LAW OUTSIDE THE MARKET:
THE SOCIAL UTILITY OF THE PRIVATE FOUNDATION

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INTRODUCTION ............................................................356
I.  A THEORY OF THE PRIVATE FOUNDATION ..........357
   A.  The Theory .....................................................358
   B.  Two Primary Functions of Foundations ..........358
II. THE EVOLUTION OF OPPORTUNITY IN AMERICA...362
III. THE PRIVATE FOUNDATION .................................366
   A.  Development of the Private Foundation ....367
   B.  The Importance of Donor Intent .................370
   C.  Foundations as Independent and
       "Out-Market" Institutions...............................371
       1.  Education .................................................373
       2.  Scientific Research ..................................375
       3.  Social Policy .............................................376
   D.  External Threats to Foundation
       Independence.................................................378
       1.  The Danger of Vested Interests ..............378
       2.  Political Threats ........................................379
       3.  Claiming Foundation Assets for the
           Public Purse .............................................387
IV. WHY A THEORY OF THE PRIVATE FOUNDATION? ...392

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INTRODUCTION

As the American private foundation moves into its second century of existence, the question of what theory guides its social utility looms as vitally important. At present, however, the foundation appears to lack any coherent theory of its role in society and the economy.1

The regulatory environment in which foundations operate, roughly circumscribed by the Internal Revenue Code and state “charity” statutes, offers the barest of precedent and understanding. The law is clear about the raison d’être of foundations, namely, to pursue “charitable purposes,”2 but offers little else. Faced with an array of insistent demands, the foundation lacks a clear sense of its normative standing in relation to other institutions. Moreover, its own conception of relevance is muddled and often defined by those who solicit its funds. In the absence of a coherent thesis, government, too, can impose expectations that may destroy the foundation’s ability to achieve the purposes for which it was conceived.

This Article argues that the private foundation, an institution of democratic capitalism, exists to strengthen and facilitate the mutually supporting American systems of democratic pluralism and a free-market economy. In this, foundations are circumscribed by donor intent and donor aspirations that they be purposeful, even as the objects of their efforts change through time.

Part One sets forth a theoretical framework to guide private foundations. Part Two recounts the evolution of the American economy and society over the past two centuries, connecting the vision of the entrepreneurial founders to their ongoing foundations. Part Three discusses the historical development of the private foundation, its nature as an institution, and presents illustrative examples of foundations supporting economic growth and human welfare. Part Three then concludes with a discussion of external threats facing the foundation today. Part Four explores the utility of a theoretical framework for foundations, and Part Five discusses the unique assets foundations bring to this task. The conclusion sets forth a new rule of presumptive continued private action for foundations based on an informal treaty among founders, trustees, and governmental oversight authority.

I. A THEORY OF THE PRIVATE FOUNDATION

Existing theories about the social utility of the private foundation inadequately explain its role in society, and previous attempts to promulgate a guiding theory have fallen short. Perhaps the two most prominent efforts to lay out visions of foundation philanthropy were the Peterson and Filer Commissions.

In 1969, John D. Rockefeller III formed the Commission on Foundations and Private Philanthropy, chaired by Pete Peterson, in response to a “gathering storm” in Congress regarding foundation regulation. The Commission’s report, however, was published after passage of the relevant legislation, blunting its impact.4

The Filer Commission, formally the Commission on Private Philanthropy and Public Needs, was chaired by John Filer and operated from 1973 to 1977. It was also formed by Rockefeller, but was fractured by dissent and resistance and failed to achieve Rockefeller’s mission of presenting “a bright new vision of philanthropy’s role in meeting social needs.”5

A. The Theory

Today, absent a consensus view of their social utility, foundations are variously said to be supporters of “social capital,” promoters of civil society, and providers of public goods.6 Some declare the “sole justification” of the private foundation to be sustenance of “the grant seekers.”7 In part because of their abstract generality, however, none of these proffered purposes succeeds in providing a coherent framework to guide foundations in the constantly shifting environment in which they exist.

If one examines the emergence of private foundations, their historical behavior, and their institutional character, a new conception of their social utility becomes clear. The private foundation is an institution inextricably linked to the workings of a free-market economy, and it exists to promote and preserve the democratic pluralism underlying that economic structure. With its enormous ability to advance these principles, a foundation’s efforts must be guided by donor intent and the injunction that it engage in purposeful activity: it must not actively or inadvertently work to subvert democratic capitalism.

B. Two Primary Functions of Foundations

As an institution born out of democratic pluralism and a free-market economy, the foundation fulfills two functions: it serves as a mechanism for the reconstitution of wealth, and it plays the role of institutional entrepreneur, challenging other social institutions.

5. BRILLIANT, supra note 3, at 129; see also COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, GIVING IN AMERICA: TOWARD A STRONGER VOLUNTARY SECTOR (1975) [hereinafter FILER COMMISSION REPORT].


A clear sensibility of usefulness runs through American history—of applying wealth and knowledge to create expanded opportunity and participation that will generate greater wealth and individual freedom. It is here that the private foundation plays an underappreciated but central role in our nation’s institutional framework as a mechanism of wealth reconstitution.

Once wealth is created in democratic capitalism, it can be directed to one of several outlets. First, wealth can vacate the system and tie itself up in building aristocratic dynasties. This runs against the grain of American sensibilities, however, and has rarely been the case, particularly when America is compared with European countries in this regard. Second, the government can place wealth in the control of the state through taxation. Although the government helps prevent the establishment of dynasties (through, for example, the estate tax), concentration of wealth in the state poses another set of problems.

Neither of these two options is desirable because both harm democratic capitalism. A better use of wealth is capital reinvestment, which strengthens the system’s infrastructure and results in innovation. This, in turn, leads to an expansion of wealth.

Finally, an equally important use of wealth is philanthropy, particularly the endowment of private foundations. This reconstitution is intended to apply wealth in ways that preserve democ-

8. The history of higher education in the United States, for example, clearly encapsulates this sensibility of usefulness and application. The creation of Harvard College in 1636, for example, was “absolutely essential” for the early American settlers because it would serve the purposes of shaping “leaders disciplined by knowledge and learning.” FREDERICK RUDOLPH, THE AMERICAN COLLEGE AND UNIVERSITY: A HISTORY 7 (1962).


10. “When government has the authority to redistribute wealth, that power will fall into the hands of powerful interest groups, which usually means wealthy and influential parties. The solution to this problem can only be to limit the state’s authority.” Timothy Sandefur, A Gleeful Obituary for Poletown Neighborhood Council v. Detroit, 28 HARV. J.L. & PUB. POL’Y 651, 674 (2003); see also MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965).
ratic pluralism and a free-market economy, thereby promoting the “release of human possibilities,”11 as intended by foundation donors.

The second essential social function performed by the private foundation is that of institutional entrepreneur. When describing the nature of progress and innovation, famed economist Joseph Schumpeter focused on the disruptive role of entrepreneurs. Because the institutional actors in any system will often tend toward equilibrium—Schumpeter’s static “circular flow”—an economy will regenerate and living standards will improve only when entrepreneurs disrupt that static equilibrium and the vested interests that accumulate along with it.12

Private foundations play this role in society. Creations of successful entrepreneurs who seek the reconstitution of wealth, foundations are conceived as having the particularistic entrepreneurial role of challenging other institutions to continuous renewal. In this way, foundations break the static equilibrium toward which social institutions gravitate and allow the economy’s welfare-generating capabilities to continue to expand efficiently and effectively.

This institutional disruption and resulting economic expansion also works to promote democratic pluralism. History has proven that diffusion of the benefits of progress occurs through neither the ministrations of “professionals” and “experts” nor the inexorable march of sweeping historical forces, but through the evolution and expansion of opportunity, expressed in the various and deliberate acts of individuals. Individual liberty and freedom lie at the heart of the American experiment, and American society has traditionally fostered the pluralism that preserves them. Frequently, this pluralism finds expression in

11. John W. Gardner, Foreword to Brian O’Connell, Civil Society: The Underpinnings of American Democracy, at xv (1999); see also Merle Curti, American Philanthropy and the National Character, 10 AM. Q. 420, 421–22 (1958) (“In general, however, there has been agreement that the American national character has emphasized practicality and efficiency; and that it has equated successful achievement with individual freedom, individual effort, individual responsibility and a wide variety of choices . . . . American philanthropy reflects the national character.”). The wealth created in democratic capitalism, through philanthropy, helps “build up the great social institutions that have a positive feedback on future economic growth.” Zoltan Acs & Ronnie Phillips, Entrepreneurship and Philanthropy in American Capitalism, 19 SMALL BUS. ECON. 189, 193 (Nov. 2002).

free-market economic activity that then reinforces individual liberty. Private foundations, which owe their existence to a regime of individual liberty and property rights, stand squarely within this tradition.

There appears to be a widespread sense, however, that many large foundations have, in the last few decades, retreated to small ideas and scaled down visions of their social utility. With some prominent exceptions, many have arguably missed the changes in our economy and society and the evolving needs and opportunities those changes present.

Most large foundations were established by entrepreneurs who changed the world with bold risk-taking in their business

13. In economic terms, this concept is illustrated by Francesca Chiaromonte and Giovanni Dosi, who developed a model in which some macroeconomic regularities, such as the growth in overall labour productivity, were the outcome of far-from-equilibrium interactions among heterogeneous, boundedly rational, agents . . . . They suggested that micro-heterogeneity was of paramount importance for the aggregate behaviour of the system. Behavioural and technological diversity among agents was a crucial ingredient of system dynamics . . . . They conjectured that micro-variety made innovation and change more likely and led to regular patterns of productivity and income growth. They recognized the importance of heterogeneity at the individual level, and noted that macro-order may arise not despite, but because of, such heterogeneity.


16. See infra Part IV.B.
practices and expected no less from their foundations. The courage to take risks and inspire progress remains at the core of foundations today, but the strategies used must evolve as the nature of social problems changes.

II. THE EVOLUTION OF OPPORTUNITY IN AMERICA

In democratic capitalism, the reinforcing characteristics of pluralism and a free-market economy create and expand opportunity. As Brian O’Connell notes, “business and free enterprise [are] pivotal factors in the development and effectiveness of our civil society.” Research, moreover, confirms that actions “consistent with expanding the economic freedom of individuals are the cornerstone of successful economic development policy.”

17. “From a social-class perspective, the big money that has gone into philanthropy has not been aristocratic or ‘old’ money on the whole but has come from the fruits of entrepreneurship and the efforts of mostly ‘self-made’ men.” WALDEMAR A. NIELSEN, THE GOLDEN DONORS: A NEW ANATOMY OF THE GREAT FOUNDATIONS 13 (1985). Will Kellogg, for example, “believed that a foundation’s role was not to serve merely as a vehicle to channel funds into ongoing charitable institutions. He encouraged his trustees to put the Kellogg Foundation’s resources behind pioneering ventures and new initiatives.” WALDEMAR A. NIELSEN, THE BIG FOUNDATIONS 112 (1972).

18. See, e.g., JIM COLLINS & JERRY I. PORRAS, BUILT TO LAST: SUCCESSFUL HABITS OF VISIONARY COMPANIES 8–9 (1994) (“A visionary company almost religiously preserves its core ideology—changing it seldom, if ever . . . . And the basic purpose of a visionary company—its reason for being—can serve as a guiding beacon for centuries . . . . Yet, while keeping their core ideologies tightly fixed, visionary companies display a powerful drive for progress that enables them to change and adapt without compromising their cherished core ideals.”).

19. See, e.g., RAY CAREY, DEMOCRATIC CAPITALISM: THE WAY TO A WORLD OF PEACE AND PLENTY 4 (2004) (“Democracy as a social philosophy means equal rights, equal responsibilities, and equal privileges for all; capitalism as an economic system means private ownership of production and distribution motivated and disciplined by competition. Democracy and capitalism become synergistic in democratic capitalism because they support and enhance each other. From democracy comes the involvement and participation of all; from capitalism comes the energy and resources to excel.”).

20. Gardner, supra note 11, at xvii.

21. Steven F. Kreft & Russell S. Sobel, Public Policy, Entrepreneurship, and Economic Freedom, 25 CATO J. 595, 596 (2005); see also Rodger Doyle, Leveling the Playing Field, Sci. Am., June 2005, at 32 (citing a study showing “that attitudes toward gender equality become increasingly more liberal as societies progress from one economic stage to the next,” from agricultural to industrial to postindustrial); GEORGE GILDER, WEALTH & POVERTY 119 (2d ed. 1993) (“[M]odes of welfare and cooperation have been integral to private enterprise systems at every phase of development, from primitive tribal capitalism through the current manifestations of the capitalist welfare state. Charity began at home in the family circle, expanded to the tribe, moved into churches and associated benevolent groups, be-
Indeed, the history of political and economic progress in the United States has been characterized by the democratization of access and opportunity and the freeing of the enterprising energy of its citizens. This energy has typically led to increases in standards of living and a strengthening of pluralism.

Men such as James Madison, Alexander Hamilton, and Benjamin Franklin recognized the interdependent relationship between economic and political liberty and the value of commerce and individual initiative. For example, as Secretary of the Treasury, Hamilton sought to harness the “spirit of enter-

come routinized in mutual aid societies, paternalistic businesses, unions, and insurance corporations, and finally devolved largely onto the state. Each of these bodies retains an important role in the net of cooperation that upholds the struggles of economic growth.” (emphasis added). Indeed, economic growth is crucial to helping undergird civil society. See, e.g., Benjamin M. Friedman, The Moral Consequences of Economic Growth (2005); Terence Kealey, The Economic Laws of Scientific Research (1996); Benjamin M. Friedman, Meltdown: A Case Study, ATLANTIC MONTHLY, July–Aug. 2005, at 66.

22. The first American settlers recognized the importance of wealth creation to the construction of civil society: “By codifying and legalizing the emerging forms of property—the land that the early settlers appropriated, the dwellings that they built, and the businesses that they formed—the state made it possible for them to mobilize latent capital, to borrow against their assets and thus grow wealth exponentially.” Charles Handy, Tocqueville Revisited: The Meaning of American Prosperity, HARV. BUS. REV., Dec. 2000–Jan. 2001, at 57; see also Gardner, supra note 11, at xii, xv (“We need a powerful thrust of energy to move this nation . . . and much of that energy will have to come from the citizens themselves . . . . There is in them something waiting to be awakened, wanting to be awakened.”) (emphasis omitted).

23. See, e.g., Michael Novak, The Fire of Invention: Civil Society and the Future of the Corporation 38–39 (1997) (“Our founders believed it to be part of their originality to establish here a ‘commercial republic,’ because they believed that a republic finds a safer foundation on commerce than on the aristocracy, religion, or the military . . . . Following Montesquieu, they held that commerce inherently cries out for law and teaches respect for law . . . . and distributes the practical interests of people, even in the same families, among different industries and different firms.”); Richard Vetterli & Gary Bryner, In Search of the Republic: Public Virtue and the Roots of American Government 200, 220 (1996) (“As the American Founders clearly recognized, economic and commercial activity assumed a central role in individual and social life. They saw parallels between the preconditions for social, political, and economic life in a society dedicated to freedom . . . . The marketplace was seen to function as a positive structure in society to the extent that it was fully integrated into the community and to the extent that its practices were regularized by law, thus restraining its most extreme expressions, while carefully preserving the core of its creative, competitive, and productive freedom and protecting the rights associated with it.”); see also Ralph Lerner, The Thinking Revolutionary: Principle and Practice in the New Republic (1987). Benjamin Franklin was himself a prolific inventor and founded the American Philosophical Society and helped shape what became the University of Pennsylvania. See generally Walter Isaacson, Benjamin Franklin: An American Life (2003).
prise” of Americans and their “peculiar aptitude for mechanic improvements” to increase economic growth and solidify the independence of the young nation. The founding of America was thus a joint political and economic experiment.

