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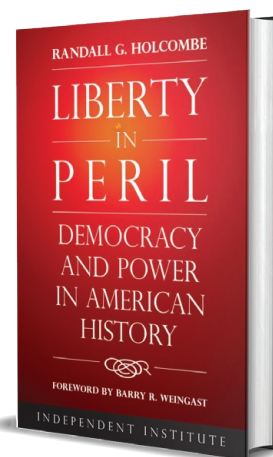
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# Making the Voluntaryist Venn Work for Us, Not against Us

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MICHAEL C. MUNGER

**M**any people in the liberty movement have been operating with a misleading mental schematic of the goals of reform. We generally think of something called “markets” as being the only setting in which voluntary private cooperation takes place. And we argue that “private” charities are an alternative to state action.

Both of these claims tend to trap us in a binary market–state dualism that limits our understanding of the broad scope of voluntary organizations and institutions, or so I argue in this essay. First, the “voluntary–coercive” distinction should be viewed as a continuum, a dimension along which there is marginal variation, not as a clean set of two discrete categories. Second, the essence of “private philanthropy” is its voluntary and decentralized features. It is private because it is voluntary and decentralized, but it is philanthropy because it is focusing on accomplishing shared or collective goals as opposed to mere commercial exchange.

The trend among charities and other nongovernmental organizations has recently been toward centralization, as in the case of advocacy for the ill-advised Common Core (Julian 2013) reforms imposed on state governments in top-down fashion. As Lenore Ealy and Steve Ealy (2006) note, such an impulse seeks to direct activity in massive blocs toward top-down social change, such as that advocated by the National Committee for

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Responsive Philanthropy, exhibiting precisely the “man of system” conceit described by Adam Smith that we often (and rightly) decry when the state tries to undertake similar centralized initiatives. Lenore Ealy (2014) points out that this trend is less a “new philanthropy” than it is a return to the notions of centralized social planning that motivated the Progressive movement in the United States. As John Dewey put it, “Organized social planning, put into effect for the creation of an order in which industry and finance are socially directed in behalf of institutions that provide the material basis for the cultural liberation and growth of individuals, is now the sole method of social action by which liberalism can realize its professed aims” ([1935] 2000, 60).

The paper proceeds as follows. First, I discuss “voluntary private cooperation,” or VPC, as an alternative means (alternative to market processes) of organizing division of labor. Then in the second section I review the very interesting but underappreciated contributions of Richard Cornuelle, who advocated for the consideration of “the independent sector” as the focus of the liberty movement. There is no reason for classical liberals to advocate for the perfection of markets or the price mechanism as the exclusive means by which diverse, decentralized groups can be organized. In my analysis, the comparison is represented by two Venn diagrams that capture what I claim is the present rhetorical strategy for advancing a free society, which focuses on markets, and the Cornuellian rhetorical strategy, which proposes a more robust freedom encompassing anything voluntary. The third section considers some problems for the independent sector, including adverse centralization and the restrictive nature of donor intent. The final section offers some conclusions.

## Voluntary Private Cooperation

The argument for human liberty is not an argument for “markets.” The question is how best to achieve the myriad benefits of voluntary private cooperation, or VPC. Markets are part of doing so, a useful way of achieving prosperity, but a variety of other emergent social arrangements—more properly viewed under the rubric “society”—are also crucial for prosperity.

The hiving off of the market process as a separate category has some logic because in the market setting the direction of production and consumption is controlled mostly by prices. If prices are free to adjust, if property rights are clearly defined and enforceable, and if the transaction costs of exchange are not prohibitive, then certain useful consequences are likely to follow. But it does not follow, by any means, that the absence of a price mechanism to provide knowledge by which people choose their plans and activities implies the absence of voluntary human action.

The first argument I usually hear, especially from those who assume government coordination is necessary to redress market failure, is: “If markets are so great, why is most of the world poor?” The problem is that poverty is not what needs to be explained. Poverty is what happens when groups of people fail to find or are prevented from finding

ways to cooperate. Cooperation is in our genes; the ability to be social is a big part of what makes us human. It takes actions by powerful actors such as states or warlords or cruel accidents such as deep historical or ethnic animosities to prevent people from cooperating. Everywhere you look, if people are prosperous, it is because they are cooperating, working together. If people are desperately poor, it is because they are denied some of the means of cooperating, the institutions for reducing the transactions costs of decentralized VPC. So forget about explaining poverty. We need to work on understanding prosperity.

There are two key reasons it makes sense to view VPC as the core of human prosperity and flourishing: exchange/cooperation and specialization.

First, we have to remember that exchange *is* cooperation. If each of us has an apple and a banana, and I like apple pie and you like banana cr me pie, each of us can improve our lot by cooperating. I give you a banana, you give me an apple, and the world is a better place. Moreover, the world is better even if there is no change in the total size of our pies; the total amount of apples and bananas is the same, but each of us is happier.

