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# **The Third Sector: Comparative Studies of Nonprofit Organizations**

Editors

Helmut K. Anheier and Wolfgang Seibel



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## Preface

This is a volume which could not have been written a few years ago, for it represents the coming of age of a completely new field of policy research.

The systematic investigation of the non-profit sector in the United States began less than two decades ago, although of course traditional studies of charity, social welfare and cognate subjects had long existed. For a variety of reasons, most significantly deriving from the retreat from Great Society social programs, U.S. scholars of the 1970's began to identify the behavior of non-profit organizations as crucial to understanding socio-political behavior. They quickly came to locate the space occupied by a wide variety of organizations operating outside of both the political and commercial spheres.

The question for research thus became how to identify "non-profit" behavior and how to conceptualize its significance in U.S. social behavior. Scholars from a wide variety of disciplinary backgrounds began to work in the emerging field — from economics, political science, history, sociology, anthropology, psychology, education, law, social work. A number of paradigms for interpreting the role of what came to be called either the "third sector" or the "independent sector" were put forward, while at the same time empirical researchers described the sector and began to test the paradigms. By the late 1980's, it was clear that non-profit scholars had created a new field of study in the United States. The field grew and became institutionalized in university-based centers, academic departments and think-thanks. In Europe, the study of organizational forms located between the state and the commercial world predates American efforts in this area. However, it took place in the context of distinct national scholarly traditions and specialized communities. Comparative and international research questions were rarely asked. As the field in America grew, U.S. scholars very naturally began to wonder about cognate behaviors in other national cultures. National comparison research began, first in economics and then sociology and political science, in an effort to locate the culturally specific aspects of the U.S. system. Not surprisingly, Americans discovered that disciplinary colleagues abroad were exploring similar or cognate problems. They also discovered that U.S. paradigms were not necessarily appropriate in foreign contexts.

So began a series of international scholarly conferences, of which the Bad Honnef meeting was one of the earliest and best. The papers deriving from this conference constitute the core of the volume in hand, and represent the most important exemplar of current international work on non-profit organization in different countries and internationally. The essays cover a wide range of subjects, disciplinary approaches and national cultures, and

thus provide the most important approach to the national and international study of non-profit organizations published to date.

This in itself would be enough to recommend the volume, but the tumultuous events of late 1989 in Eastern Europe and the Soviet Union illuminate an aspect of the subject which was not yet fully apparent in Bad Honnef. The "transition from socialism," or whatever the democratization of Eastern Europe is to be called, immediately demands fresh thinking about the organizational alternatives to the administrative state. It may well be (and there is already evidence available) that non-profit models will prove extremely useful in the emergence of socio-political organizations poised between capitalism and socialism. If so, we shall feel grateful to the intrepid scholars who have already begun to chart the course.

The study of non-profit organizations has thus emerged as a central task of policy research for social scientists. The Anheier-Seibel volume demonstrates how much has already been accomplished by the growing international community of scholars — and it also provides an indication of how much important work remains to be done.

New York, 20 March 1990

*Stanley N. Katz*

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# Introduction

*Helmut K. Anheier and Wolfgang Seibel*

During the past few years, a substantial research agenda has begun to develop around the topic of nonprofit organizations, private voluntary organizations, philanthropic and operating foundations — in short, on those organizational forms located between the private, for-profit world and the government. We will refer to this intermediary organizational universe as the *Third Sector*. Research shows that the third sector performs important social, economic, and political functions in Western societies. In many European countries, researchers have begun to examine how nonprofits provide social services, contribute to the arts, research, and education, and, increasingly, help shape and formulate policies at local, regional, national, and even international levels. Other scholars have found that nonprofit organizations are playing an increasingly important role in the development of Third World countries. Indeed, nonprofit organizations exist in virtually all societies. Recently, eastern European countries like Hungary, Poland, and the Soviet Union have allowed, to varying degrees, the private, nonprofit provision of quasi-public goods.

When theories of nonprofit organizations were first introduced in the 1970s, the organizational universe of North America provided the background for their development. Theories either highlighted “market failure” or “government failure” or some combination of private and public deficiencies in the delivery of quasi-public goods as the reason behind the emergence of nonprofit organizations.

By the end of the 1970s, changing political and economic tides led to a reconsideration of the division between “private” and the “public” in many European countries and elsewhere. Researchers and policy-makers have begun to reexamine decentralization and privatization and to consider the third sector as a possible remedy for the “crisis of the welfare state.” In England, there is concern about the trend towards transferring social services from the government to the non-statutory sector; in France, the “associational” movement is being widely discussed; in Germany, the role of the larger welfare organizations, political foundations, and the smaller self-help organizations is under consideration. In many European countries, an increased interest in foundations and individual philanthropy is being discussed against the background of a restrictive tax structure.

Recently, researchers into the third sector have begun to compare the role — both historical and current — of nonprofits in European, Asian,

African and Latin American countries. Major questions that have been asked include: Why do different countries make different choices about the public—private division of responsibility for providing quasi-public goods and services? Why and under what conditions has the nonprofit organization developed as an institutional form? Under what circumstances does it have comparative advantage over government and profit-maximizing organizations? How do nonprofits and government bureaucracies compare with respect to quantity, quality, cost, efficiency, and distribution of services? To what extent can fees and donations replace tax revenues for financing these goods? Is private funding a desirable alternative to higher government budgets? What are the implications (for efficiency and equity) of relying on private funding versus government subsidy for the provision of quasi-public goods? What kinds of regulations are needed to mitigate the less desirable effects of privatization? What is the relationship between traditional voluntary associations, churches, and the new grassroots movements in most European countries? Can third sector organizations avoid bureaucratization and competitive entrepreneurship?

