

Nonprofits and the Federal Budget Crisis

By Geoffrey W. Peters, President & CEO, CDR Fundraising Group*

Background

Two seemingly disparate developments spur this writing. One is the fiscal disaster that is the United States Postal Service, and the other is the unprecedented attack on the deductibility of charitable donations. I see these as related and stemming from the same problem.

Simply stated, the background on the Postal Service problems is that this government monopoly has been unable to keep its financial house in order due to spiraling labor costs, reductions in services and increasing rates. Oral arguments on the U.S. Postal Service's appeal of its loss of an exigent rate case that called for an average 5.6 percent increase are scheduled for March 15 in the U.S. Court of Appeals for the District of Columbia Circuit. Whether the USPS wins or loses (and they will likely lose), it is clear that without intervention by the federal government, its "owner," the USPS is unable to remedy its own failings. The intervention most commonly sought is Congressional relief from a current requirement to prefund future retiree health care benefits to the tune of \$5 billion.

During the health care debate of 2009–10, in order to find a way to "pay for" the huge costs of the proposed legislation, the Obama administration proposed to reduce the amount of the charitable deduction for higher income taxpayers, thus generating new tax revenues that could be used to offset the costs of the proposal. This solution was rejected by Congress but has made its way back into the current 2011–12 budget proposal by President Obama.

If resolved negatively to nonprofit interests, I believe that both of these issues would severely damage the ability and success of nonprofit fundraising. I also believe that the solutions will be very difficult to achieve given fiscal and budgetary realities at the federal level.

A Brief Look at U.S. Postal Service Financial Problems

The Postal Service identifies its problems as having four aspects. They outline those as follows:

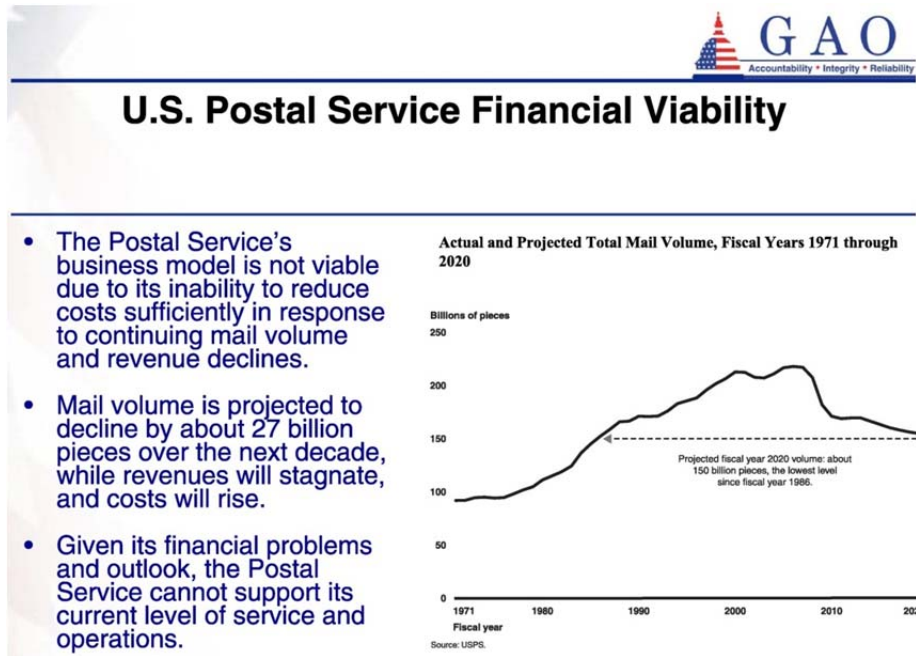
- **Declining mail volumes.** After experiencing an 8.6 percent decline from FY 2008 to FY 2009, first-class mail volumes declined another 6.6 percent from FY 2009 to FY 2010. In FY 2010, first-class single-piece letters and cards volume declined by 9.8 percent.
- **Capped prices.** The USPS complains because they have only been able to raise prices at the same rate as inflation in general. The fact that other logistics businesses and



retailers have reduced prices during the recent recession seems to be irrelevant.

- **Universal mail delivery.** The concern here is that the USPS is unable to reduce its costs for, among other reasons, political concerns. This includes a requirement to serve rural areas, 5- vs. 6-day delivery, and the fact that the USPS has some 36,000 local postal facilities—that’s more retail outlets than Walmart, Starbucks and McDonald’s combined!
- **Workforce costs.** The USPS employs 656,000 workers, making it the second largest employer in the United States.
 - The average postal employee earns \$83,000 a year in total compensation.
 - Eighty-five percent of its workforce is covered by collective bargaining agreements with four different unions.
 - Labor accounts for 80 percent of the USPS’ cost structure.
 - Most postal employees are protected by “no-layoff” provisions, and the USPS must terminate lower-cost part-time and temporary employees before it can lay off a full-time worker not covered by a no-layoff provision.

