

## **Chapter I**

# **THE ORIGINS AND IMPLICATIONS OF PERCENTAGE LAWS**

**The percentage system in Central and  
Eastern Europe  
– implications for civil society and public  
philanthropy**

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## **The percentage system in Central and Eastern Europe – implications for civil society and public philanthropy**

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I am very grateful to the editors for inviting me to write a section of this publication. I am sure this study will bring a substantial contribution to the discussion on the affinities and differences in the processes of creating a legal environment for third sector activity in Central and Eastern European countries. The discussion is especially interesting because among its contributors are not only commentators but also those actively involved in developing percentage systems in their own countries. My great hope is that the debate will continue, for just now serious reflection on the condition of civil society, its nature, characteristics, values, and unique local traditions is urgently needed, more than ever before. In particular, the peculiar historical and political context of the relationships in the region between the civil society institutions and the state should foster such a debate. Reflection is also needed to verify a conclusion, often heard, that efforts to restore civil society in the region have succeeded. Is that really so? I seriously doubt it.

In a well-functioning civil society, there is no doubt that channels are needed where the public, voluntary and private sectors can debate and develop policies. One type of channel – non-governmental organisations – cannot on their own keep civil society alive. Indeed, NGOs are a necessary, but in no way sufficient, condition of civil society's good health. In most of the countries of this region NGOs may operate quite freely - though their activity is not free from concerns. One such concern, maybe even the deepest, is the need to secure financial resources to enable their functioning and growth. Percentage laws, which allow taxpayers to support NGOs with a percentage of their personal income tax, give NGOs a hope – sometimes real, and sometimes a vain one – that the financial problems they face will be solved, at least in part.

Presenting the percentage system as a “success” is rather a fashionable view. In a way, that is why this study has been prepared. Naturally enough, we want to share the success story with others. But before joining in the celebrations, I wish to question what the new percentage system means for civil society in terms of:

- relations between NGOs and the state
- and promoting genuine philanthropy.

It is also important to examine who wins and loses from the introduction of this new system, and to ask where percentage laws take us and whether this is actually the direction in which we want to be led.

What is the point of posing such questions in a study designed to serve as a kind of “handbook” on percentage laws? First, I believe it is necessary to consider wider concerns and rise above the basic, if important, issues of how percentage laws work in practice. Second, I believe this study can reach many places where the interest in a percentage system is only a small part of broader concerns about the condition of civil society, and third, I fear that the successful proliferation of the system in the countries of the region may obscure the

fact that they essentially lack any consistent vision of mutual relationships between the state and NGOs, and the sector's future sustainability. It cannot simply be assumed that because percentage systems are so widely accepted in countries in Central and Eastern Europe, they are perfect models and they solve some more fundamental problems. This would be a serious misunderstanding.

As readers will see from many of my comments made below, my attitude towards the percentage system and its possible long-term effects is ambivalent. Some of those comments may even be considered provocative. As for myself, I would sincerely wish them to be false predictions. So, I would like to make clear at this point that I am in favour of the percentage laws. However, I believe that if we want to reap their fruits, we have to learn how to avoid unwanted and originally unintended (but nonetheless possible) results of their implementation.

### **State-civil society relations**

When money is at stake, and that is mainly the case with a percentage system, it is easy to lose sight of more fundamental issues. The Hungarian percentage model has many advantages that helped its spread in the region: it is relatively simple and it can be introduced administratively (unlike other, more organic and long-term processes). But, in my opinion, the most important thing is that the system seems to give an easy answer to the common problem of NGOs in the region, namely the lack of financial resources. Even in Poland, the debate on the Law on Public Benefit Activity and Volunteerism mainly focused on the 1% system though it is an issue of minor importance in comparison with its other provisions. However, discussion on those more fundamental issues, and on the mechanisms for the division of work between NGOs and the public administration in particular, has not been so heated.