But there is no reason to fetishize exchange. (That’s the “markets versus social/state” dichotomy; don’t give away the farm here.) Nobelist James Buchanan’s central recognition was that cooperative arrangements among groups of people are just “politics as exchange.” Nonmarket types of exchange, where we cooperate to achieve ends that we all agree are mutually beneficial, may be even more important than commodity exchanges. Banding together for collective protection and taking full advantage of emergent institutions such as a language, property rights, and a currency are powerful tools created through VPC.

If we cooperate, we can use existing resources much better by discovering the higher-valued uses and redirecting resources toward these uses. Even if we are thinking of cooperation only in a static sense, within a fixed pie, we all are better off if we cooperate. Cooperation is just a kind of sharing so long as every cooperative arrangement is voluntary. Market processes foster this kind of cooperation: the only way you and I agree to a new arrangement is if each of us is better off.

The (possible) problem with this form of cooperation around price is that both the goals and the plans of the wealthy are privileged. For this reason, many philanthropists see the role of nonmarket and nonpriced cooperation as an indispensable complement. Some on the political left are worried enough about the privileging of wealth that they would advocate for the outright *replacement* of market process with nonprofit activity and exchange. The problem is that such a replacement would throw out the useful aspects of market cooperation, one of our best mechanisms for discovery. We don’t need to be satisfied with making better use of a static pie. Working together and becoming more dependent on each other in market settings, we can also make the pie bigger. There is no reason to expect that each of us is well suited to produce all the things we happen to like, and even if we are, we can produce more of it by working together.

This leads us to the second reason VPC is the core social process of flourishing societies: specialization. Remember, I like apples, and you like bananas. But I live on tropical land and in a warm climate where producing apples difficult. You live in a much cooler place, where growing your favored bananas would be prohibitively expensive. We can specialize in whatever our conditions, talents, and training makes each of us relatively best at doing. I grow bananas, you grow apples, and we trade. Specialization allows us to increase the variety and complexity of mutually beneficial outcomes.

Interestingly, this would be true even if one of the parties is actually better at producing both apples and bananas. David Ricardo's analysis of "comparative advantage" shows that both parties are better off if they specialize, even if it appears that the less-productive person can't possibly compete, because the opportunity costs of action are different; that's all that is necessary for there to be potential benefits from cooperation.

There is no reason to fetishize comparative advantage any more than exchange. In fact, true instances of deterministic comparative advantage are rare. The real power from specialization comes from division of labor or the enormous economies of scale that come from discovering synergy. Synergy can result from improvements in dexterity, tool design, and capital investment in a production process composed of many small steps in a production line or from innovations, using the entrepreneurial imagination to see around corners. Synergy is not created by the sort of deterministic accidents of weather, soil quality, or physical features of the earth that economists obsess about. Producing wool and port depend on location; human ingenuity can create synergy anywhere that division of labor can be voluntarily promoted. All the important dynamic gains from exchange are created through such voluntary private cooperation.

Far from enabling the atomistically individualist man, the division of labor and specialization create a setting where only a few people in society are remotely self-sufficient. Furthermore, the size of the "market"—or, more accurately, the horizon of organized cooperative production—limits the gains from division of labor and specialization. If I hire dozens of people and automate my production of apple pie filling, I can produce more than you, your family, your village, or perhaps even your entire nation can consume. I have to look for new customers, expanding both the locus of dependency and the extent of improved welfare from increased opportunities to trade.

The expansion of markets made possible through specialization and trade produces gains and social interdependence that have wide benefits. In a village of five people, the medical specialist might know first aid and have a kit composed of Band-Aids and compression bands for sprains. A city of 5 million will have surgeons who have invented new techniques for performing complex procedures on retinas and the brain as well exotic enhancements in appearance through plastic surgery. A village of 250 people may have a guy who can play the fiddle; a city of 250,000 has an orchestra. Division of labor and specialization, nevertheless, is limited by the extent of the VPC.

The power of that insight, taken directly from Adam Smith, is the basis of the argument for VPC. People are assets, not liabilities. Larger populations, larger groups available to work together, and more extensive areas of peaceful cooperation allow greater specialization, expanded production, and more gains from trade. Four people in a production line can make ten times as much as two people; ten people can make a thousand times more. Larger groups and increased cooperation create nearly limitless opportunities for specialization—not just in making refrigerators but in making music, art, and other things that may be hard to define or predict.

VPC allows huge numbers of people who don't know each other to begin to trust each other, to depend on each other. Émile Durkheim, the famed French social theorist, recognized this point explicitly and correctly noted that the market part of the division of labor is the least important aspect of why we depend on it. In his masterwork *Division of Labour in Society* ([1893] 1997), he stated, “[T]he economic services that [division of labor] can render are insignificant compared with the moral effect that it produces, and its true function is to create between two or more people a feeling of solidarity” (17).

