The Importance of the Not-for-profit Sector in the International Community

(Paul Atkinson’s speaking notes, 7 September 2006)

[SLIDE 2]

Introduction

• Thank you, President Flannery. I am pleased to have the opportunity to speak to Workability International’s Annual Conference today about the non-profit sector.

• It is particularly gratifying given that I have no special expertise whatever in helping the disabled.

• I am going to focus instead on the wider sector and its place in the overall economic and social context.

• The not-for-profit sector – sometimes referred to as the third sector, the voluntary sector or civil society -- includes a large and heterogeneous collection of organizations whose purpose is not profits. It ranges from charitable foundations to sports clubs and soup kitchens.

• One consequence of the heterogeneity of scope and purpose is that, especially outside the United States, we know relatively little about the sector in overall terms. The European Commission produced a communication nearly 10 years ago; and the Johns Hopkins University Comparative Study has been an important source of conceptual work and such real data as we have (covering up to 40 countries).

• [I have provided copies of several tables printed from the Hopkins web site which provide more country detail, for reference, than I can put in a power point.]

• There are some US-based research centers (Hauser at Harvard, Urban Institute, Indiana University) that do both empirical and policy analytic work. There is relatively less in many other countries.

• Another consequence of the sector's heterogeneity is that its overall governance does not fall within the responsibility of individual ministries or agencies in national administrations. So little attention has been given to the overall design of policy as it affects the sector as a whole.
• This has led the European Commission in the communication I just mentioned to describe the sector as operating “in what amounts, at least in strategic terms, to a policy vacuum”. I suspect this applies pretty well elsewhere.

• I cannot cover everything today. I want to focus on the challenges that prospective ageing populations will create over the medium to longer term, especially in advanced countries, their likely impact on the sector, and the contribution non-profits such as Workability International can make to meeting them.

• I would like to spend around half my presentation providing an overview of what we know about the sector. I will spend the rest of my time trying to identify some avenues that could be pursued in strengthening its contribution as societies age.

[SLIDE 3]

Overview of the not-for-profit sector

[SLIDE 4]

What is the not-for-profit sector?

• Intuitively we are talking about those parts of the economic system that do not fit easily into standard categories.

• It is not households or persons, not businesses, not the state.

• It is private organizations that are philanthropic or operate otherwise on a non-commercial basis. Sometimes the term “social enterprise” is used. These organizations often enjoy some favorable tax status. This may be on the funding side, the operations side or both.

• Definitions can be debated. There are gray areas but they are mainly important for statistical purposes. Larger issues don’t turn on them.

• The Johns Hopkins project, in collaboration with the UN Statistics Division, arrived at a definition based not on activities but on certain structural or operational features of organizations:
  1. Formality: there is some structure and regularity to operations, with people subject to rules and procedures.
  2. Private: they are not part of the state, even if dependent on state funding.
3. *Non-profit distribution*: they are not primarily commercial in purpose and any profits get channeled back to the objectives of the organization.
4. *Self-governing*: they have mechanisms of internal governance and control their own affairs;
5. *Voluntary*: participation is not legally required or otherwise compulsory.

- Some points to note:
  1. This does not require contributing to public good, which may be the basis for any favorable tax status.
  2. It includes organizations whose benefits primarily accrue to its own members, such as trade unions, housing associations and religious groups.
  3. “Voluntary” does not imply any meaningful giving of time or money, although these are important features of much of the sector.

**[SLIDE 5]**

**Table 1**

*How is the sector funded?*

- According to the Johns Hopkins work, non-profit organizations in developed countries receive around 48 percent of their financial resources from government support. [Highlighted in blue.]

- Income the sector generates for itself provides around 45% of the total. This is mainly fees and services, but also contracts, other trading income and investment income, which is obviously important for foundations and other endowed institutions.

- Philanthropy therefore amounts to just 7% of total financial resources.

- If volunteering, i.e. the giving of time, is included, philanthropy rises to nearly 30% of the total.

- These figures mask wide variations across countries. I’ll return to this.

**[SLIDE 6]**

*Why is the sector important?*

- The voluntary sector is significant in macroeconomic terms.
  1. Operating expenditures in 37 countries studied -- including all major developed countries -- average above 5% of GDP.
  2. In aggregate, $1.6 trillion (2002 US dollars). About the same as UK GDP.
3. The sector also occupies an important part of the workforce. In developed countries, its paid employment averages 4.7% of the workforce.
4. Furthermore, 15% of the adult population average more than half a day per week volunteering, contributing another 2.7% of the active workforce on a full time equivalent basis (FTE).
5. In developing and transition economies these figures are smaller, around ¼ of those for developed countries.
6. Overall, the civil society workforce amounts to around 7.4% of the active population in developed countries and 4.4% for the total Hopkins sample. [Caution: it is difficult to say that the developing and transition economies covered in the Hopkins study are representative.]