To my mind, the central issue that needs to be addressed is the relationship between the state and NGOs. Clearly, percentage laws are an important feature of an environment conducive to the development of NGO activity. But these particular mechanisms have been introduced quite apart from, and maybe even instead of more fundamental arrangements. In most countries in Central and Eastern Europe the freedom to organise is a constitutional right. In some countries, additional principles relating to mutual relationships between NGOs and the state are also enshrined in the constitution. In that connection, the principle of subsidiarity (very European and very ancient in its nature) is particularly important. It provides for a specific "division of labour" between communities of a different size and capability for self-sufficiency. But as a rule, such general arrangements are far from being conclusive for the practical model of mutual relationships between the state and self-organising citizens.

During the last decade or so, representatives of almost every political persuasion were, for some time, in power in most countries of the region, but it is hard to see any direct and clear connection between a government's political colour and its attitude towards the third sector. Thus, the idea of civil society, both in its more communitarian and more individualistic version, can be translated into almost every political idiom. The problem is that the commitment to the idea of civil society, so often espoused by politicians, is a kind of verbal "ad hoc ideologising" that hardly entails any practical action. Even worse, such statements are often only a cover to conceal inaction, or even harmful action. Perhaps, the well-known and clear-cut controversy between Havel and Klaus on that subject in the Czech Republic was the

only occasion for a deeper debate (such debate is more widely lacking both among politicians and also members of non-governmental organisations).

The notion of civil society is reiterated like a mantra in a quite simplified language. Some people say that recently the idea has had its renaissance in Central and Eastern Europe, but nevertheless, there was no thorough discussion of it even among civil society actors themselves. Most actors have remained unaware that they use the current jargon without deeper, meaningful reflection. Besides, all the (mostly) velvet revolutions in the region had some disturbing feature in common, namely that their participants lacked any clear idea of what the world should look like in the aftermath of the revolution beyond removing the regime. It can even be said that, for that reason, they were not “genuine” revolutions. It is true the revival of civil society could be heard from many quarters, but the notion was so popular – partly because of its vagueness and ambiguity – that many people may have used it while having quite different things in mind. But soon, the misunderstanding was revealed, and I am not at all sure if what is being experienced is a real strengthening of civil society.

What the debate on the condition of civil society should actually focus on is the question of its relations with the state. In my view, the very concept of these mutual relationships is in a deep crisis. Various models are tried out – in fact, the whole of Central and Eastern Europe experiments. Its states are too poor to afford welfare state policy, while their citizens are too poor to accept the liberal model. Different models of welfare mix are tried out where the role of NGOs is not always evident. The mutual relationships between both parties are not clearly defined, and any effort to straighten them out fails because of dogmatism on both sides. As a consequence, the third sector plays marginal role in solving the basic problems (with the exception of a very few areas) the countries are facing.

### **The inherited percentage model**

The percentage system idea originated in a different part of Europe. This type of measure available to taxpayers was initially adopted, inter alia, in Spain and Italy, as a mechanism for allocating funds to the churches. It was in this form – as an idea for financing the main Hungarian churches – that it was transplanted to Hungary. That it evolved to the form suitable for NGOs, but not only for NGOs (the Hungarian case of 1+1% with separate categories for NGOs and the churches), did not happen by chance. For in both areas (the churches and NGOs), the same challenge consists of ensuring that the institutions are independent from the state, and at the same time, that the state acknowledges the beneficial nature of their activities. For both groups, de-politicisation of the rules that govern the granting of subsidies is needed as well as a way to respect the individual choices of every taxpayer.

There is an interesting parallel to the anonymous nature of confession – a relic of this arrangement exists in the Hungarian percentage model where the principle of taxpayers’ anonymity is in force in relation to NGOs, not only churches. Perhaps, the church-related origins of the Hungarian 1% system is why the principle of choosing only one beneficiary organisation was adopted – it is appropriate in the case of a church, but in my opinion unfortunate for NGOs where it is natural for people to have a range of different interests and causes they wish to support.

