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THE PUBLIC-PRIVATE DICHOTOMY:

TWO CONTEMPORARY CASE STUDIES

A Thesis Presented

By

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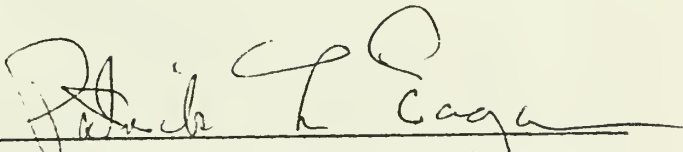
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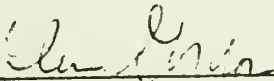
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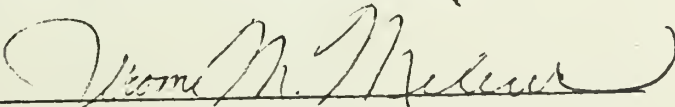
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I N T R O D U C T I O N

Terms most commonly used in description often lose their precision and eventually their meaning. This is particularly true with politics wherein hallowed norms and values are invoked so often and by such divergent factions that their conceptual clarity is jeopardized. The purpose of this essay is to explore some of the more basic of American political terms and their attendant manifestations in the contemporary context. Of primary interest will be the distinction between "public" and "private," the character of the relationships which obtain between elements of those supposedly discreet sectors, the notion of "public interest" in whose name public authority is alleged to function, and the public policy by which the public interest is enacted.

The essay will first attempt to generalize about these terms with an historical sketch, then focus on a concrete instance of public-private interaction followed by a broad look at another example of public-private relationships.

Some concluding remarks will summarize any "findings" and address significant observations emerging from the study.

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CHAPTER I
A BACKGROUND SKETCH

Interpretation of the public interest has long been a major theme in American politics. Despite its universal acclaim, however, it has not always been achieved or even perhaps diligently sought after. Even before the Constitution was adopted, there were evidently those who placed other values ahead of it. In Federalist #45, Madison reminds his soon-to-be countrymen of the meaning and importance of the public interest.

It is too early for politicians to presume on our forgetting that the public good, the real welfare of the great body of people, is the supreme object to be pursued. . . .¹

Not the good of one or a few or even a large number, but the "welfare of the great body of people" was proclaimed to be the guiding principle of public authority. Since then claims made on behalf of the public interest have been many and varied. As a result its definition has been continually in question while its integrity as a concept has remained untarnished.

Durkheim has written that every society is a moral society; that is "it entails a set of norms and values which live both in the minds of its citizens and in the patterns of their social relations."² Madison has shown that the concept of the public interest was held in some esteem by early American citizens. What remained was to determine its expression in the "patterns of their social relations."

The Constitution of the United States provided the initial framework for that expression. The three branches of government were to be balanced so that one would not tyrannize over the others; officials were to be

elected regularly in a representative way; and other measures were to be taken by the executive, legislative, and judicial branches to promote the general welfare. Among the expressed powers of the Congress was that which allowed the peoples' representatives "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."³ Madison said of this power that while it was admittedly novel, no one seemed to oppose it and it had aroused no apprehensions.⁴

The power was new because it was claiming for the fledgling central Government a prerogative previously held by the several individual States. It was unopposed in principle because it was designed to correct problems of trade experienced by the States under the Articles of Confederation. Madison explained the idea behind the clause in a letter to J. C. Cabell in 1829, long enough after the Constitution had been activated for the new Nation to begin feeling the effects of its various privisions.

It is very certain that it [the commerce clause] grew out of the abuse of the power of the importing state in taxing the nonimporting and was intended as a negative and preventive provision against injustice among the States themselves, rather than as a power to be used for the positive purposes of the General Government, in which alone, however, the remedial power could be lodged.⁵

In Madison's perspective, then, the Government was to stay out of the commercial sector except to protect the States from each other.

Article I, Section 10, of the Constitution provides that "no State shall . . . pass any . . . Law impairing the Obligation of Contracts."⁶ This supports Madison's contention that public authority is not to meddle in the affairs of private individuals or groups who do not abuse the tax laws and whose commercial dealings are governed by legal contracts.

Madison and his colleagues could not have known how important these

two clauses came to be. In them rests the germ of distinction between public and private; between what the government can do in the name of the public interest, and what it cannot do; between that with which it is appropriate for public policy to deal, and that which is to be left to the private sector. The commerce and contracts clauses have been used to forge social policy, such as in those cases which brought about and later tested the Civil Rights Act of 1964. Their most obvious and long-standing application, however, has been in commercial matters where public and private interests are construed in economic terms. There may be several ways to trace the development of the distinction between public and private and its implications for public policy, but none more graphic than the legal evolution of the concept as expressed by the courts. To the extent that the norms and values held by a nation are implied at all in patterns of social relations, it is the laws and political institutions people devise and accept which are most revealing about their basic beliefs and perceptions of what is in the public interest. A brief and highlighted review of some of the most significant legal and political developments in defining the public and private sectors in the economic context will therefore provide a necessary, but unfortunately abbreviated, introduction to a consideration of the contemporary condition of this distinction, some of its implications for public policy, and perhaps yet another interpretation of the public interest.

The Corporation as a Private Legal Entity

In 1816 the New Hampshire legislature passed three acts designed to wrest control of a college from its original group of trustees. Through a confusing set of circumstances clouded by local politics and personalities,

the case eventually reached the Supreme Court and established the key legal precedent for the protection of private property against public control. The majority opinion in Dartmouth College vs. Woodward (1819) was written by Chief Justice Marshall and featured this now classical declaration:

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. . . . It is no more a state instrument than a natural person exercising the same powers would be.⁷

The most obvious intent of this language is to accord to a corporation, an association of individuals granted permission by the State, the Crown, or whomever, to operate as a group for some legal purpose, the same status as a legal citizen; i.e., a corporation is a private person with the same rights and privileges granted to individuals by the Constitution. This intent may be based on two explicit Constitutional provisions. First, in terms of a Madisonian interpretation of the commerce clause, it is a denial to the Federal Government of the right to regulate commerce, in the broadest sense, within State boundaries. Second, and more precisely, Marshall invokes the power of the contract clause to prohibit the State legislature from interfering with a "private" contract; in this case, one allegedly agreed upon by George III and the original trustees of the College. In a fascinating article first printed in the Independent of August 19, 1909, Mr. Jesse F. Orton of the New York Bar made a compelling case for the absurdity of the Dartmouth College case as reliable precedent because of its erroneous factual bases and assumptions. Nevertheless, Mr. Orton admitted that the case "made law in regard to the most solemn and vital interests of a great nation and is still, in spite of strong efforts to evade its consequences, a mighty force in the economic and social institutions of the country."⁸

Sixty-four years have mellowed its impact, but not erased it. The case is so important in fact, that it is worthwhile to quote at length Orton's succinct summary of Marshall's decision.

The chief question in the case was thought to be, whether this institution was public or private. . . . Chief Justice Marshall admitted that the purpose of the institution was public, that "education is an object of national concern" and that "there may be an institution founded by government and placed entirely under its immediate control, the officers of which would be public officers, amenable exclusively to government." His decision was based on the conclusion that this institution was founded by private parties with private funds and that the incorporation [by the State legislature] did not change its character except to make it "immortal" and its management more convenient.⁹

Regardless of the merits of the case, the major implications were two. First, that which may be defined as private is that which is initiated by private money under private contract and, despite its effect upon the public, is managed privately. Second, it is in the public interest to preserve such entities from governmental regulation. The consequences of these implications may be viewed from two perspectives. The President of Yale University wrote in 1908 that as a result of the Dartmouth College case, "the power of control by the government was weakened and the rights and immunities of the property holders correspondingly strengthened."¹⁰ In 1874, Justice Cole of the Iowa Supreme Court had written that "the practical effect of the Dartmouth College decision is to exalt the rights of the few above those of the many . . . under the authority of that decision more monopolies have been created and perpetuated, and more wrongs and outrages upon the people effected, than by any other single instrumentality in the government."¹¹ In any case, Dartmouth College was clear in articulating the public's interest in an unregulated private sector.

Public Regulation of Private Interests

A second major but often ignored challenge to comprehensive public authority came from John C. Calhoun in A Disquisition on Government, published in 1853. The strains that tore the nation apart in civil war were many, but one of the more crucial ones was the economic control of the wealthier, industrial northern states over the agricultural South. Calhoun's argument was simply that public policy should be generated on a more localized economic basis, not by a central government dominated by a consistent majority to the exclusion of the interests of the equally consistent minority. This was, in effect, a rather radical version of the Dartmouth College logic, extending it to prohibit a central government from interfering with local government representing discreet, private, economic interests.

[A just governmental system] can be accomplished only in one way, and that is by such an organism of the government. . . as well by dividing and distributing the power of government, give to each division or interest, through its appropriate organ, either a concurrent voice in making and executing the laws or a veto on their execution.¹²

Calhoun perceived the public interest to be in the harmony of various smaller interest units, each pursuing its own economic well-being without encroaching upon the others, and each with a decisive voice in matters of common concern. In other words, the public interest was in preserving separate units of private interest. The Civil War made it clear that a unity of national purpose, not the preservation of decentralized economic interests, was the order of the day.

The Dartmouth logic suffered a frontal assault in Munn vs. Illinois (1877), in which the owner of a series of grain elevators attempted to resist regulation by the State of Illinois. Chief Justice Waite wrote the

words which have come to be a significant qualifier of the notion of a corporation enjoying the same legal status as a person. Quoting Lord Chief Justice Hale of more than two hundred years prior, Waite wrote:

Looking, then, to the common law, we find that when private property is "affected with a public interest" it ceases to be "juris privati" only . . . Enough has already been said to show that, when private property is devoted to public use, it is subject to public regulation.¹³

The majority opinion emphasized the right of public authority to interfere with private property in the public interest. Because the grain elevators were used by farmers on the one hand and buyers on the other, the Court viewed them as functionally within the public domain and thereby appropriate objects for public regulation. In the same case, however, was the seed of destruction for this modification of Dartmouth in Justice Field's dissent.

There is no magic in the language which can change a private business into a public one. . . . If this [majority opinion in Munn] be sound law, if there be no protection . . . against such invasion of private rights, all property and all business in the States are held at the mercy of a majority of its legislature.¹⁴

The impact of Munn vs. Illinois was significantly reduced by Justice Harlan in Mugler vs. Kansas (1887) in which he affirmed Field's dissent of the earlier case.

It does not follow that every statute enacted ostensibly for the promotion of these ends (protection of public morals, health, and safety) is to be accepted as a legitimate exertion of the police powers of the State. There are, of necessity, limits beyond which legislation cannot rightfully go.¹⁵

In the guise of new language such as "police power" and protection of public health and safety, a trend toward public regulation was blunted

by Mugler, but not obliterated. Even in Harlan's basic reaffirmation of the principles of Dartmouth College, there is room for "a legitimate exertion of the police powers of the State." The absolute sanctity of contract and its implication for the private sector as expressed in Dartmouth, then, had been significantly abridged, first boldly by Munn and then more circumspectly by Mugler.

The pattern to this point seems to be a recurrent support of private property by the courts in the face of increasing regulatory attempts by state governments. In 1868 with the adoption of the Fourteenth Amendment, a dramatic reversal took place. Private interests began appealing for Congressional and administrative protection against invidious and discriminating state and local taxes and regulations. One of the first of these cases was San Mateo County vs. Southern Pacific Railroad (1883) in which Roscoe Conkling pled on behalf of the railroad that the county had directed discriminatory taxes against the private company, and was therefore in violation of the Constitution under the "due process" clause.¹⁶ Excessive numbers of such cases, as well as the vast variety of regulatory laws which existed from State to State, led in 1887 to the establishment of the Interstate Commerce Commission.

It [the Commission] was designed to bring monopoly power under popular control; it was intended to be expert; and it was built to be free of "politics". . . For the most part, popular desire for regulation in the public interest (as seen in Progressive terms) was the more important and the more consistent motivation.¹⁷

Grant McConnell's parenthesis above is a subtle indication of an increasingly obvious tension infusing the late 1800's. Private property in the

form of railroads and industrial plants was expanding virtually unhamp-
ered by public authority, except for a few sniping attempts by parti-
cularly bold state governments. At the same time, the Progressives
were becoming a serious force in America. While they believed in the
ideal of free enterprise, they also were committed to the concept of
an active public interest as expressed through responsible public policy.
They recognized the evils of monopoly, while eschewing public control
as the alternative. Referring to the Interstate Commerce Commission,
Herbert Croly indicated that while it was "the first emphatic recogni-
tion in American political and economic organization of a manifest public
responsibility," it should be watched closely lest it "work more harm
than good."¹⁸

It would be fair to state that prior to 1890, America was groping
for a way to manage her growing prosperity. While the commercial sector
was clearly the heart and soul of the country, there was some fear that
its unchecked progress might impair other parts of the body politic.
Then Congress took a firm stand against the courts and their support
of the fiercely independent business community by passing the Sherman
Anti-Trust Act. The battle line was drawn; Congress on one side asserting
its power to accomplish purposes far beyond anything hitherto attempted
under the commerce clause, and the courts and "business" on the other
marshalling the due process clause and their own reading of the commerce
clause as their Constitutional weapons.

The Supreme Court struck hard at the Sherman Act in the 1896 E. C.
Knight decision which validated a virtual monopoly in sugar and shook
the hope that public policy could have a significant effect upon

"private," i.e., commercial affairs.¹⁹ Congress was swimming against the tide. Although the disadvantages of monopoly and economic control by small centers of private power were becoming more evident, Americans were still convinced of the inviability of the "free enterprise" ethic. Those who linked invigorated competition with an equality of economic advantage as enforced by the Sherman Act were suspected of socialism. The bywords of the Republic, "freedom" and "liberty," as Grant McConnell suggests, "in that hour often meant nothing more complex than an absence of restraint by government."²⁰ Perhaps the temper of those times is caught most aptly by Croly whose contention was that the public interest lay not in equality, but in progress; and that the primary task of public policy should be to avoid disturbing the momentum of private development.

The huge corporations have contributed to American economic efficiency. They constitute an important step in the direction of better organization of industry and commerce. They have not, except in certain exceptional cases, suppressed competition; but they have regulated it. Deliberately to undo this work of industrial and commercial organization would constitute a step backward in the process of economic and social advance.²¹

It would not be an exaggeration to surmise that, for most people at the turn of the century, what was good for commerce was good for the Nation.

Free Enterprise Revised

Champion vs. Ames (1903) was the first of a series of cases before World War I that clearly established the principle that the commerce power could be used as a device for accomplishing purely social goals.²² Champion dealt with the sale of lottery tickets, and while Justice Harlan was careful to declare that the case in question concerned only their

status as objects of interstate commerce,²³ the implications for a more active public policy were not lost on the judiciary or the public. Defenders of the independence of the commercial sector were quick to point out that "however much public feeling may at times move in the direction of socialistic measures," this Nation would remain far from socialism, for the integrity of "property in the modern [1908] sense represents the basis on which the whole social order was established and built up."²⁴

Nevertheless, modernity had brought a new set of situations with which the more traditional free enterprise framework was having some difficulty coping. Even such a staunch proponent of commercial independence as Herbert Croly had to admit in 1914 that "private business of all kinds is becoming affected with a public function," and that the "successful conduct of both public and private business" depended upon the same kinds of administrative and technological expertise.²⁵ There was a sense that while the commercial freedom that had built the country was surely a grand thing, Congress had not been altogether wrong in trying to channel private enterprise in certain ways.

The Sherman Act had issued a challenge to the commercial sector, and there had been considerable backing and filling in attempts to adjust, philosophically as well as practically. One of the first scholarly works which tried to come to terms with this transition was Arthur Bentley's The Process of Government, first published in 1908 and in which was announced:

All phenomena of government are phenomena of groups pressing one another, forming one another, and pushing out new groups and group representatives [the organs or agencies of government] to mediate the adjustments.²⁶

Bentley depicted the American system as a dynamic, self-renewing polity with government occupying a high profile as a referee for the commercial contestants scrambling for prizes the growing nation had to offer. This was a major departure from the vision of government as a guardian against foreign invasion and trespasses of one state against another. The most important part of Bentley's exposition was to elevate government to full partnership in the American system--a partner whose task it was to broker the interests of its private colleagues.

The nation was growing quickly and the demands upon public authority were pressing resources to the limit. The country now spread from coast to coast and war in Europe was imminent. America needed money. In 1913, the Sixteenth Amendment was adopted, giving the national treasury a needed influx of dollars, and the traditional public-private distinction a severe jolt. Some claimed to have recognized this trend all along.

For some twenty-five years there has been a marked recession among English-speaking peoples from the strong individualism of the early 19th century towards a gradual extension of government authority in economic matters.²⁷

Whatever the percipience of some, the American ideal of unfettered free enterprise was in need of revision.

There was a last-ditch holding effort by the Supreme Court to restore the Dartmouth doctrine, despite Munn, the Sherman Act, Champion vs. Ames, and the Sixteenth Amendment. While there was no going all the way back, Justice Taft in the Wolff Packing Company case (1923), did consider it worthwhile to take issue with the "affected-with-public-interest,"

principle set forth in 1877 by the Munn case.

It is manifest . . . that the mere declaration by a legislature that a business is affected with a public interest is not conclusive of the question whether its attempted regulation on that ground is justified.²⁸

This was, in fact, a paraphrase of Field's dissent in Munn, and while it perhaps carried the moment, it did not carry the day. The courts and the commercial sector had put Congress on the defensive with the Knight case in 1896, but it was now the legislative branch pressing the advantage.

Still, there was considerable confusion about the relationship of government to the private sector and to what extent governmental control was in the public interest. In Profit and Social Security published in 1935, Nelson B. Gaskill emphasized the uncertainties by citing first Munn vs. Illinois and its successors wherein the public interest was seen to be in government regulation of private enterprise in a few conspicuously "public-private" concerns, the anti-trust cases in which the public interest seemed to be related to all instances of commerce, and finally such cases as Wolff in which the public interest was seen to obtain only under special circumstances and conditions.²⁹ The Great Depression was, if a cruel catalyst, an event which forced the nation to some kind of consensus on this issue. Private power had failed to supervise itself properly. When it collapsed, it brought ruin not only to the corps of managers who could be held responsible for it, but to thousands of Americans whose lives were permanently blighted. If it did nothing else, the Depression confirmed the foresight of those who had earlier argued for a firmer government hand on the private sector. Even the courts were beginning to realize this. Two key cases set the legal tone for the Nation until after the second world

war. In Home Building and Loan Association vs. Blaisdell (1934) Chief

Justice Holmes began with Justice Taft's words to completely reverse Wolff:

It is manifest . . . that there has been a growing appreciation of public needs and of the necessity of finding ground for a rational compromise between individual rights and public welfare . . . the question is no longer merely that of one party to a contract as against another, but of the use of reasonable means to safeguard the economic structure upon which the good of all depends.³⁰

Holmes' points were: (1) that the nation could no longer afford rugged individualism, at least legally; and (2) that all private arrangements were carried on within the context of the public realm, that is that the health of the private sector was crucial to the public interest and therefore to some extent subject to it. Justice Roberts in Nebbia vs. New York (1934) pressed these points further by stating flatly that "equally fundamental with the private right is that of the public to regulate it in the common interest."³¹

The implications of these cases as forced upon the country by the catastrophic Depression pushed the role of public authority beyond that of mediator between elements of a largely independent private sector, as earlier described by Bentley. Now, as Gaskill recognized in 1935, the public interest was seen to be attached to all commercial activity and public policy, therefore, was regarded as the maintenance of that system and those methods publicly agreed upon to regulate the private sector.³² There were more than just traces of Bentley's ideas left in this new perspective, however. As Bentley had been concerned with government as a public arena in which private disputes could be arbitrated, Gaskill, too, betrays a notion of government as referee, as an enforcer of rules.

Just as the public interest is derived from the understanding of the common welfare, so is public policy the statement of procedure expected or required from the citizen body, conformance with which will promote the common welfare. It is public interest reduced to concrete terms.³³

By the end of the 1930's, then, a reasonably clear picture of the role of public authority and its relationship to the private sector was emerging. The public interest appeared to be an identifiable concept to be recognized by public authority and put into action through public policy. America was growing up, and there was a sense that it was growing together, that maturity would mean a revision of the youthful ideas of "free enterprise" and "private" activity. The laissez-faire or non-interference principle was withering in the face of changing social scale and technological developments. Progress, Justice Jackson observed, would come in the new era "through closer integration of society and through expanded and strengthened governmental controls."³⁴

Pluralism and its Enemies

On the eve of America's entry into World War II, Pendelton Herring remarked that, given a continuation of social stability and the desire for increased economic activity, there was no reason why government intervention could not proceed to penetrate into the economy.³⁵ The war, of course, proved Herring's insight. Under a virtually nationalized economy America was the Allies' arsenal, pushing production records sky high. The nationalization, however, was not accomplished by government take-over. To the contrary, it was the private sector which joined the government in the war effort. Countless advisory commissions and panels were established, businessmen served without public compensation at various levels of

government, and combinations of industrial leaders set policies for their own industries. Business and government leaders enjoyed almost free and direct horizontal access to their respective counterpart sectors. There is no question that the tie between public and private grew impressively strong and, at times, drew the sectors into one another as Grant McConnell has suggested.³⁶

The War years, however, were cluttered with exceptions to traditional understandings. At the end of the decade which had brought the most all-encompassing war in history, it was time for a re-evaluation. David Truman provided a perspective readily ascribed to by most of the scholarly community of the early 1950's. The Governmental Process attempted to update Bentley's vision of society as a cluster of interacting economically-based groups by emphasizing "the moving pattern of a complex society such as the one in which we live."³⁷ Underlying this complexity, however, in what Durkheim had called "norms and values" inhabiting the minds of the citizenry, was what Bentley had defined as a certain sense of the "rules of the game." Truman termed it a consensus on fundamentals such as the value of the "dignity of the individual" and the ethic of "fair dealing" as verbalized in such formulations as the Bill of Rights.³⁸ Basic to this perspective on the American system was the idea of "compromise--not in the merely logical sense, but in practical life--in the very process itself of the criss-cross of groups in action."³⁹

Where this theoretical brush with pluralism leads the discussion is directly to a revised notion of policy-making. If the pluralist perspective for the post-war years is valid, there are two significant consequences which follow its acceptance. First, to use Truman's understatement, "the

attempts to harmonize group demands and widely held expectations may produce a pattern of policy superficially lacking in rationality."⁴⁰ In a consensus situation, public policy is again seen as an arbiter between interests. Furthermore, the results agreed upon may make no sense to anyone but the immediate parties to the dispute because public policy had no real goal other than the protection of the public interest, which is embodied in those common elements formulating the consensus in the first place. Government as a leader as seen by Justice Jackson and Pendleton Herring, then, was not encompassed by the pluralism espoused by Truman. Second, an emphasis on compromise leaves little room for serious debate on basic policy questions which further leads to a depoliticizing of the system. If, in other words, government and the private sector are in agreement about fundamentals, there remains but to work out details of implementing the unanimously endorsed policy. The advisory committee is a case in point for, again in Truman's words, it has the stabilizing and efficient capability for "keeping administration out of politics by formalizing access and by restricting the area of controversy."⁴¹

Two examples characterize policy-making within such a framework. In 1953, the new Secretary of Commerce, Sinclair Weeks, announced the creation of The Business and Defense Services Administration to "see to it that, while private business, of course, cannot dictate government policy and plans, it can be placed in a position where it can effectively approve or disapprove of the implementation of such policy and plans. . . ." ⁴² The second, perhaps more graphic example, cited by Henry Kariel, is the action by the Alabama State Legislature providing that "the Medical Association of the State of Alabama . . . is the state board of health."⁴³ Both these

instances demonstrate a tendency toward the erasure of the distinction between private and public. They further illustrate the identification of public policy and hence public interest with one element of the private sector, and in that rather limited identification is the test of pluralism as a realistic model.

