Future foundations for giving

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Introduction

Thank you for the invitation to speak today.

I want to begin by thanking Craig Furneaux and Wendy Scaife for their work in arranging this event. I would also like to acknowledge the value of the work of academic research centres like ACPNS and others - and how the work of people likes Myles McGregor-Lowndes and his colleagues at QUT has been so influential in informing policy development in this area.

Today I would like to discuss some of the analysis and recommendations in our draft Productivity Commission report on philanthropy, entitled *Future Foundations for Giving*.

The terms of reference for the inquiry are wide ranging: from tax deductibility of donations to regulation; from motivations and trends for giving, to the effectiveness of philanthropy. And all in the context of the Government's goal of doubling giving by 2030.

It is certainly the most comprehensive inquiry into philanthropy undertaken by a government body in Australia, and quite possibly beyond Australia as well. It builds on the work of those before us – the Not-for-profit Tax Concession Working Group in 2012-13, and of course the Commission's own 2010 study into the not-for-profit sector.

The draft report

There is a lot to cover, and I will not be able to discuss all of the recommendations in detail in the draft report.

Instead, I will discuss some of the report's big themes and explore some of the "thinking behind the thinking" that the Commission has been engaged in over the past year.

I will begin with a quote from Steve Landsburg, author of *The Armchair Economist*, who has long been one of my favourite authors.

Landsburg once said: "A few lines of reasoning can change the way we see the world."

That will be the spirit of my remarks today.

The draft report focuses on three main areas which are designed to establish firm foundations for the future of philanthropy so the benefits of giving can be realised across Australia. The three main areas of reform are:

- **DGR system reform:** refocusing which charities can receive tax-deductible donations to help donors direct support to where there is likely to be the greatest net benefits to the community as a whole.
- **Regulation:** bolstering the regulatory system by enhancing the ACNC's powers and creating regulatory architecture to improve coordination and information sharing among regulators.
- **Information:** improving public information on charities and giving to support donor choice and accountability.

The Commission's draft report did not recommend removing the charitable status of any entity or class of entities.

Motives for giving are diverse, and religious faith matters

But first, stepping back a bit, it is important to note that philanthropy generally involves the voluntary giving of money, time, information, goods and services, influence and voice to improve the wellbeing of others.

Given this definition, one fact that immediately emerges from the research on giving is that people and organisations can have complex and multifaceted reasons for giving – and these reasons can change over time.

Some motivations for giving are highly personal, such as those associated with an individual or family experiences or connection to religious faith or culture; while others are broader, such as wanting to make a difference or out of a sense of obligation.

Contrary to some recent public commentary, our report explicitly recognises the fact that religious charities in their diverse forms play an important and valued role in the lives of many Australians.

We also very clearly and explicitly note the fact religious faith and values can and do provide inspiration for donating and undertaking a range of charitable activities.

And we firmly believe some of our recommended reforms will make it easier for religious charities to contribute to the community and building social capital.

Given this diversity of motives for individual giving, our draft report looked at broader structural policy levers that, given these motives, would potentially alter incentives for giving.

Information is king

Any consideration of a policy lever needs to acknowledge the fact that philanthropic giving is not a conventional market with price signals, or where goods and services are exchanged for financial benefit.

While donors motivations for giving are quite diverse, due to absence of conventional price signals, and in the absence of other institutional arrangements, donors lack the information about which recipients are in the greatest need.

Institutions – charities – have sprung up spontaneously in order to address these informational barriers.

From a pure economic point of view, the role of a ‘good’ charity is to act as an intermediary between donors and final recipients, reducing the informational barriers and matching donor preferences and dollars with the needs of final recipients.

In doing so, a charity combines all the different inputs involved – money, people (including volunteers, importantly), knowledge and expertise, to deliver impact and benefit the community through furthering its charitable purposes.

The broader point is that information is king, and philanthropic networks are very important.

Overall, the information flows in the Australian philanthropic sector seem to work pretty well. But sometimes, like any market in economics, things can go wrong. And this leads me to my next point.

There is a case for government support of philanthropy

One of the first questions we grappled with in the report was whether there was a case for government support for philanthropy.

The Productivity Commission is the Australian Government’s independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians.

We apply robust, transparent analysis and we adopt a community-wide perspective. Our independence is underpinned by the *Productivity Commission Act (1998*) and our processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

So our primary ‘client’ – for want of a better term – is the government.

If there was no role for government in philanthropy, we would have written a very short report!

But for various reasons, we think that there is a clear role for government support.

One role relates purely to resource allocation.

Markets and governments provide many goods and services, but there will always be gaps.

Philanthropy can provide funding for activities that the community values and constraints on governments mean it would otherwise be underfunded, or not funded at all.

By supporting philanthropy, government is indirectly helping to fill some of these gaps. This enables governments to focus on other priorities.

