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THE INFLUENCE OF THE LEGAL ENVIRONMENT ON THE DEVELOPMENT OF THE NONPROFIT SECTOR

by

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THE INFLUENCE OF THE LEGAL ENVIRONMENT ON THE DEVELOPMENT OF THE NONPROFIT SECTOR¹

Lester M. Salamon and Stefan Toepler

INTRODUCTION

The recent growth of interest in the nonprofit sector throughout the world has prompted increased attention to the creation of an enabling legal environment for such organizations. Evidence of this attention is apparent in the efforts to formulate new laws on foundations and associations in Central and Eastern Europe, South Africa, Japan, other parts of Asia, and even Western Europe; and in the work of such organizations as the World Bank, Civicus, the Open Society Institute, and the Commonwealth Foundation to outline the rudiments of what a favorable legal framework for nonprofit action might look like.

Underlying these efforts is the belief that the evolution of the nonprofit sector in different countries can be significantly affected by the “favorability” or “unfavorability” of the legal framework within which nonprofit organizations operate. While nonprofit organizations are, to a significant extent, informal organizations, they nevertheless interact with the formal mechanisms of the law in a variety of ways, from the establishment of legal personality and its resultant protection of members and officers from personal legal liability for the organization’s actions, to provisions in the tax law which encourage or discourage philanthropic contributions to such organizations. Indeed, denial of the right to organize associations has been a favored mechanism used by repressive regimes to avoid protest and maintain control (Fisher 1998, p.40). By no means, however, are unfavorable legal frameworks for nonprofit action restricted to authoritarian regimes. In France, for example, intermediary organizations were abolished after the French revolution and a law authorizing private associations was not put into place until the beginning of the 20th century. Foundations, moreover, remained without explicit legal status until the late 1980s (Archambault, 1997; Archambault, Boumendil and Tsyboula, 1999). Similarly, in Germany, as one scholar had noted, “the tax law constitutes the central barrier that prohibits the evolution of a prosperous foundation community” (Flämig, quoted in Toepler, 1998, p.154).

For all the conviction with which it is held, however, the presumed link between the legal environment for nonprofit action and the development of a viable nonprofit

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sector may not be as clear cut as many believe. For one thing, despite considerable discussion, there is still a great deal of disagreement over what a “favorable” legal regime for nonprofit action really is. In some places, for example, favorable laws on tax exemptions for charitable contributions are considered absolutely essential for the development of the nonprofit sector, whereas elsewhere they are considered at best irrelevant and at worst actually harmful to the promotion of the altruistic spirit for which this sector is supposed to stand. Indeed, an effort by the World Bank to outline a set of principles to guide the framing of such laws encountered considerable resistance, even among many in support of its general goals. One reason for this may be that an effective conceptual framework has yet to be developed for linking provisions of law to the development of the nonprofit sector and for deciding which provisions are likely to be most important and which least.

Beyond this, the analysis of legal provisions is especially fraught with difficulties. Law, by its nature, is exceedingly complex, and seemingly innocuous phrases can have immense special meaning. What is more, legal provisions affecting nonprofit organizations can be scattered widely throughout national legal systems, and it is quite possible that seemingly encouraging provisions in one body of law can be countermanded by restrictive provisions in another. Anybody seeking to analyze the impact of law on the development of particular social and economic structures must therefore proceed with great care.

In addition to this, the legal framework is only one part of the larger social and institutional context that determines the proliferation, or non-proliferation, of nonprofit organizations, and other political, economic or cultural factors may mitigate or even counter any direct effects of the law. Brazil, for example, adopted an essentially British model of nonprofit law in the early nineteenth century, but it was not until the latter twentieth century that other conditions became ripe for the blossoming of nonprofit activity in this country (Landim, 1997). Not only can enabling laws fail to produce nonprofit action, moreover, but restrictive laws can also fail to discourage it. Regulatory action that seeks to suppress or prevent the emergence of nonprofits can simply push nonprofit actors towards informal, legally unrecognized forms of organizing. In the case of Egypt, for example, Kandil (1997, p.361) notes: “Severe legal constraints faced by Egyptian associations and foundations reflect the efforts of the State to dominate not only the voluntary or nonprofit sector, but civil society in general. But as with many such efforts, they have proven only partially successful. Indirectly, and perhaps ironically, the distrustful State has served to strengthen at least one broad-based form of opposition: the Islamic movement.”

Finally, the presence or absence of laws that are favorable to nonprofit action is only one part of the equation that determines the legal impact on the development of this sector. Laws must also be enforced to be effective. Conceivably, repressive laws may not have negative effects because in practice they are not fully enforced (Fisher, 1998, pp.40-1) and the same can be true in reverse. Beyond the formal provisions of law, therefore, attention must be paid as well to the way in which laws are enforced.

