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**“The Clash of Values in Civil
Society”**

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The Clash of Values in Civil Society
by Richard Steinberg

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Abstract

Nonprofit organizations can serve as a countervailing power to limit abuses by government. Thus, reformers in Eastern and Central Europe promote the growth of a viable and truly independent sector. In other nations, nonprofit organizations are under attack for that very independence and consequent waste, excessive compensation, and lack of accountability. Each is seeking an appropriate balance of competing values. In this essay, I describe some necessary tradeoffs between competing values (universalism vs. particularism; expression of the voluntary impulse vs. professionalism), illustrate these conflicts with several recent U.S. policy controversies, and sketch a tentative proposal to postpone the need for a values tradeoff.

I thank Steven Rathgeb Smith, Warren Ilchman, Rita Solloway, Mark Lyons, Jennifer Wolch, Laura Huntoon, Robert Edwards, Paul Schervish, Susan Keen, Astrid Merget, and participants at various conference presentations for helpful suggestions. I am also grateful for the support extended by the Indiana University Center on Philanthropy. Much of the section "What is the Difference?" is drawn from Steinberg (forthcoming).

The Clash of Values in Civil Society by Richard Steinberg

The great political-economic experiments continue. Dissatisfied with market outcomes and processes, promoters of communism assigned primary legitimacy to state action; promoters of mixed capitalism restrict the legitimate role of the state to that of correcting various market failures. Throughout there has been a third arena for collective political and economic behaviors, variously conceived as the nonprofit, voluntary, or independent sector. Some refer to this "space of uncoerced human association and ... the set of relational networks - formed for the sake of family, faith, interest, and ideology - that fill this space" as the "civil society" (Walzer, 1991, p. 293). In this paper, I consider the proper balance of contending values expected of civil society within the broader social, political, and economic space where all three sectors compete, augment, and cooperate. More specifically, I consider the balance of roles appropriate for private nonprofit organizations, an important element of the broader civil society.

Some ascribe the failures of previous capitalist and communist regimes in Eastern and Central Europe to shortcomings in the local civil society, and actively promote the growth of a viable and truly independent sector. For example, a resolution by nonprofit leaders meeting in Stupava in 1991 declared: "The re-establishment of the Czechoslovak independent or so-called third sector is part of the recreation of a civil society and therefore presents a valuable means of progressing towards European standards of pluralism and democracy. We are convinced that the third sector is one of the necessary cornerstones of a balanced society which is in turn a condition of a stable government." (as cited in Siegel and Yancey, 1992, p. 73). Yet, those Western nations renowned for their thriving civil society are now actively attacking the independence and legitimacy of the third sector. It is alleged that charities abuse donor trust through wasteful fundraising practices and excessive managerial compensation, that the public benefits of nonprofit organizations are much smaller than the tax breaks conferred on them, that nonprofit governance is undemocratic, unrepresentative, and conducted in secret, and that resources are wasted when several organizations attack the same problem or when amateurs with little business acumen run nonprofits. Government calls for accountability and regulation compromise the independence of the third sector. Independence is also compromised when private organizations accept grants and contracts and join in formalized partnerships with the government.

I find no contradiction between these seemingly opposing views of the role of the third sector. Rather, I think they reflect legitimate values that stand in partial opposition to one another. The pluralistic relationship between government and the market is well-known: governments and market organizations provide countervailing accumulations of power that fragments decisionmaking while serving as a check on abuses by either sector. Associations, including religious institutions, other nonprofit organizations, and a host of other organizational forms neglected in this essay, provide a once-neglected third prong that may either stalemate collective action or check abuses. In turn, governments and market organizations may block either

desirable or abusive collective action by this third sector.

In this paper, I shall have nothing to say about the design of specific policies that foster appropriate civil society in any particular nation; rather, the task for this paper is to describe some necessary tradeoffs between competing values, and to speculate on factors that support one balance in one society or for one type of third-sector organization, and a different balance of values elsewhere. I interpret several current regulatory controversies in the U.S. as illustrations of the adjudication of competing values, and suggest that this way of thinking about things might be helpful in policy design here and elsewhere.

Here is the agenda for this paper. First, I provide a working definition of the distinction between government and the third sector. Second, I discuss how structural differences lead to differences in the values promoted by the two sectors and so help to define their respective roles in society. Third, I discuss the blurring of the sectors when governments provide direct or indirect aid. Fourth, I illustrate how these competing values play out in several recent U.S. policy controversies. Finally, although I believe that ultimately, nations must face values tradeoffs, I advance a sketchy and tentative proposal designed to postpone the need to choose.

What is the Difference?

Nonprofit organizations can and do make profits. Often, profits are used to finance subsidized care, so that in non-mission activities (fundraising, unrelated commercial activities, investment returns, sale of property), nonprofit firms may wish to maximize their profits. In fact, the average profit rate for a nonprofit organization in the U.S. is about 10%, the same as the profit rate among for-profit firms (Steinberg, 1987). This is all perfectly legal and as it should be, for the key defining characteristic of the sector is not the absence of profit, but a prohibition on the distribution of profits to those in control of the organization.

