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A Note on Voluntary Failure and Human Service Delivery**

by

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Abstract

Throughout the advanced English-speaking democracies governments are embracing the voluntary sector in human service delivery and Australia is no exception, with its new Job Network program. Fortunately economic theory has much to contribute in the formulation of appropriate policies. The extant market failure and government failure paradigms, which have proved so useful to policymakers, can be augmented by an emergent theory of voluntary sector failure, in order to design social service delivery policies based on comparative institutional advantage. This paper summarises the generic economic approaches to the voluntary sector and outlines the embryonic theory of voluntary failure. It concludes by briefly discussing the applicability of the theory of voluntary sector behaviour to the delivery of public employment services in contemporary Australia.

Key Words: voluntarism, voluntary sector failure, social service delivery

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1. Introduction

In almost all advanced English-speaking countries governments are increasingly focusing on the voluntary or “not-for-profit” sector to deliver social services previously the predominant domain of the public sector. For example, the Blair government in Britain supports the development of religious schools to augment the faltering public education system. Similarly, in the United States the Bush administration has emphasised a stronger role for the voluntary sector in official welfare programs. In Australia, drawing *inter alia* on the recommendations of Final Report of the Reference Group on Welfare Reform, entitled *Participation Support for a More Equitable Society* (or the McClure Report), the Howard government has enlisted voluntary organisations, like the Society of St. Vincent de Paul, Anglicare, and the Salvation Army, to participate in the Job Network (Webster and Harding, 2001).

These policy initiatives derive partly from a recognition that existing social service delivery mechanisms cannot achieve designated objectives efficiently. Traditional public sector agencies charged with the administration of human services often appear unable to meet their responsibilities efficaciously. In many cases where social services are publically financed but privately provided, similar problems have been evident. Governments have thus turned to the voluntary sector in the belief that not-for-profit

organisations may be able to accomplish social objectives more effectively than their public agency and private firm counterparts.

Economists and policy advisers alike have long been aware of the shortcomings of both the public and private sectors in the pursuit of social welfare. A massive literature exists on the nature of market failure and the most appropriate ways of tackling this pervasive problem (Bailey, 1995). An analogous government failure paradigm has been developed which provides useful insights into the imperfections manifest in the public sector (Mitchell and Simmons, 1994). These intellectual frameworks have greatly assisted in the design and implementation of rational policies and systems of social service delivery.

But much less is known about the characteristics of the voluntary sector and its capacity to achieve social goals in an efficient manner. Given the current emphasis on voluntary organisations as an integral part of social service delivery in Australia and elsewhere, it thus seems appropriate to review approaches to the voluntary sector which form a conceptual analogue with extant market failure and government failure paradigms in order to at least partly remedy the problem. This forms the subject matter of the present short article.

The paper itself is divided into three main sections. In part 2 we seek to outline the generic theoretical approaches to the voluntary sector, evaluate the major characteristics of voluntary organisations and highlight the heterogeneity evident in this sector. Section 3 examines Salamon's (1995) theory of voluntary sector failure as a means of

determining the comparative advantages and disadvantages of the voluntary sector in social service delivery. The paper ends with some brief concluding comments in section 4.

2. Economic Approaches to the Voluntary Sector

Economic theories of non-profit organisations (NPOs) tend to view them as institutional alternatives to private profit-maximising firms and tax-funded government bureaux. They highlight a number of the distinctive characteristics of NPOs. Firstly, like government bureaux, voluntary organisations are restricted from distributing surpluses and may be limited, both through their charters and government regulations, in the ways in which they are allowed to raise funds. This not only ensures that they do not have access to the market for equity capital, but may also give them greater eligibility than private firms for government grants. Secondly, unlike government bureaux, they may not levy taxes. Moreover, they operate largely outside the political context that can shape the behaviour of bureaux. This is because their directors or trustees are not elected by broad constituent groups.

The complex and heterogeneous nature of the voluntary sector has greatly complicated the work of theoreticians who seek to model the origins and behaviour of voluntary organisations using the tools of economic analysis. Nevertheless, considerable progress has been made and several plausible theories now exist which shed much light on the voluntary sector. In broad terms, we can distinguish between two genre of theories dealing with voluntary organisations. In the first place, a number of theorists have sought

to develop models which can explain why the voluntary sector came into being at all; that is, why do voluntary organisations exist? This category of theorising can be further subdivided into “demand” and “supply” models of the voluntary sector. In essence, demand theories attempt to explain the genesis of voluntary organisations as a response to either market failure, characterised as the inability of a market or system of markets to provide goods and services in an economically optimal manner, or government failure, defined as the inability of public agencies to achieve their intended objectives. By contrast, supply models endeavour to explain voluntary organisations as the outcome of “social entrepreneurship”, “a variety of explicit and implicit subsidies, including tax exemption from federal, state, and local taxes, special postal rates, financing via tax-exempt bonds, and favourable treatment under the unemployment tax system” (Hansmann, 1987, p.33), and other factors.