Second, acts of philanthropy can contribute to social capital – capital that benefits the community but would otherwise be underprovided. Social capital can have public good characteristics, and this immediately raises the possibility of government support.

Finally, philanthropy can be a source of risk capital and patient capital, in many situations where governments cannot.

It can also be a source of policy and program innovation, an incubator for addressing social challenges which, if successful, can be replicated and scaled up by governments.

And, if the innovation fails, it can provide important lessons for government about why certain programs or policies may not have worked.

In that sense, philanthropy can make a broader contribution to how we grapple with complex issues we confront as a society.

Incentives matter

Accepting that there is a role for government support of philanthropy, what might that support look like?

The first thing to note is that in Australia, most charity revenue comes from government grants and contracts.

Of the nearly $200 billion in revenue received by the sector in 2021, only about $13 billion came from donations from philanthropic donations from individuals, corporates, giving vehicles and bequests.

Our report focuses on this $13bn slice, but it is important to keep the broader context in mind, particularly the interactions between government grants and donations and whether grants tend to crowd in our crowd out voluntary donations.

So what are the policy tools available to governments to influence individual donations?

The major policy lever is our deductible gift recipient (DGR) system.

Under this system, individuals can claim a tax deduction for a donation, as long as that donation is given to a charity which has been granted DGR status. In 2019-20, 4.4 million Australians claimed $3.9 billion in tax deductions for donations.

But not all charities have DGR status.

So the DGR system really consists of two policy levers:

1. **The design of the deduction.** Under the current system, the benefit to an individual taxpayer depends on the marginal tax rate that they face. Under our graduated tax system, higher income earners face higher marginal rates, and so face a lower tax price. But this is unlike any other deduction, because the more that is given, the more benefit is provided to the more marginalised and disadvantaged in our community, and the more we build social capital. It also means that the government – actually, other taxpayers - are shareholders or silent partners in billions of dollars' worth of programs each and every year. So one policy question is: does this system incentivise more giving than would otherwise be the case, and what is the cost to revenue?
2. **The scope of the deduction:** which charities should be able to access DGR donations?

On the first question, our estimates, using a very large data set from the ATO, give a very clear answer: the DGR tax incentive works, in the sense that thanks to the deduction, there is more individual giving in Australia than would otherwise be the case.

Trade-offs matter: incentives are not free

One way of viewing the tax deduction is in the context of the incomplete, asymmetric information that I discussed earlier: government is providing a signal to donors, putting an explicit social value on donations where no such market price exists, as a way of guiding individual behaviour.

Given that the tax deduction incentives additional giving, the next question is: how could its design be improved?

And one of the main issues here is that each time someone claims a deduction, there is less revenue available for other government priorities.

This raises the question of *treasury efficiency*: when considering a change in the deduction, would the increase in giving outweigh the loss in revenue?

To take an extreme, hypothetical example: one very simple way of doubling individual giving would be to have a very high tax deduction of (say) 300%.

But while giving would undoubtedly increase under such a system, the risk is that this would come with a very large revenue cost.

Individuals facing higher marginal tax rates (a low tax price) might tend to give more, but the revenue foregone could be large. The net incremental gain could be very low - even negative.

The broader point is that a change in policy in this area – just like other areas – is not free. There are benefits and costs, there is no free lunch.

It is also important to note, however, whether a tax deduction for giving is treasury efficient or inefficient is not the only factor to consider when designing a policy to incentivise giving.

Treasury efficiency only considers the total value of giving relative to forgone revenue – it does not account for the costs and benefits of giving or the other uses of forgone revenue.

- It does not consider the benefits that may flow from additional philanthropic giving that is incentivised by the tax deduction, including improved social capital.
- In some cases, the efficacy of delivering support through government grants – as an alternative to a tax deduction – may be reduced by government having imperfect information and the administrative costs to government and charities of managing grants programs.
- Giving to some organisations or programs will generate greater net benefits to the community than others (although assessing this can be highly subjective).

Our statistical analysis, again using a large ATO data set, does not suggest a strong case for changing the basic design features of the deduction based on the concept of treasury efficiency.

Individuals are responsive to the deduction, but they do not appear to be so responsive that the increase in giving that would flow from a more generous deduction would outweigh the loss in revenue.

The DGR system is broken

This then led us to the second policy lever of the DGR system: its scope.

And it is here that we found a system that was not fit for purpose.

Our report finds that there is no coherent policy rationale for why certain charities are eligible for DGR status, while others miss out.

- DGR eligibility requirements can inadvertently limit access for some smaller charities, which also tend to be more reliant on volunteers.
- The complexity of the system continues to increase as new DGR categories are added in a piecemeal manner.
- Charities that have multiple purposes may need DGR endorsement for each eligible activity, so accessing DGR status can be complex.