That “feeling of solidarity” is the soul of society—voluntary, uncoerced natural human society. We don't need national economic plans, political allegiances, or military predation to make us prosperous. All we need is voluntary private cooperation and the feeling of solidarity and prosperous interdependence that comes from human creativity unleashed.

## Tocqueville, Cornuelle, and the Independent Sector

I am certainly not the first to argue that liberty and voluntary private but nonmarket associations are an alternative both to market processes and to state action. As Alexis de Tocqueville said,

Americans of all ages, all conditions, and all dispositions constantly form associations . . . religious, moral, serious, futile, general or restricted, enormous or diminutive. The Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons, and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or an aristocrat in England, in the United States you will be sure to find an association. ([1835] 2002, 129)

Karl Zinsmeister (2017) notes that the recognition of the roots of nonstate “democracy” goes back even further than Tocqueville to Edmund Burke. Burke observed

that “[t]he little platoon we belong to in society is the first principle (the germ as it were) of public affections. It is the first link in the series by which we proceed towards a love to our country, and to mankind” (1999, 69). As Zinsmeister notes, this origin story, recognized also by Tocqueville, is important: it may be true that a rich, diverse set of private associations is a hallmark of a well-functioning society, but in many ways VPCs are actually the *cause* of effective civil society, serving as a check on the impulse to let the government do everything and then blame bureaucrats when they fail to do things we shouldn’t hope for the state to accomplish in the first place.

Burke’s observation comes from *Reflections on the Revolution in France* (1790, in Burke 1999); Tocqueville was likewise concerned about the effects of state action in displacing voluntary private action in France. The French Revolution was, of course, one of the first experiments with mass democracy focused purely on the state, and it is interesting that its flawed principles and its bloody consequences evoked such similar reactions from Burke and Tocqueville, even forty years apart.

Tocqueville was quite explicit in identifying private groups as the primary cause rather than the secondary effect of American self-governance. He claimed that Europeans had lost “the habit of acting in common” ([1856] 1998, 243), apart from the state, and perceived this loss as a road to soft despotism.

As Tocqueville put it,

Amongst democratic nations . . . all the citizens are independent and feeble; they can do hardly anything by themselves, and none of them can oblige his fellow-men to lend him their assistance. They all, therefore, fall into a state of incapacity, if they do not learn voluntarily to help each other.

If men living in democratic countries had no right and no inclination to associate for *political* purposes, their independence would be in great jeopardy; but they might long preserve their wealth and their cultivation: whereas if they never acquired the habit of forming associations in *ordinary life*, civilization itself would be endangered. . . .

[Some claim that] the more enfeebled and incompetent the citizens become, the more able and active the government ought to be rendered, in order that society at large may execute what individuals can no longer accomplish. . . .

[But it] is easy to foresee that the time is drawing near when man will be less and less able to produce, of himself alone, the commonest necessities of life. The task of the governing power will therefore perpetually increase, and its very efforts will extend it every day. The more it stands in the place of associations, the more will individuals, losing the notion of combining together, require its assistance. . . .

Feelings and opinions are recruited, the heart is enlarged, and the human mind is developed by no other means than by the reciprocal influence of men

upon each other. I have shown that these influences are almost null in democratic countries; they must therefore be artificially created, and this can only be accomplished by associations. ([1835] 2002, 490–91, emphasis added)

In striking contradiction to standard “Progressive” dogma, which holds that citizens are capable of acting in concert only through the state’s intercession, Tocqueville clearly understood that there are three arenas or sectors for citizen action: through politics (the state), through commerce (the market), and through voluntary association (civil society). Richard Cornuelle took up this insight in his book *Reclaiming the American Dream* ([1965] 1999), where he clearly riffs on Tocqueville in describing the Progressive reforms of the turn of the twentieth century: “We see a mounting agenda of problems so large and complex that only government, the largest single force in sight, seems big enough to handle them” (24).

The Great Depression and its aftermath made things even worse: “Our habit of sending difficult problems to Washington quickly became almost a reflex. A one-way flow of responsibility to the federal government, begun by Depression remedies, has continued and gained speed. In less than thirty years the government has nearly cornered the market for new public responsibility” (24).

Cornuelle’s diagnosis was that the voluntary private sector had partly shriveled, just as Tocqueville had predicted in 1831. But Cornuelle also argued that private nonmarket activity had largely been ignored by academic analysts, who didn’t recognize its significance.