One of the major results of recent research has been the acknowledgement of the complex interdependencies between the public and the private sectors in all industrialized countries. Concepts such as “third party government,” “neo-corporatism,” or “private interest government” suggest that the distinction between government and third sector has become increasingly blurred. Moreover, analysis of the evolution and current state of the third sector tells the history of the country, and the way in which societies “choose” to govern themselves.

Estelle James was among the first to present comparative theories of nonprofit organizations. Her theory predicts a strong and positive relationship between a society’s religious heterogeneity and the size and importance of its third sector. Countries with a diversity of religious groupings such as the Netherlands develop a large third sector, while homogeneous countries like Sweden are characterized by a small third sector. While differentiated demand, based on religious preferences, explains the size of the third sectors in developed countries, excess demand for public and semi-public goods — combined with donor preferences and religious competition among suppliers — explains differences in third sectors in the Third World.

Yet despite recent advances in theories on nonprofits, many central aspects of the subject have still not been covered. Comparative research on the third sector faces several problems. Studies of the third sector differ from one country to another, according to different histories, traditions, and developments of these countries. Most European countries have accumulated a varied and broad literature on specific forms of third sector organizations, cooperatives, and firms offering public services. However, until recently, the broader scope suggested by the term third sector or nonprofit sector has



been absent from the European debate. The first editor of this volume, Helmut K. Anheier, has attempted to stimulate international exchange and collaboration among researchers by producing the *International Directory of Research on Non-Profit Organizations*, compiled for the Yale Program on Non-Profit Organizations in 1985–6. The Directory lists more than 200 researchers from more than 40 countries worldwide.

In 1986, a group of researchers from Europe and the United States formed a “*Planning Committee for the 1st European Conference on the Nonprofit Sector and the Modern Welfare State*” (members were Professors Estelle James [State University of New York, Stony Brook], Ralph Kramer [University of California, Berkeley, and Hebrew University, Jerusalem], Christoph Sachsse [University of Kassel], and the editors Anheier and Seibel). The Committee identified a group of some 50 scholars from 12 European countries, the United States, and Israel, who were each asked to propose a paper for presentation at the conference. From these the planning committee selected 30 papers for presentation. The 1987 conference aimed to draw up a list of research needs and activities which would enhance comparative as well as country-specific studies of nonprofit organizations. The conference, funded by the Stiftung Volkswagen (Volkswagen Foundation), took place in Bad Honnef, West Germany, in June 9–12, 1987. The 30 papers presented at the conference served as the matrix for the present volume.

## How to Use this Book

The book offers a survey of international research on the third sector. It does not claim to be exhaustive but incorporates the major issues of third sector research from nine countries and various academic disciplines. The study of the third sector has emerged as a truly interdisciplinary field of the social sciences. In each part of our book, we have included an introductory chapter designed to bridge the various disciplines and so assist the specialist and non-specialist reader alike. These chapters by Anheier (Part 2), Rose-Ackerman (Part 3), and Bauer (Part 4) give an overview and orientation.

Part 1 offers a general introduction to the study of the third sector. The following two parts deal with key theoretical and empirical aspects of third sector research: the question of institutional choice and organizational behavior (Part 2), and the problems of efficiency, resource dependencies, and organizational autonomy (Part 3). Finally, Part 4 presents several country studies and offers a general profile of the third sector (or special industries) in Hungary, France, Japan, Switzerland, Spain, and the Federal Republic of Germany. The chapter on Africa deals with the role of third sector organizations in the developing world.

## Acknowledgements

This book owes much to the efforts of others. It is more than a formal obligation if we express our appreciations to all those who, in one way or another, contributed. As the first editor, I would like to express my gratitude to John Simon and Paul DiMaggio of the Yale Program on Non-Profit Organizations for their intellectual guidance and support. Jürgen Reese of the University of Kassel, West Germany, and the Arbeitsgruppe Verwaltungsforschung he assembled have made the "Third Sector" known to the West German scholarship and inspired much of what resulted in the present book project.

We were particularly glad to have been able to count on Estelle James's advice and encouragement. We would also like to thank the Salzburg Seminar for American Studies who brought many of us together at Schloss Leopoldskron in June 1986. The hospitality and support of the Salzburg Seminar allowed us to concentrate on comparative research on the third sector for two weeks, and to plan the Bad Honnef conference a year later. We wish to thank Christoph Sachße and Ralph Kramer as members of the planning committee. Our thanks also go to the Stiftung Volkswagen which funded the conference and to its Secretary General, Rolf Möller. For Wolfgang Seibel the stimulating atmosphere of the Institute for Advanced Study at Princeton provided a perfect environment during the final editing of this volume.

Producing an edited volume on a relatively new and emerging research area with authors from various countries and disciplines proved a major logistical and intellectual task. Several people were of great assistance in this respect. Bianka Ralle from De Gruyter's has carefully managed our novice editorship, and has patiently tolerated more than one delay in delivering the final manuscript. Sioban Gibbons, graduate student in sociology at Rutgers, carefully read the manuscripts and helped reduce some of the stylistic and grammatical Babel created by authors of seven different mother tongues.

