

## The Role of the Not-for-profit Sector

( Paul Atkinson's speaking notes, 27 March 2006)

[SLIDE 2]

### *Introduction*

- Thank you, Mr. Chairman. I am pleased to have the opportunity to speak to this committee.
- The not-for-profit sector – sometimes referred to as the third sector, the voluntary sector or civil society -- has attracted increasing attention in recent years.
- It 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 in Europe, 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).
- 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 Europe.
- Another consequence is that the sector's 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 cannot cover everything today. I want to focus on the pressures that prospective ageing of European society will create over the medium to longer term and the scope for non-profits to be useful in dealing with 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.

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*Overview of the not-for-profit sector*

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*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.
- 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.

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*How is the sector funded?*

[Table 1]

- 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 the total.
- If volunteering is included, philanthropy rises nearly 30% of the total.
- These figures mask wide variations across countries.

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*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. In developed countries, its paid employment averages 4.7% of the workforce.
  4. 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).

**[SLIDE 7]**

- The voluntary sector fills 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 European societies.
  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.

**[SLIDE 8]**

- These gaps between what the state and the market can do may become larger and more important as age-related budget pressures rise.
  1. Ageing of European populations over the next 50 years will be dramatic.

[Chart]
  2. Budget pressures will 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 be significant in some countries.
  5. Offsetting these will be reduced spending on education and on family and child allowances.

**[SLIDE 9]**

[Table 2]

6. A recent study carried out in national administrations but coordinated by OECD merits examination. [Focus on the left hand column.]
7. With today's generosity, old-age pension spending can be expected to rise by around 6% of GDP over the next 50 years in EU countries on average. Since demographics are known, this is a pretty hard figure.

8. The other items are more speculative and require strong assumptions about the evolution of social policies affecting the labor market.
9. On average EU countries project savings here, around 2% of GDP. But note that the largest continental economies did not do the calculations and that significant reductions in pension generosity are incorporated into many of these calculations. Given the pressure that is likely on health care costs it seems difficult to believe that these savings will be realized.
10. For comparison, figures are given for the total sample of countries studied, i.e including notably the US and Japan. Pension spending pressures seem slightly less but the direction of the average effect of other forces is reversed.
11. The inevitable result of this will be significant pressure for reductions in other types of public spending and/or increases in taxation.
12. 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.
13. In this circumstance, philanthropy, volunteering and fees raised by non-profit organizations have the potential to complement public sector efforts where market mechanisms cannot deliver or are believed to be inappropriate.
14. In this regard it is notable that 2/3 of the paid workforce of the non-profit sector is engaged in the fields of health, education and social services.

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- Mobilizing older people as volunteers can add to potential output
  1. The economic challenge of ageing societies will not be just budgetary, i.e. financial, but also one of mobilizing real, especially human, resources.
  2. The older population, having qualified for pensions, will still have a lot to contribute if the economic and social environment encourage it. This population has valuable skills and competences, and can look forward to good health and reasonable financial security for a

long remaining lifetime: around 20 years for 60-year old men in the EU and nearly 25 years for women of the same age.

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[Table 3]

3. The first priority is to reverse policies that push or entice middle-aged people out of the gainfully employed workforce and to dependency on available sources of retirement income. This would lead to higher employment rates for the over 55.
4. Even where people prefer the freedom and leisure associated with retirement, ways to supplement income and voluntary activity may have appeal. Ways should be sought to take advantage of this.

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[Table 4]

5. Potential amounts are significant. I will not go into details but my calculations suggest that the effective workforce in the EU, i.e. volunteers measured as FTEs plus paid employment, could be augmented by 3-4% by 2025, and by 4-5 ½ % by 2050, if participation in volunteering could be raised to Swedish and UK rates and to a full day per week per volunteer.
6. This is not quite the same as potential output for the European economy but it is clearly material. For comparison the Cecchini Report in 1988 estimated the long-term positive effect of the Single Market project at 4.5%.

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- Volunteering appears to be good for health and well-being, particularly of the elderly and socially excluded.
  1. It typically involves physical exercise, purposeful activity and social interaction.
  2. There is an emerging literature in the medical and gerontology fields that calls attention to these benefits. All age groups seem to benefit but the elderly more than others.

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

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*Mobilize private resources*

- Since the state provides nearly half the non-profit sector's financial resources, the budget pressures I just described will put pressure on its existing patterns of funding.
- If any relief is to be provided by the sector private resources will have to be mobilized. 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. And once trading becomes peripheral to an organization's purpose 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.

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- *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*.

[Private philanthropy table]

- Philanthropy's relatively low contribution on average masks wide variations across countries as the table indicates. 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 on basis of social and economic arrangements that already exist in Europe.
- Financial assistance can be channeled *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.