Despite these difficulties, we believe it is important to investigate more systematically than has been done to date the actual relationship that exists between the legal environment for nonprofit action and the development of nonprofit organizations. To do so, we tap a unique body of data on both the scope and structure of the nonprofit sector and the key provisions of law pertaining to this sector developed as part of The Johns Hopkins Comparative Nonprofit Sector Project (Salamon and Anheier 1996; Salamon et. al. 1999). More specifically, the paper first sets forth a conceptual framework for thinking about the relationship between law and the nonprofit sector. Against this backdrop, it then shows how this framework can be applied to develop a set of “scores” measuring the extent to which a country’s laws are favorable or unfavorable toward the development of the nonprofit sector. Finally, the paper provides a preliminary test of the extent to which the favorability of a country’s legal framework actually affects the size of its nonprofit sector.

In undertaking this analysis, we are well aware of its preliminary nature. For one thing, our focus at this stage is on the formal provisions of law only and no attempt has been made to gauge the actual implementation or administration of these laws. In the second place, we treat the various legal provisions as essentially equally important even though we know that some are likely to be more influential than others. Although an attempt has been made to assess the relative importance of different legal provisions through a survey of legal experts, we do not utilize that data here. Thirdly, to facilitate any meaningful comparative analysis, we have had to concentrate on only the broad outlines of some of the key legal provisions. While we realize that legal scholars will find this reduction of complexity problematic, it nevertheless represents a necessary compromise in order to permit even the kind of exploratory cross-national testing we are undertaking of prevailing beliefs about the consequences of the legal environment on nonprofit development. Finally, the legal information available—to the extent that we could ascertain—reflects the legal and fiscal frameworks in place for the base year 1995. Although it is reasonable to assume that such provisions have been in place for a considerable period of time in most countries given the relative slowness of legal change, this assumption is doubtless inappropriate in some cases, particularly those in Central and Eastern Europe, and this will have to be taken into account in drawing conclusions.

Despite these acknowledged limitations, however, we believe the kind of systematic analysis of legal provisions and their apparent consequences that we have undertaken here can shed useful theoretical and empirical light on the development of the nonprofit sector from place to place, and may be of assistance as well in guiding policy in this field. Let us turn, therefore, to the framework we have developed and then to the results that it yields.

TRANSACTION COSTS AND NONPROFIT LAW: AN ANALYTICAL FRAMEWORK

With few exceptions, such as economic analyses of the effects of tax law changes on private donations (see Steinberg, 1990, for an overview), systematic empirical study of nonprofit law is still in its infancy. This is even more true in comparative perspective. Discussions of nonprofit law internationally have so far been largely descriptive, identifying salient issues and, at best, grouping them under common headings (Salamon, 1997; World Bank, 1997). While some useful work has been done in analyzing legal provisions (e.g. Silk et. al. 1999), the analysis is rarely based on systematic evidence about what the impact of various legal provisions actually is. Legal scholars and policymakers are thus left with nothing but conjecture to assess the likely consequences that particular legal provisions might have.

To make progress in this field, therefore, a more systematic analytical framework is needed, one that can provide a more conceptually coherent basis for measuring the effects of legal provisions on nonprofit development. One promising source for such a framework is the set of concepts embodied in what has come to be called the "New Institutionalism" that has emerged in various disciplines, such as economics, sociology and organization theory. Central to neo-institutional thinking is the concept of "transaction costs." Transaction costs are the costs associated with the costs of the interactions necessary to accomplish various tasks in a complex society. As articulated by economist Douglas North, one of the important functions of institutions is that they reduce transaction costs by creating permanent structures through which interactions can take place. As North succinctly put it in his Nobel Prize Lecture, "When it is costly to transact, then institutions matter" (North, 1998, p. 248): "[I]nstitutions arise and persist," DiMaggio and Powell (1991, pp.3-4) thus note, when they confer benefits greater than the transaction costs [*sic*] (that is, the costs of negotiation, execution, and enforcement) incurred in creating and sustaining them."

This concept of transaction costs has important implications for nonprofit organizations, and for the impact that law may have on them. In a sense, law can affect the transaction costs involved in creating and utilizing nonprofit organizations. It can thus importantly affect the extent to which nonprofit institutions come into existence and persist. It can do so, moreover, in two different ways: first, it can affect the *demand* for such institutions by influencing the costs faced by those contemplating relying on such organizations (the demand side effect); and second, it can affect the *supply* of such organizations by influencing the costs involved in forming and operating such organizations (the supply side). Some legal provisions can affect both sides of the equation at once, moreover, and often in divergent ways. This is the case, for example, with public reporting requirements, which can give the public more confidence that nonprofit organizations are not abusing their trust, but at the expense of discouraging potential nonprofit entrepreneurs from forming nonprofit agencies because of the reporting burdens involved.

Whatever the exact impact of particular provisions, the notion of demand-side and supply-side transaction costs suggests a framework for conceptualizing the impact of law on nonprofit development. Essentially, we can argue that law can encourage the development of the nonprofit sector to the extent that it reduces both the demand-side and supply-side transaction costs associated with nonprofit organizations. But how can this occur?