In Hungary there was another aspect behind the percentage system idea – the mechanism of tax allocation was initially intended for state-financed public institutions (e.g. culture-promoting institutions) and for public foundations that are a special kind of government quango.<sup>1</sup> In both cases, the government wanted to recourse to citizens' choices in its internal debate on the allocation of tax revenues between those direct and indirect governmental institutions. The model, with some modifications, was also present in other countries, including Poland. Quite deliberately, it covered areas like culture or education where, as a rule, the possible allocations from individual citizens prove to be much more generous than the politically determined budgetary allocations – it would be unlikely for public institutions dealing with interior or military affairs to capture the public's imagination and win their financial support.

Such “select” ideas on potential beneficiaries were promoted as a result of the strong position of a given ministry, e.g. Ministry of Culture and Education, or of quango-type organisations. Their interest was limiting the number of possible beneficiaries so the percentage mechanism would be more profitable for them. In the end, it proved to be politically impossible, or at least very hard, to justify the preference for only one limited type of beneficiaries. Inevitably, the public sector had to share the possible revenues from the proposed percentage system with other organisations, i.e. NGOs. Quite obviously, governmental organisations – lacking the broader appeal of NGOs – had little chance to win the competition.

So in Hungary, where the modified and much promoted idea – also via this study – of the percentage system comes from, strengthening civil society was not the original motivation for tax allocation. However, thanks to the efforts of other institutions (the churches and public institutions) that were not able to save all its benefits for themselves, NGOs have come to benefit from the percentage system.

### **Possible gains for the state**

The situation that has emerged in Central and Eastern Europe is rather odd. Neither the state, nor the NGOs have any clear idea of how to divide between themselves the work to be done, but both are willing to agree that a certain percentage of personal income tax revenues should be channelled to NGOs. Are there any gains for the state from the deal? Is the state honest about its willingness to give up a percentage of revenues from personal income tax? The answer is far from obvious but the following theses can be considered:

- The fact that several governments have signed up to the percentage system suggests that, for them, the price of giving up a portion of tax revenues is not considered too costly.<sup>2</sup>
- The adoption of the percentage system brings governments serious profits in the field of public relations. It could even be considered as a cheap way to please taxpayers, to allow them to take personal decisions, or to sweeten the bitter pill of taxation.

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<sup>1</sup> A British and American acronym: “quasi autonomous non-governmental organisation” ie. A body set up by statute with, in the UK, a board appointed by the government.

<sup>2</sup> In 2000, 1% income represented 2.58% of total government support for Hungary's NGO sector. Source: *Nonprofit organisations in Hungary*, 2001 KSH (Central Statistical Office).

- Perhaps most importantly, the percentage system is often introduced as a smoke screen for parallel cuts in social spending. Readers themselves may decide whether the additional financial resources made available to NGOs are intended as support for their efforts to alleviate social implications of the cuts, or the money involved is simply the price paid by the state for their silence.
- The state may use the percentage system to make economies introducing it, as it were, in exchange for eliminating the traditional tax incentives for philanthropy (as was the case in Poland in recent months, though the attempt proved to be unsuccessful).
- As the percentage funds involved are considered state support, the government can still keep tabs on where the money goes and how it is used.
- Regarding the possible rise in NGO net revenues, it is still not clear how the habits of traditional philanthropy will be affected (and, perhaps, weakened) by the new percentage system. Even if it is assumed traditional philanthropy is positively affected by the percentage system (namely, private giving through the tax system increases), it does not seem, for the time being, that the state has to worry about the increased total cost of existing tax allowances.
- It should not be forgotten that NGOs will give part of the amounts received under the percentage system back to the state in the form of taxes on their expenditure. For example, the VAT on goods and services purchased, and their staff will have to pay the personal income tax due on their salaries.
- And finally, there may be other reasons we cannot even think of that make it attractive for the state to give up a certain percentage of personal income tax.

Therefore it is not at all apparent what intentions motivate the state to give up the percentage in question of its fiscal revenues. Does it want to support NGOs and honour the taxpayers' choices, or is it looking for a better excuse for keeping discretionary spending of the remaining 98-99%?