This "non-distribution constraint" (Hansmann, 1980) is the ultimate source of all inherent differences between for-profit and nonprofit organizations. First, it implies that there are no stockholders, hence no equity capital or takeover bids. There can be no hostile takeover bids or stockholder revolts against current management because there are no shares to sell. This gives nonprofit organizations the latitude to pursue goals other than profit-maximization. These goals can be noble or selfish. Nonprofits can remedy market failures in the provision of collective goods, treat ill-informed customers honestly in situations where for-profits would have the incentive and capability to shortchange patrons, or work toward social justice, as they conceive it, in the distribution of income or in public and private policies. On the other hand, nonprofit organizations might waste resources through mismanagement, provide excessive non-cash compensation and perks to circumvent the non-distribution constraint, or, with whatever noble intentions, work against more general notions of the common good. Perhaps Mother Theresa's organization works towards social justice, Jimmy Bakker's worked towards excessive compensation, and the Ku Klux Klan works

against the common conception of the general good. Most organizations fall within the triangle bounded by these three poles.

Donations are pooled, making it difficult for individual donors to determine whether their contributions add to the good work financed by others, or merely substitutes for others' funds. In such a situation, for-profit firms have a strong incentive to divert donations to dividend checks; donors know this; and so for-profit firms rarely receive substantial donations. Nonprofit organizations cannot legally divert donations to dividend checks, so that donations to nonprofit organizations are more likely to add to the common good. However, those nonprofits that waste resources through mismanagement or excessive compensation may waste donations as well, so that the nonprofit form does not provide an iron-clad guarantee that donations will be well-used.

It is much harder to distinguish private nonprofit organizations from governments. Both, at least sometimes, serve public purposes, although the size of the respective publics served may differ. Both are legally bound by a nondistribution constraint, at least at the managerial level (The non-distribution constraint prohibits financial distributions to owners and others in control of the organization, but who "owns" the government? If the view is taken that the population as a whole owns the government, then it is perfectly legitimate to distribute financial surplus to owners through lower taxes and welfare checks. However, there is no ambiguity about distributions to those in governmental leadership positions in many state constitutions.): the President of the U.S. cannot receive a bonus based on the national budget surplus. Both sometimes violate this nondistribution constraint - self-dealing, embezzlement, and the promise of future high-paying jobs for former regulators in the regulated industry can compromise the trustworthiness of governments. Both may make excessive non-cash compensation payments of perks and power. Both have oversight mechanisms that are not based on the threat of financially-motivated takeover bids.

The main difference appears to be in the structure of ultimate responsibility and accountability. The government (at least in democracies) is responsible and accountable to an electorate. Political systems vary, and no doubt the electoral details have an impact on the division of activities between the state and private nonprofit sectors, but whoever wins an election (generally by securing only a plurality of public support) gets to declare policies affecting the entire electorate. A government is answerable to a majority; a nonprofit can be answerable to a minority. As a result, government organizations place differing priorities on the values expressed by organizations in both sectors. As Steven Smith and Michael Lipsky noted in 1993, government agencies place greater primacy on the appearance of societal equity - of treating all needy groups the same, whereas nonprofit organizations place greater primacy on responding to the needs of individual clients.

The Differing Values Expressed by Nonprofits and Governments

Political scientists, including James Douglas, Lester Salamon (each in 1987), and Smith and Lipsky have detailed three distinctions of interest: Governments obey

"universalist" norms or the "categorical constraint" whereas nonprofit organizations embody "particularist" impulses; governments stress professionalism, whereas nonprofits employ more "amateurs"; and governments utilize coercive taxation, whereas nonprofits rely heavily on contributions of time and money. These same scholars disagree over whether these are virtues or vices for each sector. Let us examine the arguments in more detail:

Particularism. An independent nonprofit sector allows the expression of those civic values that do not achieve a sufficiently broad consensus for government action. Smith and Lipsky explain (p. 27): "In a democracy government is limited to producing only those collective goods which are either accessible to all, or, if targeted to benefit certain groups, enjoy the support of the majority. Other goods and services, such as orchestras and ethnic-specific burial societies, are not candidates for public policy because, while perhaps desired by many, they are not preferred by a critical mass." Douglas elaborates (p. 46): "[A] democratic state is more constrained to ensure that benefits are distributed fairly and equitably than is a voluntary organization." In contrast, Salamon argues that philanthropic particularism is one of four sources of "voluntary failure" that lead to state action (the others are philanthropic insufficiency, paternalism, and amateurism). He argues (p. 40) that:

"[T]he tendency of voluntary organizations and their benefactors to focus on particular subgroups of the population, is, of course, one of the purported strengths of the voluntary sector. Voluntary organizations provide the vehicle through which such subgroups -- ethnic, religious, neighborhood, interest, or other -- can join together for common purposes... But particularism also has its drawbacks... Some subgroups of the community may not be adequately represented ... [or may lack] needed resources -- financial as well as organizational. ... Particularism, and the favoritism that inevitably accompanies it, [can] leave serious gaps in coverage ... [and also] contribute to wasteful duplication of services. Voluntary organizations and charitable activity are motivated not alone by considerations of social need, but also by considerations of communal or individual pride. Each group wants its own agencies, and appeals to donors are frequently made along religious, ethnic, or sectarian lines. ... The number of agencies can increase well beyond what economies of scale might suggest, reducing the overall efficiency of the system and increasing its costs."

