

**PUBLIC PHILANTHROPY?:  
THE UNPERSUASIVE CASE FOR MORE  
GOVERNMENT CONTROL**

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WLF

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In 2001 Dr. Lenkowsky was confirmed by the United States Senate as chief executive officer of the Corporation for National and Community Service, a position he held until 2003. He has served as president of the Hudson Institute, president of the Institute for Educational Affairs, deputy director of the United States Information Agency, research fellow at the American Enterprise Institute, and research director of the Smith Richardson Foundation. He is a fellow of the National Academy of Public Administration.

# **PUBLIC PHILANTHROPY?: THE UNPERSUASIVE CASE FOR MORE GOVERNMENT CONTROL**

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## **INTRODUCTION**

We are witnessing the most aggressive challenge in 80 years to the idea that the private sector is largely capable of running its affairs without government intervention. Though the results are most evident in the fields of business and finance, the challenge is also underway in the non-profit sector.

It starts by claiming that charitable organizations, including both foundations that make grants to other non-profit organizations and non-profits that provide goods and services, are not adequately serving the public and its priorities. And it concludes by advocating a variety of measures, including specific changes in the legislation and administrative rules that regulate charities, directing them to act in ways that meet public expectations, as defined by government officials or interest groups.

This challenge has already produced changes in public policies and the practices of many organizations. More such proposals are likely to come in the next few years. Yet, both conceptually and factually, the criticisms leveled against the

non-profit sector are shaky. Moreover, they are premised on an assumption—that charities best serve the public by targeting their efforts on the needy—that the history of American philanthropy has proven false.

## **I. THE ARGUMENT FOR PUBLIC CONTROL**

A recent and widely publicized report by the activist group National Committee for Responsive Philanthropy (NCRP), titled *Criteria for Philanthropy at Its Best: Benchmarks to Assess and Enhance Grantmaker Impact*, provides a good example of the charges against the non-profit sector, and particularly, grant-making foundations.

The report asserts that “foundation dollars should be viewed as ‘partially public dollars.’” It explains why: “The generous tax subsidies provided to donors and to foundations make the government and the public partners with philanthropists.”

Speaking for the “public partners,” NCRP sets out a series of “benchmarks” by which we should measure the performance of grant-making foundations. These benchmarks cover areas including the governance and ethics of foundations, the relationships that grant-makers should have with their grantee organizations, and the obligations of foundations toward particular racial, ethnic, economic, and gender groups. The benchmarks raise serious issues, and almost all of them would require changes in the way many foundations operate.<sup>1</sup>

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<sup>1</sup>For example, one benchmark would require foundations to make annual grants amounting

The benchmarks that would seemingly require the most dramatic changes involve issues of “social justice.” According to NCRP, a grant-making foundation should use at least 50% of its grant dollars “to benefit lower-income communities, communities of color and other marginalized groups;” it should spend at least 25% of its grant dollars on “advocacy, organizing and civic engagement to promote equity, opportunity and justice;” and it should have a board of “at least five people who include among them a diversity of perspectives—including of the communities it serves.”

NCRP’s report concludes that most foundations fall far short of these benchmarks. For example, the report finds that only 33.2% of the grant dollars of large foundations are spent on “intended beneficiary groups NCRP identified as marginalized or vulnerable.” NCRP defines these groups as the “economically disadvantaged, racial or ethnic minorities, women and girls, people with AIDS, people with disabilities, aging, elderly, and senior citizens, immigrants and refugees, crime/abuse victims, offenders and ex-offenders, single parents, and LGBTQ citizens.”<sup>2</sup> The report finds these data “[e]ven more disturbing” because

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to at least 6% of their assets, more than the 5% currently required by the Internal Revenue Service, which is the standard met by most large foundations.

<sup>2</sup>The LGBTQ Resource Center of Brown University defines the term as standing for “lesbian, gay, bisexual, transgender, queer and questioning.”

NCRP research “has suggested that smaller foundations provide significantly lower percentages of their grant dollars for the intended benefit of vulnerable communities.” Similarly, the report concludes that only 12% of grant dollars go to “social justice philanthropy” and that 87% of foundation board members are white.

NCRP wants government to use its benchmarks and data to make policy aimed at charitable organizations. “Policymakers will find the benchmarks and the mapping of current practices informative,” the report puts it, “when considering issues related to philanthropy.” Additionally, the report issues a warning: If foundations don’t do a “better job of regulating themselves,” and “if more grantmakers don’t demonstrate their relevance to nonprofits and marginalized communities by meeting the benchmarks, . . . the likelihood of more government regulation of the sector will increase.”<sup>3</sup>

## **II. ARE FOUNDATION ASSETS “PARTIALLY PUBLIC DOLLARS?”**

NCRP’s position—its claim of broad public obligations on the part of foundations and broad public rights to enforce these obligations—is based on the assertion that because of the tax benefits enjoyed by foundations and their donors, foundation assets are “partially public dollars” and government and the public are “partners” with foundations in spending these dollars. Considerable scholarship has challenged this assertion. Most recently, for example, in *How Public Is Private*

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<sup>3</sup>NCRP has long advocated legislation to increase in the amount foundations are required to spend annually.