As early as 1940, Pendleton Herring disputed the value of the consensus image of American society. "Utterly divergent economic forces are seeking to use the financial machinery of the government to promote their own ends."⁴⁴ Other critics using the same social and political phenomena offered conclusions about the American system which differed rather radically from those proposed by pluralists. Ralf Dahrendorf, for instance, in 1957, explained the existence of groups in society as stemming from conflict instead of consensus.⁴⁵ C. Wright Mills argued in the Power Elite that the ruling power of society was not the balance of competing groups but the well-situated class or corps of military and industrial leaders. Gerhard Linsky theorized that groups with better access to government and subsequently more power tended to maintain their power and thereby to sustain the status quo as a kind of prejudiced pluralism.⁴⁶

The Post War Era

From the debate between pluralism and its challengers certain facts emerge. The post-war era has introduced significant new elements into the American system which, though seen from different perspectives, can be agreed upon by most observers. The first is a trend identified and initially favored by Croly and other Progressives--the growth of technology.

Following World War I, both public and private sectors found themselves relying on increasingly similar methods and machines to deal with increasingly similar problems. The phenomenon of a burgeoning technology is inextricably linked to a dramatic change of the scale of life. The nation was brought closer together by the railroad, radio, air travel and television. Attention had shifted from an occupation with daily local affairs to a concern for national issues. Those few powerful groups which had given Bentley and Truman grounds for their theories of an American pluralism were competing with other previously unorganized or less noticed groups. Strains in the societal consensus were giving more credibility to notions of conflict as the social dynamic. Despite an emerging pattern of social variation, however, the core fact was that especially during and since the Roosevelt years, because of the combination of technology and a change in scale, America was witness to a third phenomenon--centralization. "Ideally," writes Kariel, "in the fully mature technocracy, efficient industrialization comes to mean concentration in decision-making."⁴⁷

Because more decisions emanated from a centralized source, however, did not mean that the American system had been simplified. To the contrary, the complexity produced by the rapid technological advances meant an increasing interdependence among previously disparate elements. The automobile industry, for example, became dependent upon a great variety of suppliers and subcontractors all across the country. Both depended upon reliable transportation to ship parts, necessary raw materials, and the finished product. A breakdown anywhere along the line, from the shipment of iron ore to the steel mills, to a railroad strike halting delivery of

new cars, could be felt by the entire nation. Michael Reagan emphasizes the dimensions of the situation this way:

Interdependence, plus the size of individual producers, give the latter power over the economic activity . . . of the entire nation. Thus, when corporate leaders say that this or that must be done, because it will help or hinder their efforts to maintain a "sound" economy, their words carry great weight.⁴⁸

Reagan's statement added to the discussion above thrust the commercial sector into the forefront of American activity. In some respects, it is the power and position of this sector that is at issue in the theoretical debate between pluralists and "social conflict theorists," etc. There is no question that technology, change in scale, centralization, and interdependence have changed the relationship between public and private power--from almost complete separation as announced in Dartmouth, to government as referee under pluralist-progressives, to government-commercial collusion or joint directorship in the post-World War II era. It is the extent to which this last stage has evolved that is not clear. When juxtaposed to the most recent prevailing world situation, however, the nature of the relationship is somewhat more understandable. "In the cold-war economy that prevails today, the national government is heavily dependent upon business corporations in fulfilling the most basic of all government responsibilities--national survival."⁴⁹ From the example of the automobile industry, it can be cogently argued that the "business corporations" to which Reagan refers are not just the defense industries, but the entire corporate structure which supports them. This is to suggest, then, that it is actually the commercial sector upon which the health and well-being of the nation is hinged, which in turn implies a secondary position for the

public sector. "When we come to examine business' position in relation to government, the first fact that emerges," contends Reagan, "is government's dependence on business."⁵⁰

What is indisputable about this claim is the importance of the commercial sector to the entire American system. What is disturbing about it is its relegation of public authority to virtual spectator status. Because the nation is dependent upon the corporate structure for its well-being or even perhaps its survival, surely does not mean that it is the corporate structure itself which actually makes public policy, directs public authority, and, in fact, is the embodiment of the public interest. There are those, however, who believe just that. The most famous perhaps is Herbert Marcuse whose theory of unconscious repression by and submission to the technological state is worth examining if the importance of the commercial sector is held above others. Kariel gives a somewhat more gentle interpretation of basically the same phenomenon.

As its [the corporation's] millions of day to day decisions take cumulative effect, it manages to reshape the physical foundations, the emotional dispositions, and, ultimately, the political ideology of the American community. The makers of corporate policy, by their ad hoc decisions, suggest what is painful and what is pleasurable, attach prestige to some forms of behavior and detach it from others, and legislate the relative soundness of popular indulgence and deprivations.⁵¹

This image of social control is, to say the least, not the traditional understanding of the way in which the American system operates. Even in the heyday of free enterprise, when the railroad and steel barons exerted a ruthless dominance over their competitors, there was a sense that there was a higher court, and indeed there was. Munn, Mugler, the Knight sugar case--all conscious decisions from the Supreme Court--did make a difference

in the system; they were controlling factors. The Fourteenth and Sixteenth Amendments, the Sherman Act, and other measures of control by Congress did affect the direction of policy in the country by changing the operation of elements within the commercial sector to protect the public interest. Now, however, Kariel, Marcuse and others push that heritage into obscurity with a new perspective on the corporate world as the ruling power. It may furthermore be argued that the importance and dominance of "private" interest over public is not a novel concept, but one that goes back at least as far as Hobbes whose remark regarding the inimical effect of "the great number of corporations" was that they were "many lesser commonwealths in the bowels of a greater, like worms in the entrails of man."⁵²

Despite the vehemence of the imagery, these claims do make demands on any contemporary observation of the relationship between the public and private sectors. Some substantiation is in order. Morton S. Baratz lends some credence to the overwhelming power of the corporate structure by rather boldly stating:

At any time the federal government is in a position to bail out the private managers of large enterprises situated in key positions in the economy. Moreover, the dominant position of the giant firms demand that public policy-makers avoid at all cost decisions which could conceivably jeopardize the financial integrity of the mammoths.⁵³

This brings what was becoming a markedly radical discussion back toward the center. First, there is an attribution of responsibility noted here by public authority for corporations in trouble. It appears that when a major corporate concern is in financial danger, it is the government that is the final resource--not some other private source. Second, Baratz notes

that it is the "public policy-makers" who are making the crucial decisions in these cases, and not business executives. Nevertheless, the thrust of the remark is that the public ignores the private sector at its peril, that the corporate world is able to bring to bear considerable pressure upon the decision-making process; in other words, that the public interest lies with the preservation of established economic interests. Edward S. Mason underlines this notion by maintaining "that to suggest a drastic change in the scope or character of corporate activity is to suggest a drastic alteration in the structure of society."⁵⁴

If it is true that public authority's decisions with regard to individual elements of the corporate structure bear on the public interest at large, it may also be true that individual corporate decisions also are "affected with the public interest" as more strongly argued by Kariel and others. Reagan uses the automobile example to demonstrate that "the most apparent influence occurs when developments in the private sector of the economy compel complementary expenditures in the public sector" such as when improvements in vehicles require new roads, parking facilities, etc.⁵⁵ While still emphasizing the considerable power of the corporate structure here, Reagan avoids the sense of wilfull public manipulation and "evil-doing" that Kariel and Marcuse attribute to the managers of the private sector. It is appropriate at this point to allow a spokesman from the corporate world to participate in this debate. The following statement is by W. B. Eagleson, Jr., President of the Girard Company, and taken from a portion of a letter printed in the Annual Report for 1973.

National forecasts of strong business activity with a reasonable control of inflation have given way to doubts and concerns about large Federal deficits, credit shortages and inflationary incrcads on the purchasing power of

the dollar . . . On balance, however, and barring a major mishap in the execution of monetary and fiscal policies by the Federal Government, we believe that business conditions will continue to improve throughout the year.⁵⁶

There is certainly not a sense of responsibility for public policy emanating from Mr. Eagleson's remarks. In fact, the executive seems to be saying that if the government will just leave things alone, the corporation will be able to steer its own course. On the other hand, Mr. Eagleson does betray a respect for public authority because if nothing else, it can make things worse.

A summary of the development of the relationship between the public and private sectors since World War II suggests that circumstances such as technological development, a change in scale, the subsequent interdependence of elements of the commercial sector and in turn the interdependence of public and private realms because of the demands imposed by the cold war, have projected the private sector in general and the corporation in particular, into a position of prominence in the American system. The degree of power held by private interests seems to be debatable; but it is still reasonable to assume that whatever power they do hold is focussed on or channeled through public authority.

Post-War Public Policy

Public authority has apparently responded to the assumption of a greater public role by private institutions with three control-oriented policies. The first is directed to enhance the characteristic feature of the private sector, competition, and thereby prevent private interest from becoming either a challenge to public authority itself, or from

diluting the vitality of the commercial sector by the creation of a limited number of widely held monopolies.

Reliance on, and protection of, competition in the markets for goods and services has long been our declared general policy, but of course it has also long been subject to manifold exceptions. . . .⁵⁷

The Sherman Anti-Trust Act is the most obvious example. Empirical data, claims Donald Turner of Harvard Law School, appear to confirm the hypothesis underlying antitrust policy, which is that at least some aspects of economic performance are worsened when effective competition is absent.⁵⁸ Furthermore, the stimulation of competition has always been thought to be a more effective policy than outright regulation of monopoly and oligopoly. Its prime virtues, argue its supporters, are a healthier distribution of profits and an incentive for innovation. However, "the prime requisite of competition," writes Reagan, "is a large enough group of sellers and buyers so that the individual producer has to adapt himself to price changes, rather than have them in his control."⁵⁹ The fact that the modern American economy features major industries dominated by just three or four firms, Reagan contends, means that a true competitive situation does not and cannot exist, and that therefore competition-oriented policy is fatuous.

The second major policy attempt has been the regulation of the private sector by agencies and commissions. While the Progressives expressed fears that these organs of government would create a tyrannical centralized system, quite the opposite has occurred. Earlier examples cited the attempted erasure of the public-private distinction in the Department of Commerce and in the State of Alabama. While the agencies were originally designed to control various elements of the private sector, they have instead become

their captives as is persuasively documented by Grant McConnell in Private Power and American Democracy. Donald Turner points to an even more fundamental difficulty in that the regulatory agencies have failed to recognize that regulation is at best a poor substitute for competition.⁶⁰ Lacking the necessary ingredients for competition and assuming the irresistible clientel pressure upon the regulatory agencies, this public policy cannot be regarded as effective in protecting a public interest which is broader than that held by the regulated commercial concerns.

The third policy is fiscal control. Taxes are, of course, an important part of this aspect of public monitoring of the private sector; but the fact that taxes are applied equally retards the government's ability to more selectively manage the economy and thereby exert control in the public interest. The most immediate influence government has with private interests is via contract agreements. "When a business firm enters into a contract with the government, the contract gives the government a handle for imposing requirements that would be beyond its authority in the absence of the contract."⁶¹ Reagan points out two examples of firms put on notice in 1962 for noncompliance with anti-discrimination clauses in their contracts with the government. While setting a general tone and example to be followed, this policy lacks the comprehensive force required for genuine control by public authority. A more effective instrument in this regard is the incentive of outright subsidy which:

. . . is also a time-honored characteristic of the American political economy. A few numerous examples are the Reconstruction Finance Corporation . . . which primed business for a generation; the Small Business Administration, which has supplemented private banking capital in more recent years; and the lead-zinc stabilization program of 1961, which will subsidize small producers at least through 1965.⁶²

To gain a subsidy, private interests must meet publicly determined criteria and in some way be responsible to public authority, which gives this policy a positive control of elements of the economy. Again, however, in terms of a comprehensive, well-articulated policy for the regulation of the private sector by the public, the government has, at least in the superficial sketch presented here, failed to counter effectively the growth of the influence of various private concerns.

A fourth source of control is in the private sector itself. Because, as Robert Gordon has observed, commercial enterprises are not democracies with regard to the participation in decision-making by either workers or stockholders, any claim for control by the rank and file is invalid.⁶³ Similarly, despite Adolph Berle's sweeping statement that "history has shown that corporations will conscientiously seek to anticipate public reaction before it finds expression in legislation,"⁶⁴ the value of public opinion as a check on corporate activity must be regarded with a good deal of suspicion, especially in light of claims made by Marcuse, Kariel and others. The only remaining possibility is the self-awareness of corporation management; the possibility that it is aware of its power and therefore of some concomitant responsibility. Eagleson's statement would not lead one to believe this was universally the case. William T. Gossett, a former vice-president of the Ford Motor Company, provides another perspective.

We find a new role and responsibility thrust upon management, the adjudication of the conflicting legitimate interests of the groups who are intimately involved with the corporations. We find management learning to sit in judgment upon itself in those relationships where its power is preponderant, and not subject to ready control or review by others.⁶⁵

Gossett could have been speaking about government's role in relation to conflicting claims by private interests, at least in terms held dear by Bentley and Truman; but he was using political language to describe the legitimate function of a private corporation--the words of Hobbes updated. Not only is there a recognition of a public responsibility here, but also a sense that it is welcomed and will be duly dispatched. A return to Eagleson is instructive, for later in the Girard report there is allusion to this same sense of corporate responsibility for public matters.

Since we are committed to the philosophy that a healthy and growing community is vital to the success of a healthy and growing bank, we have continued to provide financial aid for many residential, commercial, and industrial projects in our City and area.⁶⁶

Coupled with an understanding of the firm's impact on its social environment is also the distinct awareness of self-help in assuming public responsibility. This goes deeper than simply maintaining a "good public image"; it involves the creation or the influence in creating a totally friendly or favorable "business climate," one in which the commercial enterprise can continue to prosper.

The business of business, however, is profit. Social responsibility makes grist for speeches, charitable acts, and community involvement; but when profit is threatened this baggage is the first to be jettisoned from the corporate craft.

When welfare or cultural expenditures are seen as "paying off," they will be undertaken. When they conflict with profit, they will be passed by. . . . The corporation conscience is, then, a self-interested conscience and hardly a reliable vehicle for achieving the common good.⁶⁷

The tobacco industry, as Reagan points out, is a classic example of a case

in which a good "public image" is applied to a product which evidence strongly indicates is inimicable to the best interests of the public.

The rather unsatisfactory summary of the response of public authority to the expansion of private or corporate influence must show that it has not developed a comprehensive policy. A good case can be made for the absence of a competitive base among major industries, making government attempts to stimulate competition doomed to failure. Government regulation by agency is highly suspect, while selective policies of subsidy lack the coherence necessary to maintain effective control of the entire private sector. Finally, corporate self-control may be a significant restraining force while profit holds out, but is a necessarily fickle regulator.

Summary

The first 125 years of the Republic's search for an adequate interpretation of the public interest and the role of public authority vis a vis private concerns was highlighted by legal sparring over the proper balance between commercial and governmental entities. The Dartmouth College case set the stage by declaring that a private corporation had the same legal rights as an individual, with certain immunities against public authority. For years thereafter, the precedent was tested, but a firm belief in a free enterprise laissez-faire system was the crux of the American ideology. Dissent grew, however, until the Great Depression forced a rather radical revision, for which ample groundwork had been laid by such events as the Granger cases (Munn vs. Illinois), the Sixteenth Amendment, and the first formulations of the theory of pluralism. Government took a more active

role in commercial affairs, and vice versa. World War II led to a further blurring of the distinction between public and private with the creation of the RFC and other public-private bodies. David Truman used these developments as evidence of a new pluralism, a system in which various private interests would compete for the attention and subsequent goodwill of public authority. As the exigencies of immediate war receded, there were serious challenges to the pluralist perspective--challenges which preferred a more positive, goal-directed public policy to the "referee" -mediator government role of the pluralists; challenges which recognized the emergence of previously unnoticed groups now making demands of their own. Empirical factors such as the growth of technology, economic interdependence, and changes of the scale of problems and the consequences of their solutions led to an alteration of private economic and public political relationships.

The growth of the private sector, primarily construed as business, began to outstrip government control, if indeed it ever really existed. The image of the public sector increasingly at odds with the private may not be entirely inappropriate. Private decisions encroached upon public responsibilities and public authority found itself concerned with decisions brought about by the growth and complexity of the private sector. E. E. Schattschneider provides a useful perspective on this situation:

The scene of conflict has shifted so greatly that the government itself is now involved in a wholly new dimension of conflict. The unresolvable conflicts are no longer carried on within the old governmental structure; the new conflicts characteristically involves the whole government in struggles with powers wholly outside of the government. Today, the government itself competes for power.⁶⁸

While the language may be dramatic, the point is a good one, and that is

that with public authority on one side, battling to maintain its prerogatives and control and the private sector on the other attempting to expand its influence, the public interest may have been lost somewhere in between. Further complicating the issue or perhaps at the heart of it, lies the apparent fact that although the two sectors are in opposition and in some sense perhaps in competition, the distinction between them is increasingly less precise.

The Task Ahead

As hasty as this review has been, it does offer some tentative observations and, more importantly, questions. First, in the context of this study, "public" may be taken to mean that which has been traditionally the concern of government; "private" seems to mean commercial. Control of the total private sector by the public sector is not apparent (with allowances for such selective cases as the postal service, the Tennessee Valley Authority and a few other limited examples), while private control of public policy must not be ruled out. There is, it seems, great confusion about what constitutes "free enterprise." Finally, there is no clear distinction between public and private, despite legal and institutional attempts to enforce various definitions at various times. One explanation may be that the distinction is relative, that an economic decision is private until it affects the public interest, a point which is itself open to question. Another explanation may be that such a distinction in practical terms no longer exists, and that, in fact, it is not that crucial anyway. Grant McConnell disagrees:

The precise location of the distinction between what is private and what is public is much less important than its maintenance; nevertheless, it is necessary to look carefully at any change in the location to be certain that the basic conception itself is not destroyed.⁶⁹

If the location is unimportant, why, then, is the maintenance of the distinction itself important? The discussion in this chapter has left only a very crude understanding of the terms "public interest," "private power" and "public policy." While it would be inaccurate to equate "private" with commercial in any comprehensive sense, economic examples do confine the analysis of the public-private dichotomy within manageable limits. Observations and conclusions drawn from such examples may not necessarily relate directly to questions of public-private relations in, for instance, foreign policy or in some aspects of civil rights. However, to the extent that general concepts such as "public," "private," "public interest," and "public policy" have any broad applicability and hence real meaning for even a rudimentary understanding of American politics, selected examples from one of the major areas of public-private interaction should provide a valid perspective on at least some aspects of the political system as a whole. Therefore, the second chapter will be concerned with a specific example of public policy-making involving a private, profit-making corporation. The third chapter will attempt to delineate recent public policy with regard to the private, non-profit sector. Perhaps with a careful look at two disparate examples of the relationship between the allegedly public and private sectors, a more precise picture of the contemporary character of these general concepts and their importance to the American political system can be ascertained.

C H A P T E R I I

THE PROFIT SECTOR

One way to explore contemporary relationships between the public and private sectors is to focus on one instance of their interaction. The first chapter has been clear in suggesting that "public" has come to mean government and that "private" at least in an economic context, traditionally has meant commercial, profit-making enterprises. The task at hand, then, is to observe government and business at close range.

Before the examination begins, it is important to clarify this traditional understanding and perhaps to bring it up to date. It may be colloquially correct to read "business" for "private," but it is not an accurate translation today, even confining "private" to the commercial sphere. As Hamilton suggested in the Federalist Papers, the life of any nation is carried on from day to day largely in economic terms, but this is not to define a rigid distribution of economic activity into that which is governmental and that which is commercial. Economists Ginzberg, Hiestand, and Reubens help dispel the conventional model of the economy which concentrates on the private, profit-seeking sector, by suggesting that a more realistic model has three sectors--profit-seeking, government and non-profit.¹ They further point out that there are significant exceptions to these categories in public utilities, defense industries and government subsidized private enterprise. The fact that these exceptions are so large adds to the justifiable impression that the modern economic order is exceedingly complex.

With this caveat duly registered, attention may again be directed to the commercial sector and its representative, the corporation, as the most typical "private" element in the American economic system. To select a particular corporation for study in its relation to public authority requires a set of criteria. The corporation must be a profit-making enterprise of sufficient size and impact to have generated information about itself. It must have been involved directly with public policy formation rather recently and it must not fall into one of the special categories generated by Ginzberg, et. al.

Several possibilities suggest themselves. One interesting study would be to concentrate on the Price and Wage Board of the Nixon Administration. However, besides the fact that this agency concerns itself with many private enterprises, its own policies are still in a state of flux. The whole area of public housing versus private developers is fraught with interesting possibilities, but again variety of encounter tends to dilute the impact of example. The ITT "scandal" has definite implications of odd public-private interaction but the ethical problems involved are perhaps more over-riding than pure public policy considerations.

Out of the hat comes the Lockheed Guaranteed Loan case. This incident concerns a large, profit-making corporation whose direct involvement with public policy-making was the subject of much recent newspaper journalism, political speech-making, and extensive congressional hearings. The objection that will be raised is that Lockheed is a military contractor. It may also fall under the category of a "government subsidized private enterprise." Both of these objections have substance, especially when placed alongside Lockheed's long involvement with the Department of Defense.

Ginzberg says of corporations of this ilk:

In many instances, the facilities that the company uses, even its equipment and much of its know-how have been provided by the Federal Government. These are not governmental enterprises; but neither are they conventional profit-seeking enterprises. . . .²

Lockheed's eligibility for this study, however, remains intact because the subject in question, an application by the corporation for a federal guarantee of a \$250,000,000 bank loan, concerns a commercial profit-making venture. In fact, much of Lockheed's case turns on its ability to function in the commercial market with the manufacture of a wide-body jet aircraft, the L-1011.