Non-profit organizations are also important for what they do. They fill important gaps between the state and the market.
1. Charitable foundations finance, and non-profit organizations deliver, a significant share of the social services available in many countries.
2. They often address neglected problems that neither the market nor the state can confront.
3. They perform an important advocacy role, calling attention to new issues and working to find solutions.
4. They serve as important infrastructure for artistic, religious, cultural, recreational, political and humanitarian activities that enrich our lives.
5. [Workability International and its affiliates would seem to illustrate these points quite well.]

These gaps between what the state and the market can do may become larger and more important as populations get older and age-related budget pressures rise.
[We get to a very core issue here. First and foremost for governments. But by extension, for anyone benefiting from public funding or whose private funding could be hurt by tax increases.]

1. Ageing of populations worldwide, but especially in Europe and Japan, over the next 50 years will be dramatic.

[SLIDE 10]  
[Chart]

2. Government budget pressures are going to rise in line.

3. Old-age pensions and medical care will be the main items affected.

4. But early retirement programs and long-term care may also be significant in some countries.

5. Offsetting these will be reduced spending on education and on family and child allowances.

[SLIDE 11]  
[Table 2]

6. A recent study carried out in national administrations but coordinated by OECD merits examination. [Focus on the left hand column. Note that I have included a more complete paper copy of this table with the Hopkins tables I have circulated.]

7. With today’s generosity of pension systems, old-age pension spending can be expected to rise by around 5% of GDP over the next 50 years in developed countries due to demographic change alone.

8. This is not the future level but the increase from now. The US, UK and Australia face relatively less pressure than most. Japan and continental Europe will be more severely affected. Since demographics are largely known, this is a pretty hard figure.

9. The other items affecting age-related spending [middle column] are more speculative and require strong assumptions about the future evolution of social policies, including those affecting the labor market.

10. A number of EU countries and Japan project savings here, often substantial ones. [Note the negative numbers.] This seems hard to believe. Significant but politically difficult reductions in pension
generosity are incorporated into many of these calculations. And the largest continental European economies did not even do the calculations. Given the pressure that is likely on health care costs it will take a great deal of political courage for these savings to be realized.

11. Indeed, for the non-EU countries other than Japan that participated these other items generally imply an additional 3% of GDP in increased age-related spending.

12. The inevitable result of this will be significant pressure for reductions in other types of public spending and/or increases in taxation.

13. This is probably the most important message I have to give in my presentation today. Age-related budgetary pressure will be the dominant feature of the financial environment in which organizations like Workability International and its affiliates operate as early as 2010 and for the foreseeable future beyond.

14. Norms and traditions about the role of the state vary across countries. But wherever the margins are, fiscal pressures are likely to force nearly all countries to take an increasingly narrow view of what the state can finance on its own.

15. In this circumstance, both opportunities and challenges will confront non-profit organizations. They have the potential to complement public sector efforts where market mechanisms cannot deliver or are believed to be inappropriate. But this is provided they can finance themselves from donations, volunteers, fees, subscriptions and trading income.

[SLIDE 12]

How can we take advantage of the not-for-profit sector’s potential?

[SLIDE 13]

Mobilize private resources

- Since the state typically provides nearly half the non-profit sector’s financial resources, the budget situation I just described will put pressure on its existing patterns of funding.
• If the non-profit sector is to meet this challenge, it will have to mobilize private resources. What are some possibilities?

• *Fees, subscriptions and trading income*, already a major source of support for the sector, may have their limits. Especially in social policy domains, many people may see no difference between taxes and fees. So fees won’t help much because they will face the same resistance as taxes. And once trading becomes peripheral to an organization’s purpose, as a matter of competition policy, it should be governed by rules of the business sector. It should have no special tax status; and a profit objective will be essential if it needs to raise capital.

• *Philanthropy*, on the other hand, has a great deal of potential in many countries. This means both financial assistance in the form of *gifts and donations* (including *in kind* contributions, such as office space) and *volunteers*. **[SLIDE 14] [Table 3]**

• Realistically, organizations such as Workability International and its affiliates should be thinking about ways of mobilizing this kind of resource. Alternatives are likely to be difficult to find.

