Repugnant to the Whole Idea of Democracy? On the Role of Foundations in Democratic Societies

Rob Reich, *Stanford University*

Aristotle, a founding father of political science, wrote, "To give away money is an easy matter and in any man's power. But to decide to whom to give it, and how large, and when, and for what purpose and how, is neither in every man's power nor an easy matter" (Aristotle, *Nicomachean Ethics*).

Aristotle was prescient: giving money away well is one of the challenges of our own time, and meeting this challenge brings with it profound consequences for democracy. Philanthropy—especially big philanthropy, in the form of foundations—can enhance or threaten the health of democracy.

Aristotle notwithstanding, few political scientists have seized on his insight. For the most part, philanthropy has been the preserve of moral philosophers, such as Peter Singer (1972; 2009; 2015), who seek to understand the personal morality of giving. Singer famously argued that the moral obligation to assist others in desperate poverty is extremely demanding. Circumscribed within the domain of personal morality, the questions that arise include whether giving is supererogatory or obligatory, to whom and how much should one give, and whether motive or only consequences matter in philanthropy.

Yet philanthropy poses equally weighty questions for political science and political theory. The subject is all the more urgent in light of the dramatic growth of foundations and the efforts of billionaires to shape public policy. Concerns about philanthropy go back to Aristotle, and large foundations were viewed with great suspicion in the early 20th century. Today, however, foundations are celebrated and donors are treated as heroes deserving of civic gratitude. There is occasional scrutiny and criticism, but press coverage of foundations is overwhelmingly positive. For their philanthropic endeavors, Bill and Melinda Gates and Bono were *Time*'s People of the Year in 2005. Recent Gallup polls routinely name Bill Gates and Warren Buffett among the 10 most-admired Americans.

Political scientists should pay more attention to philanthropists. These actors deserve our scrutiny rather than automatic gratitude. One reason is that big philanthropy represents a type of plutocratic voice in democratic societies, private power directed at a public purpose. A second reason is that in an age of public–private partnerships and privatization of public services, we need to ask what role philanthropy should have in the funding or delivery of essential goods and services. Third and most important for political science, philanthropy is not—contrary to conventional opinion—the mere exercise of individuals' liberty to dispose of their resources as they please. Whether, when, to whom, and how much people give is partly a product of laws that (1) govern the creation of nonprofit organizations, charitable trusts, and private and community foundations and define the rules under which these may operate; (2) set up special tax exemptions for philanthropic and nonprofit organizations and frequently allow tax exemptions for individual and corporate donations of money and property; and (3) enforce donor intent, often beyond the grave, creating philanthropic projects and entities that can exist—in principle—in perpetuity. Philanthropy is not an invention of the state but instead can be viewed as an artifact of the state.

This article focuses on a particular and peculiar philanthropic entity: the private foundation. Analogues of the contemporary philanthropic foundation can be found in antiquity, when endowments funded the creation and sustenance of public monuments and educational institutions, including Plato's Academy. However, the modern grant-making foundation in which private assets are set aside in a perpetual, donor-directed, tax-advantaged endowment with a fraction of the assets distributed annually for a public purpose is a recent institutional form, distinctly American, and no older than the early 20th century. By definition, it is a plutocratic entity representing the legal permission—indeed, tax-subsidized invitation—for large wealth to play a consequential role in public life. What could confer legitimacy on such an entity in a democratic society?

Such entities were viewed with great skepticism 100 years ago. The private foundation as we know it today is a creation of the first Gilded Age, in which Andrew Carnegie, John Rockefeller, and others amassed enormous fortunes and sought an institutional arrangement that would permit wide latitude in giving money away for public purposes. For most of the 19th century, creating a foundation at one's private initiative with one's private wealth was not possible; formal authorization and incorporation by a democratic body was necessary.

