

**Nonprofit Governance & Accountability Project  
Critical Themes and Issues  
Faculty Seminars – 2005**

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## **Corporate Governance Reforms and Their Implications for the Nonprofit Sector**

*Robert C. Clark*

*Harvard University Distinguished Service Professor*

*Harvard Law School*

*March 1, 2005*

In this seminar, participants discussed the challenges involved in developing public policies and regulations aimed at improving the governance and accountability of nonprofit organizations. Marion Fremont-Smith, Senior Research Fellow at the Hauser Center for Nonprofit Organizations, opened the seminar with a brief review of some policy reforms under consideration in Congress. Following that, Professor Robert Clark of Harvard Law School shared his analysis of recent reforms in corporate governance, noting their limitations in the corporate sector, and the bigger problems involved in attempting to “transplant” them to the nonprofit sector. Participants were:

Joseph Bower, Harvard Business School

Robert Clark, Harvard Law School

Dan Curran, Harvard Business School

Marion Fremont-Smith, Hauser Center for Nonprofit Organizations

Archon Fung, Kennedy School of Government

Jerry Grossman, Center on Business and Government

James Honan, Harvard Graduate School of Education

Reiner Kraakman, Harvard Law School

Nancy Kane, Harvard School of Public Health

Herman “Dutch” Leonard, Harvard Business School

Martha Minow, Harvard Law School

Mark Moore, Hauser Center for Nonprofit Organizations

William Ryan, Hauser Center for Nonprofit Organizations

Detlev Vagts, Harvard Law School

## **Current reforms in regulation of nonprofit governance and accountability**

*Marion Fremont-Smith summarized some of the key provisions in reforms recently proposed by the staff of the U.S. Senate Finance Committee. Fremont-Smith was one of a number of experts who were asked by the Committee to submit a critique of the proposals and participate in a round-table hearing at which their views were discussed. She also served on a special panel convened by Independent Sector, at the Finance Committee leadership's invitation, to respond to the proposals and develop recommendations for improving them. Anticipating Professor Clark's talk, she noted that many of the reforms reflected the regulatory approach of the Sarbanes-Oxley Act, created to improve corporate governance in the wake of several business scandals.*

MS. FREMONT-SMITH: Last June, after spending a fair amount of time, and giving the sector warning that they were after the nonprofits, the Senate Finance Committee staff issued a discussion draft with almost forty specific recommendations for changing both the substantive laws governing nonprofits and the method of regulation. ...

In the critique of them I submitted to the Committee, I broke the report into three general categories: The first included amendments to the Internal Revenue Code designed to increase disclosure provisions to improve accountability. Apropos for our talk today, they do include importations from Sarbanes-Oxley, specifically a requirement that organizations of a certain size have their finances audited.

The second set of proposals are extremely far reaching and, if adopted, would transform the Internal Revenue Service from an organization that enforces tax rules, which do now demand a degree of accountability of nonprofits, into an accrediting organization that would require as a condition of tax exemption compliance with rules that they describe as "best practices." As an alternative, they proposed that the IRS could delegate the accrediting function to one or a number of independent exempt organizations that would monitor compliance. Among the rules would be one requiring that there be no more than 15 board members of any charity, that they establish certain committees, including an auditing committee; as well as a number of other provisions that were adopted from materials used by the Better Business Bureau, Wise-Giving Alliance to evaluate organizations that conduct public solicitations.

The third group of proposals were directed toward improving the regulatory process. At base, they raise the issue of whether the IRS is the appropriate body to regulate charities or whether this function should be lodged in another or new governmental agency, and the

degree to which it could or should be delegated to the states. For example, the Staff proposal was to give equity powers to the Tax Court to enforce the federal rules, a function now available only in state courts. They also proposed that co-fiduciaries, as well as unrelated individuals, be given the right to bring suits against charities and their fiduciaries to enforce the federal rules - a change that would reverse long-standing precedent which reserves to the IRS and the state attorneys general the right to bring suit, thereby protecting charities from unwarranted actions. For example, under this proposal, after notice to the IRS and posting a \$250 fee, I could bring suit against the Harvard Corporation for failing to comply with the IRS provisions against private benefit and, if the suit was held to be frivolous, the fine would be \$10,000. A sufficient deterrent for me, but not for others who might want to pursue charities for their own purposes.

### **Learning from corporate governance reforms**

*Noting that many of the nonprofit reforms “look like transplant attempts” that would simply impose corporate governance reforms on nonprofit organizations, Professor Robert Clark outlined the key features of the Sarbanes-Oxley Act, as well as similar reforms instituted by the stock exchanges and promoted by various independent corporate governance ratings agencies.<sup>1</sup> Before reviewing the evidence on the efficacy of these reforms, Clark argued that they may be fundamentally misguided in that they reduce the corporate board to a narrow enforcement role.*

MR. CLARK: What is interesting to me is the most subtle kind of argument, that the whole thing is misdirected, because it misunderstands what boards are supposed to do, and emphasizing all these things is hurting boards of directors. So that leads to a kind of basic thought, which is relevant to the nonprofit sector: What are boards supposed to do? You can group a lot of what they are supposed to do under two headings, management and monitoring.