This experiment did not remain static, however, and the United States moved steadily away from an agrarian economy in the nineteenth century and toward Hamilton’s vision of expanding industry and enterprise. State legislatures, for example, replaced “special” incorporation statutes with “general” incorporation laws to make it easier for people to pursue commercial aspirations, opening the door to greater economic participation. Furthermore, in December 1862, in his Second Annual Message to Congress, Abraham Lincoln laid out sweeping economic plans focused heavily on industrial expansion and economic growth. That same year, Lincoln had created the

24. Alexander Hamilton, Report on the Subject of Manufactures, Dec. 5, 1791, reprinted in GREAT ISSUES IN AMERICAN HISTORY: FROM THE REVOLUTION TO THE CIVIL WAR 171–176 (Richard Hofstadter ed., 1958). Hamilton also echoed Adam Smith’s praise of the benefits of the division of labor: “The separation of occupations causes each to be carried to a much greater perfection than it could possibly acquire if they were blended. . . . [I]t is the interest of nations to diversify the industrious pursuits of the individuals who compose them.” id. at 173, 176; cf. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 8 (Edwin Cannan ed., Univ. of Chicago Press 1976) (1776) (“The division of labour, however, so far as it can be introduced, occasions, in every art, a proportionable increase of the productive powers of labour.”).

25. See LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 390–91 (3d ed. 2005) (“Perhaps the biggest event in incorporation law, between 1850 and 1900, was the decline and fall of the special charter. This was, if nothing else, an advance in legal technology. It was cheap and easy to incorporate under general laws—a few papers filed, a few forms and signatures, and that was all.”). Similarly, an instrumentalist judiciary helped release economic energy through, for example, infrastructure improvements. See, e.g., Proprietors of the Charles River Bridge v. Proprietors of the Warren Bridge, 36 U.S. 420 (1837), in which the Court declined to recognize perpetual rights to bridge construction as upholding such rights would hamper upgrades in transportation and travel. Chief Justice Roger Taney declared: “[A]nd in a country like ours, free, active, and enterprising, continually advancing in numbers and new wealth; new channels of communication are daily found necessary, both for travel and trade; and are essential to the comfort, convenience, and prosperity of the people.” id. at 422; see also FRIEDMAN, supra, at 137–38 (“[T]he case also stood for ‘progress,’ for impatience with vested rights; it stood for the idea that you can’t make an economic omelette without breaking eggs. The old bridge . . . had to give way to what was more dynamic, more modern, and more progressive.”).

26. Lincoln pushed for the completion of trans-Atlantic and trans-Pacific telegraphs, the “scientific exploration” and development of the “immense mineral resources” of the American territories, the completion of the Pacific Railroad, “enlarging the capacities of the great canals in New York and Illinois, as being of
Department of Agriculture to develop “a correct knowledge of recent improvements in agriculture” and signed the Morrill Act, which aided the development of state land-grant universities, many of which grew into prestigious research institutions. His plans stood squarely in the American tradition of harnessing technology and intelligence within the free-market to drive the country forward.

Lincoln’s vision became reality as the U.S. socioeconomic structure became more industrial. Firms established by entrepreneurs such as John D. Rockefeller and Henry Ford grew into conglomerates, and the country witnessed the emergence of “big business,” particularly in manufacturing, banking, and railroads. One commentator has noted that it was the rise of such large-scale companies “that signaled the coming of a new economic order in the land.”

As Rockefeller, Ford, and Andrew Carnegie reshaped American industry, the rise of department stores “democratized desire” and brought what had previously been luxury goods to the masses, a trend that accelerated after World War II. Similarly, the G.I. Bill of Rights created enormous opportunity for returning soldiers and helped usher in a period of post-war prosperity. This trend has continued in the last few decades, as the spread of innovations, such as the personal computer, has furthered and rapidly increasing importance to the whole nation,” and measures to stabilize the currency to “protect labor against the evils of a vicious currency and facilitate commerce by cheap and safe exchanges.” Id. Lincoln recognized the industrial changes that were only beginning to transform the country and that would continue past the end of the war. He also understood the importance of commerce and the free-market and urged Congress to take action “without injury to business and with the least possible burdens upon labor.” Id.

27. Id. at 86.
29. GLENN PORTER, THE RISE OF BIG BUSINESS 1860–1920, at 8 (2d ed. 1992). Looking back on that period of industrial transformation, Schumpeter pointed out that the “rate of increase in output did not decrease from the [1890s] from which . . . the prevalence of the largest-size concerns, at least in the manufacturing industry, would have to be dated; . . . the modern standard of life of the masses evolved during the period of relatively unfettered ‘big business.’” JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 81 (Harper Perennial 1976) (1942).
31. Peter Drucker called the G.I. Bill of Rights “arguably the most successful” of “traditional welfare state measures.” PETER F. DRUCKER, POST-CAPITALIST SOCIETY 112 (1993).
ther democratized economic participation. These are only a few examples, but this brief historical survey highlights the steady upward trajectory of democratic capitalism in the United States.

A free-market economy creates and maximizes opportunities. Rather than attempting to equalize results or minimize effort, it offers a variety of choices and the “sense of living in a world with possibilities, a world that can reward those who accept the challenges it offers.” Openness to continual brainstorming and experimentation confirms the observation of Adam Smith that the “universal, continual, and uninterrupted effort [of individuals] to better their own condition” drives progress “toward . . . improvement.” As Nobel Prize-winning economist Robert Lucas explains:

For income growth to occur in a society, a large fraction of people must experience changes in the possible lives they imagine for themselves and their children, and these new visions of possible futures must have enough force to lead them to change the way they behave . . . . [E]conomic development requires a million mutinies.

The private foundation plays an integral role in this system, applying wealth that is created to strengthen these tendencies.

III. THE PRIVATE FOUNDATION

The private foundation does not exist in a vacuum. Rather, an investigation of its historical origin and development reveals that the foundation is inseparable from the fabric of democratic capitalism.


33. ROBERT E. LUCAS JR., LECTURES ON ECONOMIC GROWTH 17 (2002).

34. SMITH, supra note 24, at 367. Paul Romer points out that “the more people you have who are potentially looking for ideas, the better off we’re all going to be.” Ronald Bailey, Post-Scarcity Prophet, REASON, Dec. 2001, at 52, 56 (interviewing economist Paul Romer).

35. LUCAS, supra note 33, at 17–18 (2002) (internal quotations and citation omitted).
A. Development of the Private Foundation

As discussed, institutions are crucially important for advancing economic growth and human welfare. Indeed, to sustain itself and achieve greater performance in its constantly shifting environment, a free-market economy invents new institutions to address evolving needs. From the market’s decentralized structure emerge innovative ideas that become institutionalized in new forms through a process of emulation and dissemination. By means of this process, anachronistic and irrelevant institutions are replaced by new and more efficient institutions. Examples include the factory system celebrated by Adam Smith, the principles of scientific management embodied in Fordist mass production via assembly lines, the modern graduate school of business, the Securities and Exchange Commission, the modern venture-capital industry, and the Employee Retirement Income Security Act.


37. See SMITH, supra note 24, at 7–9.


40. In the two decades before 1900, business education grew in importance and spread from specialty schools (such as a retailing program at New York University) to established programs within universities. In the first decade of the twentieth century, the leading schools were the Wharton School of Business at the University of Pennsylvania, the Amos Tuck School at Dartmouth, the University of Chicago Graduate School of Business, and the Harvard Business School. See generally WAYNE G. BROEHL, JR., TUCK & TUCKER: THE ORIGIN OF THE GRADUATE BUSINESS SCHOOL (1999); WILLIAM LEACH, LAND OF DESIRE (1993).

41. See, e.g., THOMAS K. MCCRAW, PROPHETS OF REGULATION (1984); Donald A. Ritchie, U.S. Senate Historical Office, The Legacy of James M. Landis,
The private foundation is one such invented and necessary institution, which arose as an institutional response to the rapid social, economic, and cultural changes of the late nineteenth and early twentieth centuries. Before this, charitable endowments in the United States had operated largely at the local level and had focused on specific issues. Such an approach to charity and philanthropy, however, was not immune to the broad forces reshaping the country. These broad forces included a widespread and accelerating tendency toward organization, professionalization, and hierarchy, “demanding industrial discipline and engendering a managerial and bureaucratic outlook” across the economy and society. For example, to bring order to increasing complexity, the nation created such agencies as the Federal Reserve and the Food and Drug Administration. Unionization gathered speed, and by the end of the 1930s the American Federation of Labor, Congress of Industrial Organizations, United Auto Workers, and United Mine Workers of America had gained extraordinary power. Finally, the research university arose and altered the face of higher education.

Amid such evolution, private charities and philanthropies “were also compelled to change, seeking ways to be more effi-


42. See, e.g., EVANS, supra note 39, at 302–07; RICHARD N. FOSTER & SARAH KAPLAN, CREATIVE DESTRUCTION: WHY COMPANIES THAT ARE BUILT TO LAST UNDERPERFORM THE MARKET—AND HOW TO SUCCESSFULLY TRANSFORM THEM 169 (2001).

43. See, e.g., LAWRENCE M. FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 419 (2002).


46. See, e.g., GORDON, supra note 32, at 344–45.

cient, more professional, and, in the end, more scientific in their approaches to social and economic problems.” 48 This impulse found its manifestation in the emergence of large-scale, nationally-oriented charitable organizations. For example, although the American Red Cross had a budget of only $2,730 in 1904, by 1925 its collections and expenditures had ballooned to hundreds of millions of dollars. Other organizations such as the NAACP, the National Urban League, and the American Cancer Society also appeared. 49

Foundations and their search for “root causes” and systemic change were part of this trend towards efficiency, professionalism and science. 50 Wealthy entrepreneurs such as Carnegie and Rockefeller began to establish formal institutions rather than simply give money to charitable organizations. 51 This trend culminated in the emergence of the eponymous, general purpose foundations: the Russell Sage Foundation (1907), the Car-


50. Philanthropy is “a search for cause, an attempt to cure evils at their source.” MARK DOWIE, AMERICAN FOUNDATIONS: AN INVESTIGATIVE HISTORY 52 (2001) (quoting John D. Rockefeller); see also NIELSEN, THE BIG FOUNDATIONS, supra note 17, at 48 (noting that Rockefeller’s adviser in philanthropic matters, Frederick T. Gates, helped formulate “a policy based on ‘the principles of scientific giving’ by which ‘retail’ charity was abandoned for institutionalized ‘wholesale’ philanthropy.”); Daniel Akst, What Are Foundations For?, CARNEGIE REPORTER, Fall 2004, at 3, 3–4 (“Carnegie and Rockefeller . . . went off in a different direction, hoping with their vast wealth to attack the root causes of social ills rather than fund mere palliatives.”); Barry D. Karl & Stanley N. Katz, The American Private Philanthropic Foundation and the Public Sphere 1890–1930, 19 MINERVA 236, 234–44 (1981).

51. The list of these institutions is long. Carnegie founded, among others, the Carnegie Institute of Pittsburgh in 1896, the Carnegie Institute of Technology (now Carnegie-Mellon University) in 1900, the Carnegie Institution of Washington, D.C. in 1902, the Carnegie Hero Fund in 1904, the Carnegie Foundation for the Advancement of Teaching in 1905, and the Carnegie Endowment for International Peace in 1910. Rockefeller established, among others, the Rockefeller Institute for Medical Research in 1901, the General Education Board in 1903, and the Rockefeller Sanitary Commission in 1909, and he transformed the University of Chicago into a world class institution. “All these enterprises provided the basis of experience on which Rockefeller’s greatest venture in the field of philanthropy—the Rockefeller Foundation—was later built.” NIELSEN, THE BIG FOUNDATIONS, supra note 17, at 48–49; see also Robert H. Bremner, Private Philanthropy and Public Needs: Historical Perspectives, in RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 89, 102 (1977); RON CHERNOW, TITAN: THE LIFE OF JOHN D. ROCKEFELLER, SR. (1998); PETER KRASS, CARNEGIE (2002).
negie Corporation of New York (1911), and the Rockefeller Foundation (1913).  

The evolving process of democratic capitalism thus necessitated the creation of the private foundation to bring a new approach to the changing needs and demands of society and apply the enormous wealth being created. “Radically new approaches would require new institutional forms, and at least one type began to seem fairly obvious and attractive... This was the endowment, generally organised legally as a trust, with a specific yet untraditional goal.”

B. The Importance of Donor Intent

In addition to the foundation’s historical roots in capitalism, an appreciation of the importance of donor intent is vital to an understanding of private foundations. Indeed, donor intent, together with the foundation’s role within democratic capitalism, serves as a primary touchstone for private foundations. Yet the issue of donor intent remains one of the thorniest and most politically charged in any discussion of foundations. Some commentators, for instance, view donor intent as a canard used to shield the ideological biases of a foundation and advocate abandonment of any deference to it in favor of an ad hoc approach to using a foundation’s resources.

Considering, however, that a foundation’s endowment is the donor’s money, and not the possession of the foundation’s executives and staff, donor intent clearly deserves the utmost

52. See, e.g., BRENNER, supra note 44, at 131.
53. Karl & Katz, supra note 50, at 244 (emphasis added). Thus, the “creation of the modern foundation and its legitimation as a national system of social reform—a privately supported system operating in lieu of a government system—carried the United States through a crucial period of its development: the first third of the twentieth century.” Id. at 243; see also PETER D. HALL, INVENTING THE NONPROFIT SECTOR (1992).
56. See, e.g., DOWIE, supra note 50.
57. “The only reason... the foundation officer has any power is that... the donor had certain principles they wished to see put into effect.” Robert Bork, Interpreting the Founder’s Vision, in THE PHILANTHROPIC PROSPECT, supra note 55, at 7.
respect. That said, in many cases, donor intent can take a foundation only so far, whether the intent was vague or nonexistent from the beginning, targeted to a specific problem that has been solved, or made irrelevant by changing circumstances.58 The challenge for foundation executives and staff is to strenuously adhere to “self-discipline in the service of the founder’s, rather than [their] own, moral purposes,”59 while operating within a shifting context that requires adaptation. Even when donor intent is nonexistent or hopelessly irrelevant, foundation executives must seek guidance in the spirit of the donor. For example, most founders of large foundations were entrepreneurs who succeeded through risk-taking within the American democratic capitalist system and would have expected the same from their philanthropies.60

C. Foundations as Independent and “Out-Market” Institutions

Most institutions within American society are subject, in varying degrees, to an externally imposed accountability mechanism. Business firms are entirely subject to market discipline; they cannot exist without customers and revenues. Voluntary nonprofit organizations face market forces in their necessity to raise funds, and universities are reliant on tuition and grant revenue. Governments both sell services and must respond to the electorate.61

The private foundation differs in character from other institutions in that it possesses no constituents, no shareholders, and only a slim connection to the market through its invested endowment. It is in the fortunate position, one commentator

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58. Nielsen advised donors to be “more serious and mindful” in determining their intent and principles: It requires “the skills, the commitment, and the time to really make use of [a foundation’s] potentialities.” Nielsen, supra note 55, at 19–21.
has noted, “of having all assets and no liabilities.” In contrast to other institutions, the foundation was purposefully and intentionally formed by donors and the common law as free and independent. It is perhaps best described as an “out-market” institution.