Demand-Side Transaction Costs

To date, most of the discussion of nonprofit law and its impact on the nonprofit sector has focused on what we have termed the supply side of the equation—how hard it is to start or operate nonprofit organizations. It may be useful to begin our discussion here, therefore, by examining the important demand-side factors that are also involved. This is particularly so given the centrality of these factors in much of the broader theoretical work on this sector.

One of more salient nonprofit theories, for example, argues that the nonprofit sector exists largely because of information asymmetries that confront consumers with respect to particular classes of goods and services (Hansmann 1980). In particular, these asymmetries are most severe where the consumer of a good or service is not the same as the purchaser (e.g. day care or nursing home care), breaking a link that is crucial to market transactions, or where the nature of the good or service makes it difficult for consumers to judge the quality effectively (e.g. health care). In such situations, Hansmann observes, consumers need some assurance other than what the market can provide to give them the confidence that they are getting their money's worth. In Hansmann's conceptualization, nonprofit organizations can provide such assurance because of the "nondistribution constraint" under which they operate, i.e., the fact that they do not distribute profits to their owners or directors. This makes them more trustworthy since they have fewer incentives to cut corners in order to increase their profits. Put somewhat differently, to the extent that the nondistribution constraint applies, consumers can avoid the transaction costs they would otherwise confront in assessing the quality of the goods and services they are purchasing simply by securing these goods or services from nonprofit providers. What this means for our purposes is that legal provisions that clearly impose a nonprofit distribution constraint on nonprofit organizations can have the effect of reassuring potential consumers of nonprofit services, further reducing their transaction costs, and thereby increasing their propensity to turn to nonprofit organizations. To the extent this is so, therefore, we would expect a positive relationship between the presence of such legal requirements and the scale of the nonprofit sector in a country.

The nondistribution constraint and its enforcement in law is only one factor that will affect the transaction costs that consumers may face in their dealings with nonprofit organizations. In fact, Ben-Ner and Van Hoomissen (1993, pp.45-8) argue that additional safeguards are needed to create the trust on which nonprofit organizations depend. Thus, for example, potential purchasers need assurance that there will not be a hidden

distribution of profits, for example through unreasonable personal benefits or compensation for members or managers. Similarly, explicit transparency requirements can provide additional assurance that organizations are operating in a way that is consistent with public expectations.

Although perhaps less obvious at first sight, internal governance arrangements can also reduce the transaction costs involved in dealing with nonprofits and therefore affect the demand for nonprofit services. This is so for two reasons. Firstly, both consumers and suppliers need to know who is authorized to act (and to enter into valid contracts) on behalf of the organization. Otherwise, there is no security in transactions with the organization. Secondly, requirements for democratic governance can give consumers additional confidence that the organization is operating in a way that is consistent with public trust.

In addition, the regulation of fundraising campaigns and activities also figures prominently as a mechanism of protecting public trust. Donors typically assume that their contributions are fully put to use for the intended purposes. Fraudulent fundraising practices, inaccurate promises for the use of funds, or high fundraising and administrative costs that reduce the share of a donation that is actually used for providing services, when exposed, undermine the credibility and legitimacy not only of the offending organization, but frequently also of the sector or parts of the sector as a whole. The existence of legal provisions curbing the potential abuse of fundraising can therefore have important demand-side effects on nonprofit revenues and development.

In short, as shown in Table 1, four sets of legal provisions can significantly affect the transaction costs that users of nonprofit services or activities face and therefore the likelihood that they will turn to such organizations and consequently increase their size. The first of these relates to the nondistribution constraint under which nonprofits operate; the second to the broader transparency requirements to which they are required to adhere; the third to the governance structures and degree of democratic control they are required to exhibit; and the fourth to the regulation of public campaigns and other fundraising activities. In each of these cases, the nonprofit form in and of itself provides some reduction in transaction costs that consumers face compared to what they would face if they had to contract for such services on the open market. At the same time, in each case, the protections that consumers gain can be enhanced by reinforcing the natural protections afforded by nonprofit status with the power of law, strengthening and institutionalizing the protections far more than mere voluntary compliance might provide.

Table 1: Demand-Side Indicators*Nondistribution Provisions*

- Nondistribution constraint?
- Personal benefit restrictions?

Reporting

- Reporting requirements?
- Public access to information?

Governance

- Responsible agent?
- Participation requirements?

Fundraising

- Registration or permit requirements?
- Substantive restrictions (e.g., fundraising costs)?

To the extent this is true, we would expect that in countries with nondistribution constraints on the books, consumers are more likely to patronize nonprofit organizations than in countries where the legal system does not stipulate such constraints. Similarly, legally enforced personal benefit restrictions, information disclosure requirements, governance provisions, and fundraising regulation can be expected to work in the same way. The greater the degree to which such "consumer protections" and information requirements are formalized in the legal system, the lesser the transaction costs for demand-side stakeholders and the greater the size of the nonprofit sector.