*Philanthropy? Separating Reality from Myth*,<sup>4</sup> Evelyn Brody and John Tyler evaluate the arguments for viewing philanthropic assets in whole or in part as “public dollars” or “public money.” The most prominent of these arguments states that because charitable organizations are generally exempt from federal income tax and their donors may deduct their contributions when computing their taxable income, government foregoes tax money; in budget parlance, this is called a “tax expenditure,” to distinguish it from better-known types of public support, such as grants and contracts.<sup>5</sup> In this view, just as with spending programs, tax expenditures enable government to subsidize, in this case, charitable organizations, and thus give it the right to determine or set limits to their missions, governance, and use of resources.

Brody and Tyler, in a detailed examination of the relevant legal authorities, say this argument misstates the basis of the charitable exemption and deduction. They note that although the legislative explanations for exemptions and deductions

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<sup>4</sup>Published by Philanthropy Roundtable (2009). Co-author Evelyn Brody is a professor at the Chicago-Kent College of Law, Illinois Institute of Technology, and immediate past president of the Nonprofit and Philanthropy Law Section of the Association of American Law Schools. Co-author John Tyler is general counsel, secretary, and chief ethics officer of the Ewing Marion Kauffman Foundation

<sup>5</sup>The concept of a “tax expenditure” is a recent one, introduced to U.S. tax policy in 1967 by Stanley S. Surrey, a Harvard law professor, who served as Assistant Secretary of the Treasury for Tax Policy in the Kennedy administration. The Joint Committee on Taxation, in a recent report, notes that tax expenditure analysis “has been undercut substantially by the depth and breadth of the criticisms leveled against it” and proposes to restore its usefulness by dividing tax expenditures into two new categories: “Tax Subsidies” and “Tax-Induced Structural Distortions.” *A Reconsideration of Tax Expenditure Analysis* (JCX-37-08), May 12, 2008.

are very sparse, there is evidence of a number of goals behind the federal tax treatment of charities.

One goal, undeniably, is subsidy. But Brody and Tyler also note that to the extent the federal tax benefits to charities were meant to be subsidies, the “bargain” underlying these subsidies—the obligations that charities must fulfill in exchange for their tax benefits—is set out in law. The Internal Revenue Code requires charities to be dedicated to broadly defined charitable purposes and to abstain from certain kinds of political activity. There is virtually no evidence that the bargain provides the public with authority to determine the specific purposes of charities, their particular beneficiaries, or their arrangements for governing themselves.

Federal tax policy toward charities has other goals as well. One is to define the tax base properly: that is, one reason for not taxing the assets of charities is that these assets are thought to lie outside the bounds of taxable income, since they are not used for activities aimed at making and distributing profits. Another is to regulate the behavior of people who manage charities, so that they will not misuse the resources of these organizations for personal gain. A final goal is to set boundaries between the non-profit activities of charities and the for-profit activities of businesses and individuals in order to curtail tax-avoidance.<sup>6</sup>

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<sup>6</sup>The definitive discussion of these goals can be found in John Simon, Harvey Dale, and Laura Chisolm, “The Federal Tax Treatment of Charitable Organizations,” in Walter W. Powell and Richard Steinberg, *The Non-Profit Sector: A Research Handbook*, Yale University Press, 2006, at 267-306.

A voluminous body of laws, administrative rulings and court decisions spells out—often in excruciating detail—the requirements organizations need to fulfill in order to meet each of these goals and reap the tax benefits of being charities. But these rules generally give wide latitude to non-profits with regard to what they do and how they do it, as long as they refrain from using their assets chiefly for the private gain of any individual.

In sum, in the view of Brody and Tyler and many other authorities, when “public money” advocates maintain that the tax benefits enjoyed by charities give the public a controlling interest in their work, they do so without a proper legal foundation. Thus, NCRP’s claim that “generous tax subsidies . . . make the government and the public partners with philanthropists” states a political program, not a historical or legal fact.

