



# The Public Economics of Community Foundations

ECON 4314 – Topics: Public Economics

## Abstract

Examining how community foundations decide how to allocate their funds available to grant in support of the community, based on their interpretation of community wellness.

Kevin Parsons

3138123

## Introduction

Community foundations are charities with unique properties. The two which are most notable is the focus on endowment building, investment, and distributing a portion of funds under management every year to other charities or municipal projects. This contrasts with a typical charity, which fundraises and spends all, or nearly all, the funds raised every year.<sup>1</sup>

The second difference is that while most charities have a narrow mandate (e.g., a food bank, homeless shelter, the opera, elder care, etc.), community foundations exist to benefit a specific area or homogenous group (French language speakers, for example). Since community foundations are location- or group-based, they have ultimate flexibility which charities and projects they support. While all community foundations have a mandate related to improving wellness and community life in general, the best way for the community foundation to accomplish these goals is open to interpretation.

Finally, while community foundations will occasionally fund a specific public project, they primarily fund operational charities whose mandates align with the desired outcome of the community foundation. This means that an individual community foundation typically does not deliver the service to those in need, but rather supports the organization which does. While this adds complexity, and potentially inefficiency, to the funding model, it also allows for flexibility. A community foundation can choose to change the charities and/or causes that it supports over time, evolving with the needs of the community and seeking out the most efficient use of its funds.

---

<sup>1</sup> <https://communityfoundations.ca/wp-content/uploads/2019/05/What-is-a-Community-Foundation-english.pdf>

## Community Foundations as Social Planners

Charities, and by extension community foundations, are part of what is considered the 'third sector,' meaning they are not government nor private industry. However, charities are not only exempt from income tax, but their donors are eligible for a tax receipt to offset their individual income tax<sup>2</sup>. By forgoing earning any tax revenue from charities, as well as refunding individuals' income tax relative to their charitable donations, it can be interpreted that the government has decided as a matter of policy that charities exist primarily to serve the public good, like government itself.

Due to the similarities in the missions of government and charities, and since community foundations are organizations that can be thought of as a sort of 'social planner' (disbursing funds for the public good with the primary goal of improving community members' utilities), the theories and decision-making frameworks of public economics can be utilized by them in their own evaluations. Community foundations can use these theories and tools to define and realize their purpose as an organization, while measuring which of their activities works and which do not.

### Rawlsian Approach

Before determining a decision-making approach, a community foundation must first determine what approach they want to take in raising social wellbeing. Being that community foundations exist to better the community that they serve, it would be reasonable to take a utilitarian approach: Maximize the increase in total utility.

---

<sup>2</sup> <https://www.icnl.org/resources/research/ijnl/an-introduction-to-canadian-tax-treatment-of-the-third-sector>

However, while the fundamental mandate of all community foundations is broad, to best improve the social wellbeing of their community it would be best to adopt a Rawlsian philosophy, primarily supporting projects and programs for the worst-off in society<sup>3</sup>. One reason for this approach is that by focusing on those with the worst-off, community foundations will improve the overall baseline level of social welfare in society, without leaving any individual behind. This focus on equity rather than equality will also have the greatest impact on the economy overall, based on the demographic information of those that are traditionally thought of as the “worst off” in society.

What is unique about community foundations as ‘social planners’ is that there is no formal mechanism for accountability. There are structures like boards of directors, but as long as a community foundation operates within the guidelines outlined through legislation and administered by the Canada Revenue Agency, they have a high level of freedom to operate as they choose. Unlike a government which can be voted out of power, the model of a community foundation of holding donations in trust, granting the returns, they are sustainable over long time periods which is a strength, as well as a weakness.

The implication of this is that community foundations must endeavor to be held accountable by the community, which starts with having a vetted process for selecting where to grant funds.

### Alternative Funding Selection Methods

Like with other social planners, community foundations have different alternatives for their decision-making process. While they all have their merits, it is not a given that they will

---

<sup>3</sup> Hindriks and Myles; Intermediate Public Economics, Second Edition; Page 440

each provide the same social impact. It is therefore important to understand the different mechanisms in order to evaluate them.

#### Pure Public Good

Since community foundations can provide funding to municipal projects, one philosophy that they may consider is to only fund pure public goods, such as green spaces, public art, and free community amenities. The rationale for a community foundation choosing this philosophy is that it would be supporting projects and programs that truly everyone in the community has access to (not considering limitations like capacity that exist in the real world).

In order to pursue this course of action, a community foundation would only provide funding to public goods that have the following two properties:

1. *Nonexcludability: If the public good is supplied, no consumer can be excluded from consuming it.*
2. *Nonrivalry: Consumption of the public good by one consumer does not reduce the quantity available to consumption by any other.*<sup>4</sup>

This approach to funding is the most straight-forward. Goods are provided to the public, and the public can choose whether or not to consume them. For those that do, there is no payment required to consume the good and therefore it increases their personal welfare without costing them anything. For those who don't consume the good, it does not harm them in any way.