A basic problem for all societies is how to combine competing notions of the "public good" into public decisions, whether made by governments or voluntary organizations. Government policymakers weigh the arguments and influence of competing interest groups to form a common policy for all ("universalism"). When we move from universalism to particularism, we can simultaneously express competing views through voluntary organizations. Is such simultaneous expression good for society? On the one hand, the legitimacy of the social system is promoted by opportunities for each citizen to express their public values in a tangible way and not just through the abstract act of voting. There is less coercion, more room for experimentation, more citizen participation, and a deeper realization of associational and expressive values through what Robert Payton has called "voluntary action for the public good." On the other hand, because particularism reduces the need to

achieve a cross-cutting vision of the public good, it enhances the danger of faction and enables mutual intolerance. Thus, voluntary agencies add another layer to the age-old problem of individual freedom vs. the public good.

Although third-sector organizations can enhance legitimacy by allowing diverse expressions of the public interest, they may stifle within-organization diversities in ways that threaten legitimacy. Paradoxically, the universalist state may promote particularism by enforcing appropriate rules for associational activity. Walzer (1991, p. 302) writes: "[A]cross the entire range of association, individual men and women need to be protected against the power of officials, employers, experts, party bosses, factory foremen, directors, priests, parents, patrons; and small and weak groups need to be protected against large and powerful ones. For civil society, left to itself, generates radically unequal power relationships, which only state power can challenge."

Particularist impulses can be expressed through governments, but there is still a role for voluntary agencies. In a federalist system, responsibilities for public decisions are delegated to local and provincial governments unless centralized solutions are necessary. This system fosters particularist impulses. Jurisdictions are free to express their own vision of the public good, and if some residents are dissatisfied, they may choose to move to another jurisdiction where the local government implements a vision more to their liking (Tiebout, 1956; Weisbrod, 1975; Wolpert, 1977). However, the limits to government fostering of particularism were clearly explained by Estelle James (1989, p. 5): "Nonprofit organizations can be thought of as organizations tied to interest-based communities that are an alternative institutional form to geographical-based communities for providing quasi-public services. ... Local governments provide variety and choice for bundles of quasi-public goods, all tied to the consumers' place of residence, but nonprofit organizations provide this choice for each good separately, without requiring movement to another geographic area."

The values of universalism and particularism are both valid, so that a mixture of government and private voluntary agencies is a good thing. Governmental policies that support or inhibit the growth of an independent nonprofit sector alter the balance between these two competing values. A different balance may be appropriate in, say, Bosnia-Herzegovina than in Australia because of historical differences in tolerance for diversity. This is clearly an area for further research and reflection, for the balance of institutional types may itself alter the evolution of societal tolerance. Walzer (1991, p. 302) finds that balance is a prerequisite for this evolution, arguing that "Only a democratic state can create a democratic civil society; only a democratic civil society can sustain a democratic state. The civility that makes democratic politics possible can only be learned in the associational networks; the roughly equal and widely dispersed capabilities that sustain the networks have to be fostered by the democratic state." But we know too little about when such balance is sufficient as well as necessary; we need to understand when short-run factionalism worsens tolerance and when it supports evolution of a social contract of mutual respect. When I consider organizations such as the Aryan Nation, the Italian Anti-Defamation League, the Unitarian Church, Solidarity, the Red Cross, the Jewish Defense League, or the Civil

Liberties Union, I am humbled by my ignorance in this regard.

Amateurism. Demands for accountability lead the public sector to a professionalized and bureaucratic delivery of services, with explicit criteria for decisionmaking and extensive monitoring of service efficiency. Although the Secretary or Minister in charge of a government bureaucracy may be a political appointee subject to differing criteria, staff are governed by civil service rules which generally require specific training and credentialing prior to employment. Voluntary agencies are accountable to a more homogenous group and operate in an environment of greater trust, so training and rule-based management are less dominant.

Douglas explains the evolution of formalized rules and procedures (p. 46):

"The state's distribution of benefits must not only be equitable; it must be *seen* to be equitable. One of the things we mean by political accountability is that state officials can be made to justify why they provide a benefit to one citizen and deny it to another. State action has to fit a pattern of rules. Voluntary action can be more spontaneous, ... releas[ing] that style of human warmth and loving care that a generalized pattern of defensible rules tends to crush. At its best, voluntary action can be based on true charity; ultimately, state action has to be based on justice."