On other hand, we have had some feedback that reforming the DGR system has little relevance to the goal of increasing giving.

With respect, the Commission firmly disagrees.

While we take no position on the goal of doubling giving as a policy objective, we do think that in a system which lacks firm policy foundations, should the doubling goal be realised, there is a material risk that the current inefficient, inconsistent and unfair outcomes for charities, donors and the community could also rise. Therefore – and particularly in light of the doubling giving goal – we think that reform of the DGR system is clearly needed.

The system could and should work in a much better way, and that the scope of the reformed DGR system should be based on the following principles:

1. There is a rationale for Australian Government support because the activity has net community-wide benefits and would otherwise be undersupplied.
2. There are net benefits from providing Australian Government support for the activity through subsidising philanthropy.
3. There is unlikely to be a close nexus between donors and beneficiaries, such as the material risk of substitution between fees and donations.

The Commission used the principles to assess classes of charitable activities, not individual charities. Applying the principles means that most, but not all classes of activities, would be eligible for DGR status. We refer to classes of activities, rather than purposes, because governments subsidise activities rather than purposes.

The deductible gift recipient (DGR) proposed reforms would have four possible outcomes for charities:

1. **Charities retaining DGR status:** Most charities that currently do have DGR status, including public benevolent institutions, health promotion charities, animal welfare, environmental, cultural and formal higher education charities. More than 20,000 charities are in this group.
2. **Charities not gaining DGR status**: Charities undertaking activities including advancing religion, advancing industry, as well as some **aged** care, childcare and education charities would remain outside the DGR system. About 15,000 to 20,000 charities are in this group.
3. **Charities gaining DGR status:** Charities that currently do not have DGR status, such as those focused on advocacy and **prevention**, a wider range of animal welfare charities and many local community-based grassroots charities run solely by volunteers. An estimated 10,000 to 20,000 charities could gain DGR status.
4. **Charities with DGR status withdrawn:** Mainly charities that have DGR status for school building funds or to provide religious education in government schools. Fewer than 5,000 charities are in this group.

Initial responses to the draft report have predominantly focused on the reforms to the DGR system. We have received a high volume of feedback centred around entities that will have their DGR status withdrawn. There has also been support for broadening eligibility for DGR status, including those engaged in advocacy and prevention activities.

The Commission's draft recommendation on school building funds would apply equally to government, non-government, secular and religious education providers.

While there are sound reasons for governments to support the provision of school infrastructure, the Commission's preliminary view is that providing tax deductions for donations for school buildings is unlikely to be the best way to direct support to where it is needed most.

There are several possible alternatives that could be considered, including, for example:

1. a new and separate capped tax deduction
2. a system of government funded matching grants which give explicit regard to private donations
3. a system of capital grants that are designed in a similar way to Gonski recurrent funding
4. making more use of arm's length entities that receive donations (which could be tax deductible under specified circumstances) and which distribute them according to equity and other criteria
5. inserting a clause in school building funds to require providing access to facilities by community groups, to reduce the relative incidence of private benefits as occurred for *Building the Education Revolution* funding.

Submissions have also focused on the Commission's recommendation that the status quo be maintained for entities whose sole charitable purpose is advancing religion. Currently these entities do not have access to DGR status.

As I said earlier, contrary to much of the media commentary, the Commission explicitly recognises that religious charities play an important and valued role in the lives of many Australians. Religious faith and values can and do provide inspiration for donating and undertaking a range of charitable activities.

The contribution that such entities make in the community is one reason why they are already able to access some tax concessions associated with their status as charities, such as an income tax exemption.

The Commission has not recommended any changes to these other tax concessions, nor to the charitable status of religious organisations. However, the Commission did not find a strong policy rationale, in terms of net *additional* community benefits, for changing the status quo and expanding DGR to charities with the sole purpose of advancing religion.

On the other hand, some charities with the advancing religion subtype already undertake additional, separate charitable activities (such as advancing social and public welfare).

Under the Commission's proposed reforms, which would expand the scope of DGR, these entities could gain DGR status more easily for these other, separate activities, which are shaped by a religious ethos and values.

For example, a local community based religious organisation whose activities also include providing support for those experiencing disadvantage, could obtain DGR status for those activities which advance social and public welfare without the need to set up a whole new entity and obtain public benevolent institution status.

There are also charities with a religious ethos currently endorsed as DGRs, such as public benevolent institutions working to address disadvantage. They would continue to be eligible for DGR status.

Ancillary funds: what exactly do they do?

A related contribution of the draft report is our thinking on so-called structured giving vehicles, which enable donors to structure their giving over time.

One such vehicle, an ancillary fund, is a trust set up and maintained solely for the purpose of providing money, property or benefits to entities with DGR status.

These funds have been accounting for a large slice of philanthropic giving over time, so it is important to understand how they work and the policy tradeoffs that are involved in their design.

