

# INTRODUCTION

## NONPROFIT ORGANIZATIONS IN A DEMOCRACY—ROLES AND RESPONSIBILITIES

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**N**onprofit organizations are a vital force of civil society, distinct from both government and business. Nonprofits are like government in some of their goals, but they are different in others. Through both collaboration and conflict, they shape and are shaped by government policies and funding. Nonprofits have in common that they are voluntary and self-governing, may not distribute profits, and serve public purposes as well as the common goals of their members. These organizations are even more diverse than the terms typically associated with them: nongovernmental organizations, civil society, philanthropic sector, tax-exempt organizations, charities, voluntary associations, civic sector organizations, third sector organizations, independent sector organizations, nonprofit organizations, and social sector organizations.

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This introduction provides a broad overview of nonprofit organizations and their finances, the roles they play in society, and their relationships with government—themes the following chapters examine in detail.

“Nonprofit” is the generic term used in this chapter and in this book to describe organizations that make up the “nonprofit” sector,<sup>1</sup> distinct from the government and business sectors. The nonprofit sector includes religious congregations, universities, hospitals, environmental groups, art museums, youth recreation associations, civil rights groups, community development organizations, labor unions, political parties, social clubs, and many more. Nonprofits play prominent social, economic, and political roles in society as service providers, but they are also employers and advocates. Their numbers and economic impact have grown recently as they increasingly contract with government to deliver a variety of services, particularly health care. This relationship is usually collaborative. As advocates, however, they lobby for and against government policies that affect their constituencies or interests, often invoking conflict.

Nonprofits also play less visible but vital roles that are captured under the rubric of “civil society”—fostering community engagement and civic participation, and promoting and preserving civic, cultural, and religious values. These roles are usually financed through giving and volunteering rather than fees and contracts, and can involve either collaboration or conflict with government, although they typically fall outside direct government purview.

The service provision and economic dimensions of nonprofit activities tend to be better documented than their contributions to democratic pluralism. Scholars are increasingly, however, exploring the central role that formal and informal nonprofits play in creating the glue that holds communities together and the avenues they provide for civic participation and a robust civil society (O’Connell 1999; Putnam 2000; Skocpol and Fiorina 1999; Verba, Schlozman, and Brady 1995).

Voluntary associations strengthen and add to the prosperity and success of democracies. They help build the networks of trust and reciprocity, the social capital that allows democratic societies to function effectively (Putnam 1993; Walzer 1995). Cooperative activities bring together people with divergent opinions who learn to work together on issues of mutual interest or for the common good. Citizens participate in democratic governance by joining together to accomplish public purposes, voice their concerns to government, and monitor the impact of business, government, and nonprofit activities on the public. Nonprofits also promote and defend values and competing visions of the public good, and they harness altruism and public and private resources to serve those who need assistance. All of these activities require the freedom to associate, deliberate, and act in the public

sphere—freedoms constitutions and laws guarantee. Inevitably, however, competing values and interests often produce conflict. Also inevitably, where public resources are directly or indirectly involved, government regulation and oversight follow.

The interaction between government and nonprofit organizations in civil society is complex and dynamic, ebbing and flowing with shifts in social and economic policy, political administrations, and social norms. Because nonprofits are heterogeneous, they reflect sharp differences as well as common aspirations. Their impacts can be positive or negative, antagonistic or conciliatory, depending on their activities as well as the perspective of the analyst. Of course, speaking about nonprofits in the aggregate invites overgeneralization—obscuring the huge variation and diversity of nonprofit roles, contributions, and interactions with government. Similarly, misconceptions of the scale and financial capacity of nonprofits relative to government lead to unrealistic expectations of what these institutions can do, as well as to misconceived public policies that lean too little or too much on them. Partly to avoid these perils, this book analyzes the relationships of nonprofits and government in myriad detail.

## **DEFINITION AND REGULATION OF NONPROFIT ORGANIZATIONS**

Nonprofits in the United States are defined and regulated primarily under the federal tax code. They are self-governing organizations that do not distribute profits to those who control them and are exempt from federal income taxes by virtue of being organized for public purposes. Regulation of nonprofits is fragmented; there is no central U.S. government agency that focuses solely on the oversight of nonprofits. At the national level, the Internal Revenue Service (IRS) is the primary regulator of nonprofits and is charged with determining their legitimacy as tax-exempt entities and overseeing their activities. State governments oversee and regulate nonprofits that operate in their jurisdictions, and the Federal Election Commission regulates nonprofits engaged in federal elections. (See chapter 4 for a discussion of rationales for tax exemption, the impact on activities, and the value of preferential tax treatment for nonprofits. Chapter 5 provides an analysis of state tax exemption and regulation, and chapter 10 discusses regulation of advocacy and political activities.) A legal framework based on tax definitions and enforcement is not the norm for regulating the nonprofit sector in other countries (see chapter 12).

All U.S. nonprofit organizations with annual gross receipts of \$5,000 or more, except religious groups, are required to register with the IRS.

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Organizations with revenues (gross receipts) of more than \$25,000 are required to complete and file an annual IRS Form 990; all private foundations must file IRS Form 990-PF. These forms are public documents that provide the basis for federal and state oversight of nonprofits and the only financial data on nonprofits required to be publicly available.<sup>2</sup>

Nonprofit organizations that serve broad public purposes and are organized for educational, religious, scientific, literary, poverty relief, and other activities for the public benefit are eligible to apply for charitable status under section 501(c)(3) of the tax code. Charitable status permits organizations to receive tax-deductible contributions, an important incentive to encourage donations. Religious congregations, however, do not have to apply for charitable status; they have it. Charitable nonprofits serving broad public purposes account for the majority of tax-exempt organizations, and are the focus of most chapters in this book. Membership organizations, such as labor unions, recreation clubs, credit unions, and political parties, are also tax-exempt but receive less attention here.

Even within the charitable portion of the nonprofit sector, nonprofits are extremely diverse. They vary greatly in mission, origin, structure, size, sources of revenues, and financial means. They are accountable to multiple constituencies—board and staff, members, donors, clients, volunteers, funders, and the public.<sup>3</sup> Public confidence and trust are crucial to their success, yet the public has limited understanding of the scope and operations of nonprofits. Lack of transparency, particularly about the use of donated money, and scandals of any type negatively affect the whole sector, often leading to public outcry, congressional inquiries, and new regulatory proposals.<sup>4</sup>

Nonprofits' diversity confounds attempts to explain them through some overarching theory (although see chapters 1, 9, and 12 for discussions of theories of the government–nonprofit relationship). Researchers have made progress in measuring the scope of the formal organizations (Weitzman et al. 2002), but less has been accomplished in measuring the informal groups, coalitions, and religious organizations (Smith 2000). There is also a dearth of information on the direct and indirect impacts of nonprofit groups on society.

### **SCOPE OF NONPROFIT ORGANIZATIONS IN THE UNITED STATES**

The nonprofit sector in the United States is dynamic and has grown significantly in recent decades. Although characterized by a great diversity of organizations and activities, resources are concentrated in a small number of organizations, while activities are fragmented and

vary in scale and by geographic area. In total, nonprofits have assets of approximately \$3 trillion and expenses of \$1.3 trillion. In economic terms, the nonprofit sector represents 6 percent of national income and employs over 9 percent of the labor force (excluding volunteers). (See chapter 2 for a comparison of the resources of the nonprofit sector and government and a breakdown of nonprofit revenues by source.)

There were approximately 1.8 million tax-exempt nonprofit organizations (including congregations) in 2004, up from fewer than 1.3 million in 1989. This 39 percent increase (table I.1) may be somewhat exaggerated by nonprofits failing to file statements of their demise.

Among the 1.5 million nonprofits required to register with the IRS because they had more than \$5,000 in gross receipts in 2004, were over one million “charitable” 501(c)(3) organizations eligible to receive tax-deductible contributions. This group includes operating public charities (such as hospitals, universities, and soup kitchens) as well as supporting organizations (such as private and community foundations) that provide resources to other nonprofit organizations. Congregations are charitable organizations that are not required to register with the IRS, although many do.<sup>5</sup> The total number of charitable organizations registered with the IRS more than doubled between 1989 and 2004 and rose from less than half to about two-thirds of all registered nonprofits.<sup>6</sup>

In this period, small charities, many recently created, grew more quickly than charities overall. Defined as organizations with between \$5,000 and \$25,000 in revenues, they represented about 62 percent (631,000) of 501(c)(3) charities in 2004.<sup>7</sup> The information on these small charities is limited because they do not have to file the yearly IRS Form 990 that tax-exempt organizations with \$25,000 or more in gross receipts must submit.