Again, I find that both amateurism and professionalism are worthy of accommodation in a civil society. Although amateurs may be less adept at delivering services or managing finances, the voluntary impulse is fostered when extensive training is not a prerequisite, and freedom to express the voluntary impulse enhances the legitimacy of a civil society. Amateurism may also enhance social innovation and experimentation, as Carl Milofsky and Albert Hunter explain in their (1993) penetrating analysis of Toynbee Hall, the first settlement house (p. 17):

"[S]ettlements are instruments of social innovation, not routine service providers. They are driven by ideological commitment to orderly social change, to community service, and to linking national issues to local settings. For this, it is important that settlements have an amateur or activist quality to them. ... Amateurs are valuable in voluntary organizations because they bring enthusiasm, idealistic zeal, fresh ideas, and often a desire to include other amateurs in their work. They are a source of innovation and they work against the hum-drum routines that managers and bookkeepers try to impose."

This is not to say that professionals do not have a role to play, as Milofsky and Hunter continue: "Amateurs usually are inexperienced, so that they must rediscover facts of organizational life that experienced or trained people have learned through hard experience. ... [Amateurs are also] hard to direct. ... Toynbee Hall tends to be full of chiefs and to lack Indians." Thus, once again, I conclude that a mixture of professionalism and amateurism is ideal, but the optimal balance between the two may differ across nations, industries, and the

organizational life-cycle.

Insufficiency. Salamon's third source of voluntary failure is philanthropic insufficiency. Independent nonprofit organizations must rely on donations of time and money for resources, which leaves them vulnerable to free-riding - the tendency of some supporters of a public service to leave the necessary sacrifices to others. A community of free-riders may unanimously agree that a service is worth providing but be unable to support the desired level of provision through voluntary action. If so, "coercive" taxation through state action would make every individual better off, so coercion loses much of its normative force.

Of course, unanimity on any tax-financed government initiative is vanishingly rare. Thus, government-financed initiatives contain an element of real coercion, but this coercion can often be justified by the greater good. Citizens accept a social contract whereby they do not view government taxation as illegitimate merely because they disagree with some governmental decisions. The universalist bent of government is linked to this social contract -- compulsory taxation is only regarded as legitimate if the government is responsible and accountable to pretty much everyone. When narrow interest groups are too politically powerful, compulsory taxation loses some of its moral authority, but as long as competing interest groups are free to organize, taxation of all is regarded as legitimate. Nonetheless, it is desirable to reduce coercion, and voluntary action for the public good diminishes the need for state taxation.

There is another virtue to voluntary action. Donors part with their time and money, but in return receive the warm glow of satisfaction for having done well. Taxpayers also part with their money, but perhaps feel less virtuous in doing so when the alternative is imprisonment. In contrast to the partial mitigation of costs accompanying voluntary action, taxes have undesired side-effects that add to these costs. This "excess burden" of taxation can be enormous. One of the best studies of the pre-1986-reformed U.S. corporate income tax concluded that each dollar collected through this tax reduces the value of aggregate private output by one dollar and forty nine cents (Ballard et al., 1982). Most taxes have excess burdens that are considerably smaller than 49%, but all create excess burdens.

In contrast, voluntary action creates an excess burden of zero, a point which heavily favors donative finance. This does not imply that we should entirely refinance government-supported projects using donations, for they will not suffice. Likewise, there is no implication that taxes should be set to zero in order to eliminate excess burdens -- governmental expenditures create value that, one hopes with some regularity, outweighs the total societal costs of taxation. Rather, efficiency and sufficiency are competing legitimate values, and the optimal balance between them will differ across societies and, over time, within societies. In societies where preferences are heterogeneous and politically-feasible taxes are especially damaging to the economy, a larger voluntary sector is appropriate, all else held equal.

There is an old Sufi saying that vices and virtues are neighbors, that a vice is a virtue

gone sour. Maybe economists and political scientists are using the wrong rhetoric when they speak of market failure, government failure, and voluntary failure, for the focus on failure may blind us to the strong points of each sector and the complementarities among them.

The Voluntary Dependent Sector

In 1901, Frank A. Fetter "remarked that subsidies to private charities were a 'medieval device' that reflected an era when the boundaries between the public and private sector were dim. He hoped that states would ... 'escape the evils and the cost which the practice of subsidizing private charities has brought upon every community that has rashly entered into it.'" (as cited in Lipsky and Smith, p. 48). Evidently, the medieval times are still very much with us.

An independent voluntary sector promotes one set of values, government another. In practice, these pure institutional forms constitute more the exception than the rule. Governments do not just tolerate private alternatives, they establish and subsidize nonprofit organizations and regulate those in existence. Nonprofit organizations may remain apart, but often are willing collaborators seeking subsidies and helping to formulate governmental policies. How is the balance of values altered by these interdependencies?

I will consider two categories of sectoral interpenetration - direct and indirect. Governments provide direct aid to nonprofit organizations when they found them, provide initial capital through bond issues, provide grants, negotiate purchase-of-service contracts, or form public-private partnerships. Governments provide indirect aid when they exempt nonprofit organizations from various entity taxes, provide tax deductions or credit for donations to these entities, exempt nonprofit organizations from burdensome regulations, or provide consumers with vouchers that support purchases from nonprofit agencies.

