distant from the facts on the ground; California is in a different universe with respect to Washington DC! So as a prognosticator I'm happy to join the consensus here, but only because it seems to be insider's knowledge! I would love to perform emergency-room surgery to resuscitate it so it's not dead on arrival. (Laughter.)

By way of trying to answer the first part of the question about locking us all together in the room, Diana (Aviv), you really helpfully, I thought, acknowledged something that's both a political dynamic and also part of the moral argument. If Obama and others who defend the proposal really think that this will have no effect on giving, doesn't that constitute an argument against the abolishment of the entire incentive in the first place? And if Naomi (Riley) thinks – conditional on a different tax structure – we should get rid of the incentive entirely, it seems to me that the proposal that is on the table, a very marginal change, all things considered, that would affect only 1.2 percent of the taxpayers, is a good way to experiment. I would be optimistic that if you locked us all in the room, we could all endorse it. It is a small, small change, all things considered.

NAOMI RILEY: I don't have a prognostication; I just have an observation, which is this: Who would have thought that the new bipartisanship in Washington would be in opposition to Obama proposals? As for locking us all in a room I'd just eat the rugula.

JOSEPH CORDES: One little anecdote about this issue of if we think it matters or not: Apparently the implicit elasticity of giving – the price sensitivity of giving that they have used to estimate the impact of this – is like 0.75, which is a little bit on the low side. One might say one partly was doing that because, yes, it reduces the extra revenue that you claim you are getting from this, but it also would have reduced the estimated impact on charities. I mean, this is all part of a political process. I'm not saying that in a bad way; that's the reality of how this stuff happens. You've got to start making these tradeoffs on a number of things. It was pretty evident in this that there was a lot of thought, I think, given to some of those tradeoffs.

The other way would have been – and maybe this will happen with the Volcker commission, although I don't think so; it's got a pretty narrow mandate for what it is supposed to do with the code – the other way would have been to say, let's take a look at this. The evidence now does suggest that giving is less price sensitive than we once thought it was. There is some new interesting work on the effect of matches and how they affect people's behavior or not. Do we want to rethink this and *not* make it sensitive to tax rates? That's another issue.

One consequence, which really gets to the earlier question of making this part of the deduction structure, is if you make the charitable incentive in a way a hostage of what we do to the rest of tax policy. I will say, and not because Diana (Aviv) is sitting here, that Independent Sector has been very, very good in terms of standing aside when we did fundamental tax reform, which clearly lowered marginal rates. You could argue this is something they should have lobbied against. The position they've taken on the estate tax, has been very thoughtful. In both of those cases you get that consequence because you are linking the thing to a deduction. If you just 'fessed up and said, okay, this is a sector we think we want to subsidize, so let's do it explicitly – but not with the government handing out the money, in effect, through some kind of credit structure. You would take it out of the debate, right? That may be a reasonable way to go down the road, although it does involve some tradeoffs because the flat rate would be less, probably, than the top rate that people are now using.

ANNE HEALD, ________________: It seems to me that there would be some unintended consequences if this were not dead on arrival. One would be, if you are talking about reducing the sector by $5 billion to $10 billion, you are talking about a lot of dislocated workers right at the time when the economy is very fragile and they are an intimate part of our social safety net. It looks like a pretty rough transition to that money going toward either healthcare or other Obama objectives.

Another unintended consequence might be the impace on rural areas. We were looking at growing rural philanthropy when I was at New Ventures. Now, this wasn't very scientific, and Diana (Aviv) or Joe (Cordes), you may have more information on this than me. But it seemed to me that in many ways philanthropy was an exporter of wealth in rural areas. If you're donating to your university, many of those institutions are outside of the community in which you were in. For instance, that's one of the reasons why in Indiana they are trying to build community foundations in every county – so that you can hold some of that philanthropy in the county. So I raise the question: Would this have a bigger negative impact than the planned alternative? Historically, we have health policy experience of poorly serving people in rural areas. You can't get doctors and nurses there. If you are going to reduce further the philanthropy within a rural area and you have trouble getting healthcare in that area, are you further disadvantaging the area other than cities where we have our greatest poverty?

I was just trying to think through, practically; with that kind of movement, there is going to be a lot of impact in people's lives.

One other comment on the dislocated workers within the nonprofit sector. It's not just people suffering from losing their jobs. You are losing a lot of know-how and expertise as you do in any sector when you downsize. And again, is this the right moment, when you are trying to reconfigure, in some ways, the social contract?

DIANA AVIV: You are raising so many interesting questions; let me see if I can connect some of those dots. Firstly, if this were not dead on arrival, which it probably is, but if it weren't, this would kick into effect in January of 2011. That's really important because the idea would be – their theory is – that 2009 and 2010 is going to be the hardest time, but by 2011 hopefully healthcare would be in place, and then the impact would happen after that. So the assumption would be that we can stem this tide. And if in fact these organizations can save a whole bunch of money also by having lower costs that they have to pay for healthcare, that would improve the opportunity. One would have to believe that this money's not fungible, and that the structures that they have in place would make it impossible to use it for anything other than healthcare. That's not just a leap of faith; one would have to build that in. So regarding the dislocated workers, they would argue back that the timing you mention isn't quite right; it wouldn't work that way, as they see it.

