Long Reads

Philanthropy vs. Democracy

Jul 12, 2019 | **HELMUT K. ANHEIER**

BERLIN – Donating private wealth to worthy causes is an ancient, noble institution. But, for as long as philanthropy has existed, it has also been a controversial practice. "To give away money is an easy matter, and in any man's power," according to Aristotle. "But to decide to whom to give it, and how large, and when, and for what purpose and how, is neither in every man's power nor an easy matter."

If anything, that controversy is even more salient in today's world, because the role of philanthropy has become profoundly unclear. Governments too often regard philanthropic foundations as cash machines to fill gaps in public budgets or to help implement policy. Wealthy donors eager to mitigate questionable behavior or otherwise bolster their public standing are easy prey for politicians seeking quick fixes. And other beneficiaries of philanthropy are afraid to bite the hands that feed them.

The result is a lack of real debate about the sector's potential and limitations, much less answers to fundamental questions related to equity and democracy. And yet it is becoming increasingly clear that this state of affairs is no longer sustainable. If philanthropy is to continue flourishing in the twenty-first century, two requirements must be met: the development of clear guiding principles that reflect the sector's diversity, and better governance.

To Tax, or Not to Tax?

In purely financial terms, philanthropy in advanced economies plays a relatively minor role in serving the public good. The 87,000 foundations in the United States, for example, have total assets of around $800 billion and make $55 billion worth of grants per year. These numbers seem impressive on their own, but they pale in comparison to the $4 trillion US federal budget. US philanthropic assets could cover federal government expenditures for only a few months, and then all that private wealth would be gone. The picture is similar in other rich countries with large numbers of foundations, such as Germany, the United Kingdom, and Switzerland.

Nonetheless, some critics want philanthropic funds to be taxed in order to redistribute wealth and promote social justice. They frequently point to the double standards of predatory investors who have become do-gooders in order to whitewash tainted money. If Russian oligarchs, along with the Googles and Amazons of the world, do not pay their fair share of taxes, isn't it morally objectionable if they then engage in tax-exempt philanthropy?

Moreover, many in the philanthropic sector are too self-righteous and set in their ways, as a visit to almost any of their many conferences will confirm. Philanthropists and their beneficiaries prefer preaching to each other, and avoid questions from critical audiences. Some wealthy donors are even affronted by probing queries, and reply with an argument that amounts to: "It's my money, not yours or anyone else's, and I can do with it as I please."

Such thinking is profoundly misguided. Depending on national tax rates, philanthropic funds and the profits they generate include between one-third and one-half of foregone tax revenue. Some regard this tax exemption as a silent subsidy for the rich, who not only legally avoid paying taxes on the wealth they donate, but also decide how the money is used. Part of philanthropy is public, yet the public has little or no say over it. Accountability is a fundamental problem for the sector.

One Size Does Not Fit All

Both supporters and critics of philanthropy are guilty of two generalizations. For starters, they focus mainly on the largest foundations – those with endowments worth billions of dollars. True, the field is highly concentrated: in the US, the 50 largest foundations account for nearly 30% of the sector's total assets, and the pattern is similar in Europe and Australia. Yet most philanthropy is much more modest in scale, often involving locally oriented foundations with less than $1 million in assets. Such foundations make up well over 90% of the total, and are multiplying much faster than large philanthropic organizations.

Most of the nearly 20,000 foundations in Germany, for example, were established in recent decades, and their geographic distribution reflects that of the country's population. These institutions are located in small and medium-size cities, and are an expression of local commitment by local philanthropists. They are part of their communities' social fabric. (The wider public, however, knows little about them, which points to the need for more transparency.)

But the philanthropy debate currently centers on the small number of very large foundations and super-philanthropies, such as those of George Soros, Bill and Melinda Gates, Len Blavatnik, Vladimir Yakunin, and the new cyber-billionaires like Mark Zuckerberg or Jeff Bezos, as well as corporate foundations. These organizations tend to be located in global cities, and are typically not part of, or even close to, the communities they seek to serve. Moreover, their funds may be located in offshore tax havens. By aiming their criticism of philanthropy mostly at these large global donors, the sector's opponents fail to recognize the many other thousands of individuals who voluntarily donate part of their fortunes to the common good.

The second generalization is to regard the grant-making foundation established in perpetuity as a sort of philanthropic gold standard. Philanthropy has thus become largely synonymous with what was mostly an American invention by the Carnegies, Mellons, and Rockefellers over 100 years ago, even though the world has changed considerably since then. Many more forms of philanthropic engagement now exist, including donor-advised funds in the US and models such as the *fonds de dotation* in France, not to mention the local foundations that account for the bulk of the sector in many countries. Yet the world continues to see and judge mostly one form of philanthropy.

Old Debate, New Question

Suspicion of philanthropy is not new. Enlightenment philosophers feared the weight of the dead hand of tradition on future generations. The young American republic's founders worried that residual dynastic elements would undermine a political order based on individual liberty and equality. Various socialist movements regarded philanthropy as a subtle instrument of worker suppression. Free-market advocates fretted about the sunk capital in foundations. And proponents of the modern welfare state regarded philanthropic foundations as an outdated paternalistic response to social problems.