A related question worth asking is why European Union countries have virtually never tried to introduce percentage mechanisms through their NGOs, much more often than ours, draw on public funds within the system of contracting services. First, the public financing of NGOs in EU countries is based on different systems that generate sufficient resources, so the hard-to-win 1% or 2% of personal income tax may not be so appealing. Second, in the EU the management of public funds is much more orderly and transparent, so there is no need for any measure, like the percentage system, to de-politicise decisions on granting funds (in Hungary, such de-politicisation was an important reason for adopting the system there).

Political motivation in public financing, supporting a clientele and even political capitalism are the common faults of governments in our part of Europe. In this regard, the percentage mechanism, requiring decisions to be taken by individuals, can be seen as an exercise in "personal democracy", made in view of the weakness of "public democracy".

The extent of the experiment is, however, rather limited. But this begs the question: how far can we go with that experiment? The idea of the percentage system may lead to somewhat

risky scenarios. If the percentage system is such an attractive, inexpensive tool, why not to raise taxes, if higher taxes increase the amounts available for this form of “philanthropy”? So far, we have mostly heard about 1%, but in fact, nothing prevents it from being 2% (as introduced from the start in Lithuania and as the increased level now foreseen in Slovakia) or the 1+1% model that exists in Hungary where separate schemes operate for churches and NGOs. Some people say that the ceiling should be 3%, or even 7%! Where is the thin dividing line between bold ideas and politically dangerous reverie? I do not know, but I would not like to live in a country where the state abdicated its social responsibilities, and decisions on social support are left entirely to the discretion of its citizens. But if that were the case, the very taxation system would be dispensable, for redistribution of wealth is its sole general justification. On the other hand, I would like to live in a country where government spending, as well as government spenders, can be controlled effectively by its citizens.

So, at the end, another controversial thesis can be raised, namely that the percentage system is so popular because of the very weakness and poor credibility of state mechanisms in this region, together with the willingness on the part of citizens to curtail the role of state institutions. In this respect, the percentage mechanism may serve to alleviate tensions within the political structure of the state.

### **Possible gains for NGOs**

There is no doubt that most civil society institutions need financial resources to exist and to function properly. But this material need should only form a basis for their higher mission which involves much more, including the genuine commitment, dedication and unselfishness of their members. Public support which, under certain circumstances, may bring about the more tangible, financial support, is also required. Unfortunately, the connection seldom holds the other way round.

NGOs too share the common hierarchy of needs, and for them, like for any one of us, a very basic need is material subsistence. But to subsist NGOs need resources that have recently become scarce, especially as foreign donors gradually withdraw from the region. The latter strongly encourage the extension of the percentage system, and are eager to hear that measures like the percentage system or so-called “community philanthropy” will compensate for their much reduced contributions. Naturally enough, they dearly wish to hear about a success story, but even if they do hear it, will they believe it?

The simple truth is that financial resources available for NGOs’ activities are too small, and acquiring them involves competing with other organisations (in most cases the competition is silent). If we look, so to speak, at the institutional ecosystem of the third sector in Central and Eastern Europe, its recent history may be seen as a proof of Malthusian predictions: the number of organisations grows at faster rate than the resources necessary for their activity. New funds are urgently needed to give the third sector hope for survival. We have to ask ourselves whether the percentage system can really solve the problem.

The expectations on the part of NGOs regarding financial gains from the percentage system are usually too high. Many organisations ignore the simple fact that there will be hard competition for the funds, and instead hope to be the ones that will benefit. In fact, the resources from the system reach only some, rather than most NGOs and forms a very minor part of overall sector income. Two statistics from Hungary are very striking:

- In Hungary, out of a total of approximately 50,000 NGOs, around 20,000 are beneficiaries of its 1% system
- The income the 1% system generates each year, welcome as it is, represents 0.7% of the NGO sector's total annual revenue.<sup>3</sup>

The idea behind introducing the percentage system is, however, not all about money. One of the positive aspects of the percentage system is the introduction of a mechanism that may be called the “public acceptance” test. To win support an NGO has to “translate” its activities into an idiom that is intelligible to taxpayers. The mechanism may help to make some NGOs less “self-contained” in their activities and less alienated from the real social problems. But here too, there are some unwanted side-effects. NGOs begin to compete with each other for the taxpayer's favour and the fight gets tougher, the closer the deadline for submitting tax returns.