We would also like to thank Maria Muschong of the University of Konstanz for preparing the name and subject index for this volume.

Last but not least, we wish to thank the authors of this volume. They patiently attended to the repeated and sometimes bothersome objections, suggestions, revisions, and modifications expressed by the editors. Together, we hope that this book will contribute to comparative research on the third sector and will help stimulate cooperation amongst researchers in this field.

## **Part I**

# **The Third Sector Between the Market and the State**



## 1.1

# Sociological and Political Science Approaches to the Third Sector

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## 1. Introduction

Few countries use the American terms “*nonprofit sector*” to describe the set of organizations located between the private, for-profit, and the public sector. While the term “nonprofit sector” refers to a relatively well-defined organizational universe in the United States and perhaps in the United Kingdom, the term seems less precise when used to distinguish such sectors in most European countries (Anheier 1988). For comparative purposes, it seems useful to adopt the term “*third sector*” to designate all organizations which are neither profit-oriented businesses nor governmental agencies or bureaucracies. We assume that despite considerable differences in history, legal treatment, organizational activities, and composition, the French “*économie sociale*,” the British “*non-statutory sector*,” or the German “*gemeinnützige Organisationen*” and “*gemeinwirtschaftliche Unternehmen*,” and the American “*nonprofit sector*” share many central features.

The term “third sector” was first used by several U.S. scholars (Etzioni 1973; Levitt 1973; Nielsen 1979) and the influential *Filer Commission* (1975), and it is now increasingly applied by European researchers (Douglas 1983; Reese 1987; Reese et al. 1989; Reichard 1988; Ronge 1988). The term has both normative and strategic roots. For Etzioni (1973), the term “third sector” suggested elements of the then widely discussed convergence thesis. “Third sector” was intended to express an alternative to the disadvantages associated with both profit maximization and bureaucracy by combining the flexibility and efficiency of markets with the equity and predictability of public bureaucracy.

Due to the more visible impact of the market and the state — which together provided 97.8% of U.S. GDP in the 1970s (Rudney 1987: 56) —, discussion of the third sector was somewhat neglected by policy-makers and social scientists alike. Aware of this neglect, the *Filer Commission*, initiated by John D. Rockefeller in 1973, applied the term “third sector” as a pragmatic convention and useful shorthand to draw public and scholarly interest to these organizations. The term exists also in West Germany and Austria,

where "third sector" is applied to all those organizations which, for one reason or another, do not readily fit into the dichotomy of for-profit sector versus public sector.

It is perhaps not surprising to find that such pragmatic and apparently ideologically neutral approaches also contain normative elements. The "discovery" of a "third sector" occurred at a time when politicians and policy-makers in most Western societies began to reconsider the division of labor between the public and the private sectors, and to examine ways of reducing state responsibilities. This intensified interest in the third sector was supported not only by conservative political forces but also by others from across the political spectrum. The reasons for this new, or — in some countries — rediscovered, interest in the third sector are complex and can be only partially conveyed by catchwords such as "*new solidarity*," "*sociabilité*," "*private initiative*," "*self-reliance*," "*alternative to both market and state*," and "*reduction of big government*." The broad range of economic and social attributes which exist under the term "third sector" allow politicians to support those parts or aspects of the third sector which seem to support their own critique and interpretation of the "welfare state in crisis."

The ideological shift of the mid-1970s coincided with growing national and international economic difficulties. The public sector and expectations of what it could or should achieve moved to a more central place in the political agenda. U.S. and European scholars approached this discussion of the third sector from very different angles: Whereas U.S. social scientists — as Hall (1987) argued — viewed the third sector as an essential ingredient of a civil, liberal society, many European scholars emphasized its historical importance in conservative political scenarios (Bauer 1987; Heinze and Olk 1981). While U.S. researchers refer to de Tocqueville's observations in "*Democracy in America*" on the role of voluntary associations in a liberal and democratic society, Europeans are quick to point to the conservative goals served by the third sector in the nineteenth century, and agree with the founder of an influential Protestant welfare association, *Wichern*, that charity organizations are the "*armed daughter of the church*" for combatting atheism and socialism. Finally, whereas it took a "crisis of nonprofit sector scholarship" (Hall 1987) to make researchers realize that they had to acknowledge fully the importance of the state in order to understand the third sector in the United States, researchers in Europe found it difficult to see the third sector as an organizational universe of its own.

But does the term "third sector" signify a substantive concern that goes beyond current political debates? To what extent is the term conceptually justified? What are the major theoretical approaches used by political scientists and sociologists to understand an organizational universe which is neither market nor state? What are the criteria which differentiate the third

from the other sectors? We will briefly address these questions in the following pages.

In reviewing the available literature, we can identify three major sets of criteria that are used to differentiate the third sector from both the for-profit world and the state (Ronge 1988): institutional characteristics of organizations; the different rationales for social and economic action in the three sectors; and, finally, the institutional functions served by the organizations.

## **2. Institutional Characteristics and Classifications**

The first set of criteria — institutional characteristics of third sector organizations — appear plausible at first; yet, as already mentioned above, they fail to encompass cross-cultural variations. By applying the dual criteria “private, not for-profit” and “non-governmental,” we may distinguish a core set of organizations across different countries. But we will also exclude those types of organizations which cannot be easily classified under these headings, as such: autonomous public enterprises and administrative units, types of cooperatives, corporations of public law, quasi non-governmental organizations, state churches, certain types of foundations, and nonprofit organizations legally established as for-profit businesses.