---

<sup>4</sup> Descriptions of the properties are quoted from Hindriks and Myles; Intermediate Public Economics, Second Edition; Page 148

Practically, however, this approach is not the most effective option for a community foundation to select. Considering the practicality of public goods, while they may be enjoyable to a wide variety of consumers, realistically they do not address the specific needs of any consumer. Since this is the case, public goods can have a positive impact on consumer and social welfare in a broad sense, but nothing will be done to help those who are the worst off in society.

### Voting

Another alternative when selecting which projects to fund is to provide community members with an opportunity to vote. By giving all residents in a community the opportunity to vote to select which projects and programs receive the community foundation's funds, it ensures that everyone has the opportunity to participate in the process. This open form of selection is appealing because it is completely community-led and encourages participation in the community foundation.

The primary concern with the use of this mechanism is that even if there is 100% turnout from the community (which is extremely unlikely), the preferences for the entire community will not be reflected in the result. This is due to the realities of Median Voter Theorem and the diversity of communities' needs.

"Median Voter Theorem ensures that the consumer with the median preference for the public good will be decisive in the majority vote."<sup>5</sup> While this may seem like an efficient solution, there are many social programs that are vital for the small portion of the population that accesses them, but completely unused by the majority. For example, an individual that

---

<sup>5</sup> Hindriks and Myles; Intermediate Public Economics, Second Edition; Page 156

relies on a food bank for their meals will place a very high value on the services that the food bank provides. However, in most Canadian communities the majority of people do not need to rely on a food bank. Therefore, it is likely that the median vote for the amount of funding a food bank should receive will likely be zero, unless there is a very large amount of altruism in the community.

For a project or program to be selected via voting it would have to appeal to the greatest number of community members, which may not necessarily be a bad thing overall. However, it will result in leaving the worst off in society behind.

#### Incorporating Altruism

Since community foundations act as a social planner not out of obligation, but because of need in the community, it is reasonable that high level of altruism in the decision making of the foundation, as well as those that support it through donations. Since this is the case, it can be assumed that all the disbursement decisions which community foundations make do not have to adhere to strict 'rational economic decision making' by those involved.

Even for those organizations which are supported by a community foundation that do not necessarily improve the lives of the worst off, the support can be seen as an altruistic act. If the foundation itself, as well as most of its supporters, do not directly benefit from any of the transactions, then altruism is incorporated. Therefore, the primary goal of a community foundation is social impact, and in order to be able to have the greatest impact the foundation must understand how to measure and compare the different opportunities presented.

## Social Impact

According to the Centre for Social Impact, “Social impact can be defined as the net effect of an activity on a community and the well-being of individuals and families.”<sup>6</sup> In essence, it is how much any particular action improves a community for those in it. However, since there is an argument that all charities and municipal projects have a social impact, it is vital there be a way to compare their impacts to one another, even when they are operating in completely different areas. The measurement of social impact is therefore a fundamental consideration for community foundations.

### Measuring Social Impact

In order to compare social impact, it is important that a community foundation must consider measurement. It is important to create an objective system for measuring social impact, based on a human’s needs.

### Canadian Index of Wellbeing

Developed at the University of Waterloo, the Canadian Index of Wellbeing (to keep with the University of Waterloo’s naming convention, wellbeing and welfare will be used interchangeably<sup>7</sup>), “provides Canadians with a fuller picture of wellbeing that measures real life, for real people.”<sup>8</sup> The Canadian Index of Wellbeing (CIW) regularly reports on eight domains that are used to represent Canadians’ wellbeing. The domains are meant to provide a more well-rounded look at the wellbeing of Canadians than a traditional economic measure such as

---

<sup>6</sup> <https://www.csi.edu.au/about-social/#:~:text=Social%20impact%20can%20be%20defined,business%20and%20social%20purpose%20sectors.>

<sup>7</sup> <https://www.econlib.org/library/Topics/College/wellbeingandwelfare.html>

<sup>8</sup> <https://uwaterloo.ca/canadian-index-wellbeing/>



per capita GDP. Recognizing that a country and its citizens' wealth is important to their wellbeing, but not provide the entire picture, the CIW offers a framework that organizations like community foundations can use to measure, compare, and understand their community's strengths and deficiencies.

Using a framework like the Canadian Index of Wellbeing, a community foundation can begin to understand how different organizations have differing levels of social impact. For example, an arts organization can improve the lives of those who experience it, it would not be the same as feeding someone who does not have stable access to food. By quantifying the social impact, a community foundation can start to understand how their funds can best be used to the greatest effect.

While thinking about someone who accesses a charity's services, it provides that individual with a direct income effect: They are receiving benefit that has a monetary value at no cost to them. A simple representation of this is the following equation:

$$\beta^h = \frac{\partial W}{\partial U} \alpha^h$$

Where  $W$  is how much weight we put on person  $h$ 's welfare and  $\beta^h$  measures the increase of social welfare of an individual, based on a marginal increase in income.<sup>9</sup> This weighted measurement will allow a community foundation to compare supporting different organizations, based on the amount of impact they have on the individuals they serve. Being able to do so will allow the foundation to be confident in the decisions they are making are for the betterment of society.