Particularism. Dependent private organizations are less able to promote particularist objectives. This is well known in the literature on purchase-of-service contracting, where analysts talk of "goal deflection" due to "resource dependence". Grants contain fewer strings than purchase-of-service contracts, but still can tempt nonprofit organizations to change the mix of their services, governance structures, and target clientele. Presumably, governmental strings are more likely to move the organization towards consensus goals and universalist service provision than towards greater diversity, a point modeled by Susan Rose-Ackerman (1981). There is one exception, however -- governmental aid to nonprofit organizations that comes without any (implicit or explicit) conditions attached can free the organization from the need to pursue mainstream and lucrative activities and allow them to concentrate on their particularist mission (James, 1983; Rose-Ackerman, 1987; 1990).

Even absent goal deflection, too much reliance on government funding can endanger the public's perception of the values expressed through the third sector. Grønbjerg (1993, p. 26) writes:

"[A]s participants in "third-party" government ... nonprofits easily come to share in the broad decline of public confidence in government. They become part of the "hollow state" (Milward, Provan, and Else, forthcoming) in which public agencies externalize their problems onto the nonprofit sector, including fiscal shortfalls, staff turnover, limited career mobility, and visible responsibility for the (often inadequate) funding and delivery of mandated public services (Sosin, 1990). Under these circumstances, nonprofits that rely heavily on government grants and contracts risk becoming part of an "organizational sink" in which government submerges its problems."

Indirect aid is one way for governments to help nonprofits with minimal goal deflection. Perhaps it is appropriate to restrict government grants for artistic creations to images that do not offend the majority, an issue raised in the U.S. by National Endowment for the Arts funding of Maplethorpe's work. If, however, government subsidies are determined by individual decisions to donate, as in the deduction for charitable contributions, taxpayers are less likely to object. True, some may pay slightly higher taxes to cover revenues lost to deductions that support art which they find offensive, but the connection is sufficiently indirect that the objection is muted. Taxpayers are less likely to think that they are being coerced into supporting works they regard as offensive if governmental aid is provided in indirect fashion.

When government aid fosters the growth of a private sector that shares governmental imperatives, what Salamon (1987) has called "third-party government", this is not always bad. Particularism can be overdone, and interdependence would reduce but not eliminate particularism. If some organizations are deflected from their particularist missions and instead help government deliver universalist services, other organizations may arise to carry the torch. Freed from the moral obligation to deliver services, these new organizations can concentrate on advocacy and unpopular missions without worrying about hurting their clients. Finally, some nonprofit organizations never intended to promote particularism but were instead created to take advantage of governmental contract and grant opportunities. One can hardly speak of goal deflection in organizations that are opportunistic from the start.

Interdependency is not simply a matter of replacing one set of values for another, but, to some extent, creates an arena that fosters a third set of values. The literatures on contracting and partnerships speak of the replacement of pluralism and particularism by corporatism. Smith and Lipsky explain (pp. 179-82):

"In a pluralist order policymakers act after weighing the arguments and influence of groups competing for favor, whereas corporatism places at the table of policymaking the key actors affected by the policy under consideration. Public officials and sector leaders join in a bargaining relationship; ... those consulted are expected to, and would have a stake in, the agreed-upon arrangement. ... This new corporatist-like politics appears to relate to the growth of contracting and the interpenetration of government and the nonprofit sector". Corporatism would make

service providers more powerful, but it would also constrain their advocacy. ... [E]xecutives in nonprofit ... agencies keep getting recruited by government for their experience and connections, and vice-versa. ... The state builds upon the capacity of nonprofit organizations to invent and administer programs, ... [resulting in] a service sector of greater scope and arguably higher expenditure levels."

Corporatism thus has some virtues, and deserves a place in the mix of competing values.

Amateurism. Even third-party government must be seen to be accountable, so that a dependent third sector is under pressure to adopt a rule-based culture with extensive auditing and reporting and to employ appropriately-credentialed professionals. This pressure extends to boards of directors as well, which must alter their composition to secure the favor of government bureaucrats. The pressure is not entirely against amateurism, however. Some government grants require that services be provided by volunteers and do not require professional credentials for these volunteers. Purchase-of-service contracts also encourage the use of volunteers when payments are inadequate to finance the contracted level of service using paid professionals. Again, the professionalization of some nonprofit organizations is not bad as long as there are appropriate alternative outlets for the voluntary impulse of amateurs.

Insufficiency. Nonprofit organizations have multiple stakeholders - the donors, the staff, the volunteers, and the clients - who may have conflicting objectives. Universities, which are often organized as nonprofit corporations, have an even lengthier list of stakeholders, including at least two kinds of staff (administrative and faculty) and three kinds of clients (students, alumni, and contractors of research). We know very little about how these competing claims are arbitrated within independent organizations, but surely the balance of power shifts away from donors and volunteers when government aid reduces philanthropic insufficiency. This can be good or bad. Many organizations would find their particularist goals deflected, but some would be freed to pursue these goals because they would become less dependent on the whims of major donors.

