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Social-Service Groups Won't Survive Without New Sources of Revenue

By Diana Aviv and Antony Bugg-Levine

The financial base that underpins the social-service system in America is crumbling.

Government is providing less money to help nonprofits provide food, shelter, health care, and other services to our most vulnerable citizens, even though nonprofits face increased demand. The situation is so dire that for the first time since the recession started, more than half of charities say they were unable to fully meet demands for assistance last year. Even more groups expect to struggle to do so this year.

Private donations aren't nearly enough to take up the slack; they represent just 2 percent of gross domestic product and haven't grown as a share of the economy for decades. Even so, the specter of the reduced charitable deduction, as detailed in President Obama's budget, has nonprofit leaders and their supporters deeply concerned.

While we stand with many in the nonprofit world advocating for preservation of tax incentives for giving, we can no longer afford to make that the exclusive focus of our efforts.

It is time for nonprofits to stop putting all our energy into defending the edges of our old economic order. Instead, we need to exert equal passion to identify and embrace fundamental, systemic change in the ways we finance social services in America—and no longer simply see our advocacy role as protecting tax incentives for giving and government aid for social causes.

The first essential step is to tap new pools of money to support charitable endeavors. The emergence of impact investing—the deliberate effort to channel for-profit money to social causes—could mobilize substantial resources to complement government and private efforts to solve real problems. To realize the potential of impact investing we will need to:

Unlock private foundation capital. Private foundations hold $600-billion in endowment assets. A growing number of foundations are experimenting with using these assets to invest in organizations that work to solve the same social problems they are helping to tackle with their grants. If private foundations dedicated even 5 percent of their assets to these mission-focused investments, they would put $30-billion to work in new ways to improve society. That's a lot—after all, foundations gave away a total of $44-billion last year.

Government plays an important role here: The Treasury Department last year updated its guidance to foundations on program-related investments, such as low-interest loans. It could now encourage substantial new capital to flow to the nonprofit world by providing similarly clear guidance to foundation trustees to explain that approving impact investments would in no way violate a board member's fiduciary duty.

Expand the Community Reinvestment Act. For more than 35 years, the act has prompted banks to lend in underserved markets and spurred the creation of the community-finance industry. Expanding the law to facilitate easier investment in a wider range of organizations could make billions of dollars available to social-service organizations.

Remove the barriers that make it hard for individuals to become impact investors. The Jumpstart Our Business Startups Act, or JOBS, is smoothing the way for start-up entrepreneurs to attract money from individual investors. A similar change to investment regulation could enable nonprofits and socially oriented businesses to tap into loans from interested supporters more easily.

Give nonprofits the same perks as small businesses. Federal programs could also provide nonprofits with access to business-development resources. For example, allowing nonprofits to be eligible for offerings of the Small Business Administration would provide access to loans, management advice, mentors, and other support.

These new sources of capital could help finance nonprofit work, but even if they all came to fruition we could not rely on them entirely to keep up with increased demand. We do not join the chorus of critics who say charitable organizations are incompetent and lazy. The data show clearly that most are barely breaking even, paying lower salaries, and chronically underinvesting in basic infrastructure.

A growing "pay-for-success" movement is showing how we can improve the efficiency and outcomes of our social programs by steering more money to nonprofits that focus on helping people before problems fester.

Many of the social challenges nonprofits solve cost more to treat than they would to prevent. Helping people at risk of diabetes improve their eating habits and exercise costs far less than treating them once they get sick. Anger-management and relationship-counseling services cost much less—socially and economically—than sheltering women and children fleeing abusive partners and fathers.

Another movement that some believe also offers much promise: The growing number of states that are passing laws to allow "for-benefit corporations" to mobilize private investment capital to expand businesses that seek both to make money and to create social value. Companies in 12 states can now register as for-benefit corporations.

The entrepreneurs building these companies as well as their investors want to stand alongside nonprofits in running organizations that improve the social good, creating better jobs, and selling affordable essential services. This is a time of vital experimentation and creativity.

As the federal government gets closer to the end of the fiscal year in September, it's likely that we'll all be devoting resources to protect charitable-giving incentives. We must simultaneously invest in other efforts to substantively improve the ways we pay for social services.

The president's plan to shrink deductions for the wealthy puts at most $9-billion of the $218-billion donated by individuals at stake.

While this amount may only represent 4 percent of estimated private giving last year, the near-universal anguish over efforts to reduce the charitable incentive is symptomatic of a deeper problem.

Maintaining the charitable deduction alone will not be good enough to solve the fundamental capital needs of our nation's social-service system. We must direct some of the fervor stirred by the threat of the charitable deduction's demise toward ensuring more disruptive long-term change.

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