Existing as an out-market entity brings not only the freedom to innovate but also a responsibility:

This is the only institution in our society that does not have constituencies that it has to keep looking to. All the others have to worry about pleasing a lot of people, so they’re bound to tend toward conventional wisdom, respectability, and the lowest common denominator. A private foundation, where the board of directors is answerable only to itself, is in a completely different situation, and if it doesn’t take advantage of that uniqueness, it’s just blowing its opportunity, and perhaps even its moral obligation.

The private foundation is, of course, subject to regulation by state attorneys general and the Internal Revenue Service. In general, though, government oversight is premised on a view of nonintervention in the substantive decision-making and operations of foundations. The law’s proper role is thus limited to two responsibilities:

[To ensure] that each charitable organization is carrying out the purposes for which it was established, and that its managers are not obtaining personal benefits from their positions at the expense of the charity. With few exceptions, the law neither attempts to control the decisions of managers, made in good faith, as to how the purposes will be achieved, nor how their organizations will be administered.

Generally, a state attorney general can pursue legal action against foundations in cases where charitable assets are in

64. Nielsen, The Golden Donors, supra note 17, at 110 (quoting Rod MacArthur).
jeopardy (thus possibly violating donor intent), and in cases involving illegal actions.66

Many foundations have translated their exceptional freedom into substantial achievements. Three areas—education, science, and social policy—illustrate the manner in which foundations can act as catalysts, often producing results that government and business are either unwilling or incapable of producing.

1. Education

Philanthropic foundations consistently focus on constructing, enhancing, and shaping America’s educational substructure, a pillar of American capitalism. This legacy began with a precursor of modern foundations: the Peabody Education Fund, formed in 1867 to rebuild and strengthen education in the South.67 Investment banker George Peabody recognized that the agrarian South could not “reconstruct” and move forward unless it joined the emergent technical-industrial age and that such progress required substantial upgrades in basic education.68

Other entrepreneurs likewise began founding institutions of higher learning through charitable donations to serve and shape a swiftly expanding and industrializing nation. Universities endowed by such entrepreneurs from the 1860s through the early 1900s include Cornell, Johns Hopkins, Carnegie-Mellon, Duke, Vanderbilt, Rice, the University of Chicago, and


Stanford.\textsuperscript{69} Entrepreneur-philanthropists helped “build a university tradition” in the United States by spreading higher education throughout the nation and demonstrating that research universities were essential for the continued advancement and growth of the country.\textsuperscript{70}

To strengthen this emerging system of higher education, foundations also began to develop new tools. For example, Carnegie’s foundation devised the Teachers Insurance and Annuity Association (known today as TIAA-CREF) to provide a centralized, and hence portable, insurance and retirement plan for university professors.\textsuperscript{71} By making the professorate more secure and by encouraging competition among universities, the Association helped attract better talent to American university faculties and had a profound impact on college teaching.\textsuperscript{72}

At other educational levels, foundations played key roles in opening doors to opportunity. In the 1920s and 1930s, the Rosenwald Fund—established by Sears Roebuck magnate Julius Rosenwald—funded the construction of thousands of rural schools for blacks across the South.\textsuperscript{73} In the 1950s and 1960s, the Carnegie Corporation funded numerous programs in early childhood education, including the launch of “Sesame

\begin{quote}
69. Rockefeller and Frederick Gates completely reshaped the University of Chicago: “Their first great joint undertaking was the creation of the University of Chicago which, by the injection of a total of $35 million, was transformed from a small, third-rate institution under Baptist auspices into one of the nation’s great universities.” \textit{Nielsen, The Big Foundations}, supra note 17, at 48–49; see also \textit{Roger L. Geiger, To Advance Knowledge: The Growth of American Research Universities, 1900–1940} (1986); \textit{Veysey, supra} note 47.

70. Curti, supra note 11, at 420, 425; see also Bremner, supra note 51, at 89, 108; Acs & Phillips, supra note 11, at 193; Hammack, supra note 68, at 43, 54–55. For decades, various foundations have also established and funded fellowships and scholarships that reward excellence in educational pursuits and stimulate research; see, e.g., \textit{Brian O’Connell, Philanthropy in Action} 40–41 (1987); \textit{Nielsen, The Big Foundations}, supra note 17, at 54, 101–03.

71. See \textit{Claire Gaudiani, The Greater Good: How Philanthropy Drives the American Economy and Can Save Capitalism} 132 (2003); see also TIAA-CREF, Company History, \url{http://www.tiaa-cref.org/about/press/about_us/history.html} (“With customary foresight, the legendary philanthropist recognized that colleges needed to offer adequate pensions in order to attract talented teachers.”).

72. “With secure pensions, teaching became a profession that could attract and sustain bright and able people .... The economic energy created by this single gift and the initiative it sparked has transformed thousands of lives.” \textit{Gaudiani, supra} note 71, at 132; see also \textit{Veysey, supra} note 47, at 313.

73. See, e.g., \textit{Bremner, supra} note 44, at 131; \textit{Nielsen, The Big Foundations}, supra note 17, at 337.
\end{quote}
Street” in 1969.74 The Kellogg Foundation, moreover, played a major role in the development and improvement of community colleges.75

2. Scientific Research

Foundations in the early to mid-1900s transformed the funding paradigm for scientific research and catapulted the United States to the global forefront of technological advancement. From the Age of Enlightenment, Europe had dominated the scientific research arena through its universities and “gentlemen scientists.”76 Into the twentieth century in the United States, on the other hand, the federal government and business firms played comparatively minor roles in funding research.77

The modern foundation changed the history of scientific research in a revolution led by the Rockefeller Foundation, which compiled an astonishing record in medicine and public health. Over the first few decades of the twentieth century, the Rockefeller Foundation heavily supported the eradication of hookworm, developed a vaccine against yellow fever, funded the first American school of public health, and made innumerable research grants. Furthermore, the Foundation’s work, led by Simon Flexner, revolutionized medical education by making it a graduate discipline.78 After World War II, the federal government emulated these extraordinary efforts and created the National Institutes of Health (1948) and the National Science Foundation (1950).79 The Rockefeller Foundation ultimately did more than merely finance scientific research—it created whole new fields of inquiry. Warren Weaver, vice president of the

75. See, e.g., O’CONNELL, supra note 70, at 53.
77. See, e.g., GEIGER, supra note 69.
78. See, e.g., NIELSEN, THE BIG FOUNDATIONS, supra note 17; NIELSEN, THE GOLDEN DONORS, supra note 17; JOHN ENSOR HARR & PETER J. JOHNSON, THE ROCKEFELLER CENTURY (1988); CHERNOW, supra note 51; DOWIE, supra note 50, at 53 (noting that, in 1901, Rockefeller “created the Rockefeller Institute for Medical Research in New York . . . . Within six years it had identified the cause of several diseases.”).
79. DOWIE, supra note 50, at 65.
Foundation in the 1930s, “prodded scientists onto paths they might never have taken if left to their own devices.”80

Other foundations also contributed to this revolution in scientific research. In the 1920s, the Guggenheim Foundation supported Robert Goddard’s seminal experiments with rocketry.81 The Salk polio vaccine and the Pap-smear test were created with support from foundations.82 In agriculture, the so-called “Green Revolution” research of the 1960s, which produced new andhardier strains of many food crops, was funded principally by American foundations, particularly the Ford Foundation.83 The system of scientific research conducted within universities today and the new industries it spawns (such as computing, life sciences, and biotechnology) would likely not have developed as quickly, or as strongly, if private philanthropic foundations had not invested so creatively and effectively in education and research.84

3. Social Policy

In the late nineteenth and early twentieth centuries, the United States experienced exponential economic growth. Accompanying this new wealth, however, was the introduction of new types of human misery.

80. For example, his “persistent encouragement of the synthesis of physics and biology . . . eventually led to the formation of the new field of molecular biology.” ld. at 64.

81. Goddard received funding for research into jet propulsion, leading to the development of the multistage rocket that first took Americans to the moon. Guggenheim’s funding of Goddard was part of a wider interest in aeronautical engineering; it established a lab to study fog flying (i.e., solely by instruments), and funded research development of the gyroscope compass, the first commercial airline in America, and several schools of aeronautical engineering. GAUDIANI, supra note 71, at 113–14; see also O’CONNELL, supra note 70, at 15.

82. See, e.g., Council on Foundations, Great Grants, http://www.cof.org/learn/content.cfm?ItemNumber=607&navItemNumber=2516 (“Salk was able to establish and equip his virus laboratory . . . because of a 1948 grant from the Sarah Scaife Foundation.”); O’CONNELL, supra note 70, at 80–81 (citing Howard A. Rusk, Health Dividend Report: A Review of Foundation Contributions to Medical Research and the Results, N.Y. TIMES, Mar. 11, 1956, at 123).

83. See, e.g., Council on Foundations, supra note 82; see also NIelsen, THE BIG FOUNDATIONS, supra note 17, at 67–68; O’CONNELL, supra note 70, at 77.

84. “Foundation-supported research has influenced the polity most by establishing the idea that scientific research was both valuable to the nation and an activity that belonged in major research universities. Once established, this idea affected both the development of the flagship campuses of state university systems and the expansion of federal funding for scientific research.” Hammack, supra note 68, at 43, 45; see also O’CONNELL, supra note 70, at 19–21, 80–83.
Though industrial capitalism did not “create” poverty—there had long been vast numbers of poor people—it gave poverty a new form. Millions of low-wage earners, many of them immigrants, poured into American cities. They sought (and often found) greater opportunity, but the squalor of slums and tenements as well as the dangers of factory work exposed them to modern health hazards. Capitalism’s dynamic nature, while ameliorating one series of problems, left an altered set in its wake.

As new foundations appeared, many of them took on these pressing social problems. The Rockefeller Foundation, for instance, focused on public health. Others, like the Russell Sage Foundation, attempted to go deeper into contemporaneous issues by funding academic studies in the new disciplines of social science, social work, and labor law reform.85

Though different from their role in education and research, foundations performed a necessary service in addressing social problems. Capitalism had created externalities in the form of urban ills and labor strife. Foundations played a vital role in addressing these externalities in ways business firms could not. By pressing for improvements in working conditions and social-welfare programs and bolstering social science research, foundations helped smooth the rough edges of the capitalism of their time. This ultimately helped democratic capitalism in the United States advance to its next stage without the vicissitudes that occurred in other countries: descent into political unionism, class warfare, state socialism, and communism.86

Just as they had done in the area of scientific research, foundations helped “teach” the government how to implement social welfare programs. In the early part of the twentieth century, “when the nation had reached a certain point in its economic development and was ready to move forward in its educational, medical, and cultural development, the Rockefeller and Carnegie foundations along with a few others launched experiments that blazed the trails that government and others subsequently followed.”87

85. See Karl & Katz, supra note 50, at 247; see also GAUDIANI, supra note 71, at 66–67.
86. See, e.g., SELIG PERLMAN, A THEORY OF THE LABOR MOVEMENT (1928); SELIG PERLMAN, HISTORY OF TRADE UNIONISM IN THE UNITED STATES (1922).
87. NIELSEN, THE GOLDEN DONORS, supra note 17, at 442 (“The foundations saw their role as catalysts for the creation of new programs to help realize the national dream of progress and equality.”).
D. External Threats to Foundation Independence

The preceding examples of foundation actions illustrate both the importance of independence, which allows foundations to innovate, and the value of an institution that can approach problems with a long-term view and dedicate itself to exploring new paths. Yet foundations continuously face threats to their independence and attempts to blunt their effectiveness by preventing them from evolving as capitalism changes.

1. The Danger of Vested Interests

The private foundation has no fixed interest to which it is beholden; it has no constituents, and no shareholders. Many observers and organizations nonetheless persist in identifying “stakeholders” that would attempt to dictate foundation programs and priorities. This maneuver endangers the necessary independence of foundations by making them vulnerable to “capture” by third parties. In politics, capture occurs when a regulatory agency becomes beholden to the sector it purports to oversee; the agency is then limited in its ability to operate effectively. A similar limitation can be imposed on foundations when they willingly give away their freedom to outsiders by naming stakeholders.

The naming of stakeholders not only prevents foundations from fulfilling their role of challenging other institutions, but it also creates vested interests in foundations, which contravenes their nature and historical character. In the seminal Dartmouth College case, Chief Justice John Marshall addressed the question of whether external parties possessed a direct stake or interest in the college, a charitable corporation. He concluded that they did not: “When acting in a collective and fiduciary capac-

88. See, e.g., Peter Frumkin, Private Foundations as Public Institutions: Regulation, Professionalization, and the Redefinition of Organized Philanthropy, in PHILANTHROPIIC FOUNDATIONS, supra note 68, at 69; Patton, supra note 66.


ity . . . the Court found that ‘the whole legal interest [of a charitable organization] is in [the] trustees, and can be asserted only by them.’” 91

Another difficulty presented by vested interests is their preference for the status quo. By definition, vested interests have a stake in things staying the same, so that they continue to receive benefits from the foundation. Accordingly, vested interests resist foundation evolution and instead prefer that the foundation continue to adhere to outdated paradigms.

2. Political Threats

Private foundations are subject to a number of regulations that seek to deter illegality and ensure that foundation funds advance charitable purposes and fulfill donor intent. 92 Though the regulations have accumulated over the past several decades, the historical development of this regulatory regime has been marked by a more sporadic cycle of criticism, attacks, and investigations. 93 The history and effects of these regulations are especially worthy of consideration today, amid a resurgence in scrutiny from Congress and attorneys general.