There are probably millions more small formal and informal associations (with less than \$5,000 in revenues) that are not required to register or report to the IRS. Recent research is attempting to document the prevalence of these small and often volunteer-led organizations, as well as the many nonprofits that should be registering with the IRS but are not (Gronbjerg and Paarlberg 2002).

In addition to the charitable organizations, approximately 138,000 public-serving social welfare organizations are tax exempt under IRC section 501(c)(4). Most of these organizations may not receive tax-deductible gifts; many elect to do substantial lobbying and advocate for specific issues.<sup>8</sup> Along with public charities and congregations, they are considered a key component of the independent sector, as defined in various editions of the *Nonprofit Almanac* (Weitzman et al. 2002).<sup>9</sup> Unlike charities, the numbers of social welfare organizations are declining.

Other types of tax-exempt organizations primarily serve their members; for example, business leagues, social and recreational clubs, war

**Table I.1. Number of Nonprofit Entities in the United States, 1989–2004 (numbers in thousands)**

	1989		1993		1998		2004		1989–2004 % change
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	
<b>Total private nonprofit organizations</b>	<b>1,262</b>	<b>100.0</b>	<b>1,386</b>	<b>100.0</b>	<b>1,526</b>	<b>100.0</b>	<b>1,758</b>	<b>100.0</b>	<b>39.3</b>
Tax-exempt orgs. Registered with the I.R.S.	993	78.7	1,118	80.7	1,273	83.4	1,541	87.7	55.2
Total 501(c)(3) charitable organizations	464	36.8	576	41.5	734	48.1	1,010	57.5	117.8
Total public charities	422	33.4	527	38.0	675	44.2	934	53.2	121.4
Reporting with financial data	138	10.9	172	12.4	228	14.9	303	17.2	119.6
Out-of-scope organizations <sup>a</sup>	0.5	0.0	0.5	0.0	0.6	0.0	0.4	0.0	–20.0
Reporting public charities	137	10.9	171	12.3	227	14.9	303	17.2	121.2
Operating <sup>b</sup>	124	9.8	152	11.0	201	13.2	263	15.0	112.1
Supporting <sup>c</sup>	13	1.0	18	1.3	26	1.7	39	2.2	200.0
Mutual benefit <sup>d</sup>	0.5	0.0	0.6	0.0	0.6	0.0	0.6	0.0	20.0
Nonreporting	284	22.5	355	25.6	447	29.3	631	35.9	122.3
Private foundations	42	3.3	49	3.5	59	3.9	76	4.3	81.0
501(c)(4) social welfare organizations	141	11.2	142	10.3	140	9.1	138	7.9	–2.0
Other registered tax-exempt organizations	388	30.7	400	28.9	400	26.2	392	22.3	1.1
Religious congregations not registered with the IRS <sup>e</sup>	269	21.3	268	19.3	253	16.6	217	12.3	–19.3

Sources: The Urban Institute, NCCS Core Files, Public Charities and Private Foundations, 1989, 1993, 1998, 2004; Internal Revenue Service Data Book, Publication 55B, 1989, 1993, 1998, 2004.

<sup>a</sup> Includes governmental or supporting government entities (such as public colleges), organizations located in another country, and organizations whose location could not be determined.

<sup>b</sup> Includes organizations that engage in a variety of activities, producing information, delivering services and products to their members and the public.

<sup>c</sup> Includes organizations that primarily collect funds and distribute them to operating organizations.

<sup>d</sup> Includes organizations that primarily provide services to members and customers.

<sup>e</sup> Authors' estimates; see "Note on Data Sources" in this chapter.

veterans' organizations, nonprofit cemetery companies, labor unions, benevolent life insurance associations, and credit unions (table I.2). Donations to these organizations are not tax-deductible, although earnings on their assets are often tax exempt. Their numbers have not grown since 1993, and they are a declining proportion of the nonprofit sector. While these groups potentially contribute to the social fabric of the country, we know most about the "charitable" 501(c)(3) organizations and the social welfare 501(c)(4) organizations that make up the

**Table I.2. Tax-Exempt Organizations Registered with the IRS, 2004**

<i>Section</i>	<i>Description</i>	<i>Number</i>
501(c)(1)	Corporations organized under act of Congress	116
501(c)(2)	Title-holding corporations	7,144
<b>501(c)(3)</b>	<b>Charitable and religious<sup>a</sup></b>	<b>1,010,365</b>
501(c)(4)	Social welfare organizations	138,193
501(c)(5)	Labor and agriculture organizations	62,561
501(c)(6)	Business leagues	86,054
501(c)(7)	Social and recreation clubs	70,422
501(c)(8)	Fraternal beneficiary societies	69,798
501(c)(9)	Voluntary employees' beneficiary associations	12,866
501(c)(10)	Domestic fraternal beneficiary societies	21,328
501(c)(11)	Teachers' retirement funds	16
501(c)(12)	Benevolent life insurance associations	6,716
501(c)(13)	Cemetery companies	10,728
501(c)(14)	State-chartered credit unions	4,289
501(c)(15)	Mutual insurance companies	1,988
501(c)(16)	Corporations to finance crop operations	21
501(c)(17)	Supplemental unemployment benefit trusts	462
501(c)(18)	Employee-funded pension trusts	2
501(c)(19)	War veterans' organizations	36,141
501(c)(21)	Black Lung trusts	33
501(c)(22)	Multiemployer pension plans	—
501(c)(23)	Veteran's associations founded prior to 1880	2
501(c)(24)	Trusts described in Section 4049 of ERISA	4
501(c)(25)	Holding companies for pensions and other entities	1,285
501(c)(26)	State-sponsored, high-risk health insurance organizations	11
501(c)(27)	State-sponsored workers' compensation reinsurance organizations	9
501(d)	Religious and apostolic associations	141
501(e)	Cooperative hospital service organizations	38
501(f)	Cooperative service organizations of operating educational organizations	1
501(k)	Child care organizations	3
501(n)	Charitable risk pools	1
<b>Total</b>		<b>1,540,738</b>

*Source:* Internal Revenue Service Data Book, Publication 55B, 2004.

*Note:* Exempt subsections change over time according to IRS regulation. Farmers' cooperatives (1400 in 1998) are no longer reported in the Data Book.

<sup>a</sup> Some 501(c)(3) organizations, such as churches, integrated auxiliaries, subordinate units, and conventions or associations of churches, are not included because the IRS does not require that they apply for tax exemption.

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majority of formal nonprofit organizations. We focus on them because of their public-serving nature.

### TYPES OF ORGANIZATIONS

The National Taxonomy of Exempt Entities, developed by the National Center for Charitable Statistics,<sup>10</sup> classifies all nonprofit organizations and demonstrates their variety (Stevenson 1997). It includes 9 major groups, 26 categories, and over 400 subcategories.<sup>11</sup> The major groups are

- Arts, culture, and humanities (e.g., art museums, historical societies)
- Education (e.g., private schools, universities, PTAs)
- Environment and animals (e.g., Humane Societies, the Chesapeake Bay Foundation)
- Health, hospitals (e.g., nonprofit hospitals, the American Lung Association)
- Human services (e.g., Girl Scouts, YMCA, food banks, homeless shelters)
- International, foreign affairs (e.g., CARE, the Asia Society, International Committee of the Red Cross)
- Public societal benefit (e.g., Rockefeller Foundation, the Urban Institute, civil rights groups, United Ways)
- Religion-related (e.g., interfaith coalitions, religious societies, congregations)
- Mutual and membership benefit (e.g., nonprofit credit unions, labor unions, fraternal organizations)

Among the 262,897 charitable operating nonprofits that report financial information to the IRS, environmental, education, and religion-related organizations increased most rapidly, while the number of health organizations grew much more slowly (table I.3). In terms of numbers, however, human services added the most organizations (53,768), increasing by 119 percent from 1989 to 2004. Education and religion-related organizations also grew significantly, probably due to the increase in charter schools and faith-based providers.