Monitoring is easier for outsiders to see. It's super easy to see if you're a lawyer. Lawyers, judges and law professors are almost obsessively and totally focused on the monitoring function...If you teach corporate law from a case book, as I do, you get warped after a while. You begin to think the whole world is full of slack and self-dealing and bad performance by executives, and that's what the law is all about, trying to control that; and, indeed, that is what the law is all about.

The board is supposed to look out for these things, and it also has powers to decide and vote on certain kinds of transactions that pose

risk, like a takeover where the self-interests of the management might be different from that of the shareholders; or a transaction between the managers and the company. And that monitoring role is what all the SOX related changes tried to reinforce. The unifying theme strengthening the monitoring role, make it more likely, structurally, incentive-wise, etcetera, that the directors can act as policemen or as diligent, judgmental monitors, looking out for bad behavior?

*Clark contrasted this conception of the board as a narrow enforcement agent with a historic view of the board as an important actor in the strategic management of a corporation.*

MR. CLARK: It's very interesting, if you look at the corporation statute of any state, say Delaware, 141A, and you ask what is a board of directors supposed to do, the basic idea is the business and affairs of a corporation are supposed to be managed by or under the supervision of the board. That is the statement. It's a statement of managerial power and responsibility. There is not even a mention of monitoring for bad behavior...If you do a historical inquiry as to what the theories are for giving power to a board rather than say an autocratic chief executive or all the shareholders as a group, you see a similar kind of analysis: Boards get the benefits of group decision making without the confusion of having all the shareholders do it. And their whole role is to run a business more sensibly. You find almost nothing in the history of boards that reflects the monitoring role. Nowadays it's different.

[T]here are many people in the business world who think that by strengthening the policeman role, the monitoring role, you're going to hurt the collegiality of the board, which is important, they say, for other stuff. The other stuff -- I can tell you as a director of several public companies -- is what takes up most of the meeting time and the activity. You spend most of the time talking about lines-of-business decisions, new ventures, the strategy, the CEO succession, how to finance things, whether to have this or that dividend policy. It involves potential bad management conduct only collaterally.

The SOX related changes, the law, and the listing and the governance ratings all shift things to the monitoring side... You can argue it's not a big deal, that these two things can coexist; you can shift your hats if you're a director. And anyway, the net effect of the shift might be good. So it's an empirical question. But it's a profound one, very profound.

*Turning to the evidence on the efficacy of SOX-style reforms, Clark summarized some of the relevant research, which he characterized as "very sobering." One set of studies, for example, found that reforms restricting the role of audit firms had little apparent effect on*

*corporate malfeasance. Even studies on the much more established idea of mandating independent directors offer little or no supporting evidence. Clark reflected on one possible explanation for these findings:*

MR. CLARK: My doubt [about the efficacy of these reforms] comes from a simple reflection on the scandals that led to all these legal changes. Most of them were scandals that were done at the top. They involved very aggressive accounting judgements or characterizations by the CFO, sometimes the CEO, even though Bernie Ebbers now says he didn't understand it. They didn't come about because the company didn't have documentation of its rules about access to the computer system, which is where all the money is going now, to make sure you have all that in place. So my worry is we'll have a lot of businesses that are run a little better; they have better management systems; there is less cheating at the lower level; but we still might have the mega frauds, which are based on some characterization in top level judgement.

*In closing, Clark commented on the prospects for improving the policy reform process itself, so that legislation like Sarbanes-Oxley is more likely to produce the effects it seeks.*

MR. CLARK: [L]egal change is likely to come about only because of these social processes -- people getting outraged, bandwagons -- but that leads to suboptimal laws often. What to do about it is my concern. My approach is don't fight it; if you want reform you've got to get excitement. But try to build into the statutes the process of research and readjustment, like we do in the environmental area sometimes.

So that's basically the reform. Next time we do a SOX we should mandate, authorize and fund empirical studies; let the SEC control them; give money to academics to do it, for example; then reassess the regulations that they have devised themselves. The law shouldn't try to spell it all out because we don't know what we're doing half the time. And then maybe we can adjust laws as we go, be more rational.