It would be naive to believe that the taxpayer always makes rational choices. NGOs try to “sell themselves”, using (and spending money on) different marketing methods. They have to make the public believe (rather than convince them) that their activities are better than those of “competitors”. In the end, some NGOs may spend more on such campaigns than they could possibly gain on them. An analogy with the financing of general election campaigns is quite instructive: some parties take out loans, and when they do badly in the election they end up in debt.

Marketing campaigns have their own logic – to succeed they have to offer a “product” that is “easy to sell” and in the case of a percentage system this means those causes (e.g. a children's care charity) where taxpayers' money is most likely to go. On the other hand, it is doubtful whether the percentage mechanism can help NGOs working in less popular, but equally important areas. In consequence, only organisations renowned for their clear, convincing, uncontroversial mission are likely to be the winners.<sup>4</sup>

Many NGOs have no need to use marketing instruments. Some do not even try to reach mass audience with big campaigns. Their strength lies in that they work locally and are well known in local communities. They have no need to justify their existence using sophisticated methods because their trustworthiness is based on their everyday presence in the neighbourhood and local community they serve. In such examples, the notorious problem of asymmetry of information (individual donors are rather unable to get informed in detail on the way their money is spent) also disappears.

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<sup>3</sup> Figure for the year 2000. *Nonprofit Organisations in Hungary, 2001*, KSH (Central Statistical Office)

<sup>4</sup> Both in Hungary and Slovakia organisations supporting education and health care attract most funds via the percentage system.

It is worth raising the idea of balancing the intensive marketing efforts on the part of NGOs with a kind of consumer protection movement for taxpayers – so that the marketing techniques do not limit their freedom of rational choice. There are some useful analogies with the commercial market. Consumers have the right to be informed about the “ingredients” of the product. They should be allowed to make rational choices on what they spend, rather than be induced to yield to pressures such as the folly of “Christmas” shopping. Bad products should be taken off the market. The state should guarantee minimum market and trade safety conditions. The state and the consumer protection agencies should be separate, and institutionally independent so consumers can have trust in the opinions issued. Effective institutional systems for supervising NGO activities in this way are lacking in the region.

Normally, state intervention is justified by its capability to solve problems of accountability (e.g. by limiting the group of beneficiaries to NGOs having the status of public benefit organisations). Such intervention is neither effective, nor needed on the local level. In a way, it is similar to when we go shopping to buy foodstuffs for our family. We want to be sure of the food quality, so we buy it either in a big supermarket that seems to guarantee high standards, or from small retailer in the neighbourhood that has its own farm in the belief that his products are “natural”. The percentage system covers a multitude of such small “farmers”. The scale of their activity is small, and they have a small number of customers. The funds that they receive are petty in comparison to sums given to known, national-level organisations, but for them they are very important, as shown in a survey of a group of NGOs in Hungary. For the smallest organisations surveyed the revenues from Hungary’s 1% system were equal to 25% of their annual budgets, while for the biggest ones it was only 4%.<sup>5</sup>

Some NGOs may use the percentage system to improve the collection of contributions from their members. In recent years, the share of people declaring membership of NGOs has dramatically fallen, practically in the whole Central and Eastern Europe. In general, the level of membership is lower than before 1989. Of course, its quality (in terms of freedom of membership in contrast to former collectivist compulsion) is different, and perhaps higher. But the rate is falling systematically, and many years after the change of political system, we cannot blame it entirely on the communist past (and besides, the rate is also falling in other regions of the world). When the membership base narrows, the sum of members’ financial contributions also falls. Many members do not pay their dues at all. The percentage mechanism may be used at least to motivate members of NGOs to support their own organisation with the funds at their disposal under the new system.