### FINANCES OF NONPROFIT ORGANIZATIONS

Nonprofits vary tremendously in resources and capacity. Almost all nonprofits, however, benefit financially from their tax-exempt status,

**Table I.3. Growth in Nonprofit Organizations by Type of Service, 1989–2004**

<i>Type</i>	1989	1993	2004	<i>Change</i>	1989–2004 <i>% change</i>
Arts and culture	13,817	16,961	30,009	16,192	117.2
Education	16,939	22,240	44,133	27,194	160.5
Environment and animals	3,305	4,639	11,077	7,772	235.2
Health	23,039	26,892	33,355	10,316	44.8
Human services	45,156	58,267	98,924	53,768	119.1
International	1,196	2,347	5,216	4,020	336.1
Public and societal benefit	8,352	11,548	19,408	11,056	132.4
Religion related	5,764	7,478	16,488	10,724	186.1
Not classified	6,119	2,073	4,287	–1,832	–29.9
<b>Total</b>	<b>123,687</b>	<b>152,445</b>	<b>262,897</b>	<b>139,210</b>	<b>112.6</b>

*Source:* The Urban Institute, NCCS Core Files, Public Charities, 1989, 1993, 2004.

*Note:* Only operating public charities are included (see table I.1 for definition).

and charities additionally benefit from the incentives that charitable income tax deductions provide to donors.<sup>12</sup> Most nonprofits are extremely small entities with meager resources that operate locally with modest budgets and volunteer labor. Some organizations, however, are large and professional, with hundreds of employees and many millions of dollars in expenditures; nonprofit resources are concentrated in these large organizations, largely hospitals, universities, and multipurpose service organizations.

Nonprofit revenue sources include fees for service, government and foundation grants, individual and corporate donations, income from special events, member dues, investments, revenues from commercial ventures, and miscellaneous other sources. Direct government grants are less important than fee-for-service income, which is the dominant source of revenue for the sector in aggregate terms. Government provides significant amounts of fee income, both directly and indirectly, although it varies significantly by type of organization. Fees involve payments for services provided (including, for example, individual payments for tuition), government contracts through Medicare and Medicaid, and government or private vouchers for job training or child care. According to Steven Rathgeb Smith, Medicaid is a driving force in the growth of government funding of nonprofits. (See chapter 6 for a discussion of the mechanisms government uses to finance social services and the impacts these funding mechanisms have on nonprofit activities and operations.)

The resources of charities are highly concentrated in the largest organizations. Only 4 percent (10,513) of all operating charities (those health, education, arts, etc. organizations required to register and report to

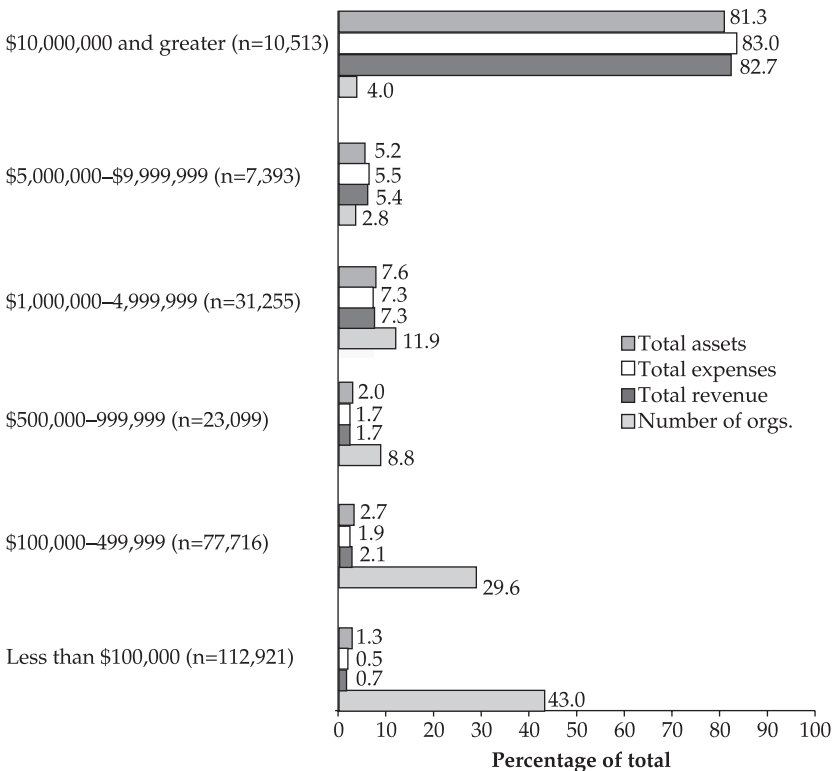
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the IRS) have \$10 million or more in expenses. These large organizations are professionally staffed and account for 83 percent of the \$947 billion in expenditures and almost 82 percent of the \$1.6 trillion in assets of operating charities.

In contrast, about 43 percent of organizations (112,921) have expenses of less than \$100,000 and represent only 0.5 percent of the total expenses for operating charities in 2004 (figure I.1). These smaller organizations are largely volunteer run with minimal, if any, paid staff. Because large organizations and the tremendous resources deployed in the health sector drive aggregate financial statistics, such statistics fail to reveal a great deal about the majority of organizations in the nonprofit sector.<sup>13</sup>

Health and educational institutions dominate the finances of the nonprofit sector. Almost 57 percent of the revenues and expenses of public charities are in health-related organizations. Hospitals make up

**Figure I.1. Nonprofit Finances by Total Expense Level, 2004**

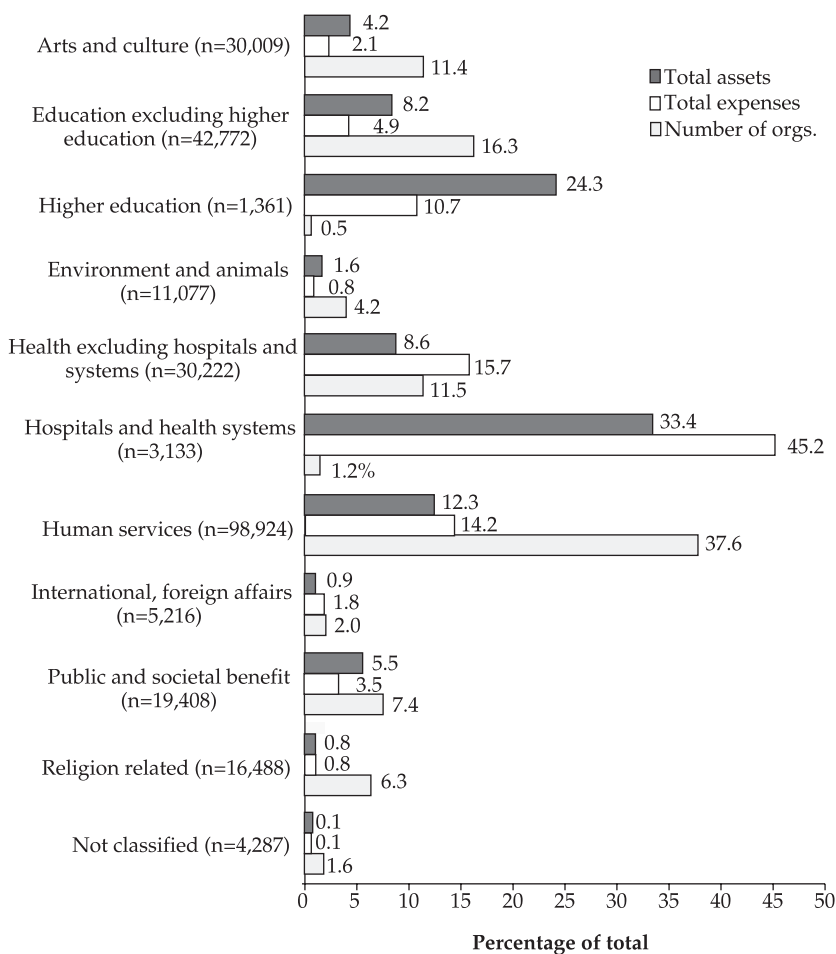


Source: The Urban Institute, NCCS Core File, Public Charities, 2004.