*Seminar participants discussed a number of conditions that would make the regulation of nonprofit governance and accountability even more complex and uncertain. Dutch Leonard noted that standardized metrics for assessing performance are sometimes difficult to develop because of the special nature of the services that nonprofits often provide.*

MR. LEONARD: ...We use charities to deliver social goods, why is that, what are charities? In that sense I think the sense you're invoking is whether tax exempt or not tax exempt or whatever else, it is that they are organized in such a way that is designed to operate as a trust market, not as a for-profit. A for-profit organization has incredible incentives to produce whatever it is the customer wants and to be as efficient as it can possibly be, because it gets to walk away with the difference between the value it creates and the costs it sustains in producing it. So that is a pretty powerful incentive. So why would we want to organize something different than that? Well, what if you couldn't tell very well what was actually getting accomplished, what if you didn't have a good way to assess whether it was valuable? Or the people to whom it was valuable weren't there to watch, you know, there was different people to whom it was being delivered than the people who were valuing and supporting it.

So for a variety of those kinds of reasons you might want to create an organization that basically ran on and required a much higher level of trust, that what things were going on here were basically all in good faith and good intentions and as well as we can figure out how to do it. Now to do that you create organizations where it was hard to walk away with the money, because it --. So you'd have a lot of restrictions against self-dealing, but you would recognize that there might be a sector in which there were things that were intrinsically hard to manage and assess, hard to figure out what the performance was. Those would, in effect, be things that would have gravitated toward this sector. There might be some other things in the sector that where a fairly high degree of performance could be established or you could manage more directly.

What I observe is that over time we have seen a lot of those things that were formerly not really easy to assess, become better able to be assessed, and a lot of those we've migrated to in the private sector, because you can then use the private sector mechanism to produce better value. So I'm a big proponent, as many of you have heard me go on endlessly about, about trying to bring more performance management of the sector.

But I want to be cautious about the notion that you can specify everything in the sector to the degree necessary to be able to operate essentially on the same as a for-profit basis.

*Mark Moore introduced another complexity: Nonprofit employees may imagine themselves less as agents of the organization and more as principals, qualified to make their own judgments about the proper means and ends of the organization. So even the assumption of a*

*central governing authority – fundamental to conceptions of the for-profit firm – may be misplaced in the voluntary sector.*

MR. MOORE: Just as an observation, you could imagine then that an important part of the resources that are fueling at least some part of nonprofit organizations emerge not from the motivation to the people at the top, but the people at the bottom, and that is in some sense a political movement grafted on top of the functioning as a producing organization, would be one picture of it.

If that's true, the amount of control that one would expect an authoritative center to be able to, over an organization, has got to be much less, and the principle reason is they're controlling fewer of the assets and the incentives that are actually allowing the organization to run, because most of the assets that are allowing the organization to run are held in [an employee's] head and heart. And if that's true then he is an equity holder in this enterprise because he has got control over his own level of motivation and effort, and he votes with his feet, about whether he is going to, what he is going to do with that particular asset.

So there is a way in which all nonprofit organizations, insofar as they depend on quasi-volunteers, will have this profoundly decentralized structure of governance because every worker will think of themselves as being an equity holder in the institution, not subject to restrictions and rules and guidance that would come from the top of the organization. Which really makes it a very interesting governance problem because then these poor people are sitting on top of the board's accountable for the performance of the people at the grass roots, but depending upon their independent initiative to get the job done.

*Archon Fung raised a troubling “disanalogy” between the nonprofit and for-profit sectors that could limit the effect of the disclosure requirements featured in many for-profit accountability reforms: The nonprofit sector lacks an organized, empowered set of accountability agents interested in and capable of using that information to hold nonprofits to account.*

MR. FUNG: [T]here is no audience for disclosure in the nonprofit sector. ... they don't get to buy and sell shares. ... what effective transparency policies depend on is an organized set of consumers of that information. And for the for-profits you obviously have analysts, institutional investors, other kinds of stockholders that are very, very sensitive to every detail that is disclosed. So it makes sense to improve some disclosure because it's actually being consumed. Whereas there are other potential donors for the nonprofit sector who do exercise some power, but it's a much more concentrated group, and then the people that are much more directly affected by the actions or inactions of the nonprofits, the service delivery ones anyway, are the clients who don't consume that information.



*Fung also argued that no nonprofit accountability agent (including donors, for example) is likely to identify with the broad public interest that justifies a charity's tax-exempt status in the first place, a point that prompted Marion Fremont-Smith to remind the group about the role of state attorneys general.*

MR. FUNG: ... I think normatively need to be accountable to the general public because they are getting a tax break from the American people, they're getting a tax break, they're being absolved of this responsibility because they're providing general kinds of goods.

But it's very hard to see what kind of accountability agent can be coalesced that plausibly stands in for the general public, and it's very unlike a for-profit firm that way, which is actively accountable to its shareholders, maybe ought to be accountable normatively but is not as much to its workers and to the communities in which it operates. But has a kind of more specific set of obligations that is being contemplated for the purposes of accountability in the charitable case.