Rockefeller's fortune was so large, and the man so unpopular, that when he sought in 1912 a federal charter to incorporate the Rockefeller Foundation with a general-purpose mission to benefit mankind, he encountered fierce resistance. Testifying before the Commission on Industrial Relations

  doi:10.1017/S1049096516000718

in 1912, the Reverend John Haynes Holmes, a well-known Unitarian minister who served as the board chair of the American Civil Liberties Union, said:

> I take it for granted that the men who are now directing these foundations—for example, the men who are representing the Rockefeller foundation—are men of wisdom, men of insight, of vision, and are also animated by the very best motives. . . [M]y standpoint is the whole thought of democracy. . . From this standpoint it seems to me that this foundation, the very character, must be repugnant to the whole idea of a democratic society." (Commission on Industrial Relations 1912, 7916)

The chairman of the Commission on Industrial Relations, Senator Frank Walsh from Missouri, opposed not only Rockefeller's foundation but also all large foundations. Walsh challenged "the wisdom of giving public sanction and approval to the spending of a huge fortune thru such philanthropies as that of the Rockefeller Foundation. My object here is to state, as clearly and briefly as possible, why the huge philanthropic trusts, known as foundations, appear to be a menace to the welfare of society" (Walsh 1915, 213).

In Holmes's and Walsh's view, foundations were a deeply antidemocratic institution, entities that exist in perpetuity and exercise significant and unaccountable power. This view has no resonance today; yet, it deserves to be taken seriously—especially by political scientists concerned with the well-being of democracy.

What Carnegie and Rockefeller were to the early 20th century, Gates and Buffett (and their fellow Giving Pledge signatories) are to the 21st century. The last decade of the 20th century witnessed the creation of unprecedentedly large foundations such as the Gates Foundation. It is not only billionaires and their megafoundations that command attention. The last two decades also witnessed a boom in millionaires that fueled unprecedented growth in small foundations, in both number and assets. Private foundations are no longer controversial; they are mundane.

Should democratic citizens welcome this development? Are foundations repugnant to the idea of democracy, as the Reverend Holmes thought? As political scientists and theorists, we need to ask what role foundations should play in a democratic society.

The following discussion provides one answer to this question. I first explain in greater detail why the private foundation is an institutional oddity in a democracy. I then argue that despite many antidemocratic features, the modern foundation is not incompatible with democracy. When foundations operate in support of what I call "discovery"—an experimentalist approach to funding and assessing long-time-horizon policy innovations—they can be important contributors to democratic societies, thereby gaining a significant measure of democratic legitimacy. Private wealth can be domesticated to serve democratic purposes.

However, the modern grant-making foundation in which private assets are set aside in a perpetual, donor-directed, tax-advantaged endowment with a fraction of the assets distributed annually for a public purpose is a recent institutional form, distinctly American, and no older than the early 20th century.

INSTITUTIONAL ODDITIES

The private foundation lacks meaningful accountability, allows a donor-directed mission in perpetuity, and is generously tax-subsidized.

Foundations Lack Accountability

In the commercial marketplace, when companies fail to make a profit because consumers opt not to purchase their goods, they go out of business. If consumers do not like what a company produces, they do not buy it; if most consumers think this way, the company disappears. This is the accountability logic internal to the marketplace: meeting consumer demand.

In the public institutions of a democratic state, officials responsible for allocating tax dollars must stand for election. If citizens do not approve of the spending decisions of their representatives, they can elect replacements. This is the accountability logic internal to democracy: responsiveness to citizens.

By contrast, foundations have no market accountability; they have neither goods for sale where consumer behavior nor marketplace competitors whose superior performance can push them out of business. Instead of selling a product, foundations give money away to other organizations, whose own livelihood frequently depends on continuing support from foundations. If citizens do not like their grant-making decisions, there is no recourse because there is nothing to buy and no investors to hold the foundations accountable. Moreover, foundations have no electoral accountability: no one stands for election, regardless of what the public thinks about the distribution of a foundation's grants. If we do not like what the Gates Foundation is doing, there is no mechanism to un-elect Bill and Melinda Gates, which is why critic Diane Ravitch called Bill Gates the nation's "unelected school superintendent" (see Reckhow, this issue).

Foundations do have certain minimal obligations of procedural accountability. In the United States, a "payout" rule requires that foundations disburse five percent of their assets every year (although administrative costs count toward this payout). There also is a requirement to file an annual tax form with basic data about foundation trustees, employees and their salaries, and assets. However, this is far from substantive accountability. Without constituents, consumers, and competitors, wealthy people are free to set up foundations for any purpose, with whatever money they wish, and continue to hew to this purpose—regardless of the outcome of the foundation's grant making.