On the other hand, the obligation to "do good," and the idea that philanthropy benefits donors as much as, if not more than, recipients, is found in all the major world religions – including the Christian notion of charity, the Jewish obligation of *tzedakah*, and the Islamic practice of *zakat*. In *The Gospel of Wealth*, Andrew Carnegie wrote that the rich had a responsibility to use their wealth for the broader good of society.

But the fundamental question of accountability raised by the emergence of liberal democracy will not go away. Should modern societies permit independent private agendas in the public realm, and allow their advocates to pursue objectives that may not be shared by governments, popular majorities, or even influential minorities?

This question applies to any civil-society institution, association, or lobby group. But it is especially relevant for philanthropic foundations, which are beholden neither to market expectations nor to results at the ballot box. With neither shareholders nor electorates to please, their leaders can, at least in principle, do pretty much as they wish. And, critically, as unaccountable sources of wealth, they also represent unaccountable sources of power.

Aristocrats or Innovators?

So, are foundations latter-day quasi-aristocracies that all right-thinking democrats should reject, or are they much-needed engines of innovation that politicians and publics should embrace? The question entails three main issues, starting with the existence of foundations themselves. Supporters say that philanthropic organizations exist in order to use private money for public benefit. On this view, philanthropy offers governments additional resources that supplement or complement public initiatives, thereby ensuring better use of both public and private funds. Opponents, meanwhile, accept that foundations have some useful features – such as flexibility in responding to unforeseen needs – but claim that they shrink the tax base and represent a misallocation of public funds.

The second issue is philanthropy's contribution and impact. Proponents argue that the social benefits foundations provide outweigh the costs, and that this value added would be lost if they were abolished or discouraged by the tax code. In addition to reducing the strain on public budgets and potentially acting as extra tools of government policy, foundations are also civil society's banks, helping to fund innovative, risky projects that neither governments nor markets will support.

Opponents counter that foundations are an expensive, tax-inefficient way to allocate private funds for the public good. As a result, they argue, foundations' tax-exempt status is hard to justify unless these organizations meet clearly specified public needs in line with government programs.

The third issue concerns foundations and the political system. Philanthropists say foundations give a voice to those who would otherwise be excluded or marginalized in the political process. Furthermore, foundations can develop new approaches outside the constraints of party politics; provide an independent bulwark against government and big business; and bolster pluralism by supporting think tanks and non-governmental organizations.

For critics, however, foundations are self-appointed groups of self-righteous do-gooders, and ultimately represent the voices of the elite and upper middle class. They represent special interests, and rarely the public good, and should be treated as such. In today's open, formally egalitarian societies, the argument goes, foundations are bastions of pre-democratic values whose privileged status is as costly politically as economically.

Again, however, it is essential to distinguish between different types of philanthropy. Should a $1 million endowment dedicated to a local cause by a Swiss member of the *Mittelstand*, for example, be treated the same as a multi-billion-dollar foundation funded by wealth of uncertain origin? And shouldn't all foundations have transparency obligations toward the public, given their independence from markets, voters, and the taxman?

Six Principles

It may not be possible at present to establish a comprehensive framework for the future of philanthropy that takes the views of proponents and critics into account. Nonetheless, six guiding principles could help to address some of the current misperceptions about the sector, and allow for a more differentiated approach.

First, *origin matters*. Philanthropic assets should be clean. Tainted money, or funds of uncertain provenance, should not be allowed to flow into philanthropy. Prospective donors should therefore be required to prove the origins of endowments beyond reasonable doubt, and invest such assets in ethical ways.

Second, *transparency matters*. Although US and UK foundations must comply with some transparency requirements concerning their finances and governance, their counterparts in other countries often have few such obligations. And the requirements they do face tend to involve financial disclosures to the tax authorities rather than to the public.

Third, *performance matters*. Foundations should be accountable for their actions, receive independent feedback on their performance, and benefit from advice on how to improve their financial and operational track records.

Fourth, *alternatives matter*. The endowed, grant-making foundations established in perpetuity should be recognized as only one of many ways and means to realize philanthropic objectives. Others include time-limited foundations, gifts, donor-advised funds, and donations to community foundations.

Fifth, *size matters*. Like big corporations, larger philanthropic entities should have to meet higher transparency, accountability, and performance standards. Moreover, the governance of large foundations should reflect the fact that the general public is a silent stakeholder.