MS. FREMONT-SMITH: Charities have had a preferred status before we even thought about tax exemption for them. And the enforcement power has always been in the states and the attorney general representing the general public, this comes from English Common Law, and it is the law in every state. So there has been a mechanism, it's been, in many states, just totally dropped because the states don't do anything because of budget or disinterest, and because of the all important factor of tax exemption and the deductibility of contributions. That's what it really is. So it isn't that it isn't there, it's that we haven't has, as a society, the interest in it.

*Professors Bower and Clark both argued that most governance reforms overlook the informal, social, and personal forces that are so important to producing accountability, in both the for-profit and nonprofit sectors.*

MR. BOWER: I was thinking, for example, something that has been fascinating in Japan is how desperately difficult they find what we call restructuring in the private sector, because basically it involves, as far as they are concerned, being a bad person. There permanent employment is not something they take casually. It was sort of deeply ingrained in the way they thought about what society was, it's ideological.

If you look at the Jesuit organizations, it's quite interesting because it's worldwide' it's four levels. And on the whole it's been remarkably effective. And it is very clear that compliance and performance are both managed by a relatively intense system of indoctrination and training in earlier years, and then you are kind of on your own.

Slumberger is a very interesting company because basically what they sell is information, processed information, not the raw material. And you have relatively young people in really strange places in the world, out on drilling platforms or in Africa, things like that, who possess astonishingly valuable information, and they don't give it to their client, who they're living with. Now to my knowledge I don't know of any scandals in that system, and that is all done through indoctrination and training and morals.

So I hope that as we go at this we can keep in mind that the objectives we have in mind, both compliance and performance, are often accomplished in other organizational systems through things other than [formal regulation].

MR. CLARK: For certain kinds of activities where it's hard to measure the output, or where there is some redistribution that you'd like to monitor, you want to have two kinds of alternative arrangements: one, you want to have a structural nonprofit, namely no residual owner class that has a claim on what is left over, so no shareholders. But two, you want to have a set of controls that sort of steers people towards accomplishing the mission that is non-legal. So you'd like to have nonprofits controlled by people who have a religious commitment or an ideological commitment, in the case of an environmental organization, or a kind of exaggerated notion of the importance of education and research, in the case of a university -- that sort of thing. So you want to have these small and ideological controls in place and encouraged.

*Drawing on his experience in the health sector, Jerry Grossman pointed out how attempts to increase accountability often founder. On the one hand, the things that government regulators can measure are often poor proxies for quality health care. But on the other hand, attempts to develop more relevant metrics are often opposed by those arguing there is no substitute for subjective judgment on such complex matters.*

MR. GROSSMAN: [I]nstitutions with very large government relations are regulated, overseen and audited by those agencies. My guess is that's true of the ever-increasing number of not for-profits whose principle source of revenue is the government, I mean that's what we've been doing. But it's not performance based. There is an enormous pressure by the legislature to keep government

payments commoditized rather than based on performance.

MR. LEONARD: That actually is I think at the root of a lot of what Bob observes in the paper, which is that not only is there an orientation not to management but to monitoring, but the form of orientation to monitoring is all about procedural compliance, rather than even the outcomes.

So one could imagine a scheme for accountability that was to say gee, we don't think these folks are performing very well, we ought to figure out how to get some performance out of them. But almost all of the effort in Sarbanes-Oxley is to define a series of procedural activities that you have to engage in, as if those were obviously going to produce those results. There is no obvious connection, as you are pointing out.

## **The Governance of Not-for-Profit Organizations**

*Edward L. Glaeser*

*Fred and Eleanor Glimp Professor of Economics*

*Harvard University*

*May 10, 2005*

Professor Edward L. Glaeser<sup>2</sup> presented a model for understanding how various stakeholders affect the governance of nonprofit organizations. The seminar participants were:

James Austin, Harvard Business School

Derek Bok, Harvard University

Robert Clark, Harvard Law School

John Donahue, Kennedy School of Government

Marion Fremont-Smith, Hauser Center for Nonprofit Organizations

Archon Fung, Kennedy School of Government

Edward Glaeser, Harvard Faculty of Arts and Sciences

Dan Halperin, Harvard Law School

Nancy Kane, Harvard School of Public Health

Herman "Dutch" Leonard, Kennedy School of Government

Mark Moore, Hauser Center for Nonprofit Organizations

William Ryan, Hauser Center for Nonprofit Organizations

Guhan Subramanian, Harvard Law School

### **A Nonprofit Choice Model: Contesting X**

*In Professor Glaeser's model of nonprofit choice, four actors – the manager (representing the CEO and the board), workers, donors, and customers – attempt to influence the character of X:*

Glaeser: There are going to be two key choices that are going to be made, one of which is the quantity of the goods to be produced, and the second of which is the nature of the goods. I use the most abstract, non evocative, algebraic symbol, X, to describe this nature of the good. But I had in mind a very rich set of characteristics, and we're all very familiar with them because we live it in our daily lives. So in the case of a university X can easily be the extent to which we focus on research relative to teaching, for example. X can be, in the case of a hospital, a research versus more clinical orientation. In religion, this can be the extent to which you cater to the sovereign's interest, or you cater to your own in terms of sermons or other things like this. In theater, as well, it's a question of being more commercial versus more high brow.