Moreover, foundations have no electoral accountability: no one stands for election, regardless of what the public thinks about the distribution of a foundation's grants.

The lack of any accountability is compounded by the difficulty foundations have in developing mechanisms to generate honest feedback from grantees. Generally, people who interact with foundations are supplicants, seeking a grant or seeking the next grant; there is little incentive for a potential or actual grantee to offer critical feedback. People who become foundation officers are famously surprised to find themselves transformed overnight into the smartest and best-looking people in any room.

Donor-Directed Purpose in Perpetuity

Foundations are legally designed to enshrine donor intent and protect philanthropic assets in perpetuity. Laws defining a foundation allow the donor to control its governance and purpose, even beyond a donor's death. Foundations must be governed by a board of trustees, but donors and their family or trusted associates can serve in this role; there is no requirement of community or public governance. The board of the Gates Foundation, for example, is composed of Bill and Melinda Gates, Bill Gates, Sr., and Warren Buffett. The governance arrangements of countless smaller family foundations are similar. Financial advisors routinely market their services in setting up a family foundation as a vehicle for the intergenerational transmission and sustenance of family values.

Of these arrangements, the legal theorist and judge Richard Posner observed, "A perpetual charitable foundation…is a completely irresponsible institution, answerable to nobody. It competes neither in capital markets nor in product markets…and, unlike a hereditary monarch whom such a foundation otherwise resembles, it is subject to no political controls either. The puzzle," he wondered, "is why these foundations are not total scandals" (Posner 2006).

Foundations Are Generously Tax-Subsidized

The foregoing discussion might be understandable, if not necessarily justifiable, if foundations were simply one way for the wealthy to exercise their liberty: some choose to consume their wealth; others choose to provide gifts and bequests for heirs; and still others choose to give their money away for a philanthropic purpose. Why demand accountability for the philanthropists? One answer is that foundations are not simply exercises of personal liberty.

In his 2002 book, *American Foundations*, Mark Dowie related an instructive anecdote about the Open Society Institute (OSI), one of several foundations set up by financier George Soros. During a meeting to resolve a disagreement about grant-making priorities, Soros allegedly announced, "This is my money. We will do it my way." A junior staff member interjected that roughly half of the money in the foundation was not his money but rather the public's money, explaining, "If you hadn't placed that money in OSI…about half of it would be in the Treasury" (Dowie 2002, 247).

Philanthropy in the United States is not just the voluntary activity of a donor. Philanthropy in general, including the creation of foundations, is generously tax-subsidized. The assets transferred to a foundation by a donor are left untaxed in two respects: (1) donors make their donations (more or less) tax-free, diminishing the tax burden they would face in the absence of the donations; and (2) the assets that constitute a foundation's endowment, invested in the marketplace, also are (more or less) tax-free.

Why provide a subsidy for the exercise of a liberty to donate money that people already possess? We can imagine various possible justifications for a subsidy—most prominent is the idea that a tax incentive will stimulate more philanthropy, more and larger foundations, and therefore more public benefits, than would occur without the subsidy.

Whether this is true is an empirical question; if it is so, whether this constitutes a good justification for providing a subsidy is a normative question. My intent is to answer neither question here. Instead, I assert only that the existence of foundations is not correctly seen as the product of the exercise of people's liberty to establish a foundation. Foundations *are* created voluntarily and yet they also are the product of public subsidies—the loss of funds that would otherwise be tax revenue—to subsidize their creation. (In 2014, tax expenditures for charitable giving cost the U.S. Treasury more than $50 billion.) So foundations do not simply express the individual liberty of wealthy people. Citizens pay in lost tax revenue for foundations and, by extension, for giving public expression to the preferences of rich people.