The Case

Prior to the L-1011, the Lockheed Aircraft Corporation had a distinguished history in military and commercial aircraft. The corporation's military record, as recited by its Board Chairman, Haughton, is impressive:

Excluding the C5-A [giant military cargo plane] on which there were disputes, Lockheed's composite record on more than 12,000 military airplane deliveries since World War II is very close to 100% compliance with schedule and cost targets. Our workers, our supervisors, and our managers take great pride in this kind of a record, and they take even greater pride in the performance of these aircraft which have helped to provide for our national security during this period.³

Commercially, Lockheed's three-tipped tale Constellation--the beloved "Connie"--was a staple in commercial aviation for years.

In the sixties Lockheed plunged into the weapons systems business. The Corporation successfully contracted the Polaris system, acclaimed one of the most well-designed and managed of the modern weapons systems. Building on their engineering and political experience gained in the

Polaris project, Lockheed also won the contract for the Cheyenne Helicopter, proving that, as New York Times columnist Gilbert Blackburn has suggested, there is more to dealing with the pentagon than technological expertise.

Lockheed, unlike its competitors, had never before managed the production of a helicopter. But Lockheed writers knew the magic words the evaluators had been tuned to expect--words like "life-cycle costing" and "maintainability reliability."⁴

The next major corporate coup was the C5-A project, an opening night sensation that laid one of the biggest eggs in the military procurement business. The Air Force was in the market for an extremely large, long distance cargo plane of rather remarkable specifications. Nothing like it had ever been built. After extremely costly and competitive bidding by America's three largest air-frame manufacturers, Lockheed, Boeing, and McDonnell-Douglas, the Air Force's Source Selection Board announced the winner--Boeing with a bid of 2.3 billion dollars. Lockheed had been the lowest bidder; so low at 1.9 billion that the Source Selection Board had regarded the quotation as unrealistic and a not-very-subtle piece of competitive bidding. Undaunted, Lockheed and its friends applied pressure in the right places and, as Berkeley Rice reports in the New York Times on May 9, 1971, shortly thereafter the Air Force Selection Board was over-ruled by "top Pentagon officials." Lockheed was awarded the contract.⁵

But the top Pentagon officials bought a lemon. The Defense Department's insistence on a new purchasing technique, the "package procurement procedure" made conscientious technological development extremely difficult because it demanded that, among other things, production accompany development. Treasury Secretary Connally described this unfortunate system and

its effects before the Senate Banking Committee during the Lockheed loan guarantee hearings.

During 1969 and 1970, a series of adverse events arose involving several of Lockheed's major military programs, leading to major contractual and financial legal disputes. The common ingredient in three of the four programs . . . is a total package procurement procedure, which required that development be undertaken under a fixed price type contract with concurrent production commitments with respect to price, schedule, and performance. We tried mutually to make it work, but in hindsight it turned out not to be workable and is no longer being used on new programs.⁶

Confirming Conally's admission, Gilbert Blackburn has shown the tremendous increase in the cost of military hardware in an article in the New York Times entitled: "Soaring Defense Costs: Blame it on the System."⁷ The table below demonstrates that the costs of modern weapons "systems" has far outstripped previous procurement.

Table II - A

Comparative Costs of Military Equipment

<u>Original Equipment</u>	<u>Replacement</u>
McDonnell-Douglas, F-4 Phantom: \$4 mil.	Grumman Tomcat, \$13 mil.
Chrysler Mark 60 Tank, \$343,000	GM, MBT-70 \$1 mil. plus
Destroyer, mid 60s, less than \$40 million	Litton's new Spruance class destroyer 1969 est. - \$60 million 1973 est. - \$100 million

Cost over-runs and expanding budgets are now commonplace in the business, but Lockheed was the first to be trapped by "the system." Lockheed claims that hindsight should not be used to judge the wisdom of their eagerness to participate in the C5-A project.

With today's knowledge of the inflation that began almost before the ink was dry on the C5-A contract, that the

quantity of C5-As ordered would be reduced (from 115 to 81), and that the protective clauses of the contract would not be available to us because of differing legal interpretations, some people might say we should not have gone for the C5-A program. In 1965 we did not know those things. Nor did Lockheed's competitor who was bidding for the same business, under the same contract terms and with the same expectation of Air Force planning.⁸

Things did not get better for Lockheed or the Air Force. In March of 1970, Lockheed's board chairman asked the Pentagon for \$200 million to bolster the C5-A budget and threatened that without it, the Air Force would get no airplanes. Assistant Secretary of Defense Packard then asked Congress for a "contingency fund" which was quietly granted.⁹

It was under these trying economic conditions, brought on by Lockheed's relationship with the military, that the corporation decided to buy its way out of bondage to the Pentagon by entering the commercial air-frame business. The airline companies had let it be known that they would be interested in a new design for a wide-bodied, medium range passenger plane. Boeing had just committed itself to the longer haul 747 and McDonnell-Douglas had no plans for such a project. The market was ripe and Lockheed decided to take the opportunity to diversify. On the basis of a favorable reception by the airlines of its initial design, Lockheed was able to secure enough bank loans to begin what would be known as its L-1011 Tristar. The market was good; in fact, by June of 1971, when the congressional hearings began on the loan guarantee, Lockheed had orders for 178 Tristars, of which 103 were firm. These sales, said Haughton, would generate enough cash flow to pay off loans and finance additional planes. By the 255th plane, the corporation would be breaking even.¹⁰ These were the projections in June of 1971.

In February of the same year, however, Lockheed had been shocked by an event which jeopardized its entire project. On February 1, Haughton and a party of Lockheed executives flew to London for a last round of talks with the Rolls-Royce people, who had agreed to build the engines for the L-1011. On February 2, Rolls announced that it was broke and was going into receivership; its contract with Lockheed was void. Lockheed turned quickly to General Electric and Pratt and Whitney whose original test engines Lockheed had rejected in favor of Rolls Royce's. After extensive new tests and over a million dollars more in testing expense, the two domestic engines were again rejected. Meanwhile, Lockheed's creditors cancelled \$5 million in loans.¹¹

In May of 1971 Rolls-Royce was reorganized (under the management of Her Majesty's Government) but would not agree to proceed with the Lockheed project until Lockheed was guaranteed funding by someone. Lockheed turned to the consortium of twenty-four banks who first increased their loan from \$350 to \$600 million¹² and then granted the corporation \$50 million more.¹³

It was not enough to give Rolls-Royce the confidence to proceed. Rolls would not fulfill the contract unless Lockheed's loans were guaranteed by the American government. The banks concurred and added the condition of support from prospective airline customers. Treasury Secretary Connally explained it to the Senate hearing:

It was made eminently clear by the banks that there are two essential elements to their providing . . . additional financing. One is guarantee support from the U.S. government for any advances beyond the \$400 million level. The other is participation by L-1011 customers to assist in the financing of the Tristar program. . . . The government guarantee is the key to activating now only the credit agreement, but also the other interrelated conditional agreements with Rolls-Royce and with the airlines.¹⁴

The U. S. Government was thus the last resort for Lockheed. Without the government's guarantee of \$250 million in bank loans, neither Rolls-Royce, the banks, nor the airlines would risk investment in the L-1011 project. Lockheed came to the government to arrange a business deal, not a subsidy, or a hand-out. Chairman Haughton explained the guarantee this way:

We believe the government and the taxpayers stand a minimal risk. . . . the guaranteed funds will be used for a relatively short period and will be liquidated rapidly as the early aircraft are delivered. The other factor. . . is the provision for a prior lien on Lockheed's property, which would more than amply secure \$250 million in loans.¹⁵

In support of the guarantee, Secretary Connally alluded to the consequences of the corporation's failure.

For want of a relatively small amount of additional financing, it is almost certain that in the absence of Federal guarantees the L-1011 program would be terminated and the company forced into bankruptcy. The whole of the sizeable investment in the L-1011 would be lost. The costs of such a failure in terms of lost jobs, scrapped inventories, financial hardships, and undermined confidence would be very great.¹⁶

This, then, is an outline of the "case history." It remains to be seen what issues were at stake and what this encounter has to demonstrate about the private sector and public policy.

The Issues

On the opening day of the Senate hearings, June 7, 1971, Senator Proxmire of the Committee on Banking, Housing, and Urban Affairs, followed the committee chairman's initial remarks with a set of questions he hoped would be answered by the hearings. Among them were, why is the loan necessary; if the project is too risky for the banks, why should the taxpayers guarantee it; would the guarantee force the government into

continued contracts ("sweetheart" contracts, as Proxmire put it) with Lockheed to preserve its investment; and finally what precedent would the guarantee set for the economy?¹⁷ Senator Cranston was concerned about the competency of Lockheed's management, and other members of the committee wondered what other measures, short of federal help, had been taken to ease Lockheed's distress. These were the issues attacked by the committee and they offered an appropriate perspective on the case with regard to its role as exemplar of a public-private relationship.

The first question to be answered was what made the Lockheed management feel that a federal guarantee was first necessary and second, appropriate. Certainly the unfortunate experience with "package procurement" had a great deal to do with Lockheed's ultimate inability to finance its commercial project. Too much of its capital was tied up in disputes over government contracts, and outright losses in the recent past had been significant. Here, Ginzberg's caveat concerning defense industries ought to be introduced, according to Berkeley Rice of the New York Times. It seems that Mr. Rice had discovered that "some of those C5-A progress payments (those [the \$200 million contingency Fund] coaxed from the Government under threat of abandoning the project) may have been siphoned off to cover the developmental costs of the L-1011 Tristar." Although the C5-A was built in Lockheed's Georgia plant, Rice points out, government accountants estimated that \$181 million in C5-A costs (of the \$200 million total requested) were charged by the company to its California plant where the L-1011 was being built.¹⁸ This is a serious challenge to the use of this case in a "private" context. Under the guise of "two wrongs sometimes provide an acceptable," however, it may be argued that if the government had put Lockheed in

trouble with the original C5-A contracts, it was permissible for Lockheed to use government money to get out of trouble.

In any case, it is clear that Lockheed suffered at the hands of "package procurement" and possible, although not so clear, that the company may have received at least some compensation. The fact was that Lockheed was trying to launch a commercial venture and was handicapped to some extent by its previous government contracts. W. H. Moore, Chairman of the Board of Bankers Trust Company, one of Lockheed's twenty-four bank creditors, put the problem in this perspective:

It must be remembered that this company has taken \$480 million in losses during the last three years in defense contracting. This, plus the Rolls-Royce bankruptcy, has made it impossible for Lockheed to obtain the normal kind of financing.¹⁹

There is no question that the Rolls-Royce bankruptcy and subsequent hold-out for financial guarantees put excessive pressure on Lockheed. In fact, according to the Lockheed people, Rolls-Royce had specifically asked for a United States Government guarantee. A quick solution might have been to drop Rolls-Royce altogether. But the alternatives had proved unsatisfactory. General Electric's closest engine was bigger and heavier, and therefore required structural modifications in the L-1011 airframe. The Pratt and Whitney was smaller, but provided less power and was too noisy for federal "noise pollution" laws. The Rolls-Royce engine represented several significant technological break-throughs. The engine had fewer moving parts than its competitors', provided more thrust per pound, and produced a decibal rating significantly below federal standards. Lockheed felt there was no choice.

Senator Cranston had suggested that whatever the origins of Lockheed's predicament, it was its top management that had been unable to extricate the company, and therefore should resign.²⁰ The company countered by pointing out that it had taken rather drastic steps to correct the situation:

As our defense program disputes began to have an impact on the company's financial condition, a number of steps were taken to reduce expenditures beyond the normal budget and manpower controls. . . . Cash requirements were thus \$31 million less than originally planned. . . . Salaries of key executives have been cut an average of 12%, and a moratorium has been placed on pay increases for more than 30,000 salaried employees not represented by a union. In January 1971, Lockheed sold for \$9 million approximately 195 acres of unimproved land.²¹

In addition, Haughton reported to the committee, the company had laid off a substantial number of workers, such that by spring of 1971, Lockheed was employing 27% fewer workers than at year's end in 1969. In short, there was no hard evidence that Lockheed had been mismanaged.

Senator Cranston pressed his attack, arguing that even if management had done a creditable job, the company really had no alternative but to reorganize under Chapter X of the Bankruptcy Laws. If nothing else, this would, the Senator suggested, be a show of good faith on the part of the company. But others prevailed in maintaining that Lockheed's management should not be punished for the errors of others, and that continuity of management was more important than retribution.

The reluctance of the banks to finance the project was a persisting issue dealt with most extensively in the hearings by the House Committee on Banking and Currency. Chairman Wright Patman began the hearings with the firm belief that the banks should be willing and able to finance

the project alone.

The very best solution to the immediate problem would be for the commercial banks . . . to come forward and provide the additional capital without a Government guarantee or subsidy. . . . The twenty-four banks involved in the Lockheed loan represent almost one-third of the banking assets of the Nation and it is their responsibility to provide "venture capital" in just such situations as these.²²

Furthermore, Patman insisted, there was no reason to pressure the taxpayers into taking the risk. There were no legal barriers, as far as he could see, to additional credit being granted by the banks and if the banks were so insistant about the value of the project, why should they not make the loan?²³ Another of Patman's arguments was that banks have accepted "massive government subsidies" in the form of the so-called "bad debt reserve" to encourage their participation in "venture" situations and cushion them against the problems of making such difficult loans.²⁴ There was, however, considerable confusion among members of the committee and the bankers themselves as to the purpose for which the "bad debt reserve" was to be used. Representative Windnall relied on the example of the Penn Central to show that "substantial losses can be incurred notwithstanding prudent care in making loans (and that therefore) loss reserves are to absorb the unforeseen losses that do and will occur."²⁵ Representative Johnson, a former Pennsylvania banker, pointed out that loans over a certain limit were "classified" by National and State banking authorities and that further loans to a company already holding "classified" credit was against regulations.²⁶ Bank of America's President Medberry had already indicated that loans by the bank consortium were classified.

The confusion stalemated representative Patman's argument, but Medberry swept aside the whole dispute by focussing on an even more public issue.

There is little question that the banks can make the loan. We have sufficient funds . . . But in view of the enormous public interests at stake, we are convinced it is appropriate for the Government to assume a certain measure of risk. . . .²⁷

The banks viewed the issue as public, with the consequences of Lockheed's failure bearing heavily upon public authority. Therefore, they reasoned, the government should take an active role in preserving Lockheed. The short answer, then, is that the banks claimed they were not afraid to bear the risk of an additional loan to Lockheed, but that they considered the loan to be in the "public interest" and therefore within the province of the federal government.

The final argument for a federally guaranteed loan was based on the sheer magnitude of the project to be undertaken. The point was that modern technology and the demands of increased scale made it increasingly difficult for any one corporation to accomplish a major production task. This is becoming particularly obvious in the field of defense procurement. Senator Brock came to this issue on the first day of the Senate hearings by asking Secretary Connally, "aren't we getting to the point in this country where our defense purchases are so large that they stretch or even exceed the capacity of existing financial institutions under the best of circumstances?"²⁸ Connally responded with a hypothetical example. Suppose, he suggested, a company has a defense contract for \$9 billion--not unreasonable these days. If it runs even a decent ten percent over expected costs, that amounts to \$900 million! Someone then has to pick

up that deficit. Even for the largest, most healthy corporation, that is a lot of money. For the federal government, it represents a severe budget challenge. The problem is no less significant in the commercial sector. The scale factors are the same, the financing poses the same problems, and the resolution is just as difficult. More specifically, the production of the L-1011 posed financial problems too serious to be solved by one corporation already plagued by losses incurred in similarly scaled projects.

Proponents of the loan guarantee cited some or all of these situations to emphasize the necessity of federal help for Lockheed: the unworkable Defense Department designed package procurement system; pressure from the Rolls-Royce Corporation; careful management of Lockheed despite adverse conditions; the reluctance of the banks to finance the project privately; and the sheer magnitude and importance of the program taken on by one private corporation. The precedents and justification for such aid form the second and third major categories of issues involved.

John Connally opens the debate on precedents. Speaking to the Senate Committee in support of the loan guarantee, Connally said:

One can cite many examples of ways in which the Congress has authorized credit assistance to various sectors of the economy. . . . federally guaranteed mortgage loans at the end of the coming fiscal year are expected to exceed \$140 billion. . . . The Reconstruction Finance Corporation played a major role in this Nation for almost two decades. Small Business Administration loans and guarantees are expected to reach almost \$4 billion within the next year. . . . And, with reference to the Lockheed legislation in particular, the V-loan program has provided many guarantees,²⁹ through the Federal Reserve banks, to American corporations.

Lockheed's Haughton cited an article entitled "Why the Drive to Bail Out Business is in Trouble" in U.S. News and World Report for May 24, 1971, in which it was estimated that \$137 billion was outstanding in federal

guaranteed and insured loans (as of May 1971), and another \$54 billion was outstanding in direct government loans. Haughton went on to point out that \$600 million had been committed in guaranteed loans and credits to finance foreign purchase of seventy-one Boeing 747's, and \$190 million outstanding to finance foreign purchase of twenty-nine McDonnell-Douglas D.C.-10's (the L-1011's competitor). "These loans have provided for employment instead of welfare," declared Haughton, "stimulation of agricultural production--establishment of ghetto businesses--and a whole host of other activities in the public interest. But we are told none of these is an exact precedent for the Lockheed case--that the Lockheed case is unique."³⁰ Anticipating a sharp response from Senator Proxmire, the Lockheed people had researched the Senator's 1967 support (with Senator Nelson) of a tax-amendment to bail out American Motors. At the time, Senator Nelson had argued, "we will preserve effective competition in an industry that is already highly concentrated . . ." Senator Proxmire had added, "This is immensely important to the biggest employer in the State of Wisconsin."³¹

Arthur Burns, Chairman of the Federal Reserve Board, also listed precedents but made an important distinction:

guarantees (now outstanding under different pieces of legislation) apply to small business and small farms, and they amounted in June of 1970 to \$6.8 billion outside of the housing field . . . We have nothing that can prevent a national emergency, a serious injury to the national economy, from a failure of a large, well-established and credit-worthy firm.³²

Burns' distinction was one of size. The government, he argued, has provisions, and well-established precedent to assist small enterprises, but no formal policy for aid to large commercial entities which, by their very size, threaten the "public interest" with economic disruption

should they fail. Finally, the "V-loans" were often cited by protagonists of the loan guarantee. Since the program began in 1950, more than \$20 billion has been authorized under this plan to help industries related to national defense.³³ It is interesting to note that those who petitioned the government for assistance for Lockheed's commercial project would cite the V-loans as an applicable precedent.

Alan Greenspan of the firm of Townsend-Greenspan, Inc., appeared before the Senate Committee at Senator Proxmire's request to discuss the precedent issue. Regarding parallels to defense related industries, Greenspan stated:

Let me immediately distinguish between any loans . . . which are somehow related to defense production. Clearly this is a wholly different question and one which relates to the whole nature of our military structure and has nothing to do with this issue. . . . I think at this point the fact that there is substantial disagreement among a lot of us as to whether this is a precedent, clearly makes the issue, at least at a minimum, an open question. There is very little doubt that if this Lockheed loan is made, any question of confusion on the issue is completely obliterated.³⁴

Senator Proxmire, in spite of the American Motors incident cited by Haughton, was on the offensive in his questioning of Treasury Secretary Connally. His major concerns on this point were two. First, he was willing to make the same distinction made by Burns as to scale, but argued that assistance to smaller enterprises in the past not only did not set a precedent for the case in question, but also that such aid to large scale enterprises did not necessarily follow. "Mr. Secretary," asked Proxmire, "doesn't it come down to this bill having our government for the very first time in history, making a huge guarantee; Number One, to prevent a firm from going bankrupt, one firm, and Two, to permit it to sell a product in competition with other American firms?"³⁵ His second concern was that because there

were no prior policies which could properly be regarded as precedents for the Lockheed case, there were therefore no publicly arrived at standards by which to judge the merits of the case. Still addressing Connally, Proxmire declared, "You say we have done it before, but we have also done it under guidelines that were available to all comers who could qualify, not for one firm."³⁶

Senator Cranston again invoked his solution of a change in management, this time arguing that it would effectively discourage other imperiled firms from regarding the Lockheed case as a precedent for unqualified federal assistance. The price of extraordinary public measures on behalf of a private concern, he maintained, must be balanced by a concomitant sacrifice by the petitioner.³⁷

Professor T. G. Moore, Professor of Economics at Michigan State University amplified an earlier theme suggested by Mr. Greenspan. Whether or not there was precedent for granting the guarantee to Lockheed, if it were granted, it certainly would set a precedent for other corporations and that, Professor Moore insisted, would be bad.

If the Lockheed guarantee is approved, then the next logical step will be to guarantee loans to all large financially-distressed corporations. While the Lockheed guarantee is alleged to be a special case, each corporation failure or would-be failure will be a special case. [This precedent] will reduce the size of the "stick" of bankruptcy. It will therefore reduce the incentives for American business--at least "big business"--to be efficient.³⁸

While proponents of the guarantee maintained that public policy had accommodated such support for private enterprise in the past, opponents argued that the Lockheed case represented a radical departure from public policy and one which would set an awkward precedent for the future.

As well as presenting the factors which in their opinion, made government support of Lockheed necessary, and describing the precedents which would make the guarantee appropriate, Lockheed supporters also were able to provide skeptics with reasons why such federal help would be justified. In the first place, there was a feeling by some that because of the difficulties with government contracts, Lockheed had experienced, the government was under some obligation to sustain the corporation. Medberry had alluded to government's responsibility in protecting the "public interest" involved. W. H. Moore of Bankers Trust strengthened that notion by suggesting that the bankers had done their part for the project and now it was up to the government to provide the confidence that the program required for successful completion.³⁹ Mr. Medberry of Bank of America put the matter most forcefully.

The package procurement plus other government contracting problems contributed to Lockheed's losses of nearly \$500 million on four programs. Without such losses, the additional expense arising from the Rolls-Royce crisis would not have necessitated the government guarantee. To a great extent, the federal government shares responsibility and thus the federal government has an obligation to assist the firm through its present liquidity crisis.⁴⁰

Mr. Haughton shared Mr. Medberry's opinion in this regard and added that with the government's help, Lockheed would not only strengthen itself but the market in general by re-entering the commercial field. Assistant Secretary of Defense David Packard was sensitive to the difficulty experienced by former military contractors which attempted to expand into non-defense work. So much of modern weapons systems development involves highly sophisticated engineering, "pressing at the forefront of technology" were Packard's words, that these corporations very seldom are

imbued with the "commercial discipline to be able to take their resources and move into non-defense areas."⁴¹ Presumably, Packard was of the opinion that package procurement waste should be condoned in the commercial as well as the defense sector.