The percentage system is favourable for NGOs that can offer the taxpayer some specific services, as it were “in exchange” for a percentage of their personal income tax. By adopting the percentage mechanism, the state gives up a portion of its power to allocate tax revenues for so-called “public goods”. Sometimes it means that the funds are allocated to other public goods, chosen by taxpayers themselves – but sometimes, in fact, they are spent for “individual goods”. The problem, quite interestingly, corresponds with an influential, though rather outdated theory in economics relating to the NGO sector (the so-called Weisbrod’s median voter). It says that the NGO sector grows mainly in the areas neglected by the government as unimportant for its voters’ base - that is, generally, in the field where services are rarely

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<sup>5</sup> *The Effectiveness of Hungary’s “1% Law” – A Survey of NGOs*, NIOK 1999. See [http://www.onepercent.hu/Dokumentumok/NGO\\_Report\\_and\\_Evaluation\\_revised.doc](http://www.onepercent.hu/Dokumentumok/NGO_Report_and_Evaluation_revised.doc)

provided (for example, advocacy activities). In my opinion, the theory is rather simple-minded, but the percentage system seems to solve the problem. If taxpayers themselves may allocate a portion of their taxes, they can channel them to NGOs that provide services they personally need. It means that, in a way, they pay for the services with the percentage of their tax (in this way, they can pay for various services, for example by allocating funds to NGOs that support or manage the school where their children are educated, or a hospital where they receive some medical help). On the other hand, it is also likely that the geographical areas in greatest need will also be those where the lowest income tax is generated. Of course, such an exchange of a “donation” for a service has nothing to do with philanthropy, for the essence of the latter consists in unselfishness. But the fact is that this kind of “fake philanthropy” is quite common in Central and Eastern Europe.

### **The percentage system and philanthropy**

As mentioned earlier, the idea behind introducing the percentage system is, however, not all about money; it is also the broader public participation that it entails. Some say that people are more willing to participate in “percentage philanthropy” than in traditional philanthropy. But here again, we have to remain cautious in our opinions. Data from fiscal authorities often prove to be somewhat misleading. For example, in Poland, over 90% of those who engage in philanthropy (that is, according to different estimates, 37% to 55% of taxpayers) do not exercise their right to tax allowances, so they are not included in the tax authorities’ statistics. On the other hand, the percentage system requires the taxpayers’ intentions to be “cleared” by the tax authorities, so precise figures exist. A good example is Hungary where the system was introduced seven years ago, and attracts about one third of taxpayers each year (of course, this is a great number of people, but we may also wonder about the remaining two thirds).

Comparing the different sets of data highlighted above may be misleading. Some view the percentage system as a learning process that will result in genuine philanthropy. However, the question remains about the moral value and significance of an act consisting in giving owed tax, a sum which, in a way, does not belong to the giver. Is it, indeed, a sign of a taxpayer’s commitment? The Book of Proverbs tells a parable about a widow whose offering, though the smallest, was most valued for she gave away all that she had, while others gave what they had in excess. Then, what should we say about giving from what is not owned? The parable cited above is important in that it shows that the intrinsic worth of a gift is something quite different from its value. Leaving aside these subtle distinctions, even assessing the scale of support given to NGOs proves to be difficult. We have no convincing proof that the percentage system does not reduce the amounts given through traditional philanthropy. On the other hand, a scenario where the system adds nothing to philanthropy, or even weakens it, is not so hard to imagine. It is a scenario which would be alarming.

As most would agree, NGOs face a day-to-day struggle for survival and they are vitally interested in the adoption of mechanisms that generate resources for financing their activity. In this regard, the percentage system is widely welcomed. In one sense, this is the easy way in comparison to the painful process of building and restoring genuine habits of philanthropy. The percentage system is a kind of “quasi-philanthropy” for less wealthy countries and societies. But it should be remembered that the two processes lead in different directions, so

should not be confused. For if they are, they will not complement, but rather, in a way, impede one another.