In the midst of intense labor strife in 1912, Congress created the U.S. Commission on Industrial Relations to investigate industrial and management issues. With the establishment of the Rockefeller Foundation in 1912 and John D. Rockefeller’s involvement in labor-management struggles, the commission (known as the “Walsh Commission”) expanded its charge to examine private foundations and the possibility that their creators used them “to manipulate the economy and . . . influence

91. Patton, supra note 66, at 162 (citing Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 645 (1819)).


93. “[D]espite the continuous encouragement of philanthropy in American tax laws, ever since the earliest foundations were formed, a corresponding contrapuntal note of alarm had frequently been sounded from both the left and the right, in Congress and elsewhere.” BRILLIANT, supra note 3, at 4. These “attacks on foundations . . . are part of a historical pattern of Congressional concern about the institutions of organized charity, and even more specifically, about some perceived leaders of the field—the major American foundations.” Id. at 26; see also WALDEMAR A. NIELSEN, THE ENDANGERED SECTOR 209–10 (1979) (“Such intermittent bursts of Congressional concern have in most instances produced rather little in the way of objective information and useful proposals for changes in public policy.”).
public opinion.”94 The Walsh Commission recommended limits on how much money foundations could accumulate and urged the federal government to vigorously counter their influence.95 Congress, however, ignored these recommendations, and in subsequent decades, with the increase in wartime charitable activities, public goodwill toward foundations increased.96

The largely laissez-faire governmental approach to foundations97 began to recede in the 1940s and 1950s after significant growth in the number of foundations and increasing reports of abuses. The Revenue Act of 1943 mandated the filing of annual information returns, and legislation in 1950 and 1954 imposed further public disclosure provisions.98

In 1952, the House of Representatives established the Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations (the “Cox Committee”) to examine suspected foundation involvement in “un-American activities.”99 The Cox Committee absolved foundations of communist activity (and, in fact, urged greater contributions “to these worthwhile entities”100), but was quickly succeeded in its investigations by the far more critical Reece Committee.101 Neither the Cox nor the Reece Committees resulted in onerous legislation, although their reports were “clearly built on the implicit as-


95. Its final report (supported by only a minority of the membership) was not well-received: Congress eliminated its funding, while the press criticized the chairman, Frank Walsh. See BRILLIANT, supra note 3, at 12 (“Walsh was soundly rebuked in the New York Times for being an excessive ideologue.”).

96. See Karl & Katz, supra note 50, at 236.

97. In the first half of the twentieth century, Rudko observes, “there was little statutory law in the United States concerning the supervision and enforcement of charitable trusts.” Francis Howell Rudko, The Cy Pres Doctrine in the United States: From Extreme Reluctance to Affirmative Action, 49 CLEV. ST. L. REV. 471, 472 n.4 (1998); see also Frumkin, supra note 88, at 69.

98. See BRILLIANT, supra note 3, at 39; FREMONT-SMITH, supra note 44, at 92.


100. Brody, supra note 44, at 924.

sumption that certain kinds of organizations which enjoy tax benefits . . . should be held publicly accountable.”

Intense Congressional scrutiny in the 1960s, led by Rep. Wright Patman, culminated in the Tax Reform Act (“TRA”) of 1969, which transformed the relationship between foundations and government. Patman issued a series of reports describing problems and abuses, and the Treasury Department in 1965 issued a report recommending new regulations, leading to an extensive array of rules and regulations. Though the TRA subjected foundations to public oversight, it did, importantly, recognize a distinction between private foundations (created by donors) and public charities (such as schools, churches, and medical institutions).

Over time, however, this distinction faded. Although some attempted to defend a measure of foundation independence.


103. Patman, the “strongest critic of private foundations ever to emerge from Congress,” launched a decade-long crusade against them. EDIE, supra note 99, at 9; see also BRILLIANT, supra note 3, at 51.

104. See EDIE, supra note 99, at 9. Patman called for suspending the creation of foundations, limiting their life to 25 years, imposing a 20% tax on foundation income, prohibiting foundations from borrowing or lending money, and requiring that all contributions and capital gains be spent currently. Brody, supra note 44, at 924; see also BRILLIANT, supra note 3, at 51.

105. STAFF OF TREASURY DEPT., 89TH CONG., REPORT ON PRIVATE FOUNDATIONS TO THE S. COMM. ON FINANCE (Comm. Print 1965); see also Brody, supra note 44, at 924–25 (“Many, but not all, of Treasury’s proposals found their way into the Tax Reform Act of 1969.”).

106. EDIE, supra note 99. The TRA divided the universe of 501(c)(3) organizations into “two distinct categories: private foundations and all other organizations described in that section. Private foundations were singled out in the act for separate, restrictive treatment on the theory that they were not responsive to the public, as were churches, governmental instrumentalities, schools, hospitals, and organizations primarily dependent upon support from the general public.” FREMONT-SMITH, supra note 44, at 4 (emphasis added). Reflecting on the palpable hostility toward foundations present in the 1960s and manifested in the TRA, Waldemar Nielsen opined that it was “apparent even in 1969 that many elements of the Congress were more interested in crippling foundations than in correcting their abuses.” NIELSEN, THE BIG FOUNDATIONS, supra note 17, at 18.

107. A 1972 report by the American Assembly “focused on ways that foundations could remain viable organizations in the face of government’s expanding role . . . and in light of new tax laws that were seen as discouraging the establishment and growth of foundations.” Debra E. Blum, Philanthropy Should Focus on Gap Between Rich and Poor, Report Says, CHRON. PHILANTHROPY, May 7, 1998, at 14.
the TRA’s codification of the public-private distinction was soon forgotten amid growing calls to subsume foundations within the rubric of public institutions.\textsuperscript{108} Many foundations acquiesced to these pressures,\textsuperscript{109} and two independent commissions (the Peterson and Filer Commissions),\textsuperscript{110} though ostensi-

\textsuperscript{108} From the 1970s there was “a conceptual shift in the understanding of the foundations’ place in society. Foundations emerge[d] as profoundly public institutions, open and accountable to all.” Frumkin, \textit{supra} note 88, at 69–70.

\textsuperscript{109} Frumkin places the blame on both overbroad government regulation and the response of many foundations to that regulation: “In an effort to defend philanthropy from further government investigation and regulation, foundations strategically recast themselves as public trusts to be governed by public purposes.” In particular, the Council on Foundations “sought to define a new understanding of the place of foundations within society, one that defined foundations as public trusts, open and accountable to all, and, most importantly, operated for public purposes . . . . [Its] principal concern following TRA 1969 was to open up foundations to the public and to instill in foundation workers the belief that foundations were really public trusts to be operated for public purposes.” Id. at 70–75.

\textsuperscript{110} During congressional deliberations in 1969, John D. Rockefeller III initiated the creation of the Commission on Foundations and Private Philanthropy (the Peterson Commission). Intended to preempt and possibly lessen intrusive federal regulation, the Peterson Commission did not issue its final report until almost a year after the TRA. \textit{See Peterson Commission Report, supra} note 4. The commission did, however, exert an influence on the legislative process and represented an important development in the evolution of attitudes toward foundations and their social status. It “played an important role as spokesman for the sector during the deliberations on the act, and undoubtedly mitigated the effect of the proposals before Congress that would have been most restrictive.” \textit{Fremont-Smith, supra} note 44, at 81. The commission generally supported philanthropy’s societal role, but was critical of many aspects of foundations, particularly their lack of innovation. \textit{Brilliant, supra} note 3, at 92. It called for increased governmental regulation, rather than self-regulation, and suggested that, “in the absence of external constituencies, foundations should involve the public more in evaluation efforts.” \textit{Id. See generally Peterson Commission Report, supra} note 4. The commission report called for the formation of a permanent, “quasi-governmental” Advisory Board on Philanthropic Policy, with members appointed by the President and with powers to evaluate the performance of foundations and government regulation and suggest improvements. \textit{Id. at} 121–25; \textit{See also Brilliant, supra} note 3, at 92; \textit{Fremont-Smith, supra} note 44, at 81. In 1973, the Senate Finance Committee created a Subcommittee on Foundations, signaling a new round of scrutiny. In response, Rockefeller again initiated the formation of a commission: the Commission on Private Philanthropy and Public Needs (the Filer Commission). \textit{Brilliant, supra} note 3, at 110. The Commission initially confined its purview to taxation issues but soon enlarged its research focus to include the entire nonprofit sector. In 1975, it released its final report and nineteen “far-reaching” recommendations. \textit{Fremont-Smith, supra} note 44, at 82; \textit{See also Filer Commission Report, supra} note 5. Its proposals called for broadening the charitable “contributions base” and increasing public access, visibility, and accountability. \textit{Brilliant, supra} note 3, at 129. Only two recommendations dealt exclusively with foundations: a new category of “independent” foundations and a payout rate of 5%. \textit{Id. at} 130. Additionally, like the Peterson Commission, the Filer Commission proposed a
bly formed to guard foundation viability, actually called for more regulation and greater public accountability. By 1998, an American Assembly report on philanthropy pushed for a yet more public character for private foundations.

Apparent in this legal and regulatory evolution is a clear policy trajectory leading from the early years, through the attacks of the 1950s and 1960s, to today’s debates, which center on various legislative proposals and attorney general actions. This trend is characterized by an increasing regulatory burden on foundations and an accelerated willingness to view them as public, quasi-governmental institutions.

In recent years, revelations of improprieties and the illegal actions of a handful of foundations have moved state attorneys general to take a more active approach to their duties of charitable oversight. In many of these cases, attorneys general

permanent, quasi-governmental national commission to monitor and evaluate the nonprofit sector and serve as its mouthpiece to the government and public. FREMONT-SMITH, supra note 44, at 82. Brilliant notes, for “a group concerned about the voluntary sector, the report gave considerable attention to regulation.” BRILLIANT, supra note 3, at 130.


113. While it was noted earlier that the investigations of the 1950s and 1960s followed an increase in the number of foundations, it is interesting to observe that contemporary scrutiny follows extraordinary growth in the sector. From 1990 to 2002, the number of active grant-making foundations doubled, from 32,400 to almost 65,000. THE FOUND. CTR., FOUNDATION GROWTH AND GIVING ESTIMATES 9 (2004).

have done an admirable job of reining in wayward executives and reminding trustees of their fiduciary obligations to donor intent. Yet in other instances, this “new sensibility” among attorneys general has pushed the limits of authority and even resulted in unwarranted and harmful intervention.\textsuperscript{115} This trend poses a major threat to foundations, as politically-motivated government intervention, often without regard to the nature and social utility of foundations, can damage both foundation independence and effectiveness by supplanting the will of the donor with that of government officials whose objectives may be political in nature.

The recent experience of the Hershey Trust in its attempts to diversify investment holdings furnishes the most recent example of this phenomenon.\textsuperscript{116} When the Trust’s proposal to sell Hershey company stock raised the possibility of a sale of the company, the Trust drew the ire of the local community and prompted state involvement. The Pennsylvania attorney general (a candidate for governor at the time) asserted extraordinarily broad powers as well as a capacious interpretation of the interests and beneficiaries a charitable trust must consider: “In the attorney general’s view, the Trust’s duty involved full consideration of community impact in addition to the vested inter-


\textsuperscript{116} The facts of this episode have been well-covered elsewhere and will not be recounted in their entirety here. See In re Milton Hershey Sch. Trust, 807 A.2d 324 (Pa. Commw. Ct. 2002); Brody, supra note 114, at 943; Sarah Ellison, Hershey Results Are Hurt by Bid to Sell Company, WALL. ST. J., Oct. 18, 2002, at B5; Jennifer L. Komoroski, Note, The Hershey Trust’s Quest to Diversify: Redefining the State Attorney General’s Role When Charitable Trusts Wish to Diversify, 45 WM. & MARY L. REV. 1769 (2004); Mark Sidel, The Struggle for Hershey: Community Accountability and the Law in Modern American Philanthropy, 65 U. PIT. L. REV. 1, 2–3 (2003) (“In Hershey and other recent cases, attorneys general have expanded their supervisory and enforcement inspection beyond these relatively narrow bounds, exploring the negative effects of charitable and philanthropic activity on communities and the public that go well beyond safeguarding trustee fidelity to fiduciary duty and the interests of beneficiaries that regulators are traditionally required to safeguard.”).
ests of the [local] beneficiary.”117 Furthermore, the local court bolstered the Attorney General’s actions by directly intervening on the issue of the composition of the Trust’s board.118

The powers of state attorneys general in matters of private foundations are circumscribed by statute, precedent, and tradi-

117. Sidel, supra note 116, at 17. “The Attorney General asserted that its parents patriae authority went beyond merely inquiring into whether the Hershey trustees’ actions comported with the deed of the trust, a more traditionally limited definition of the state regulator’s role. The state Attorney General asserted the parents patriae role more broadly, to include ‘protecting the public against any social and economic disadvantages which may be occasioned by the activities and functioning of public charities.’” Id. The crux of the attorney general’s expansive argument was “that charitable trusts bear a broader responsibility to the public and the community than only to their defined legal beneficiaries under a trust deed, and the Trust’s actions have ‘demonstrated the need for the broader perspective which it is the Attorney General’s function to provide.’” Id. at 23. In the local court, Judge Morgan agreed with the attorney general’s broad assertions of power: “The Attorney General has sufficiently carried his burden of proving the potential harm that he seeks to prevent, namely, the adverse economic and social impact against the public interest.” Judge Morgan’s opinion is reproduced at the end of the majority opinion in the appeal. See In re Milton Hershey Sch. Trust, 807 A.2d at 331. Komoroski points out that the “stated purpose of the Hershey Trust is to fund schooling for underprivileged children residing in certain Pennsylvania counties, not for the protection of job security for workers employed at Hershey Foods.” Komoroski, supra note 116, at 1791. Komoroski also notes the political interests of the attorney general in this case—at the time, the attorney general was running for governor and relied heavily on support in mid-state Pennsylvania, where Hershey is located. The prospect of a sale of Hershey Foods purportedly hurt his electoral chances: “possible layoffs and plant closings always catch the attention of voters.” Id. at 1786. Even discounting motivations and interests, as legal matters the assertions of the attorney general and court far exceed the cognizable boundaries between private institutions and valid public enforcement.

118. The court opined: “The memorials of a good and generous man have not been well served by events surrounding this litigation. In this midstate area, Hershey is everybody’s town…. It appears to many that the Directors/Managers, whatever their skills and however well-intentioned their efforts, have become detached from that philanthropic scheme…. Reconstituting the Boards in number and composition closer to the model utilized by Milton S. Hershey during his lifetime, and until recently by all succeeding Boards, will hasten the reconciliation.” Decree and Adjudication, In re Milton Hershey Sch. Trust, No. 712-1963, slip. op. at 4 (Orphan’s Ct. Div., Ct. Com. Pl. Dauphin County, Oct. 16, 2002). With that statement, Judge Morgan intruded on the internal governance of the trust—eventually, under public pressure and prodded by the judge’s comments, ten members of the Hershey Trust board were ousted for supporting the sale. Brett Marcy, Hershey Ousts Sale Advocates, HARRISBURG PATRIOT-NEWS, Nov. 15, 2002, at A1; see also Sidel, supra note 116, at 3 (“In Hershey, a local court not only acquiesced in an expanded view of state regulator authority but went still further,… seemingly becoming close to direct supervisors of trust activity. The Hershey court arguably also redefined and expanded the legal duties of charitable trustees.”).
tion. The same cases that established attorney general primacy in charitable enforcement also confirmed that charitable trusts and corporations “would be protected from state meddling in internal governance and contractual affairs.” To that end, the attorney general must
guard against charity fiduciaries’ wrongdoing, and
...enforce charitable obligations without interfering in discretionary decision making carried out in good faith. An attorney general is vested with the authority to seek to correct breaches of charity responsibilities and of fiduciary duty that have not otherwise been remedied by the board, but the attorney general is not a ‘super’ member of the board.

