

FOR-PROFIT CHARITIES IN EDUCATION

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Every once in a while developments in academia combine with developments in the real world to help expose some of the fallacies which continue to dominate our public life. In September 2006, Posner and Malani (2006) (University of Chicago) published a paper which critically examined the purpose and performance of non-profit organisations and challenges the decision by governments to couple the non-profit organisational form with tax benefits – thus putting profit-making organisations at a relative disadvantage.

As a result, in recent years there has been a growth of non-profit organisations selling their services in different sectors of the economy. However, problems begin to emerge when non-profits begin to compete with for-profits delivering the same service, or when for-profits enter into traditional non-profit sectors. Imagine two separate private schools (or universities), School A and School B, each serving the same customers and each adopting a different organisational form, structure and management. Over a period of time it becomes increasingly clear that School A outperforms School B at a fraction of the cost. Which school is more beneficial to individual pupils and to society as a whole? The answer is obviously School A. However, what happens if School A is a for-profit school, and School B is a non-profit school. Should this influence how you answer the question?

For many within the educational establishment, it almost certainly will. For example, according to the National Union of Teachers, 'Education is for children and not for profit'. The fact that School A outperforms School B is for them irrelevant, as these improvements are being driven by the profit motive. Therefore, School B is now the preferred option simply because it is apparently motivated by an altruistic desire to better children's education.

This is the current position adopted by the UK government, which offers all private non-profit schools preferential tax treatment, simply because they have adopted the non-profit organisational form. However, according to Posner and Malani, if governments are going to encourage certain charitable activities then tax-exempt status should be available to both for-profit and non-profit organisations. For the government the important point is not whether the entrepreneur acts out of altruistic or selfish motives, but whether his actions benefit society or not. Posner and Malani therefore conclude that for-profit charities may well be

desirable institutions and that if the government were to remove all tax discrimination, then a new generation of for-profit charities would emerge. Charitable entrepreneurs would then be free to choose among organisational forms on the basis of their efficiency and not on their tax advantages.

In the case of education, any entrepreneur who sets up a private school would therefore receive preferential tax treatment. In other words, tax subsidies would be based entirely on the social value of the activities of the school, whatever its corporate form. This raises the question – why are tax subsidies needed in education? But if the present government believes in the importance of 'education, education, education', why would it want to introduce any kind of taxation on any kind of school? Whichever way you dress it up, taxing education can only act as a disincentive and, as Arnold Harberger has noted, it will be the teachers that will bear the brunt of any tax, a brunt that may be even larger than the tax itself!

The important development to occur in the real world in September 2006 was the announcement from Google, that it was launching its philanthropic arm, Google.org. To the surprise of many, Google.org is a *for-profit charity*, with an endowment of \$1 billion, and a mission to address climate change, global public health and economic development and poverty. But why would Google or an educational entrepreneur wanting to set up a chain of new private schools choose the for-profit status which means it will be taxed, instead of the non-profit, tax-free status? What possible benefits can come from introducing the profit motive into their organisation? Or to put it another way, what would happen if you removed the profit motive from an organisation such as Google itself? No profit motive, no property rights. No property rights, no ownership. No ownership, no motivation or capacity to improve efficiency, expand or innovate. No innovation results in stagnation. Or in the words of Ludwig von Mises, 'If the profit motive is abolished, chaos results'.

Reference

Posner, E. A. and A. Malani (2006) 'The Case for For-profit Charities', Olin Working Paper No. 304, University of Chicago Law and Economics. Available at <http://ssrn.com/abstract=928976>.

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