- As we already saw, *volunteering* currently provides more resources than gifts or donations and its contribution could be substantially increased. [It is not essential that volunteers be suitable, in terms of skills and competences, for the particular kinds of work for which demand will be high. A large supply of volunteers in any particular area can be expected to put downward pressure on demand for paid labor there and, provided the market is allowed to do its job, it can redirect people from overly supplied jobs to those where demand is highest.]

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- 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.

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*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 willingness to use not-for-profits and will vary across countries.
- But a concrete example can illustrate some of the possibilities. Consider France, which has just released some real official data in the form of satellite national accounts developed by the Hopkins project and the UN.

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[Table 6]

- 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 is 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.]
- 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 indicate where the potential is greatest.

- Let's take the example of higher education, which former EU Commissioner Chris Patten recently cited as central to meeting the Lisbon goals.
- A recent study at Shanghai University attracted attention with its ranking of universities internationally which disproportionately gave US universities high ranks. Only two European universities rank in the top 20, and the highest-ranked French university is no. 41. Why? Consider the financial picture.

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[Table 7]

- In France, only 3% of the total value added in the entire non-profit sector goes to higher education and research, reflecting 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.

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[Table 8]

- For many of the US universities cited in the Chinese study [here re 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 know about Tokyo University. But it is clear that this is an area where significant sums can be mobilized and used effectively.

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*What can be done at national and EU levels?.....*

- This is where the overall framework which governs the activities of the non-profit sector is determined. I know that regional and local authorities don't make policy here. But they can influence the policy agenda and contribute to public debate about the direction of change that is needed.

- Perhaps the single most important policy domain influencing the ability of the sector to mobilize funding is *tax*. Much of the attraction of philanthropy is the scope for tax advantages to limit the net cost of making contributions to worthwhile causes.
- Tax advantages should not be given lightly. Donations and gifts are not costless to government budgets since they erode the tax base. And tax-privileged status for fee and trading income raises questions for competition policy in the wider economic context.
- Nevertheless it seems clear that where an organization's activities are directed toward to some public benefit that favorable tax status can be an effective way of leveraging any lost tax revenues.
- Tax is complex and I cannot develop this much further here. Model conventions exist which provide guidance at the level of principles. Some areas that warrant review include
  1. The criteria for granting tax privileged status (for foundations at least these vary widely across Europe).
  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 European 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. But legally mandated estate plans that override the wishes of a benefactor can also be an impediment. 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, both within the EU and globally, non-profit organizations often remain limited by international borders. Improvements are possible.
- One good step would be greater use of *mutual recognition* or *the creation of a "European" status* for charitable foundations and operating non-profits as an alternative to national ones. 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.

- Fourth, *mobilizing volunteers* is complex. It raises two main issues: (1) reducing impediments to using them productively; and (2) motivating them to volunteer.
- Two broad sets of impediments to using them stand out:
  1. Managing them is difficult. They are not paid and are providing a favor. It is difficult to apply normal management methods, especially where significant numbers of volunteers are involved.
  2. Their status vis-à-vis employment law, the social safety net, tort law, etc. may be unclear or in some ways a problem.
- As regards motivation, relying on good intentions may have its limits. But since many retired people would welcome some supplemental income, it may be fruitful to think in terms of a hybrid: employment with a “voluntary element” – i.e. work with only token payment.
- This would raise issues of compatibility with employment law, not least minimum wage laws, and could risk being politically contentious. A lot of issues would have to be sorted out. But a radical rethink of current arrangements will be necessary in many countries if they are to take advantage of the potential offered by the growing population benefiting from pensions, whatever the balance between paid employment and volunteering.
- Note that by formalizing employment status many of the impediments we just described would be reduced if not eliminated.

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*...and at regional and local levels?*

- There are also areas where regional and local authorities can engage more directly.
- 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.] The European Foundation Centre ([www.efc.be](http://www.efc.be)) is the best starting point for general information about these.

- 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, by mobilizing and managing donor funds to build an endowment, to make grants to charities and community groups and to link donors with local needs.
- Well over 1000 of these exist in over 35 countries, including at least 19 countries or regions in Europe. 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, and is most advanced in the UK and perhaps Germany.
- While these are still pretty small, efforts to develop and build them up could generate important returns for at least some regions and localities.
- 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 paper work, simplify regulatory and administrative requirements and generally reduce red tape* are as important for non-profits as for SMEs.
- 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 join forces in an area where they have mutual or complementary interests but cannot act as efficiently alone.
- 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.

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*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.
- 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 face neither 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 in place.

Thank you.