We know that the Progressive movement had two distinct branches—one statist and one voluntarist—of comparable intellectual vigor. We know that before America’s Great Depression, there appears to have been a formidable alternative to government action for almost every aspect of the public business, from disease control to economic stabilization. And we know that by 1958, in *The Affluent Society*, John K. Galbraith could write about American society as if it had only two sectors—one public, by which he meant governmental, and the other private, by which he meant commercial—and that no one noticed the omission for years.

How we could lose a sector of this size and scope is something of a mystery. Perhaps the decline of this dimension of our pluralism began when Woodrow Wilson set out to use his extraordinary wartime powers to jail all our most gallant, original, and entertaining misfits and rationalize American society. By 1946, the American tradition of independent, nongovernment action on the public business had been buried alive. ([1965] 1999, 183)

The process was not all in one direction, however. Zinsmeister notes that in 1970 the Peterson Commission, a politically ecumenical group, called for a (re)recognition of the



importance of private voluntary action: “Our society . . . is in obvious need of philanthropic institutions standing outside the frame of government but in support of the public interest . . . just as scouts move in advance of a body of troops to probe what lies ahead. [Likewise, private associations] can spot emergent problems, diagnose them, and test alternative ways to deal with them” (Peter Commission 1970, 14, quoted in Zinsmeister 2017, 18). Cornuelle dubbed voluntary charitable and other private associations the “independent sector” and noted that although such institutions seem innocuous, they have had a complex relationship with government, their natural competitor.

Both sectors operate in the same industry: public service and welfare. Sometimes, over the years, leaders on each side have sensed their competitive positions and built a fascinating record of both creative competition and deliberate collusion. The quality of life in the U.S. now depends largely on the revival of a lively competition between these two natural contenders for public responsibility. The struggle would enhance the effectiveness of both.

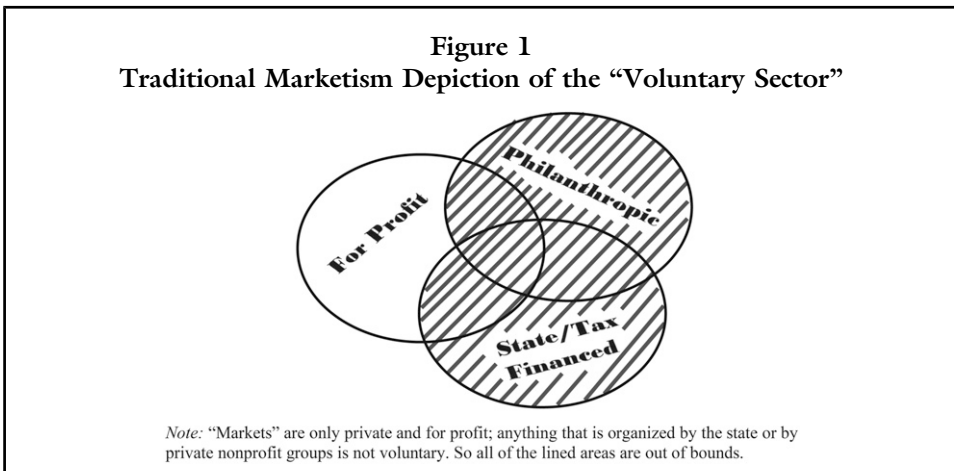
The government doesn’t ignore public opinion because the people who run it are naturally perverse. It isn’t wasteful because it is manned by wasteful people. [The problem is that] without competition, the bureaucracy can’t make government efficient. . . . Innovation painfully disrupts [bureaucracy’s] way of life. Reform comes only through competitive outsiders who force steady, efficient adjustment to changing situations.

The independent sector will grow strong again when its leaders realize that its unique indispensable natural role in America is to compete with government. It must be as eager as government to take on new public problems. It must be imaginative, vigorous, persistent. Independent groups must line up in Washington, not begging for help but looking for bigger jobs to do. ([1965] 1999, 66)

Cornuelle called for the independent sector to compete with state action rather than to lapse into a form of “crony philanthropy,” where not-for-profit leaders and social entrepreneurs seek to parlay their influence into social status and/or public subsidies for their programs.

I have tried to summarize the standard view of the relationships among these sectors and Cornuelle’s heterodox view in two Venn diagrams. If we consider the three sectors, to use Cornuelle’s language, to be (1) the “for-profit” or market/commercial sector, (2) the coercively tax-financed or state sector, and (3) the independent or philanthropic sector, then what portions of the social universe can libertarians plausibly support as means of facilitating voluntary human action?

The orthodox “marketist” view, in my opinion (and obviously in Cornuelle’s view), gives away too much. We leave the responsibility for the health of civil society and its little schools of voluntary association to those who would either ignore the importance of VPC or seek to harness collective action to the ends of the state. Libertarians and classical liberals make a mistake in fetishizing markets at the expense of a broader understanding of VPC. Markets have problems. In fact, the best argument for markets is not that markets are perfect but that the world is imperfect. Given the fact that information is widely dispersed and hidden, the price mechanism can under some circumstances allow a process of discovery and reallocation. This narrow view, which we might call “market idolatry” or *marketolatry*,<sup>1</sup> appears in figure 1.