With few or no formal accountability mechanisms, practically no transparency obligations, a legal framework designed to honor donor intent in perpetuity, and generous tax breaks to subsidize the creation of a foundation, what makes foundations compatible with democracy? By definition and by law, they seem to represent the expression of plutocratic voices directed toward the public good. Yet why, in a democracy, should the size of one's wallet give a person a greater voice in the public good? Why should this plutocratic voice be subsidized by the public? Why should democracy allow this voice to extend across generations in the form of tax-protected assets? It seems that foundations are a misplaced plutocratic and powerful element in a democratic society.[1]

THE CASE FOR FOUNDATIONS: DISCOVERY

Because conventional opinion is broadly supportive of foundations and their work, I previously developed a strong case for skepticism that foundations are a complement to democracy. Now I develop a redemptive argument that foundations can complement and support democratic institutions. The argument rests on the idea that foundations can operate on a different and longer time horizon than businesses in the marketplace and elected officials in public institutions, taking risks in social-policy experimentation and innovation that we should not routinely expect in the commercial and state sectors. I call this the *discovery argument*.

This argument is not intended to justify the full range of legal permissions currently afforded to foundations. I am particularly skeptical that it is possible to defend the legal permission for a foundation to exist in perpetuity. I also am skeptical that the array of tax incentives attached to philanthropy today is necessary for the creation and sustenance of foundations. I present the general cast of an argument on behalf of foundations that deflects the criticism that they are misplaced in democratic societies and that confers on them a high degree of autonomy, a relative lack of accountability, and offers a case for some type of subsidy. The idea is that foundations can serve as a potent mechanism for democratic experimentalism—that is, a discovery vehicle for innovative social policy.

I begin with an uncontroversial supposition: citizens of a democratic state want to advance general welfare or to pursue the aims of justice, however understood. Democratic representatives do not know the best means for achieving these aims, either at any given moment or, especially, with the uncertainties that obtain as social conditions change over time. What types of policies and programs, for instance, will best promote educational opportunity and achievement? Some believe universal preschool is the answer; others, a better school-finance system; and others, better and more pervasive opportunities for online learning. Examples easily multiply. What types of policies will best reduce recidivism rates in prisons or in substance-abuse programs? Or, consider environmental policy: What types of changes will reduce carbon emissions with the lowest cost to economic growth?

A democratic society—recognizing that its leaders are not all-knowing, that reasonable disagreement about the best means to pursue just ends is likely, and that social conditions are always evolving—might want to stimulate and decentralize experimentation in social policy so that better and more effective policies at realizing democratically agreed-on aims can be identified and adopted. Moreover, this need for experimentation is never-ending. In light of constant change in economic, cultural, technological, and generational conditions, the discovery process—in ideal circumstances—is cumulative in contributing to society a storehouse of best, or simply effective, practices for different contexts and shifting priorities.

To be sure, a democracy can stimulate experimentation and risk-taking innovation on its own. It can invest, for example, in basic research with uncertain outcomes. It can develop federal structures of government that treat jurisdictional subunits as laboratories of policy experimentation—hence, Justice Louis Brandeis's famous description of American states as "laboratories of democracy." Democratic governance has good reason to be experimentalist, to approach policy and institutional design as a form of problem solving.

Philanthropy in general, including the creation of foundations, is generously tax-subsidized.

Such approaches notwithstanding, political leaders would also be right to harbor skepticism that government is ideally suited to carry out such experimentation. Citizens in a democratic system tend to expect tested and reliable outcomes in public policy. Elected representatives who allocate public funds to highly risky strategies for social problems—in the sense that the selected policy may fail in delivering any benefits—also run the risk of being punished at the ballot box. Furthermore, wasteful government spending tends to be deplored; yet, experimentation requires that some experiments fail if the approach is to deserve the label "experimentation."

What extragovernmental mechanisms, then, could be designed to carry out decentralized innovation and experimentation? My claim is that foundations can be one mechanism among others for this discovery procedure. An essential feature of the discovery argument focuses on the *time horizons* involved with innovation and risk-taking in the marketplace and public institutions of the democratic state. Unlike profit-driven businesses, foundations are not subject to quarterly or annual earnings reports, bottom-line balance sheets, or impatient investors or stockholders. Commercial entities in the marketplace do not have an incentive structure that systematically rewards high-risk, long-time-horizon experimentation; they must show short-term results to stay in business. Similarly, public officials in a democracy do not have an incentive structure that rewards high-risk, long-time-horizon experimentation; they must show short-term results from the expenditure of public dollars to stand a strong chance of re-election.