Supply-Side Transaction Costs

Demand-side transaction costs are not the only ones that are likely to affect the scope of the nonprofit sector in a country. Also important are the transaction costs facing those who would create and operate such organizations, and hence affecting the supply of such organizations available to meet the demand.

A central tenet of neo-institutional economics is that organizations come into existence when the costs of operating without them exceeds the cost of creating them (Coase, 1937, 1960; Williamson, 1975). The more burdensome the requirements to establish and operate such organizations, therefore, the less likely are entrepreneurs to come forward to establish them (Ben-Ner and Van Hoomissen, 1993, pp.40-1). On the other hand, the easier it is to form and operate such organizations, the more likely they are to be formed.

Law is only one of the potential barriers to the formation of nonprofit organizations, of course. Others include time, the ability to mobilize financial resources and the mobilization of additional adherents. But law can clearly play a role. More specifically, as summarized in Table 2, three sets of legal provisions can importantly affect the supply of nonprofit organizations: first, provisions establishing the general

posture of the legal system toward nonprofit organizations, including the kind of protection that is given to the right to associate; second, provisions governing the granting of legal personality status to nonprofit organizations; and third, provisions relating to the financing of these organizations. Let us look at each of these in turn.

Table 2: Supply-Side Indicators

GENERAL LEGAL POSTURE

- Right to associate
- Allowable general purposes
- Allowable political activities

ESTABLISHMENT

- Unincorporated organizations permissible?
- Membership requirements?
- Capital requirements?
- Government involvement on boards?
- Government discretion in granting legal status?
- Appeal procedures?

FINANCING

- Broadness of organizational tax exemption
- Income tax exemption
- Real estate/property tax exemption
- Stamp and other duties exemption
- Indirect tax exemptions
- Permissibility and tax treatment of unrelated business activities
- Taxation of “unrelated” business income?
- Organizational tax benefits for contributions
- Tax benefits for individual donors
- Tax benefits for corporate donors

General Posture of the Law Toward Nonprofit Organizations. At the most basic level, laws can shape the general climate for the formation of nonprofit organizations. At issue here is the question of whether there is a legally protected general “right” to establish such organizations, or whether their creation is considered to be merely a “privilege” that governmental authorities can bestow or take away. The more clearly that prevailing laws, constitutional provisions, or legal norms establish a fundamental right to

form private organizations serving public purposes, the more likely it is that persons interested in promoting such purposes will take on the task of establishing them. By the same token, the more restrictive the range of purposes such organizations can serve, the less likely organizational entrepreneurs are to come forward to establish them and therefore the smaller the nonprofit sector we can expect. Thus, for example, restrictions on the political or advocacy activities of nonprofit organizations can discourage some “political entrepreneurs” from the nonprofit field.

Establishment. Legal provisions can also significantly affect the transaction costs involved in starting up a nonprofit organization. For one thing, laws can stipulate whether legal status is available to such organizations and, if so, under what circumstances. Such status can be important in protecting those involved with an organization from personal legal liability for the organization’s actions. Moreover, legal personality is often necessary to exercise essential property rights, such as the right to own real estate, to have a bank account, or to receive and manage bequests.

However, formal incorporation, establishment or registration not only accord benefits, but also obligations, such as disclosure requirements. Occasionally, the information to be disclosed for formal legal recognition can be extensive. While in open and democratic countries this may serve to protect and foster trust in these organizations, as discussed above under demand-side features of the legal system, in more autocratic and restrictive regimes it may easily open avenues for close governmental supervision, control, and interference. It is thus important that nonprofit organizations retain the option of remaining unincorporated and are not being forced to register in order not to become illegitimate. From this point of view, the most favorable framework permits nonprofit organizations to stay unincorporated or unregistered, but still grants a certain degree of legal protection to these organizations.

To the degree that nonprofit organizations seek to obtain legal personality, the law may stipulate certain requirements, such as membership and capital requirements or special licenses, which may increase the barriers and costs to forming nonprofit organizations. Clearly, the greater the number of members that must be identified and assembled (Ben-Ner and Van Hoomissen, 1993, p.40) or the higher the amount of the required minimum capital that must be generated, the greater the concomitant costs for the nonprofit entrepreneur.

Furthermore, the process of securing legal personality (by registration or incorporation) may also involve significant transaction costs. Some countries require separate registration in each of a number of jurisdictions, for example, while others subject nonprofits to long delays in granting approval. Also important is the availability of appeals procedures so that arbitrary actions by administrative officials can be questioned by courts and challenged by applicants.

