Bookshelf

The Nonprofit Sector: A Research Handbook

Edited by Walter W. Powell

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During the last decade, a large body of literature has emerged from the Program on Non-profit Organizations based at the Institution for Social and Policy Studies at Yale University. *The Nonprofit Sector: A Research Handbook* is a useful compedium of much of this literature. Under the expert guidance of editor Walter Powell, 24 separate essays by 28 authors have been brought together "... to produce a state-of-the-art review and assessment of scholarly research on the non-profit sector" (page xi). To this end Professor Powell and his associates deserve a resounding "well done", for even though the handbook provides few new insights, it does set forth "a thorough and realistic appraisal" of the existing literature on the non-profit sector.

The material in the handbook is set primarily within the American context, and is organized into six parts and 24 rather heterogeneous chapters. The first section, which provides an overview of the non-profit sector, is sufficiently broad in scope to be of interest to anyone with a curiosity about that sector. It contains four chapters that, respectively, provide: an historical perspective; an examination of some economic theories; a discussion of the non-profit sector in the context of political theory; and a study of the empirical dimensions of the non-profit sector in the United States.

Part Two, "The Nonprofit Sector, the State, and Private Enterprise," will be of particular interest to economists. It begins with a chapter on the tax treatment of non-profit organizations at the state and federal levels. A conceptualization of the interactive relationship of government and the non-profit sector is attempted in the next chapter and, finally, the non-profit sector is compared and contrasted with the for-profit market.

Those concerned with the administrative side of non-profit organizations will find the third section helpful. Its four chapters illuminate important organizational and management issues, including the governance function of boards of directors, measurements of non-profit organization performance, executive leadership, and organizational change.

What can best be described as "sociological issues in the non-profit sector" are presented in the six chapters of Part Four which provides a cursory examination of the functions the non-profit sector performs in society. This section is by no means exhaustive. Rather, it focuses on what the editor calls, "the core functions", i.e., those areas where the non-profit sector is either the "predominant" actor or plays a "particularly vital role." These areas include culture, health care, personal social services, education, neighbourhood organizations, and policy advocacy.

Fund-raising consultants will find section five useful. Entitled "Sources of Support for Nonprofit Organizations," this part of the handbook examines personal, corporate, and foundation giving and, in its last chapter, enterprise and commerce within non-profit organizations.

The final section of the handbook moves beyond the American context of the earlier chapters in three essays which examine the role of the non-profit sector in other industrialized and developing nations. The critical role of organized religion and the importance of cultural heterogeneity in the development of the non-profit sector are discussed and some interesting evidence relating to indigenous voluntary associations in Africa is examined. The last chapter considers the question: "Producer Cooperatives: Why Do They Exist in Capitalist Economies?"

The last few paragraphs reveal the extreme diversity of the 24 chapters comprising *The Nonprofit Sector: A Research Handbook*. This is to the credit of the authors who have succeeded fairly well in fulfilling the purpose of the handbook: "... to build a solid foundation under the burgeoning field of multidisciplinary scholarship on the nonprofit sector" (page xi). Indeed, attempts by the contributors to address scholars from their own field of study, and at the same time make their points intelligible to readers not conversant with the language of the contributor's discipline, or cognizant of that discipline's assumptions, have, for the most part, met with success.

This heterogeneity occasionally moves beyond a multidisciplinary perspective to one of intradisciplinary diversity. Many of the contributors make valiant attempts to present, in an unbiased manner, widely divergent theoretical approaches to the same problem. Unfortunately, others do not. Indeed, some of the authors (particularly Lester M. Salamon in chapter six, "Partners in Public Service: The Scope and Theory of Government-Nonprofit Relations") are predisposed to the notion that the non-profit sector has a closer relation to the government sector than to the voluntary for-profit market. Consequently, they neglect much of the literature that views the emergence of the non-profit sector, and activity within the sector, within the framework of the market process. This is an unfortunate shortcoming. However, one important exception to this narrowness of viewpoint is the chapter by James Douglas, "Political Theories of Nonprofit Organizations" (pages 43–54). Professor Douglas makes a clear and persistent point that should be remembered by all scholars who examine the non-profit sector:

> The most obvious distinctive characteristic of a state service is that it can invoke the coercive power of law . . . this power is most frequently used to commandeer money through compulsory taxation. Organizations in the private sector (both for-profit and nonprofit) have no such power to commandeer the resources they need. They must either exchange something they own (or to which they have some form of title) for something they need or rely on tapping some vein of generosity . . . Exchange also plays a part in the transactions of the voluntary nonprofit sector. Indeed if we use the term exchange in a sufficiently broad sense, it can be made to cover even the most altruistic of voluntary endeavors (p.44).

One concept that has permeated, in one way or another, many of the contributions to the handbook is called the "nondistributional constraint." This arises from the legal rule that non-profit organizations must not distribute profits to a residual claimant(s) such as a single owner, shareholders, or a board of directors. This concept is given prominence in the chapters dealing with economic theory. Indeed, Henry Hansmann (chapter three, "Economic Theories of Nonprofit Organizations"), uses the nondistributional constraint as the foundation of a theory which he believes explains why non-profit organizations emerge in a capitalist economy.

