

The Gates-Buffett Merger

Billions served.

BY IRWIN M. STELZER

LET'S GIVE TWO CHEERS for Bill Gates and Warren Buffett. They have given new meaning to the word philanthropy, and not only by virtue of the magnitude of the funds they are jointly deploying. Not that somewhere between \$60 billion and \$70 billion is chicken feed. The lifetime donations of philanthropist Andrew Carnegie, who famously said, "The man who dies rich, dies disgraced," came to a comparatively meager \$7 billion in today's money. The Gates Foundation—thanks to the infusion of \$31 billion or so from Buffett—will give that much away every two years. It is now more than five times the size of the \$11 billion Ford Foundation. And the \$1.36 billion spent by the Gates Foundation last year—due to double next year—came pretty close to the entire \$1.66 billion budgeted by the World Health Organization for this year.

Indeed, if this were an industrial merger of the first and second largest companies, as it is of the first and second largest philanthropies, the antitrust authorities would already be putting together teams of economists and lawyers to investigate the effect of the deal on competition.

Fortunately, the enhanced Bill and Melinda Gates Foundation does have substantial competitors. The approximately \$3 billion per year that the foundation will henceforth spend is only one percent of the \$260 billion of

annual charitable giving in the United States, according to Richard Jolly, chairman of Giving USA.

Then there are the world's governments, which are in the same business as the Gates Foundation. But those agencies give away other people's money and therefore don't effectively scrutinize the use to which those contributions and grants are put, a situation the World Bank's Paul Wolfowitz is now trying to correct. A bit of competition from a private philanthropist who knows how to get value for money might just provide a yardstick of efficiency that will embarrass even the bureaucrats who specialize in no-questions-asked handouts. It would be wonderful if the Gates-Buffett merger triggered a Schumpeterian gale of creative destruction in the global giving business.

Another advantage of the Gates-Buffett arrangement is that it sends a signal to other potential donors that it is no shame to admit that knowing how to make money involves a different skill set, to use management-consultant jargon, from knowing how to give it away. In choosing the Gateses to manage his giving, the self-effacing Buffett deployed the vaunted skill at due diligence that made him such a sought-after adviser and enabled the "Sage of Omaha" to invest so successfully over the years in Coca-Cola, Anheuser-Busch, Wells Fargo, and furniture, carpet, candy, jewelry, restaurant, and natural gas companies. "You need to seek out people with a talent to distribute money in the same way as you do for those to accumulate it," Buffett told an admiring press corps. Giving away money

is "a much tougher problem than amassing money," he added, to the surprise of all those Buffett wannabes in the hedge fund business for whom amassing is a top priority. Buffett has given huge impetus to what is being called "venture philanthropy" or "philanthrocapitalism."

His belief in Bill Gates began quite by chance. Gates's mother invited Buffett to a Seattle picnic to meet her son, who had no interest in meeting a man who made his living by investing in, rather than building, companies. But when Gates heard that Katharine Graham, then-publisher of the *Washington Post*, would also be there, he decided to attend. He did meet Buffett. They came to play bridge and vacation together. The Omaha investor persuaded the Seattle geek to read poverty studies put out by the World Bank. And the rest, as they say, is history.

The friendship is resulting in promises to accelerate progress in the fights against malaria, tuberculosis, and AIDS. Indeed, Gates, never one to think small—his software dominates the world market—told the *New York Times* that he might be "overly optimistic," but he believes he might have a real chance to find cures for the 20 leading fatal diseases and ensure that every American has a decent education. His wife thinks in similarly grand terms: Her "fondest dream" is to develop an AIDS vaccine, which she reckons could take 20 years.

So why only two cheers? For one thing, there is something odd about a policy that allows Bill Gates and Warren Buffett to transfer their huge fortunes to a private foundation, free of tax, while a much more modest gift to one's child (in excess of \$12,000 annually or \$1 million lifetime per individual giver) is subject to a gift tax of up to 46 percent. For another, it does raise a question about the sincerity of the lobbying that both Gates and Buffett did to persuade Congress to reimpose high

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inheritance taxes. After years of preaching that “dynastic wealth” violates the American principle of meritocracy, Messrs Buffett and Gates have arranged their affairs so that they will remain in control of the bulk of their fortunes for so long as they shall live, and their children will have billions of foundation money of their own to manage, with all the salaries, power and prestige that confers. If you have any doubt that running a large foundation confers about as much power as running a large business, consider press reports of the hundreds of powerful politicians who sit patiently in the Gates Foundation waiting room as Bill tries to work them into his schedule.

And remember: Gates will have an important say in how the Microsoft shares he has donated to his foundation are voted, giving him continued effective control of the company he started. For his part, Buffett will retain ownership of some \$7 billion of Berkshire Hathaway shares that he has yet to give away, plus the shares he has yet to donate during the long period of their gradual turnover to the Gateses, plus voting rights for any shares he might retain should control of the Gates Foundation’s policies and administration pass from Bill or Melinda Gates.