Financing Provisions. Yet a third set of legal provisions can significantly affect the financial base of nonprofit organizations. Included here are tax exemptions for

organizations and preferential tax treatment for contributions to these organizations. Both of these accord financial advantages that offset, in whole or in part, the significant financial disadvantage nonprofits have in raising capital because of their inability to offer an equity stake in their operations to potential investors (Hansmann, 1987). The breadth or depth of these provisions can thus significantly affect the feasibility of funding such organizations, and thus their ability to prosper and survive. For example, organizations can be exempted from all taxes or just a selected range. Similarly, different tax advantages can be afforded to different types of donors (individuals, foundations, corporations). In addition to these tax provisions, laws can influence the financing of nonprofit organizations more directly. For example, certain types of revenue can be prohibited or constrained, such as income from business activities, even if taxed.

OPERATIONALIZATION: THE JOHNS HOPKINS NONPROFIT LAW INDEX

In order to test this framework against the data from our comparative analysis of the scope of the nonprofit sector, it was first necessary to transform these concepts into operational terms. For this purpose, we drew primarily on Salamon and Flaherty's (1997) discussion of the ten most crucial issues in nonprofit law and assigned relevant legal issues discussed there to the demand- and supply-side features of our framework. This resulted in an index with 24 items designed to capture the essence of the issues involved (see Appendix A). Armed with this index, we then reviewed the legal framework for nonprofit activity in our 22 countries as compiled by the team of legal experts we had assembled for this purpose and assigned values of 0, 1 or 2 to each country depending on the way its laws addressed the specified item. We then summed the "scores" for each country to yield an aggregate score on both the demand and supply dimensions. Since several of the legal dimensions involved more than a single provision of law, moreover, we compiled subtotals and averages for these to avoid biasing the overall results with these provisions and built these subtotal averages into our overall average.

Given the complexity of legal provisions, this assignment of values to the different countries has taken an extraordinary amount of time. In fact, it is still not complete, so that the results we can report here are still partial. In fact, so far, we had complete legal information on all index items for only thirteen countries, and further follow-up on the remaining countries is necessary. While we aimed to design this process to be as objective as possible, moreover, there inevitably remains a certain degree of interpretation and discretion involved. Finally, the use of a scoring system invariably blurs some of the finer distinctions of which the law is capable. Our hope, however, is that even this preliminary review of the data we have gathered in the light of the framework we have created can shed useful light on how legal provisions can be analyzed.

In what follows, therefore, we first review the range of variation our data reveal about the extent to which countries offer an enabling legal environment for nonprofit

action, as we have defined it; and then test the extent to which variations in the legal environment are associated in the predicted ways with variations in the strength of the nonprofit sector from country to country.

TESTING FOR THE IMPACT OF LEGAL FRAMEWORK ON NONPROFIT DEVELOPMENT

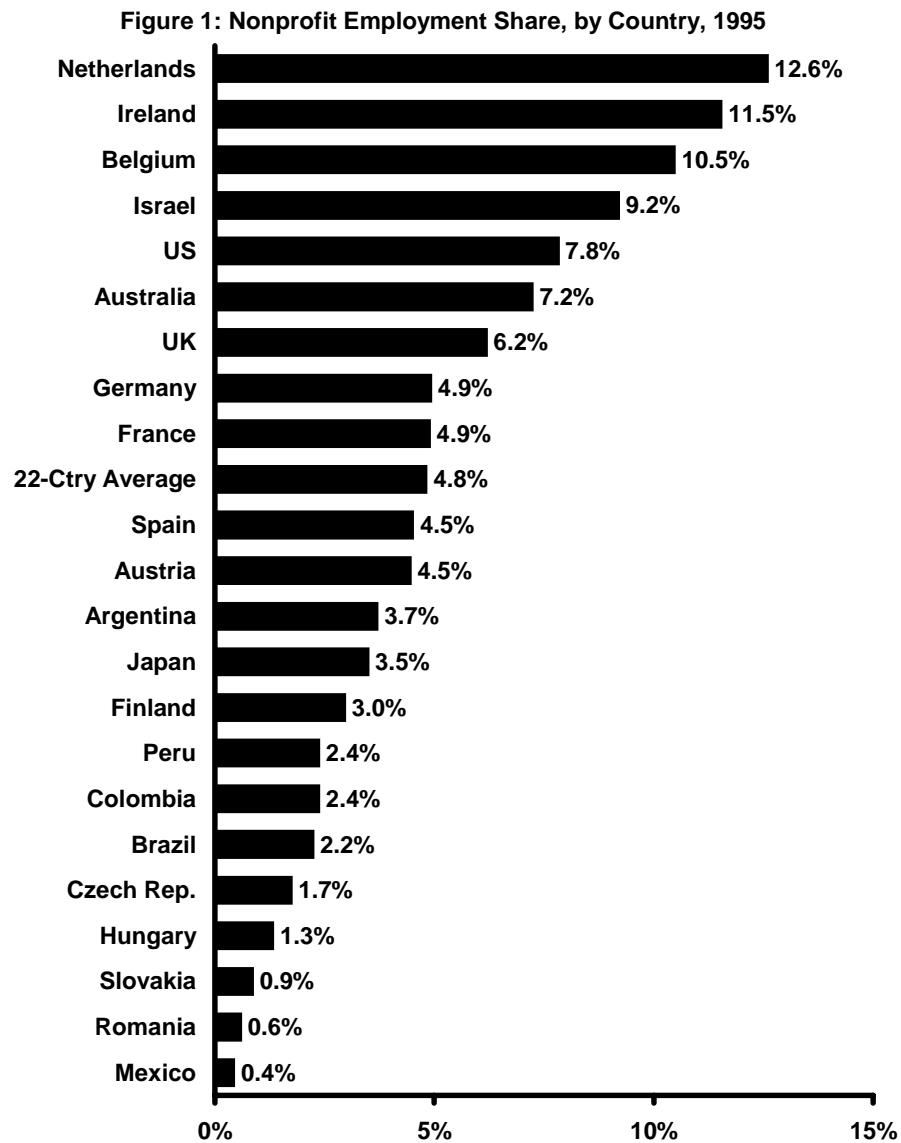
With this operationalization of our basic framework, it was then possible to test the widespread hypothesis that legal environment affects the development of the nonprofit sector. To carry out this test, we first computed the overall index scores for the 13 countries where we had sufficient legal information. Out of a possible full composite average score of 8, these countries fell into a range from a score 6.67 (Israel) at the higher end to 4.17 (Japan) at the low.