The demand-side theories tend to focus on how the institutional characteristics of voluntary organisations seem to give NPOs a comparative advantage in the provision of certain types of goods and services. They appear to be particularly suited to the provision of private goods, the consumers of which are subject to significant information asymmetries, or public goods in respect of which there exists a significant diversity in demand. However, as Weisbrod (1988) has astutely observed, policy-orientated economists should be careful not to let these theoretical perspectives obscure their appreciation of the actual heterogeneity of the non-profit sector. There is a danger that they could treat NPOs as if they only fall into two broad categories. The first is what he calls “trust-type nonprofits” (TRUNPOs). These are NPOs “that are thought to provide

trustworthy information to consumers who cannot easily judge the quality of services for themselves; day-care centres and nursing homes are potential examples” (p.10). The second category comprises “collective-type nonprofits” (CONPOs), such as providers of medical research and aid to the poor, that typically “produce public-type services that bring widely shared benefits” (p.10). In countries, like Australia, that are moving toward the US model of “third party government” (Salamon, 1987) or a “mixed economy of welfare”, there would seem to be scope for expanding the contribution to social service delivery made by these types of NPOs through subsidies, grants or government-funded contracts.

The potential benefits of this development should not, however, blind policy analysts to the other types of NPO that can co-exist with TRUNPOs and CONPOs in this sector. Weisbrod (1988) draws attention to two additional types of NPOs. Firstly, an “enormous number” of NPOs are “clubs” that tend to confine collective benefits to their own members. Although these “club-type non-profits” (CLUNPOs) may be exempt from taxation, they are typically (and appropriately) given little other government assistance. Accordingly, “they depend heavily for finance on membership dues and these can be expected to be set to ensure that the clubs ‘break even’, but no more” (p.10). They are largely ignored in the literature on the economics of the voluntary sector, not because they are of no interest, but because separate streams of economic theory –the theory of clubs and collective action (Sandler and Tschirhart, 1980) - have developed to deal with their distinctive characteristics and behaviour.

Another type of NPO identified by Weisbrod (1988, pp.11/12) is what he calls “for profits in disguise”. He observes that:

“Acting like profit-maximizing firms, these nonprofits are of dubious legality. They exist only because incomplete enforcement of the constraint against distribution of profit permits them to abuse their nonprofit status. These nonprofits have been misclassified; they are treated by tax authorities as if they were providing trust or other collective services, but they actually pursue the private interests of managers and directors . . . Abuse of the privileges granted to nonprofits can take many forms. Nonprofits can act as for-profits in disguise by evading the constraint on distribution of profits by dispensing profits in the form of increased wages. Disguising a distribution of profit by calling it a wage payment is illegal, but given the costs of enforcement, excess payments to managers as well as to firms associated with trustees of the nonprofits can go undetected. Opportunities are abundant for directors and managers of nonprofits to benefit from having their own companies sell services, such as accounting, laundry and legal representation, to the nonprofit. . . The nondistribution constraint may also be evaded when a nonprofit is controlled by a for-profit firm as a vehicle for the pursuit of profit. If the same persons own a private firm and control a nonprofit operating in a related field, the possibility of their taking advantage of the different tax treatments and subsidies for private gain is clearly present”.

As is the case with CLUNPOs, this type of NPO has generally not been the subject of inquiry by economists with a specific interest in the voluntary sector. This is because they clearly fall within the ambit of the burgeoning literature on the economics of rent-seeking (Tollison, 1982). Indeed, they can be dubbed “rent-seeking nonprofit organisations” (RENPOs). Like other actors with this orientation, they essentially exist to take advantage of the opportunities for the rents or transfers that have been “artificially” created by the government’s regulatory and taxation framework. The “socially wasteful” allocation of resources to form and sustain them so that they can engage in rent-seeking activities has been viewed as a distinctive form of “government failure” in mixed economies (Wallis and Dollery, 1999).