The second thing – and I tried to make this point at the beginning of my formal remarks, but probably not as clearly as I should have; it's really important – we have to look at who are likely to be the losers if this proposal were to go into effect. In fact, the donors who are above $250,000 are more likely to be giving to arts and culture, higher education, and some healthcare in the broader sense, maybe hospitals and so on. Those are important entities, but it's not the same group as who you are talking about in terms of rural communities and in terms of the most dislocated and serving the needy. So it's different groups and different organizations that will benefit from the healthcare changes and different organizations that will lose from this, hence this robust response. Just take a look very carefully at who is objecting and you will see, it is those that have those donors. Those are usually the very big organizations, the very successful organizations. And in that sense, it is different parts of the sector that are being affected.

JOSEPH CORDES: The only thing I'd add, and this is maybe a suggestion for a new panel, is that it's also clear in the new budget that the Obama administration is less ideologically predisposed to contracting out than the Bush administration was. I'm wondering what affect that will have – and that could be potentially far greater than this. But that's really the subject of another panel. Diana (Aviv), you all may be looking at this aspect. Because I don't know whether that is true or not. It may just affect defense contractors. But if it affects the whole devolution and idea that – in the Bush administration, an effective positive thing an organization could do or should have done was to demonstrate that they'd done competitive outsourcing. Of course, there was a lot of that involving nonprofits. There may be less of that now, and I think the dollars there could potentially be bigger than here. But that's another matter altogether.

DOROTHY WEISS, Center for Law and Social Policy (CLASP): I work for CLASP, but I am speaking completely personally in this regard. I'd like to go back to both the conversation we were having about what is a public good, and the question earlier about the use of this money. The thing that has been troubling me the most in this broader conversation is that if I – a good progressive – were going to pick something to use this money for, it would be healthcare reform. Yet I'm a big defender of the sector and the principles of philanthropy, and if you spin out the argument about who decides what the money should be used for in the charitable sense, I'm not sure it should be the government. I would be most interested in hearing Rob (Reich) and Diana (Aviv)'s thoughts on that, but certainly others also.

ROB REICH: Of course, the big distinction between the way a donor decides to distribute charitable dollars – by choosing which organizations they prefer – and the way the state or our elected representatives allocate our tax dollars is that there's a formal democratic mechanism of accountability for the tax dollar revenue. If we don't agree or don't like the way our elected representatives are dispersing our tax dollars, we can vote them out at the next election. With respect to charitable dollars, of course, none of us has any say whatsoever in the giving preferences of our fellow citizens – except insofar as we can have effect on defining what the eligible recipient category is, or in other words, tinkering with who is in 501(c)(3) and who is not. So I agree with you that there is a concern of just the sort you indicated. But with respect to the tax dollar revenue, there is a formal democratic accountability structure with all kinds of transparency built in. Accountability in the charitable universe is much murkier; there's no democratic accountability for how those dollars are allocated.

DIANA AVIV: Dorothy, you raise in some ways the fundamental question. I want to start by saying that as a society a long time ago we came to the conclusion – or it was a leap of faith; it depends what arguments you follow – that incentivizing giving and providing some kind of tax protection and help to charitable organizations because of their public purposes of serving the public good was a good idea. We now have some evidence from other countries where they don't have the same kind of tax systems that giving is much lower even though they have just as wealthy donors. So we know that it does have an effect. We may be quibbling around the corners about what that effect is, in what year, and how it kicks in. But there is no doubt that people give much more and in certain time frames if they are incentivized to give. After Hurricane Katrina we had lawmakers on the Senate Finance Committee quickly move to pass legislation that would extend when you could give all the way through, I think, April of that following year. There was a big uptick in giving for that reason. So we know it makes a difference.

So that is one issue, and I think that is the reason to argue for keeping this system in place.

I think the argument that the administration moved in with in order to pay for healthcare was what Rob started with in his formal remarks – the equity issue. Should donors of substantial means have more of a tax break than donors of lesser means, and is it such a big deal to go from 35 percent to 28 percent? I think if you look at it from that point of view, it's not such a big argument.

If you look at it from the other side – that I'm a nonprofit organization and I have to raise *x* amount of money this year in order to fulfill my mission, and now government is stepping in at this moment in time, even though it will be 2011, and limiting the opportunity – it potentially could limit what donors give, given that's always been an incentive. And therein lies the problem. To me the heart of this discussion ultimately comes down to two questions: What are our particular interests, and how do we protect our particular needs as opposed to what we believe is important in the larger public good? I think that nonprofit organizations have been caught in the crossfire of that debate. And I think it's not the first one; I think we are going to see a whole number of these throughout the next couple of years.

WILLIAM SCHAMBRA: Joe (Cordes) and Naomi (Riley), last thoughts on this question?

JOE CORDES: (Inaudible.)

NAOMI RILEY: I'll defer to Diana (Aviv).

WILLIAM SCHAMBRA: Okay, very good! Let's give our panel a round of applause….

(Applause)