Giving into private and public ancillary funds has grown both in value (from $692 million in 2011-12 to $2.4 billion in 2020-21) and as a share of giving by individuals (donations to private ancillary funds have grown from 15% to 27% of individual giving).

As a result, ancillary funds have accumulated a pool of net assets that has grown from $4.6 billion in 2011-12 to $16.4 billion in 2020-21.

Although donations to an ancillary fund are tax deductible, it does not undertake charitable work itself.

Instead, it acts as an intermediary between donors and entities with DGR status that do undertake such work.

Ancillary funds encourage philanthropy by allowing donors to receive an upfront tax deduction for gifts that are distributed over time to entities with DGR status that undertake charitable work.

In the course of putting together our draft report, we found that hardly any good analytical thinking had gone into the tradeoffs involved in the design of the main policy lever that governments have to ensure that there is a reasonable and steady flow of money from ancillary funds to charities, so that it can be used to provide benefits for the community – the minimum distribution.

Guidelines made under the *Taxation Administration Act 1953 (Cth)* require funds to make a minimum distribution each financial year to type 1 DGRs. For private ancillary funds the minimum distribution is the greater of $11,000 or 5% of the fund's net asset value.

One question is whether this minimum distribution rate is appropriate.

A key point in our draft report is that rules around distribution rates can potentially alter the timing of flows out of ancillary funds – in the draft report we noted that a higher minimum distribution rate will bring disbursements forward in time, with the opportunity cost that fewer funds are available for the future.

Charities with a certain purpose may prefer to receive funds earlier rather than later and others may prefer existing funds to build up over time to be deployed in later years.

And there is little information available on charities' rate of time preference.

Given this, changing minimum distribution rates is likely to have both costs and benefits. In addition, changing distribution rates may alter incentives for people to donate, as well as the investment strategies of the funds themselves.

In the draft report, we discussed whether the current minimum distribution rate produces a reasonable flow of donations from the philanthropic sector to charities, but did not make a recommendation to raise or lower the rate.

Instead, we have sought further views on what minimum distribution rate would maximise the net benefits to the community, and the possible outcomes of a change to the minimum distribution rate.

Conclusion: the role of philanthropy

I will conclude with some reflections on the role of philanthropy.

Notwithstanding the case for government support, a major theme in the draft report is that government policy changes have their own limitations, and the philanthropic sector itself has an important role to play in shaping its own evolution over the years and decades ahead.

There is no doubt that government action has advantages in certain situations: it has big policy levers like tax and regulation.

But many proposals for government intervention could be replicated, at least in a partial sense, by philanthropy itself.

For example, throughout the inquiry we heard calls for governments to grant a tax deduction for costs incurred by volunteers – for example, a deduction for travel and other costs.

And there is no doubt that these costs can be significant and could deter some individuals from volunteering. But given the complexities, the integrity risks and the potential revenue cost, is such a change warranted? Again, it comes back to benefits and costs, about which we know very little.

During the public hearings I made the point that such a scheme could be replicated by an innovative philanthropist. A donor could say to a charity: I will give you a grant that explicitly covers the travel costs of your volunteers. The results of such a trial – the cost, whether it encouraged more volunteering, and so on – would be very interesting and informative for policy.

And remember, such a trial would not be without government support: as a result of the tax deduction available under our DGR system, the government – actually, other taxpayers – are shareholders or silent partners in billions of dollars' worth of such programs each and every year.

Similarly, just as government and philanthropy can act alone to support giving, they can also work together to address complex social and environmental problems.

If government can engage with philanthropy in such a way as 'crowd in' funding for activities that government may not be able or willing to fund alone, then there would likely be clear benefits from such collaboration.

Conversely, philanthropy has an incentive to engage with government to leverage its ability to deliver programs at scale.

In light of these potential gains from cooperation, both government and philanthropy should consider how they can coordinate their respective contributions more effectively to enhance outcomes for the community, especially given the different characteristics of government and philanthropic funding.

The Commission is proposing, for example, that Australian, state, territory and local governments more actively consider how changes to policies and programs would affect volunteers.

We think that Governments should, for example, consider from the outset how major reforms (such as the NDIS) may affect the demand for – and supply of – volunteers (like in the disability sector), and what steps could be taken to facilitate or 'crowd in' volunteer contributions, rather than crowding them out.

The broader point is that philanthropy has important role to play, both in its own and in collaboration with government – it's not just always about government action alone.

And it's not just about the amount of giving, but also the way in which philanthropy is practiced – for example, more flexible or untied grants are likely to be worth more to a charity than a restricted one. The extent to which philanthropy evolves, changes its funding practices, looks at the way it innovates, and so on, will be important over the decades ahead.

Thank you for listening and I look forward to your questions.

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