

Health, Charity, and Leviathan

By Diana M. Ernst and John R. Graham

“Not one of these, our citizens, should ever be abandoned to the indignity of charity. Charity is indignity when you have to have it. But we don’t want these people to have anything to do with charity and we don’t want them to have any idea of hopeless despair.”¹

Through these comments at the signing ceremony for the bill that introduced Medicare and Medicaid into American life in 1965, President Lyndon B. Johnson declared his desire to eradicate philanthropic initiative in U.S. health care, a task at which—fortunately—he failed:

- In 2005, Americans contributed \$48 billion to health and social services via individual donations, as well as through foundations and corporations.
- Philanthropic giving is insensitive to tax rates, constantly hovering around two percent of income for the last half century.
- However, income is extremely sensitive to tax rates, and the burden of taxation incurred largely by the welfare state has crippled America’s growth.
- If the government had not raised taxes in the 1960s to fund the welfare state, economic growth would have been so great that the increased charitable giving to health and human services would now fund about half of the public assistance currently provided by the federal, state, and local governments—eliminating the “need” for much government intervention.

Americans consider health-care costs to be a high priority for government action, but in this area the government is already the 800-pound gorilla. We have long promoted more individual choice and less government control in health care, but we don’t just advocate “dog-eat-dog” capitalism. Another helpful solution is philanthropy. Rooted in American principles of savings, growth, and volunteerism, philanthropy may play an increasingly important role with future

generations as government programs become fiscally fragile. Indeed, if we had relied more on philanthropy over the last four decades, those programs would be in a lot better financial shape.

Some Americans maintain a delusion that everything good and generous comes from government. The harsh reality is that tax dollars cannot fund everything Americans demand. Examples include overgrown programs such as Medicare, Medicaid, and Social Security. By 2030 deficits in Social Security and Medicare will require 37 percent of federal income taxes.² The more we rely on government as our great welfare provider, the less equipped we will be to wield our own power as individuals to innovate, incentivize, and even give back to charity.

America is the world’s most charitable country, giving more of its GDP every year to charity than any other democracy in the west, and more than the entire GDP of some countries.³ In 2005, Americans gave \$260 billion to charity.⁴ A full \$48 billion went to health care and social services.⁵ Interestingly, charitable Americans also volunteer their time at these organizations, and those who gave more time also gave more money.⁶

The U.S. has a long established history of tax deductions on charitable gifts, but charitable giving has remained consistent during the last 50 years, at about two percent of personal income even when tax rates on the highest incomes dropped from 90 percent due to the Reagan tax cuts. About half of large donors would give just as much even if there were no tax incentives for philanthropy, a statement about the inherent munificence of American donors.⁷

The U.S. government takes a disproportionate share of our hard-earned dollars compared to what we voluntarily give away. The wealthiest philanthropists

have the most impact on charities, but they must also face the highest taxes, paying federal rates of up to 35 percent, and states levy taxes too.⁸

Boston University economists Laurence J. Kotlikoff and David Rapson find that federal and state income taxes, sales taxes and major government programs costs us all about 40 percent of our annual income.⁹ One day, America will face government cutbacks as large federal programs become unsustainable. Perhaps charitable giving could help to offset this debt. Indeed, if President Johnson and his collaborators had resisted the temptation to take over care for the needy, charitable giving would have already solved much of the challenge.

Gerald W. Scully, Professor Emeritus of the University of Texas at Dallas, has examined the effects of the huge tax increases that accompanied the growth of the welfare state.¹⁰ With the country's entry into World War II, taxes as a share of GDP increased above 20 percent for the first time. However, transfers and subsidies as a percentage of GDP did not start increasing until President Johnson's Great Society welfare programs started going full throttle in the late 1960s. In 1969, the first year of Richard Nixon's presidency, taxes hit 30 percent of GDP and have run consistently between 30 percent and 34 percent since then. This tax burden is significantly higher than the optimal 23 percent that Scully calculates; with the result that our national income would have been three times as much as it is now: \$44.5 trillion in 2005 versus \$12.5 trillion.¹¹

If Americans had continued to give the same share of their incomes to philanthropy, which is what history indicates, they would have given \$171 billion to health and human services, not just \$48 billion. This would have funded fully 47 percent of the public assistance for health care, plus medical research, which our federal, state, and local governments funded with our taxes in 2005.¹²

This increased philanthropy would have had better oversight than current government programs. As one of us has previously pointed out, Medicaid, the joint federal/state program for the poor, has grown about twice as fast as Medicare since its inception, because of poor incentives facing those who spend our tax dollars.¹³ But the number of poor Americans has not increased faster than the number of elderly.