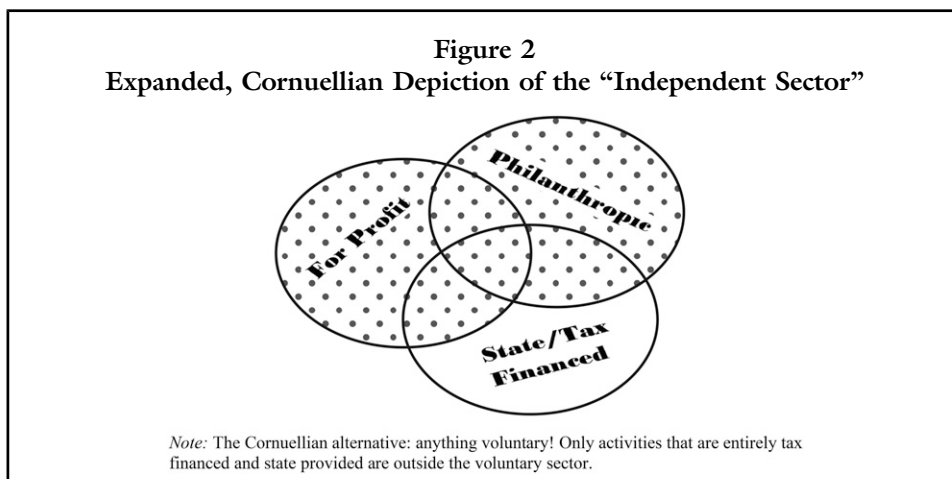


Pro-market fetishists focus narrowly on self-interest and the price mechanism. Any activity motivated by charitable impulses or financed by anything other than fee-for-goods/services payments is ruled out; only action in the unlined or “pure” portion can be legitimately pursued.

Unsurprisingly, this approach has failed on both substantive and tactical grounds. Substantively, there is much good that can be done by voluntary private action through dispersed, decentralized, targeted voluntary and charitable organizations. It may be true that national or even state bureaucracies may have difficulty solving knowledge problems. But a local charity or nonprofit often has both the information and the incentives it requires to take effective action. Further, state funding of private activity, if not theoretically desirable, may sometimes be tactically useful—for instance, vouchers of various types can create competition to state-run enterprises such as schools or hospitals.

1. “Marketolatry” is Lenore Ealy’s idea. I like it.

Tactically, it is a mistake for classical liberals to concede the study of leadership in the “independent sector” to the statist. Our North Star should be voluntarism, not markets. If we adopt the principle that “anything voluntary” belongs to our side, the relevant Venn diagram looks more like figure 2, with classical liberals able to claim all of the dotted areas. Only coercively financed activities with no private voluntary component are outside our areas of advocacy.



Even if one accepts my claim (extending the argument made by Cornuelle and others) that “anything voluntary” should be our guiding principle, there are drawbacks to relying on the exclusively philanthropic side of voluntary action as a means of promoting human flourishing. I want to highlight two problems in particular: a tendency toward centralization and mission drift, or violation of donor intent.

## Two Problems

Philanthropic organizations have objectives; donors have objectives; but communities have *needs*. The particular needs of communities that get served may depend on the objectives of donors and philanthropic organizations rather than on the community members’ true needs (Kretzmann and McKnight 1993). There is little reason to believe that the needs that a given community sees as most pressing always align with or are necessarily related to goals that donors see as most interesting or important. In the market setting, the problem of communicating importance is achieved through the price mechanism. In the independent sector, there is some hope that local actors will have interests that match community needs or that new organizations can be created to match strongly felt needs. The problem with this optimism is that there is a tendency toward centralization of the charitable impulse to increase the “impact” of giving. This

centralization may well be a mistake because it makes the independent sector less nimble, more bureaucratic, and more like the government programs with which this sector is supposed to compete.

Another wrinkle is that an organization created for one purpose may be changed, either gradually over time or abruptly if there is a coup on the board. The challenge of sustaining credible commitments in terms of mission over time hampers the effectiveness of voluntary independent associations over any but the very short run. There are many organizations in government and the nonprofit sector that look to answer unmet needs. But there is a general trend in philanthropy to morph from (*a*) discerning and answering a community's needs to (*b*) redefining problems in more general and abstract terms to (*c*) attempting to centralize direction and control of philanthropic enterprise and to solve problems at the level of the logic of system rather than at the level of the needs of people.