Dennis Thompson (2010) casts the issue somewhat differently by identifying one problem of democratic societies as a structural difficulty in representing the interests of future generations. He calls this the problem of "presentism"—that is, democracy's systematic and pervasive bias in favor of the present. He identifies several sources of this bias, including the fact that, as behavioral psychology has taught us, humans tend to favor the present and short term over the distant and long term. Moreover, democratic governments are designed to be responsive to citizens' preferences, so we can expect governmental policies in democratic societies to favor the present and short term. In the face of undeniable problems (e.g., climate change) that will confront future generations, democracy's presentism is a major liability.

Thompson's preferred solution to combat democracy's presentism is democratic trusteeship: the idea that present generations can represent the interests of future generations by acting to protect the democratic process over time. I agree but propose that foundations also are a valuable institutional design for the protection of the democratic process over time.

Unlike profit-driven businesses, foundations are not subject to quarterly or annual earnings reports, bottom-line balance sheets, or impatient investors or stockholders.

Foundations—precisely because of their governance structure—can fund experiments and innovation where the payoff (if it comes) is over the long haul, benefiting future rather than present generations.

The institutional design of foundations allows them to operate on a different time horizon than the marketplace and the government. Because their endowments are designed to exist intergenerationally, foundations can fund higher-risk social-policy experiments. They can use their resources to identify and address potential social problems decades away or innovations the success of which might be apparent only over a longer time horizon. In short, unlike the marketplace and the state, foundations can "go long." They can be the seed capital behind one important discovery procedure for innovations in effective social policy in a democratic society. When they operate in this mode, foundations are not merely compatible with but can enhance democratic purposes.

What becomes of a foundation-funded innovation after it has been evaluated? Failed innovations and experiments die, and society presumably has learned something from the failure. Others may take up and modify the failures and generate positive results. Other foundation projects succeed in showing positive effects. From the perspective of a foundation, success in its philanthropic giving consists not in funding social-policy experiments and then sustaining forever the most successful of them. Rather, because the assets of even the largest foundations are dwarfed by the assets of the marketplace and the state, success consists in seeing the successful or proven policy innovations "scaled up" by the commercial marketplace or by the state.

In this discovery model, foundations gain their democratic legitimacy by providing funding for policy experiments that (to use Eric Beerbohm's apt term) "audition" for the "stamp of approval" by a democratic public (Beerbohm forthcoming). A foundation project that was initially privately funded and democratically unaccountable auditions for adoption as a publicly funded and democratically accountable government responsibility.

In the United States and elsewhere, how well do foundations perform when measured against the discovery standard? This is a question for empirical researchers to explore. In conclusion, I hazard a few guesses. To be sure, some of the greatest accomplishments of American foundations fit this model: the creation of public libraries by Andrew Carnegie and the emergence of microlending. These are all the result of foundation-funded innovations brought to scale by either the state or the marketplace.

However, many prominent foundation observers—including several who are friends of foundations—believe that foundations are underperforming. Gara LaMarche, who spent more than 15 years at two of the world's largest foundations, thinks that foundations tend to be risk-averse rather than risk-taking. "Courageous risk-taking is not what most people associate with foundations," he wrote, "whose boards and senior leadership are often dominated by establishment types. If tax preference is meant primarily to encourage boldness, it doesn't seem to be working" (LaMarche 2014, 55).

Perhaps the critics are correct. If so, then so much the worse for foundations as well as for the distinctive institutional privileges that currently attach to them. My aim is not to defend the actual behavior and performance of foundations but rather to identify the right standard by which to evaluate them. I provide an argument about the purpose of foundations in a democratic society, about why a democracy would opt to create something as odd as the institutional form of a foundation. This article counters the idea that foundations are essentially repugnant to democracy.[2] ■

NOTES

1. We can quickly reject one common idea to justify foundations: that they provide welcome assistance in meeting the needs of the poor or disadvantaged, thereby defraying what might otherwise need to be spent by the public. Giving for basic needs represents a surprisingly small percentage of foundation activity, on the order of 10%. Furthermore, the greater the size of assets in a foundation, the smaller the percentage of grants intended to meet basic needs (Reich 2013).
2. This article draws on material from my post *"What are Foundations For?"* in Boston Review (2013) at https://www.bostonreview.net/forum/foundations-philanthropy-democracy.