Instead, the perverse political incentives created by massive federal transfer payments to states, which give state politicians taxpayers' funds "on the cheap" have caused Medicaid and similar welfare programs to jump from less than 10 percent of the country's health spending in the 1980s to about 17 percent today. Absent currently out-of-control government intervention in health and social services, Americans might have found that the \$171 billion that would have come from charity, under a more merciful tax regime, might well have been adequate to fund all necessary public assistance and research free of the bureaucracy and corruption characteristic of government programs.

Further, increased philanthropy would include more support for independent public policy research on health and social services. (Yes, we realize this is a self-serving claim!) Such private foundations can link research and decision-makers together. They can supply policy leaders with facts, provide information for the general public, and scrutinize government practices.¹⁴ Uninhibited by the pressures of political acclaim, constituents, and bureaucracy, private foundations at local, state, and national levels can play an important role in shaping policy outside of government.¹⁵ They can help to preserve the very principles of innovation, savings and growth that keep a healthy economy, and thus, philanthropy alive.

If our tax system allowed Americans to save more of their own money and donate it according to their own initiative, then they could conceivably take the reins, and the responsibility, to improve our society and steer us away from increasing reliance on a growing and failing welfare state. Obviously the purpose of philanthropy has to do with compassion, not recompense, but one cannot deny the positive correlation between thriving philanthropy and a healthy economy that fosters incentives to work, save, and invest.

It's not too late. In order to preserve America's renowned history for charitable giving to health care and all areas, tax policy should reward more for giving more away, and individual donors should also wield their power to fund foundations that can influence our policy makers. We need to free ourselves from government dependency in health care and channel the charitable spirit of individual Americans so that we can truly help each other, and truly change health care, without government in our way.¹⁶

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 - ² Andrew J. Rettenmaier and Thomas R. Saving, "Reforming Medicare," NCPA Policy Report No. 261, (Dallas, Texas: National Center for Policy Analysis, May 2003).
 - ³ "Embrace Philanthropy Instead Of Welfare," *Wall Street Journal Europe*, September 2002.
 - ⁴ *Giving USA 2006: The Annual Report on Philanthropy for the Year 2005*, Giving USA Foundation, Glenview, Illinois.
 - ⁵ *Ibid.*
 - ⁶ The Center on Philanthropy at Indiana University, *Bank of America Study of High Net-Worth Philanthropy Initial Report* (Indianapolis, Indiana: Trustees of Indiana University, 2006).
 - ⁷ *Ibid.*
 - ⁸ *Ibid.* See also United States Department of the Treasury, "Charitable Contributions for Use in Preparing 2006 Returns," Publication 526, (Washington D.C: Department of the Treasury, Internal Revenue Service, 2006); United States Department of Treasury, "2007 Federal Tax Rate Schedules," (Washington D.C: Department of the Treasury, Internal Revenue Service, 2006); Federation of Tax Administrators, "State Individual Income Taxes, Tax Rates for tax year 2007 – as of January 1, 2007" (Washington D.C: Federation of Tax Administrators, 2006).
 - ⁹ Laurence J. Kotlikoff and David Rapson, "Comparing Average and Marginal Tax Rates under the Fair Tax and the Current System of Federal Taxation," (Cambridge, Massachusetts: National Bureau of Economic Research, October, 2006).
 - ¹⁰ Gerald W. Scully, *Taxes and Economic Growth*. Policy Report No. 292 (Dallas, TX: National Center for Policy Analysis, November 2006).
 - ¹¹ Scully reports 2004 GDP in constant 2000, following the Bureau of Economic Analysis' convention. I extrapolate his conclusions to 2005 and report current dollars, in order to reconcile with the reported data on philanthropy in 2005.
 - ¹² Graham's estimates applying Scully's model to National Health Expenditure Data at Centers for Medicare and Medicaid Services.
 - ¹³ John R. Graham, "Taming the Medicaid Monster: The President Pushes Progress But States Shirk Solutions," *Health Policy Prescriptions*, Vol. 4, No. 8 (August 2006).
 - ¹⁴ Dennis F. Beatrice, "The Role of Philanthropy in Health Care Reform," *Health Affairs*, Summer, 1993.
 - ¹⁵ The Center on Philanthropy at Indiana University, *Bank of America Study of High Net-Worth Philanthropy Initial Report* (Indianapolis, Indiana: Trustees of Indiana University, 2006).
 - ¹⁶ George A Pieler, "Is this the way to manage philanthropic impulses?" *Financial Times*, January 4, 2006.
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