Difficulties in classifying organizations by applying institutional characteristics such as “nonprofit” versus “for-profit” or “private” versus “public” are, to a large degree, the result of continuous shifts in what societies define as private and public, for-profit and nonprofit. We are reminded by Kramer (1981) and Kaufmann (1986) that sectoral boundaries are far from constant and have become increasingly blurred. Moreover, authors like Wuthnow (1988) and Watt (1988) argue that “private” and “public” produce a misleading dichotomy which gives the false impression of a zero-sum game between the two sectors.

Political scientists have conceptualized the third sector as an intermediary zone between market and state, and have analyzed the way in which third sector organizations act as mediators between the organized economic interests of market firms, labor, and the political interests of state agencies and their constituencies on the other (Berger 1981; Lehmbruch and Schmitter 1982; Schmitter and Lehmbruch 1979). Whereas most non-political science research on the third sector is in the tradition of either micro-economics or organizational analysis, political science research tends to describe the third sector’s macro-political functions. However, political science research in general deals with the third sector’s mediating role, and gives little attention to analysis of the sector’s service-providing organizations.

The third sector mediates between special and general interests. The central characteristic of mediating organizations in this sector is their ability to combine aspects of social and political integration with economic objectives. Several scholars demonstrate this duality in a variety of cases: Bauer (1978) links the development of voluntary welfare agencies to the emergence of social and political movements in Germany. Kramer (1981) has similar conclusions in the case of the United States and Israel. Karl and Katz (1987) suggest that large foundations in the United States served as ideological shelters for business interests.

Anheier (1988; see also chapter 4.5 in this volume) demonstrates that some European societies such as West Germany do not apply the for-profit versus nonprofit criterion with the same consistency with which they apply the public versus private dichotomy. In legal, fiscal, and administrative terms, the West German organizational universe is primarily divided along the "commercial" versus "non-commercial" line (cf. Hansmann 1980). The distinction "profit versus nonprofit" is less important in West German classification than both the "public-private" and the "commercial-non-commercial" distinctions. West German national accounts tend to recognize only the non-commercial provision of services as part of third sector GNP; however, they tend to exclude commercial for-profit and nonprofit service-provision as well as interest-mediation groups.

Few countries treat the third sector as a separate category in national account statistics (see also chapter 4.4 by Wagner); and those who do rarely report in the same detail as the for-profit and the public sector. Systems of national accounts in Italy, the United Kingdom, France, and West Germany treat the third sector in many ways as a residual category necessary to correct the GDP contributions of public and for-profit sectors, and private households. Consequently, GNP data are not directly comparable from one country to another. Moreover, only in recent years have official statistics begun to pay more attention to the employment provided by the third sector. For example, in France, the SIRENE data base system (*Système d'identification pour le répertoire des entreprises et de leurs établissements*) includes all operative organizations with at least one employee (see chapter 4.3 by Archambault; Kaminski 1987). In West-Germany, the 1970 and 1987 employment census included data on the number of third sector organizations, the type, income, number of employees, and salaries for all those which employ at least one person.

Following Venanzoni (1981), we can use data from the 1970 employment census to put the German third sector into perspective. With about 52,000 organizations, 582,000 employees, and a payroll of DM 5.8 billion, the third sector contributed about DM 7.966 billion or 1.15% to GDP, a similar contribution to that of the insurance business. The comparison with the insurance industry, however, cannot be taken too far. Insurance companies



are relatively large corporations with detailed, complete, and homogeneous accounting systems; they represent a mature industry and operate in a relatively well-defined oligopolistic market. By contrast, the third sector is composed of many small organizations which often have only rudimentary accounting and reporting procedures and operate in a highly heterogeneous field of diverse constituencies.

In some European countries, the heterogeneity of the third sector has encouraged the study of one or two particular types of nonprofit organizations rather than of the third sector as a whole. This is particularly the case in countries where the cooperative movement produced a well-developed system of cooperative enterprises, such as in Scandinavian countries, Austria, West Germany, and France. In Germany, for instance, the study of public service enterprises (*Gemeinwirtschaftslehre*) has long occupied a prominent place in the social sciences (Thiemeyer 1970).

In countries where the division of labor and spheres of influence between secular and religious powers are regulated by state law and/or contract (*concordat*), the political and legal study of religious organizations and churches looks back on a long tradition (Weber 1983). In Germany, research shows that two factors led to a well-defined sharing of responsibilities and to a complex division of labor between the state and the third sector (Rinken 1971). First, governments had active control over the early emergence of private welfare organizations in the late nineteenth and early twentieth centuries. Second, legal and financial autonomy of the welfare organizations has consistently grown by a process which, although it came late, stressed compromise rather than confrontation. As a result, in West Germany's "decentralized state and centralized society" (Katzenstein 1987), the government and large parts of the third sector are "walking hand in hand," neither very quickly nor dynamically, but smoothly and without excitement.

However, this neo-corporatist arrangement is not without its price. When, as part of the economic crisis of the 1970s, the social security system began to experience difficulties, new social movements challenged the harmony within the welfare state. Reluctantly, the neo-corporatist arrangement between the state and the traditional welfare organizations had to accommodate and incorporate the claims of the new social movements.