• I have already noted that philanthropy’s contribution varies widely across countries. This is evident from the table. In some countries philanthropy is important. [Again I have highlighted key numbers in blue.]

• Experience of the US, Canada, Israel and Argentina suggests what is possible in terms of raising financial support; and Sweden and the Netherlands suggest that large increases in volunteering are possible in many countries on the basis of social and economic arrangements that already exist in Europe.

• I should note that financial assistance from gifts and donations can be provided in two ways. It can be channelled *directly* to operating non-profits.

• Alternatively it can effectively be *intermediated* through charitable foundations and other grant giving organizations.

• Such organizations are potentially important since one-off contributions can generate significant amounts of continuing income. Such institutions are also ways of mobilizing large coherent blocks of finance that permit large programs to be carried out over a long time period.
Finally, and somewhat experimentally, public-private partnerships offer a vehicle for leveraging public resources. These are unproven but in some domains they may have a useful role to play. I’ll come back to these shortly.

Activities where direct contribution of the not-for-profit sector is potentially high

As I have already noted, traditions and attitudes to the role of the state in particular domains will affect the political willingness to use non-profits. And it will vary across countries.

But a concrete example can illustrate some of the possibilities. Consider France, which earlier this year released some real official data in the form of satellite national accounts developed by the Hopkins project and the UN.

The table shows the contribution of the various parts of the not-for-profit sector to the French economy.

Nearly 75% of the value added, and more than 1 million paid employment, are in major social policy domains: health, social services, education and research. The lion’s share of this is accounted for by social services, activities often at the margin but formally outside the health care domain. [Specify – distressed children; handicapped adults and children; shelters for the homeless; assistance at home; support for people coping with alcohol abuse; etc. Workability International clearly falls within this category.] I suspect that such social services are well-represented in the sector nearly everywhere.

High figures show what is possible in one country. But low numbers should not be taken as indicative in the sense of suggesting areas where little is possible. Low numbers may in fact indicate where the potential for increase is greatest.

Provided of course that we can build the political will to do so by changing attitudes about what is appropriate or feasible.

Let’s take the example of higher education.
A recent study at Shanghai University attracted attention with its ranking of universities internationally. These disproportionately gave US universities high ranks. Only two European universities and one Asian university rank in the top 20, and the highest-ranked French university is no. 45. Why? Consider the financial picture.

**[SLIDE 17] [Table 5]**

- In France, only 3% of the total value added in the entire non-profit sector goes to higher education and research. Just over EUR 1 billion, a tiny amount in the French context. I suspect that the business sector’s contribution is even smaller.

- This reflects their dependence on direct state funding and management. And recall that much of that funding may even come indirectly from the state, rather from fees or gifts.

**[SLIDE 18] [Table 6]**

- For many of the US universities cited in the Chinese study [here are the top 15] I have been able to provide the size of the endowment on a per student basis. This is essentially the accumulated capital from gifts, and returns from investing it, available to supplement other sources of income, whether the state, fees or gifts. If 5% per year, a typical amount, is used to support operations or capital expenditures, it often makes a material contribution to the activities of the institutions.

- The 2 European universities that rank highly, Oxford and Cambridge, also benefit enormously from the wealth of many of their colleges, which are essentially private foundations that exist to support higher education.

- I do not have figures for the three University of California campuses, which are not private, but it should be noted that state universities can and do mobilize significant endowment support.

- It is clear that significant sums can be mobilized and used effectively in higher education even though this is not the current practice in many countries.

- The model can be applied to most of the non-profit sector’s activities if the funding and the political will are there. I see no reason why the activities of organizations such as Workability International could not benefit from similar financial support.

**[SLIDE 19]**
What can public policy contribute?……

- Public policy determines the overall framework which governs the activities of the non-profit sector. I know that Workability International and its affiliates don’t make policy. But they can contribute to public debate about the direction of change that is needed and by doing so they perhaps can influence policy developments.

- Perhaps the single most important policy domain influencing the ability of the sector to mobilize funding is tax. Much of the attraction of philanthropy to contributors is the scope for tax advantages to limit the net cost of making contributions to worthwhile causes.

- And favorable tax status can be an effective way for governments to leverage any lost tax revenues.

- Tax is complex and I cannot develop it much further here. Model conventions exist which provide guidance at the level of principles. Some areas that warrant review in a number of countries include:
  1. The criteria for granting tax privileged status (for foundations at least these vary widely).
  2. Limits on tax relief to donors (as of 2001 all European countries except the UK had upper limits less than the donor’s income).
  3. The treatment of in kind donations and, in particular, the basis for valuing them (this varies across jurisdictions).