### **III. WHAT PORTION OF FOUNDATION GRANTS BENEFITS THE UNDERSERVED?**

The charge that donors—and particularly, foundations—are doing little to help the needy is difficult to verify. This is partly because information about the more than \$300 billion Americans now give to charities each year is widely scattered among more than a million non-profit organizations, rather than collected in a way that would readily permit identifying who really benefits from their activities.<sup>7</sup> As a result, estimates of how much of this money assists the poor—or

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<sup>7</sup>*Giving USA*, the most authoritative annual survey of philanthropy in the United States, uses broad categories of recipients, such as religion or education.

any other group—are necessarily based on extrapolations using whatever data are available (such as the incidence of poverty in a particular location) and thus, inevitably debatable. In addition, charities often conduct a variety of activities and serve many types of people. Even gifts to Harvard University or the local performing arts center may confer benefits that go far beyond their wealthy patrons.

However, in a recent report titled *Broad Benefits: Health-Related Giving by Private and Community Foundations*,<sup>8</sup> economist Phillip Swagel has tried to scrutinize another element of NCRP’s argument: its claim that only 33.2% of the grant dollars of large foundations are spent on “intended beneficiary groups NCRP identified as marginalized or vulnerable.”

NCRP reached this conclusion on the basis of a sample provided by the Foundation Center, an organization that maintains a database of foundations and their grants.<sup>9</sup> Some foundations provide the Foundation Center with information about their grants; for other foundations, the Foundation Center collects information about grants from the foundations’ IRS Forms 990-PF. When the available information about a grant includes the “intended beneficiary,” the Foundation Center inputs the information in an “intended beneficiary” field under one or more codes—for example, a code for children or men, for a racial or ethnic

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<sup>8</sup>Published by The Philanthropic Collaborative (2009).

<sup>9</sup>Foundations account for about 13 percent of gifts to charities in the United States.

minority group or for people with disabilities. When the Foundation Center does not have this information, it leaves the “intended beneficiary” field blank.

If the Foundation Center did not specifically code a grant as intended to benefit a disadvantaged group, the NCRP report did not count the grant as benefiting any disadvantaged group. The report acknowledges that because of this limitation, there “likely are many more foundations that prioritize special populations.” But it does not attempt to correct for this limitation in arriving at the 33.2% figure for large foundations and, indeed, calls the number “even more disturbing” because the performance of smaller foundations is probably worse.

Swagel, like the NCRP, used Foundation Center data as the basis for his analysis. Looking at grants in the health-care field, he found that 31.4% were coded as intended to benefit an under-served group, while the remaining 68.6% were not (we will call them “non-coded” grants).<sup>10</sup> For a sample of the non-coded grants, he performed a grant-by-grant analysis of the location of the grantee organization and the types of activity that the grant supported.

One example is a grant to the Juvenile Diabetes Foundation (JDF), a national organization that combats Type 1, or juvenile, diabetes. Swagel used national demographic data on the percentages of children under 18 who are minority-group members and the percentages of children whose families have incomes of 200%-or-

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<sup>10</sup>Swagel’s non-coded grants included grants with no coding at all and those coded as intended to benefit non-disadvantaged groups. Grants that were coded as intended to benefit women, the elderly, or children were counted as intended to benefit “disadvantaged or vulnerable” in the NCRP analysis, but Swagel did not count them as such; instead, for the sake of caution, he counted them as “non-coded” grants and performed an individual analysis of each of them.

less<sup>11</sup> of the federal poverty line. He assumed, on the basis of nation-wide health data, that a minority-group child was only half as likely as a non-minority-group child to have Type 1 diabetes. Using these assumptions, Swagel estimated that 36.4% of the grant should be counted as benefiting underserved groups, rather than none of it, as the Foundation Center had done because of the JDF's unrestricted national reach.<sup>12</sup>

A contrasting example is a grant to La Rabida Children's Hospital, which focuses on treating children with chronic illnesses (including asthma, diabetes, and sickle cell disease) or developmental disabilities or who are victims of abuse. The hospital describes its mission as providing care to children regardless of ability to pay. According to the hospital's 2008 annual report, around 90% of its net patient revenue came from Medicaid reimbursements. The patients are 80% African-American, 10% Caucasian, 6% Hispanic, and 4% "other." Although the Foundation Center had categorized this grant as serving children and youth generally, Swagel counted 100% of it as benefiting disadvantaged groups.

Swagel emphasizes the definitional problems and ambiguities in this type of analysis. "There are no easy answers," he sums up, "but only shades of gray." In his overall determination of the percentage of non-coded grants that in fact benefit

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<sup>11</sup>Swagel also performed alternative analyses on the basis of incomes of 100%-or-less and 300%-or-less of the federal poverty line.