*In Glaeser's model, the elite (professional or specialized) workers at wealthy nonprofits, whose endowments make them less sensitive to the preferences of current donors, will eventually impose their sense of X on the organization, sometimes leading the organization away from its original mission:*

Glaeser: The punchline of this is that nonprofits represent conflicts between [these] groups, and wealthy firms' workers tend to take over. I want to emphasize that this is not necessarily bad. We all work in firms that substantially reflect workers', particularly elite workers' preferences. I don't think that's particularly bad for society. I don't think that's particularly bad for the organization. But we certainly know that the way that Harvard is run now does not particularly bear close resemblance to the original wishes of the donors back in the 1630s. That's not particularly a bad thing, but it certainly is clear what those donors particularly wanted us to do. In poor firms customers and donors tend to be more powerful.

*Testing his model against the evolution of universities, hospitals, art museums, and the church, Glaeser finds the same outcome:*

Glaeser: [A]s places get richer they almost always seem to get taken over, relatively, by their elite workers...It's clearly very interesting that the mission changed so radically as we saw in the case of Massachusetts General, or as we saw in the case of universities. There's an original mission which then completely reverses itself from being about just taking care of the indigent or training Congregationalist priests to something totally different.

*Glaeser anticipated the chief interest of the seminar participants, which was to explore whether the control of X by elite workers is inevitable or whether governance and accountability systems could be structured to encourage a process for determining X:*

I have the suspicion that no matter what specific rules you write down it seems likely that a bunch of smart workers at the top of the place are going to figure out how to subvert the interests of the entity for their own uses... But to me the interesting question is whose interests do we want these groups to be maximizing and how is it that we design some combination of regulations, tax policy, and law to achieve that.

### **Elements of a Regime for Determining X**

*Bob Clark suggested that, in approaching this question, the goal is not to prevent elite workers from influencing the X of their nonprofits. (Sometimes their preferences are not motivated by self-interest but by deeply held convictions, which may even be shared by the other actors.) The point, rather, is to construct a system to prevent their preferences, unexamined, from inevitably trumping those of others:*

Clark: But [workers' X preference] is also embedded in an ideology which is related to the mission of the organization: The professors all believe research is a public good that benefits the world in the long run, and they may well be right to some extent...How do we start thinking about any normative assessment, and any possible public policy or legal moves to try to move the governance in a way that gets the mixture between the good control of the professors and doctors and clergy, versus the overly selfish? Is there any way of finding out what's optimal or having a legal structure that promotes a move toward it? What would the mechanisms be? I'm pretty clear it's not Sarbanes-Oxley type reforms. But the question is, What would it be?

*Marion Fremont-Smith and Nan Kane further suggested that, just as total deference to workers' X preference is misplaced, so, too, would be unquestioning fidelity to the X preference of a nonprofit's founding donors. Indeed, the X preference of some founders actually values the ability of their successors, or of other stakeholders, to influence the organization's X.*

Fremont-Smith: [T]he essence of [the philanthropy] part of the sector is the wide freedom to define social value. Andrew Carnegie set up the Carnegie Endowment and said to a totally unrelated board, "Achieve world peace, and when you have achieved world peace then do other things to benefit mankind."

Kane: [For many nonprofits] their mission isn't very well set up by donors to begin with. There is no great founding statement, and it's sufficiently vague, that, in fact, they are directed to try to do good within the context of whatever their modern situation is -- not just to take care of polio, but to take care of a broader [set of concerns of which polio is one manifestation]...[I]t is the role of the board and management, to figure out how, within that extremely broad [mission] to do good in health care, or improve the health of the community...[T]hat should evolve over time, based on what else is going on in the community...So there's a whole environmental interaction going on here that is constantly updating the mission, and either creating or not creating alignment depending on how well it's done.

*In a similar spirit, and given what he considers the near certainty that organizational mission and values will change over time, Jim Austin proposed focusing on a process of alignment, where the objective is not to curb any change to X, but to facilitate a consensus about when and how to change it:*

Austin: The piece that I remain intrigued about is the actual role of mission as a driver in the nonprofit field and the concept of alignment among different groups that may indeed be anchored to the mission. That becomes a control mechanism. So rather than the conflict model that we have here we may have a congruency model if you get alignment right. ... [A]ll enterprises change their missions and their strategies, and their values over time regardless of their form. So the question, in part, that I find intriguing still goes to the alignment issue. So it changes, the mission may change but do you have misalignment of interests or can you still preserve an alignment even though you've changed the focus? Exploring and understanding that dynamic I think is important for us.