The percentage system and philanthropy therefore have their differences that should be exposed rather than obscured. Philanthropy is based on conscious unselfishness. That virtue is maybe rare, but is nevertheless very valuable. We have to ensure that the percentage mechanism does not induce us to go for quantity instead of quality, or maybe width instead of depth. To label the percentage system as a philanthropy is an unfortunate mistake unless we are ironically calling it poor – or stingy – people’s philanthropy, in other words that members of societies in this part of Europe are not wealthy enough and not compassionate enough to share their own resources with others. Nonetheless, they quite agree on their pitiless assessment of state institutions – their bureaucracy, the system of patronage, politicisation, and they would readily like to participate in distributing state resources. But let us ask a simple hypothetical question: if, in the countries where percentage mechanisms have already been introduced, the taxation rate were generally reduced by the one or two percentage amounts involved, then what part of these amounts left in the taxpayer’s pocket would go to NGOs? I fear that the outcome would be hardly noticeable.

The percentage mechanism’s popularity is associated with the down-to-earth necessity of searching for new sources of financing. Simplifying somewhat, it could be said that the tax allocation mechanism is intended to balance the deficit in donations of a purely philanthropic nature. It is not quite clear whether the effect of adopting the mechanism is, indeed, positive for organisations in terms of amounts gathered. The stance taken in Poland by the Roman Catholic Church on this issue is quite interesting. The Church, of its own accord, gave up any effort to be included in the proposed 1% system because of its possible negative effect on traditional charity. In Poland, the Church substantially benefits from charity, so it decided (perhaps rightly) that the risk of “spoiling” what it already receives was too high. In general, we can suppose that the percentage system finds much less justification in countries where traditional philanthropy thrives.

It is therefore important to repeat the following warning one more time: beware that the taxpayers do not adopt the view that allocating a percentage of their income tax is philanthropy, and that by participating in the system they fulfil their moral obligation to do philanthropic deeds. If they acquire such a belief, they may begin to exercise a form of “ritual” charity which is false, mechanically done once a year when they complete their tax declaration. Such an idea about philanthropy can undermine genuine philanthropy. Thus, generally we should remain suspicious about the possible results of introducing percentage systems to promote philanthropic attitudes. The connection between the two is far from obvious. But one thing seems to be clear: such instruments may be as harmful as they are helpful.

### **Widening the percentage system net**

Resources coming from the percentage system, even if they cover only a small part of an organisation’s budget, are of special interest: NGOs may use them more flexibly than in the case of funds from institutional donors or clients. Sometimes these are the only resources

giving them a minimum element of flexibility in their activities.<sup>6</sup> In general, it is not easy to find a donor that understands the need to finance these types of expenses, and NGOs' self-generated income tends to be low.

The newly adopted Hungarian National Civil Fund, which may finance the administrative costs of NGOs, is a quite interesting arrangement. The government has pledged to match however much is allocated by taxpayers to NGOs through Hungary's 1% scheme the previous year, which means that the amount of resources at the Fund's disposal directly depends on the extent of public participation in the 1% system.

Apart from some inevitable technical problems, this programme is a sign of great political boldness on the part of the Hungarian government because it entails a doubling of the income tax revenues already provided to the sector through the percentage system. Moreover, the central allocation of funds involving the sector itself implies more strategically targeted funding than is achieved through individual taxpayers' preferences. It is worth noting that the Fund's decision-making structure involves delegated NGO representatives and that its resources are available for all NGOs, not only for those receiving funds under the 1% system. In the case of the new Fund, both the state and NGOs agreed (and perhaps, they had no other choice) to ignore in part the public acceptance test of the 1% system. Citizens' 1% contributions determine the size of the Fund but not its direction – the Fund may establish its own beneficiary selection criteria for awarding grants.

If there are no parallel policies to encourage other forms of support and private giving to NGOs, some fear that NGOs may develop a far-reaching, misleading feeling of dependence on the state for meeting their operating costs through the Fund. On the other hand, remembering the income the percentage system generates to the Hungarian NGO sector is only less than 1% of the total, the overall budget allocation offered by the Fund, although significant, still represents a very small share of the sector's overall income. In addition, given the current level of public participation in the 1% income tax allocation system, the proportion of this revenue is limited.