The Hershey episode illustrates the biases likely to influence an attorney general’s approach to foundation oversight. These include a tendency to favor local rather than national interests, immediate rather than long-term future benefits, and politically palatable rather than unpopular or minority interest positions. Such tendencies are part of an attorney general’s job and in the nature of political office. Yet these biases run against

119. See generally Komoroski, supra note 116.
120. Crimm, supra note 102, at 1101.
121. Brody, supra note 114, at 976 (emphasis added). As the dissent in the Hershey case stated: “Absent a showing that the Trustees’ actions are against the terms of the Trust or that the Trust provisions themselves are against public interest, the parents patriae powers of the Attorney General do not apply . . . . Moreover, there is no basis in the law, either statutory or case, giving the Attorney General a right to become ‘fully involved’ in the decision-making of the Trust; he is neither a co-manager nor co-Trustee of the Trust.” In re Milton Hershey Sch. Trust, 807 A.2d at 337–39 (Pellegrini, J., dissenting) (noting that the Deed of Trust "specifically gives the Trust Company, with approval by the School, sole and exclusive authority over the management of investments, including the sale of stock," and that legal precedent did not stand “for the proposition that the Attorney General, in exercising his parents patriae powers, can take action to see that some non-trust goal is accomplished,” such as the preservation of jobs); see also FREMONT-SMITH, supra note 44, at 301 (observing that the power of enforcement “implies the duty to oversee the activities of the fiduciary who is charged with management of the trust funds, as well as the right to bring to the attention of the courts any abuses that may appear to need correction. Thus a duty to enforce implies a duty to supervise (or oversee) in its broader sense. It does not, however, include a right to regulate, or a right to direct, either the day-to-day affairs of the charity or the action of the court.”) (emphasis added); Komoroski, supra note 116, at 1778.
122. See Brody, supra note 114. Recently, the Michigan attorney general launched an investigation into the Ford Foundation, asserting that the foundation has failed in its obligation to spend money in the state. See, e.g., Ian Wilhelm, Michigan Asks For Foundation to Show It Is Following Donor’s Intentions, CHRON. PHILANTHROPY, Apr. 20, 2006, at 10.
the very character of foundations and threaten the uniqueness that can make foundations innovative and effective. Attorneys general and judges must recognize that foundations are not political or public institutions and adjust the regulatory regime such that foundations can work toward their social purpose. A clearly articulated theoretical framework can also help define the proper relationship between foundations and government.

3. Claiming Foundation Assets for the Public Purse

Many commentators assert that foundation money rightfully belongs to the public. Advocates of this position would thus circumvent donor intent and fashion foundations into public, quasi-governmental institutions. At times, these commentators are even more explicit and would have foundations operate as a second tier of government. Ballooning federal deficits, for example, have led to calls for foundations to plug holes in public budgets: “federal spending cuts have increased the need for [foundations’] support of social services and the arts.”

123. Imposing responsibility upon foundations for filling government shortfalls is not a wise course. For example, such government conscription of foundations would be, in effect, delayed taxation of private fortunes accrued in the past, an inefficient and reactionary method of taxation. Fritz Heimann observed that the “role of being a junior partner in government-dominated programs does not provide an adequate solution to the future role of foundations.” Fritz Heimann, Foundations and Government: Perspectives for the Future, in THE FUTURE OF FOUNDATIONS, supra note 62, at 259, 263; see also O’CONNELL, supra note 70, at 7 (“[T]hough philanthropy has a responsibility to deal with emergency matters, particularly those involving human suffering, in the long run the small amount that philanthropy represents must be reserved for unique extra purposes. If not, philanthropic expenditures will not represent anything very different or unique and therefore might not be worth preserving.”).

124. Making foundations into adjunct government agencies or public institutions would contravene the inherent nature of these institutions. Peter Frumkin notes that, in a sharp break from precedent, foundations since the 1970s have willingly presented themselves as “profoundly public institutions, open and accountable to all.” Frumkin, supra note 88, at 69–70. Furthermore, “nothing in [philanthropists’] work suggests an interest in taking over day-to-day social welfare functions of government.” Paul Rosenberg, How Philanthropy Shapes American Life, CHRISTIAN SCI. MONITOR, Dec. 9, 1996, at 15. “Rather than forcing it to be like other conventional institutions, let us see what we can make of it.” John W. Gardner, President’s Essay: Private Initiative for the Public Good, in ANNUAL REPORT FOR 1964, at 12 (Carnegie Corp. of N.Y. ed., 1965).

The underpinning of this argument is “tax expenditure theory,” which holds that tax exemption operates as a direct government grant or subsidy, from which the leap is made to claiming the money as public.\textsuperscript{126} For example, one commentator has argued that “[t]he benefits granted through the tax code have the same value to the recipients as an equal amount of direct government subsidies… It is as if the taxpayer incurred and paid a tax liability, and the government gave the taxpayer a direct subsidy for the same amount.”\textsuperscript{127}

It is certainly true that the operation of tax exemption is equivalent, in effect, to a direct subsidy; monetarily, there is no difference. Beyond that specific mathematical effect, however, the government possesses no control over the money or the recipient. Few would contend, for example, that individual 401(k) plans, because they involve tax-exempt contributions, are owned or can be directly controlled by the government.

Some foundation observers, however, make precisely this inference regarding the assets of foundations: “Foundation money is not just private money. It’s public money. It’s our money.”\textsuperscript{128} Supporting this assertion is the tenuous argument distributed more of their money now instead of saving for the future.”); Cullen Murphy, \textit{Innocent Bystander, Fat Target}, ATLANTIC MONTHLY, May 2004, at 143.

\textsuperscript{126} This theory ignores that foundations pay considerable amounts in excise taxes on net investment income and that additional growth of the corpus occurs.


that, because foundations pursue public purposes, their money is therefore public property.\textsuperscript{129}

In his successful argument before the Supreme Court in the Dartmouth College Case, Daniel Webster declared: “That all property, of which the use may be beneficial to the public, belongs therefore to the public is quite a new doctrine. It has no precedent, and is supported by no known principle.”\textsuperscript{130} The Court, which adopted most of Webster’s arguments, agreed with him on this point as well and quickly disposed of the question of whether a charitable corporation that pursues public purposes thereby assumes the character of a public institution.\textsuperscript{131}

American society is full of instances in which private money furthers public purposes and public money aids private purposes. Many cities and municipalities use Tax Increment Financing (TIF) districts to revitalize decaying city centers and neighborhoods. Benefits accrue both to the public and private firms, but the use of public money does not make the city

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\item \textsuperscript{129} “We are the stewards of this money. It is not our money . . . . It is for public purposes.” Lance Lindblom, Remarks at Governance and Accountability in America’s Foundations 19 (Jan. 29, 2004), http://cpnl.georgetown.edu/doc_pool/IF01Governance.pdf.
\item \textsuperscript{130} Daniel Webster, Argument in the Dartmouth College Case, in MAKING THE NONPROFIT SECTOR IN THE UNITED STATES 125, 127 (David C. Hammack ed., 1998).
\item \textsuperscript{131} “Doctor Wheelock [the original donor] . . . could scarcely be considered as a public officer, exercising any portion of those duties which belong to government; nor could the legislature have supposed, that his private funds, or those given by others, were subject to legislative management, because they were applied to the purposes of education.” Trs. of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 634–35 (1819). In his concurring opinion, Justice Story discussed this issue at length, agreeing with the majority and Webster that a private institution that pursues public purposes does not then become a public institution:
\item If, therefore, the [establishment] be private, though under the charter of government, the corporation is private, however extensive the uses may be to which it is devoted, either by the bounty of the founder, or the nature and objects of the institution. This reasoning applies in its full force to eleemosynary corporations . . . . This is the unequivocal doctrine of the authorities; and cannot be shaken but by undermining the most solid foundations of the common law . . . . Yet whoever thought before, that the munificent gifts of private donors for general charity became instantaneously the property of the government; and that the trustees appointed by the donors, whether corporate or unincorporated, might be compelled to yield up their rights to whosoever the government might appoint to administer them? If we were to establish such a principle, it would extinguish all future eleemosynary endowments; and we should find as little of public policy, as we now find of law to sustain it.
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\textit{Id. at 672 (Story, J., concurring).}
“owner” of the businesses that move to the TIF area, nor are the private firms transformed into public institutions. Our basic philosophy favors such methods, and the establishment of foundations continues America’s tradition of taking a private sector route to achieve public goals.132

Moreover, arrogating a donor’s private endowment violates the contract between society and the donor. Centuries of English common law, as well as American common law, established a donor’s right to dedicate private money to public purposes. The public agreed not to tax that money, and certain beneficiaries enjoyed the fruits. Control of the endowment, however, never shifted. The common law remains clear in establishing a donor’s right to be free from external intervention, except in egregious instances.133

132. See Karl & Katz, supra note 50, at 260 (“Americans had found a way of doing ‘privately’ what governments in other advanced industrial societies were beginning to do.”).

133. See Brody, supra note 114, at 938 (“Anglo-American law recognizes the authority of private parties to create, fund, and operate nonprofit organizations for public purposes.”); see also Dartmouth Coll., 17 U.S. at 637–38 (“The objects for which a [charitable] corporation is created . . . are deemed beneficial to the country; and this benefit constitutes the consideration, and, in most cases, the sole consideration of the grant. In most eleemosynary institutions, the object would be difficult, perhaps unattainable, without the aid of a charter of incorporation . . . . They apply to the government, state their beneficent object, and offer to advance the money necessary for its accomplishment, provided the government will confer on the instrument which is to execute their designs the capacity to execute them . . . . The benefit to the public is considered as an ample compensation for the faculty it confers, and the corporation is created. If the advantages to the public constitute a full compensation for the faculty it gives, there can be no reason for exacting a further compensation, by claiming a right to exercise over this artificial being a power which changes its nature, and touches the fund, for the security and application of which it was created. There can be no reason for implying in a charter, given for a valuable consideration, a power which is not only not expressed, but is in direct contradiction to its express stipulations.”). The argument based on tax exemption also fails as a historical matter. Beyond the tax code, the long history of tax exemption strongly supports the argument that tax exemption does not qualify foundation assets as public money. Since the earliest days of taxation, exemptions have been granted. See Evelyn Brody, Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption, 23 J. CORP. L. 585, 587 (1998); see also Chauncey Belknap, The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy, in IV RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS app. at 2025, 2027 (1977) (“[T]he granting of tax immunity to ecclesiastical and military property is probably as old as the history of taxation.”). In medieval England, “[p]roperty held in frankalmoign was exempt from the usual feudal incidents . . . .” Patton, supra note 66, at 134–35. The Statute of Elizabeth, moreover, “was essentially an exemption statute.” Belknap, supra, at 2029. In the United States, the first federal income tax law in 1894 included a charitable exemption.
Related to the issue of taxation and foundation assets is the question of whether foundation grants should be “discounted” to shift more money to present, rather than future, needs. In a 2002 article, Paul Jansen and David Katz, applying the “time value of money” to foundation assets and giving, concluded that “the current approach to building and distributing this wealth isn’t serving the best interests of society. . . . Numerous foundations and endowed nonprofit institutions ought to spend their wealth sooner rather than later. . . .”134

A cogent rebuttal of the discount rate argument was made by Michael Klausner, who explained that “[t]he discounted cash flow approach [Jansen and Katz] use is inapplicable to the foundation payout issue.”135 Klausner labeled the authors’ analysis “flawed,” since “[t]o compare the private return available in the market with the social return available in the charitable sector . . . is an error of the apples-and-oranges variety.”136

That said, in some cases, focusing more on current problems benefits both current and future generations. For example, when the Rockefeller Foundation invested in the research that led to the vaccines for hookworm and yellow fever, it created a cross-temporal benefit. As out-market institutions, private foundations were never intended to be captives of the moment, and their freedom allows them to tailor their time-frame to particular issues.137

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Though this law was declared unconstitutional, all subsequent income tax provisions have contained it. See Pollock v. Farmers’ Loan & Trust Co., 158 U.S. 601 (1895). FREMONT-SMITH, supra note 44, at 56.


136. Id. at 53, 55. In private investments, projected cash flows of a proposed investment are discounted at the rate of return available on an alternative investment: “by making the proposed investment, the company or the individual would forgo the alternative investment. For foundations, however, when a grant is deferred to the future, there is no loss of an opportunity to earn a return on the foundation’s investments. . . . The funds remain invested in the foundation’s portfolio. . . . There is no loss of value as a result of delay regardless of the payout rate.” Id. at 54 (citation omitted).

137. Henry S. Pritchett, The Use and Abuse of Endowments, ATLANTIC MONTHLY, Oct. 1929, at 517, 524 (“Of one thing we may be reasonably sure—the problem cannot be solved by surrendering the capital of a great trust to the real, or imaginary, demands of the present moment. Some causes hang on the long result of time. Their contribution to human progress is cumulative. In the service of such
IV. WHY A THEORY OF THE PRIVATE FOUNDATION?

A. Rising Foundation Assets and Numbers

The question of what theory guides the private foundation looms as important as ever because of the enormous recent growth in the sector and auspicious projections of future philanthropic wealth. From 1987 to 2003, the number of private foundations rose from 25,094 to 58,991, a 135% increase.138 The real assets of private foundations grew by 150% over the same period.139 Comparatively, real Gross Domestic Product (GDP) in that time grew by an average of 3% each year, while real assets of foundations increased by an average of 6.2% each year. (See Figure 1).140


139. Id.

Moreover, some observers predict that, over the next fifty years, trillions of dollars will be directed toward philanthropy. Indeed, we are already beginning to see extensive philanthropic activity deriving from the fortunes made from the information technology boom of the past two decades. The potential opportunities presented by this wealth make it imperative that foundations have a new, more coherent theoretical framework to help guide them.

141. See, e.g., Gose, supra note 137 (“Researchers at the Social Welfare Research Institute at Boston College estimate that more than $34 trillion could go to charity in the next 50 years.”); see also John J. Havens & Paul G. Schervish, Why the $41 Trillion Wealth Transfer is Still Valid: A Review of Challenges and Questions, 7 J. GIFT PLAN. 11 (2003); GLOBAL BUSINESS NETWORK, THE COMING FLOOD: PHILANTHROPY IN THIS DECADE (2002), www.cof.org (searchable under the title “The Coming Flood”) (last visited Oct. 7, 2006). One prediction is that $6 trillion of the projected wealth transfer will go to foundations. Michelle Conlin, Lauren Gard & Jessi Hempel, The Givers, BUS. WK., Nov. 29, 2004, at 87.