There are two major objections to the notion of government obligation. The first is that the government had been pumping large sums of money into Lockheed to salvage its defense projects. Just one previously cited example is the \$200 million "slush fund" assistance for the Georgia-based C5-A project, \$181 million of which the government guessed found its way to California and the L-1011 project. The second major objection is that Lockheed's management are big boys--they know their business and they know their company. No one forced them into the commercial field. They took a calculated gamble and because of a series of what some would claim to be unforeseeable events, they lost. The Rolls-Royce squeeze play, for example, was regrettable, but that is the risk involved in a "free enterprise" economy.

Aside from a proclaimed government obligation, there was an initial attempt on the part of government officials to claim that the rescue of Lockheed was vital to the national security. On May 7, 1971, when Secretary Connally had announced the Administration's support of proposed legislation to grant Lockheed a loan guarantee, he had cast the recommendation in terms of "national security and the present state of the economy."⁴² However, in his first day of testimony for the Senate committee on June 7, Secretary Connally, lamenting the possibility of a narrowed airframe industry, indicated that national security would not be in jeopardy with Lockheed's demise.

If Lockheed should go broke . . . portions of it will be sold off. The space and missiles division of it is a very active, very prosperous segment of the entire company; it would be bought by, I assume, one of the other larger defense contractors and you diminish your competition to that extent.⁴³

In response to questions from Senators Proxmire and Roth, Mr. Packard was quite explicit about the lack of any concern for national security relative to Lockheed.

Sen. Roth: . . . should this guarantee be looked upon as a cost of maintaining a viable defense for the future?

Mr. Packard: At the present time, we have what I would consider to be an excess of capacity in terms of the minimum needs to support a production base for an emergency. I don't see that we could justify necessarily supporting all the present companies.⁴⁴

Government obligation and national security, then, do not alone offer convincing rationale for federal aid to Lockheed.

A third justification is found in the claim that a strong commercial Lockheed is necessary for the good health of a competitive airframe industry, as indicated by Secretary Connally above. Mr. Haughton suggested that the preservation of such competition was in the public interest, that with the bankruptcy of Lockheed would come "a de facto monopoly for a single air-frame company and a single engine company in a \$20 billion aircraft market."⁴⁵

Sometimes, however, market conditions dictate monopoly, argued others such as Leonard Woodcock, President of the United Auto Workers.

. . . if there is a given demand for this kind of ship and there is no L-1011 available then that demand will be filled by increased sales of DC-10's which are mainly manufactured in the same area in which Lockheed has existed (thus absorbing workers) and using General Electric engines (keeping American money in America).⁴⁶

Mr. Woodcock's belief in supply and demand was undoubtedly enhanced by the fact that both the manufacturer of the DC-10 (McDonnell-Douglas) and the General Electric engine plant employed sizeable numbers of workers belonging to the United Auto Workers. Lockheed did not. Nevertheless, Woodcock had a point and that was that if there were real demands for an L-1011-type aircraft, it would be produced by someone.

Mr. Jack H. Vollbrecht, President of Aerojet-General Corporation, a small competitor of Lockheed's and therefore having more than a little interest in the case, rejected Lockheed's concept of competition as something other than monopoly. "The only significant competitive discipline in the aerospace industry," Mr. Vollbrecht asserted, is "the threat of ultimate failure" which would be removed from Lockheed with the Government guarantee.⁴⁷ Vollbrecht was speaking to one of the fundamental beliefs of American business, i.e., that competition is built around risk, and the essence of risk is the real possibility of failure. To grant Lockheed government help would mean placing upon competitors not the usual strictures of the "free" market but the burden of dealing with a major competitor who was, in effect, subsidized by the taxpayers. Even if the subsidy were not direct, the effect of continued confidence in the company engendered by the government's concern, would place competitors at a disadvantage. Senator Taft had invited an old friend and Ohio constituent to address this issue. His guest was Edward Durell, the President of the Union Fork and Hoe Company of Columbus, who added this for the record:

My experience has indicated to me that bankruptcy and corporate reorganization are needed just as much as the profit potential to keep our business enterprises productive. Without the possibility of profit, on the one hand, and the threat of loss, on the other hand, businesses will not have the incentive to increase their productivity. Once we let our productivity slide, we will not be competitive.⁴⁸

This debate has a familiar ring to it as one remembers the discussions of "free enterprise" as traced through the courts and public philosophy in Chapter I. A summary sentence on "competition" as a justification for the Lockheed guarantee must note some rather striking conceptual differences among the parties to the debate.

Another argument pursued by the L-1011's defenders was that, even disregarding former considerations, the L-1011 Tristar was a product vital to the interests of the airlines and America. One reason was that a European consortium was building an L-1011-type airplane for use among Common Market countries. The Lockheed people relied on the fact that U.S. airlines had chosen Boeing's 747 over a European rival for their long-haul planes, and that, therefore, they would be inclined to favor another American product, the L-1011 over a European competitor, thus keeping all the economic benefits of production "at home." Secondly, it was assumed that the L-1011, equipped with British engines, would stand a good chance of competing for the European market. Finally, Lockheed's market predictions showed advance sales, a good reserve of unconfirmed orders, and the promise of even more orders after initial deliveries had been made. In short, the airlines wanted the plane badly enough to help with the early financing which should have been conclusive evidence that the value of the L-1011 was beyond question.

But it was not. The assumption of the L-1011's value initiated a spirited, if short lived, debate on "priorities." The first to challenge the Tristar was Leonard Woodcock who, after reciting deficit figures for the major airlines which had contracted for the L-1011, argued a modified "planned obsolescence" theme.

The more fundamental cause of the financial problems of the airlines has been their inability . . . to absorb the new generations of jet aircraft to which they have committed themselves. It is no coincidence that the largest airlines, with the latest and largest equipment, showed huge losses last year while most small and moderate-size airlines, which cannot afford to engage in the expensive competition for the newest models, did well. Clearly, new generations of aircraft are being forced on the airlines faster than they can be assimilated, at a rate that cannot be justified on the basis of either growth of air travel or the financial ability of the airlines to absorb them.⁴⁹

Woodcock went on to contend that the public interest was not in big airplanes, but in other things such as mass transit, social problems, etc., which could use the energies and talents of the people employed at Lockheed. Senator Proxmire had invited Ralph Nader to comment on the guarantee proposal, and he was in fundamental agreement with Woodcock. What the airlines needed, he contended, to meet consumer needs, was more "feeder line planes," not the huge transports which serve as "surrogate liquor lounges."⁵⁰ It was Vollbrecht of Aero-jet who perhaps surprised the committee in his concurrence with Woodcock and Nader. Casting the Lockheed debate in terms of "principle versus expediency," Vollbrecht maintained that the growing scope of public policy in fulfillment of social, environmental and urban needs forced a greater need for "corrective action through self-discipline in order to insure adequate Defense and Space programs at a price the country can and will support."⁵¹

Despite Lockheed's claim, then, and the avowed needs of the airlines, it is not clear that the L-1011 is a "vital" product in any rigorous sense of the term. This is not to say that its absence may not be felt, but simply to cast a rather serious suspicion on the claim that the availability of the product itself is vital to the national interest.

Throughout the debate on the Lockheed guarantee in the press and in the congressional hearings, one issue stood out as being of paramount concern to everyone--unemployment. Lockheed argued that the corporation's failure would put at least 60,000 workers out of work at Lockheed itself, and affect countless others employed by subcontractors. Treasury Secretary Connally, in an early moment of candor revealed that his real concern about the whole affair was the economic impact of the unemployment that would be created by Lockheed's ruin.⁵² Assistant Secretary Packard, judiciously circumspect about most of the other considerations in the case, was unequivocal about his concern in this regard. If Lockheed were to go bankrupt, Packard reported to the Senate, "there will be a great many Lockheed employees and a great many employees of the suppliers to Lockheed affected. That is really what we are talking about and that would be a severe problem on top of an already depressed industry."⁵³ Packard pointed out that even if employees shifted to McDonnell-Douglas, as Woodcock had argued, there would be at least some time lag and considerable non-re-employment which would have a tremendous economic impact on the West Coast.

Meanwhile, Lockheed's employees were not unaware of their precarious position. During the later days of the Senate hearings, a group of Lockheed employees appeared before the Senate Committee with the following

petition:

PETITION FOR THE CONTINUATION OF EMPLOYMENT AND PRESERVATION OF THE AEROSPACE INDUSTRY.

We, the undersigned, as concerned citizens do hereby submit to the Congress of the United States, the following petition:

As citizens first, and potentially jobless aerospace workers second, we sincerely hope that this petition marks the beginning of a concerted effort to reverse an unhealthy, un-American trend created by outspoken opponents of the industry . . . These (opponents) are having a major detrimental influence on future defense and security of our country and all those industries which for so long have supported making the American way the free way. . . . We urgently request [approval of the guaranteed loan for Lockheed . . . which will] help preserve a part of the industry which has contributed and dedicated so much to the American way of life.⁵⁴

The flag, national security, freedom, and the American Way of Life were never wrapped so tightly together. As early corporations had sought protection from state legislatures in the Fourteenth Amendment, as steel executives appealed to the government for protection against foreign manufacturers and the preservation of "free enterprise," so the aerospace workers defended public rescue of Lockheed in the name of the American Way of Life.

The real issue, of course, was employment and there was no question that a good many people would lose their jobs if Lockheed failed. George Meany kept the flag-waving to a minimum and joined the public interest to the Lockheed loan guarantee with employment:

The AFL-CIO has studied every argument against the Emergency Loan Guarantee Act of 1971. We have concluded that its enactment is essential to the welfare of America's workers and is therefore in the national interest.⁵⁵

The idea that Lockheed employees were unrelocatable, however, was not convincing to some. Leonard Woodcock, for example, proposed that the

United States Government do for Lockheed employees what Great Britain did for Rolls-Royce people. The British government did indeed let Rolls go under, but they then stepped in and set up a government firm to continue its operations.⁵⁶ The proposal met the same resistance that had dispelled Cranston's fascination with a change of management--continuity of management expertise was to be favored over an abstract principle of retribution or total operation by the American Government which was ill-equipped to perform such a task.

There were other suggestions. Professor Weintraub of the University of California stressed the inefficiency of maintaining jobs of dubious value when a redistribution of manpower would be much more efficient in the long run.⁵⁷ Professor Moore of Michigan State agreed:

Even if it [the L-1011 project] were [abandoned]; is it desirable to keep uneconomic projects afloat simply to preserve jobs? This perpetuates inefficiency. If a company is producing the wrong product, it is clearly wasteful for the Government to aid it to continue to waste resources and produce unwanted goods.⁵⁸

Two objections met this sentiment. First, despite previous discussion to the contrary, the Lockheed people and their supporters obviously felt that the L-1011 was not "unwanted goods." Second, Lockheed employees had good jobs, and it was unclear where they could get equally good employment should Lockheed fail. The burden of proof was upon those who proposed the "relocation" of Lockheed employees, but who were unable to articulate a practical plan.

To recapitulate, no clear policy emerged from discussion of the issues. Proponents argued that previous government mishandling, the Rolls-Royce bankruptcy, prudent but unsuccessful management, the banks' desire for public confidence and the magnitude of the project made the loan guarantee

necessary. Critics maintained that regardless of "bad luck," the public interest in Lockheed was not sufficient to warrant federal help. With regard to precedent, Lockheed people found appropriate analogies to their situation in such government programs as the Small Business Administration, the V-loan program, the American Motors tax amendment of 1967, and others. Opponents did not, and argued furthermore that positive congressional action in the question at hand would set a precedent of federal aid to large corporations without adequate standards to guide public policy. Corporate backers provided justification for the loan guarantee with varying vehemence by citing government obligation, the Rolls-Royce bankruptcy, national security, preservation of competition, the importance of the product, and the threat of unemployment of national significance. The opposition (and it is important to note that neither pro nor con positions were solid in all issues in either the Senate or the House) believed there was no government obligation, that the Rolls-Royce bankruptcy was unfortunate but hardly grounds for a major policy decision by the United States Congress, that national security was not at stake, that competition would not best be served by government help for Lockheed, that the value of the product was questionable, and that the unemployment problem could be solved by redeployment.

These were the issues. What they have to do with public policy and its relationship to the private sector is the subject of the sections that follow.

The Results

On August 3, 1971, Eileen Shanahan reported in the New York Times the results of congressional deliberations. The "Emergency Loan Guarantee Act of 1971" was passed by the House with a vote of 192 to 189 and in the Senate by 49 to 48.⁵⁹ No mention was made of the Lockheed Aircraft Corporation, but the understanding was that all of the \$250 million dollars in bank loans guaranteed by the Act would go to Lockheed. Other bills proposing broader authorization, such as one by Senator Javits to create a new Reconstruction Finance Corporation, and another by Senator Bayh to create a \$200 billion guarantee loan authorization for commercial and non-profit organizations received little notice.

The mechanics of the Act were explained in the Times on September 10. Administration of the guarantee is by a three-member board composed of the Secretary of the Treasury, the Chairman of the Federal Reserve, and the Chairman of the Securities and Exchange Commission. The guarantee covers \$250 million loaned to Lockheed by the twenty-four member bank consortium. Lockheed is to pay an annual interest rate of 8 percent, with more than 2 percent of that going to the government in the form of a guarantee fee. The approximately 6 percent raw annual interest rate, paid to the banks, is to be based on nine-month treasury bill rates, plus three-eighths of 1 percent for handling the loans. The guarantee loan agreement expires on December 31, 1975.⁶⁰

On March 2, 1972, the Lockheed Aircraft Corporation reported a profit of \$1.9 million on fourth quarter earnings, compared with a \$99.6 million loss one year before. The corporation reported net 1971 earnings of

\$15.4 million, up from its 1970 deficit of \$86.3 million.⁶¹

On August 22, 1972, the first Annual Report of the Loan Guarantee Board declared that the Emergency Loan Guarantee Act of 1971 had saved the Lockheed Aircraft Corporation from bankruptcy.⁶²

Trans World Airlines now announces with pride that it has the "most comfortable fleet of planes in the world" and features the L-1011 in its advertising. The Air Transport Association of America, a lobbying organization for the airline industry, explains the cost of airplane transportation in a pamphlet entitled, "Where Your Airline Ticket Dollar Goes." Under a section labelled "Paying for Equipment," the ATAA has this to say:

The part of your ticket dollar . . . which goes towards paying for aircraft and for the wear and tear associated with their use, accounts for seven of our [100] pennies. . . . Since the 1930's technological advances have forced airlines to undertake a re-equipment cycle every eight years on the average--meaning a new and better fleet of aircraft and, in time, retirement of a predecessor fleet. The latest transformation is taking place now with wide-body jets--the 747, DC-10, and L-1011.⁶³

These are the more immediate results of the Emergency Loan Guarantee Act--a prospering Lockheed Aircraft Corporation and an updated airlines industry. The implications of the public policy formulated by the Act, however, are much more profound.

The Implications

A crude sketch of the implications of the Emergency Loan Guarantee Act must begin with the fact that it set a precedent which other corporations are anxious to follow. On April 19, 1972, Leonard Silk, in an article entitled: "Why Overruns in the Defense Market?", reported that

the Chairman of the Board of Grumman Corporation (E. Clinton Towl) had requested \$545 million extra from the government to complete its contract on the F-14 fighter. Even with that help, Towl maintained, Grumman would lose \$23 million. Silk goes on to report that Litton Industries, having been granted \$600 million over renegotiated contract amounts for destroyers, was now asking for even more money.⁶⁴ While these incidents involve defense industries, the Lockheed example serves as a precedent. If Lockheed could receive federal help for a commercial venture, the government would be obligated to ensure projects bearing on the national defense.

Describing Lockheed's subsequent "success" in the New York Times of August 29, 1972, Representative Les Aspin of Wisconsin wrote:

While collecting much of its \$250 million in bail-out funds, Lockheed has continued its miserable performance on the C5-A, sought a new \$120 million bail-out for some thirty uncompleted jet-prop transport planes, collected more cash from the taxpayer via the Pentagon this year than ever before, and encouraged two other giant industries--Litton Industries and Grumman Aircraft to begin lobbying for a spot on the corporate welfare roles. Lockheed has taught Litton and Grumman a very practical lesson--the way to succeed in the defense business is to fail.⁶⁵

While there has not yet been a strictly commercial enterprise which has capitalized on Lockheed's experience, the stage is set. One likely candidate is the steel industry. On June 3, 1971, four days before the Lockheed Senate hearings opened, Michael K. Draphin reported on a convention of steel executives in New York City. His article in the Wall Street Journal, "Steel and the New Industrial Welfare State," focussed on the threat to domestic steel from foreign imports. Mr. E. H. Gott of U.S. Steel, for example, made it clear that "it was high time for the folks in Washington to quit concentrating on give-a-way programs for foreigners and

instead aid domestic industries."⁶⁶ Philip Block of Inland Steel said, "We have every right to expect government help against unfair foreign competition," and suggested such remedies as an "enlightened" tax policy granting more rapid depreciation write-offs to increase corporate cash flow and a "more progressive anti-trust policy" to permit or encourage mergers and consolidations of steelmakers.⁶⁷ In a sentence, the implication of the precedent set by the Lockheed case seems to be that modern corporate organization has perhaps outgrown previous public policy.

A second major set of implications has to do with the "priorities" honored in the Lockheed case. The value of the product per se was not the object of serious debate. A few people called it into question, but its defense was limpid and seemed unnecessary. What was the object of great concern to many was the survival of the corporation. Even then, its preservation was not defended in earnest in the name of national security or competition or any abstract notion, but in terms of the economic realities of employment. It would not be unfair to suggest, then, that the outstanding priority suggested by the debate on the Lockheed guarantee was the economic immediacy associated with employment.

Third, should other major corporations actively pursue Lockheed's course, the government would be hard-pressed to apply standards generated by the Loan Guarantee Act. The language of the Act concerned itself with the mechanics of the Lockheed case in particular, and did not include any clue as to how future similar situations should be judged. In discussing the possibility that the Lockheed case would set a precedent, Ralph Nader had indicated that there are established principles which guide the government's involvement in areas of health and safety; but that it was not at all clear what goals the government should try to achieve for the public

interest in matters of the economy which could not or would not be achieved by private enterprise.⁶⁸ Senator Javits had offered some advice in this regard when he introduced his own bill to the Senate Committee:

. . . the test should be the essentiality of the production of the goods and services produced by the individual corporation to the economy of the nation or of a region thereof or the unusual case where the whole economy of the country could be imperiled by one such stop. But I would not make both tests, I would make either test.⁶⁹

There are three important parts to this recommendation. The first two are in the phrase, "essentiality of the production of the goods and services. . . ." Does the Senator mean to emphasize the essentiality of "production" or of "goods and services"? He would probably maintain that both should be considered. The third part of his statement is the implication that any corporation whose scale of operation is so vast that its loss would affect the national economy ought to be protected. At best, this recommendation is vague; the priorities by which the standards should be developed are not clear.

Arthur Burns was more precise and perhaps more realistic in his suggestion. After stating his belief in free enterprise and the obvious exceptions recognized for smaller businesses, homes, farms, etc., he went on to say:

In extraordinary circumstances, however, even a large, well-established, and credit-worthy enterprise may experience difficulty in obtaining needed credit, and failure to provide that credit could be extremely costly to the general public--in terms of jobs destroyed, income lost, financial markets disrupted, or even essential goods not produced. We should be able to find a way to deal with this problem without injuring the free enterprise system.⁷⁰

Burns, like Javits, suggests two criteria--the possibility of economic disruption and the value of the goods being produced--but his emphasis is

on the first. This comports well with the results of the hearings, which seemed to develop a consensus on the importance of maintaining employment and honoring credit agreements. In all, Burns' proposal, formulated in Senate Bill 2016 and sponsored by Senators Sparkman and Tower, had five standards for granting a loan guarantee:

1. Assistance should be given in "those rare instances" where it is required to "continue to furnish goods or services to the public, and where failure to meet that need could have serious consequences for the Nation's output, employment, and finance."
2. Recipients should be able to prove that the guarantee is a last resort, and that there is "reasonable assurance of repayment."
3. The guarantee should cover private loans, not outright advances of public funds.
4. No new staff or bureaucracy should be created to handle these guarantees. They should be authorized by "top Federal officials."
5. A guarantee should be authorized "only if the President certifies that it is needed to avoid serious and adverse effects on the economy and a copy of that certification, with a detailed justification is sent to the Congress and the two Banking Committees at least ten days in advance."⁷¹

There is concern for economic disruption and reference to the value of the product. There are "protection" clauses about repayment and private financing. No new staff is created to avoid the possibility of developing a "clientel" of eligible corporations. Finally, it is the President who makes the recommendation for the guarantee, develops justifications, and submits his proposal to the Congress.

Again, three aspects are strikingly important. The first is, like its predecessors and the Lockheed case itself, the overwhelming concern is for the economic consequences of the failure of the petitioner. The second is that it is left to the President to develop a justification for the guarantee--

there are no guidelines to help him. There is the sense that the reasons for the corporations dilemma are relatively unimportant; that eligibility for a guarantee is hinged more on consequences than on cause. Third, and perhaps most important, the issue is to be submitted to Congress for debate by publicly elected officials whose deliberations are, the assumption is, held accountable to the public.

A third suggestion for standard-setting is weak in comparison to the Burns proposal but does emphasize less-well developed dimensions of the debate. Professor Turner of the Harvard Law School deals with the concept of government subsidy in general, and accepts its necessity when:

One, it is designed to promote activity which, without subsidy, would fall short of the social ideal; and second, beyond that, beyond the simple increase in allocation, it does not affect the operation of competitive markets.⁷²

His first provision considers the "social ideal," presumably conveyed to public authority by elections and public opinion and enforced or activated by the public's elected representatives. Turner is putting in conceptual terms here what Burns had suggested in practical terms by having the President submit his recommendation to the Congress. Second, Turner places at least as much emphasis on a healthy competitive market as on the more immediate economic repercussions of corporate failure, which is to suggest that there is more to a stable economy than excessive regard for one company's employees and their subsequent unemployment.

The final word, though, is that these plans were speculations, gestures, which were ignored or set aside when the actual policy was made. Discussion about consequences, ability to repay, etc., do not standards make. The most important implication, then, is that other than the verbiage of the

hearings, the Emergency Loan Guarantee Act set no real standards for corporate petitions for public aid.