The tendency for demand-side economic theories of the voluntary sector to focus on TRUNPOs and CONPOs as institutional alternatives to profit-maximising firms and government bureaux has exerted a strong influence on the research program of economists who have sought to understand the supply-side of these organisations by analysing the distinctive aspects of the behaviour of their key stakeholders. Relishing the challenge of breaking free from the mould of being “narrow economic rationalists”, these economists have mainly sought to model the altruistic or idealistic features of this behaviour. As Rose-Ackerman (1996, p.701) has commented:

“In recent decades economists have begun to re-examine the psychological and organisational premises of their discipline. The result is a greater willingness to consider activities formerly viewed as outside the field, such as selfless individual behaviour or mass political action, and a growing effort to analyse ‘non-economic’

institutions like churches, clubs, political parties, and charities. Altruism and nonprofit entrepreneurship cannot be understood within the standard economic framework. Theoretical progress requires a richer conception of individual utility functions, and a base in cognitive psychology that incorporates the power of ideas and emotions in motivating behaviour”.

Nevertheless, it should be borne in mind that the tendency of supply-side theories to present TRUNPOs and CONPOs as “outlets for altruism” (Weisbrod, 1988) reflects a theoretical specialisation rather than naivete on the part of the economists who have contributed to this literature.

3. Salamon's Theory of Voluntary Failure

In an insightful, but largely ignored, contribution to the economics of voluntary sector, Lester Salamon (1987) has formulated a theory of "voluntary failure" that identifies key areas of institutional disadvantage NPOs might have compared with government bureaux. The point of departure for Salamon is the recognition that voluntary organisations may be important sources of nonmarket entrepreneurship. Any government intervention in the nonprofit sector should therefore be based on an appreciation of this advantage of NPOs as a distinct institutional form. As Salamon (1987, p.39) puts it:

“The central argument . . . is that the 'transactions costs' involved in mobilising governmental response to shortages of collective goods tend to be much higher than the costs of mobilising voluntary action. For government to act, substantial segments of the public must be aroused, public officials must be informed, laws

must be written, majorities must be assembled, and programs must be put into operation. By contrast, to generate a voluntary sector response, a handful of individuals acting on their own or with outside contributed support can suffice. It is reasonable to expect, therefore, that the private, nonprofit sector will typically be the first line of response to perceived 'market failures', and that government will only be called on only as the voluntary response proves insufficient. So conceived, it becomes clear that government involvement is less a substitute for, than a supplement to, nonprofit action”.

Salamon then goes to identify four sources of "voluntary failure" that are specific to NPOs rather than to nonmarket organisations in general.

The first is the "philanthropic insufficiency" that can be associated with the inability of the voluntary sector "to generate resources on a scale that is both adequate enough and reliable enough to cope with the human-service problems of an advanced industrial society" (p.39). This would seem to be because neither altruistic "sympathy" and "commitment" nor the "warm glow" effect or "in-process benefits" can completely overcome the free-rider problems that limit private giving. Cyclical factors may also be important. Contributions may thus diminish during an economic downturn at the very time when growing numbers of disadvantaged people are looking to voluntary organisations for support. Similarly, the downswing phase of a Hirschman-type "collective action cycle" (1982) may be marked by a falling off in individual commitment that coincides with a "rolling back" of state involvement in the provision of welfare

services. The capacity to give may also vary from region to region, so that voluntary organisations may be concentrated in less needy areas. Given the vastness of Australia, this may also mean rural and regional areas.

A second source of voluntary failure arises from "philanthropic particularism". Salamon (1987, p.40) characterises this as "the tendency of voluntary organisations and their benefactors to focus on particular subgroups of the population". This tendency can, of course, be related to the ideological basis of many NPOs. Most are founded by entrepreneurs with a strong belief in the "need" to support a particular group. Moreover, this belief can underlie the hopes that give rise to an action tendency to make and sustain commitments of money, time and effort to the advancement of the voluntary organisation's mission. However, from a broader societal perspective, the particularism of NPOs can have its disadvantages. Some societal subgroups may not be targeted by voluntary organisations, while even those whose support falls within the boundaries of their mission statements may not be given adequate representation in their governance structures. According to Salamon (1987), the nonprofit sector "has long had a tendency to treat the more 'deserving' of the poor, leaving the most difficult cases to public institutions" (p.40). This type of particularism or favouritism can cause two major problems from a policymaker's perspective. On the one hand, there can be serious gaps in the coverage as NPOs "leave significant elements of the community without care" (p.41). On the other hand, where NPOs concentrate on specific activities or target groups, a wasteful duplication of resources may arise. In this regard, Salamon (1987, p.41) comments that:

“Voluntary organisations 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 upshot is that 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”.