142. See, e.g., David Teather, Net Benefits, GUARDIAN UNLIMITED, Feb. 6, 2006, http://technology.guardian.co.uk/online/search/story/0,,1703453,00.html (“Now the enormous wealth that has been created by Silicon Valley and the information age appears to be breeding a new wave of philanthropists, who are in some ways very different from the industrialists of the past. Crucially, they tend to have made their money far more quickly and some are giving large sums away at a younger age.”) (last visited Oct. 7, 2006); see also Katie Hafner, Philanthropy Google’s Way: Not the Usual, N.Y. TIMES, Sept. 14, 2006, at A1; Jolayne Houtz, Philanthropic World Giddy at Possibilities of Gates’ New Role, SEATTLE TIMES, June 18, 2006, at A17.
B. Evolving Problems and Criticism

As their numbers and assets rise, foundations will face new types of problems within social structures that constantly evolve. For example, three traditional areas of foundation programs—education, health, and poverty—have evolved over time, due in part to the ways in which democratic capitalism has affected them. We now recognize that their nature is not immutable. The problems facing our education and healthcare systems are different today than they were fifty or one hundred years ago. Democratic capitalism did not create poverty, yet it shapes the nature of poverty such that our approaches must evolve accordingly. For instance, statistics indicate that half of those in poverty in the United States today will not be so three years hence.145

By understanding that they exist to promote pluralism and a free-market economy as well as to challenge other institutions, foundations can operate within a broader social and economic context. This wider vision will help them act flexibly and imaginatively in addressing an evolving set of problems.

Judging by the scope and volume of contemporary criticism, however, there appears to be a widespread sense—both inside and outside the philanthropic community—that today’s foundations have not lived up to their potential and have failed to adapt to changing circumstances. Criticism, of course, has always attended the work of foundations. In the 1910s, for example, the Walsh Commission warned about the power foundations potentially could wield.144 Forty years later, at the height of the alarm over communist infiltration of the United States, the House of Representatives formed the Cox and Reece Committees to investigate suspected foundation involvement in “un-American activities”.145

Today, in part, because of the proliferation of private foundations and the growth of the assets they control, criticism has broadened and comes from all points on the spectrum of debate.146 Although much of it is perhaps unfair—foundations,

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144. See, e.g., Hall, supra note 94, at 4.
145. EDIE, supra note 99, at 8 (footnote omitted).
after all, present an easy target precisely because of their out-
market character—such criticism serves to highlight persistent
challenges that may hinder foundations’ effectiveness. Much of
the criticism targets the perceived reticence of foundations to
act boldly and exploit their possibilities, particularly over the
past forty years. Indeed, the only agreed-upon proposition
seems to be that, since the first three decades of foundation phi-
lanthropy, performance has steadily declined.147

In 1970, the Peterson Commission concluded that foundation
grant-making was characterized by “a rather pervasive passiv-
ity.”148 Waldemar Nielsen echoed this criticism, observing that
most foundations see their role as “that of beneficent crack-
fillers” instead of “architects or builders.”149 Alan Pifer, former
president of the Carnegie Corporation, warned that many
foundations, “afflicted as they are by severe cases of ‘programi-
this’ that constricts their horizons, narrows the range of their
perception, and dulls their imaginations, are poorly equipped
to be of much value to our times.”150

More recent critics have lamented the absence of “ambitious”
programs151 and foundations’ “institutional unwillingness to
support initiatives that pose significant risks.”152 Still more
criticism is directed at foundation attempts to improve them-
selves, as seen in the wave of “performance metrics” that has

147. See, e.g., Roger M. Williams, Know Thy Critics, FOUND. NEWS & COMMENT.,
May–June 1998, at 25, 26 ("Foundations today are assailed for a wide variety
of perceived sins. They're said to be arrogant and insular; rigid, nonintellectual, non-
strategic, politically correct; too politically motivated or elitist or managerial (or,
insufficiently so); scheming to get their programs adopted by government; and
insensitive to grantees and grantseekers.").
148. PETERSON COMMISSION REPORT, supra note 4, at 119.
149. NIELSEN, THE GOLDEN DONORS, supra note 17, at 426; see also id. at 426
("The great majority [of foundations] are not on the whole disposed . . . to serve as
catalysts of institutional or social change . . . . They are overwhelmingly institu-
tions of social continuity, not change.").
150. ALAN PIFFER, SPEAKING OUT: REFLECTIONS ON 30 YEARS OF FOUNDATION
151. Samuels, supra note 90, at 28.
152. Joel Fleishman, Simply Doing Good or Doing Good Well, in JUST MONEY: A
CRITIQUE OF CONTEMPORARY AMERICAN PHILANTHROPY 101, 109 (H. Peter Karoff
ed., 2004); see also Eisenberg, supra note 128, at 23 (“What’s amazing to me . . . is
that foundations still talk about themselves as the cutting edge of civil society. Oh,
how little cutting they do. How few risks they take.”). Mark Dowie wonders if the
large philanthropic foundations will “continue their minimal, unimaginative
funding of safe and soft institutions proposing weak, incremental solutions to
urgent and undeniable crises.” DOWIE, supra note 50, at xxxiii; see also Samuels,
supra note 90, at 28.
swept the foundation world. I53 Foundations, complains Ira Cutler, “spend millions trying to prove . . . obvious propositions.” I54 Observers dispute the reasons for this loss of imagination, with some citing a failure of leadership I55 and others noting the growth of the federal government in areas previously dominated by foundations. I56

In addition to these forms of criticism, a vocal strain excoriates foundations for subverting capitalism. Heather Mac Donald alleges that foundations have become “a political battering ram targeted at American society,” I57 and Willa Johnson


155. See, e.g., Pablo Eisenberg, Op-Ed., Where is the Leadership of the Foundation Community?, BOSTON GLOBE, Feb. 21, 2004, at A19 (complaining that, “[c]ompared to past outstanding foundation leaders . . . the current crop of foundation CEOs pale in comparison. They appear to be institutional managers, not visionary leaders possessed with courage and a commitment to improving the performance of the foundation sector.”); see also Pablo Eisenberg, Solving the Nonprofit Leadership Crisis Will Take Much Work, CHRON. PHILANTHROPY, Dec. 9, 2004, at 44 (“Nonprofit organizations and foundations suffer from a critical lack of leadership. The top executives of too many organizations lack vision, courage, a collaborative instinct, and intellectual rigor. While a few promising new leaders have begun to make their mark, their ranks are much too thin to provide great encouragement about the future.”).

156. A primary example is research. After World War II, spurred by the conflict in Korea and the Cold War, Washington recognized the need for greater investment in universities and general research. Before the war, only 2% of the federal budget was allocated to scientific research. Soon after, however, the federal government became “America’s leading patron of science,” establishing the Atomic Energy Commission, the National Institutes of Health (NIH), and the National Science Foundation (NSF). DOWIE, supra note 50, at 65. By the 1950s and 1960s, federal funding dwarfed foundation investments: the NIH budget climbed from $50 million in 1951, to $400 million in 1960, to $1.4 billion in 1967, making it “increasingly difficult for foundations to make a significant contribution to biomedical science.” Id. at 67. By the late 1960s, “the government had become the central bank of science in America.” Id.

157. MAC DONALD, supra note 90, at 3. Criticizing “the thirty-year-long foundation assault on the bourgeois virtues that once kept communities and families intact,” id. at 16, Mac Donald states: “No longer content to provide mainstream knowledge dispassionately, America’s most prestigious philanthropies now aspire[] to revolutionize what they believe[] to be a deeply flawed American society.” Id. at 4; see also Acs & Phillips, supra note 11, at 197 (“American philanthropists created foundations that in turn contributed to greater and more widespread economic prosperity by investing in the future of America. However, such views are not really fashionable among scholars of philanthropy and more than a few of
charges that foundations have “lost faith” in “traditional American values.”\textsuperscript{158}

Finally, some commentators point to a profound shift in the conception of philanthropy within foundations over the past thirty to forty years, citing this shift as a drag on effectiveness and beneficial impact.\textsuperscript{159} This line of criticism focuses on the professionalization of philanthropy:

[D]ating from around the turn of the century to 1960, private foundations appear to [have been] uncomplicated institutions with minimal administrative staffs.... With small or nonexistent administrative staffs and little concern with public accountability, foundations used their tremendous resources however they saw fit.... [F]rom the 1970s and beyond, large private foundations appear [to have been] dramatically transformed. Gone is the simple administrative structure that enabled early foundations to act quickly and decisively. In its place is a complex administrative bureaucracy staffed by a new cadre of foundation professionals, often with multiple approval levels through which grant decisions must travel.\textsuperscript{160}

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  \item the professionals who staff foundations.... At an American Assembly meeting a few years ago, the participants... produced a statement calling on philanthropists to do more to redistribute their wealth from the ‘haves’ to the ‘have-nots.’ Carnegie would have been appalled since he thought that by fostering greater economic opportunities, philanthropists could prevent such redistributive schemes.”\textsuperscript{158}.
  \item \textsuperscript{158} DOWIE, supra note 50, at 15 (quoting WILLA JOHNSON, CAPITAL RESEARCH CTR., ANNUAL REPORT (1991)); see also WOOSTER, supra note 49. Ironically, from the other side of the spectrum comes the critique that foundations have become ineffective because they seek to sustain and strengthen capitalism: “Brilliant and constructive as some of their work has been, much of it has also been fruitless, uninspired, and designed to do little more than perpetuate the economic and social systems that allow foundations to exist.” DOWIE, supra note 50, at xx.
  \item \textsuperscript{159} William Schambra observes that many foundations concentrate heavily on “professional norms” and sustaining “the elaborate institutional apparatus built around those norms,” instead of producing economic and social benefits. William Schambra, Small is Bountiful: In Defense of Small Foundations, PHILANTHROPY, July–Aug. 2005, at 34, 35.
  \item \textsuperscript{160} Frumkin, supra note 88, at 69–70. For Frumkin, the primary contributing factor to this shift was the effect “of government regulation on organizational behavior and culture.... In an effort to defend philanthropy from further government investigation and regulation, foundations strategically recast themselves as public trusts to be governed by public purposes and brought in a new class of foundation professionals to manage external relations. In this sense, government regulation was the direct trigger to the paradigm shift that occurred throughout organized philanthropy starting in the 1970s.” Id. at 70. The professionalization of foundation philanthropy and overemphasis on procedure, says Schambra, leads foundation staff to
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To withstand these forms of constant criticism and the possibility of further government scrutiny, foundations must possess greater clarity as to their role and raison d’être.

V. UNIQUE ASSETS OF FOUNDATIONS

A. Purposefulness

Because a private foundation has no external market signals to help it to remain faithful to donor intent, maintain its relevance to a free-market economy, or give warning when the foundation no longer creates value, foundations bear a greater individual responsibility than other institutions to maximize their potential. “Ultimately, the question is not simply whether [a foundation does] some good but whether . . . it has fully exploited all its possibilities.”161 Little will indicate to a foundation that it has drifted into irrelevance. Rather, the foundation’s invulnerability to market forces requires increased vigilance to ensure that it remains focused, deliberate, and purposeful.162

In one sense, purposefulness connotes economically purposeful activity promoting the expansion of human welfare by helping individuals acquire skills and competencies. In another sense, however, a purposeful approach entails consistency with the bedrock principles of democratic pluralism and a free-market economy: individual dignity, the expansion of opportunity, and individual freedom.

Such a focused strategy also involves innovation. Freedom to innovate is one of the singular virtues of the private foundation. Foundations, by self-renewing and adapting to the shifting nature of capitalism, can continue to serve as a resource for

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view “individuals as unimportant, passive playthings of social, political, or biological forces which rule humanity and can only be understood and managed by experts. Yet the American way of life is grounded in the opposite view.” William A. Schambra, Root Causes vs. Reality, PHILANTHROPY, Nov.–Dec. 2004, available at http://www.philanthropyproundtable.org/article.asp?article=799&paper=0&cat=148.

162. In 1949, a study committee formed by the Ford Foundation to outline the future direction of the Foundation produced a comprehensive report. The committee warned about the dangers of external threats both because of the necessary independence of foundations and the impact on foundations’ ability to innovate: “it might lead foundations to become timid, to concentrate on the little and the safe projects, and thus to commit their funds to inconsequential work.” FORD FOUNDATION, REPORT OF THE STUDY FOR THE FORD FOUNDATION ON POLICY AND PROGRAM 114 (1949) [hereinafter FORD FOUNDATION REPORT].
society to use in meeting new challenges and exploring new paths. This is what foundations have historically done when they have been most productive in exploiting opportunities, as illustrated by the examples discussed above.

This is not to say that every foundation, or every foundation dollar, must be committed to innovation. Sustaining funds are highly worthwhile. No symphony orchestra or social service program can do something new every day, and there is often great value in their continuing to do what they have long done. We must be thankful that there are foundations to help sustain such activities, preserving the received social order and incidents of civilized society. Even foundations such as these, however, must be judged with respect to donor intent and social contributions, and it must be ensured that they do not subvert capitalism.

163. In describing the record of the Kellogg Foundation, Nielsen opined that though it had not “helped spawn new organizations,” the Foundation, “in its own fashion and within its own value framework . . . has moved with the times. . . . Structurally it has also evolved and improved.” Nielsen, The Golden Donors, supra note 17, at 275 (emphasis added); see also Editorial, Catching Malaria, WALL ST. J., Apr. 25, 2006, at A18 (discussing the effectiveness of anti-malaria efforts by a private foundation when compared to programs run by the World Bank).

164. See, e.g., Ford Foundation Report, supra note 162, at 100 (“The success of any program will not depend solely on the urgency of the problem it seeks to solve, or on the wisdom of the program’s general approach, but upon finding the right projects headed by the right men at the times that offer the most strategic opportunities. This job of strategic selection and tactical execution must, of course, be left to the President and officers of the Foundation, under the direction of its Trustees.”) (emphasis added).

165. For example, museums play a crucial role in facilitating “cultural exchange,” letting “people enter a world that they couldn’t otherwise reach or imagine,” and providing a place for people “to think about the rest of the world, and to reflect on their proper position in it.” Peter Aspden, The Museum as Global Mediator, FIN. TIMES, Mar. 28, 2006, at 15 (quoting Neil MacGregor, director of the British Museum).

166. Nielsen observed that one of the arguments in defense of the Kresge Foundation’s focus on “bricks-and-mortar grants” is that, since many large foundations are “prejudiced” against these types of grants, Kresge actually fills “something of an unoccupied niche.” Nielsen, The Golden Donors, supra note 17, at 281. Nielsen went on to note that the counter-argument that small and medium-sized foundations—the majority of foundations—“do little more than contribute to capital fund campaigns and bricks-and-mortar projects of various kinds. Indeed even the largest foundations, if one examines the grant lists of most of them, have a strong predilection for such giving.” Id. at 282.
Furthermore, in the nonprofit marketplace, sustenance is not a long-run differentiator. To justify the continued existence of this unique social institution, there must also be a significant amount of the kind of activity that only an organized private foundation can carry out—namely, systematic and sustained innovative activity. Foundations account for only twelve percent of total charitable giving in the United States. Their unique advantage is that they represent institutional concentrations of wealth and other non-financial assets, which enhance the leverage and innovation they are able to apply to social and economic problems.

Ultimately, to achieve purposefulness there must be enough high-impact results to demonstrate that the opportunity cost of foregoing the foundation’s chosen activity would be prohibitive. Otherwise, the rationale for the foundation’s actions would appear to be on shaky ground. Foundations, then, must engage in opportunity cost analysis. Such analysis provides a

Jeremy Grant, Just Don’t Cut the Artistic Content, FIN. TIMES, Jan. 30, 2006, at S3 (emphasis added).