In short, both men will retain control of the companies they have built. And Buffett will have on his board one Bill Gates, while Gates will have one Warren Buffett sitting on the board of his foundation. Since the Sarbanes-Oxley law requires most directors to be independent of management, one can’t help wondering how eager a properly appreciative Bill Gates will be to question the management decisions of a man who has enriched his foundation with a contribution of some \$31 billion. And it is reasonable to ask whether Buffett will want to question Gates’s philanthropic decisions, at the risk of antagonizing a member of his own company’s board.

Then there is the question of “giving back,” which is what both philanthropists say they are doing. Really? It is the wonderful free-market capitalist system that allowed them to amass their great fortunes. Gates is one of the world’s most successful entrepreneurs, and arguably changed the way the world communicates and does business. He succeeded because the American system encourages geeks like him to invent things, protects their intellectual property, and provides the deep and liquid capital markets that make success for newcomers more possible in America than in any other country (think France, or Germany, from which entrepreneurs are fleeing to escape high taxes and strangling regulations). Buffett has been a successful investor in part because our capital markets are transparent, providing him with the information successful investors need.

But very little of the duo’s giving will remain in the country that made their success possible. As laudable as giving away such large sums might be, most of the money is destined for places far from our shores, and hardly constitutes “giving back” to the system that made the wealth creation possible. As Britain’s *Daily Telegraph* put it, Buffett and Gates have decided “to focus their funds largely on foreigners rather than the folks back home.”

Education is an exception. In addition to the Gates Foundation’s efforts in the field of health, it is more than dabbling in education policy. Among other things, this creates an odd alliance between Bill Gates and the man who, as head of the Department of Justice’s Antitrust Division, tried to break up Microsoft, Joel Klein. Klein is now head of the New York City school board, and the recipient of \$100 million in grants from the Gates Foundation. But in an earlier life he led the charge that resulted in Microsoft being convicted of illegal monopolistic practices in America, a conviction that since has led to similar findings and the prospect of huge

finances in the European Union and South Korea.

Gates’s history of monopolistic practices makes it more than a little ironic that he reciprocated Buffett’s generosity by presenting him with his personal copy of Adam Smith’s *Wealth of Nations*. The grateful recipient of Buffett’s billions, appropriately “awed” and “humbled” by the wealth transfer, ignored Smith’s exaltation of the virtues of free and open competitive markets, and instead chose as his text the Great Scot’s observation, “However selfish so ever man may be supposed, there are evidently some principles in his nature which interest him in the fortune of others, and render their happiness necessary to him.”

The foundation’s efforts in education have been aimed at supporting some charter schools and shrinking the size of schools and classes—the latter a long-time goal of the teachers’ unions, as it creates more jobs, even though most critics say smaller classes have no effect on educational outcomes. Stanley Katz, a Princeton professor in public and international affairs, told the *Christian Science Monitor*, “On the education side . . . they’ve spent huge amounts of money, in my judgment not very well.” Which may be a good thing if it demonstrates that the sheer size of the foundation allows it to take risks and suffer losses, and if the Gateses’ management skills allow the charity to be flexible enough to correct its giving patterns as experience dictates.

In the end, the main reason to withhold that last cheer is the perpetual power that this private foundation will have. Hugh Freund, a leading New York estate tax lawyer and planner, points out that although foundations are required to dispose of 5 percent of their assets every year, they will not fade away, as they generally earn enough to refresh their balance sheets and have a perpetual life. No problem, you might say, since the Gates Foundation’s main effort is to improve world health, and who can object to that?

But history suggests that most

foundations tilt left when their founders pass away and the next generation takes over. A hint that history will be repeated at some point comes from the concerns of the four foundations that Warren Buffett has set up, three for his children: environmental improvement; educational opportunities for low-income children; human rights; and abortion rights and antinuclear proliferation. All laudable, perhaps, but all issues high on the priority list of the liberal establishment.

The possibility that charities on the scale of the Bill and Melinda Gates Foundation might eventually throw their weight behind causes primarily appealing to one or another side in policy disputes that are essentially political in nature is one reason Congress might want to consider the policy issues raised by the Gates-Buffett merger. Is the tax code that encourages donations to private foundations, but taxes many wealth transfers by the not-so-very-rich to children, fair, especially since, as Freund puts it, “Most people can’t afford to do what Buffett did”? Should the requirement that 5 percent of a foundation’s assets be distributed every year be raised, so that these organizations are no longer self-perpetuating? Should interlocking relations on philanthropic boards count when considering whether directors of publicly held companies are truly independent of managements?

There are others. But you get the idea. Warren Buffett and Bill Gates are in the grand tradition of American private philanthropy. They will undoubtedly do much good and improve the lives of millions of people, especially if they give in a manner that encourages self-sufficiency rather than permanent dependence, and leverage their power to improve the efficiency of government-funded giving. But if we are to heed Buffett’s warnings about the evils of dynasties, we might just want to take another look at the incentives we have built into our tax laws. ♦