- Another important area is policies towards inheritances, estates and successions. Tax is obviously an important part of this since provision of large sums of capital to vehicles such as charitable foundations has often been influenced by a desire to preserve individual or family fortunes rather than see them confiscated by the taxman at death.

- [As an aside, I am aware that the future of estate taxes is being debated in the US Congress and in some other countries as well. I hope that Congress will think long and hard about the implications for, say, higher education, before moving to eliminate such taxes either substantially or entirely.]

- Another impediment in some countries is the existence of a legally mandated estate plan that overrides the wishes of a benefactor. This is not a major issue in the United States but it exists in some European countries. Policies in this area could do more to encourage philanthropy.
• Third, wealth that endows foundations is often earned and managed internationally and operating non-profits increasingly have cross-border activities. While market based activities have been largely liberalized to facilitate open and integrated international markets, especially within North America, and the EU, but globally as well, non-profit organizations often remain limited by international borders. Improvements are possible.

• One good step would be greater use of mutual recognition or, in Europe, the establishment of the “Country of Origin” principle for charitable foundations and operating non-profits. This could be helpful as regards, for example, tax deductibility and recognition of legal personality by host countries, formalities required to operate in host jurisdictions, etc.

• Another avenue to pursue is to identify and address barriers to mobilizing volunteers. Issues here relate both to incentives to volunteer and to challenges involved in managing volunteers.

[SLIDE 20]

• Some areas are largely for regional and local authorities.

• One is the development of community or region based philanthropic mechanisms to mobilize private funding for social purposes. [These include Community Foundations, United Ways and locally-oriented funding intermediaries.]

• Community Foundations have attracted the most interest and are the fastest growing type of community philanthropic organization. Their purpose is to support local community causes, usually defined or interpreted broadly. They do this by mobilizing and managing donor funds to build an endowment, by making grants to charities and community groups and by linking donors with local needs.

• These provide a vehicle for operating non-profits to build on a local reputation and establish a relationship which can provide regular funding for operations over a sustained period.

• Well over 1000 of these exist in over 35 countries. [In the United States they commanded some $35 billion in 2003 and awarded some $2.6 billion in grants. Development in Europe is fairly recent, but they exist there in at least 19 countries or regions. They are most advanced in the UK and perhaps Germany.]

• Second, supporting and attracting businesses are already important objectives of many regional and local authorities. Much of what can be
effective in this effort can be applied or extended to facilitate the operations of non-profits as well since in many respects they resemble SMEs.

- In this regard, efforts to minimize paperwork, simplify regulatory and administrative requirements and generally reduce red tape are as important for non-profits as for SMEs.

- Capacity building efforts, such as management training programs, are another area where support for enterprises can be extended to non-profits. An important extension would be to include management of volunteers in the training, as difficulties in this area are an important disincentive to using volunteers.

- Finally, a word about public-private partnerships. These may be set up as operating non-profit organizations. Or they may just be looser frameworks in which public authorities and private actors, which may include non-profits, join forces in an area where they have mutual or complementary interests but cannot act as efficiently alone.

- A desire to show strong corporate social responsibility may also play a role in making businesses receptive to some partnerships.

- They are best known for building physical infrastructure. But a number of countries have experimented with them in the science and innovation area, especially as a device to facilitate communication between the science sector, which generates advances in technology, and businesses that might be best placed to commercialize it.

- There is much to be learned about what is effective and what is not. But there are many areas, e.g. vocational training, where the business sector and regional and local authorities may have common interests. Given the scope for leveraging public sector resources and the potential for generating better outcomes, the potential of partnerships should be explored further.

[SLIDE 21]

A word of caution: avoid uncritical cheerleading for the sector.

- Both private profit-driven activity and state bureaucracies have their critics, and there is much in the criticisms that can be hard to argue with.

- This makes confidence in social enterprises, charities and other non-profits easier to sell politically.
• But caution is warranted. Both the commercial and bureaucratic models for carrying out activities have a clear basis for funding the activities and provide means of ultimate accountability in the form of market or electoral tests.

• Non-profit organizations mostly face neither direct market nor electoral tests.

• It is important to compensate. Insist on mechanisms to ensure the accountability and legitimacy of organizations operating outside the constraints of the market or the ballot box, especially if they benefit from tax privileged status.

• These mechanisms need to ensure that operations are carried out effectively, that their outputs serve the purposes which underpin any tax-free status and that checks against fraud, self-dealing and excessive pay to insiders are all in place.

Thank you.