As indicated in Table 3, at the most enabling end of the spectrum in terms of this dimension of nonprofit law were Israel, the Netherlands, and the United States, with highly favorable legal regimes for nonprofit activity. Mexican nonprofit law also ranked highly. Australia and most European nations (except the Netherlands) occupied a middle place. Brazil and Japan were the two countries that ranked lowest.

Table 3: Country Scoring

| Index Score | Country |
|------------------------------|---|
| High (score of 6 or more) | Israel Netherlands USA Mexico |
| Medium (score of 5) | Spain Australia Ireland Finland U.K. France Germany |
| Low (score of 4 or less) | Brazil Japan |

Further, we made use of the data generated by the Johns Hopkins Comparative Nonprofit Sector Project on the scale of nonprofit employment in different countries throughout the world (Salamon et. al., 1999). As shown in Figure 1, the size of the nonprofit sector varies greatly worldwide from 12.6% of total employment in the Netherlands to only 0.4% in Mexico. Employment was used as the dependent variable in this analysis because it is the most reliable measure of the scope of nonprofit action, but other measures will also be employed in subsequent tests. Both the legal scores and the nonprofit employment shares of total employment were then converted to z-scores, which measure the number of standard deviations that a country varies from the average of all countries on the given variable.

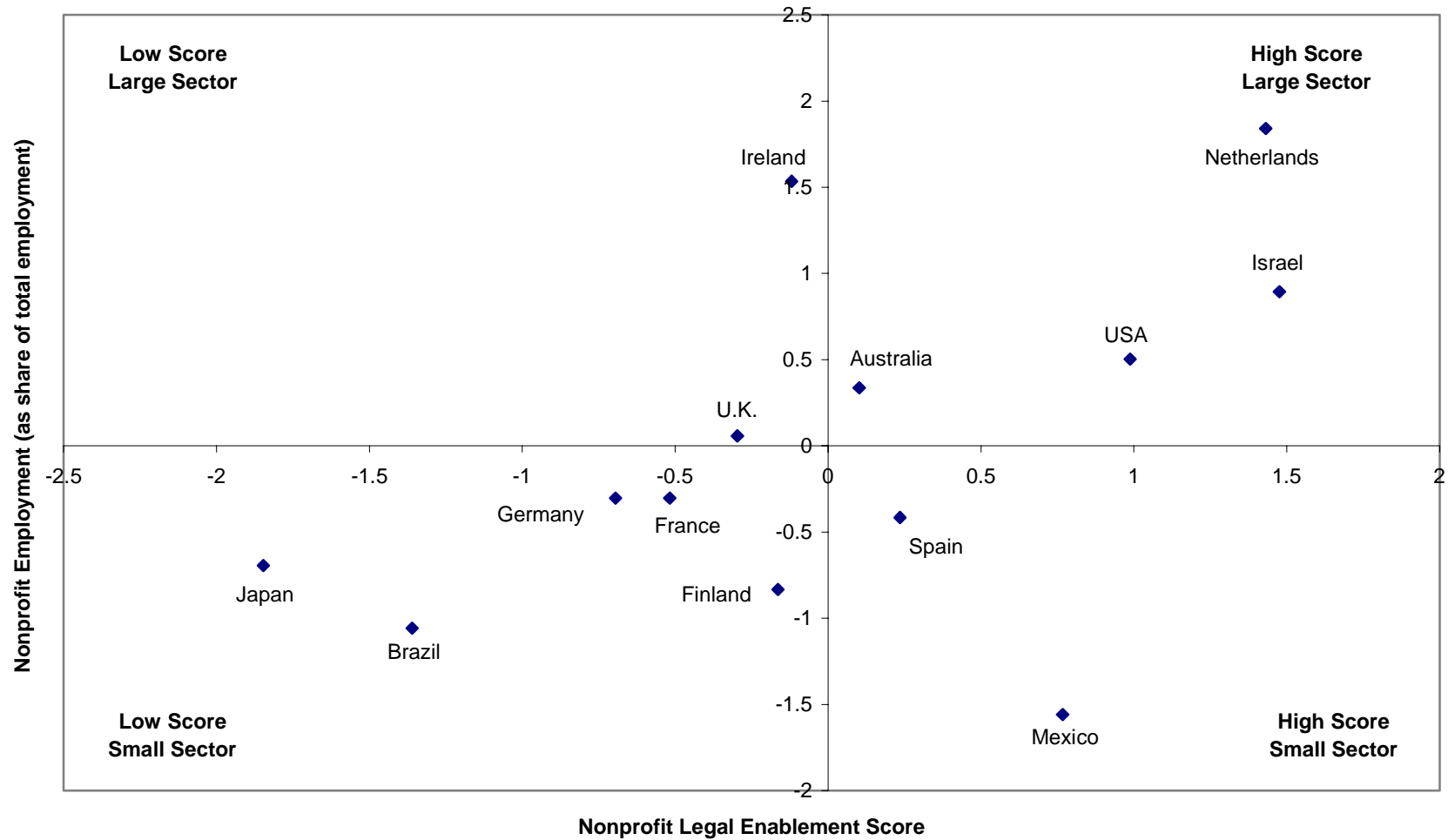


Source: Salamon et al., 1999, p.14

Results

Figure 2 below records the results of this analysis. What it demonstrates is that the hypothesized relationship between the enabling quality of the legal environment for nonprofit action does seem to be related to the extent of development of the nonprofit sector. Thus, most of the countries that scored the highest (Israel, the Netherlands, and the U.S.) also were among the countries with the relatively largest nonprofit sectors. The reverse seems true for Japan and Brazil. Most of the countries with medium score cluster in between.

Figure 2: Nonprofit Law and the Scale of Nonprofit Activity



While for most of the countries in the sample thus the relative favorability of the legal framework appears to relate to the size of the nonprofit sector, there are some important exceptions. More specifically, Irish nonprofit law scored relatively poorly—largely due to extremely limited tax incentives in this country, but the Irish nonprofit sector ranks nevertheless among the largest studied. What this suggests is that limitations of the legal framework can be compensated, or even over-compensated, by other non-legal institutional arrangements. In this country, nearly three-quarters of nonprofit revenues are derived from the public sector (Donoghue et al., 1999). The nonprofit sector development in Ireland has thus likely been driven more by public subsidy than by the degree of enablement (particularly fiscal enablement) of the legal framework. A similar argument could be made for the U.K., where perhaps the prevalence of charitable and philanthropic traditions outweighs a somewhat lacking nonprofit legal system (especially in terms of tax provisions).