Note: Only operating public charities are included (see table I.1 for definition).

about 1 percent of organizations, but 45 percent of expenditures and 33 percent of assets. Private higher education accounts for about 0.5 percent of organizations but almost 11 percent of expenses and 24 percent of assets. Human service organizations, in contrast, account for almost 38 percent of operating charities but less than 14 percent of expenses and about 12 percent of assets (see figure I.2). Human service organizations tend to be smaller organizations, and their financial status is often quite weak.<sup>14</sup>

**Figure I.2. Nonprofit Finances by Type of Activity, 2004**



Source: The Urban Institute, NCCS Core File, Public Charities, 2004.

Note: Only operating public charities are included (see Table I.1 for definition).

Significant nonprofit assets are held by endowed foundations that make grants to nonprofits. Private grantmaking foundations are 501(c)(3) organizations created by an individual or a family (60,031) or by a corporation (2,596) to fund other, mostly nonprofit, entities over time.<sup>15</sup> Community foundations are endowed public charities that raise money from individuals to benefit a city or other geographic area. Together, these organizations had approximately one-fifth of the assets of the charitable sector (excluding religious congregations). The number and assets of philanthropic foundations grew significantly over the past decade. The more than 67,000 foundations had an estimated \$510 billion in assets in 2004 and made about \$32 billion in grants. Resources are concentrated in the largest 50 foundations, which held over a third of foundation assets in 2004 (Lawrence, Atienza, and Barve 2005; Renz, Lawrence, and Atienza 2006).

In chapter 3, Abramson, Salamon, and Steuerle explore how federal budgetary priorities affect both the need for nonprofit services and the revenues available for providing those services. They estimate that 82 percent of federal funding for nonprofits (primarily for hospitals, nursing homes, and some social service providers) is from Medicaid, Medicare, and Temporary Assistance for Needy Families (TANF) programs.

While hospitals and higher education have long relied on fees, commercial fee-for-service income is increasingly important for other types of charities. Recent analyses show that, in 1982, commercial revenues for nonprofits (excluding hospitals and higher education) accounted for 48.1 percent of nonprofit revenue and, by 2002, had grown to 57.6 percent.<sup>16</sup> Increasing reliance on fee-for-service income from government and other sources inevitably affects the character and operations of many nonprofits (see chapter 6). As government contracting with nonprofits increases, some fear the commercialization of nonprofit service providers, even as government continues to be the dominant, if indirect, funder. Competition for clients and for government contracts—among nonprofits and between nonprofits and businesses—has led to more business-like marketing strategies and management practices. In addition, the Charitable Choice provisions of welfare reform designed to permit congregations to compete for government contracts enhances the resources of religious providers while potentially creating competition between secular nonprofits and religious congregations (see chapter 7). Involving congregations in fee-for-service government contracts raises concern about government involvement in religious affairs and loss of independence for faith-based providers, who presumably will have to respond to government demands for transparency and accountability in the use of resources and evidence of successful programs.

The uncertainty of sole sources of revenues has helped to fuel the search for resource diversification. Opportunities for commercial ven-

tures and social enterprise have increased as new entrepreneurs enter the sector and businesses seek ways to use charities to enhance their marketing and visibility and expand their client bases. These market forces lead to greater concern for efficiency, the financial bottom line, effectiveness, and program outcomes.

Foundations are also stressing organizational effectiveness and measurement of outcomes in the nonprofits they fund.<sup>17</sup> Yet, funders are generally reluctant to make grants for operating support—which permits organizations to strengthen their infrastructure; most foundations prefer to support specific programs and often do not provide overhead costs. Of course, notable exceptions, such as Venture Philanthropy Partners and the Edna McConnell Clark Foundation, among many others, make significant capacity-building grants. However, a growing number of charity monitoring organizations base their ratings on low overhead and fundraising costs (efficiency) rather than results attained (effectiveness), thereby discouraging organizations from investing in strengthening their internal operations, a necessary ingredient for effectiveness.<sup>18</sup>

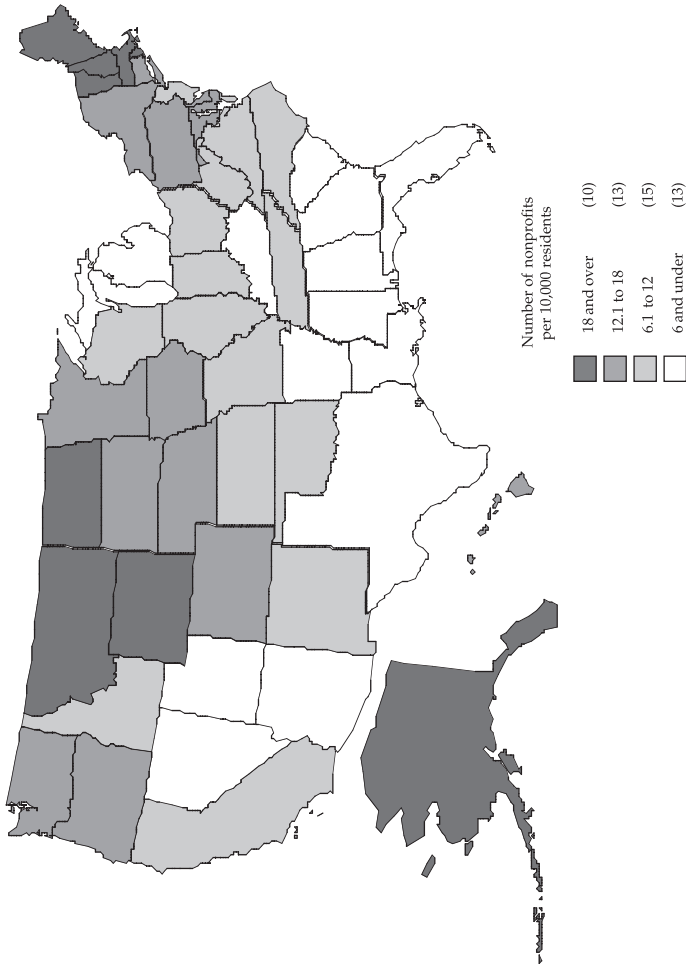
## REGIONAL VARIATION

Numbers, types, finances, and growth of charitable nonprofit organizations vary by state and region. Obviously, the numbers of nonprofits tend to increase with population. California, Texas, and New York have the most charitable nonprofits. Similarly, the growth rates for nonprofits tend to be higher in states with rapidly growing populations. Density of nonprofits across the states, however, varies widely and tells a different story. Sparsely populated states have among the highest density of nonprofits. Vermont, for example, had a density of about 23 organizations per 10,000 people in 2004, and Montana with almost 16, compared with just under 7 for Texas, more than 10 for New York, and almost 9 for California. There are 9 nonprofits per 10,000 people nationally (figure I.3).

The Northeast has proportionately more arts, culture, and humanities organizations; the Midwest more human services; and the West more environmental groups. The Northeast, with about one-fifth of the population, is home to almost a quarter of nonprofits that account for nearly 30 percent of the expenditures of the sector, while the South, with 31 percent of organizations, accounted for 28 percent of expenses (table I.4).

Some areas have higher rates of giving and stronger civic and nonprofit infrastructure than others. Wealthier areas have larger numbers of nonprofits that provide amenities such as recreation, private schools, and art activities (Wolpert 1993). Cultural, political, economic, and

**Figure I.3. Number of Nonprofit Organizations per 10,000 Residents, 2004**



Source: The Urban Institute, NCCS Core File, Public Charities, 2004.  
 Note: Only operating public charities are included (see table I.1 for the definition).

**Table I.4. Total Number and Expenses of Nonprofit Organizations by Region, 2004**

<i>Region</i>	<i>Organizations</i>	<i>Percent</i>	<i>Expenses (\$ millions)</i>	<i>Percent</i>
Northeast	59,825	22.8	272,807	28.8
Midwest	60,052	22.8	223,361	23.6
South	81,881	31.1	264,181	27.9
West	60,734	23.1	185,435	19.6
U.S. Territories	405	0.2	1,587	0.2
<b>Total</b>	<b>262,897</b>	<b>100.0</b>	<b>947,371</b>	<b>100.0</b>

*Source:* The Urban Institute, NCCS Core File, Public Charities, 2004.