A comparison between the German and the French situation highlights the development of distinct national styles in the third sector (see chapter 2.5 by Hood and Schuppert). In France, the third sector was only recently discovered when the term "*économie sociale*" entered political discourse in the 1980s (see chapter 4.3 by Archambault). At that time, the third sector seemed to offer for the socialist government an alternative to both capitalist and public bureaucracy, and thus fitted well into the government's approach to decentralization. A quasi-official "*Conseil pour la vie associative*" was initiated by the government in 1982, and was followed by the appointment of a secretary of state responsible for the "*économie sociale*."

### 3. Organizational Rationales

Although it seems impossible to distill the immense body of literature on cooperative societies, public service organizations, and religious organizations into a single basic theme, we can, nevertheless, discern a common concern: how do cooperatives, autonomous public organizations, and church-related bodies fit into the dichotomy of state versus market? Can we find distinct organizational cultures and rationalities in church-related charities, independent public service corporations, or rural savings associations?

It is here that we confront a basic issue: If we assume that cooperatives, churches, charities, autonomous public organizations, or any organization located between the market and the state must operate efficiently in allocating goods and services, and obey the same rational dictum as for-profit enterprises and state bureaucracies, on what grounds can third sector organizations be distinct (see Horch 1988)? And, if they are distinct from both state and market organizations, is it this distinction that justifies their special status — for example, in tax treatment — or is it something else? More concretely, what differentiates *Crédit Agricole* or *Raiffeisenbank*, a transnational cooperative society, from giant corporations such as *Crédit Lyonnais* or *Deutsche Bank*?

One answer to these questions has been suggested by classical theorists, such as Franz Oppenheimer (1896) in the case of cooperatives, and Robert Michels (1911) in the case of political parties. Oppenheimer's law of transformation and Michels's "iron law of oligarchy" predict a general convergence and assimilation of organizational types. Similarly, Max Weber argued that bureaucracy may evolve as the ubiquitous organizational type of modern society. Since then, organizational theory has largely modified the general statements by classical theorists and has begun to consider organizational fields and environments (Hannan and Freeman 1977, 1983). DiMaggio and Powell (1983) argue that the processes of institutional isomorphism and differentiation account for the convergence as well as the divergence of organizational types.

What are the underlying rationales which form the basis of the third sector? Reichard (1988) suggests that this basis consists of four variables: means rationality, formality, solidarity, and type of exchange. Thus, third sector organizations tend to be characterized by lower degrees of means rationality and formality, and higher degrees of solidarity and direct exchange. Moreover, third sector organizations are defined by a higher degree of autonomy in relation to these aspects than either state agencies or for-profit firms. Therefore, third sector organizations are different in relative, not in absolute terms: they may be less means-rational and less formal, and they may put more emphasis on solidarity and direct exchanges than do organizations in other sectors.

To some extent, Reichard's view is a more general formulation of Powell and Friedkin's (1987) assertion that, in contrast to for-profit firms, nonprofits tend to be loosely coupled and characterized by multiple goal structures and heterogeneous, often conflicting, constituencies. Moreover, the informality of social relations within and between third sector organizations is described by Boorman (1981) and Boorman and Levitt (1982) who argue that acquaintance networks and the availability of informal resource allocation and distribution channels are the true human capital of this sector. Similar claims are made by Horch (1983) and Winkler (1988).

Solidarity and altruism as independent components are far less accepted by scholars. Following Olson (1965), micro-economic research suggests that solidarity and altruism may be interpreted as elements of individual utility maximization (Derlega and Grzelak 1982). As Boorman's work (1981) demonstrates, the often observed informality of inter-organizational relations among nonprofits rests on means-rational behavior to maximize utility, and not, as it is sometimes asserted, on notions of solidarity or altruism. Moreover, in a study on the motives of founders of foundations and philanthropic trusts, Odendahl (1987) reports that altruistic motives played, at best, a minor part.

#### 4. Sectoral Functions

The third general approach to the third sector does not analyze underlying organizational rationales nor does it investigate the *modus vivendi* of third sector organizations; rather it examines their functions and contributions to resource allocation and social welfare. For example, which third sector organizations achieve results and supply goods and services that cannot be provided by other sectors, including households?

Two broad orientations emerged from this approach. The first is represented by the American micro-economic school which views the third sector either as a combination of market and state failure within the framework of institutional choice, or as an institutional option to reduce transaction costs (see chapter 1.2 by James and Chapter 2.2 by Badelt in this volume for an overview; Rose-Ackerman 1986). Weisbrod (1977, 1988), for example, sees the third sector as compensating for the state's failure to meet minority demands for public or semi-public goods. According to Hansmann (1980, 1987), however, nonprofit organizations arise as a response to market failure, such as information asymmetries between producer and consumer. In this case, Hansmann argues, nonprofit organizations appear more trustworthy since they have fewer incentives to downgrade quality in order to increase profits.

Micro-economic approaches have been extensively criticized on various grounds (see chapters 1.2 and 2.2 by James and Badelt). For comparative purposes, their greatest deficiency is, as James argues, that they cannot explain cross-national variations in third sector size and composition, without introducing variables external to the micro-economic model, such as social, ethnic, and ideological heterogeneity. Going one step further, Salamon (1987, and chapter 3.4 in this volume) and Badelt (see chapter 2.2) argue that neither the market failure nor the state failure thesis can explain why a third sector is needed to compensate for failures in the first place. Why do market and state not compensate each other's shortcomings, as assumed in classical political economy, instead of resorting to a third sector?

