Faster Charity

By Bill Bradley and Paul Jansen - May 15, 2002 - The New Yourk Times

The burgeoning federal deficit, coupled with new spending for defense and homeland security, will soon put health care, education and other social programs in a serious squeeze. Yet this crunch can be eased if America's richest nonprofit groups distributed more of their money now instead of saving for the future. They could provide America with some $20 billion more a year to spend on urgent social needs.

As a nation, we've made a huge investment in nonprofit organizations. People who give to charity get a write-off, and charities pay little or no tax on their income. The tab for these subsidies comes to roughly $50 billion a year – more than all federal aid to education combined. We grant these incentives to boost giving for good causes, and in one sense the strategy has worked. Personal charitable contributions, driven by a strong economy, rose 87 percent in the last decade, to top $150 billion in 2000. Foundations and other endowed nonprofit organizations (primarily universities) now control almost $1 trillion in investment assets.

Yet these organizations generally distribute only 5 percent of their financial assets each year, a sum well below the income generated by their investment returns – which averaged more than 12 percent over the last decade. These returns, along with new contributions, have allowed nonprofit groups of all types to increase the size of their endowments dramatically. Assets held by charitable foundations, for example, grew from about $140 billion in 1990 to almost $490 billion at the end of the decade.

To be sure, large endowments burnish a group's reputation and enable it to deal with future problems. But these organizations should be judged by their achievements, not by their endowments. Their current strategy is especially harmful today, when some 13 million children live in poverty, nearly 41 million Americans have no health insurance and many urban schools are failing. The decision by nonprofit groups to increase their endowments in the face of these needs suggests that for some, the endowment has become an end in itself.

Perhaps nonprofit executives can learn some lessons from their counterparts in the for-profit sector. In business, managers decide whether to make an investment based on how much it will earn and how quickly it will earn it. Future returns are discounted – that is, treated as less valuable than those earned this year. Discounting quantifies the common-sense notion that a dollar today is worth more than a dollar tomorrow.

Consider a foundation with $1 million. Each year it invests in stocks and bonds and disburses 5 percent of its assets in grants. If the foundation has typical costs and investment returns, the initial $1 million will result in more than $6 million in grants over a 50-year period. But because the money is distributed over time, the present value of those grants – assuming an annual discount rate of 13 percent – will be only about $600,000.

The foundation's impact is thus diluted by the decision to distribute its funds slowly. (Corporate foundations tend to recognize this and on average paid out at a higher 18 percent rate in 2000.) The current disbursement practices of most endowed nonprofit groups leave too many good causes short of funds each year.

Charity can never replace government: the need is too great. But just as we scrutinize how corporations and governments manage their resources, it is fair to ask if nonprofit groups are managed in ways that maximize social benefit and merit their enormous tax subsidies. Faster disbursement rates could not only help offset the temporary shift in our fiscal priorities, but also promote new notions of nonprofit stewardship.