We have noted that independent and voluntary nonprofit agencies can enhance economic efficiency by reducing the need to employ distortionary taxes to finance public purposes. Paradoxically, indirect aid by governments can reduce these distortionary taxes as well. If donors are particularly responsive to tax incentives, their giving is said to be "price-elastic". Russell Roberts showed, in 1987, that when donations are sufficiently price-elastic, indirect aid is more efficient than direct government expenditures because each tax dollar not collected due to tax deductions stimulates more than a dollar of private expenditures on the public good. When direct government provision or direct government aid to nonprofits is replaced by this form of indirect aid, the governmental cost of a given level of service provision is reduced. Consequently, there is less need to employ distortionary taxes to finance other governmental outputs. Note that the price-elasticity of giving remains an unresolved empirical issue despite more than one hundred studies, but enough studies find that giving is elastic to warrant taking this argument seriously.

In two unpublished papers I wrote with Catherine Eckel (1994, 1995), we argue that this logic should apply equally well to other forms of indirect aid such as the exemption of nonprofit organizations from the corporate income tax. If each dollar of subsidy stimulates more than a dollar of public good expenditures, subsidies are less distortionary than direct government expenditures because they have a lower requirement for distortionary taxes per unit of the favored output. However, there are additional complications, best left for the time when this paper finds a willing publisher. So here, we have a theoretical possibility whose empirical significance has yet to be studied.

Some Examples

United Cancer Council. In 1990, the U.S. Internal Revenue Service retroactively revoked the tax-exempt status of a national organization known as the United Cancer Council (UCC); this revocation is being challenged, and I served as an expert witness on behalf of UCC in this challenge. The case raised many important policy issues (see Steinberg, 1993), one of which is relevant here - the state's right to require that an organization receiving only indirect state aid in the form of the deductibility of donations be professionally managed. Streckfus phrases the issues colorfully (pp. 516-7):

"Assuming that a contract is at arm's length, and is between unrelated parties, should the charity now be penalized ... if it once entered into a disadvantageous contract, even if it should have been obvious at the time the contract was entered that it would be detrimental to the charity's interests? (Let's call this the "how stupid can you be" principle.) Should ... exemption be revoked if the board of directors of a charity is so stupid that it gets taken advantage of in every transaction (let's call this "the clueless board defense"), [o]r must the IRS prove fraudulent conduct? Suppose a charity board has an average IQ of 50 -- is revocation appropriate in this instance? Or should there be different standards depending on whether a board is composed of financially unsophisticated volunteers, or whether it is dominated by accountants and lawyers?"

In here challenging the judgments made by the UCC board, but not their motivation or the structure of control, the IRS is urging fine distinctions that endanger the virtues of amateurism expressed in nonprofit boards. The danger is compounded by the ex post nature of the prosecution and lack of articulated bright-line standards detailing the required level of professionalism. Perhaps a more deliberate and thoughtful approach would be, on balance, helpful, mindful of the tradeoff between competing values.

William Aramony, the Philadelphia Inquirer, and President Clinton. The controversy over nonprofit executive compensation and the distribution of nonprofit surpluses brought to the forefront by the conviction of former United Way of America director William Aramony and the investigations of Gilbert Gaul and Neil Borowski reported in a prize-winning series first published in The Philadelphia Inquirer incited much legislative interest. Congressman Pickle convened hearings, and the Leslie Samuels presented the

President's plan to stem this practice in testimony on March 16, 1994 (prophetically reprinted in Philanthropy Monthly's November 1993 issue). Clinton's proposal would allow the IRS to impose "intermediate sanctions", that is, a tax penalty proportional to the size of the prohibited activity, as an alternative to the current all-or-nothing approach that allows only total revocation of tax-exempt status. In particular, the Administration proposes a tax equal to 25% of any "excess benefit," including compensation deemed unreasonable, provided to an "insider." Of course, the recipient of excess benefits would also have to repay the amount in question and any interest on that amount.

In itself, this seems like a proper "border patrol" function for the tax authorities, fine-tuning their ability to keep taxable activities taxed and exempt activities exempt. However, the details of the proposal suggest that a new balance will be struck between particularism and universalism and between amateurism and professionalism. The proposed reforms restrict the discretion of nonprofit boards to run their organization as they see fit. Nominally, there is not much change here, for insider compensation has long been governed by proscriptions on private inurement. However, intermediate sanctions make it more likely that the IRS will substitute its subjective (and universalist) judgments about proper compensation for the (particularist) judgments of the nonprofit board. This change might or might not be appropriate; the point here is that it represents a rebalancing of competing values.

To me, the alarming part of the proposal is not the penalty on executive officers, but the proposed penalty to be applied to the personal income of members of the (generally unpaid) board of directors. Anyone approving compensation deemed excessive would face a tax penalty equal to 10% of the excessive amount, up to \$10,000. This tax penalty would be borne personally, for if the nonprofit organization attempted to reimburse the director or manager, this transaction would itself be regarded as an excessive payment and subject to additional penalties.