---

<sup>9</sup> Hindriks and Myles; Intermediate Public Economics, Second Edition; Page 522; Equation 15.26

## Marginal Social Impact

Using a weighted measurement of marginal social impact to compare different charities is a way of addressing the social planning issues previously discussed. Rather than only considering the marginal impact that funding will provide a specific charity, the magnitude of their contribution to social welfare is also considered. Using this measurement, the community foundation can act as a social planner and take into consideration comparisons that it may be difficult for an individual donor to understand.

For example, even an altruistic individual donor may put a higher value on an arts organization than a food bank, because of their personal preferences. However, by acting as a social planner with a holistic view of society, a community foundation is able to show that money given to the food bank has an overall greater social impact, based on it providing a more essential service and therefore being weighted higher. The improvement of the welfare of the individuals accessing the food bank is much greater overall.

## Social Welfare

As previously stated, like the role of government, a community foundation's work is focused on improving social welfare of the community they serve. Unlike government, community foundations do not collect taxes or have a relationship with all citizens in the area, but instead rely on donations to fund their activities, as well as outreach to engage the community. This autonomy means that community foundations can set their own agendas and determine which areas they focus their support, so long as they comply with legislative guidelines. Since the concept of 'welfare' can be interpreted in different ways, it is important for community foundations to understand their community to determine areas to prioritize.

For example, in 2021 The Winnipeg Foundation distributed “\$84.9 million to approximately 1,100 charities.”<sup>10</sup> While this is objectively good news for those charities and by extension Winnipeg as a whole, the strategy of providing grants to effectively all charities in the city may not maximize social impact or overall welfare. The funding evaluation approach currently used by The Winnipeg Foundation can be described as more of a utilitarian philosophy, in other words “a social welfare function that is the sum of the individual utilities”<sup>11</sup> in society.

While focusing on being a funder that supports a broad selection of organization, with the goal of impacting the lives (and utility) of as many Winnipeggers as possible, what is not being asked is if this is the correct measure of social welfare. While it is true that access to the arts does increase the welfare of those who are fortunate enough to experience them, the weight of that increase in welfare cannot be compared to that of a person who is being provided a meal they otherwise would not have access to.

## Conclusion

Community foundations are unique charities with opportunities and obligations that are not common. Existing to support an entire community is a difficult endeavor, especially considering the community foundation itself must determine for itself what the needs of that community are and how to have the greatest social impact.

---

<sup>10</sup> <https://www.wpgfdn.org/community/the-winnipeg-foundation-announces-2021-distributions-totaled-a-record-breaking-84-9-million-to-approximately-1100-charities/>

<sup>11</sup> Hindriks and Myles; Intermediate Public Economics, Second Edition; Page 440

Using the framework of public economics, a community foundation can first define its philosophy, create a system of measurement and comparison of social impact, and finally disburse funds to the community in the most impactful way they can. Throughout this process it is important that the community foundation continues to engage with the community to best understand it and its evolving needs, as well as be able to properly weight and prioritize the needs of the worst off. Modelling and analyzing its potential disbursements are not only ways for the community foundation to continue to improve, but also builds on community engagement and trust, ultimately benefiting both the foundation and community in the long run.

In addition to all the benefits to decision making, the same tools can be used to analyze the results of the community foundation's distributions. Since the distribution cycle is annual, this will better inform the decisions of the community foundation in perpetuity.

## Bibliography

1. Community Foundations of Canada; What is a community foundation; Copyright 2018; <https://communityfoundations.ca/wp-content/uploads/2019/05/What-is-a-Community-Foundation-english.pdf> Accessed April 9, 2022
2. <https://www.icnl.org/resources/research/ijnl/an-introduction-to-canadian-tax-treatment-of-the-third-sector> Accessed April 19, 2022
3. Hindriks, Jean and Myles, Gareth D.; Intermediate Public Economics, Second Edition; The MIT Press (2013)
4. The Winnipeg Foundation; The Winnipeg Foundation announces 2021 distributions totaled a record-breaking \$84.9 million to approximately 1,100 charities; Published January 11, 2022; <https://www.wpgfdn.org/community/the-winnipeg-foundation-announces-2021-distributions-totaled-a-record-breaking-84-9-million-to-approximately-1100-charities/> Accessed April 16, 2022
5. Centre for Social Impact; About Social Impact; <https://www.csi.edu.au/about-social/#:~:text=Social%20impact%20can%20be%20defined,business%20and%20social%20purpose%20sectors>. Accessed April 27, 2022
6. Econlib; Wellbeing and Welfare; <https://www.econlib.org/library/Topics/College/wellbeingandwelfare.html> Accessed April 16, 2022
7. University of Waterloo; Wellbeing as the lens for decision-making in Canada; <https://uwaterloo.ca/canadian-index-wellbeing/> Accessed April 10, 2022
8. University of Waterloo; About the Canadian Index of Wellbeing; <https://uwaterloo.ca/canadian-index-wellbeing/about-canadian-index-wellbeing/wellbeing-canada> Accessed April 10, 2022
9. Milken Institute School of Public Health; Equity vs. Equality: What's the Difference?; November 5, 2020; <https://onlinepublichealth.gwu.edu/resources/equity-vs-equality/> Accessed April 9, 2022