*Note:* Only operating public charities are included (see table I.1 for definition). Regions follow the Bureau of the Census definition.

historical factors all affect the types of organizations and their financial strength in each region (for California, see Gammal et al. 2005; for Indiana, Gronbjerg and Allen 2004; New York City, Wolpert and Seley 2004; Pittsburgh, DeVita et al. 2004; Washington, D.C., Twombly and Auer 2004).

State policies and federal devolutionary policies that fund programs and people based on financial status, as well as the local capacities of nonprofits, sometimes magnify regional differences. Because the fiscal capacities of states and cities vary widely, projecting how future shifts in governmental priorities and spending on charitable organizations will affect nonprofits is difficult. Some policies increase resources available to nonprofits, while other policies increase the number of people who need services. Certain programs, like faith-based initiatives, may benefit some types of organizations and not others. Government financing decisions seldom, if ever, affect all nonprofits equally.

An infrastructure of associations at the local, state, and national levels provides a voice for nonprofits in the policy process, seeking to affect funding decisions on the one hand and trying to enhance nonprofit capacity, conduct research, educate nonprofit managers, and encourage collaboration on the other (Abramson and McCarthy 2002). This infrastructure, dating generally from the early 1980s, has had significant, if rarely documented, impacts on the nonprofit sector.

The portrait of the nonprofit sector that emerges is one of disparate groups, thinly and unevenly spread across the states, with a great range of missions and activities. Although their increasing economic strength raises their visibility as a whole, most are community-based, modestly funded, and not well known outside of their neighborhoods. Despite the increase in numbers of nonprofits in recent decades, they are still only a small proportion (less than 8 percent) of all business, government, and nonprofit entities in the country.

## NONPROFIT ACTIVITIES

A great diversity of activities matches the wide variety of nonprofit organizations. Nonprofits produce and display art, culture, and music; generate knowledge through research and education; protect consumers, the environment, and animals; promote health; prevent and treat diseases; provide basic social services, such as housing, food, and clothing; promote international understanding; provide international aid and relief; create community social and economic infrastructure; advocate for and against public policies; provide services and funding to other nonprofit groups; transmit religious values and traditions; provide solidarity, recreation, and services to members and others; and educate and register voters, as well as many other activities.

This laundry list gives some sense of the difficulty of defining and describing the nonprofit sector. It also makes clear that voluntary organizations do many things that governments and businesses also do. There are no sharp boundaries among the sectors; in fact, there is increasing concern about the blurring of boundaries, particularly with regard to commercial activities. However, some activities (such as religious worship, membership activities, and the monitoring of government) are almost exclusively accomplished in the nonprofit sector, and other activities (such as museums, botanical gardens, and zoos) are more likely to be undertaken by nonprofits than by government or business. Some activities are more evenly divided between government and nonprofits (such as providing social services), while others (such as primary education) are largely a government activity. Business and government also sometimes collaborate or cooperate with nonprofits in providing, for example, low-income housing and disaster relief.

Nonprofits have a long history of pioneering programs that other sectors subsequently take over. Nonprofits popularized primary education, kindergartens, and disease control, which government then took over when demand outpaced nonprofit providers' ability to supply services. Businesses picked up recreation programs that nonprofits pioneered and developed the programs into profit-making enterprises. Nonprofits are often lauded for being flexible and innovative, a source of ideas for improving society; those ideas transcend sectors.

Collaboration with government, however, is frequently difficult for both partners. Experiences with disaster relief in large-scale tragedies, such as the attacks of September 11, the Asian Tsunami of 2004, and the hurricanes of 2005, reveal the strengths and weaknesses of nonprofits and of their collaboration with government. Nonprofits are quick to respond and galvanize volunteers and donations, but their capacity varies in different regions of the country and the world. They are flexible problem solvers, but weak on long-term logistics and coor-

dination with other nonprofits and government, although coordinating mechanisms were improved after the attacks of September 11 (Foundation Center 2004; Goldman 2006). But importantly, given their relative size (see chapter 2), they cannot compensate for weak government leadership or inadequate government responses in large-scale disasters.

Some nonprofits have the characteristics of business corporations or of government programs, and a small proportion of organizations do change from one type of organization to another.<sup>19</sup> Governments set up nonprofit corporations, such as the Corporation for Public Broadcasting, to carry out public programs. Nonprofits may create profit-making subsidiaries (which pay taxes on earned income) to subsidize their charitable activities, a trend that appears to be accelerating (Steuerle 2001). They also engage in social enterprises that directly use market activities as part of their missions; for example, nonprofits may train youth in business practices by employing them to manage a nonprofit-owned ice cream shop (Dees 1998; Kerlin 2006; Skloot 1988).

The interaction of nonprofits with the business sector affects their relationship with government. A few nonprofits give up their tax-exempt status when they can accomplish their missions more effectively as business corporations or when economic incentives, government policies, or the need for capital make it profitable for them to become businesses. The conversion of nonprofit hospitals to for-profit businesses is one example. Conversions raise questions about whether it is in the public interest for businesses to take over hospitals and other services, but as long as the assets are reserved for charitable purposes and some form of community service is maintained, the current barriers to conversion seem minimal. Scholars' efforts to discern whether program outcomes are different depending on whether organizations operate as nonprofits or for-profits suggest that the nonprofit form adds value, but the results are not definitive (Gelles 1993; Gray and Schlesinger 2002, Schlesinger and Gray 2005). Some members of Congress, however, are particularly interested in the rationale for permitting nonprofit hospitals to compete with for-profit hospitals when donations are a minor portion of their revenues and charity care is a small part of their services.<sup>20</sup> John Goddeeris and Burton Weisbrod discuss the policy implications of the conversion of organizational form in chapter 8, "Ownership Forms, Conversions, and Public Policy." They note that higher education is likely to be the next area of for-profit conversions.

The sometimes overlapping and complementary nature of the three sectors may seem inefficient at times, but it provides flexibility and adaptability. Public-serving activities are not restricted to government but can be undertaken through multiple avenues. Diverse populations with different tastes and requirements can create entities to meet their perceived needs. Government can contract with nonprofits to provide

social and health services without expanding the government workforce. Social entrepreneurs can implement their visions through nonprofit organizations, and the alternatives they develop sometimes find their way into the public or business sectors.

## ROLES OF NONPROFIT ORGANIZATIONS

Why do nonprofits exist? Scholars answer that question in different ways depending on their disciplines and orientations. Economic theories include the notions of “market failure,” “government failure,” and “nonprofit failure,” to explain the public services nonprofits deliver and the partnership of the government with the nonprofit sector in financing public services.

Market failure is based on the concept that there are desired services or collective “goods” that do not have sufficient potential for profit to attract business providers. Market failure is also precipitated by insufficient information on the quality of services, which may lead consumers to turn to nonprofit providers, which are perceived as trustworthy because they do not have a profit motive. Similarly, government failure implies that government will not provide certain public services for reasons that may include the cost or the limited constituency that desires the service (Hansman 1987; Weisbrod 1988). Nonprofit failure explains the nonprofit–government partnership as a consequence of the public demanding services best met by nonprofit provision but requiring government financing. In this theory, nonprofits are the preferred providers of services, and government action becomes necessary because nonprofits are unable to meet perceived needs (Salamon 1995). Dennis Young reviews economic theories of the relationship of nonprofits and government in chapter 1. Lester Salamon uses slightly different terms for a similar analysis applied to the international context in chapter 12.

In contrast to economists, political scientists tend to stress the role of the nonprofit sector in terms of providing avenues of civic participation and representation of interests in the pluralistic political system of a heterogeneous society. Nonprofit groups aggregate diverse values and interests and represent them to the political system through political advocacy and lobbying of the government (Berry 1984; Berry and Arons 2003; Boris and Krehely 2002; Douglas 1987; Verba et al. 1995; Warren 2002). Roger Lohmann builds on the idea of the commons as the civic arena in his book on the nonprofit sector (Lohmann 1992).

