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Viewpoint

End Bloated Salaries in the Nonprofit Sector

By Dean Baker

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INSIGHTS FROM THE FRONT LINES

End Bloated Salaries in the Nonprofit Sector

Taxpayers should not have to subsidize excessive pay for executives at charities meant to serve the public good.

BY DEAN BAKER

An average family participating in the federal Temporary Assistance for Needy Families (TANF) program costs taxpayers $400 a month. We pay $126 a month to the typical beneficiary of food stamps—the Supplemental Nutrition Assistance Program (SNAP).

By contrast, Susan Desmond-Hellmann, the CEO of the Bill & Melinda Gates Foundation, costs us $44,200 a month. This figure may catch some readers by surprise, because they probably don't think of themselves as paying the salaries of people who work at nonprofit organizations. But we do pay her that amount, and it is a problem.

The salary of the Gates Foundation's CEO costs taxpayers money because we gave Bill Gates a large tax break that subsidizes his contribution to his eponymous foundation or any other philanthropy. If Gates was in the 40 percent tax bracket (a safe bet before the 2017 Tax Cuts and Jobs Act pushed by President Donald Trump), then the government effectively picked up the tab for 40 cents of every dollar that Gates decided to contribute to his foundation.

There is a tendency to treat tax deductions, for charitable contributions or other purposes, as being qualitatively different from direct government spending. This may be a convenient way of thinking for the people who most benefit from these deductions, who tend to be richer on average. But it is nonsense.

From the standpoint of the federal budget, it makes no difference whether the government pays someone $10,000 each year as a housing subsidy or allows them to deduct $10,000 from their income tax payments due to the mortgage-interest deduction. We construct a tax code that fits the government's needs for revenue. If we allow people to reduce their tax obligations through deductions, it increases the deficit just as if we added to spending by the same amount.

We should have this fact in mind when we consider the purpose of the charitable-contribution tax deduction. In effect, we are saying that certain categories of activities are serving a general public purpose. If individuals choose to support these activities, through religious organizations, educational institutions, or philanthropic organizations such as the Gates Foundation, we will subsidize their contributions by allowing them to pay less in taxes.

ILLUSTRATION BY LJ DAVIDS

This is a reasonable policy for the federal government. It provides subsidies for organizations that address a wide variety of social ends in diverse ways. These subsidies can help promote new and innovative practices that may ultimately be adopted more broadly.

However, the government does put conditions on the sorts of organizations that are eligible for tax-exempt status. For example, they must not be for-profit organizations. The government does not, at least explicitly, allow deductions for money paid to profit-making corporations. Nonprofits also must serve the general public purpose. I cannot have a charity to pay the person who mows my lawn. Nonprofits cannot advance a partisan political agenda.

This is important background for thinking about the money that taxpayers effectively pay to support the salary of the Gates Foundation's CEO. Most people view the rise in income inequality as one of the major problems in the US economy. Desmond-Hellmann's $1.33 million annual salary is way above the cutoff for the top 1 percent of US wage earners. In fact, it is far above the cutoff for the top 0.1 percent of wage earners.

While many factors have led to the rise in inequality, part of the story is the excessive pay of CEOs and other top executives. This is more an issue in the corporate sector, where the average pay of CEOs now approaches $20 million a year. Nonetheless, when pay for top executives in the nonprofit sector crosses the million-dollar mark, even at philanthropies such as the Rockefeller Foundation that worry about inequality, this is also part of the problem.

PAY-CAP SAVINGS

As fans of arithmetic know, the more money that goes

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to the CEO and other top executives, the less money is available to pay people lower on the ladder. This means less pay for both midlevel workers and the lower-level workers who clean the bathrooms and serve the food. And in the case of nonprofits, it also means less money for the beneficiaries of the charity in question.

While there are policies that the government can pursue to lower the pay of CEOs in the corporate sector (my preferred route is giving shareholders more power to rein in pay), government can act directly to lower CEO pay in the nonprofit sector. Specifically, it can impose a limit on pay as a condition of keeping nonprofit status for tax purposes. My preferred cap is the $400,000 annual salary that the president of the United States receives.