Declining mail volumes are a fact, but there are questions regarding the causes. Certainly, the



recent recession was one factor and the growth of electronic communications is another. But do poor service and increasing costs of postage play a role? How about inflexibility in creating products and services to meet changing market conditions? The Government Accounting Office (GAO) had its own view of the problems of declining volume.

When shown graphically, the overall conclusion of the GAO is terrifying to nonprofit mailers that rely upon the mail as a major source of revenue.

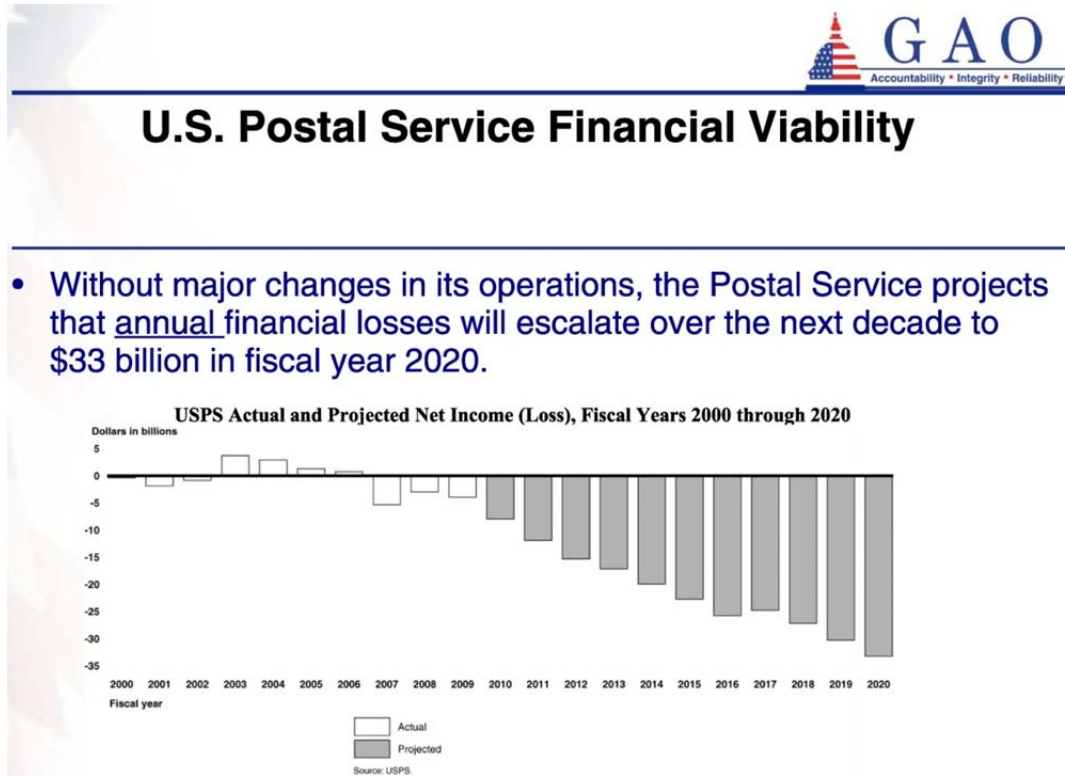
How can the USPS reverse this decline in revenues and mail volume? What are its solutions?

With labor costs representing 80 percent of its cost structure, there is no way to solve its problem without addressing issues such as labor costs, pension costs, health care costs and outsourcing. While politically unpalatable (just look at the current political unrest in states like Wisconsin, where public employee pensions and health care costs are at issue), addressing labor costs and structure is an absolute necessity if the USPS hopes to unravel the financial mess it is in.