Neo-corporatist theories represent the second functional approach. From this perspective, the third sector offers a buffer zone between state and society and mitigates social tensions and political conflicts. Third sector organizations take on functions which the state, for various reasons, cannot fulfill or delegate to for-profit firms (Heinze and Olk 1981; Hilbert 1988; Streeck 1983). Consequently, Seibel (1987, 1989, and chapter 2.6) argues that an essential function of the third sector is the institutionalization of organizational responses to "unsolvable" problems. Finally, Reese (1987) approaches the delegation of functions to the third sector from a different angle. He asserts that voluntary associations compensate for functions no longer fulfilled by the family which finds itself less able to integrate individuals into society and to provide services for them (Becher and Pankoke 1981; Gross 1982; Offe and Heinze 1986).

## 5. Research Strategies

We suggest two avenues for research. First of all, it seems useful to disaggregate research problems. Taking up an approach first suggested by Hansmann (1987), DiMaggio and Anheier (1990) differentiate between two major research strategies: the first tries to explain the existence of nonprofit organizations in organizational, sectoral, and societal terms, while the second shows the effects of nonprofit organizations on selected variables. Thus, the first strategy uses "nonprofit" as a dependent variable, and the second uses it as an independent variable. Together, this yields six main research questions:

The first three questions refer to "nonprofit" as a dependent variable: (1) Why are some organizations nonprofit? (2) How do we explain the division of labor among sectors, their industries, and branches? (3) Why does the prevalence of nonprofits and their organizational forms vary from one society to another? The second set of questions address "nonprofit" as an

independent variable: (4) Do nonprofits behave differently from for-profit firms and public organizations? (5) How do predominantly for-profit, public, and nonprofit industries and branches differ? (6) What is the impact of nonprofits at the national level, and are societies with a well-developed third sector in a better position to face social, political, and economic challenges than societies with a small third sector?

The second avenue for research is to abandon strict sectoralization and to proceed instead from the observation that all three sectors – for-profit, nonprofit, and public – contain fluid institutional arrangements. Population ecology, structural analysis, the theory of organizational niches (see Hannan and Freeman 1977; see Seibel's chapter 2.6), and inter-sectoral relations (Gronbjerg 1987) offer good starting points for understanding and measuring sectoral morphologies and boundaries.

With this in mind we can then focus on the exchange and adaptation processes that occur between the third sector and the for-profit and public sectors. DiMaggio and Powell (1983: 149), paraphrasing Schelling (1978: 14), observe that organizations "respond to an environment that consists of other organizations responding to their environment, which consists of organizations responding to an environment of organizations." Though some of these responses are reactions to market and political influences, we can argue that third sector organizations are less subject to market and political pressures, if we assume that means rationality is not as prevalent there as in the for-profit and public sectors. The third sector has only partial access to mechanisms of correction comparable to that of the ballot box for the public sector and that of the market for the for-profit sector.

A consequence of this is that third sector organizations, once established, may be less challenged and threatened in their survival than for-profit organizations which are subject to market considerations, or public agencies which are subject to various forms of majoritarian control. Although they may not actively seek niches, third sector organizations may carve out niches for themselves in the course of their organizational life cycle.

These niches, in turn, increase the probability of survival. In fact, few organizations in Europe are older than the foundations, and few a more stable than those linked to the Catholic church. The remarkable longevity of third sector organizations is further demonstrated by foundations in Germany, a country where few public and private organizations can look back on a history spanning more than two generations: yet about 20% of the existing German foundations were created in the nineteenth century, 10% between the sixteenth and the eighteenth centuries, and about 100 predate 1500 (Neuhoff, Schindler, and Zwingmann 1983).

Seibel (1989) shows that the survival of third sector organizations seems remarkably independent of their performance criteria. Some welfare organizations and nonprofit ambulance and emergency services continue to operate

unchallenged despite serious shortcomings and failures. The value rationality of third sector organizations makes permanent failures more likely (Meyer and Zucker 1989). Since means-rational considerations are relatively less important, members of nonprofit organizations may find it easier to divorce performance from goals. This built-in characteristic of nonprofit organizations is at one and the same time their greatest weakness and their greatest strength. It makes third sector organizations suitable candidates for "functional dilettantism," a "mellow weakness" which can be utilized by political bodies to project the illusion that "at least something is being done" (see chapter 2.6 by Seibel, and Seibel 1989).

However, the third sector, though having distinct features, is by no means independent of the government and the for-profit sectors. This interdependency is not only based on subsidies and other financial transfers. Hall (1987: 17) uses several striking examples to show the overlap between the three sectors in terms of executive career patterns. To give just one example: Robert McNamara's career brought him from the Harvard Business School, to the Ford Motor Company, to the Defense Department, and to the presidency of the World Bank, while he also served on the board of directors for the Ford Foundation, the Brookings Institution, and the California Institute of Technology (Hall 1987: 17).

Public and nonprofit sectors also overlap in the area of policy formulation. Whether at local, regional, national, or international levels, governments seem to find it increasingly difficult to formulate policies on their own. Third sector organizations, foundations, and "think tanks" in particular, serve as policy-formulating and consulting institutions for political bodies. Analyzing sectoral dependencies (Gronbjerg 1987) will most likely lead to a more explicit consideration of inter-sectoral powers and influences, and will help to explain why the third sector, despite continuing to be relatively insignificant economically, has achieved a visible and prominent status.