167. Even in the world of nonprofit arts organizations, merely sustaining the status quo is undesirable. Michael Kaiser, president of the Kennedy Center for the Performing Arts, asserts:

Almost never do you save your way to health in the arts, it’s about revenue generation. Your health comes from doing exciting work, and from marketing that work very aggressively so people either want to buy tickets or contribute funds. . . . The mission of an arts organization is completely different from the mission of a corporation. When you are a for-profit corporation it’s clear what you’re for. When you are a not-for-profit, what are you for? What is your mission? And how do you make that mission come true? . . . Because the mission of the Royal Opera House [in London’s Covent Garden] is not to balance its books. The mission is to do exciting opera and ballet.

168. See, e.g., Bremer, supra note 51, at 102 (“[T]heir number, and even the size of their capital assets, [is] less significant than the boldness of the enterprise to which they [are] committed.”). Foundations, says Schamba, must break loose of “the confines of technocratic tinkering.” William A. Schamba, Seven (Bad) Habits of (In)effective Foundations, CHRON. PHILANTHROPY, Feb. 9, 2006, at 35, 37.


170. See, e.g., NIelsen, THE GOLDEN DONORS, supra note 17, at 425 (noting that foundations can be “instruments by which the best available intelligence, experience, and specialized knowledge can be brought to bear in the least distorting and inhibiting circumstances” on complex problems”).

171. Every decision incurs opportunity costs because “making a choice in effect costs us the opportunity to do something else”; for “every time we make a choice
check on the use of financial and non-financial assets, and infuses foundations with the purposeful character that is critical for their survival.\(^\text{172}\)

Devoid of purpose, foundations become not only wasteful stewards of wealth, but also more vulnerable to the interference of grantees and public officials.\(^\text{173}\) Moreover, the general-purpose mandates of many foundations demand that they continuously measure themselves against just such purposeful criteria. Paying attention to purpose can thus help guard foundation independence and prevent wasteful use of resources.\(^\text{174}\)

B. Non-Financial Foundation Assets

The prevailing image of private foundations is that of passive conduits of money aimed at sustaining nonprofit organizations. In other words, foundations are simply “charitable intermediaries” or “nonprofit banks.”\(^\text{175}\) Money, however, is not the primary asset of the private foundation.

1. Institutional Innovation

In democratic capitalism, progress arises out of a perpetual contest among institutions and individuals. Economic, social, governmental, and cultural institutions constantly bump against one another, influencing the direction others take and driving the evolution of the entire system.\(^\text{176}\)

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172. See, e.g., William A. Schamba, How to Make a Big Foundation Effective, CHRON. PHILANTHROPY, Sept. 14, 2006, at 43 (suggesting that foundations ask themselves: “When we choose an approach to a problem, what competing, alternative paths are we rejecting, and what are we giving up by so doing?”).

173. See, e.g., Charles Handy, Tocqueville Revisited: The Meaning of American Prosperity, HARV. BUS. REV., Jan. 2001, at 57, 60 (“It is one of capitalism’s laws that riches have a use-by date; kept too long unused, they start to stink.”).

174. Cf. Daniel J. Boorstin, From Charity to Philanthropy, in AMERICA’S VOLUNTARY SPIRIT 129, 139–40 (Brian O’Connell ed., 1983) (“But the foundations which dominate the scene nowadays are extremely general in their purpose. . . . The Ford Foundation’s purpose is to serve the public welfare. Spontaneity, drift, fluidity, and competition among American institutions have given our future much of its vitality. Some of the dangers which come from the new large foundations spring from the very vagueness and generality of their purposes as well as from their sheer size.”).


176. See, e.g., HODGSON, supra note 13.
Private foundations must engage in this institutional contest to promote the adaptation and evolution of other institutions. Indeed, the fundamental question at the heart of philanthropy is, “how do foundations induce others, at all levels of government and in the private sector, to give and to do?”

Skill at this institutional engagement is one of the key non-financial assets of foundations and requires that they be attuned to underlying forces and trends; they must “anticipate the strains of social change.” For example, “having foreseen the coming of the ‘biological age’ in science,” the Rockefeller Foundation was able to use its money to stimulate advances in genetics, biophysics, and biochemistry.

Often, this approach takes the form of creating completely new institutions harnessing individual knowledge and skills. For example, when the Peabody and Slater Funds set out to rehabilitate the war-torn South, they established a completely new educational system. The Rosenwald Fund built an entire educational structure for blacks previously denied access to quality educational institutions. Later, foundations initiated new institutional outlets for knowledge by helping to establish and operate such capable organizations as the Brookings Institution (Carnegie Corporation, Rockefeller Foundation), the National Bureau of Economic Research (Carnegie Corporation, Commonwealth Fund), the Social Science Research Council (Laura Spelman Rockefeller Memorial, Russell Sage Foundation, Rosenwald Fund), the National Academy of Sciences-National Research Council (Carnegie Corporation, Rockefeller Foundation), the RAND Corporation (Ford Foundation), and

177. Foundations must promote “institutional efficiency and flexibility.” Smith, supra note 6, at 42. Alan Pifer, former president of the Carnegie Corporation, insisted that foundations must “facilitate the adaptation of major institutions to” the continued evolution of social problems. Nielsen, THE GOLDEN DONORS, supra note 17, at 45. In the institutional contest of capitalism, rather than pursuing a “servicing approach” that achieves “little intellectual impact,” foundations have often played their most important roles as “organizers,” “reinventors,” and “reshapers” of institutions. Id; see also Marilyn Chase, Gates Won’t Fund AIDS Researchers Unless They Pool Data, WALL ST. J., July 20, 2006, at B1 (“Bill Gates is tying his foundation’s latest, biggest AIDS-vaccine grants to a radical concept: Those who get the money must first agree to share the results of their work in short order.”).


181. See supra Part III.C.1.
the Institute of Medicine (Robert W. Johnson Foundation).182 Private foundations thus “embody an idea absolutely vital to American democracy, namely the need for independent centers of initiative to challenge, criticize and provide a creative spark” for other institutions, always with the goal of advancing growth and human welfare.183

2. Ideas

Julius Rosenwald believed ideas to be the primary asset of private foundations.184 Historically, foundations have indeed played a key role in generating, cultivating, and disseminating ideas. For example, Frederick Gates, as advisor to the Rockefeller Foundation, followed a strategy of exploring new ideas and then choosing individuals and organizations to execute them.185 The Robert Wood Johnson Foundation used its grants for training dentists to treat handicapped children and adults to spread awareness of pervasive problems and obstacles in the dental field.186 The John M. Olin Foundation is largely credited with creating the field of law and economics.187

182. See Karl & Katz, supra note 50, at 248. In health care, foundations played a significant role “in the replacement of small, parochial, denominational clinics and hospitals by large, professional, scientifically-based medical centers.” Ham-mach, supra note 68, at 56. Foundations “provided money, expertise, and credibility that helped establish a new set of institutions—insti-tutions which then flourished.” Id. (emphasis added). “When existing organizations do not seem adequate for addressing a particular problem, foundations sometimes create new ones.” Fleishman, supra note 152, at 101.

183. Nielsen, The Big Foundations, supra note 17, at x; see also Bailey, supra note 34 (“We should not assume that we’ve already got the ideal institutions and the only thing we need to do is just throw more money at them.”) (quoting Paul Romer); Schambra, supra note 168, at 35 (“To generate serious change, more often than not it is necessary to provoke serious opposition.”).

184. “Real endowments are not money but ideas. Desirable and feasible ideas are of much more value than money.” Julius Rosenwald, The Trend Away from Perpetuities, ATLANTIC MONTHLY, Dec. 1930, at 741.

185. Nielsen, The Big Foundations, supra note 17. See also Ford Foundation Report, supra note 162, at 100 (noting that foundation must “consider the three basic approaches to the solution of problems—the advancement of knowledge by research; the practical application of knowledge; and the dissemination of knowledge by education and the development of personnel.”).

186. See O’Connell, supra note 70, at 74–75.

Ideas, and in particular “meta-ideas,” play an essential role in promoting growth in democratic capitalist systems. The ability of private foundations to explore and disseminate new ideas through the economy and society as well as use them to advance human welfare is arguably the signal resource of foundations. This also requires foundations to remain open and flexible to ensure incorporation of new ideas.

3. People

The effectiveness of a private foundation depends on the degree of open-mindedness of the foundation and their ability to imagine new possibilities, translate ideas into action, and improve the performance of others. Foundations must concentrate on developing human capital within their own ranks. Thus, rhetorical fads such as “strategic philanthropy” and “high-engagement funding” are less important than attracting the top minds in a given field to come to foundations and undertake independent research.

188. Meta-ideas are “ideas about how to support the production and transmission of other ideas.” Paul Romer, Economic Growth, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS (David R. Henderson ed., forthcoming 2007). Romer observes: “We consistently fail to grasp how many ideas remain to be discovered. The difficulty is the same one we have with compounding: possibilities do not merely add up; they multiply.” Id.

189. When she established the Josiah Macy Jr. Foundation, Kate Macy Ladd wrote, “Experience seems to show that in an enlightened democracy private organized philanthropy serves the purposes of human welfare best by investigating, testing, and demonstrating the value of newer ideas.” Susan M. Fitzpatrick & John T. Bruer, Science Funding and Private Philanthropy, 277 SCIENCE 621 (Aug. 1997).

190. Nielsen concluded that foundations can become “intellectually narrow and desiccated” by a “negative attitude toward new ideas.” NIELSEN, THE BIG FOUNDATIONS, supra note 17, at 90–91.


Indeed, many of the earliest donors were quick to see the value of recruiting knowledgeable people to their foundations. They recognized that, for foundations to make any progress, they must first build a suitable knowledge base. As Fritz Heimann has observed:

Careful and sophisticated determinations must be made within each field of activity to find areas where foundations can make a distinctive contribution. The development of such programs is no job for dilettantes. . . . *What it requires is detailed knowledge and convictions with respect to the particular field of activity, not expertise in the methodology and procedures of philanthropy.*

Though foundations should retain a corps of knowledgeable and talented people, they must also stimulate similar development outside their walls. Human welfare is advanced in large measure by individuals who challenge the status quo; foundations must seek out such individuals. Many do this, for example, through awards and fellowships, which leverage the power of individuals to spread certain ideas. A contempo-

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193. As previously discussed, independent research is an important foundation activity for several reasons. First, foundations need some level of knowledge and expertise in the fields in which they operate. Second, research can lead to disciplined and informed thinking, which is essential for generating impact. Third, it can help insulate foundations from passing fads and keep them focused on long-term projects aimed at lasting structural change. Finally, independent research can help prevent foundations from defaulting to ideological crutches that are easily substituted for clear thinking.

194. “[F]rom the very start it seemed clear that a substantial portion of the annual income of these institutions was to be devoted to scientific and social research, much of it done through grants to universities, but substantial portions performed by scientists employed by the foundations themselves.” Karl & Katz, *supra* note 50, at 246 (emphasis added).


196. “To get the best long-term results the Foundation should not only provide grants to help competent men do their best work, but should also seek to increase the supply of competent men.” *Ford Foundation Report, supra* note 162, at 122.

197. “There are, of course, great sweeping tides in history—plague, famine, financial panic, the calamities of nature and war. Yet time and again, more often than not history turns on individual personality, or character.” David McCullough, Jefferson Lectures in the Humanities: The Course of Human Events (May 15, 2003), available at http://www.neh.gov/whoweare/mccullough/lecture.html.

198. Such an approach is very effective because it applies individual leverage to raise awareness of certain ideas or research. “Foundation managers are well aware that the recognition that comes with an individual grant or prize is often more valuable than the money. To the extent that they change the distribution of
rary example is the X Prize Foundation, which helped galva-
nize the race for private space flight and will soon apply itself
to other areas as well.199

4. Leverage

Money may be a less important asset of the private founda-
tion than institutional innovation, ideas, and people, but it is
with money that foundations turn the other assets into pro-
grammatic achievements that advance economic growth and
human welfare. Still, the financial assets of foundations are
relatively small compared with the budget of the federal gov-
ernment and represent only a tenth of aggregate charitable con-
tributions. Thus, foundations must realize their inadequacy in
directly implementing large-scale solutions and instead seek to
apply leverage in instigating change.

This does not mean foundations should retreat to small-scale
programs or policies of “scatteration.”200 Such strategies often
fail the test of focus and produce little of social value. Rather,
foundations can be effective by researching and gaining
knowledge of how a system works. They may then leverage
that knowledge to create ripple effects, indirectly inducing oth-
ers to change.201

For example, the Peabody Education Fund began with a $2
million endowment at a time when the federal government
was pouring money into Reconstruction. Given their small size,
the Fund’s programs could have been drowned in the face of
such a daunting sea of challenges. Instead, to make an impact
and achieve its goal of rebuilding the South, the Fund chose the

recognition, prestige, and honor, foundations promote public agendas.” Hammack, supra note 68, at 46. Outstanding examples of this method include the Danforth Foundation’s graduate school fellowships, the Markle Scholars Program, the Robert Wood Johnson Foundation’s scholarships and fellowships, and the Lasker Foundation awards. See O’Connell, supra note 70, at 39–45.
201. “By concentrating on a limited area, a foundation is more likely to bring to bear meaningful expertise, and its available resources are more likely to have a perceptible impact.” Heimann, supra note 123, at 263. In his catalog of “great gifts,” O’Connell warned that “if these funds are not targeted carefully they would add an incidental rather than an extra dimension to our efforts to address major needs and aspirations.” O’Connell, supra note 70, at 6–7.
lever of access to quality education.\textsuperscript{202} When Carnegie, Rockefeller, and other foundations transformed the American systems of medical research and education, they commissioned and undertook voluminous amounts of research before strategically intervening at the opportune moment and location.\textsuperscript{203} Finally, when it sought to improve the delivery of health care in the United States, the Robert Wood Johnson Foundation leveraged a specific angle, which ultimately yielded greater dividends than a comprehensive grant program could have. The result was the 911-emergency response system.\textsuperscript{204}

VI. CONCLUSION

As the number and assets of private foundations continue to grow, foundation legitimacy will be the subject of continuous examination. This examination will not be limited to individual institutions but will extend to the entire class of foundations. Such scrutiny is appropriate given that foundations represent pools of wealth specifically set aside for the advancement of humankind.

This Article argues that, to justify its continued existence as a unique institution, the foundation must see its actions as the basis of its legitimacy and definitive of its purpose. Furthermore, foundation actions must ultimately relate to the “meta” institution of democratic capitalism, which allowed foundations to exist in the first place. Such consideration of purposefulness is of little concern to other familiar institutions, whether in the public or the private sectors, because they are continuously tested by market forces. Whether such institutions continue to exist reflects the decisions of customers. The private foundation, however, is an out-market institution blessed with the resources and the protection of law so as to continue to act into the indefinite future, irrespective of customer satisfaction.

Criticism of foundations is based on their actions. What a foundation does today is tested against what a different institu-

\textsuperscript{202} This focus on access to quality education became the Fund’s “single animating idea.” Peabody’s “aim was ‘the widest possible influence upon the surrounding country’ so that local school district successes would ultimately transform state educational systems, inspire the establishment of state normal schools, and improve teacher training.” SMITH, supra note 48, at 3.

\textsuperscript{203} Hammack, supra note 68, at 56.

