Bookshelf

The Economics of Non-Profit Institutions: Studies in Structure and Policy

Edited by Susan Rose-Ackerman

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This book of essays is one of a series of research publications which have emerged from Yale University's Program on Non-profit Organizations that was launched in 1977. The founding of the Yale program was motivated by the view that much research and public policy analysis have falsely dichotomized institutional and organizational choices into "public sector" and "private sector" modes of production and delivery, while largely ignoring the practical and theoretical importance of a third option—the "independent" or "voluntary" or "non-profit" sector. This particular volume in the Yale series brings principally an economic perspective to bear on explanations for the existence and growth of this third sector and on a range of public policy issues that directly affect the vitality and prospects for the sector.

Two general classes of demand-side explanations for the existence of the non-profit sector are offered by contributors to the volume. First, Weisbrod offers a theory of government failure that is offset by the growth of non-profits. The theory holds that the public sector will be primarily responsive to the median voter when it generates new programs and services. This implies that smaller groups of people with high demands for collective goods may not have their demands met by government and will instead turn to the non-profit sector. Hansmann, on the other hand, offers a theory of private market failure which holds that where consumers or donors are not well placed to evaluate the quality or quantity of the goods or services being delivered, the inability of non-profits to distribute surplus funds to their owners or principals removes one of the incentives that for-profit enterprises have to reduce the quality undetected. Krashinsky suggests a further form of private market failure in cases where goods or services generate positive externalities and would be underproduced by the private sector because "free riders" would take advantage of the benefits without sharing the costs. Non-profit enterprises may be able to contain this problem through appeals to a sense of community and altruism.

Supply-side explanations for the emergence of non-profit enterprises are somewhat less fully developed in the book, but Young suggests that a natural screening process exists which channels entrepreneurs with certain kinds of characteristics and motivations into the public sector, the for-profit private sector, or the non-profit sector. This is not a tightly specified model, although it is descriptively suggested.

Contributors to the volume focus on four aspects of public policy that bear directly on the welfare of the non-profit sector: (a) the charitable deduction; (b) government grants to non-profits and the effects of government transfer programs generally on the evolution of the non-profit sector; (c) fund raising by non-profits and its regulation; and (d) the corporate income tax exemption of non-profits.

One of the strengths of the volume is that, on a number of these issues, a diversity of views is presented and contributors often explicitly debate with one another. For example, discussing the charitable contribution, Hochman and Rodgers argue that a tax credit rather than a tax deduction is a more appropriate response to the undersupply problem generated by free riders, in large part because there seems no reason to suppose that the positive externalities associated with activities supported by high-income taxpayers (for whom a deduction is more valuable than a credit) are greater than the positive externalities associated with activities supported by lower-income taxpayers. This view is then challenged by both Strnad and Simon, for slightly different reasons. Strnad argues that the charitable deduction may reflect a Pareto-efficient political bargain between high- and low-income individuals, whereby high-income taxpayers derive significant advantages from the charitable deduction but the spillover benefits for lower income taxpayers leave the latter no worse off by virtue of a deduction rather than, for example, a tax credit. Simon argues that in principle the charitable deduction violates notions of equality of treatment, but suggests that for pragmatic reasons the deduction may be defensible to the extent that it encourages large-scale donors to support activities that would be much less easy to initiate if they depended on dispersed small-scale fund raising from low-income taxpayers.

As to the effect of government grants to charities, Rose-Ackerman disputes a widely held view that these are likely to reduce private donations. She suggests that, for example, matching grants actually reduce the "price" of charitable donations. In addition, such grants create the potential for the government, through regulation or other policies, to induce a better quality or quantity of output from non-profit providers than would be induced by dispersed donors. However, Abrams and Schmitz find empirical evidence that government transfer programs have a partial "crowding-out" effect on private contributions, as donors reduce contributions to the non-profit sector in light of increased tax demands made to underwrite government transfer programs.

Rose-Ackerman argues that excessive fund-raising activities and excessive fund-raising costs are a concern to the extent one assumes an atomistic market for non-profits with free entry, where entry is likely to occur until the point is reached where fund-raising costs exactly equal returns from fund-raising efforts. This might suggest a case for some formal restrictions on entry or for the promotion of united charities operating as umbrellas for smaller organizations, although such restrictions would entail some trade-off in reduced diversity in the non-profit sector.

Hansmann offers a novel rationale for the exemption of non-profit organizations from corporate income taxation. He sees the exemption as a form of compensation for difficulties in capital-raising created by the non-distribution constraint imposed by law on non-profit associations. This rule makes it next to impossible for non-profits to raise equity capital, since distribution of any portion of their revenues to residual claimants is prohibited. To the extent that one believes that non-profit enterprises are more efficient in some contexts than for-profit enterprises, e.g., because of private market failure induced by information asymmetries (noted above), one will approve the policy by which the income tax exemption facilitates expansion by non-profits out of retained earnings which, in the case of for-profits, would be subject to tax.

These brief comments will, I hope, provide some indication of the general orientation of the volume. There are many other useful contributions and, unlike many collective works by diverse contributors, the contributions to this volume are remarkably consistent in the high quality of their analysis.

I note only two substantive criticisms. First, the volume lacks any systematic historical perspective. Both Hansmann (at page 82) and Weisbrod and Schlesinger (at page 147) refer to data that suggest a very rapid recent growth in the number of non-profit organizations in the United States. On the other hand, Abrams and Schmitz point to data suggesting a high level of constancy in private charitable contributions per taxpayer over recent decades, suggesting that governmental transfers have been shouldering a greater relative share of the social welfare burden. A longer and more systematic historical perspective is crucial to figuring out the relationship between the non-profit sector and the public sector on the one flank and the for-profit private sector on the other, and the determinants over time of the relative roles of each of these three sectors. This issue was broached provocatively by Professor Albert Breton in his 1988 Presidential Address to the Canadian Economics Association ("The Growth of Competitive Governments" (1989), 22 *Canadian J. Ecs.* 717) and seems to warrant further exploration.

A second and related criticism pertains to the absence of any systematic comparative perspective in the contributions to this volume. Hansmann, for example, suggests that the bulk of the growth in the non-profit sector in recent years relates to hospital care and private education, particularly post-secondary education. Given the predominance of public provision of services in these two sectors in many other countries, it is not clear that the same growth rates in the non-profit sector would be observable elsewhere. The different roles assigned to the three sectors from one country to the next might suggest that economic analysis of the strengths and weaknesses of alternative organizational forms may not exhaust all the reasons for the role assigned by different societies to the non-profit sector. Perhaps some significant scope needs to be recognized for the role of ideas and ideology. This again is an issue that seems to warrant further exploration.

However, these two criticisms do not detract from my overall judgment of this book, which has led me (and I suspect many other readers) first to view the non-profit sector as warranting more serious attention than it has hitherto received in academic research, and second, to try to think more systematically about the determinants of the role of this sector rather than viewing it as simply an anomalous legacy of history or the product of non-economic, random, altruistic behaviour which defies analysis.