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## 1.2

# **Economic Theories of the Nonprofit Sector: A Comparative Perspective**

*Estelle James*

In recent years, social scientists and policy-makers have paid increasing attention to the possibility of providing quasi-public goods through private rather than public organizations. Quasi-public goods yield both social and private benefits and can be funded from either private or social sources. Common examples are health care, education, cultural activities, and social services. These are major services associated with the modern welfare state. Nonprofit organizations (NPOs) are also the major private providers of these services. Therefore, when we consider the private provision of welfare state services, we are also discussing the role of the nonprofit sector in a society. Some of the questions economists ask are: What factors determine the size of the nonprofit sector? How do nonprofits behave when they bear key responsibility for providing public services? If we shift some of the responsibility for these services from the government to the private nonprofit sector, would this make matters better or worse in terms of variables such as quantity, quality, cost, efficiency, and distributional equity?

Let me start with a brief definitional comment, which has substantive implications as well. In the U.S., the term “nonprofit organization” is commonly used and refers to a set of organizations that qualify for tax exemption and for tax-deductible donations. However, in other countries, the term nonprofit organization is much less common, and tax privileges often don’t apply. Similar organizations exist, however, and are called by many other names: non-governmental organizations (NGOs), private voluntary organizations (PVOs), or community associations, for example. The characteristic they all share in common is that they do not have owners who are entitled to receive the profits of the organization in the form of dividends or capital gains. These organizations may earn profits, but may not distribute them. Instead, all earnings must remain with the organization, and used to further the purposes of the organization.

This important characteristic of NPOs has led to the development of several economic theories that help explain which goods will be produced by the nonprofit sector (for a comprehensive survey of these theories see James and Rose-Ackerman 1986; also see Rose-Ackerman 1986). One important set of theories draws the boundary line between private NPOs and

private PMOs (see Easley and O'Hara 1983 and 1986; Fama and Jensen 1983a and 1983b; Hansmann 1980 and 1986; Krashinsky 1986; Nelson and Krashinsky 1973; Thompson 1980). They stress that NPOs will be found in situations where consumers don't have enough information to evaluate the quality of a product and therefore must place their trust in the enterprise that is producing it. In such situations, consumers may be more willing to trust nonprofits, because profit-maximizing managers would have an incentive to downgrade quality, but this incentive is weakened in nonprofits by the non-distribution constraint. The basic idea is that if managers cannot benefit financially by receiving profits, they will be less likely to cheat consumers; therefore nonprofits are more trustworthy. For similar reasons, potential donors (of money or of volunteer labor) are more willing to donate to NPOs because nonprofits are more likely to use donations for the intended purpose. Thus, nonprofits develop where trustworthiness is important, because many small customers or donors do not have adequate information about the product. Examples are frequently given from the fields of education and health services where consumers clearly have problems in measuring quality.

While the non-distribution constraint is thus said to make nonprofits more trustworthy, another line of theory suggests it also makes them less efficient. If no one has a "property right" in the residual, no one has an incentive to keep the organization free from sloth and waste. This tendency toward inefficiency is the other side of the coin of the tendency toward trustworthiness, implied by economic theory (see Alchian and Kessel 1962; Alchian and Demsetz 1972; Clarkson and Martin 1980; Leibenstein 1966; Steinberg 1986). Nonprofit managers may also divert excessive revenues to staff and emoluments (see Williamson 1964, for a discussion of expense preference); and may downgrade the quality of one good in order to cross-subsidize another which he or she prefers (James 1978, 1983, 1986a; James and Neuberger 1981).

While these theories based on consumer information and the non-distribution constraint may help explain the American situation, where private fees and donations are a major source of nonprofit revenues, they do not help us with many of the questions we would like to answer about other countries. Three such questions are particularly important for our purposes. (These questions, as well as answers based on international experience, are also discussed in James 1988b.)

First, theories based on the American experience alone ignore the fact that NPOs in many countries are in competition with government, not with for-profit firms. Therefore, we need to draw the line between government and NPOs, to explain why government is used in some cases, nonprofit provision in others. This is the question we must address, in particular, when

we are considering the best way to provide public services in the modern welfare state.

Second, we observe that, while government is a substitute for NPO's in production, it is usually a complement in financing. Indeed, from a worldwide point of view, private philanthropy is insignificant while government subsidies are a crucial source of funds to nonprofit organizations, particularly in countries where the nonprofit sector is large. Therefore, we need to explain why governments contribute resources to NPOs which may be competing with them. And we also need to explore some of the problems that this creates.

Third, these theories do not explain why the nonprofit sector varies so widely from one country to another.

Weisbrod's work (1977, 1980) provides a starting point for the answers to some of these questions. Weisbrod views nonprofit organizations, particularly those financed by donations, as providers of goods with "external" benefits, i. e. quasi-public goods, in situations where government does not produce as much service or the precise kind of service that people demand. My own work provides empirical evidence that nonprofit provision has emerged as a market response to excess demand or differentiated demand. Using education as an example, many private schools exist in developing countries because the public school capacity is not large enough to enroll everyone who wants to attend. If the private rate of return is high, people are willing to pay for a privately produced service. In modern societies, private schools exist as a result of differentiated tastes, often stemming from deep-seated cultural (religious, linguistic) heterogeneity. The more heterogeneous the society, the larger we would expect the private sector to be, and empirical work I have done confirms this expectation (see James 1984, 1986b, 1986c, 1987a, 1987b; James and Rose-Ackerman 1986).