We often consider the problem of organizing groups of people in terms of binaries: public versus private; states versus charities; coercion versus voluntary action. But it's rarely that simple. Modern philanthropy is a business. It's a business with goals and methods and institutional structures that are quite different from for-profit businesses, but a business nonetheless. And in the past couple of decades, a wide variety of philanthropic enterprises have retargeted—becoming weapons of mass instruction.

The “business” of philanthropy, as a general matter, is a combination of brokerage services—linking donors with needs—and management and execution—spending money in ways that advances the purposes of donors. An increasing trend, at least in terms of the size of the operations and activities being funded, might be called “scientific philanthropy” (see, e.g., the discussion in Ealy 2014). This “evidence-based philanthropy,” or the “Money Ball approach” to giving, may not be entirely new, but it in some ways harkens back to the ambition of the Progressive Era. As Lenore Ealy puts it,

Scientific philanthropy arose out of the charity organization movement as an effort to bring the tools of scientific expertise to the social problems of rapidly urbanizing and industrializing societies. Scientific philanthropy departed from traditional forms of charitable relief, such as direct material relief and mutual aid, in favor of research to discover the root causes of social problems. *These causes were often found to be some moral deficiency of the person in need of aid*, and so Progressive philanthropy helped forge a “problem-industrial complex” which united the forms of Protestant morality with the agencies of institutional social control, especially through public education and the burgeoning administrative state. (2014, 87, emphasis added)

We must put this notion of philanthropy as an activity focused on the funders' goals, possibly at the expense of the goals of those being “helped,” in a broader context. It is interesting to think of philanthropy as a business, an enterprise. Taking a step back this

way provides us some analytical tools that may help us recognize some directions that philanthropy might take and highlight some problems that we may be able to avoid.

H. L. Mencken famously evaluated the “executive secretary” of the Progressive Era philanthropic organization. The satire is, I think, uncharitable, and yet it is hard not to recognize at least several grains of truth if not in your organization, then certainly in some others of which you have heard rumors.

The executive secretary is relatively new in the world. . . . He belongs to the order of live wires. He speaks the language of up-and-coming men, and is not sparing with it at the sessions of Rotary and Kiwanis. In origin, not uncommonly a shady and unsuccessful newspaper reporter or a press-agent out of a job, he quickly becomes, by virtue of his craft, a Man of Vision. The cause that he represents for cash in hand is not merely virtuous; it is, nine times out of ten, divinely inspired. If it fails, then civilization will also fail, and the heroic doings at Chateau Thierry and Hog Island will have been in vain.

It is a good job that he has. . . . There is no need to get up at 7 A.M. and there is no need to fume and strain after getting up. Once three or four—or maybe even only one or two—easy marks with sound bank accounts have been snared, the new “national”—or perhaps it is “international” association is on its legs, and all that remains is to have brilliant stationery printed, put in an amiable and slightly stenographer, and begin deluging bishops, editors and the gullible generally with literature. . . . Once a year he launches a drive. But it is only for publicity. The original suckers pay the freight. (1927)

Of course, the “executive secretary” of Mencken’s day has been promoted and is now an “executive director.” We might also call this person an entrepreneur, of course, but entrepreneurship can have different tactics and consequences outside the for-profit world.

Revenue still has meaning in the philanthropic enterprise, of course. The money an organization raises from foundations or donors may be an important objective for public charities. Even for private foundations, the revenue earned from the endowment is of crucial importance. “Operating foundations” fund and manage programs directly, while nonoperating foundations provide funding for other organizations, often in the form of grants. All of these organizations are formally “nonprofits,” but that doesn’t mean that they are run for the benefit of anyone except the donor(s) and the management of the organization. There are no stockholders to please and no stock price to serve as a metric of the organization’s success or failure. Nevertheless, there is an understandable desire to make nonprofits “accountable,” as donors try to evaluate impact and effectiveness. But the effect of accountability has been to bring philanthropy under the control of the administrative and regulatory state. One could concede the

premise that philanthropy may “benefit the public” without granting the conclusion that, “therefore, the state should control philanthropy.”

Eugene Fama, winner of the Nobel Prize in economics in 2012, wrote a series of research papers with Michael Jensen outlining the logic of nonprofit organizations (Fama and Jensen 1983a, 1983b, 1985). Their work is essentially a wrinkle in the problem of separation of ownership and control, with the difference being that “ownership” for nonprofits is either the document specifying donor intent (for a private foundation) or the dual legal responsibilities to adhere to both the organization’s educational, scientific, or charitable purpose and contributors’ express intent (for a public charity). “Control” is then exercised by the organization’s board or (in at least some cases) by the executive director. All of which raises the question of whether donor intent, board intent, or the discretion of the executive officer should drive the nonprofit’s operations.