Another significant outlier is Mexico, where an apparently quite favorable legal framework coincides with an extremely small nonprofit sector in terms of its economic size. The reasons for this exception are not clear. It could be an indication that favorable nonprofit laws are a necessary, but not sufficient precondition for the economic development of the sector. In other words, enabling laws are no guarantee for actual enablement. However, as the Irish case has shown, an enabling fiscal framework does not even appear to be a necessary precondition. Whether it is only favorable tax laws that may not be truly necessary or whether this may also apply to other aspects of nonprofit law remains the subject of further analysis.

An alternative explanation for the Mexican case could be that nonprofit law in this country was improved only fairly recently, and has thus not yet shown any effects. As Verduzco et al. (1999, pp.433-4) have noted, “the post-revolutionary state and the PRI [Party of the Institutionalized Revolution] discourages the formation of autonomous and voluntary associations ... Since 1990, however, Mexico’s increasing democratic openness has been creating a new and favorable ground for the development of the nonprofit sector. Nonetheless, the effects of these recent changes will be seen only in years to come.”

This latter explanation might also be applicable to the Spanish case, where—to a lesser degree than in Mexico—the size of the sector is also smaller than the legal framework suggests. However, the Spanish legal provisions were adopted only relatively recently (in 1994) so that the size of the sector may really reflect earlier legal realities.

CONCLUSION

The data reported here thus do generally support the hypothesis that the more favorable the legal regime for nonprofit action, the more highly developed the nonprofit sector is. At the same time, there are also important exceptions that make it clear that other factors are also at work.

Most importantly, however, while still in a preliminary stage, the analysis presented here may offer a useful framework for evaluating more systematically than has been possible heretofore the impact that nonprofit law actually has on nonprofit development. As such, it can hopefully move the discussion of the legal environment of the nonprofit sector beyond the realm of conjecture and at least a few steps closer to the realm of objective proof.