True, there are some protections for board members -- the IRS would have to establish that the authorization was "willful" or resulted from "willful neglect" and was not due to a reasonable cause; taxpayers who disagree with the IRS determination would have recourse to normal review procedures, including administrative appeals and judicial proceedings. And this plank does have some redeeming values -- further reassuring the donating public and encouraging the board to be more vigilant and involved. Nonetheless, I am alarmed for three reasons. First, absent bright-line standards spelled out in advance, boards of directors will need to become more professionalized, bureaucratic, and formal in their decision-making to head off costly legal proceedings. Leslie Samuels described the proposal this way (p. 12):

"The reasonableness of compensation ... would be determined based on all of the facts and circumstances ..., including the nature of the insider's duties, his background and experience, the time he devotes to the organization, the size of the organization, general and local economic conditions, and the amount paid by similar

organizations to those who perform similar services. The approval of the compensation or transfer by an independent governing body of the organization would weigh in favor of a finding of reasonableness. ... The weight to be given to this factor would depend on the circumstances. For example, approval by a nominally independent governing body may be given little weight if the governing body is comprised of close friends of the organization's founder and president who routinely endorse proposals made by that person."

The particularist nature of many small nonprofit organizations would lead many, if not most, new organizations to fail this IRS test of the relevance of board approval, for friends and family often control inaugural boards. Nor would amateurs prosper in this environment. Board members would need to become expert in the legalities of compensation, and governance would become more professionalized and more like a state enterprise.

Second, it would become much harder to find volunteer board members willing to serve in an uninsurable capacity when their personal wealth is put at risk by their voluntary activities. True, only evildoers need fear prosecution in an omniscient state, but the IRS is regarded as notoriously capricious by many Americans. Finally, faced with a shortage of volunteers, nonprofit organizations would feel pressure to compensate board members, further eroding the amateur and voluntary character of the sector.

Regan, Rust, and Jones. State regulation and oversight of nonprofit board decisionmaking is increasingly justified by the state's interest in the efficacy of and values promoted by indirect aid. In the case of Regan v. Taxation with Representation of Washington (461 US 540 (1982)), the U.S. Supreme Court upheld the denial of eligibility to receive tax-deductible contributions to an advocacy organization that engaged in substantial lobbying. In Bob Jones University v. U.S., the Supreme Court upheld denial of tax-exempt status on the grounds of racial discrimination. In both cases, the government's interference with the expression of particularism was rationalized by reference to the indirect governmental aid provided to these organizations. These cases have readjudicated the balance of values in favor of universalism. By the Regan standard (and oversimplifying the legal issues to aid exposition), the Catholic Church would lose its unfettered ability to advocate legislative restrictions on abortion (should the IRS, in its infinite discretion, choose to bring suit). Thus, they would have to pay a financial penalty to effectively advance their particular notion of the public good.

The same problem is evidenced in Bob Jones. The Court based its decision on the common law of charity on two grounds: that charitable gifts fail to qualify as charity if the terms of the gift violate the criminal law and that to qualify as a charitable body, an organization must serve some public purpose and confer a public benefit. John Simon (1987) had no objection to the first rationale, but is deeply troubled that the Court also applied the second, for he fears the subjectivity of the public interest test, explaining that "It is conceivable, if not likely, that these standards could be used to deny tax deductibility to

groups favoring homosexual rights or *opposing* (through lawful means) black or women's rights, with grave consequences for the pluralism the nonprofit sector is widely valued for nurturing." (p. 88).

In Rust v. Sullivan, the Supreme Court upheld restrictions on speech for nonprofit family planning clinics that accepted government funds. The Bush administration had prohibited any employee of any family planning clinic accepting government funds from discussing the abortion option with clients, again on the rationale that it did not have to subsidize all forms of speech. The Court was not swayed by the argument that this administrative order was overbroad in covering activities funded by nongovernmental sources as well as those funded by government, nor was the Court persuaded that this order comprised an "unconstitutional condition" whereby the state utilized its buying power to obtain that which would have been unconstitutional if carried out directly. The recent history of unconstitutional condition cases seems self-contradictory and confused (Sullivan, 1990), so that it appears this sort of state entanglement will continue. In this case, the Court readjudicated the balance in favor of government values upon finding direct governmental aid, but perhaps the principle will be extended to indirect aid in future cases.

Towards a Harmonization of Goals

The bluntness of current regulatory instruments in this country has made the conflict between values worse than it needs to be. Local governments can only accommodate particularism along geographic lines, so we must rely on the third sector to manifest other forms of particularism. Tax codes, regulations, and corporation statutes too rarely recognize distinctions among third-sector organizations, and those distinctions that do exist take too little account of the differing balances of competing values appropriate to differing types of nonprofit organizations. It seems perfectly appropriate to require nondiscrimination, a relatively high standard for the duty of care required of directors, appropriate training and credentialing, and specified structures of bureaucratic responsibility for those nonprofit organizations that are founded as instruments of governmental objectives and fully-financed through purchase-of-service contracts. Third-party government of this sort is valuable even if it does not promote the expression of voluntary impulses, particularism, freedom of assembly, or the like.