The argument is rather involved, but Fama and Jensen summarize their conclusions in a later paper:

When the activities of an organization are financed in part through donations, net cash flows are in part due to the resources provided by donors. Contracts that define the share of residual claimants in net cash flows are unlikely to assure donors that their resources are protected against expropriation by residual claimants. Our hypothesis is that the absence of residual claims in non-profits avoids the donor-residual claimant agency problem and explains the dominance of non-profits in donor-financed activities.

Given that there are no residual claimants in non-profits, there seems to be a puzzle about whose interests are to be satisfied in resource allocation decisions. . . . *Without the analytical crutch provided by residual claimants, criteria for optimal investment decisions in nonprofits must be viewed in terms of the more general competition for survival among non-profits and between non-profits and other organizational forms that could engage in the same activities.*

The key to the analysis is in the economics of donations. . . . Donations can mean that a non-profit survives even when it is otherwise less cost effective than a for-profit organization in the production and delivery of the goods and services demanded by customers. (1985, 115, emphasis added).

Suppose that the donor’s intent is clear. Is an honest adherence to donor intent *sufficient* to guarantee that the foundation is benefitting the public? Suppose that the donor’s intent is vague or ambiguous. Is divining donor intent *necessary* to ensure that the foundation is benefitting the public? And in either case how can the legislature be reasonably certain that nonprofit “exempt” (U.S. Code 501(c)) status is being conferred

on an organization that justifies such insulation from property taxes and taxes on income?<sup>2</sup>

The problems explored by Fama and Jensen are not so very different from those satirized by Mencken: the nonprofit form is useful as a means of raising funds through donations, either in the foundation form of endowment or in the public charity form of attracting annual operating funds, but the absence of an obvious product or a residual of revenues over costs—and often a structure of third-party payers—means that it is difficult to measure the efficiency or effectiveness of a particular nonprofit organization. In fact, scrutiny is often restricted to ensuring that the organization spends the required amounts and that the spending can be demonstrated to have been devoted to the required purposes.

But what might the funds have been spent to try to accomplish? Donor intent might plausibly be directed at one or more of the following:

- A perceived need of the relevant community or population
- Doing “good”
- Spending our budget, subject to constraints
- Attracting donations
- Multipliers, especially leveraging with matching funds from other organizations or through public–private partnerships

Note how these goals seem innocuous. In many ways, to be fair, they are innocuous: How could anyone quarrel with “donor intent” as the basis for the nonprofit’s goals?

The problem is that an organization’s goals can evolve over time in ways that may be hard to see from either the inside or the outside. I may be one of the few people in America with simultaneous membership in two particular organizations: the National Rifle Association (NRA) and the American Civil Liberties Union (ACLU). I get lengthy letters from each at least once a month detailing how evil people (the NRA for the

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2. The relevant portion of the U.S. Tax Code is 26 Sec 501 (c); here are parts 3 and 4 from that section:

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

(4) (A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. (B) Subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

ACLU and vice versa) will soon destroy the very fabric of society. Kenneth Boulding (1990) recognizes that philanthropic organizations can exercise a positive form of “integrative” power that helps foster social bonds, but such fund-raising tactics, precisely because they are effective, show that these organizations can also wield what Boulding refers to as “threat” power, with the result that their activities can push society toward *disintegration*. Public charities are in constant danger of succumbing to the very real temptations to maximize net revenues just as if they were for-profit firms. The difference is that public charities are selling their donors a chance to feel good about themselves, to participate in righting a wrong, and so the advertising often focuses on outrage and fear and misrepresents the positions of and questions the motives of “the bad guys.”

I’m not making a partisan point, mind you, but an organizational point. A public charity may start with some goal that involves helping the needy or improving public policy. And donations are a means to that end, to be sure. But fairly soon in the organization’s historical path, donations may become the *ends*, and the organization’s activities become simply the *means* to increase donations. We tend to think that this sort of “consumer sovereignty” is at least tolerable in private markets because consumers are receiving physical goods and services, things whose quality they can judge, at least after the fact. When a public charity uses its advertising and activities primarily to maximize donations, then it is no longer clear that any real public purpose is being served.

An analogous problem, though different in detail, can occur with foundations. Foundations don’t rely on donations, for the most part, so they don’t distort their missions in that way. But if a foundation is trying to “maximize” its influence, it may be drawn into partnerships, matching arrangements, or large-scale collaborations with governmental units. Most importantly, the mission may change from providing aid people want to providing incentives for people to do what the foundation wants.

Foundations give money for research projects, public campaigns, and aid to the needy based on what the foundation wants. The individual researcher or scholar or nonprofit organization that wants to receive foundation funds must align his or its program in that direction and often modify his or its own goals in order to receive funding.