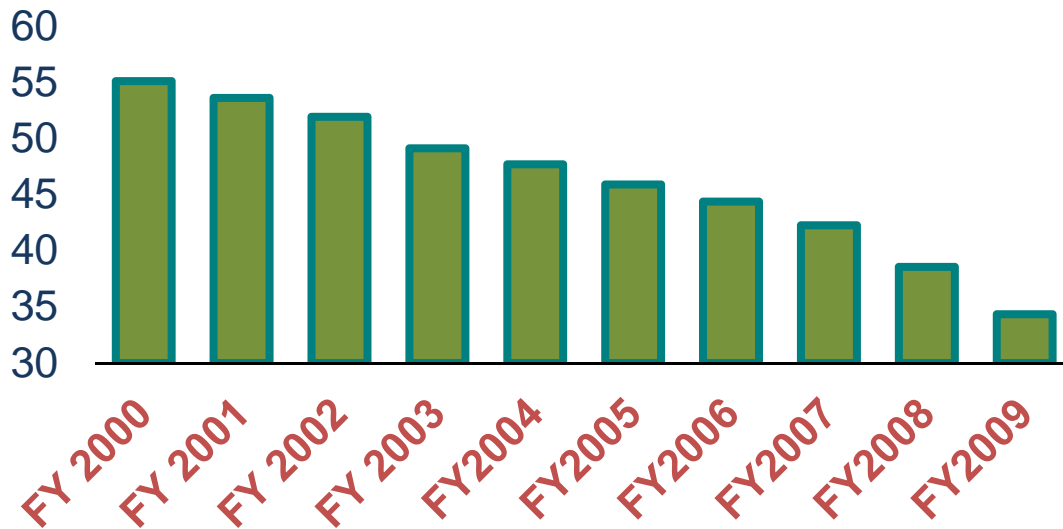
But what types of proposals do we hear from the USPS? The current Postmaster General and his predecessors suggest they consider the elimination of nonprofit postage rates, which are set by law at 60 percent of commercial rates.

Unfortunately, this proposal

reveals how little the USPS management and marketing staff understand their own business. Let me illustrate. Here is the recent history of declines in first-class mail.



First-Class Single Piece Volume (in Billions)



Those who conduct direct-mail fundraising for charities recognize an obvious fact that seems to elude the USPS. **All replies with donations are sent back to the charity via first-class mail.** Unlike catalog and other mail order purchases that are often phoned in or ordered via internet and then fulfilled via UPS, Federal Express or other logistics delivery, nearly 100 percent of USPS outbound nonprofit mailings contain a reply envelope that is always sent back via first-

class mail. Very often, these reply envelopes containing a donation, result in yet another nonprofit standard mailing in the form of a “thank you for your gift.” Thus, the outbound mailing results in first class replies which in turn results in more outbound mailings.

Yet the USPS calculates the “value” of nonprofit standard mail as requiring a general subsidy even though they admit in their own report to the Postal Commission that “first-class mail traditionally has made the highest contribution to covering institutional costs.”¹ It is exactly this type of failure to think about the entire process and to understand their markets that has led to circumstances in which the USPS’ solution to its problems is to raise rates and cut services on the theory that higher prices for fewer services will cause increased volumes to return.

The Charitable Deduction

Now, let’s look at the charitable deduction debate. President Obama raised the issue first in conjunction with the health care legislation which was and remains highly controversial. He lost round one when Congress refused to link changes to the charitable deduction to paying for health care. Now, in his new budget proposals, the President has looked at the political constituencies and suggested that changes to the charitable deduction be linked to paying for Alternative Minimum Tax (AMT) reform.

In my view, this is a canny political move: The Republicans in control of the House are very strongly interested in AMT reform, yet they’ve been opposed to modification of the charitable deduction. It is, in essence, a sweetener to get them to go along with the proposal. Politically, the proposal appears to pit the wealthy (who benefit more from the charitable deduction) against the middle class.

But what is the reality? Who benefits most from the charitable deduction? Is it truly the wealthy, or is it those who benefit from the human services provided by charities supported by wealthy and middle class alike? Isn’t it the poor and those in greatest need who truly benefit from a robust nonprofit sector?

And what about the alternative? Does anyone believe that taxpayer-funded, government-run programs are more effective or efficient in providing human services than charities supported by voluntary donations and staffed, in part, by local volunteers? It seems to me that reducing incentives for people to give to charities is the exact opposite of what would produce the best result for the poor and for the country as a whole. In fact, there are good arguments to be made that increasing incentives for charitable giving would have a more positive effect upon the economy.²

Most people don’t realize that the nonprofit sector represents nearly 1 in 10 jobs in America and that it makes up more than 2 percent of the GDP. The nonprofit sector is more important to our GDP than the airline industry, which represented less than 0.5 percent of the GDP in 2009.

¹ Annual Compliance Report, 2010 Docket No. ACR2010, United States Postal Service (December 29, 2010).

² At least one commentator, Isabel Sawhill, a budget expert at the Brookings Institution, would double the tax benefits to wealthy donors in order to create jobs in the nonprofit sector as a form of stimulus to the economy. See: http://www.huffingtonpost.com/2011/01/31/charitable-deduction-job-creation_n_814202.html.