It seems less appropriate to impose the same restrictions on an organization with a particularist mission, no direct governmental aid, and a small level of indirect aid in the form of tax-deductible donations. Accountability is less important here, as less of the general public's tax money supports the organizational mission; independence and freedom to express the voluntary impulse should emerge as the dominant values for these organizations. Yet, the standards embodied in the Regan and Bob Jones cases do not make this distinction -- the state is free to impose or encourage governmental values on any nonprofit and has chosen, on occasion, to exercise its power to do so.

Heightened accountability and professionalism should not be required of every

organization that accepts governmental aid in any form and at any level. Pluralism requires that government create conditions that favor a viable and (at least somewhat) independent third sector. Walzer (1991, p. 301) argues: "No state can survive for long if it is wholly alienated from civil society. It cannot outlast its own coercive machinery. ... The production and reproduction of loyalty, civility, political competence, and trust in authority are never the work of the state alone, and the effort to go it alone ... is doomed to failure." In embracing the nominal civil society too tightly, government becomes alienated from its true civil society, which is particular, voluntary, and at times chaotic.

To me, the right balance is struck if we extend some forms of indirect governmental aid to most every third-sector organization but restrict direct aid to professional and accountable organizations. Such aid is not essential to the viability of civil society, for we have had a third sector long before the passage of corporate and individual income taxes that exempted nonprofit income and allowed deductions for donations. Nonetheless, indirect aid does increase the market share of nonprofit organizations (Hansmann, 1987; Gulley and Santerre, 1993) and is otherwise helpful. Pluralism does not prosper when organizations must choose between the right to receive deductible donations and the right to advocate specific legislation. Because tax deductions and credits for individual donations directly recognize and reward the voluntary impulse, I feel that this form of indirect aid should be preserved and extended to all third-sector organizations. I am somewhat more agnostic on the pluralism-promoting role of other forms of indirect and direct state aid, and feel that it would be appropriate for the state to make at least some of this aid conditional on adherence to governmental values.

For the great bulk of nonprofit organizations that are neither entirely dependent nor entirely independent, I propose that we establish two new categories: citizen nonprofit, and operating nonprofit (surely better labels exist, but that is what I have for today). Although all nonprofits would receive the right to deductible donations, citizen nonprofits would receive substantially-reduced governmental aid in other categories (perhaps reduced to zero), whereas operating nonprofits would receive the full panoply of aid. In return for this aid, operating nonprofits would receive heightened governmental scrutiny. Citizen nonprofits would be substantially free of government oversight; government would enforce the nondistribution constraint, prevent a citizen nonprofit from wrongly representing itself (to donors and the general public) as an operating nonprofit, and otherwise enforce laws against fraud and criminal activity; government would have no say on matters of governance and management. The organization, and not the government, would elect to operate as one or the other type of nonprofit.

Purchase-of-service contracts between governmental agencies and citizen nonprofits would be valid and could include accountability requirements, but only the contract revenue (and not, say tax exemption) should be conditional on meeting those requirements. Further, accountability requirements should extend only to the contract activities of the citizen nonprofit; a citizen nonprofit which accepted public money to provide family planning services should not have that money stripped if it used donations to discuss abortions with

clients. In contrast, the government could, if it so chose, condition its contracts with operating nonprofits on such criteria. In effect, I would reverse Rust v. Sullivan for citizen (but not operating) nonprofits.

The distinction between the two would need to be widely understood by the general public (no easy task). Then, donors could make informed choices between supporting operating nonprofits, whose adherence to standardized management and accountability rules could be reasonably assumed but whose independence could not, and citizen nonprofits, who may consist of inefficient amateurs with peculiar ideas but whose independence is not in question.

Conclusion

We value the nonprofit sector for its expression of the voluntary spirit, then berate it for lack of professionalism. We want the nonprofit sector to be accountable to the state and to serve as independent watchdogs. We cherish the pluralism and particularism of the sector, yet penalize organizations that exclude blacks, lobby, or discuss abortion. Yet we should not judge any sector in isolation, but rather as a piece of a three-sector society. All these conflicting values are legitimate and the question of proper balance among them is complex and central.

Policymakers who cling to monolithic stereotypes as to what the sector is "supposed to be" endanger well-functioning civil society around the world. Those who struggle to create the basic framework for a civil society within the emerging democracies of Eastern and Central Europe cannot assume that third-sector organizations will remain sufficiently independent and effective to serve as a counterweight limiting state abuses, or that any regulatory environment short of prohibition will enable the third sector to thrive. Those who rethink the role of government in Western welfare states cannot assume that third-sector service provision is a perfect substitute for state provision, even if nonprofit organizations sometimes provide welfare services. Those who struggle to create regulatory coherence in state policies towards the sector should recognize that governmental values of accountability, democracy, professionalism, and universalism are not necessarily appropriate for all third-sector organizations. Instead, civil society will thrive if clashing values are accepted with civility and a balance can be struck.

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