In addition to implications of precedent, priorities and standards, another area of interest emerging from discussion of the Lockheed case is the use of the term "free enterprise" and its employment by representatives of the private and public sectors. Professor Weintraub expressed what might be referred to as a traditional outlook on the private sector as free of involvement with the public sector:

Producers, not consumers or taxpayers, must bear the risks of production if our economy is to remain free and viable. . . . American political life has benefited by the separation of political and economic power.⁷³

There was undoubtedly some hyperbola to Professor Weintraub's statement, assuming he was aware of the plethora of government policies in such periods as the Depression and World War II. Nevertheless, his point was that free enterprise was "free" only insofar as it was responsible for itself and could not rely upon consistent government support. Edward Durrell, the garden tool manufacturer, expressed himself less simplistically, but betrayed every bit as much faith in the traditional free enterprise system.

Some people are saying that this scheme [the loan guarantee program ala Burns' proposal] would be like the old Reconstruction Finance Corporation. In my judgment, RFC may have been appropriate where a general depression existed, but it would certainly not be appropriate where free market conditions are capable of functioning as they are today.⁷⁴

Despite these testimonies, other spokesmen for free enterprise were somewhat equivocal about its health and well-being in modern America. Georgia's Senator Gambrel, in whose state Lockheed's C5-A plant resided, had to

hedge on the American free market ideal.

It seems to me we are not really in a free enterprise context at all. We are dealing with a whole industry (aerospace) that is, if you want to call it subsidized, yet it is a necessary industry the U.S. Government is the largest single customer for.⁷⁵

Gambrel thus lends support to Ginzberg's categories within a basically three-sectored economy. There are exceptions to "free" enterprise, and these are, the suggestion is, found in industries associated with defense or public welfare, such as perhaps public utilities. Granted defense and utilities, the Lockheed case has demonstrated additional incursions into the free market concept. David Packard supports this notion.

I think if you really want to look at what has happened over the past decade in particular, American business seems to have gotten on a binge of wanting to be big. Growth and size has been considered for its own sake. I think this has caused a number of companies to do things that were unwise in the long term.⁷⁶

Packard's statement reflects an earlier discussion of size and change in scale, the idea that perhaps some of the projects to be accomplished today are too big for any one enterprise. Packard is not convinced by this argument and hints that it is simply avarice and not the exigencies of modernity which has expanded the scale of corporate operations. W. H. Moore of Bankers' Trust, however, feels that regardless of one's attachment to the principles of the past, contemporary problems call for more creative solutions.

I work in and believe in the private enterprise system. However, as our economy becomes more complex it is critical that the private and public sectors work more effectively together.⁷⁷

This is the same tune sung earlier by the steel executives, and even earlier by farmers, exporters, the oil industry, and others. "Free

enterprise" thus begins to take on new contours. In one sense "free enterprise" can mean government protection of domestic corporations so they can compete with foreign sources. In another sense, it can mean government subsidy or guarantees to corporations whose products or services are vital to the nation, or whose failure would cause significant economic distress. The common denominator seems to be the phenomenal change in the scale of commercial operations. Bigness cramps competition and drains private capital; it stretches the seams of the capitalistic, free enterprise system.

I think the time may have come in this country when we have to look at things somewhat differently from what we have in the past. I am not sure that some of our corporations have not reached a size and do a volume of business that at least defies the ability of the traditional lending institutions to meet their demands.⁷⁸

If what Secretary Conally said is true, and the Lockheed case certainly lends force to the argument, "free enterprise" either has no real meaning in the modern commercial sector, or its traditional meaning has been distorted beyond recognition. The caveat may be that the reference is to exceedingly large, and therefore few, private enterprises. The supporters of the Lockheed loan, however, successfully demonstrated the dependent linkage of subcontractors and satellite ventures to the primary producer. "What is good for the goose is good for the gander" may be too crude a formulation for such a sophisticated complexity as the modern economy, but one is led to suspect that if the concept of "free enterprise" has been significantly altered for major elements in the commercial sector, the minor ones will certainly feel the impact.

This perspective on "free enterprise" and the commercial sector has weighty implications for public authority. If independent corporations

are no longer able to support their own activities, the assumption is, at least by the steel and defense and now Lockheed people, that it is the government's responsibility to protect them. William L. Cary, former Chairman of the Securities and Exchange Commission and now a professor of law at Columbia, remarks on this development:

Business talks about free enterprise but asks government intervention in any financial crisis. The bailout of Lockheed was a case in point. . . . The real question . . . is whether the government should be thinking ahead even further and first attempt to identify the industries which may be sinking. . . .⁷⁹

It seems that the onus is on government to develop a public policy to accommodate problems encountered by commercial enterprise in dealing with the emerging scale and complexity of modern production. In a March 1972 article in the New York Times, Lee Loevinger writes: "the basic issue is whether government should prohibit abuses or prescribe conduct," the former leaving to regulated parties great latitude, and the latter forcing upon them "a very narrow range of choices, depending upon the generosity, wisdom and skill in legal draftsmanship of the bureaucrats who promulgate the regulations."⁸⁰ Presumably, the Loan Guarantee Act was an incident of "prescribed conduct" so narrow as to pertain only to Lockheed.

Besides balancing this difficult consideration, there are other factors which would make control of an effective public policy in this regard a difficult matter at best. One of the key developments of modern life which is alleged to make government action necessary is the growth of technology. At the same time, this dimension also circumscribes government initiative in evolving satisfactory and comprehensive policy. What has been called the "technological imperative" means, among other things,

that government can not know enough about the technological problems involved in production of various goods and services to formulate intelligent policy either to assist or regulate the commercial sector. An example of this dilemma occurred in the Senate hearings on the Lockheed guarantee. After listening to a long recitation by the Government Accounting Office on Lockheed's cost overruns, buttressed by reams of statistics and engineering technical data, Lockheed's Haughton interrupted the government official's testimony:

But all these things you reel off about this airplane. The GAO is a great organization, and a fine organization, but I am not sure they know all that much about developing airplanes.⁸¹

The question is, who does know? If only Lockheed knows, and it is the firm asking the federal government to guarantee a loan of \$250 million to cover gigantic losses on a project which private financing will not cover, public policy is based on little more than Lockheed's word that what it is doing is the right thing. This, a reasonable man would argue, is not sufficient justification for the use of public funds. Furthermore, the commercial nature of these large-scale projects puts even more severe restrictions upon public policy makers. Making the hypothetical assumption that elected officials know something about "developing airplanes," much of the information required to make decisions about government support is not available to them because, the argument goes, public disclosure of financial and technical information would endanger the petitioner's competitive position--the commercial version of "national security." Senator Proxmire was shocked to find that, although he was being asked to authorize risking taxpayers' money to guarantee a loan to a commercial enterprise, he was not allowed

to study information related to the company's financial and technological performance:

Proxmire: If lockheed is willing to have you release that Systems Analysis study, would you make it available to us?

Packard: I don't believe I would, no . . . I can't manage that department [Defense] unless I can have private studies that are not released to the public. . .

Proxmire: Ever? Under any circumstances?

Packard: I will make the decision.⁸²

In fairness to Packard, the study requested concerned the C5-A, a defense product; but the information bore directly upon the L-1011. Furthermore, company officials had already indicated that there was nothing "classified" about the C5-A project. The point simply is that obtaining sufficient information on which to base a decision by policy makers is difficult.

Another dimension to the issue of public policy control is simply economic expertise. When and when not to keep a commercial entity alive has heretofore not been a real decision, but was determined by events--the free enterprise system. Government decision-making in this sphere not only runs the risk of making mistakes, but of exerting undue influence upon the "private" sector.

The judgment whether an enterprise is economically viable . . . is one that ought to be made by the market, including the market for private capital. . . . The increased use of federal guarantees of credit expands the role of political judgment, and, therefore, political influence in the allocation of capital, and this seems to me clearly unwise, both on economic and political grounds.⁸³

Professor Weintraub and Edward Durrell would have agreed with Dean Phil C. Neal of the University of Chicago Law School.

Senator Proxmire sensed the political implications in using public policy to regulate economic matters. He echoed Dean Neal's statement in

agreeing with an earlier remark by Senator Weicker that the Lockheed guarantee would permit a firm to survive not on the test of the market place, "but on the test of political clout . . . it seems to me [Proxmire] you just open up the determination of survival in the free enterprise system to political influence and political thrust and power. . . ."84 These fears are justified.

From the discussion presented here about reasons, rationale, and evidence for and against the Lockheed guarantee, very few arguments have shown themselves to be decisive. But the Emergency Loan Guarantee Act was passed, albeit by a thin margin. Why? Dean Neal and Senator Proxmire may have foreshadowed the answer. Robert Samuelson reported in the New York Times:

Immediately after President Nixon proposed the loan guarantee, both Senators Edmund Muskie and Hubert Humphrey, who voted against the SST, endorsed the Lockheed loan. The quick reaction, some Congressional observers suggest, may have been an attempt to sooth unionists, who lobbied strongly for SST and also favored Lockheed aid.⁸⁵

If this suggestion was true, and if it affected more than two senators, it could partially explain Lockheed's success as well as lend credence to Proxmire's concern. Eileen Shanahan had reported on the voting alignment of Congress after the Lockheed measure passed, but found no consistent ideological or party pattern. All presidential candidates voted against it, except Humphrey and Jackson, who was not there.⁸⁶ (This suggests Muskie actually voted against it after initially announcing his support.)

The real clincher, and the fact that confirms fears about political involvement in the economic process was the constituency alignment of the Lockheed vote.

The one pattern in the roll call was that Senators with Lockheed installations or the plants of subcontractors in their states voted for the legislation--those with McDonnell-Douglas or General Electric plants voted against it.⁸⁷

Perhaps the most optimistic way to interpret these results is to conclude that Senators were voting to maintain employment, that pressure from large numbers of constituents persuaded them to vote for whichever side of the issue their locality was on. A less hopeful, but possibly less naive appraisal is that pressure came from the corporations themselves. In any case, it would not be too far wrong to say that political pressure, and not necessarily the merits of the situation, decided the Lockheed loan case.

A third implication for public policy, aside from questions of control and political matters, is the growth of what appears to be an expectation of protection by government of private enterprise; that, in fact, protection of the commercial sector is the job of public policy. Peter Drucker puts the issue rather bluntly:

Government has a duty to protect . . . It is unrealistic to expect modern government in a developed economy to return to the laissez-faire position of the late nineteenth century. . . . What we need, therefore, is a commitment of the developed countries to a policy of direct subsidy as against a policy of indirect protection (such as tariffs or quotas which are hidden and do not appear as expenditures of government--though of course they are--expenditures of the community).⁸⁸

This statement combines what has been said about the evolving concept of "free enterprise" with the apparent need for a more active, comprehensive public policy regarding the commercial sector. Drucker is perhaps more direct than corporate spokesmen in looking forward to unabashed government subsidy, but their anticipation is no less real. The term protection,

one begins to realize, completely vitiates traditional understandings of "free enterprise" or "competition" and proposes a rather different role from the mediating posture of previous public policy, at least as depicted by "pluralists." There are those, however, that maintain this conception of public policy is not new, but is the norm. Lockheed's Haughton is eloquent on this point, combining free enterprise, public interest, and government protection into one statement:

I think in loans of this type the greatest thing is whether or not the granting of the guarantee or the loan . . . is in the public interest, and have the applicants done all they can in the private sector to take care of themselves, and then if they can't [emphasis added] we have learned all our lives that the government is supposed to do for people the things they can't do for themselves.

All the foregoing implications of the Lockheed loan guarantee, from precedent, priorities, standards, and free enterprise to changes in public policy come down to reflect a certain understanding of the public interest, a phrase used by Haughton on the one hand and Proxmire on the other. Like "free enterprise," it is an illusive phrase, not easily contained, but let loose to wander about the floor of Congress and to grace the pages of newspapers. What does the Lockheed case have to say about the meaning of "public interest" in modern America?

Crudely, it seems to be economic immediacy, a regard for the "is" of modernity rather than the "ought." Senator Javits best expressed this in response to a question from Senator Proxmire:

Now, we face a fact, not a theory, and we simply have to make the best shift we can. So . . . on balance the virtues and strength for the United States, not for Lockheed, of maintaining operations in Lockheed is greater than the imperfections of a process by which they may have to be maintained.⁸⁹

More specifically:

the function and operation of the country or a region thereof, must be the primary consideration. . . . The fundamental policy point is the United States should have an agency that is capable of looking at the liquidity of a major enterprise, the operation of which is essential to the country.⁹⁰

Boiled down, this means that the public interest, at least in the economic context, lies in the survival of the major components in the economic system. There seems to be no question of the importance of what and how much is produced, as long as the economic engine is kept in tune. The public interest, says Javits, calls for economic productivity, underwritten, if need be, by the government. If this is the case, and there is very little in the Lockheed example to suggest that it is not, then it is somewhat superfluous to cling to any pretense of "free enterprise" or free market in the modern economy. The giant corporation, if indeed its survival is in the public interest, thus becomes, to some extent, a ward of the state, and major corporate decisions become major public decisions. The state then bears the responsibility of orchestrating the various corporations and their activities in the "public interest."

In sum, planning is an unpopular word in this country but no one seems to recognize that the actions we have taken demand it. No one can be so naive as to say these are not political questions. Yet when they reach the magnitude of a half billion dollars for a single company the allocation of resources must be treated as involving major questions of national policy.⁹¹

If corporations are willfully surrendering themselves to the political arena, they must certainly be aware that they will forfeit the right to set their own priorities, to establish their own directions. What looks like relief for major corporations and chaos for public policy now, could be

the beginning of a radical change in public policy which could place private, commercial enterprises in competition for public largess and support with non-profit or governmental units. The complexities of Ginzberg's model could be drastically simplified if the results of the Lockheed case are writ large. Senator Birch Bayh's proposed amendment to the Emergency Loan Guarantee Act should have been a major clue to the commercial sector:

I believe we can--and we must--pose the question of emergency loan guarantees as a question of national priorities. . . . I propose that the concept of federally guaranteed loans on an emergency basis be broadened to prevent the bankruptcy of major public and private non-private institutions that provide crucial social services to this nation.⁹²

Bayh's amendment did not receive much attention and it certainly did not pass. The "public interest" this time was deemed to be in maintaining Lockheed's economic capacity and the employment which it provided.

Another time, the priorities, the "public interest," may lie elsewhere.

Summary

The object of focussing on one instance of the relationship between the public and private sectors in contemporary America was to gain a better understanding of their interaction and thereby to clarify and perhaps bring up to date some concepts very basic to the American political order. In the first place, the study was hampered by the singularity of example--what is true of the Lockheed case may not be exemplary of public-private interaction in general. Second, as superficial as the attempt has been, it has revealed a tremendous complexity to which this brief glance could not begin to do justice. Modern life, especially on the scale of corporate-government relationships, is not a simple matter.

Yet, with these limitations, the heart of the issue is relatively uncomplicated and is instructive. It was not the purpose of this project to judge the Lockheed case. Whether or not Lockheed "deserved" the loan guarantee is not in question. What is at stake is some understanding of the validity of the "public-private" distinction, how public policy is made, and how public interest is defined.

The private-public distinction is not clear, unless one defines it by which side of the table one sits in congressional hearings. Neither realm is separate and discreet from the other. The public presence is felt in the private sector by regulatory policies, such as taxes, contracts, employment regulations, etc., and the public sector must be sensitive to those actions of the private sector which will have consequences beyond private control. Indeed, when the failure of a corporation has such national consequences that public policy is employed to avert it, any claim to "privacy" by the corporation is defensible only in the most legalistic, abstract way. Reality puts the public-private distinction on a continuum on which it shifts situationally. It is important that the distinction be recognized, but it is equally important to recognize its relativity and therefore not to make too much of it.

Public policy is seen to be a practical matter, an ad hoc, more-or-less responsive, as opposed to initiatory process. Public policy may be regarded as the response of "public" officials to "private" pressure, whether the pressure is exerted by voters or by more compact units, such as corporations. In a not very precise way, this perspective on public policy shows that politics works--at least some people get what they want. In the Lockheed

case, more people wanted to keep their jobs, wanted to maintain Lockheed as a viable economic unit, than wanted to solve the unemployment problem that would result from the failure of the corporation. This is not a neat or very comfortable understanding of public policy, but it does appear to be a fairly realistic one.

The "public interest" is invoked by everyone because, of course, everyone has an interest and is part of the public. Unless one could argue that the public interest was not served in the Lockheed case, it must be seen to be as ad hoc and "practical" as the public policy which is enforced in its name. It is not a comprehensive set of standards, public goals, or general understandings, but apparently is that policy or practice which has the support and/or attention of the most influential people. In the abstract, the public interest is the voice of all the people to which government is supposed to listen and respond. In reality, it is more likely many voices, only the loudest of which are heard.

CHAPTER III

THE NONPROFIT SECTOR

As Chapter II has demonstrated, "traditional understandings," of various aspects of American political and economic life do not always measure up to contemporary reality. Eli Ginzberg, et. al. discussed in The Pluralistic Economy a model of the modern American economy as having three major sectors, governmental, profit-making, and non-profit plus significant exceptions. A quick survey of public attention to any model of the American system would undoubtedly focus upon the governmental and profit-making sectors. However, public policy must concern itself with all of these categories, as well as their exceptions. To emphasize one or two of these sectors at the expense of the third would mean that public policy is incomplete, and would therefore suggest that "the public interest" is not being served; that is, unless the ignored sector is in fact insignificant in terms of its impact upon the public at large. Unlike the second chapter, where one instance was used to gain a sense of the whole, the task at hand here is to explore, however briefly, the third, "non-profit" sector in general to determine in some way its public significance and subsequently its relationship to public policy.

A first observation is that most of the nonprofit sphere is also considered to be private. This gives the lie to the more common notion of equating private with profit, at least in the economic sense. Second, the "third sector" is neither new nor insignificant:

It may be true that the key to our economic development is in the dynamism of the private (equals "profit) sector, but the historical record is unequivocal about the fact that many . . . nonprofit organizations also have long been engaged in enterprise. The relative weight (of this sector) is vastly greater today than heretofore, such that one may speak of a veritable transformation of the economy.¹

The nonprofit sector is a legitimate and major element in the American political and economic system. What follows is intended as a general description and critique of this sector, and a discussion of its relationship to public policy.

Defining the Nonprofit Sector

The defining characteristic of the nonprofit organization is that it is tax-exempt. It neither pays taxes itself nor are those individuals or groups which lend it financial support taxed on the money they give to it. Public policy recognizes the nonprofit sector in the Internal Revenue Code, Section 504(c)3 by describing four categories of nonprofit organizations, three of which may be grouped under the heading of "public charities."

- 1) "Organizations normally deriving a substantial part of their support from public contributions."

Examples are churches, schools, hospitals. Individuals contributing to such organizations may claim charitable deductions of up to thirty percent of their adjusted gross income. This percentage was increased from the twenty percent indicated in the 1954 Tax Act in 1969 to increase income for charitable organizations.

- 2) "Organizations which . . . receive a substantial portion of their support from income produced in the performance of their exempt functions."

Examples are alumni associations, symphony societies, and some museums.

- 3) "Certain satellites of organizations in one or the other of the first two categories" such as university presses, trusts formed by a public charity and so on.²

That these organizations are defined as "public charities" has led to some confusion about their "private" status. They are not underwritten by the government, or at most only insofar as the government designs the tax structure through which they exist. They are public in the sense

that they are devoted to benefitting the public at large, but are not the immediate object of public policy per se.³ The fourth category of non-profit organization is the "foundation" which is described by the Commission on Foundations and Private Philanthropy as "primarily a grant-making organization supported by contributions from an individual, a company, or a small group of persons (and) may be organized in the form of either a trust or a nonprofit corporation; it may have an endowment or distribute contributions for charitable purposes as they are received."⁴

A crude sketch of the nonprofit sector to this point, then, depicts organizations which receive tax-exempt contributions from individuals, combine those contributions into trusts, endowments, or other holding mechanisms which are themselves tax-exempt, and dispose of their resources for "charitable" purposes. The dependence of the nonprofit sector upon the tax structure puts it squarely in the hands of public policy. As such a long-held assumption has been that "charity" does not include politics, and that no tax-exempt funds should ever find their way into political activities. Stemming largely from the common sense notion that money initially permitted by policies of the government to be devoted to "good works" should not be used to affect those policies or the government itself, this assumption has been codified in the Internal Revenue Code under that section defining tax-exempt organizations.

That organization is eligible for tax-exempt status, no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office.⁵

Political parties obviously cannot be considered as eligible for tax-exempt status. Section 504(c)3 does, however, list sixteen legal components of the nonprofit, tax-exempt sector.

- | | |
|----------------------------------|----------------------------------------|
| 1. Mutual Insurance Companies | 9. Private Colleges & Universities |
| 2. Savings and Loan Associations | 10. Foundations |
| 3. Trade Associations | 11. Voluntary Hospitals |
| 4. Chambers of Commerce | 12. Research Organizations |
| 5. Professional Societies | 13. Churches |
| 6. Farmers' Cooperatives | 14. Social Clubs |
| 7. Consumers' Cooperatives | 15. Blue Cross & Blue Shield |
| 8. Trade Unions | 16. Museums and Libraries ⁶ |

The great variety represented by this list gives a clue to the confusion of the nonprofit sector, largely thought to be organized almsgiving.

The size and scope of this sector helps destroy that more parochial image, however. Ginzberg is again useful in correcting the perspective.

There is no blinking the fact that in two out of the last three decades the not-for-profit sector accounted for the largest part of the total expansion of employment. Between 1950 and 1960 the sector accounted directly and indirectly for almost nine out of every ten new jobs added to the economy.⁷

Ginzberg here speaks of the number employed actually doing the work of the nonprofit sector. What they were doing was deploying resources which were increasing at a faster rate than the Gross National Product. In 1968 philanthropic contributions totaled \$15.8 billion, which represented an increase of 155 percent from 1955. In the same time, the GNP had increased 118 percent!⁸

All this money was coming from three sources. It has been estimated that by the middle of the 1960's, approximately four to five percent of the total philanthropic dollar was being supplied by corporations, which, like individuals, are granted tax deductions for their gifts. Between six to eight percent was coming from foundations, themselves nonprofit

organizations which causes some statistical difficulties in computing total contributions to philanthropy. Finally, the remainder, as much as 90 percent of the total philanthropic contribution was coming from individuals either directly or in the form of bequests, which themselves constituted eight to ten percent of the total.⁹ A summary to this point must note that there are apparently a considerable number of people using a significant amount of money to do what is loosely referred to as philanthropy. All this goes on in the third sector, the nonprofit sector of the economy which is tax-exempt and supposedly a political neuter.

A Brief History

While it is not crucial to the project at hand to develop an in-depth historical profile of philanthropy, it is important to develop a sense of the history of this endeavor in America to begin to understand its contemporary dimensions.