In Salamon’s typology “philanthropic paternalism” constitutes the third source of voluntary failure. This arises because a societal reliance on NPOs alone effectively “vests most of the influence over the definition of community needs in the hands of those in command of the greatest resources” (p.41). The governing boards of voluntary organisations are often disproportionately filled by wealthy members so that there can be an undemocratic aspect to their resource allocation decisions. Elitist preferences may be reflected, for example, in the way the nonprofit sector promotes artistic and cultural activities favoured by the wealthy. However, even where NPOs direct their services to the poor, their critics have castigated their tendency to channel funds “into the hands of upper-class and middle-class people to spend on behalf of the less privileged people” as “the most pernicious effect” of the private, charitable system because of the sense of dependence it cultivates on the part of the service recipients (Beck, 1971, p.218). Nevertheless, it should be pointed that the tendency to create dependency relationships has been attributed to welfare organisations in general and it is not clear that NPOs should perform any worse in this regard than government bureaux that have been largely insulated from the pressures of democratic accountability.

The final type of voluntary failure identified by Salamon is “philanthropic amateurism”. The argument here is that where voluntary organisations rely on volunteer effort and are so limited by their dependence on contributions from providing adequate remuneration to attract professional staff that they may have to resort to “amateur approaches to coping with human problems” (p.42). However, this problem may not be that serious where either young professionals are attracted by the work experience they can obtain in voluntary organisations or idealist professionals of all ages choose to work at lower pay in an activity in which they strongly believe. Perhaps, though, the problem may be reflected in relatively higher levels of staff turnover as young professionals move on to better-paying organisations and the commitment of idealists is corroded by the accumulation of disappointments.

The main policy conclusion Salamon draws from his analysis is that these sources of voluntary failure can be ameliorated through partnership arrangements between the government and voluntary sector.

4. Concluding Remarks

The literature on the economics of the voluntary sector has developed to the stage where it can provide a useful framework to help policy makers design the most effective and efficient institutional solutions to social problems. This contribution can be summarised as follows: Demand-side theories of the voluntary sector can assist in identifying those activities that NPOs should engage in to ameliorate market and government failure.

Moreover, supply-side theories examine the altruistic or idealistic factors that apparently motivate people to commit themselves to founding, funding and striving to advance the goals of these organizations. They thus indicate how TRUNPOs and CONPOs may leverage-in resources beyond those that can be secured through government funding or private fee income to undertake and sustain the activities in which demand-side theories suggest they enjoy a comparative institutional advantage. To balance this generally positive perspective on the voluntary sector, supply-side theories also take into account the susceptibility of NPOs to non-market failure in general, and voluntary failure in particular. However, Salamon (1987) believes that partnerships between the public sector and voluntary organisations can address at least some of the problems deriving from voluntary sector failure.

Salamon's (1987) theory of voluntary sector failure can provide valuable insights into the potential dangers of harnessing the voluntary sector in the delivery of human services in a modern welfare state like Australia. But it can also furnish useful hints about how to design policies to minimise, or at least ameliorate, the degree of voluntary sector failure inherent in invoking the assistance of NPOs in official policy packages. For example, in the case of public employment services in Australia, the problems posed by "philanthropic insufficiency" appear to be relatively easily remedied since agencies are paid in accordance with performance (Webster and Harding, 2001). Accordingly, in their specific role as providers of employment services to unemployed clients, successful voluntary organisations would not suffer from a crippling lack of funds. However, payment for efficacious service delivery might carry the dangers of the

“bureaucratisation” NPOs and thereby damage a key ingredient of their comparative advantage.

Similarly, the potential difficulties arising from “philanthropic particularism” may also not be insurmountable. Provided a broad range of voluntary organisations is involved in public employment service delivery, so that they encompass all significant ethnic, linguistic and religious groups in contemporary Australia, it seems unlikely that substantial numbers of unemployed people will be excluded from using NPOs. In any event, since voluntary organisations co-exist as public employment service deliverers alongside private firms and public agencies, disaffected or disregarded clients can use the latter two service providers.

“Philanthropic paternalism” likewise does not seem to present intractable problems. After all, the phenomenon of “welfare dependency” is already a substantial problem in Australia, with its roots going back at least as far as the early 1970s (McClure Report, 2000), and can hardly be aggravated by the inclusion of NPOs in public employment service delivery. Indeed, the entire thrust of the “mutual obligation” philosophy underpinning the Job Network represents an attempt to deal problem of welfare dependency.

Finally, any concerns over “philanthropic amateurism” may also be misplaced. Whilst the level of professionalism exhibited in the voluntary sector is certain to vary widely between different organisations, and may represent one of the most important strengths of

NPOs in their dealings with psychologically and sociological disadvantaged clients, the very nature of the Job Network appears to render problems of “amateurism” irrelevant. Since financial assistance from the public purse is made contingent on successful job placement, where “amateurism” impedes this process the affected voluntary organisations will be sanctioned automatically.

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