Just to be clear, this restriction is not about telling the Gates Foundation or other private charities how much they can pay their CEO or other highly skilled employees. They are free to pay them whatever they want. They just can't get the taxpayer subsidy through tax-exempt status if they choose to pay their CEO more than the president of the United States makes.

After all, the rationale for tax-exempt status is to promote a public purpose. Helping to generate inequality by paying excessive executive salaries is not a public purpose.

The larger foundations will undoubtedly claim that they cannot get good people if they must cap their CEO pay at only $400,000 a year. It's worth thinking about this objection for a moment.

A salary of $400,000 would put a worker well into the top 1 percent of the pay distribution. Does a charity really want to tell us that no one who was competent was prepared to make the sacrifice of working for pay that is far more than what 99 percent of other workers make, that is 30 times the median wage, that is more than 90 times the annual earnings of a minimum wage worker? If working for this nonprofit at that pay is too great a sacrifice, then perhaps this is not the sort of organization that taxpayers should be supporting.

Having worked in Washington, D.C., for more than a quarter century, I can think of many highly qualified individuals—people who have advanced degrees from top universities—who routinely put in 60- or 70-hour weeks for less than half of this pay. Some of them receive less than one-quarter of this pay. Would the Gates Foundation really want to tell us that people place so little value on the public service it provides that no qualified person would be prepared to lead it for just $400,000 a year?

To see the implications of a pay cap, let's take the case of Harvard University, where its former president, Drew G. Faust, earned more than $1.5 million in 2016, her last year in the position. If her pay had been capped at $400,000, it would have freed up $1.1 million.

In addition to the president, many other people in top-level positions at Harvard earn salaries in the high hundreds of thousands of dollars, including the provost, college deans, vice presidents, and other executives. If we assume 30 people in such positions, with an average pay of $600,000, the potential savings would be $6 million.

Added to the savings on the president's pay, this would free up more than $7 million a year. That would be sufficient to give the 5,000 members of the Harvard Union of Clerical and Technical Workers a pay increase averaging more than $1,400 a year. That would be a very nice holiday bonus.

If this pay-cap policy were adopted, some organizations would inevitably try to circumvent it. One route would be to contract out for services. This may be fine for services such as managing the organization's endowment, but Harvard might feel a little embarrassed about contracting with its new president, Lawrence S. Bacow, LLC, for "presidential services." This cap is likely to be more enforceable than many items in the tax code.

It's also worth quickly heading off one obvious subterfuge. It would be pointless to have a compromise in which the money paid to CEOs in excess of $400,000 could not qualify for a tax deduction. The point is to change policy, not assuage liberals concerned about inequality.

We don't tell organizations that spend half of their money trying to get Democrats elected that they can only qualify for tax-exempt status on the other half of their money. Such organizations are simply ineligible for the tax subsidy. The same point should apply to organizations that find they cannot get good help for the same pay as the president of the United States earns.

CEOs and other top executives in nonprofits may legitimately argue that they are grossly underpaid compared with their counterparts in the corporate sector. This would be true. Corporate CEO pay has become bloated due to a badly broken corporate governance system that essentially allows CEOs to rip off shareholders. In fact, every worker is underpaid in relation to the bloated pay of corporate CEOs, so top executives in the nonprofit sector are not uniquely disadvantaged in this respect.

A BAD USE OF FEDERAL DOLLARS

As a practical matter, if we are serious about combating inequality, we have to recognize that we are not going to reverse a four-decade-long trend with a single step. If the beneficiaries of the policies that promoted inequality can protect their position by pointing to some other group that got even larger gains, then we will never be able to make any progress.

In this case, we should keep our eye on the ball. The federal government is providing enormous subsidies to the bloated pay of top executives at nonprofits. This is simply not a good use of federal dollars, and it is hardly in keeping with the idea that nonprofits should be serving a public purpose. We can try to develop government policies to reverse market outcomes that generate inequality, but we should first end government policies that promote inequality. ■