The "Contract Failure Theory," as it is called, has become the dominant theme in most of the economic theories coming out of Yale's Program on Non-Profit Organizations, but in my view it is based on some rather tenuous percepts. The theory postulates that, since there are certain goods and services whose quality and quantity are difficult for the consumer to judge, an incentive exists for the profit-seeking entrepreneur who is selling such goods or services to cheat on the contract and increase profits by delivering an inferior product or none at all. Non-profit organizations, however, face the legal "nondistributional constraint," which removes the incentive to cheat since then there *are* no profits. The public is thus better served by non-profit organizations in areas where it cannot make an informed judgment about quality or performance. (Examples might include health and education services.)

On the surface this may sound like a good explanation for the emergence of non-profit firms but, in fact, it is founded on faulty premises. To begin with there are very few (if any) goods or services whose output it is impossible to monitor, so these potential cheating situations will seldom arise. However, even when output *is* difficult to monitor, we can always monitor inputs. If inputs are being used effectively it is a good bet that the output is of superior quality. A firm that takes great care to insure a smoothly run and innovative production process will almost certainly produce a superior product simply because the product is the result of the production process. In a sense, the one necessarily follows from the other.

But none of this says anything about why an entrepreneur should ever be honest. In fact, it is competition amongst profit seekers that keeps them honest. The dishonest firm will quickly lose patrons to its more honest competitor and be forced to go out of business or change its ways. Entrepreneurs compete at all levels with their rivals, so even if consumers can only scrutinize the production process (and not output), then firms will compete for those consumers by displaying more innovative and effective production techniques. Competition can exist in the efficient use of inputs just as readily as it exists in the realm of output quality. As long as competition, or even the perceived threat of competition, exists the entrepreneur has an incentive to be honest.

Suppose we grant that under these circumstances the owners of for-profit firms have an incentive to be dishonest, why should we believe that non-profit firms will be any more trustworthy? Indeed, the theory says nothing about why the non-profit firm should be regarded as intrinsically trustworthy. It does say that the for-profit firm has the potential for dishonesty because extra profits can supposedly be extracted by cheating but does not note that the same argument can be directed toward the non-profit firm. It is true that a non-profit firm faces the nondistributional constraint and cannot legally distribute its net revenues amongst its members or a single residual claimant as monetary profit, but this does not mean that the members or a single member (owner) do not claim non-monetary profits. Indeed, most of us recognize that volunteers of all sorts gain tremendous psychic profit from their work. Is there a difference in principle between monetary profit and psychic profit?

We tend to assume that volunteers donate their time for honourable or selfless reasons but in reality there is nothing to substantiate this belief. In fact, we hear of perverted individuals volunteering their time to day care centers, for example, for very improper reasons. So if we cannot monitor output (and according to the theory we must be able to do so in order to see that no cheating occurs), how can we ever know for sure that the non-profit firm isn't fraudulent, or worse, sickly deranged?

Furthermore, we have said nothing about the fact that many volunteer organizations or "charities" pay wages to some of their officers and staff. Would not these individuals have an incentive to cheat by, for example, pretending that the organization was continuing to do its work long after its actual usefulness had ended?

How, then, do the proponents of the "Contract Failure Theory of Nonprofit Firms" conclude that non-profit firms are by nature trustworthy? It is my belief that they arrive at their position via the fallacy of historicism, which mistakenly attempts to derive economic understanding solely from historical observations. For example, they might argue that since most non-profit firms are trustworthy then it must be the case that non-profit firms are by nature trustworthy.

This conclusion is, unfortunately, not a proof of the honest economic nature of non-profit firms. Rather it attempts to attribute more to an historical observation than can be deduced logically. The fact that in the past the behaviour of non-profit organizations has, on the whole, tended to be trustworthy contributes nothing to our understanding of why this should be so and therefore contributes nothing to economic theory. In the words of the late Austrian economist Ludwig von Mises "(t)he antagonism between economics and historicism does not concern the historical facts. It concerns the interpretation of the facts. In investigating and narrating facts a scholar may provide a valuable contribution to history, but he does not contribute to the increase and perfection of economic knowledge."[2]

Furthermore, it is possible that the main participants in a non-profit firm have fraudulent intentions for the organization upon its initiation but, due to the competitive element in the non-profit sector, are forced to either withdraw the organization from the market or to "shape up". It is important to recognize that donations are scarce and that competition for them is fierce. Even though a non-profit organization may wish to cheat, it cannot be successful in the long run if it operates in this manner. This may explain why we observe that, on the whole, non-profit organizations tend to be trustorthy, just as it explains why, on the whole, for-profit firms are also found to be trustworthy.

If we apply the Contract Failure Theory consistently we can only arrive at its conclusions by faith. This is not to argue that faith is without merit; it is simply to point out that such a theory will not be taken seriously by most economists.

Despite these shortcomings *The Nonprofit Sector: A Research Handbook* is a coherent and well-written compilation that does credit to the competence of its editor. In particular, it is an exceptionally useful resource guide to the rather scattered literature on the non-profit sector. It would be a welcome addition to the library of anyone interested in non-profit organizations, if for no other reason than because it provides a fine example of the work of those actively participating in, or associated with, Yale's Program on Non-Profit Organizations.

FOOTNOTES

1. Mark D. Hughes is currently doing graduate work in economics at George Mason University and is the author of *The Political Economy of the Third Sector: the Nature and Significance of Charity, Voluntarism, and Philanthropy in Canada* which will be published shortly by the Fraser Institute.

2. Ludwig von Mises, *Theory and History*, (Auburn, Alabama: The Ludwig von Mises Institute, 1985), p.209.