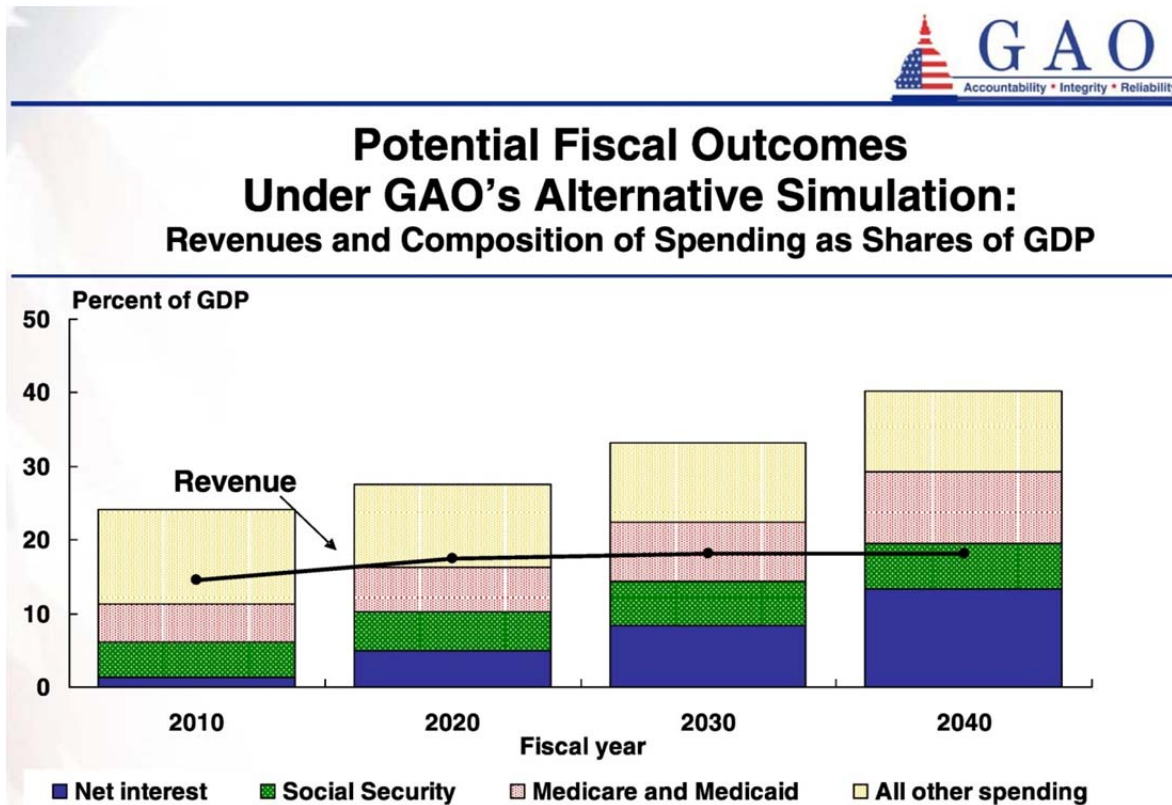
Based on this figure, the nonprofit sector is four times more important to our economy than what many would consider an industry “too big to fail.”³

Why these proposals now?

To understand the context of both of these ill-conceived proposals—elimination of nonprofit mailing rates and reduction of the charitable deduction—one need look no further than the federal budget. It illustrates both the environment that led to such proposals and the reasons why they could get serious consideration.

The government has been playing accounting games and living on borrowed time for a long while. Does anyone remember when Sen. Pryor (D-Arkansas) and the Senate Committee on Aging threatened with subpoenas any organization that said “there is no money in the Social Security Trust Fund”? It wasn’t until the late Sen. Moynihan of (D-New York) admitted that the “trust fund is bare” that the truth about Social Security became known. And this year, for the first time ever in U.S. history, more Social Security funds were paid out than were paid in. Thus, the trillions in IOUs that have been collecting in the Social Security Trust Fund are now coming due.

This is what our federal budget will look like in coming years.



As you can see, our current revenue is below the level of spending, and in about 10 years, all discretionary spending—including national defense—would need to cease to fund Social Security, Medicare and Medicaid and interest on the debt.

³ Rick Dunham, Dunham & Co., Tax Deduction Commentary (2011).

These are the facts and the situation our political leaders now have to deal with, having failed to address them for the past 20 years. Those of us in the charitable sector may clearly see that proposals from the USPS and President Obama are wrongheaded, but one must understand the context in which they are made to understand just how difficult the battles will be to preserve essential components of our civil society.

I do not suggest that we are wrong to engage in this fight on behalf of our sector, because I truly believe that a healthy charitable sector is significantly more important to our country's future than a larger or better funded government. I just think it is critical to understand that our arguments cannot be about how "nice" it would be if we could encourage the wealthy to make donations or how much it would "hurt" fundraising to see reductions or elimination of nonprofit postage rates. No. Our arguments have to be about the critical nature of the services our sector provides and why our sector is more efficient and effective at providing those services at a lower cost than the government. The stakes are too high to take any other approach.

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