While the increase in the Hungarian NGO sector's revenues from 2004 onwards as a result of the National Civil Fund is welcome, the further institutionalisation of the percentage system it involves raises a number of questions. Due to the lower income levels among the populations of Central and Eastern Europe, the percentage system is often imagined as an interim solution for supporting NGOs' activities until the time when societies in the region are more prosperous, and traditional forms of public giving are restored. My questions are:

- How long should this “interim” solution last?
- Is there a danger we are becoming hooked on (limited) state funds provided through the percentage system?

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<sup>6</sup> But even this rule may not be without exception. For example, if an NGO planned to undertake a big public campaign, financed from percentage revenues, it might promise publicly to individual donors that donations received would not be spent on meeting the unpopular administrative costs. And afterwards, being bound by the promise, it would have to solicit the necessary funds elsewhere.

- By tying further forms of funding, such as the Civil Fund, to the percentage system, are we, in our rush to increase the funds available, in danger of making the “temporary fix” a “permanent fixture”?
- If we do not consider the percentage system as an adequate solution for attracting funds, and are unsure about its role in developing public giving, should we not encourage the development of new solutions to educate the public about philanthropy?
- And finally, do we have the imagination and energy to initiate and secure other forms of income, support and private giving which promote a healthy, vibrant and independent-minded civil society in Central and Eastern Europe?

## Conclusions

The percentage system idea introduced in Hungary in 1996 soon found its followers in other countries of the region and has been widely promoted by NGOs and their networks. By the spring of 2003, modified versions had been adopted in Slovakia, Lithuania and Poland. Romania is the latest country to enact a percentage law.<sup>7</sup> Interest in a percentage system is high in the Czech Republic.<sup>8</sup>

The grounds for the percentage system’s popularity are manifold. First and above all, in the whole region the general conditions under which NGOs operate are similar, or rather the problems they face are similar. In particular, the need for financial resources is the very common feature of their situation. This is a result, inter alia, of the rapid growth in the number of organisations residing in the same limited “territory”, a substantial part of which is, additionally, occupied by politicised organisations of the “old regime”. Further, we suffer from a lack of general agreement on the division of work between the state and non-governmental organisations, the withdrawal of western donors, the weakness of domestic philanthropy etc. All these common problems lead to the belief that there are also common solutions.

The development of one such “solution”, namely the percentage system, was fostered by a kind of positive competition between countries of the region. Polish NGOs that advocated adoption of the system quite often referred to the Hungarian example. Various, both formal and informal, links between the main NGOs in countries of the region, experts (in particular, those responsible for harmonisation of legislation) circulating all over the region, and finally, the general feeling of “being in transition” and conducive to various experiments – are all factors that, when taken together, show that such means of diffusion work very effectively and with some result, but not without certain shortcomings too.

In the case of percentage systems, proposals were quite often made and adopted without concrete information or critical reflection on the likely results. This study should help fill the gap. I expect that it will foster both the further spread of the percentage system idea and

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<sup>7</sup> In December 2003, the Romanian Parliament adopted a 1% system as part of the new tax code.

<sup>8</sup> In the Czech Republic, a coalition of NGOs is pressing the government to adopt a percentage mechanism. For more details, see News on [www.onepercent.hu](http://www.onepercent.hu)

necessary adjustments. This study should also promote critical reflection on the possible results of adopting the percentage mechanism. Indeed, detailed information on the long-term effects is still lacking. Furthermore, even if we had data from individual countries at our disposal, it would be unreasonable to assume that they would give any definitive answers to other countries. In a way, what we encounter here is a problem typical for comparative studies in public policy, namely the so-called problem of small N (number of cases is too small), and in our particular situation, also the problem of small T (time of observation is too short). From that perspective, all my observations made in this paper should be seen as very indicative. In particular, we may hope that all the possible threats I have highlighted here will turn out to be illusory. I heartily wish it to myself and to my readers.