Marion Fremont-Smith attributes the modern legal status of institutional philanthropy to a precedent set in 1819 which, as she puts it, concerned "an attempt by the legislature of New Hampshire to alter the charter of a charitable corporation."¹⁰ The importance of the Dartmouth College case was emphasized in the first chapter as that legal act which set the stage for the growth of private, corporate power in America. It is interesting to note here, that not only was the case originally concerned with a nonprofit institution, but it enabled the simultaneous development of the third sector along with the commercial. The vital common element, of course, is the distinction the Supreme Court made in this 1819 case between public and private. Fremont-Smith interprets this distinction in terms of contract

relations, as prescribed by Article I, Section 10 of the United States Constitution.

The Supreme Court held that there was an implied contract on the part of the state with every benefactor who should give money to the corporation. An alteration of the charter without the consent of the trustee would be a violation of this contract and therefore an unconstitutional act.¹¹

Whether commercial or nonprofit and regardless of the actual merits of the case, Dartmouth College successfully established a legal distinction between that which is considered to be "private," and therefore free of governmental or public influence, and that which more appropriately falls under the immediate responsibility of public authority.

While the commercial implications of this laissez-faire oriented decision were all too apparent to early entrepreneurs, the nonprofit sector did not move as swiftly. A few sporadic attempts at organized philanthropy occurred through the 1800's, such as Jane Adams' "Hull House" and various other localized attempts on the part of the well-intentioned to "rescue" the morally indigent, wayward, or poor. But the big private-public battles, and therefore what public attention there was, focussed on the commercial sector and its struggle against local and increasingly national governmental organs for autonomy and self-determination in economic matters.

A survey of the frequency of foundation establishment is enlightening in gaining a sense of the quantitative growth of the nonprofit sector. Before 1900, there were very few "foundations" in existence. Between 1900 and 1910, records show the establishment of about two per year. There then begins an appreciable acceleration of the institutionalizing of private philanthropy which certainly is not unrelated to the passage of

the Sixteenth Amendment in 1913. Between 1910 and 1919, an average of more than seven foundations per year was recorded, with the bulk of them coming in post World War I years. By 1919, there was a total of seventy-six foundations in America, including the Rockefeller, Carnegie Corporation of New York, and the Commonwealth Fund, still among the nation's largest. Between 1920 and 1930, an average of seventeen new nonprofit foundation-type organizations were founded. The number jumped to thirty per year between 1930 and World War II.¹²

A major change in the structure of income and corporate taxes following the end of World War II led, in part, to (what has been described) as a 'new wave of foundations' sweeping over the country. In the 1940's six times the number of foundations created in the previous decade came into existence, almost ten times the record of the 1920's.¹³

Why?

Some Reasons for Philanthropy

In the broad perspective, the motivation for the establishment and support of "charitable" organizations has a noble character. Ginzberg gives three reasons for continued interest in nonprofit organizations.

1. There is a tradition in Western civilization that is rooted in the Judeo-Christian belief that the more fortunate should help to care for their less fortunate brothers.
2. The long-standing, general disposition to restrict the growth of government reinforced the inclination of citizenship groups to join together on a voluntary basis to further important communal ends.
3. The knowledge of possible gains that groups of farmers, laborers, employees, and others could achieve by banding together for the pursuit of a common economic or social objective.¹⁴

These fraternal and communal impulses certainly deserve considerable credit for maintaining the nonprofit concept from antiquity. For an explanation

of the modern acceleration of growth, however, there must be another reason. It is no coincidence that this acceleration began after the enactment of the income tax laws in 1913. In short, a fourth and perhaps more powerful reason for the increased significance of the third sector is that, charitably put, donors were encouraged through the new tax laws to distribute their wealth in such a way that would benefit society. Because donors can be individuals or corporations, it will be profitable at this point to examine briefly the motivations of each with regard to their involvement in the nonprofit sector.

First, for the individual, the tax laws enable a personal redirection of money which will be taken from him anyway; a donor can decide whether he wants that part of his income which is "confiscated" to go to the government or to some "charitable" organization. From the standpoint of "public welfare," his decision will make little difference because, it should be recalled, the definition of "public charities" was that their benefits were to be bestowed upon the public. For the individual, however, an earned sense of self-determination can be obtained in directing money away from the public treasury. One critical factor of note here is that the magnitude of wealth in question can determine the breadth of the donor's discretion. In other words, "big givers" have more options and more personal tax advantages in percentage terms than do smaller givers. This is perhaps highlighted by the fact that less wealthy contributors to private philanthropy give to religious organizations through tithing, regular contributions of small amounts, and so on. The rich exercise a great deal more "creativity" in their contributions to educational, medical, and cultural concerns.¹⁵

There is more incentive for larger givers than for people of more

limited resources. A person with an income of, for example, \$100,000 per year loses a larger percentage to taxes than does the person who earns \$20,000 per year. However, by giving away, say, 25 percent of his total gross income, the larger giver is able to retain more net income and have more of an impact on the object of his contributions. In 1966, those people with incomes over \$100,000 accounted for 8.9 percent of the total charitable gifts reported. People with incomes of over \$50,000 accounted for 14.1 percent of the total.¹⁶ This is to say that "big givers" are vitally important to private philanthropy. Just how important they are was revealed by data compiled by the Commission on Foundations and Private Philanthropy, chaired by Peter G. Peterson in 1969. The Commission found that of eighty-five large contributors, given the hypothetical situation of no tax benefits, four percent said they would maintain charitable gifts out of their tax earnings; 96 percent said they would reduce their giving at an average of 75 percent!¹⁷

There are other reasons than immediate tax advantage for making charitable gifts. Some of the greatest philanthropical contributions, such as those by Rockefeller and Carnegie, were prompted by a desire to fulfill some kind of social commitment, especially if that fulfillment had a political concomitant.

A clear majority of the big American foundations were created by rich men who had the good sense, late in their careers, to realize they were but one short step ahead of either outraged public opinion, their own uneasy consciences, or the tax collector.¹⁸

Rockefeller, for instance, had announced that he was a "trustee" of God's wealth and that it was only his duty as a middle-man to distribute his wealth for the public welfare. Carnegie, the steel baron, felt much the

same way and, rather than raising wages or lowering prices, built libraries. The souls of some of the great men of wealth were saved by others, often in spite of themselves. Russell Sage, for instance, who did not believe in parting unnecessarily with a penny, was immortalized by his wife when she created the Russell Sage Foundation after his death.

One of its first projects was a blistering expose of money lenders and userers, a study which caused the New York legislature to pass laws forbidding many of the practices through which Sage became rich.¹⁹

Such eccentricities were soon replaced by more sophisticated understandings of the value of large-scale philanthropy. Henry Ford, who despised the idea of "charity," of someone getting something for nothing, was persuaded by his brother, Edsel, to set up a foundation which could use as assets Ford Motor Company stock, and thereby keep the business intact and in the hands of the family.

For the Mellons, helping the Oceanic Foundation find a means of extracting . . . petroleum riches has business as well as philanthropic appeal. . . . Gulf oil is also a major item in the investment portfolios of the individual Mellons, their banks, and their holding companies. Thus, the use of tax-exempt funds to finance research in which a very rich family has a very keen financial interest.²⁰

These particular "cover" uses of philanthropic organizations come under the heading of "corporate collusion" and are an outright violation, formerly of the spirit, and now of the law, of private philanthropy. This type of "double dealing" was particularly evident in the smaller, family-run foundations and is apparent in the amount of money held in assets versus the amount of money disbursed for charitable purposes. In 1936 the average expenditure per foundation was \$117,000; the comparable figure

for 1967 was \$65,000 per foundation (and in dollars whose value has drastically shrunk in three decades).²¹

A fourth individual motivation is ideologically oriented. A foundation or other nonprofit organization is an ideal vehicle for the "non-political" promotion of ideas and/or fancy.

The "educational" foundations of the Left and Right (witness Institute for Policy Studies versus the Freedom Foundation) give the rich an opportunity to espouse their ideological beliefs at reduced cost. Foundations are also convenient for the "philanthropist" who wants to pursue a hobby with tax-exempt funds [Winthrop Rockefeller and his antique cars; James H. Rand (of Sperry-Rand) and his "Public Health Foundation for Cancer and Blood Pressure Research, Inc.-- a spa in Stuart, Florida].²²

Corporations controlled by individuals or families can be motivated to make "charitable" gifts for many of the same reasons as individuals. However, as corporate organization moves away from individual or family management, other motivations come into play. As noted above, the total charitable contribution from corporations is not overwhelming, especially considering the wealth in assets of the corporate sector. This low yield is understandable if one realizes that corporate contributions come out of profits, not assets. When it is recalled that profit is the reason for the corporation's existence, it is somewhat surprising there are any contributions at all. In the 1960's, contributions ranged from .97 to 1.12 percent of profit which, in 1968, amounted to \$925 million.²³ There are, in fact, those in the corporate community who regard business contributions to nonprofit organizations as outside the purview and perhaps authority of management. Peter Drucker, for example, feels that most shareholders would rather see corporate profits stay in the company than be given to

charitable organizations.

. . . corporate contributions to higher education for instance, would hardly survive a reform under which the individual shareholder again looked upon the corporation as "his" asset rather than the property of the managers.²⁴

Not true, says John H. Watson III in an article entitled "Corporate Contributions Policy," in which he reports that resolutions designed to restrict corporate giving generally draw no more than five percent of the shares voted.²⁵ Business conservatives have brought this question to court and have been over-ruled. The court has said, in fact, that charitable giving can be in the corporate interest and has restricted its approval to situations in which mutual benefit is apparent.²⁶ Examples are corporate gifts to university engineering departments, city recreational or beautification programs, etc. Most of these gifts are viewed in an environmental context which enhances the position and image of the corporation while contributing to the social matrix which supports it.

Gifts by private firms are justified not merely as a matter of their indebtedness to the nonprofit institutions for their past accomplishments, but also as a matter of self-interest, for the deterioration of such institutions as universities and hospitals who no doubt have serious consequences for private enterprise.²⁷

Corporations find it easier to contribute to charitable causes if they know other corporations are also contributing. In this way, a company knows it is not the only commercial venture supporting the city's parks, or the Boys Club, or clean water; but that other corporations have a stake in these things and that no one in the commercial community is getting "a free ride."²⁸ This consortium approach not only increases an individual corporation's confidence in its contribution program, it also generates

more money for the community's social needs. In this way, both corporate and public interests are served.

Motivation, then, can be broken into two general categories, regardless of whether the contributor is an individual or a corporation--genuine communal or societal interest and self-interest. It is also apparent that, according to the tax structure, one interest can help the other and therefore reinforce a commitment to the maintenance of nonprofit organizations.

Functions of Philanthropy

Given that nonprofit organizations exist, that they have a long history, and that various shades of motivation support them, it remains to be seen what they actually do. The mission of some is obvious--hospitals care for the ill; churches tend the soul; and museums and libraries harbor the cultural products of society. All nonprofit organizations, however, are not blessed with such teleological clarity. In June of 1959, the Treasury Department attempted to dispel some of the confusion surrounding Section 504(c)3 by making more specific some of the objects of what the Department felt were charitable organizations. These included:

relief of the poor and distressed . . . advancement of religion; advancement of education and science; erection or maintenance of public buildings; lessening of the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.²⁹

All this is to be done without "influencing legislation" or abusing the tax-exempt status.

The Peterson Commission, established in 1969 just before what was to become the 1969 Tax Reform Act which would greatly affect the operation of nonprofit organizations, was somewhat more grandiose in its expectations of what this sector could mean to the country. "Philanthropy," they believed, "must bring a fresh understanding of what pluralism can mean in American life."³⁰ Leslie Dunbar of the Field Foundation, has pointed to two elements embraced by the Peterson Commission in its concept of pluralism. The first is a kind of volunteerism, a sense of public participation in projects of limited scale but considerable societal impact; an echo, in effect, from John Stuart Mill.

We believe [writes the Commission] that a society which encourages a sense among its citizens that they have a reciprocal responsibility for themselves and for others strengthens its own fabric--whereas a society which spurs every man to live in and for himself alone weakens the bonds of fraternity.³¹

The second element of the Commission's pluralism involves the creation of a social "venture capital," a pool of resources to do that which is beyond the scope or immediate concern of government.

Government should not venture to do those things which private citizens and private institutions can do as well or better [such as] spot emergent problems, diagnose them, and test alternate ways to deal with them. . . . In the social realm . . . the consensus mechanism of the large, established institutions of government are not always the best and are certainly not the only way to innovate measures that lead to orderly social change.³²

Waldemar Nielsen of the International Council for Educational Development agrees that nonprofit organizations should not be conceived of as "simply financial conduits to transfer funds from their own endowments to cover the operating costs of existing nonprofit operating institutions," but that they should vigorously seek a creative and initiative-taking role,

pioneering new social ideas and experiments.

As a barometer of intent, it is worthwhile to examine at first hand the stated purposes of some of the more nebulous of the nonprofit organizations, the foundations. Remarks above about corporate collusion, personal aggrandizement and ideological idiosyncracies may have left a rather dubious pall on the social value of such institutions, and hence their tax-deductability. Nowhere does an organization defend itself better than in its "annual report," and so it is these that will perhaps speak best for a few nonprofit representatives. The first is the Commonwealth Fund, one of the oldest of the great foundations.

Since its earliest years, the Fund has concentrated its attention and resources primarily on the health and medical care needs of American society. Currently, most of its grants are to university medical centers for broad programs to improve medical education and to strengthen their leadership in development of community and regional systems of health care.³³

This is typical of the more traditional of the large foundations. It accrues wealth and parcels it out to impeccably worthwhile causes (other nonprofit organizations) such as health and health education. In many respects, this exemplifies the core of the nonprofit sector. The foundation serves a useful purpose, it involves people in that purpose and it encourages innovation in an incontrovertibly valuable field.

A more broad gauge organization is the Russell Sage Foundation, established in 1907 "for the improvement of social and living conditions in the United States." "In recent years," the Annual Report for 1970-1971 continues, "it has given primary attention to the application of social science research to social policy formation in the following areas: law, education and human resources, biology, social change, and the mass media."³⁴

This is indeed an ambitious scope and one which departs from the traditional. Its emphasis on "social change" etc., undoubtedly strains its tax-exempt status, yet certainly fulfills a commitment to innovate.

Finally, the Annual Report for 1972 of the Research Corporation has a slightly defensive tone. It is primarily a scientific research organization which sponsors projects in "pure" science, a field whose popularity has been on the decline in recent years.

Total funds for science are declining relative to our gross national product, an estimated 2.41 percent of the GNP being spent on research and development in 1972, compared with 3.04 percent in 1964. Only a small share of this is for basic research and that share has been declining. Research Corporation remains one of the very few national private sources for such funds.³⁵

Again, the avowed purpose meets the criteria sketched above; the organization is involved in an endeavor which is worthwhile, which complements public and commercial activity, but which neither of the other sectors is prepared to carry out alone. The important point here is that the nonprofit sector can afford to be irrelevant, at least in the short run. The public sector must address immediate public concerns, while the profit-making sector must meet the market. This is true in "social" areas also; commercial enterprises may find no profit in developing a cooperative farm for former tenant farmers in Georgia, while the local government agencies are occupied with paving roads and providing police and fire protection.

However, the strength of independence from immediate public concerns on the one hand and freedom from the demands of the market on the other lead to a set of fundamental weaknesses inherent in the nonprofit sector. The one most apparent at this point is an inability to judge the value of "products" of the third sector. In The Money Givers, Joseph C. Goulden

gives an example of what he must regard as a frivolous exploitation of the tax-exempt status.

If the Mellons are more interested in medieval tombstones than in Pittsburgh poverty, and care to spend their money studying 12th and 13th century church construction, that is the Mellon's affair. However, there is no obligation upon either the Congress or the American citizenry to give the Mellons tax-free dollars to finance their exotic interests.³⁶

The Bollingen Foundation is the object of Goulden's criticism here. According to its annual report, its major activity is publishing scholarly books "which would probably not be undertaken by other publishers." Recent titles have included Jewish Symbols in the Greco-Roman Period; The Shrines of Tut-Ankh Aman; and Archaic Techniques of Ecstasy. A rebuttal to Mr. Goulden's argument could place such obscure (if it is obscure) scholarship in the same plane with some of the scientific tinkering sponsored by Research Corporation. Another tact would be to argue that even if the value of the contributions are not readily apparent, the money is better spent on Jewish Symbols . . . et. al., than upon more polluting industrial development.

Such a rebuttal, however, would miss Goulden's well-taken point which is that evaluation of the nonprofit sector is poor if it can be done at all. He is more persuasive in discussing foundation productivity later on in his book.

Proven accomplishments during the period [the last half century] are as much the result of the law of averages as of philanthropic skills. Proven failures are as few, for so much of the foundation work was done in that gray area of esotericism where success is nigh indistinguishable from dignified silliness.³⁷

This point leads the discussion of the nonprofit sector away from its objective and into its abuses. With this background behind, the task is

now to begin to sketch out the relationship between the third sector and the public policy which ultimately provides its support through tax incentives.

Abuses of Philanthropy

Money and morality usually do not mix well, and it was reoccurring evidence of the truth of that maxim with regard to the nonprofit sector that prompted Representative Wright Patman, beginning in 1961, to make a practice of issuing highly detailed (and also highly selective) accounts of foundation misdeeds.³⁸ Abuses were legion, but some were more obvious than others. First, substantial contributors and their lawyers had developed a spirit of "gamesmanship with the tax laws that resulted in donors, not charity, reaping the chief benefits from 'gifts.'"³⁹ This was probably to be expected to some extent, but certainly not on the scale suggested by Patman. Second, there was an increasing misuse of corporate and family foundations to provide pseudo-philanthropists with the privilege of tax exemption to the disadvantage of competitors. As seen above, "payout" rates of foundations in 1967 indicated a marked lack of commitment to expenditure for social or charitable projects. A third abuse was a growing lassitude, an inertness which was the product of more than "corporate collusion."

A board [of directors] with sentimental ties to a founder or a cause, reinforced by strong financial resources, and lulled by an unimaginative bureaucracy, may be substantially immune to pressures to change.⁴⁰

Another reason for this lack of energy was suggested by Wolfgang F. Friedman in the February 1957 Columbia Law Review.

When a foundation bears the name of an operative enterprise, any adverse publicity may affect the competitive position of the "parent" corporation. . . . most foundations will prefer to finance uncontroversial rather than politically controversial fields of education and research.⁴¹

Adam Yarmolinsky, of the Welfare Island Development Corporation, lamented this lassitude as a waste of resources and the profligate use of a very special place in society.

What foundations have is extraordinary freedom. . . They do not have to meet a payroll (except for administrative expenses), they don't have to sell a commodity, they don't have to win periodic elections. . . . Yet . . . this is the most misused freedom in the U.S. today.⁴²

The virtue of independence is energy and creativity, and nonprofit organizations have evidently not been expending that energy. There is bound to be abuse in a system built on noble intentions; but when institutions of integrity exhibit bad faith by a failure to deploy their resources in the manner for which they were accumulated, it is only to be expected that their independence will be sharply curtailed by external controls so that funds flowing into the third sector from the second (commercial) via the first (government tax policy) are not misused.

Accountability

If there have been abuses in the nonprofit sector, accountability for them, despite the pressures and justifications or excuses for them, must rest with the people who "own" or manage tax-exempt organizations. First it must be noted that not all of the sixteen kinds of tax-exempt institutions listed in I.R.S. 504(c)3 succumb to the difficulties mentioned above with regard to foundations. However, it would not be unfair to suggest

that, in general, the management of and responsibility for most kinds of nonprofit organizations has not been as efficient or as sensitive to evaluation as it has been in other sectors.

One reason is that the nonprofit sector has fewer professional managers. Until recently it was not broadly recognized that managing a hospital, a university, or a foundation was a unique endeavor and requires training and skills somewhat different from the public administrator or the corporate executive. In the foundation field, for example, as of 1971, there were only about a thousand "professionals" in the nation's foundations, several hundred of them clustered at the philanthropic factories operated by Ford and Rockefeller.⁴³

However, even if the number of managers were to increase a hundred fold, it would not significantly alter the accountability situation. More professional managers would perhaps make philanthropy more efficient, but probably not more responsible. That burden lies with the institutions' trustees, who are obligated under the law to invest and spend funds properly and to implement to the extent possible the founder's wishes. Again, freedom is the essential problem to be surmounted by trustees of nonprofit organizations. They are not directly accountable to the public at large nor must they adjust to a competitive market.

The characteristics of trustee rule have a distinctly monarchical cast: arbitrary decisions; secrecy, nonaccountability for actions; lifetime tenure; . . . aloofness from public opinion; remoteness from the great mass of people beneath his social and economic station and unawareness of or contempt for their needs--in sum, a regal do-nothingness, nonmalicious in intent, but sorely wasteful of national resources through stifling passivity.⁴⁴

That there is truth to this stinging indictment by Joseph Goulden is revealed in a 1970 statistic from the Foundation Center, a nonprofit

organization designed to coordinate information for and about foundations, which indicates that of the 30,242 foundations then on the I.R.S. list, only 140 printed any kind of an annual report or financial statement.⁴⁵ It is not clear why this is the case. Nonprofit organizations in general have nothing in particular to gain by secrecy, except perhaps quiet, but the simple fact may be that because no one requires public accountability it is not forthcoming.

Government control has always been exercised by a loose watch on tax abuses. As earlier sections suggest, perhaps this monitoring has not been sufficient. Yet, the dilemma here is that too much involvement can, in the words of the Peterson Commission, "easily go counter to the basic principle of private philanthropy and put the government in the anomalous position of dominating a group of organizations that have, as a chief reason for being, the fact that they are not governmental."⁴⁶ This implies that nonprofit accountability must be sui generis, and must eschew any outside control which might endanger the independence which gives the third sector its unique freedom. The unique freedom, it must be recalled, is what apparently leads to the abuses which make a discussion of accountability necessary. Nevertheless, the Peterson Commission was remarkably sanguine about the nonprofit sector's ability to put its house in order and to carry out its tax-exempt purpose with an appropriate sense of obligation to the public which ultimately dispensed its privilege.

Responsive pluralism requires the majority be willing to place itself under a self-denying ordinance not to use the weight of its larger numbers to crush the minorities claim for equitable consideration and coexistence. It means conversely that the minority is willing to place itself under a self-denying ordinance not to use for frivolous and vengeful reasons any veto power it has over the desires of the majority.⁴⁷

All this means that the problem of accountability, of abuses growing out of mixed motivations, of a history of uneven development within the third sector had not been solved by the time the Peterson Commission wrote its report in 1969.

The Tax Reform Act of 1969

The Congress set about to tidy up what had become a very messy third sector. Representative Patman, in early hearings of his House Ways and Means Committee in 1969, declared, "Philanthropy--one of mankind's more noble instincts--has been perverted into a vehicle for institutionalized, deliberate evasion of fiscal and moral responsibility to the nation."⁴⁸ He had been sounding this trumpet since early 1961, when he began to decry some of the more blatant abuses of tax-exempt organizations, and with the help of a few well-publicized indiscretions by leading nonprofit institutions, had finally aroused Congress to action.