The government–nonprofit relationship in the political sphere is delineated in part by the constitutionally guaranteed rights of free speech and association and in part by the limits on using dollars subsi-

dized by the charitable tax deduction for advocacy, lobbying and similar types of political activities (Fremont-Smith 2004; Reid 2003). Conflict occurs when government and nonprofits disagree on the boundaries of permissible efforts to influence government policies and engage in political activities.<sup>21</sup> (See chapter 10 for a discussion of regulations affecting nonprofit advocacy and the implications of campaign finance reform for the political use of charities and other types of nonprofits.)

Interdisciplinary approaches to studying nonprofits provide valuable alternative perspectives. Communitarians view voluntary associations in organic terms, as the precursors of government and the market and thus as among the most basic social relationships that connect people and create communities. Those relationships became more complex over time and evolved into the state and the market (Etzioni 1993). Robert Putnam and others use the concepts of social capital and civil society in a basically communitarian framework (Putnam 1993; Walzer 1995).

Scholars also look to the civic history of the United States—the suffrage, antislavery, and child welfare movements, for example—and to the religious roots of charity, altruism, and social justice to explain the giving and volunteering that characterize involvement in nonprofit organizations and rights-oriented social movements (Friedman and McGarvie 2003; McCarthy 2003; O’Connell 1997; Payton 1988; Skocpol 1995; Wuthnow 1991).

Each approach reveals a different aspect of the roles of nonprofits, and thus their relationship with government. A civil-society approach examines the role of nonprofits in generating the social capital that links people to their communities and to others. A political analysis highlights efforts to influence the political process and create social change. An economic perspective looks at the creation of income, jobs, and knowledge, as well as service provision and economic development, often in collaboration with government. A values perspective helps explain the roles of nonprofits in alleviating poverty and promoting and maintaining religious, ideological, cultural, and artistic values and beliefs, activities that sometimes lead to conflict with government. The chapters in this book reflect the richness of these approaches.

## **Social Capital**

Nonprofit organizations, regardless of origin, create networks and relationships that connect people to each other and to institutions quite apart from the organization’s primary purposes. Research by Robert Putnam and others suggests that relationships such as those fostered by choral societies, bowling leagues, and other community associations

build the trust and cooperation essential for the effective functioning of society, politics, and the economy (Putnam 1993).

Despite growing professionalism in the nonprofit arena, most nonprofits still facilitate relationships and connect people to each other and to the constituencies they serve. Members and volunteers are critical to the success of many nonprofits. Volunteers serve in governance capacities on boards of directors, in staff management and service positions, as fundraisers, and in many other ways. Volunteers bring expertise from business, government, and the community to bear on local, national, and international problems. Volunteers enhance civic engagement and spread expertise; people of various backgrounds learn about the needs of their communities and others, and act together to solve them. Volunteering also harnesses the enthusiasm of the young and old and adds meaning to their lives. People involved in youth groups, churches, and other voluntary activities when young are more likely to give, volunteer, and be engaged in civic life as adults (Hodgkinson and Weitzman 1996). Recent research finds those who participate in the arts are more likely to give, volunteer, and be active in civic affairs (Ostrower 2005; Walker and Scott-Melnyk 2002). Those who are involved in their communities are also more likely to be healthy and happy (Seligman 1991). Other research shows that political and civic engagement is related to feelings of efficacy (Pew Research Center for People and the Press 1997).

### **Civic Activities**

Many nonprofit efforts inform and influence domestic social and economic policies as well as international affairs. Much public policy activity involves nonpartisan research, writing, evaluation, and demonstration projects. Some groups try to influence executive agencies, others, the legislative branch. Think tanks and universities conduct research and evaluations and make that information available to policymakers through publications, news media, forums, and individual conversations (Boris 1999; Boris and Krehely 2002). The role of the nonprofit policy expert is changing, however, as some think tanks strive to gain visibility for their ideas and take on the role of advocates with ideological agendas, which calls into question their expertise and credibility (Rich 2004).

Grantmaking foundations and other nonprofits try to influence public policy by demonstrating the efficacy of alternative approaches to economic development, population issues, or hunger (Hess 2003). They may conduct experimental programs, evaluate the results, and communicate them to public authorities. Foundations may also promote policy agendas indirectly. For example, foundations financed the conservative

think tanks that provided much of the intellectual capital for the Reagan and Bush administrations (Covington 1997; Rich 2004).

Nonprofit advocacy groups try to educate the public and encourage individuals to contact their representatives directly or to sign petitions for or against certain positions; they promote voter registration and inform voters. Jeffrey Berry maintains that public interest citizen groups have been very effective at setting and influencing the congressional agenda (Berry 1999). Some nonprofits also try to influence public policy through demonstrations, sit-ins, parades, and boycotts.

### **Political Activities**

Certain types of nonprofits are involved more directly in politics, and some develop multiple organizational structures to permit them to be involved in a variety of ways. They might have a 501(c)(3) charity to provide services and collect tax-deductible contributions, a 501(c)(4) social welfare organization to lobby freely for policies that serve their constituencies, a 527 organization to engage in electoral politics through independent issue advocacy, and a political action committee (PAC) so they can be involved in partisan political campaigns. These structures are a direct result of government regulation of political activities (Reid and Kerlin 2003). Elizabeth Reid, in chapter 10, discusses nonprofits as politically active organizations, highlighting the representative and participatory functions of nonprofit advocacy and the regulations that guide and constrain such activities.

Some of the most profound social changes of this century have been promoted through a combination of research, public education, advocacy, legislation, and litigation fostered by nonprofit organizations. Those nonprofits usually work in coalitions, sometimes in collaboration with government and business interests and sometimes in conflict with them and with other nonprofits. For example, civil rights groups, working with religious and other organizations, attacked racial segregation in this country through direct action, lobbying, advocacy, litigation, and public education. Environmental groups used research, public education, advocacy, and litigation in their pioneering efforts to reduce air and water pollution and protect the environment and wildlife. Mothers Against Drunk Driving used a variety of tools, including public education, to create a major change in the public perception about the consequences of drinking and driving. Anti-smoking groups fostered research and used the results to educate the public about the negative impacts of tobacco smoking on health.

Not all advocacy is designed to introduce change. Groups all along the political spectrum may aim to conserve or protect the values that they espouse, or try to prevent the erosion of values they cherish or

advantages they enjoy. The National Rifle Association, for example, promotes gun ownership and lobbies against legislation that would limit an individual's right to own guns. The American Civil Liberties Union defends individuals' rights and litigates against legislation that it believes threatens freedom of speech and other liberties guaranteed in the Constitution and the Bill of Rights.

Advocacy can be contentious work, as nonprofits may face direct and indirect opposition from other groups, business interests, and government agencies. Success for some causes may mean failure for others, and some outcomes may not be widely perceived as positive for society. For example, pro-choice organizations use public education, advocacy, and litigation to protect a woman's right to control her reproductive choices, while anti-choice groups use the same tools to limit access to abortions because of those groups' religious and ethical values. Neither side accepts success for the other as a positive outcome for society. In California, anti-tax groups successfully collected signatures and put on the ballot measures to cut public spending, while other nonprofits attempted to counter these efforts and save certain public programs. Similarly, groups successfully organized to overturn affirmative action in that state despite other groups' opposition. In these types of cases, each side perceives the other as undermining their core values and beliefs, often leading to rancorous public discourse.

Highly charged and partisan public communications, declining participation in voting and membership in civic groups, along with low levels of trust in government and other institutions, are arguably indicators that the civic base of the U.S. pluralist democracy is eroding, although this view is not universally held. Of perhaps greater concern is whether there is a participation gap in the United States, particularly among poor people, typically women and minorities, who are not as involved in politically active organizations as others and often do not have the resources, opportunities, and skills to make their needs known in the political system (Berry 1999; Burns, Schlozman, Verba 2001; Skocpol 2003; Verba et al. 1995).

A countervailing trend is the extensive use of the Internet for communication, information sharing, fundraising, and mobilizing people for causes and political activity. Electronic advocacy can mobilize communities of interest to contact legislators quickly and inexpensively. The impact of the Internet in linking nonprofits via e-mail, blogs, discussion groups, and web sites has permitted them to partner more effectively and to reach more people, both nationally and internationally. The Internet has also increased the ability of nonprofit constituents and members to interact and affect the policies and practices of their organizations. Recent elections revealed the power of such groups as Moveon.org, Civic Action, and Focus on the Family in mobilizing liberal and conservative voters, respectively.