\textsuperscript{204} See, e.g., NIELSEN, THE GOLDEN DONORS, supra note 17, at 125.
tion—principally government—might do in its place and with its resources, or against notions that the future may not need the activity a private foundation can uniquely provide. Their very potential for continued life outside the discipline of the market’s constant testing of purpose permits many foundations to shelve the express, or implicit, intentions of their founders as well as the explicit theory of their legal existence—namely, the improvement of social welfare within a system of democratic capitalism.

To the extent that every foundation must pursue charitable activity, it is important to appreciate that the very nature of charitable activity itself has changed. The American system of free-market capitalism has become more efficient and more productive, and has achieved levels of social and economic equality never seen before. Accordingly, the objectives and

205. The latter argument implicitly assumes government to be the superior institution: whatever resources it can control today are best applied today rather than to future activities. See, e.g., Bradley & Jansen, supra note 125, at A23.

206. Any measure of well-being demonstrates this fact. Recent income data from the Census Bureau show that the household income distribution of American families has over the last forty years steadily moved higher—more families are moving from lower to higher income brackets. See CARMEN DE- NAVAS-WALT, BERNADETTE D. PROCTOR, & CHERYL HILL LEE, U.S. CENSUS BUREAU, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2005, at 31; Stephen Rose, What’s (Not) the Matter with the Middle Class? AM. PROSPECT ONLINE, Sept. 4, 2006, http://www.prospect.org/ web/page ww?section= root & name = ViewWeb & articl eId = 11943. Additionally, income levels in the United States remain dynamic, not static: nearly half of people in poverty in 1996, for example, were not in poverty three years later. See CARMEN DE- NAVAS-WALT, BERNADETTE D. PROCTOR, & CHERYL HILL LEE, U.S. CENSUS BUREAU, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2004, at 2 (2005); Stephen Rose, The Trouble with Class-Interest Populism, PPI BACKGROUNDER, Apr. 25, 2006, available at http://www.ppionline.org/documents/Class-Interest_Populism_042606.pdf (demonstrating that, when family incomes are measured by their fifteen-year averages, sixty percent of Americans make over $60,000 per year.). The distribution of American jobs, moreover, has steadily moved toward higher-skilled professional jobs and away from manual labor. See Ian D. Wyatt & Daniel E. Hecker, Occupational Changes During the 20th Century, MONTHLY LABOR REV., Mar. 2006, at 35 (showing that occupational distribution in the United States has dramatically shifted toward “professional” job categories and away from categories such as laborer); Rose, supra, at 7 (“The striking thing here is that there has been a large increase in the share of elite jobs, with most of the offsetting loss coming from the share of less-skilled jobs.”). Americans’ lives have also been made ever easier by energy-efficient and energy-saving appliances, personal computers, and cheaper, more accessible entertainment. In 1978, for example, 55.8% of U.S. households had some form of air conditioning—by 2005, 85% had it. Similarly, 82% of households in 2005 had washing machines. See U.S. CENSUS BUREAU, AMERICAN HOUSING
approaches of charity, even the very concept of charitable purposes, must shift and be re-evaluated. This observation, however, raises the larger question of how society might guide the private foundation without extinguishing the freedom foundations need to creatively challenge other institutions to greater effectiveness. Precisely because it operates beyond the market, the foundation presents particularly difficult problems of governance for legislatures and courts to consider.

In many ways, foundations are the most private of all society’s institutional actors, and the law presumes that they should continue in their private action on society’s behalf, free of externally imposed objectives or timeframes. Indeed, by examining three ways in which this presumption operates, we find the potential for a rule that might guide those who would create and fund new and existing foundations, those who would assume the duty of trusteeship, and those who might challenge the presumption—most likely a state attorney general.

First, the most significant guide to a foundation’s ability to operate without the imposition of public expectations is the direction of the founder at inception. For the most part, founders are parsimonious in expressing their intent. Because the law establishes only a minimal standard, many foundations come into being with the merest of stated purposes. Even then, founder intent must be diligently sought, whether it was left in handwritten notes or videotaped instructions.

Because the foundation is usually intended to exist in perpetuity, the wise founder must consider the long-term implications of his intent. Dedicating the resources of a perpetual foundation to the cure of a specific disease, for example, may

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leave a foundation confused as to its purpose once the disease is cured. Similarly, it is easy to imagine how a new foundation dedicated to improving global climate conditions could exacerbate the problem it sets out to cure; science has shown itself vulnerable to both politics and fads. Thus, the wise donor must look into the future and weigh contingencies that others might not consider.

Second, once the donor ceases to control the foundation, the trustees must remain as loyal as possible to the donor’s intentions and thus maintain the presumption of continued private action. Even when a donor has been relatively silent as to the foundation’s direction, trustees are not at liberty to fashion their own policies. Donors should remain all important to foundations. No founder lacks a clear record of his life. It is common for founders to have been very successful business people, most often entrepreneurs. We know what they did to transform entire dimensions of human life and trustees should be able to infer values from their accomplishments.


208. Support for medical research, the spread of educational achievement, and economic growth writ large, appear to survive as perpetually relevant donor intentions. These goals appear somewhat immune to the capture of interests and the substitution of the passions of subsequent trustees for the donor’s original, clearly stated intent.

209. One convenient argument discussed above is that a foundation’s resources belong not to the deceased donor but to society. By extension then, whatever intent the donor set down at the outset may be set aside by the trustees and their counselors. This argument stretches the law, reason, and the moral guidance that respect for the donor should command. The monies in every foundation would not exist but for the initial gift of the donor, whose donation, in most private foundations, accounts for all the resources ever taken in by the foundation. That is, the initial gift is generally the only gift. While the nominal dollar amount of the gift may have long since been expended, the current corpus reflects the continued magnification of the initial infusion through investment in the free-market economy. When considered from this angle, the perpetual foundation is a creature of democratic capitalism in a particularly indelible way.

210. The lives of Henry Ford and John D. Rockefeller are instructive—exhaustive biographies with popular appeal exist for both men. See WATTS, supra note 39; CHERNOW, supra note 51. Like any person, each had his own unappealing beliefs and idiosyncrasies, yet also was possessed of traits worthy of emulation, not the least of which was philanthropic generosity. Ford’s life is often reduced to anti-Semitism, just as Rockefeller’s is pithily summed up with the term “robber baron.” Surely, however, the trustees of charitable foundations should look to the extraordinary good their founders sought to achieve as reflected in their economic contributions and charitable actions. Both Ford and Rockefeller endowed hospi-
would thus do well to respect the donor by, whenever possible, inferring values from the donor to guide the work of the foundation.211

An unfortunate strain of thinking among theorists holds that trustees should seek to be influenced by a solicited or constructed constituency, sometimes referred to as stakeholders.212 Trustees then set out to satisfy this group—identified by the trustees themselves—in a non-economic exchange of valuable resources for approbation. Because the exchange is by its nature entirely donative on the side of the foundation (its giving is compelled by law), it will always yield positive acceptance by the self-defined “stakeholder” community.

Inevitably, philanthropy is drawn to the prospect of ameliorating the negative externalities of our market-based system. Absent market direction, however, the foundation is liable to gravitate toward action that is more empathetic in nature. To approach its task instead from the perspective of changing the economic environment in ways that allow more people to prosper requires an analytic perspective that forces one to assert a belief in a particular causal relationship. This approach finds the foundation seeking improved market outcomes. In-

tals, schools, and museums. Ford was even revered for his paternalistic generosity toward employees (just as he was later reviled for his virulent opposition to their unionization).

211. Everyone’s life presents a mixed record. In developing inferred intent and values, a first step might be to look to Shakespeare’s observation: “The evil that men do lives after them; The good is oft interred with their bones.” WILLIAM SHAKESPEARE, JULIUS CAESAR act 3, sc. 2. Trustees bear an especial responsibility to recall the good as they spend the donor’s money—the ever-present temptation is to substitute the trustees’ or foundation executive’s personal agenda.

212. “Increasingly, foundations find themselves part of an expanding constellation which includes such resources as grantees, intermediaries, and external consultants all functioning as key players acting on a shared agenda.” JOEL J. OROSZ, CYNTHIA C. PHILLIPS, & LISA WYATT KNOWLTON, CTR. FOR PHILANTHROPY AND NONPROFIT LEADERSHIP, AGILE PHILANTHROPY: UNDERSTANDING FOUNDATION EFFECTIVENESS 6 (2002) available at http://www.npgoodpractice.org/PDF/Article7.PDF; see also id. at 18 (citing a survey that found that foundations and those in the philanthropic sector define foundation effectiveness “in terms of the systemic relationship that exists between stakeholder audiences.”). “We are highly driven to make a difference in the key issues that matter to the health and happiness of our stakeholders—the public.” For the Pew’s Rebecca Rimmel, the Bottom Line is Impact, Not Profits, KNOWLEDGE@WHARTON, Mar. 8, 2006, http://www.pewtrusts.org/news/news_subpage.cfm?content_item_id=3316&content_type_id=13&page=nr2 (quoting Rebecca Rimmel); see also Editorial, Trusting Pew, WALL ST. J., Feb. 18, 2004, at A14.
deed, by making individuals more competent to participate in markets through improving education, reducing disease and disability, expanding market activity by accelerating innovation, easing entry to capital markets, and understanding the ways in which markets discriminate through policy research, foundations can advance individual welfare through market means.

Trustee actions based on analytic perspectives tied to the founder’s express or imputed intent are the source of legitimacy for the presumption of continued private action. In this construct, the “success” of the foundation as judged by its grantees is largely irrelevant. Its action and the analytic basis of its action, rooted as they are in a belief that economic expansion improves human welfare, become sufficient. Trustees, as they pursue innovative programs in education, research, or public policy, should be confident that their stewardship is above all purposeful. The foundation’s action is thus fundamentally tied to the donor’s intent, and moreover, is seated solely with the trustees, free of constituencies and stakeholders. In the constituent or stakeholder model, however, the petitioner remains secure in the view of its role, and the foundation exists largely to perform the role of passive bank.

The third perspective from which to consider the legal presumption in favor of foundations operating privately involves the public oversight authority which might, wrongly, consider itself the ultimate manager of foundations. At the federal level, the oversight authority rests with the IRS, which has properly seen its role as ensuring that funds set aside with tax preference not be used for the private benefit of trustees, officers, or grantees. Far more active oversight, however, has come from state attorneys general, who have increasingly been prepared to insert themselves into the decision-making of foundations. In many instances, these intrusions have been occasioned by alleged egregious behaviors by trustees or officers. Once involved, however, the record shows that the scope of state investigation and action has far exceeded the common law power to ensure that funds within a foundation are being applied in the public interest. Furthermore, the vagueness of most state charity statutes allows investigations to proceed as though the attorney general actually possessed the authority to ensure that

213. See supra Part III.D.2.
the funds are used in the subjectively-determined "best" interest of the public.

This largely self-made approach endows the attorney general with unlimited power to create new purposes for foundations, remove trustees, and displace management. Of course, such decisions seldom appear motivated by respect for the founder's intent or an informed view of what is truly in the public's interest. Rather, such determinations are most easily explained by political motivations. Consideration of a long record of attorney general actions regarding private foundations prompted one legal scholar to caution that attorneys general must not view themselves as "super" members of the board.214

How then, may the interests of the founder, the subsequent trustees, and the public, as represented by the oversight authority residing with the IRS and state attorneys general, coexist such that the unique institution of the private foundation is secure to pursue its unique institutional role? It seems that an implicit private-public treaty must exist among donors, trustees, and the government. This treaty would include a presumption in favor of allowing the foundation wide latitude and tolerance to articulate through its actions and grants ways to instigate change and irritate other institutions into newer, more effective ways of performing their roles.

The burden also falls on the donor and trustees to not tempt government to examine the actions of the foundation and potentially restrict its freedom. As a threshold matter, the foundation must pursue non-frivolous actions. Of greater consequence, foundations must articulate programs that, using a wide perspective, advance human welfare in the context of democratic capitalism. For its part, government generally ought to defer to the trustees and executives, with four exceptions: egregious cases of obvious frivolous action, instances where foundation resources are diverted for private gain, programs that set out to erode or destroy aspects of our system of

214. Brody, supra note 114, at 976 n.174 (citing In re Estate of Horton, 90 Cal. Rptr. 66, 68 (Cal. Ct. App. 1970) ("We are cited no statutory or case law authority placing the Attorney General in the position of a super administrator of charities with control over, or right to participate in, the contractual undertakings of the charities. He has undoubted standing to seek redress in the courts of contracts entered into by charities which are collusive, tainted by fraud or which demonstrate any abuse of trust management.")).
democratic capitalism, or instances where foundation resources are used to advance partisan political ends.

Attorneys general must refrain from adopting the convenient notion that foundations are to operate democratically under the direction of either constituent groups or elected officials. Such an approach not only offends the historical legal theory of foundation freedom of action but also trades away the potential such organizations possess for long term fundamental change (since that change may offend current political sensibilities).

Finally, democratic capitalism evolves in large measure through the conflict among institutions. The foundation came into being to advance democratic capitalism by playing a new and unique role among institutions. This role, from the beginning, has been one of mediation—encouraging the continued evolution and growth of other institutions. This has been accomplished by various means. In some instances foundations have brought institutions into being to play roles required for the development of the nation. Peabody’s postbellum schools for children are one such example. In other instances, foundations have envisioned new, expanded roles for existing institutions such as Rockefeller’s pushing universities into their new roles in basic scientific research. In other cases we find foundations prodding institutions to more meaningful or legitimate roles in society and the economy, such as the Gates Foundation’s current challenge to high schools to become more relevant and useful in modern society.215

In performing these roles, foundations aid the market by intuiting needs and demands that the market itself may find difficult to perceive or articulate. They are able and free to do this because they have been expressly set up outside the constraints of the market. This somewhat paradoxical virtue is not a unique aspect of the mysterious way in which capitalism operates.216

215. See Bill Gates, Speech at the National Education Summit on High Schools, Feb. 26, 2005, available at http://www.gatesfoundation.org/MediaCenter/Speeches/Co-ChairSpeeches/BillgSpeeches/BGSpeechNGA-050226.htm (stating that he is “appalled” at America’s “obsolete” high schools: “By obsolete, I mean that our high schools—even when they’re working exactly as designed—cannot teach our kids what they need to know today.”).

History suggests that founders, trustees, and foundation executives and staff have a special responsibility to the future to see that private monies, once dedicated to improving human welfare, are applied in ways that maximize their effect for good. This kind of freedom does not exist in political institutions, churches, unions, universities, or business firms. The foundation, the only out-market institution, must use its freedom wisely. As Waldemar Nielsen observed:

It is a waste of important potential if foundations do not make use of the special freedoms they have been given: to take the long view; to back a promising but unproven idea, individual, or institution; to take an unpopular or unorthodox stand; to facilitate change rather than automatically endorsing the status quo . . . to act and not merely react; to initiate, even to gamble and dare.217

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217. 

WESTERN SUCCESS (2005)) (describing capitalism as “the mind-centered system directed to economic creativity”).

217. NIELSEN, THE GOLDEN DONORS, supra note 17, at 433–34.