*Given that X is not an immutable given, Mark Moore suggested that one mechanism of an improved regime would simply charge boards with responsibility for defining X:*

Moore: You could...separate the board from the donors and from the workers and from the customers, to some extent, and say what's distinct about the board is that it is a unique actor empowered by the society to decide what constitutes public value and see whether they can make it happen in the world, period.

*Although this arrangement might optimize legitimacy by clearly authorizing the arbiter of public value, Dutch Leonard argued that it would not optimize effectiveness:*

Leonard: There has to be some kind of external mechanism that judges whether what they [the board members, or any arbiter of value] said they want to do is actually a good thing to do or not. I think a very large fraction of the money that goes into this whole sector is very poorly spent, mainly to the gains of workers, not very well thought about – [with] wrong purposes, stupid theories on what's going to make the world better, all kinds of stuff like that.

*Particularly when the government is underwriting nonprofits through preferential tax treatment, Leonard feels additional criteria are needed to designate the arbiters of X:*

Leonard: What I've noticed is that in nonprofits you have several relatively weak parties with respect to: (a) their ability to perceive social value; (b) their ability to keep themselves from being corrupted by their own interests; and (c) their ability to actually make the organization do what they were hoping it would do. And that's the mess that we're trying to work on...[I]n effect, we want to authorize people who have the most accurate view of X -- who are in a position to be able to make a good decision about what's the right value of X for society. Sometimes we might think donors do and sometimes we might think clients do, but we might not always think that because sometimes they have it wrong. They don't realize what they need.

*Derek Bok questioned whether the seminar participants' comprehensive vision of accountability had any support in the current world of policy and politics, where the X of nonprofit accountability is being defined quite differently:*

BOK: [I]n listening to...a lot of this conversation, and comparing it with the impression I had last spring when we testified in front of the Senate Finance Committee, there is one big difference. I had a feeling the government was not concerned about could we maximize dollars and social purposes. I mean they were worried about one simple thing...: Are people using the cover of charities, and nonprofits, and public purposes for private gain? You know, they're going to vote themselves a bigger salary to finance their daughter's wedding, or they're going to vote themselves big trustees fees, or they're going to meet in Barbados when they could easily meet in Boston.

*Mark Moore offered a summary of the issues that might be animating current concerns about nonprofit governance and accountability, describing three views that might produce three different types of rule regimes:*



Moore: Let me suggest that in view are three different accounts of what the principal, social problem is facing the voluntary nonprofit sector that could be solved by improved accountability and governance in this sector, right. One of them is that there are a lot of people who would be prepared to contribute money to the voluntary sector who won't now because they aren't sure that they'll get either the money or the social return out of it that they want and therefore we need to have approved governance and accountability...

Idea number two is there's plenty of money in this and there's no more to be gotten. But the choices that are made about purposes are bad -- that's sort of the Dutch's claim that we keep picking the wrong Xs to go after -- to which one response could be yes, but actually it turns out that the X that gets bought by donors isn't available for a different version of X because that's not what they would choose to give to, and they can't be coerced to give to it. And so that would be an alternative account.

And then the third idea though, and this was, interestingly enough, I think where a lot of the theorizing about governance and accountability works in the for-profit sector, is the idea that there is rent seeking going on that has to be ruthlessly rooted out in order to make sure that the favored stakeholder gets the maximum amount of the benefits out of this productive activity and doesn't take, and that their rightful share isn't taken by some other stakeholder that has enough power to get in and wrest some of the rents away and therefore to distort the operation away from the true social benefit.

So now those are three quite different diagnoses of what the problem is in this sector that could be solved by improved governance and accountability.

## **Challenging Expert Rule: The Politics of Global Governance**

*David W. Kennedy*

*Professor of Law*

*Harvard Law School*

*Director, European Law Research Center*

*October 17, 2005*

In this seminar, Professor David Kennedy presented on his work to date in understanding the role of experts and expertise in global governance, and looked ahead to work he will undertake in the Spring (with a grant from the Nonprofit Governance and Accountability Project's research fund) to learn more about how nongovernmental institutions figure in the problems raised by expertise in global governance and how they might address them. The following people participated in the seminar:

Derek Bok, Harvard University

Joseph Bower, Harvard Business School

David Brown, Hauser Center for Nonprofit Organizations

Jonathan Clark, Harvard School of Public Health

Joshua Cohen, Massachusetts Institute of Technology

Tiziana Dearing, Hauser Center for Nonprofit Organizations

Marion Fremont-Smith, Hauser Center for Nonprofit Organizations

Archon Fung, Kennedy School of Government

James Honan, Graduate School of Education

David W. Kennedy, Harvard Law School

Dutch Leonard, Harvard Business School

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## Experts and Expertise in Global Governance