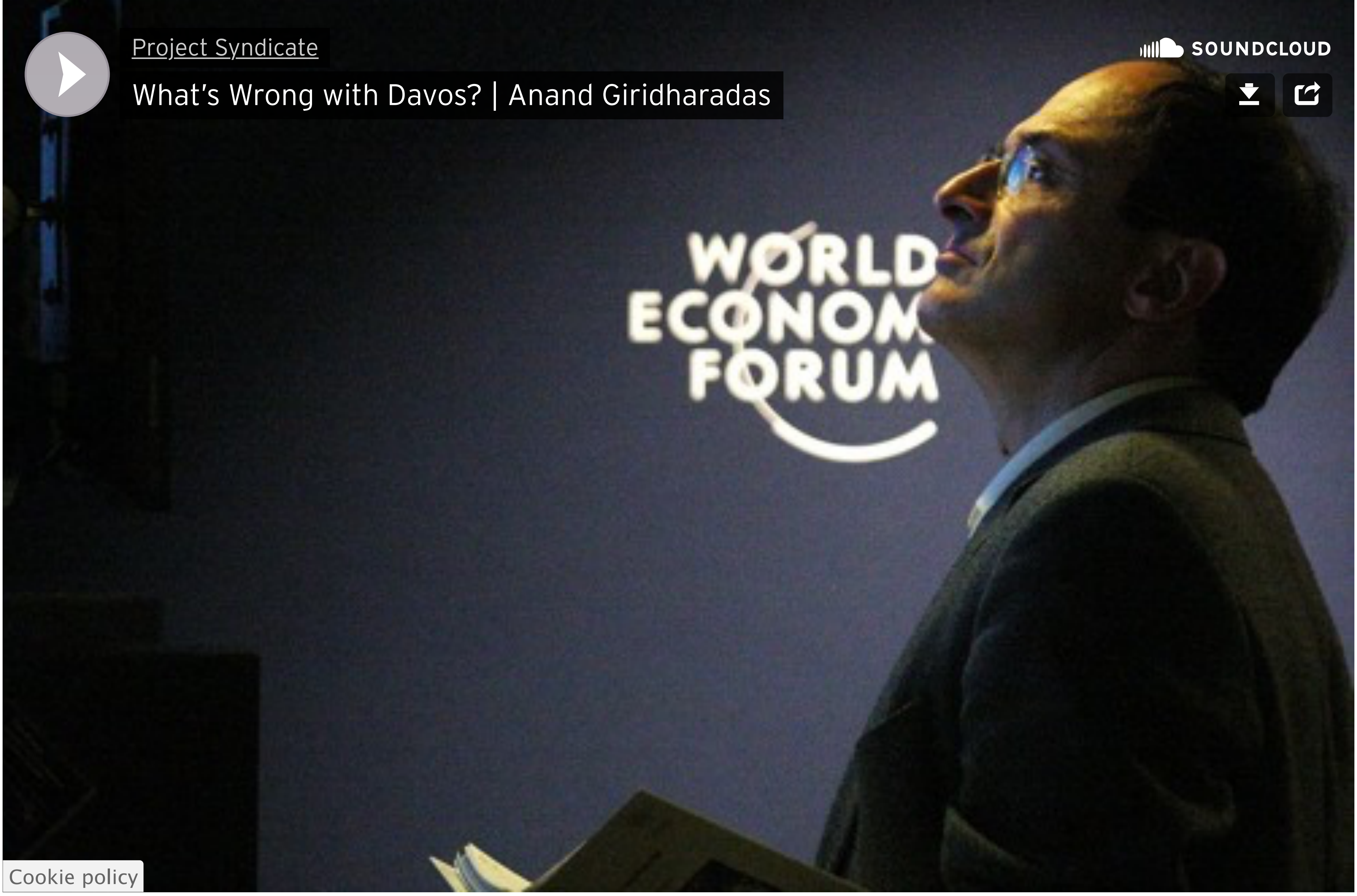
Finally, *context matters*. Philanthropy does not exist in isolation from the wider political and economic world. As long as countries have levels of social inequality that much of the population regards as unjust, philanthropy will be easily challenged. A fair tax system is in many ways the *sine qua non* for a socially and politically sustainable system of modern philanthropy.

The Philanthropy Code

Adopting these principles does not require a major policy overhaul or a big increase in laws and regulations. But it does call for concerted action among philanthropic institutions, as well as between them and regulators. One step forward would be to draw up a philanthropic governance code that reflects the six principles. Such a code would be voluntarily adopted and implemented by a growing number of foundations, with, say, the largest 25-30% (by assets) taking the lead.

Another, more ambitious step would be to establish a dedicated, arm's-length institution charged with upholding the governance code and its principles. Such a body, perhaps called the Philanthropy Board, would consist of members from across the sector. The board could gain democratic legitimacy by being tied to representative legislative bodies at local, regional and national levels, but would be independent from government. In addition, the panel could be complemented by a standing legislative or parliamentary committee to address broader taxation, equity, and accountability issues.

Their independence allows philanthropic foundations to address complex, controversial, even unpopular issues, and to propose alternatives where government and business may falter or fear to tread. Unencumbered by short-term expectations of market returns or the need for political support, foundations can also take a longer-term view of the problems they address. Yet this role also raises questions of democratic legitimacy, especially when elite-run foundations mistake their particular objectives for a public good. To secure its future, the sector must tackle this issue head-on.



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