My work also shows that the entrepreneurship for nonprofit provision of education, health, and social services, historically, has come from religious (or other ideological) groups. It is important to note that service-providing nonprofits are typically started not by individual entrepreneurs, but by religious or other ideologically motivated organizations; by providing education, health, and other vital social services, they hope to maximize faith or adherents rather than profits. Thus, we would expect to find nonprofits concentrated in areas with strong independent religious groups competing for clients — currently or in the recent past. Again, my empirical research confirms this expectation (see James 1982, 1984, 1986b, 1986c, 1987a, 1988a; also see Rose-Ackerman 1982, 1983a, 1983b).

As mentioned above, the funding for NPO services, especially in modern welfare states, comes primarily from the government. While philanthropy plays an important role in the American nonprofit scene, and private fees are important in developing countries, in most advanced industrial states,

government subsidies are the major source of revenue (see James 1987b, 1987c, 1988b). (Even in the U.S., recent evidence indicates that subsidies are large, especially when implicit tax subsidies are taken into account; see Hodgkinson and Weitzman 1984; Salamon 1981, 1987; Smith and Rosenbaum 1981.) Thus, when we describe the division of responsibility between the state and the nonprofit sector for providing welfare state services, we must distinguish between production responsibility and funding responsibility. Funding responsibility is usually retained by the government, even when the private sector carried out production.

The important question then becomes: Why does the government sometimes delegate production of public goods rather than producing itself, and what differences does this make? The work that I as well as other social scientists have been doing suggests some of the answers (see Anheier 1988; Hills 1988; James 1982, 1988b; Kramer 1981; Seibel 1988; Smith 1988). First, if policy-makers prefer (or face pressure) to provide services differentiated by language, religion, etc., delegation of production responsibilities to NPOs is one way to achieve this objective. In some instances, especially in modern societies, the religious organizations that wish to provide these services are politically powerful enough to obtain subsidies. One consequence of providing education, health, and other social services through NPOs in this case is the segmentation of the population along religious (and sometimes linguistic or ethnic) lines. Some people may consider this desirable, others may consider it very undesirable, indeed dangerous to the cohesion of a society (see James 1984, on the Dutch case).

Second, private organizations can more easily charge fees for services, so the government's share of total cost is reduced when production responsibility is delegated to them; more people can be served for the same public expenditures. For example, private schools in many countries, especially in developing countries, charge tuition which covers part of their costs, and governments in modern welfare states may also wish to pass on some of the burden to private sources (although this may, in fact, turn out not to be possible) (see James and Benjamin 1988 on the case of Japan).

Third, private organizations may also generate lower costs than government institutions, especially for labor. This is partly because such organizations do not face civil service wages and other constraints, and partly because, historically, they have benefitted from voluntary donations of time as well as money. Both these factors lead private service suppliers to pay lower wages than public on average, hence to have lower costs (see James and Benjamin 1988; Knapp 1988).

It is not clear, however, whether these lower costs imply lower quality or greater efficiency. This is what we would very much like to know but find it hard to determine because it requires us to measure the value added by the organization. Public and private schools, public and private hospitals

often deal with different kinds of customers (students with different backgrounds and prior learning, patients with different diagnoses), so if they obtain differential results, we don't know whether this is due to consumer differences *ex ante* or to the differential value added by the institution. This is a very fertile area for research, and some studies along these lines are included in this volume. Nevertheless, despite our inability to measure value added or quality, subsidies to lower-cost private producers enable the government to increase output with less taxes and are therefore tempting.

It is ironical that the subsidies, in turn, lead the private organizations to become regulated, higher cost, and therefore similar to the public sector in many respects. In many countries I have studied, these regulations pertain to inputs, rather than outputs. For example, they require salaries and working conditions that are equivalent to those in the civil service. They lead to the use of paid credentialed labor rather than volunteer labor. These rules and consequences eliminate the initial cost advantage that nonprofits may have had.

Controls extend, too, over the distribution of service, e. g. the criteria for selecting recipients and the price that can be charged, etc. The rationale is that if government is providing the funds it also wants to influence the distribution of benefits from these services, and therefore satisfy diverse political constituencies.

One of the most interesting regulations concerns the decision-making process in NPOs. For example, in some countries, NPOs must share decision-making authority with workers and consumers. This is one way to retain public accountability and control while delegating production responsibilities. It follows from this discussion that, while "private nonprofit" may remain an unambiguous legal category, the public—private breakdown of funding and management is much more mixed and continuous. In reality, NPOs are a public—private hybrid which makes the analysis of these organizations very complex. And in some cases, the public funding and regulations proceed to a point where nonprofits are virtually indistinguishable from government organizations; in effect, the nonprofits have been "nationalized," not by a hostile "takeover" of assets but by the "gift" of subsidies, which inevitably go together with controls (e. g. the voluntary schools in the U.K., and the religious schools in Holland) (see James 1984 for the Dutch case; for a detailed discussion of government subsidies and the controls that accompany them in a sample of 35 countries, see James 1987c).

Does the delegation of production responsibility to nonprofits increase the variety and choice available to consumers, raise the quantity and quality of services, and decrease their costs, thereby improving the situation, or does it mean more waste, less accountability and equity, thereby making matters worse? If subsidies are given, thereby implying tax revenues are being used to support nonprofits, should the nonprofits correspondingly be subject to

social controls over their activities, and if so, what form should these controls take? What are the probable economic consequences of alternative public policies toward nonprofits? These questions are at the forefront of current research on the nonprofit sector.

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