*Kennedy analyzed global governance in terms of 'background' and 'foreground' issues<sup>3</sup>. Foreground issues are those that are widely considered the purview of politics: Subjective matters that are settled by resorting to values, preferences and ideology in political arenas. Although they often entail some of the same subjective judgments, the contributions of experts are often accepted as background issues: Because they are viewed as technical matters that require special knowledge to resolve, they are often not subject to political discourse and deliberation, which is diminished as a result. (See Diagram 1 for a depiction.)*

Mr. Kennedy: [O]ur conventional images of public international law, private international law and so forth, just don't add up to a coherent picture of the global governance structure. I started with the idea that things in the background, particularly legal things in the background, might be more important for global governance than things in the foreground. ...Who are the people who are foregrounding this and backgrounding that? Who is making the interpretation that this is a fact and that is a public choice, and this is something that just happened and so on?

Mr. Kennedy: I began to think of expertise as the practice of interpreting where there are opportunities for choice, where there are facts on the ground that don't permit choice or compel choice, and where there is something that ought to be understood to be available for overt political contestation and where there is something that is appropriately technical. Experts are the ones that manage the gateway between the foreground and background in that context. So it's the hypothesis that I went into the study of experts with.

*Referring to Diagram 2, Kennedy explained the mechanics of expertise in global governance, and noted how experts are prone to two cognitive errors.*

Mr. Kennedy: The second chart in the paper was a first, hypothetical effort to draw a general map of all experts everywhere: What do they generally do? Here is my proposal: They make and establish and criticize vertical associations on this general chart.

Mr. Kennedy: [T]here are two kinds of typical cognitive errors that experts very commonly make, in fact errors that seem in some cases motivated to over estimate the stability of vertical associations on the chart: the necessity of connecting a given theory or policy

with an outcome; and to over estimate the difference between policies, in terms of their outcomes. It's to make the differences on the horizontal chart line seem more important than they are and the relationship between elements at different levels seem more stable than they are.

Mr. Kennedy: So you get a kind of repeated expert practice of the 'narcissism of small differences': 'Your theory and my theory, really there is a huge difference,' when actually looked back on, over 50 years, they were pretty close together in what they were trying to do, and the big issues were somewhere else. As well as over estimating: 'You really must have a tariff at this level if you want to have industrialization of that type,' when it turns out it's more complicated, there's more room to play, you have regimes that did exactly the opposite thing and got similar results, in ways that are hard to explain.

### **Making expertise contestable**

*Kennedy considers inadequate the traditional strategies for making expertise contestable -- either by translating expert issues into political issues that can be labeled left-right-or-center or into social interests. Instead, he proposes reconceiving the expert's role so that it includes considerable discretion for rendering judgments. By making the judgments entailed in their work explicit, Kennedy hopes to make their expertise contestable.*

Mr. Kennedy: What does one do to increase the exposure of expert practices to political contestation, to make the politics of global governance more visible? The three traditions I allude to at the end of the talk are ways of rendering what an expert does available for contestation by political groups. The first two are traditions of translation: translating the expert vocabulary into left, right, center terms; or translating it into terms of social interest. Identifying broad blind spots and biases in the practice of expert decision making and identifying those with left, right or center formations. All of those traditions of translation have the problem that it's extremely difficult to do. It's a problem of expertise itself to figure out what is in the interest of workers and what is in the interest of the left and what's in the interest of the right. Terms are unstable; politics is one of the things that experts themselves debate.

Mr. Kennedy: So the tradition of politicization that I'm more interested in is the one that focuses on the experience of the expert as having discretion; increasing the availability to experts of the experience of freedom and responsibility for the decisions that they make, so that: they reverse the cognitive tendency to over invest their internal debates with significance or over invest the associations

between policies and outcomes that they've prescribed with necessity; and they actually see that they have a domain of responsibility that is somewhat larger than they thought...If one could make that experience of being political in some way more available to experts throughout the system, one would have struck a blow for opening up global governance in some way.

*Joshua Cohen and Chuck Sabel argued that Kennedy's analysis overestimates the effects of expertise in global governance, underestimates the benefits, and (as he does in the paper read by seminar participants) errs in suggesting that the remedy to these problems lies at the national level – points captured in Cohen's response:*

Mr. Cohen: I don't think of those rules, as a general matter, as having an explicitly, if I can put it this way, expert legitimacy. That is, they are not covered by the claim of being a product of a kind of expertise that you then might want to unmask or remask or challenge or contest. Tax rules for example: you have to be an expert, I suppose, to understand them, but I don't think anybody thinks the legitimacy of tax rules is a consequence of their being the product of expert judgment as opposed to political choices.