<sup>12</sup>In fact, "juvenile" diabetes may have an adult onset; and research into Type 1 diabetes, which is more prevalent among whites, may have consequences for the treatment of Type 2 diabetes, whose distribution more heavily non-white. These are two of the many "challenges" that Swagel describes.

under-served populations, he arrives at a range of estimates—from 46.9% to 64.1%, with a “medium” estimate of 53.4% based on a definition of “economically disadvantaged” as 200% or less of the federal poverty line. Combining 53.4% of non-coded grants with the 31.4% of grants that were specifically coded as intended to benefit underserved groups, Swagel estimates that 68.0% of the health-care grant dollars in the Foundation Center’s data-base benefited under-served populations.<sup>13</sup>

What similar analyses might show for other areas of foundation grant-making, such as education or human services, has yet to be determined.<sup>14</sup> But Swagel’s analysis of health-care funding suggests that the NCRP’s estimate of how much foundations help the under-served is likely too low and perhaps substantially so.

## **CONCLUSION: LESSONS FOR THE CURRENT POLICY DEBATES**

NCRP has replied to Brody and Tyler, saying, “Private institutions have a variety of stakeholders beyond the official ‘owners’ . . . .” Because foundations enjoy tax benefits, “other taxpayers make up the difference with higher rates, with the

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<sup>13</sup>31.4% of the health-care grants reported to the Foundation Center are specifically coded as intended to benefit under-served groups. Thus, the remaining 68.6% is made up of “non-coded” grants. 53.4% of these non-coded grants—that is, 36.6% of the entire data-base—are estimated to benefit under-served groups. This estimated 36.6% of grants, when added to the 31.4% that is specifically coded as intended to benefit under-served groups, equals 68.0%.

<sup>14</sup>In a study prepared for Google, Inc., the Center on Philanthropy at Indiana University estimated that 31 percent of all giving in 2005 (individual and corporate, as well as foundations) “focuses on the needs of the poor.” However, while it used a variety of methods to arrive at this estimate, it did not undertake Swagel’s kind of detailed analysis of how nonprofits actually use the gifts they received.

expectation that they will reap benefits in kind . . . . As investors in this country’s philanthropic institutions, taxpayers have a stake in the missions and successes of foundations.” Yet, in addition to the ambiguity of the term “stakeholders,” which can describe anyone from shareholders to creditors to community members to observers who are passionately interested, this response provides no useful guidance about what should be expected from foundations. As Brody and Tyler have shown, the legislative history and case law make clear that the institutional obligations of private philanthropy to the public cannot be summarized as directing funds to the group of people NCRP considers “marginalized or vulnerable.” Indeed, insisting on such a duty would mark a radical departure for American philanthropy.

NCRP has also responded to Swagel’s report. The response acknowledges the limitations of the Foundation Center data it used and the value of the kind of grant-by-grant analysis Swagel performed. However, it insists his results are just “illustrative, particularly given the subjectivity of the process of evaluating the additional grants.” Fair enough, and Swagel himself recognizes the gray areas in his results. But such uncertainties are all the more reason why claims that foundations are not doing enough for the under-served should be greeted skeptically and should not be used as an argument for changes in public policies or the practices of grant-makers themselves without considerably more examination.

NCRP’s report and Swagel’s are really asking two different questions. Swagel is concerned with “both the intended direct beneficiaries and the direct ‘incidental’ beneficiaries” of foundation grants—that is, with the question of who is actually

helped by these grants. In contrast, the NCRP report consistently refers to grants “intended to benefit” disadvantaged or under-served groups, what it oxymoronically calls “targeted universalism.” In order to be counted in Swagel’s numbers, you have to benefit under-served groups; to be counted in NCRP’s numbers, you have to aim straight at these populations rather than others.

These differences reflect a larger issue that divides not only philanthropic politics but public policy as a whole. NCRP and those who share its views believe that the best way to reduce inequality is through programs focused “on those with the least wealth and opportunity.” However, some of the most important ways philanthropy has assisted the needy resulted from programs aimed at benefiting Americans generally. Andrew Carnegie’s libraries, for example, might easily have been criticized by NCRP’s counterparts a century ago as helping only those who could read, undoubtedly the better-off among the population at the time. But in fact, these gifts created, as Carnegie had hoped, enormous opportunities for Americans from all backgrounds, not least of all the “huddled masses of the poor” (in Emma Lazarus’ famous description) arriving from other shores. One could compile an equally impressive list in every area of foundation funding.<sup>15</sup>

Arguments and numbers like those put forward by NCRP are meant to drive the philanthropic debate in the direction of NCRP’s goals. But apart from questions

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<sup>15</sup>In fact, this observation applies to public policy in general. Universal programs not targeted specifically to the poor, such as public education and Social Security, have inarguably done more to reduce inequality than many, if not most, government efforts directed explicitly at closing income and wealth gaps.

about the public's authority to require targeting, the real measure of foundation performance—as Swagel's report suggests—ought to be the help actually delivered to the under-served, rather than the NCRP's measure, which asks only how many resources are given to some groups rather than others. Those who value the contribution philanthropy makes to American society have the job of helping policymakers understand that proposals like the NCRP is offering are not only ill-founded but likely to render giving by foundations and others less effective.