## Religious, Cultural, and Artistic Activities

In chapter 9, Robert Wuthow illustrates that the most deeply felt controversies over values are played out in the nonprofit sector—around religious beliefs, artistic expression, personal responsibility, individual rights, and the separation of church and state. Nonprofits express conflicts over competing values long before they reach the political system. These conflicts may be positive when they promote the dialogue and deliberation that are healthy for democracy. In extremely divisive cases, like racial segregation and access to abortions, conflicts can involve legislative and judicial battles at the national, state, and local levels over long periods of time.

The impact of religion on American society is deep and enduring. Religious organizations serve the spiritual needs of their members and promote and preserve the group's religious doctrines and values. Social and health services, crisis care, and advocacy activities may supplement sacramental and membership-serving activities, such as child care and counseling (Chaves 2002; Cnaan 1997; Hodgkinson and Weitzman 1993; Printz 1997; Wuthnow 2004). Religious congregations also impart civic skills to members who learn to organize and collaborate for common ends. Black churches, for example, are well known for their efforts to mobilize members to vote and for their political work, particularly around ending segregation and promoting civil rights (Harris 1994). Some religious denominations are vocal in opposition to birth control, abortion, gay marriage, stem cell research, and teaching evolution. Religious congregations are also among the most forceful advocates for peace, social justice, environmental protection, and policies that protect immigrants and the poor. The IRS, however, does scrutinize political speech in religious organizations to determine if they are engaging in prohibited partisan campaign activities by endorsing candidates who share their values.<sup>22</sup>

The separation of church and state in the United States involves an ongoing debate with a long evolution. Historically, however, the religious charities' receipt of government revenues for services provided to the general public is well established (Hall 1982). Government-funded social service provision by nonprofits affiliated with Catholic, Lutheran, and Jewish faiths, for example, has been widespread. Such groups accepted limitations on proselytizing when providing government-funded services and did not provide preferential services to their members.

More recently, under federal Charitable Choice and faith-based initiatives, congregations and affiliated religious service providers are permitted to compete for government contracts to deliver social services that have religious content and display religious icons. The resulting

partnership between government and congregations is a contentious issue that has raised the separation of church and state in policy debates (Wuthnow 2004). (See chapters 7 and 9 for discussions of the policy issues.)

Most religious entities fall outside of the government regulatory framework for nonprofit organizations. Houses of worship and closely aligned entities enjoy the benefits of tax exemption and deductible contributions but are not required to register or report to the IRS. Many do report, however, and the number is increasing, partially in an effort to create a formal structure to qualify for faith-based funding initiatives. Government funding requires accountability, and some fear that monitoring contracts and performance will involve the government too deeply in the affairs of religious bodies. Congregations that desire government funding often set up separate charities to segregate finances, avoid potential conflicts, and protect their sacramental activities from government involvement.

Arts and culture are embedded in community life and are reflected in worship, education, celebrations, and much more. Through arts and culture, we transmit group memory, celebrate ethnic and national identity, and interpret the past. The arts enhance our quality of life and generate economic benefits and much more for communities (Jackson 1998). Government support of the arts raises questions about the types of art that deserve public support and standards of morality and decency that may offend some people but not others. (See chapter 9 for a discussion of the controversy surrounding funding for the National Endowment for the Arts.)

### **Service Provision**

Nonprofits of all types provide services they may offer to the community, special populations, members, governments, businesses, or other nonprofits. As service providers, nonprofits overlap with business and governments, for example, in education and medical care. They may be contractors for governments and businesses (providing preschool programs or drug abuse treatment), be collaborators with governments (maintaining national and regional parks or preventing diseases), or act in lieu of government (providing accreditation or protecting consumers). As government has contracted out more services, the nonprofit's share of the workforce has increased by roughly the amount that government employment has decreased (see chapter 2).

With more government money at stake, it is not surprising that nonprofits find themselves competing with for-profit providers (U.S. Congress 1996).<sup>23</sup> The effects, including the adoption of business practices, are felt not just internally but by donors and clients. Nonprofits

often find that competition means that they must market, actively attract clients, and report on their outcomes and impacts (see chapter 6).<sup>24</sup> These changes can be positive but may affect the way donors view nonprofits and clients experience them. A pervasive bottom-line orientation may inadvertently affect even nonprofits that do not have government contracts or commercial revenues; it may increase efficiency but could also undermine charitable service missions.

Government may turn to nonprofits to undertake activities that require reaching local populations with culturally sensitive materials or to avoid building up staff for short-term projects. Nonprofits provide a way for governments to devolve programs either directly or through state and local authorities and provide services without incurring government salary scales and bureaucratic red tape. In chapter 7, Carol De Vita and Eric Twombly summarize current research on devolved federal programs and the impact these policies have on nonprofit organizations. The authors also document the lack of resources of the smaller, nonprofit human service providers.

Nonprofits also interact with and provide a variety of services directly and indirectly to the business sector. They collaborate with businesses in promoting quality of life in areas where firms operate. Donations to and contracts with cultural organizations, child care, and recreation groups underwrite amenity services that attract and hold corporate employees, thereby helping to maintain the community's tax base. Support through gifts and contracts also enable universities to undertake research, develop technology, and train current and future employees (and public servants). Environmental groups help level the playing field for socially responsible behavior by demanding, for example, that all competitors within an industry clean up pollutants. Collaboration between voluntary groups and businesses develops when industries benefit from the educational and advocacy campaigns of nonprofits, as in disease prevention and anti-smoking campaigns that assist insurance companies.<sup>25</sup>

Nonprofit business associations provide information, research, and advocacy services for member corporations. These associations monitor the health of industries and the impact of legislation and regulation on corporate activities. They may provide low-cost insurance or cooperative buying opportunities. Similar nonprofit associations provide such services for groups of nonprofits, health related nonprofits, philanthropic foundations, colleges and universities, symphonies, museums, and others.

State and local governments directly and indirectly fund nonprofits to provide services and also oversee the activities of nonprofits and their fundraising to ensure that the public is given accurate information and not misled by false claims and illegal operators. Woods Bowman

and Marion Fremont-Smith describe state financing and regulatory systems in chapter 5. They also show the prevalence of Medicare and Medicaid funds in government contracting with nonprofits.

### **Economic Impacts**

As mentioned earlier, nonprofits make significant contributions to the U.S. economy as employers and service providers. Their assets represent at least 5 percent of net worth (excluding churches), as Steuerle and Hodgkinson report in chapter 2. Millions of people serve as volunteers, further expanding nonprofit resources. This economic role, however, is disproportionately concentrated in the largest organizations and in certain sectors, especially in hospitals, private universities, and multi-purpose organizations like the American Red Cross, Catholic Charities, and others. More than one-third of nonprofit employees work in hospitals.

Nonprofits provide the entry point into the labor force for many women and minorities. About two out of three workers in the nonprofit sector are women. Employment is often at lower-than-market wages and without health and retirement benefits. Major nonprofit hospitals and universities anchor whole inner-city neighborhoods or small towns with employment opportunities, services, and amenities like arts, culture, and recreation opportunities. They contribute to public coffers by paying payroll taxes, while employees pay both income and payroll taxes.

Because nonprofits generally do not pay property taxes or sales taxes, they may be perceived as a drain on the local economy (Borowski and Gaul 1993; Brody 2002b). Some large nonprofits, including foundations, make payments in lieu of taxes (PILOTs) to city governments to help cover costs of services. Major cities, including Baltimore, Boston, Detroit, Indianapolis, Minneapolis, Philadelphia, and Pittsburgh, have developed programs to solicit PILOTs from nonprofits (Leland 2002).<sup>26</sup>

Regional studies of nonprofits reveal their significant economic contributions to local economies and are being used to grab the attention of policymakers as nonprofits attempt to negotiate for policy influence and revenues. A study of nonprofits in the Washington, D.C., metro region revealed a sector second only to the federal government in its employment. The 7,614 organizations raised over \$33 billion and spent \$29 billion in 2000 (Twombly and Auer 2005). They employed over 11 percent of the region's private workers, generating approximately \$9.6 billion in wages, or over 10 percent of the region's total in 2003 (Salamon and Geller 2005). In New York City, active nonprofits accounted for more than \$50 billion in expenditures in 2000 (Wolpert and Seley 2004). In Baltimore, nonprofits generated full-time equivalent jobs for 18

percent of the workforce and \$5.4 billion in economic activity. The Baltimore City government received an estimated \$41 million in “piggy-back” state income tax, real estate tax, and sales tax revenues traceable to spending by nonprofits, their vendors, and employees (Maryland Association of Nonprofit Organizations 1997).