Mr. Cohen: This seems to me to have so seeped into popular sensibilities that I almost feel like defending expertise as the...unusual thing, to do not showing either the interest positions or the cultural positions of the experts. So the politicization of expertise seems to me to be pretty well established.

Mr. Cohen: So I take the point about the contestability of rules on board, so now I think, here's a question: Is it better for the living standards of people who are destitute that there be global labor standards or not? And when I read your thing I felt like I was being told that I was making a mistake in asking that question; that is, once I acknowledged the contestability of the rules, then I would see that...the best place for making the rules is in locations where there is a structure of political contestation in place, namely at the level of nation states. I draw a different conclusion, which is there should be more effort to build a global space of political contestation, if you believe as may well be plausible, that at least part of the place where rules, labor standards should be getting made is not just at the national level but at the global level.

*Joseph Bower proposed another problem associated with translating expertise into political terms: the tendency of experts to take ineffective implementation of what may be a sound policy as evidence of the policy's deficits. As a result, left-right contests over the merits of a policy dominate governance, when questions of effective implementation may be more productive.*

Mr. Bower: When I think about the space in which you operate, it's a little bit in the direction I was going. I am constantly struck by what I observed being the product of two kinds of things: one being in effect intent and policy of one kind or another; and the other, how is it actually implemented? ... In effect, the debate...is very often confounded because we're mixing up intent and policy with how things work out. And my own sense is that we see appalling implementation, and that is taken as evidence, from the right or the left, of reason to do something.

*Archon Fung hypothesized that experts are reluctant to see that choice and judgment are part of their role because their expertise is the very source of their legitimacy. Without their expertise, experts would have little standing in global governance in the first place. As a result, the broader the judgments they make in global governance, the less legitimate their voice.*

Mr. Fung: I'd like to see a little bit more of the institutional piece, because my hypothesis is, especially when you're talking about the human rights NGOs and the international NGOs generally, that expertise is a source of legitimation, and maybe the only source of legitimation where there is no arena for a fuller democratic politics. And maybe even, it's a much more difficult legitimation problem for these people because their beneficiaries are distant from their funder constituencies and political constituencies.

Mr. Fung: So the hypothesis would be that the pressure to not experience freedom, either subjectively or in public, to claim that you're experiencing no freedom, is much greater when those other sources of legitimation, of institutional legitimation, are absent. That's a structural problem. It cannot be raised until there are alternative sources of legitimation, like a policy maker in a domestic context enjoys, or an elected politician. He's been elected, and so he doesn't need to claim these other sources of expert legitimation; the institution is doing the work.

Mr. Fung: I think your project really depends on, at least in part, on a project of democratic institutional expertise, about constructing an alternative way of legitimating that fully acknowledges the freedom and the contingency that these experts have, or these decision makers have, let's say, and so reduce their burden on a kind of bogus claim to expertise, which they themselves probably know is false in their deepest moments.

*David Brown produced an example of the liberated expert that Kennedy envisions, although the protagonist of Brown's example had to*

*leave his job in an expert-dominated institution and form a new NGO in order to exercise more judgment.*

Mr. Brown: I ended up thinking a lot about Transparency International, which, as you may know, got started by a man named Peter Eigen, who had been a senior official at the World Bank, and he tried to get the bank management to do something about the corruption in African development projects. And bank management said, 'That's just the way things are, cost of doing business, political issue, we can't touch it.'

Mr. Brown: He took early retirement and started this transnational network that grew into Transparency International, which changed the treaties of the OECD, it's changed the sort of global perspective on corruption and transparency, it's built a network of local institutions that are now collaborating with the World Bank to reduce corruption in lots of countries.

Mr. Brown: And in Peter's case, the way he describes getting into this, he was the director of programs in East Africa and his wife, who is an MD, was working at the local hospital. And she kept coming home and raising hell with him about corruption, saying, 'You've got to do something about this,' which may be the event that kicked him out of the expert role into trying to push the bank management to doing something different, and they wouldn't push. So what he then did was create a network of people that were really elites in their countries but were concerned about this issue, and began to reshape what expertise means in this arena.

### **Next: The institutional context**

*Kennedy concluded by noting where his inquiry into expertise and global governance will take him next: a study of institutions, including the NGOs that are so prevalent in global governance.*

Mr. Kennedy: So what I thought I would do is describe a project that I am very grateful to have the support of the Hauser Center to pursue, that actually grows out of the little talk that you had, and that I hope to actually pursue next spring...which is to ask the question, what do institutions have to do with everything that was in the talk? And how does institutional structure affect any of that? ...Is there some way to structure institutional space so as to promote this experience of responsible freedom or discretion that I'm talking about?

# *I: BACKGROUND NORMS & INSTITUTIONS*