As previous sections suggest, governmental control of third sector institutions had been minimal. In fact, they had been virtually ignored by public authority.

A further measure of the freedom accorded to foundation activity (other than ready incorporation by states) can be seen from the almost total lack of congressional interest in foundation activity before 1940 [the Rockefeller incorporation issue around 1913 excepted]. The inclusion of provisions granting tax exemption to charitable enterprises and charitable donations was rarely questioned during congressional debate on tax bills throughout that entire period.⁴⁹

Those days were over. Prompted by such incidents as the Ford Foundation's involvement in the New York City school decentralization

fight, its grant to a Cleveland chapter of CORE just before Mayor Stokes was elected, the use of a foundation-type institution for the election of Frederick Richmond from New York's Fourteenth Congressional District, all brought questions from Congress. Among them were those concerning the relationship of foundations to government, how public accountability could be enforced, how much "creative," "innovative" freedom is appropriate, and just how "public" or "private" foundations should be. The real question, however, as Joseph Goulden contends, was the political threat posed by nonprofit institutions, especially foundations, to elected officials, i.e., Congress itself. The Richmond case is a good example.

Frederick W. Richmond, a wealthy New York resident of that state's Fourteenth Congressional District, had set up a charitable foundation in 1962. In November of 1967, the Richmond Foundation began making sizeable grants to various, hard-pressed ethnic institutions in the Williamsburg area of Brooklyn, also in the Fourteenth Congressional District. This generosity coincided with the beginning of Richmond's candidacy against Representative John Rooney in the Democratic primary. Congressman Rooney cried foul and Richmond was brought before the House Ways and Means Committee for violation of the Corrupt Practices Act. Richmond claimed his grants had been made in the interest of improving his own neighborhood and that they had nothing to do with his campaign. He finally announced to the Committee this keen distinction:

There is no question that my political organization did get as much public relations benefit out of those grants as they possibly could, but the grants were made solely and separately from any political activities I happen to have had.⁵⁰

Congress would have none of it, however, and moved quickly to prevent further political and fiscal abuses by the nonprofit organization by passing the 1969 Tax Reform Act, aimed primarily at foundations. Among the most important provisions of the Act were:

1. The imposition of a four percent tax on the net annual investment of foundations. This encourages foundations to spend their assets on program items instead of hoarding it for the benefit of the trustees or the founding family.

2. The banning of "self-dealing." Foundations can no longer serve as investment holding companies for their founders or trustees.

3. The establishment of a "pay-out" rate. Foundations are now required to spend at least 4.5 percent of the value of their assets beginning in 1972; 5 percent in 1973; and 5.5 percent in 1974. This provision encourages more liberal investment and discourages stocks in low yield family businesses and non-productive property.

4. The limitation of business holdings. This means, for example, that the Ford Foundation must rid itself of all but 50 percent interest in the Ford Motor Company.

5. The ban on "expenditures on attempts to influence legislation through attempts to affect the opinion of the general public."

6. The forbidding of "attempts to influence legislation through communication with governmental personnel except by written request."⁵¹ There are other provisions which deal with even more subtle financial relationships, but those above indicate the scope of the Act.

The implications of the Act are several. First, the small, desk-drawer foundations will be hard hit, especially by investment tax and payout

requirements. This is, in fact, exactly what Congress intended. Tax advisory services now advise prospective foundation founders to look elsewhere for tax shelters. As a corollary to this, the larger, well-staffed, or at least, professionally managed organizations, will be able to fulfill the Act's requirements and still prosper. Some of their capital which otherwise would have gone into endowment or program needs will now go to the federal treasury, but the effect is more one of monitored control than economic hardship.

The second major result is that the same law which forces foundations to be less conservative in their investment policies also forces them to increase their flow of funds to recipients. The "payout" provision urges foundations to budget more carefully, to find programs for the capital they must get rid of, and therefore to stimulate activity in the entire nonprofit sector.

These first two implications call for a third and that is increased professional investment management. No longer can a board of trustees depend on annual ad hoc decisions to rule their portfolios. Investment must be managed so that the foundation can meet its commitments, increase its capacity to do so, and stay within the law.

A fourth implication comes from Science magazine in which the editor challenges the tightened political restrictions as a serious threat to foundation program activity in that "almost everything worth studying, any study worthy of foundation support might, directly or indirectly, influence a decision of some governmental body."⁵² While the distinction between what was and what was not political before made little difference because

it was ignored, the new Act made certain that a good deal of attention was focussed on the political ramifications of nonprofit projects.

Nonprofit response to the 1969 Tax Reform Act was strangely muted. Foundations themselves made plaintively hasty and therefore weak cases in opposition to it before Congressional hearings. The Peterson Commission had attempted to amass data implying the superfluity of the Act, but the more information it presented, the more congressmen and senators were convinced that the regulation of nonprofit institutions in general and foundations in particular had to be strengthened. "Public charities" did not come to the aid of foundations because they were aware that the new payout provisions would be to their advantage. The public did not rally against the law because most of what it had heard about high profile, nonprofit institutions such as the bigger foundations, churches and schools, was that they had contributed products of dubious value to society. Why support foundations which hoard money and campaign? Why support churches which seem to do nothing to improve "the quality of life"? Why support higher education if students and professors have time to demonstrate and sneer at the non-academic world? In short, the nonprofit sector found itself with no constituency.

Later comment on the Act by foundations reveals a varied approach to accepting the inevitable. The Russell Sage Foundation, for instance, speaks in its 1971 Annual Report in rather flat tones about "a comprehensive Federal regulatory system . . . directed at preventing abuse of the tax benefits granted to private foundations."⁵³ The Rockefeller Foundation, in its 1972 Annual Report, uses the four percent payout mark as a measure

of its increased commitment to expanding the program.

The RF's payout in 1972 of \$44 million represents all of its income (net of taxes), plus \$18.9 million of principal, or 4.98 percent of assets--\$8.7 million more than is required by Congress.⁵⁴

But the Ford Foundation is not at all happy.

A particular current burden is the 4 percent federal tax . . . Since the tax falls upon realized gains as well as on annual income, it has been especially burdensome to us as we have been selling Ford stock. . . . We continue to oppose this tax and we believe that at its current level the tax is proving much too high for its proclaimed and accepted objective: to cover the costs of proper federal regulations of foundations.⁵⁵

Two things are important about this statement. Taking the second first, the "costs of proper federal regulations" are indeed substantially less than the revenue received from the Ford Foundation alone; but this was never a serious objective of the Act. Of more importance is the fact that until the Ford Foundation liquidates all but 50 percent of the total outstanding Ford stock (it has eleven years from 1969 to do so) it is being hit twice; once by the investment tax and once by the "corporate holdings" tax. This is, indeed, a big bite from the Foundation's budget, and undoubtedly hampers its program activities somewhat. Nevertheless, the Act is accomplishing its purpose--to wean the foundation away from its parent corporation.

The Tax Reform Act of 1969 marks the beginning of a new era for the nonprofit sector which, it becomes more apparent, is hinged to at least some extent on foundations. Schools, churches, etc. would undoubtedly exist without grants from foundations, but it is the latter which are able to amass great sums of money and allot them at the discretion of independent trustees. Foundations are, in effect, the brokers of the nonprofit

sector. They take in money from the commercial, profitmaking area of the economy and distribute it among "public charities." Furthermore, because foundations do have money and therefore discretionary powers, the would-be recipients naturally tend to anticipate grant-making tendencies and subsequently direct their requests into those areas which will attract foundation interest. It was no accident, then, that the Tax Reform Act was directed at controlling foundations. On the one hand, previous abuse of fiscal policy had seriously undermined the rationale for tax deductions and was therefore due for review. On the other hand, foundation innovation, especially in social areas, threatened to politicize what had previously been regarded as the most "private" sector of the American system and was not to be sullied by or risk confrontation with public authority.

Hence the Tax Reform Act, some implications, a foundation response or two, and an emphasis on the importance of the foundation to the nonprofit sector. What remains is to test these images against reality. What emerges are two significant problem areas--political and financial.

Political Problems

As early as 1946, Shelly M. Harrison and F. Emerson Andrews realized that:

Foundations are clearly affected with the public interest. . . . However carefully they may avoid overt attempts "to influence legislation" . . . it is inevitable that the results of foundation research will sooner or later affect public policy.⁵⁶

Those who recognized this basic fact were increasingly troubled by what appeared to be a conflict of interest between private foundations and

governmental agencies in exploring various social problems, such as racial relations, drug addiction, etc. Some attempt was made to wiggle out of this dilemma by semantic tactics such as the Peterson Commission used in agreeing "with those who insist that, in the field of public affairs, education and not political pressure is the one and only proper aim for foundation activities. . . ." ⁵⁷ But this was an embarrassingly thin quibble, and even the Commission had to bite the bullet when discussion turned to the tax-exempt status.

The very existence of the tax incentive for philanthropy plainly means that charitable expenditures are not purely private expenditures. They are made partly with dollars which, were it not for charitable deductions allowed by tax laws, would have become public funds to be allocated through the governmental process under the controlling power of the electorate as a whole. ⁵⁸

That is the problem in a nutshell. Tax-exempt, nonprofit organizations are public concerns because they use what for all intents and purposes is public money. Lane Kirkland, Secretary-Treasurer of the AFL-CIO and a Peterson Commission member, seriously questions the wisdom of this procedure and perceives it as justifiable only if the tax privileges "forward the interest of the public." ⁵⁹ Representative John W. Byrnes, during the 1969 hearings by the House Ways and Means Committee, labelled philanthropy as a luxury for the rich in that they are able to direct their money into services they can control. This privilege, Byrnes pointed out, is not widely shared.

The vast majority of the American people do not have this choice. . . . they must also pay a higher price to carry on these services (public projects, some of which they are not enthusiastic about) simply because some people with wealth have said they do not want to support any of these services. ⁶⁰

The issue is clear. Money which would otherwise go into public projects can be directed, especially by the wealthy, to "private" programs which have virtually no accountability to the public. Yet those who support foundation activities and the goals of the variety of nonprofit organizations in general, contend in good faith that the maintenance of these institutions is, in fact, in the public interest. The conclusion must be that these tax-exempt organizations are "private" only to the extent that they are not directly controlled by the public sector, which is to further suggest that with regard to these organizations, any distinction between public and private is more definitional than operative. A complete catalogue of the reasons for this peculiar state of affairs would be long and varied; but the fundamental reasons are simple--these institutions live on tax money and conduct projects which ultimately affect the public interest.

The Ford Foundation has been one of the first to realize the implications of these facts. McGeorge Bundy's 1967 remarks serve as a good introduction to the examples that follow:

It makes no sense, in the last third of the twentieth century, to suppose an arbitrary division between what is done publicly and what is done privately. One of the obligations of the private organization is, in fact, to concern itself with the relationship between the problem it is attacking and that part of the problem which, of honest assessment, it believes is a part of the responsibility of political institutions and political forces. 61

The private organization, as Bundy perceives it, is a spearhead for public policy, intimately involved in the same kinds of issues with which public authority must deal. Two examples demonstrate Ford's commitment to this idea.

After the racial struggles of the summer of 1966, America tensely

awaited repeat performances in the summer of 1967. One of the potential hot spots was Cleveland, a city which in 1966 had seen the death of four people and the destruction of millions of dollars of property in riots and looting. Whites were moving out of the city; blacks were moving in. In spite of the more radical direction the Congress of Racial Equality had taken under the leadership of Floyd McKissick, Ford decided to trust the autonomy of a local Cleveland CORE chapter, and grant the group \$175,000 for a smaller version of a program which had worked rather successfully in Baltimore--training of youth and community workers, voter registration, and planning for economic development. As Joseph Goulden suggests, this was at once the bravest and one of the most naive operations ever undertaken by a major foundation. It was brave because it backed a principle with action and real money. It was naive primarily because the voter registration part of the program was approved exactly one month after Ohio State Representative Carl Stokes had announced his candidacy for the Cleveland mayoralty. With Ford funds, CORE concentrated registration efforts in mostly black districts. Stokes won the final election by slipping past Republican Seth C. Taft with 2,350 votes of 257,207.⁶²

The value of other parts of the Ford Cleveland program was overshadowed by this political faux faux--and there is no question that it was that. As a result, it is reasonably certain that tax-exempt funds will never again be used for voter registration drives.

The second incident involves Ford's involvement with the New York City school system. Studies had shown that by 1965, 85 percent of Harlem school-children were more than two years behind other inner city school

children who were white. One half of New York school children were black or Puerto Rican, but of the system's nine hundred principals, only four were black and none was Puerto Rican. The governing body for the entire system was the Board of Education which had centralized and professionalized the system, but had left no neighborhood voice in the way the schools were run. In 1966 black parents staged a boycott of an intermediate school, and soon the boycott had spread to other schools. The Board of Education then invited the Ford Foundation to study the matter and make recommendations. In the spring of 1967, Ford persuaded the Board to sponsor three demonstration projects where "experiments" with decentralized schools could be tried and studied. Soon there were city-wide strikes by the teachers' unions which outwardly protested new "pupil-student ratios," but inwardly feared for "job security." Trouble continued through 1968 until, after tremendous acrimony on all sides, the New York legislature apparently bowed to pressure from teacher's unions and disbanded the demonstration units, adopted a program written by the largest teacher's union, and decentralized the schools in only the most superficial ways, leaving all key decision-making to the central Board of Education.⁶³ Meanwhile the Ford Foundation had been vilified by all sides for "meddling," for injecting "outsiders" into a "local" matter.

By the time the controversy stilled, Ford was either bent upon destroying society with tax-free funds, in the opinion of the Right, or of fostering a "let-them-eat-cake" scheme of institutionalized segregation upon Blacks and Puerto Ricans, the theory of socialist Michael Harrington.⁶⁴

The incident, other than reproving the old tautology that hard problems are not easily solved, left confusion about the role of the nonprofit

organization. When summoned for assistance by a public body, the Board of Education, ought Ford not to have responded? With public policy apparently stalemated, what other institution or organization should have tried to mediate the situation? The political power of the unions ultimately carried the day; but does that not suggest that an "independent" perspective is valuable? This is not to say that the "people" or at least the organized "people" ought not to be trusted or have their say, but who was representing the black parents and their children who were not being "educated" under the centralized system?

The value of both these incidents as examples is considerably decreased when they are examined too closely. The most important point is that Ford, in both cases, seriously stretched the anti-political clauses of Section 503(c)3 of the Internal Revenue Service Code. There is no question that Ford's behavior in both instances was political, that it affected public policy directly, and that its actions, along with similar actions of similar institutions led to a strengthening of the anti-political aspects of the Tax Reform Act of 1969. The question then is, if these organizations are to fulfill anything like the purposes sketched for them by their founders, what are they to do? How can an institution be an active, creative force in society without affecting public policy, whether that active, creative force is purely scientific, as in experiments with atomic energy or communicable disease, or social, as in experiments with education, group life-styles, or the impact of technology upon modern life? In fact, if these institutions are actually underwritten by public money, should not their activities involve "public" concerns, focus on projects which will

eventually benefit the public at large? Taking the other side, if these institutions are legally deemed "private" entities, "legal persons" as are corporations, how is public control to be exerted over institutions whose legal independence has been a sine quo non since the Dartmouth College case?

The conclusion seems to be that active nonprofit organizations are in a politically untenable position. The third sector is supported, in effect, by tax money. Therefore, logically, it is the object of public policy, of public control. Yet its status as "private" remains intact, until its projects become too threatening politically, at which time its tax status is called into question.

The Peterson Commission is of no help in clinging to its professed belief in "pluralism." After examining these problems, "the commission concluded, . . . that the public interest is best served through a strong dual system of private giving and government funding as a means of allocating resources for the general welfare."⁶⁵ But the funding system is not dual. All money is from the taxpayer and is directed more by tax policy than by the free-will discretion of the citizen. Secondly, that money taken in taxes is disposed of in ways increasingly remote from the control of the taxpayer, while those resources allocated by "private giving" are devoted to purposes highly circumscribed by the law. There seems to be no way out of the dilemma. One aspect of it which needs to be seriously examined, however, is the "private giving." Without it, there would be no dilemma, and no nonprofit sector.

Financial Problems

The Peterson Commission reported that private giving has fallen a little behind the trend of the GNP in recent years while the needs of charitable organizations have increased at a rate significantly faster than the GNP.⁶⁶ Increased costs and decreased income for nonprofit institutions, assuming good management, result primarily from four causes. First, salaries and personnel expenses have increased as professional standards have been raised and competition with industry for personnel has intensified. Second, the demand for nonprofit services has risen sharply, but there has not been a concomitant rise in service fees. Third, many institutions produce a social "good" or service that benefits more people than they can charge directly.⁶⁷ A fourth explanation is that in many instances, economies of scale do not necessarily apply to nonprofit organizations as they do to manufacturing. The "unit costs" of charitable services (one hospital patient-day, yearly educational cost of one student, etc.) markedly exceeded the rise in the consumer price index and even the rise in salaries for the personnel of charitable organizations between 1962 and 1968.⁶⁸ But the big cost, again, is people, and salaries and expenses are particularly susceptible to inflation. From 1966 through 1968, for example, with wages and salaries rising at twice the level of the consumer price index, the Ford Foundation could maintain its \$200 million program budget ceiling "only at the price of a real redirection in charitable purchasing power of some six to eight percent a year," and holding annual overall increases to five percent.⁶⁹ This would be a creditable performance, even for a commercial enterprise.

The simple fact seems to be, however, that more money is going out of the nonprofit sector than is coming in.

Businessmen and public officials are sometimes impatient with this situation. They feel that any organization, if properly administered, should be able to be economically viable. The analogy of the commercial to the nonprofit sector, however, is not valid. First, the nonprofit institution is not an independent economic unit.

The business firm, alone among non-governmental institutions, generates its own wealth. Whereas a labor union . . . a charitable institution . . . receives the money it uses out of its members' pockets and consumes its assets in the course of performing the functions for which it was organized. . . . The better a corporation performs, the more money it obtains; the better a voluntary association serves its members, the more money it is likely to spend and to require from its members.⁷⁰

Second, the products of the nonprofit sector are, by definition, not sold at a profit and are, in fact, sold at a loss. Colleges and universities are a good example. At a small high tuition liberal arts college, such as Amherst College, a student pays about \$4,000 tuition which is less than 40 percent of the actual "unit cost" of his "education." At the University of Massachusetts, with a vastly greater enrollment, the differential is even more significant. A student at a state university may pay as little as 15 percent of his educational costs. The rest is paid by the public, the people of the state. At the private institution, the 60 percent remainder is provided by private gifts and interest on endowment which itself was initiated and is preserved by "private" donations. General Motors could not sell cars at 40 percent of cost for very long.

The nonprofitability of third sector institutions places a tremendous

burden on their investment management. The Annual Report of the Russell Sage Foundation sketches the difficulties involved:

The Foundation's primary investment objective is to provide for its short- and long-term financial needs so the Foundation can carry out its tax-exempt purpose of improving social and living conditions in the United States. . . . The Foundation, for example needs a regular flow of interest and dividends (augmented sometimes by portions of specified principal funds) to fulfill its operating purpose. Income must also be sufficient to absorb excise tax payments stemming from the Tax Reform Act of 1969 and to enable the Foundation's activities to expand in the future.⁷¹

Very few commercial enterprises must meet these kinds of demands without selling a good or service for profit.

A third financial bind that increasing numbers of nonprofit institutions face, which is usually not a problem with commercial enterprises, is the character of investment included in the institution's portfolio. Especially if an organization is concerned with "improving social and living conditions," it must be careful not to invest in corporations which are undoing its work by polluting the atmosphere, creating inhumane weapons of war, or not observing fair employment practices. As recent experience with "social action" mutual funds has shown, this is a very hard order to fill. Most "big money" is to some extent "dirty money." The trend now seems to be an "all-other-things-being-equal" philosophy which is to say that if a company is profitable and is a "responsible" citizen, it is to be chosen over a company which is equally profitable, but is not responsible. Russell Sage elevates the language.

The investment philosophy favors, if the primary investment criteria (i.e., profitability) are satisfied, investment in shares of companies that are clearly committing capital and management to alleviating wide-spread social problems.⁷²

Dependence upon the good will of others, a high susceptibility to inflation and severe investment restrictions are thus the rather unique and serious financial problems faced by nonprofit organizations.

The reality of this situation is brought sharply into focus with just a few examples. "The total operating revenue of all our nation's hospitals, public and private, from patient care--including insurance payments, medicare, and similar payments," pointed out Senator Bayh before the Senate Banking Committee during the Lockheed hearings, "fell \$662 million short of total expenses in 1969."⁷³ Bayh went on to stress that this not only means serious limitations in the provision of health care for the country, but also a threat to the livelihood of the nation's 2.4 million hospital workers. Bridging the gap between medical care and education, Bayh reported that "in state after state, legislators are being asked to bail out sinking medical schools with emergency grants totaling many millions of dollars."⁷⁴ This is in spite of the fact that there is an estimated shortage of 50,000 physicians in the United States. Non-medical education is not any better off. The Carnegie Commission report of 1970 indicated that at that time 540 colleges and universities, enrolling more than 1.6 million students or 21 percent of all college students in America, were in serious financial difficulties.⁷⁵

What is particularly dismaying about these facts is that private giving is actually increasing, and at unprecedented rates. The Council for Financial Aid to Education in its 1970-71 publication, Voluntary Support of Education, reported a significant rise.

The total voluntary support of colleges and universities in 1970-71 is estimated at \$1.860 billion. This is a new record high, 3.3 percent above the previous high of \$1.800 billion set in 1968-69 and 4.5 percent above last year's estimated total of \$1.780 billion. All of the increase in total support was due to increased giving by alumni (up to 20 percent) and non-alumni individuals, and much of this resulted from a sharp gain in bequests.⁷⁶

Even with more people giving away more money, nonprofit organizations continue to slip further into debt. The pool of "private" resources does not seem to be able to meet the pressing demands of the third sector.

Help for the Nonprofit Sector

Politics and money, then, are the two major problems which plague the nonprofit sector, hindering its initiative in exploiting otherwise unique institutional freedoms. The two problems are exacerbated by the fact that they are inextricably intertwined. This is most apparent in addressing suggested solutions to the funding of nonprofit organizations.

The Peterson Commission highlighted the dilemma early in its deliberations:

Legislative and executive leaders must decide whether they wish to encourage more private giving as a strategy for the solution of our social problems or to rely more heavily on public funding.⁷⁷

The statement recognizes two important realities. First, any solution is ultimately grounded in the political process; it is public authority which controls and directs the nonprofit sector. Second, granting this fact, financial rescue can ostensibly come from only two sources, both of which are regulated by public policy. The first option is to increase private giving and the second is for the public sector to assume responsibility for nonprofit functions directly.