REFERENCES

Aristotle, *Nicomachean Ethics*, Book 2, Section 9.

Beerbohm, Eric. Forthcoming. "The Free Provider Problem: Private Provision of Public Responsibilities." In *Philanthropy in Democratic Societies*, ed. Rob Reich, Lucy Bernholz, and Chiara Cordelli. Chicago: University of Chicago Press.

Commission on Industrial Relations. 1912. "Final Report and Testimony Submitted to Congress by the Commission on Industrial Relations created by the Act of August 23, 1912amprdquosemicolon: 7916–17.

Dowie, Mark. 2002. *American Foundations.* Cambridge, MA: MIT Press.

LaMarche, Gara. 2014. "Democracy and the Donor Class." *Democracy: A Journal of Ideas* 34: 48–59.

Posner, Richard. 2006. "Charitable Foundations: Posner's Comment." Becker-Posner Blog, December 31. Available at www.becker-posner-blog.com/2006/12/index.html (accessed December 1, 2015).

Reich, Rob. 2013. "Philanthropy and Caring for the Needs of Strangers." *Social Research* 80 (2): 517–38.

Singer, Peter. 1972. "Famine, Affluence, and Morality." *Philosophy and Public Affairs* 1 (3): 229–43.

——. 2009. *The Life You Can Save.* New York: Random House.

——. 2015. *The Most Good You Can Do: How Effective Altruism Is Changing Ideas about Living Ethically.* New Haven, CT: Yale University Press.

Thompson, Dennis. 2010. "Representing Future Generations: Political Presentism and Democratic Trusteeship." *Critical Review of International and Political Philosophy* 13 (1): 17–37.

Walsh, Frank P. 1915. "Perilous Philanthropy." *The Independent* 83: 262–4.

APSA Congressional Fellowship for Political Scientists

Apply This Fall for the 2017–2018 Fellowship Year

Apply This Fall!

Since 1953, the APSA Congressional Fellowship Program has brought more than 2,200 scholars and professionals to Washington, DC, to gain a hands-on understanding of Congress and the legislative process. Fellows begin their fellowship year with a comprehensive four-week orientation with leading congressional experts and policy leaders. Fellows then serve full-time placements of their choosing in the House of Representatives or Senate.

The fellowship year also includes:

- *Winter and spring seminar series on Congress*
- *A trip to the district or state of a Member of Congress*
- *Optional study visits to Annapolis, Maryland, and Ottawa, Canada*

QUALIFICATIONS: Applications are welcome from political scientists who have completed a PhD in the last 15 years or will have defended a dissertation in political science by November 2017. Candidates must be US citizens or permanent residents. The program is open to scholars in all subfields of political science who can show a scholarly interest in Congress and the legislative process.

FELLOWSHIP YEAR: Orientation begins in November 2017. Office assignments run until August 15, 2018. Two optional programs precede the main fellowship year. Candidates may apply to take a course on Congress and Foreign Policy taught in September and October 2017, as well as apply to spend up to two months as a Visiting Scholar at the APSA Centennial Center, supported by the William A. Steiger Fund for Legislative Studies, also immediately before the main fellowship year.

STIPEND: $50,000 for the 9.5-month fellowship period, plus a travel allowance.

SELECTION: Preference is given to those who have not had extensive Capitol Hill experience.

APPLICATION PROCEDURE: The application period opens in September 2016, and applications are due December 1, 2016. Applications must be submitted online and include:

- a detailed CV
- a 500-word personal statement explaining how the fellowship relates to professional goals
- the names and contact information for three professional references who have agreed to write letters of recommendation
- a writing sample

Applications available online this fall.
Learn more at www.apsanet.org/cfp

1527 NEW HAMPSHIRE AVE., NW, WASHINGTON D.C. 20036-1206 • **www.apsanet.org**