

## A Method for Measuring and Partially Testing ‘Charitability’

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### *Second of Three Parts: Applying the Tool*

All charities claim to be performing some good for others or for society. These “outputs” require inputs of charitable resources. Nongovernmental sources can be divided broadly into two major categories of contributions: financial or real capital, and volunteer labor. Both types of contributions, of course, may come in more complicated forms than outright and complete donation. Workers may provide labor services at below-market costs. Many (but not all) nonprofits have lower wage scales than business or government and pay fewer employee benefits. Individuals may also contribute extra by paying additional fees for some output produced by the charity or by paying an above-market price for some good or service at a fundraiser.

Note that these contributions of money or property and time typically are tax favored. Financial and real contributions usually qualify for a charitable deduction in the U.S., while the benefits and forgone earnings from volunteer and below-market-wage labor also are not taxed (either to the worker or ultimate charitable beneficiary).

If we exclude mutual benefit societies — associations to which people generally contribute to the society according to the benefits they receive — the activities of almost all charities involve some private transferors of resources. They intend their contributions to be transferred to others for the public good. While these transfers may not be necessary for charitable status — a charity may be totally dependent on fees and contracts, for instance, and still qualify legally as a “charity” — they are still commonly present, and it is this dimension of “charitability” we are examining in this series. According to the National Center on Charitable Statistics, about 80 percent of charities report private “charitable contributions” of financial and real resources, while they and many of the remainder also get contributions of labor and time.

How can the use of a balance sheet exercise matching uses and sources of charitable “resources” serve as a cross-check for how charitable an organization is, at least regarding this transfer function? To keep our examples simple for the moment, let us assume that there is no net worth within the charity — for example, a hospital whose

assets are matched by debts of an equal size, or a food bank that distributes its daily collections and operates out of individual volunteers’ cars.

Now consider applying this balancing exercise to the issue of whether this hospital or food bank operates as a charity. If it is claiming to provide charitable output, then the exercise requires trying to determine — even when some qualitative measures must be used — matching up the output with the sources of charitable inputs that provide the necessary wherewithal to provide the output. Take the purported failure of some nonprofit hospitals to operate as charities because they do nothing more than profit-making hospitals. If a nonprofit hospital claims somehow to be charitable, as compared with profit-making hospitals, then it is implicitly or explicitly claiming to make some additional net transfers or outputs for the public good. Those outputs could be indigent care but could also include greater educational and outreach activities in the community. The balancing exercise tests the charitable assumption by asking for a match of the purported additional outputs and their value with the sources of funds (or inputs) to support those transfers. When there are transferees, there must be transferors.

Some examiners of the charitable sector claim that individuals working in that sector should be paid wages that are competitive with the private sector. The argument is that the charity might not otherwise obtain the skills that it needs. Even if it could obtain temporarily lower-priced labor of equal quality, the short-term saving might be lost over time if it is accompanied by other additional costs such as higher turnover of this lower-paid staff.

Still, the decision to pay full market wages across the board has broad implications once one works through the balancing exercise I suggest here. After all, an organization that pays market wages for all workers removes a major source of charitable resources that might support its supplying of charitable output; that is, it would not have available workers who essentially volunteer some of their services by working for less than their market wages.

In a worst-case scenario, there could be further adverse ramifications. Once workers receive market-type wages, some pure volunteers may begin to question why they should work for nothing. This source of charitable transfers may decline. Finally, some people may begin to wonder why they should contribute to the charities. Essentially all sources of resources to make transfers could eventually be lost.

Before one thinks this is merely an abstract argument, consider again the debate over whether nonprofit hospitals are operating as charities. I contend this debate has arisen in no small part because for many nonprofit hospitals there has been a drying up in part or in full of each of those sources of charitable transfers. Fewer charitable contributions of money or property, at least

relative to cost, are now made to nonprofit hospitals. Many of them tend to pay the same wages to their doctors and staff as are paid by profit-making hospitals. Fewer volunteers and fewer moderately paid workers are around, partly because of the decline in religious orders. True, there are chaplains and some other volunteers serving the sick, but often no more so than in the profit-making hospital. With few or no sources, or when the sources are fairly small when compared with total output (charitable or otherwise), the private charitable outputs are going to be similarly small.

These statements are not meant to be judgmental. It may be that the large growth in government and private insurance payments to hospitals tends to dry up these sources of private charitable transfers. While there is little or no evidence that government efforts displace charitable transfer efforts in aggregate, there is good evidence that government programs do displace charitable transfer efforts toward activities addressing needs not met by government.

In this new world, then, how does one distinguish between a nonprofit hospital operating as a charity and one that mainly operates for the benefit of its doctors and administrators? Even something like occasional care of indigent patients is not adequate. Suppose the state government places similar requirements on profit-making and nonprofit hospitals alike. If each is charging the same market prices for their services, paying the same market wages to their workers, and indirectly providing the same amount of uncompensated care, then once again there may end up being no sources for any private charitable transfers. Cross-subsidization may occur, but one needs to distinguish between whether it involves some implicit extra private transfers or if it is simply the result of the way that government and insurance companies operate. Insurance policies, for instance, transfer money from the insured to the uninsured to cover expenses mandated by state governments. But that doesn't make the hospital a charity any more than it makes the insurance company a charity.

The point here is simply that absent any distinct sources of private funds to make charitable transfers, the nonprofit hospital cannot assume that it is making any more net private charitable transfers than the profit-making hospital simply because it has the legal status of a charity. If nonprofit hospitals claim they are able to achieve higher quality and education and broader coverage because of undistributed profits, then they should be able to provide rough evidence of *both* those additional outputs and of the input resources that financed them.

Finally, let me give a couple of examples of how this balance sheet exercise can work. A number of years ago the YMCA became concerned that its contributed support was declining relative to its growing income from membership dues and program fees. Leaders at the national and local level recognized that if the decline were allowed to continue, it would ultimately severely reduce YMCAs' ability to support important community benefit activities like providing services to disadvantaged youth. In an effort to preserve a robust capability to service those unable to pay, the YMCA responded by significantly intensifying both its charitable fund-raising and volunteer recruitment. Similarly, the Catholic Health Association (CHA) has adopted guidelines for its members that help them to document the community benefits they are providing. The vast majority of its members have agreed to use the guidelines and to publicly report their activities. The CHA has attempted to respond positively to the efforts of Congress, including that of Senate Finance Committee ranking minority member Chuck Grassley, R-Iowa, to gather information on what nonprofit hospitals were doing differently from their profit-making competitors.

While I am not judging the success or rigor of either the YMCA or CHA efforts, they demonstrate how the balance sheet exercise can be used as a powerful tool to measure charity and to make adjustments on the basis of that information.

*Next Part: Some Complexities*