To increase private giving means to structure the tax laws in such a way that more money will flow from the profit to the nonprofit sector. As indicated earlier, private giving without significant tax incentives would amount to very little. There are three basic objectives to be fulfilled in an effective tax incentive program. The first is to direct private resources into truly charitable channels. This suggests that a) genuine charitable organizations are recognizable to public authority and b) there is some public consensus on what a charitable organization is. Public policy could presumably direct "tax" dollars in any direction, but to allow them to escape outright from the public treasury can be justified only by insuring their employment elsewhere for the public welfare. Second, the tax policy must be efficient in eliciting funds for nonprofit organizations. There must be real incentives, devised in such a way that the most money possible is freed for the third sector. Finally, in the words of the Peterson Commission, "the distribution of the inducements among taxpayers (must) not offend any strong community sense of fairness."⁷⁸ Everyone must get the same benefit from taking advantage of tax exemptions.

All three of these objectives, however, cannot be met if philanthropy is to be benefitted most. The most effective tax policy, as far as recipient organizations are concerned, is the one which generates the most money. This is usually done by bestowing tax advantage based on actual dollar amount, rather than percentage of income. While the latter is more equitable, the former is more effective. Fund raisers use what they call the "80-20 rule," which simply means that eighty percent of the income

of a nonprofit institution usually comes from about twenty percent of its patrons. This further implies that it is the "big givers" at whom the most appealing tax incentives should be aimed.

The second major objection to reliance upon a tax incentive system for the sole support of philanthropy is that it leads to manipulation by those who benefit from it. With shrewd planning a wealthy philanthropist can actually make money by giving it away. There is something repugnant to the morally sensitive about a person living in relative luxury from the interest on municipal bonds or from a general life-income plan. It just is not fair, the contention runs, that someone who does no work can profit so much and be so highly regarded for his "philanthropy," especially if his or her wealth is inherited or otherwise unearned. This kind of argument is anathema to those who manage the nonprofit sector, but it is a real consideration for many who do not.

The third objection is that no matter how effective and how equitably structured a tax incentive system is, it is extremely difficult to administer. Evidence of this fact is in the myriad of procedures and regulations now employed by the Treasury Department and the Internal Revenue Service for enforcing the confused system in existence. The fact is that reliance upon tax exemptions has not maintained the health of the third sector.

Given the failure of the tax incentive system and the increasing need of charitable organizations the Peterson Commission concluded that "before long, public charities will be compelled to return to Congress for more assistance." Higher education has already resorted to this measure by asking for increased and direct support of student aid programs. During the last two sessions of Congress, Representative Edith Green of Oregon has sponsored legislation providing for per capita distribution of public

funds to all qualifying institutions of "higher learning." Senator Pell of Rhode Island in the last session sponsored a bill calling for federal money to be disbursed on an institutional basis with wide discretionary powers for its use by the recipient institution. Higher education itself defeated these measures by splitting in its support for them. Public institutions favored the Green bill and private institutions supported Senator Pell. With the defeat of both bills and increased federal belt-tightening, higher education is more on its own than ever.

Senator Bayh recognized this trend in his testimony before the Senate Banking Committee in its hearings on the Lockheed loan guarantee. Bayh's point was that many nonprofit institutions needed help as much or more than did Lockheed, and perhaps with better justification. Short of outright grants, Bayh proposed loan guarantees similar to that being considered for the Lockheed Aircraft Corporation. Specifically, he called for (1) defining precisely which social institutions would be eligible for emergency assistance; (2) applying the same criteria used in a business guarantee, ensuring that requests by petitioners would be last resort measures; (3) expanding the proposed Emergency Loan Guarantee Board to include at least one public official to protect the interests of the nonprofit sector; and (4) requiring "that at least 50 percent of the total amount of loan guarantees actually extended in any fiscal year, be committed for these health and educational needs."⁷⁹ Bayh's suggestions were not taken seriously, although they showed recognition of a problem which bears on the "public interest" and which is as legitimate a concern for congressional consideration as was the rescue of a commercial enterprise.

Nevertheless, assuming that the public's interest in the nonprofit sector was suddenly aroused, there may be some virtue in moving slowly to federal support. Attorney Thomas A. Troyer maintains that "if private choice and private control are to remain important in this sector of our national life, public charities will need help of other kinds."⁸⁰ His own suggestions, while not relying on direct governmental subsidies, do, however, call for a restructuring of tax policy or the establishment of a government matching gift program, both ideas clearly looking to public authority for their substance. Another possibility for nongovernmental assistance is suggested by the Research Corporation in its Annual Report.

With the Administration's preference to allot to the private sector those tasks it can do best, it would seem that use of these existing organizations (private research and granting foundations, for example) in drawing together other private interests could provide an organized effort which could efficiently effect the transfer of technology consistent with the desires of governmental authorities, the needs of the people and the realities of the established industrial economy.⁸¹

While even a consortium of the twenty-four largest banks in the country could not save Lockheed, it is conceivable that combinations of nonprofit organizations would be able to strengthen their collective financial positions and go at least part way to a solution of the problem of dependence on other sectors. The absence of "anti-trust" legislation for nonprofit organizations would seem to encourage this kind of activity. The one significant drawback might be that a consortium, to paraphrase an old saying, would only be as rich as its poorest member. So far, the more successful foundations and public charities have not wanted to carry their less affluent sister institutions.

Options for improving the financial position of nonprofit organizations

seem to be four. First is the status quo, which would perhaps leave the stronger institutions and "weed out" less successful ones, thereby reducing competition for the tax-exempt dollar. While a realistic approach, this alternative recognizes neither the complexity nor the importance of the third sector, nor does it address the basic problems as sketched above. Second, existing tax policy could be revised to stimulate private giving to philanthropy. This has the advantage of a show of confidence by public authority for the third sector, but probably would perpetuate or increase inequities in tax benefits which would be fiercely contested by various groups and public officials, and perhaps by the public at large. Third, the public sector may begin to develop such a concern for areas of endeavor previously reserved to the private charities that it begins to push them from the field and deal with the problems directly. This is highly unlikely for churches for instance, and would not be true of the more obscure non-profit organizations. Nevertheless, with a dramatic influx of federal money and attention directed to problems now dealt with by private charities, the position of the nonprofit sector as a whole would be seriously threatened. Finally, the least explored and perhaps therefore least likely solution to the problems of third sector finance is the consortium approach. Until this idea has the benefit of more empirical evidence behind it, its viability is questionable.

The second major problem for nonprofit organizations is political. The discussion of finance confirms the notion that the very existence of the third sector is dependent upon public authority. This is, in itself, an obvious problem. No solution to the dilemma can avoid the fact that the public sector must play at least some role in structuring support for

the nonprofit sector. With this in mind, suggestions for improving the position of nonprofit organizations regarding their dependence upon government must be limited.

A first proposal would be to eliminate any pretense of "privacy" in the third sector and to make government directly responsible for the projects now undertaken by nonprofit organizations. The scale of modern life would veto this in its extreme form--even government is not big enough to do all the tasks performed by the nonprofit sector. Short of "nationalization," then, would be direct and substantial subsidy. Objections to this are strong, not only from the commercial and public sectors, but also from nonprofit organizations themselves. Those in government and commerce argue that such disbursement of public funds would be inappropriate and would lack control by public authority, which is to say that they do not now have enough federal help for themselves, and to cut the pie three ways would be to dilute their own resources. The nonprofit people claim that government subsidy would bring a "loss of independence" through government control, would subject nominally private organizations to "partisan politics," and would therefore further reduce the initiative and creativity, which supposedly is the hallmark of the nonprofit sector. Because subsidy is favored by no one, then, it hardly makes a realistic suggested solution.

A third proposal, an alternative to more direct public control through government subsidy, is to grant the third sector even more independence. Joseph Goulden, after elaborating the crippling effects of political restrictions, maintains that accountability could be maintained, even in these more "private" organizations by encouraging or forcing the nonprofit organizations to be more candid about their operations.

Give foundations, (for instance) freedom to perform as they please, short of direct intervention in a political campaign, provided that the public has a participating role in their conduct and that there is full disclosure of what is happening and when it is happening. 82

Such public participation, he suggests, could be accomplished by putting individuals from the public sector on the boards of directors of nonprofit organizations, conducting open board meetings, and increasing the publications programs of nonprofit institutions. There is some evidence, in fact, that elements of the third sector are moving in this direction. At this point it certainly is not nonprofit policy to include active public sector people among institutional trustees or to hold open board meetings. However, more detailed annual reports are appearing, election or appointment procedures for boards of directors are being much more widely publicized, and at least one foundation is now issuing a monthly "news letter" describing its policies and activities which is sent to libraries and other appropriate public places.

A fourth suggestion is to recognize the potentially political character of nonprofit organizations and to allow them at least the same access to the political process allowed to the commercial sector. Since 1962, profit-making enterprises have been granted tax deductions for their lobbying activities as legitimate business expenses. Not only are nonprofit organizations not granted financial consideration for lobbying, but the 1969 Tax Reform Act made it clear that they were not to participate in any activity which might "influence legislation." Nor are they allowed even to share with public officials results of their projects

on a consulting basis. The lack of political influence was acutely felt, especially by the foundations, in their attempts to modify the Tax Reform Act. They had no constituency, no pressure to bring to bear against legislators whose votes might be influenced by grassroots voices. The employees and subcontractors of Lockheed certainly were heard by Congress, but the recipients of nonprofit largess were not to be found. The cynical response is because they are few. A more realistic reason is because they are many, varied, and unorganized. Senator Muskie has recognized this, and in the spring of 1971, introduced a bill which would remove the substantial limitation for direct communications by public charities with legislative bodies and personnel.⁸³ His bill failed.

Fifth, and least comprehensive but perhaps more realistic, is simply to ask for more public concern about the third sector. Fritz Heimann speaks of the Peterson Commission's discovery about public authority's lack of interest.

Our conclusion was that nobody at a policy level was paying much attention to the interests of the philanthropic sector. The decisions which went into the foundation provisions of the '69 Act were largely made by people on the staffs of the two Congressional Committees, and by people on the lower staff level at Treasury. The underlying policy issues weren't even being considered by anybody at a higher level in the Administration.⁸⁴

Certainly a segment of the American system which, in 1968, accounted for \$15.8 billion, and which, between 1955 and 1968 outstripped the GNP by 37% deserves more than passing attention.

All five very sketchy proposals for the improvement of the nonprofit

sector's political position involve a clear acknowledgement of its political character. After this, other suggestions are variations. Perhaps the most outstanding fact is that none of these tentative solutions completely resolves the political question, nor do they even begin to address the equally significant financial problems. Money and politics remain as rather high, unpadding, tightly linked hurdles for the nonprofit sector.

Summary

A summary of this review shows a collage of facts, figures, assertions and contradictions that leave an unclear picture of the nonprofit sector. The definitions given by the Internal Revenue Service as to those organizations eligible for tax-exempt status allow room for great variety in the sector, yet tell little about its specific characteristics. The fact seems to be, that although the third sector has achieved significant proportions in terms of economic impact on the American system, it has not received concomitant attention by the public or the government. The first serious interest taken by Congress in recent years was the 1969 Tax Reform Act, which was designed more to guard against a reoccurrence of recent abuses, than to capitalize on the real or potential value of nonprofit organizations. Certain provisions of the Act, such as the required payout rate, may help to stimulate activity among nonprofit institutions; others, such as the political restrictions, may tend to inhibit innovation in areas which now require unhampered creativity to be resolved.

The key point of the entire discussion is that there has been a

failure on the part of public authority and by the nonprofit sector itself to address the fundamental issue involved, and that seems to be the basically public nature of these "private" nonprofit organizations. The third sector derives its existence by money freed to it via tax policies, yet it is not accountable to the public. Nonprofit organizations genuflect before the altar of "private" exploration of social and scientific problems, but understandably stop short of activity which might displease elements of the public sector and would therefore threaten their tax-exempt status. In other words, nonprofit organizations are regarded as private under some circumstances and public under others.

Crippling as this dilemma is, it may seem rather academic in view of the crucial financial situation facing most nonprofit organizations. Resources simply are not meeting the increasing demands for services. Efforts to rescue the nonprofit organizations either are not taken seriously or become hopelessly entangled in political questions. Individuals increase their own gifts, yet the sector continues to suffer a chronic lack of funds. More money goes out than comes in.

Even in the short run, then, satisfactory answers to financial problems can be found only through a resolution of the more basic problems which are political. What is essential is a clear definition of the role of nonprofit institutions in American society and how they are to be funded. If they are to address public concerns, let the public support them more effectively and share in their management. If they are to preserve a private status, then government funding and its subsequent influence must be withdrawn and the institutions left to shift for themselves.

Perhaps proposing these distinctions is too neat, too unreal; an impossibility in a society complicated by rapid changes of scale and technology. Perhaps public policy makers can no longer afford to cast these questions in the traditional terms of "public" and "private." The nonprofit institutions may have outgrown their role as charities, as societal stop-gaps and may have become agencies whose value as independent, creative problem-solvers is vital to the public interest. These are the questions public policy makers have so far avoided. As demands upon public authority to meet growing public needs increase, however, they are questions which will have to be answered.

CONCLUSION

Emerging from an admittedly sketchy study of the relationship between the public and private sectors in contemporary America is a rather confused picture. Some of the most basic terms, such as "public interest" and "private enterprise" are far from precise and indeed seem to have varied meanings shaded by circumstance and perspective. Nevertheless, there are some unmistakable facts, issues and conclusions which are apparent and deserve final consideration.

The most noticeable fact evolving from the discussion is that things have changed. Chapter I emphasized this as more than a trite observation with a quick review of how World War II, the Cold War and rapidly growing technology have contributed to a dramatic change of scale and increasing complexities in both public and private sectors. Central to this change has been the development of the commercial sector to a position of at least suggested dominance in the total American system. The Lockheed case is a concrete example of this phenomenon. While maintaining its role as a private enterprise, Lockheed successfully argued that its demise would have national consequences, that its preservation was in the public interest, and that therefore its survival should be an object of public policy. No better example of the impact of technology, change of scale, and the attendant confusion about public and private roles could be used to demonstrate a change in the American system. The third chapter was a glance at the sector which makes obsolete the equation of public with government and private with commerce. Nonprofit institutions account for a vastly greater part of the American economy than they did just a few years ago and have their own unique relationships with public authority and private enterprise.

These special relationships not only highlight legal and logical inconsistencies in the political and financial character of the nonprofit institutions, but also point to dichotomies between practice and principle in the other sectors.

A corollary fact, then, is that while the American political-economic system has experienced some rather significant changes, institutions have remained static in form and function. Certainly there is innovation in some quarters; but the basis of all significant "private" organization is still corporatism--even in the nonprofit sector. The Dartmouth legacy lives to protect the privacy of nongovernmental institutions. In that doctrine, and wrapped in all of the traditional understandings of free enterprise and American entrepreneurship, lies the maintenance of the conceptual distinction between public and private and the subsequent preservation of corporate organization. Therefore, Lockheed could claim with some force that public authority had a responsibility for protecting the corporation's private interests which, because of scale, also affected the public interest. The fact that public money was used to support a private enterprise did not jeopardize that company's private status. Likewise, nonprofit institutions claim the rights of privacy in order to enhance their innovative quality, localized control, and political neutrality; while at the same time they are utterly dependent upon public policy for their survival.

Emergent Issues

From these two obvious facts, the change in general conditions encompassing all sectors of the American system plus the relative stability of

institutional organization, emerge three key issues: (1) the character of the distinction between public and private; (2) the definition of the public interest; and (3) the resultant nature of public policy. With regard to the first, there seems to be no clear locus for a distinction between public and private; it is apparently a matter of convenience. Lockheed is a private corporation ala Dartmouth, but because it was "affected with a public interest" (Munn) it apparently deserved public help. Nonprofit institutions use public resources for private projects which, it is claimed, will ultimately benefit the public. There is more at stake here than semantics. Both kinds of institutions seek the benefits of private organizations and public support, but apparently refuse to accept the responsibility for either. They will not accept failure as a true mark of competition in a free enterprise private system, nor will they accept public control and monitoring as a condition of public support.

In short, private institutions, commercial and nonprofit, want their cake and try to eat it too. They are able to walk this tightrope because of legal and political precedents set at other times in other circumstances. Certainly the past must be employed as a helpful guide, but when it has brought the traveler to unexplored territory, the pioneering must begin anew. The logical extensions of the Dartmouth doctrine, contemporary qualifications and loopholes aside, are ridiculous when placed in the modern context. For example, there seems to be nothing to prohibit a corporation, endowed with the rights of a legal person, from seeking the benefits of government welfare instead of declaring bankruptcy. The arguments against such a possibility may be subtle and complex, but the basic

principle poses no difficulty for this proposition. It may be argued, in fact, that this is exactly what Lockheed did. Similarly, while nonprofit organizations qualify as private institutions, they are denied the political rights that corporations have in lobbying and individuals have in direct political participation. The reason is that they use tax money which, in effect, is public money. The question comes down to whether nonprofit institutions are public or private.

The point is that despite a rather complete examination of the Lockheed case and a brief but conscientious study of the nonprofit sector, the distinction between public and private is still at issue. Institutions are private when seeking protection against the government and public when seeking money from it. Furthermore, profit and nonprofit perspectives are not necessarily consistent or congruent. It is improper, therefore, to speak of a public-private dichotomy when the private side alone has so many shades of meaning. While the distinction may have been useful in building the American system, it appears to have very little currency today.

The second unresolved issue is the definition of the public interest. An expanded arena for public discourse makes it impossible or rare for the public interest to be identified with only one segment of the public. There are too many competing voices to allow industry or railroads or even defense to claim a corner on the public interest. At the same time, the fact that there are fewer and fewer distinctions between public and private activities suggests that almost any commercial or nonprofit activity of significant scale is affected with the public interest. If any one criterion could be selected out of the jumble of values involved

in the name of the public good, however, it would probably be the immediate economic wellbeing of the largest number of people. The issue that clinched the Lockheed case was unemployment and the economic hardships that a Lockheed failure would cause. The catalyst for Congressional action in the third sector was reported abuse of tax dollars by nonprofit institutions. In other words, perhaps the most accurate, but certainly far from rigorous interpretation of the public interest is concern for the public's money.

The third issue not clarified by this study involves the standards, criteria, or basic rationale for contemporary public policy. One thing that can be said is that nowhere in quoted discussions or written material used here has there been a well-articulated, unequivocal explanation of public policy. If the tentative equation of public interest with economic immediacy has any validity, it would not be unreasonable to surmise that public policy would be directed to the preservation of economic stability. That this may in fact be the case is supported by three apparent attributes of the public policy considered in this essay. The first is responsiveness. Both the Lockheed loan guarantee and the 1969 Tax Reform Act were responses by Congress to situations developed beyond the immediate concerns of public authority. Secondly, their responsiveness has a markedly ad hoc quality. The Lockheed case produced a successful bill only for a limited loan guarantee for Lockheed--it did not establish standards or mechanics for similar situations. Likewise, the education lobby has been somewhat effective in securing public assistance, but that is only one part of the greater nonprofit picture which encompasses a variety of institutions

serving the public, directly and indirectly, yet not finding adequate resources. Responsiveness and ad hoc application of public attention to what turn out to be public problems lead to the third attribute of public policy which is the lack of a comprehensive insight into public needs. Because of the onslaught of demands made upon public authority, what results is a measure here, an act there, but little attempt to organize public decision-making into a rational, consistent, well-articulated public policy.

Despite the uncomfortable vagueness of the emergent facts and issues, some general conclusions are possible. First, there is a sense in which the American system, a term made appropriate by the complexity and inter-relatedness of contemporary society, works in a way not far removed from the pluralist perspective. Lockheed won its case in Congress because it received the votes, and the votes were undoubtedly stimulated by some kind of constituent pressure. Foundations lost their case against the 1969 Tax Reform Act because they could not generate enough constituent support. The actual merits in each case, while debated extensively, seemed in the final analysis to be obscured by rather simple political considerations. Competing interests applied to public authority and the most vocal won. Furthermore, the resultant policies appeared to be decided on negative imperatives. For instance, the threat of unemployment was enough for Lockheed's victory--not an evaluation of the product itself or of the implications either of the product or of the precedent in granting the guarantee to Lockheed. The defeat by Congress of the proposal to build a supersonic transport may be a counter example; yet even then,

Congress was vetoing instead of initiating. Another example is the fact that the 1969 Tax Reform Act was intended more to prohibit abuses than to exploit or expand the potential of the nonprofit sector. It may not be inaccurate, then, to agree with a conception of the American system as one in which organized interests barter for the ad hoc attention of public authority.

If this is the case, the second general conclusion must be that while the American system does function to a certain extent, it falters because it is not recognizing modern realities or necessities. The Dartmouth doctrine is obsolete; corporate welfare is as unacceptable a proposition as is the financial and political position of nonprofit institutions. By perpetuating the arcane and archaic distinctions between public and private, the public interest must necessarily be construed in short-run terms or at best in terms of the survival of various corporate entities. Public policy thus becomes a series of mere ameliorative measures within a relatively static institutional context. With the presence of vocal independent interests competing for public attention, there is an absence of well articulated, over-all societal goals toward which the complex energies of the various components of the system can be directed. Finally, out of this comes no clear and agreed upon understanding of the role of public authority as anything but a protector of discreet interests and an arbiter of disputes.

New Directions

The facts, issues, and tentative conclusions expressed here lead to a few passing observations about possible new directions for the relationships between the public and private sectors, and perhaps to some new

understandings of the traditional concepts of public interest and public policy. A first step is a recognition of the contemporary context. There is no going "back to normalcy" after the Depression, World War II, the Cold War, Vietnam and the threat posed to the environment by the modern way of life. Crisis, it seems, is the norm and not the exception. If so, there must be an adaptation of our institutions to meet demands of complexity and scale; a restructuring perhaps not unlike that undergone in the second World War. Whatever the format, the key point is that traditional understandings of public and private distinctions are no longer appropriate--some new accommodation with reality must be made.

The "patterns of social relations" must change to meet the facts of life. Our problems are apparently growing too large for our institutions to handle. The manner in which we organize our society is experiencing a period of transition which is marked by redefinition of the relationship between the federal government and the rest of society. There must be a replacement of the Dartmouth doctrine with a consistency of concept and policy toward elements of the commercial as well as the nonprofit sector. There must be a candid and codified recognition of the public and therefore political nature of private institutions of significant scale. And finally, there must be developed a comprehensive public policy based on the long-term interests of the public at large as agreed upon by the public's elected representatives.

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