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Appendix A: The Johns Hopkins Nonprofit Law Index (July 2000)

A. Demand-Side Indicators

Demand-side indicators comprise legal features that encourage public trust in nonprofit organizations.

| <i>Legal Feature</i> | Score | | |
|------------------------------------|---|--|--|
| | 0 | 1 | 2 |
| Nondistribution Constraint | Constraint not embodied in law | Provision embodied only in tax laws | Provision embodied in general laws |
| Personal Benefit Restrictions | No restrictions for any kind of NPOs | Restrictions for at least some types of NPOs or Limited general restrictions applicable to most NPOS | Restrictions for all or most types of NPOs |
| Reporting Requirements | No requirements for any kind of NPOs | Requirements for at least some types of NPOs or Limited general restrictions applicable to most NPOS | Requirements for all or most types of NPOs |
| Public Availability of Information | None | Limited public access for most NPOs or broad access for some types | Broad public access to information on all or most NPOs |
| Governance | No requirements | Specification of responsible organ only; or specification and decision rules for some types of NPOs | Specification of responsible organ and decision-making rules for all or most NPOs |
| Fundraising Regulation | None, or few under narrow circumstances, or basic requirements for only some NPOS | Basic registration or permit requirements for collections or fundraising campaigns for all or most types of NPOS or substantive restrictions of some types | Substantive Restrictions (e.g. fundraising costs, types of activities and solicitors) for all or most NPOs |

B. Supply-Side Indicators

Supply-side indicators measure legal features that might affect the willingness or ability of citizens to establish and operate nonprofit organizations.

B.1. General Legal Posture

| <i>Legal Feature</i> | Score | | |
|--------------------------------|--|--|---|
| | 0 | 1 | 2 |
| Right of Association | Not guaranteed | Right granted through laws or legal tradition | Guarantee embodied in Constitution |
| Allowable Purposes | Narrow, i.e. significant limitations beyond general legality, morality or public order | General prohibition of immoral purposes or activities against the public order | Broad, i.e. no restrictions beyond general legality and nondistribution of profit |
| Allowable Political Activities | Narrow, e.g. limitations on lobbying and advocacy | Limitations on political campaigning | Broad, i.e., no restrictions |

B.2. Formation

| <i>Legal Feature</i> | Score | | |
|---|--|--|--|
| | 0 | 1 | 2 |
| Unincorporated organizations permitted? | Unincorporated organizations prohibited | Unincorporated organizations lawful | Some degree of legal protection for unincorporated organizations |
| Membership Requirements | Not clearly specified | Clearly specified, but burdensome | No Requirements or Clearly specified and not unduly burdensome |
| Capital Requirements | Not clearly specified or Specified and highly burdensome | Clearly specified and moderately burdensome | Clearly specified and not unduly burdensome |
| Government right to appoint board members | Authorities may appoint board members as a condition for granting legal status for all or most types of NPOs | Authorities may appoint board members as a condition for granting legal status for only some types of NPOs | Authorities may not appoint board members for any type of NPO |
| Government discretion in granting legal personality | Discretion for all or most NPOs, even if minimum requirements are fulfilled. | Discretion for certain types of NPOs, even if minimum requirements are fulfilled. | If NPOs comply with legal minimum requirements, legal personality must be granted. |
| Appeal Procedures | Registration decisions cannot be appealed. | Registration decisions can be appealed with registering authority | Registration decisions can be appealed independently (i.e., courts) |

B.3. Financing

| <i>Legal Feature</i> | Score | | |
|--|---|---|--|
| | 0 | 1 | 2 |
| Breadth of Organizational Tax Exemptions | Specification of limited set of eligible organizations | Relatively narrow definition of eligible purposes | Relatively broad definition of eligible purposes |
| Income Tax Exemptions | No exemption from corporate income tax | Partial Exemption in terms of coverage or tax rates | Nearly or full exemption from corporate income tax |
| Real Estate/Property Tax Exemption | No exemption from real estate/property taxes | Partial Exemption in terms of coverage or tax rates | Nearly or full exemption from real estate/property taxes |
| Stamp and Other Duties | No Exemption from Duties | Partial Exemption in terms of coverage or tax rates | Nearly or full exemption from duties |
| Indirect Tax Exemption (e.g. sales tax, VAT) | No exemption from indirect taxes | Partial Exemption in terms of coverage or tax rates | Nearly or full exemption from indirect taxes |
| Unrelated Business Activities | Not permissible | Permissible, but fully taxed | Partially or fully exempt from tax or subject to reduced rates |
| Organizational Tax Benefits for donations | No benefits, such as gift or inheritance tax exemptions | Partial Exemption in terms of coverage or tax rates | Nearly or full Exemption from taxes on donations and bequests |
| Tax Benefits for Individuals | No or few tax deduction or credit | Tax deduction or credit for limited set of purposes or types of organizations | Tax deduction or credit for broad range of purposes |
| Tax Benefits for Corporations | No or few tax deduction or credit | Tax deduction or credit for limited set of purposes or types of organizations | Tax deduction or credit for broad range of purposes |

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