Again, there is no problem at all with this kind of redirection so long as there is a diversity of donor intent and foundation objectives, grants are given and received through voluntary means, and both parties retain rights of exit. A significant problem arises, however, when the directors and managers of foundations partner with government agencies and bundle their efforts to have a larger impact. Rather than dozens or hundreds of diverse projects and activities, the centralization of effort and the coordination in the helpful-sounding “public-private partnerships” transform the landscape and often eliminate a variety of choices and can even change voluntary participation into mandated participation.



## Conclusions: Considerations on “Public–Private Partnerships”

In closing, let me briefly take up three considerations that need more attention by donors and the managers of charitable enterprises: crowding out, crowding in, and the question of when incentives are distorting or even coercive.

A. *Crowding out.* One question in philanthropy is whether government action or funding might crowd out private funding. That is, if there is a private charity or foundation active in some area, will the effect of providing public funds simply be offset by a reduction in private funds? There is some evidence that the answer is yes. James Andreoni and Abigail Payne (2011) find that public spending may substantially reduce private funding of an activity, but they also find that much of the offset does not come from a displacement of funds to some other activity but simply from a reduction in fund-raising efforts by the private entity. This reduction induces a dependency and a lack of connection to the dynamic world of private-sector charitable impulses. Tocqueville, in fact, pointed to the likelihood that voluntary private associations would be “enfeebled” by such state assistance ([1835] 2002, 671–72). If we think that our charitable duties have been fulfilled at the ballot box and the tax office, why give to private organizations at all? Far from seeing public contributions as an aid, private charities should be extremely careful about replacing voluntary giving with efforts to raise funds out of mandatory tax contributions. Such a shift fundamentally changes the enterprise’s goals and strategies. Worse, at least in my view, the shift to rent-seeking competitions for the “commons” of the public purse leads to the zero-sum conception of social justice, further distorting the philanthropic enterprise’s worldview.

B. *Crowding in.* Other studies (e.g., Heutel 2014) give persuasive evidence that foundations and charities may actually exhibit crowding in, or the expansion of private activity in areas where public funds are being focused. There are several explanations for why this might happen, and they seem innocuous enough. The private organization may be unsure of how best to spend its funds, and government targeting of certain projects or activities may be a useful signal as the state calls attention to problems that otherwise might have much less salience. Consider, for example, Herbert Hoover’s famous campaign for aid to Europe in World War I as head of the U.S. Food Aid Administration (Nash 1996).

Alternatively, some donors believe that partnering with a government entity may increase the impact of their private dollars because the state agency’s administrative resources ensure both accurate accounting and reliable delivery of the resources. Numerous instances—the delivery of ice to the South after Hurricane Katrina, for example—suggest, however, that government may not be as effective at translating dollars into impact as hoped. The problem is that “impact” is a rather nebulous goal: Impact on what? One might concede that having another entity “match” spending will make each dollar count double, but the goal is not to maximize spending. The goal is to serve communities, needs, and intellectual purposes. A few dollars spent on a target or

cause discovered through diligent work may dwarf the impact of thousands of dollars spent thoughtlessly by one of Mencken's "executive secretary" poseurs.

C. *Incentives and coercion.* Research, teaching, and charitable actions are the product of individual interests and individual perceptions of needs. To some extent, this problem of subjective assessment and dispersed information echoes F. A. Hayek's (1945) "knowledge problem." But if large organizations, grown even larger by an impulse to centralize and partner with public entities, use resources to redirect individual impulses toward some centrally planned, politically sanctioned goal, the "voluntary" concentration of effort mimics coercion disturbingly closely.

The reason why is that people turn away from the myriad projects, activities, or causes toward which they would otherwise naturally have gravitated. That is not to say that each of these activities would change the world, but *some of them* would have. Centralization based on the kind of "moneyball philanthropy" described by Lenore Ealy (2014) effectively ensures that everyone is working on the same problem in the same way. It is possible, of course, that the central planner (in this case, the large foundation or charity) would get things right, and the activities being directed would in fact solve the problem. But the ambition of the central plan, the conceit of system-level change that ignores both individual incentive and dispersed knowledge, is likely self-defeating.

I wish to close by quoting a passage from Karl Polanyi, one that Ealy (2014) quotes also. It is a fundamental insight, and it is a difficult notion to internalize for those of us who want to "make a difference." The very core of philanthropy is the desire to do something, and rightly so. But sometimes we need to pull back and let individuals work to form their own associations, based on their own goals and taking advantage of their dispersed knowledge and diverse talents. As Polanyi put it:

Whether a free nation endures, and in what form it survives, must ultimately rest with the outcome of individual decisions made in as much faith and insight as may be everyone's share. Any power authorized to overrule these decisions would of necessity destroy freedom. We must have sovereignty atomized among individuals who are severally rooted in a common ground of transcendent obligations; otherwise sovereignty cannot fail to be embodied in a secular power ruling absolutely over all individuals.

[1946] 1964, 72

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