### **International Trends**

Nonprofits that operate across national borders, as well as nonprofits that work within other countries, are growing both in numbers and influence. International nongovernmental organizations (INGOs) are active in human rights, economic development, disaster relief, disease prevention and treatment, environmental protection, conflict resolution, and many other fields. They often act in concert with national governments, and multinational and international institutions, although conflicts are also common. Contracts with governments are becoming more prevalent and disaster relief and recovery have become high profile issues. The Internet has transformed the ability of INGOs to collaborate, advocate, and raise money. They are linked in global networks that have huge potential to monitor and affect public policies.

U.S.-based international nonprofits receive the bulk of their resources from contributions, but government support is a growing proportion of their revenues. About a fifth of their financing is from U.S. government grants, chiefly through the United States Agency for International Development. As U.S. foreign policy goals change, funding levels change. These organizations do not always fully agree with U.S. government policy, however, so they strive to preserve their ability to undertake independent action. They are potent advocates on a variety of issues, from development and family planning to environmental protection. (See chapter 11 for a discussion of government relationships and financing of U.S. INGOs.)

Many countries have long-standing, expansive nonprofit sectors that play economic, social, and political roles like those in the United States. In some cases, governments provide more significant support and permit more engagement in the policy process. The extent of government use of nonprofits to provide social and health services sometimes obscures the nature of some welfare states. Lester Salamon’s research illuminates the extensive scope and economic impact of nonprofits and the variation in nonprofit–government relationships in countries around the world. (See chapter 12 for a discussion of the comparative trends in government–nonprofit relationships in developed and emerging economies.)

## NEGATIVE IMPACTS

Nonprofits, of course, have the potential for negative as well as positive impacts on society and are subject to the failings of the people who lead them. Regulations are often designed to protect the public from malfeasance but are often hard to monitor. Many types of negative behaviors are not easily regulated in the first place. Some effects are obvious: nonprofits can be a divisive and fragmenting influence in the political system. They may undermine political parties (or support them). Well-funded groups can manipulate public opinion, promote ideological positions, or have a disproportionate impact on public policy, all without revealing their funders. Politicians may use nonprofits to attract donations or bestow favors on cronies. Low-income populations may be at a disadvantage in the policy process because they may not have access to groups that can represent their interests. Although the evidence is mixed, nonprofits may have an edge over businesses in the same markets because of their tax-exempt status.

Other potentially negative consequences are not as obvious. The use of nonprofits by governments to deliver services may separate governments from accepting responsibility for services funded, thus undermining popular support for public financing of programs or promoting cynicism toward nonprofits if programs fail. Nonprofits can provide a “cop out” for political leaders who wish to curtail government responsibilities. Wealthy communities can also use nonprofits to provide for their own needs, while neglecting to provide tax revenues for public education and other public health and human services for low-income residents.

## CONCLUSION

We must understand the variety of roles the nonprofit sector plays before we can thoroughly explore its relationship with government. Because the spheres of activity that nonprofits and government undertake intersect in so many ways, the nature, scope, and impacts of nonprofits are sensitive to changes in public policy.

Nonprofit and government interactions are multifaceted in a civil society. Simplistic assumptions about what nonprofit organizations can do and how they affect society may lead to public policies that are ineffective or have unintended negative consequences both for the organizations and for society. The remaining chapters in this volume describe many dimensions of these interactions.

We hope that this book will increase understanding and provoke ideas about how to improve the dynamic relationship between nonprofits and government.

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## NOTE ON DATA SOURCES

### Data Sources

Data used in this chapter are compiled by the National Center for Charitable Statistics (NCCS) at the Urban Institute. These data are derived from the Forms 990 that nonprofits are required to file with the IRS. NCCS creates research data sets and summary tables from IRS data and provides them to researchers and the public at <http://nccs.urban.org>. The most comprehensive data set, National Center for Charitable Statistics/GuideStar National Nonprofit Data Base, was developed in collaboration with GuideStar and is available to researchers on request. Forms 990 and 990 PF can be viewed at <http://www.guidestar.org> and <http://www.foundationcenter.org>. Data on private and community foundations are also available on the Foundation Center's web site.

### Religious Congregations

Estimates of the number of religious congregations are from *The New Nonprofit Almanac and Desk Reference* (Weitzman et al. 2002), which reports approximately 344,000 congregations in 1989 (number imputed from 1987 and 1992), 343,000 in 1993 (number imputed from 1992 and 1997), and 354,000 in 1998. The 2004 estimate of 330,000 congregations is from Hadaway and Marler (2005). These figures were adjusted to exclude congregations that have registered with the IRS and so are already accounted for in table I.1. An estimated 113,000 congregations registered with the IRS in 2004, based on an analysis of organizational purpose in the 2004 IRS Business Master File.

## NOTES

1. We use the term nonprofit sector to mean all nonprofit organizations.
2. Forms 990 are public documents that provide financial data—assets, revenues, expenses, etc. They are available for inspection on the web sites of GuideStar and the Foundation Center. Research databases with financial information based on Forms 990 are available at NCCS.

3. For a thorough discussion of nonprofit accountability see Brody (2002a).
4. See for example, the white paper from U.S. Congress, Senate Finance Committee (2004), "Senate Finance Committee Staff Discussion Draft, Tax Exempt Governance Proposals," June 22. The proposals in this document led to a sectorwide effort to address the proposals and develop recommendations that nonprofits could accept. The Nonprofit Panel, convened by the Independent Sector, formed working groups to draft and discuss recommendations for strengthening nonprofit transparency and governance. The results were published in Panel on the Nonprofit Sector (2005).
5. The number of congregations in the United States is estimated at about 330,000 (Hadaway and Marler 2005). About 113,000 register with the IRS, although they are not required to do so. See the section "Note on Data Sources."
6. Most congregations are not included here because they are not required to report to the IRS, although many do. See note 5 and table I.1.
7. Charities with between \$5,000 and \$25,000 in gross receipts must register with the IRS, but they are not required to report their finances on Forms 990. In table I.1, they are under the heading "nonreporting."
8. While 501(c)(4) organizations are commonly referred to as advocacy organizations because they are permitted greater freedom to lobby and conduct issue advocacy, and if they are membership organizations, they may issue partisan communications to their members (see chapter 10). Organizations in this category include a mix of organizations that serve public purposes but are deemed not to be eligible for tax-deductible contributions.
9. *The New Nonprofit Almanac and Desk Reference* (Weitzman et al. 2002) defines the independent sector components to include all 501(c)(3) charities, including congregations, and 501(c)(4) social welfare groups.
10. The National Taxonomy of Exempt Entities (NTEE) was developed by the National Center for Charitable Statistics (NCCS) and is currently used by the IRS and many researchers to classify nonprofit organizations. See <http://nccs.urban.org> for a description of the categories.
11. NTEE originally had over 600 categories that were consolidated into approximately 400 when the IRS began to use NTEE to classify organizations.
12. Each of these tax benefits has a cost to government of revenues foregone, in effect a subsidy that in tight financial times may become a source of controversy, for example, the Senate Finance Committee actions to limit the deductibility of car donations to the actual revenue realized by charities will cut government costs. Measuring the cost to the government and the benefit to nonprofits is possible; more difficult to measure is the benefit to society.
13. Salamon shows a similar picture for Germany in table 12.1.
14. De Vita and Twombly discuss the financial vulnerability of many human service organizations in chapter 7.
15. Here we focus on grantmaking foundations as defined by the Foundation Center, rather than all foundations reported in table 1.1, which include operating foundations and organizations that have lost public charity status for failure to meet the public support test (Lawrence et al. 2005).
16. Analysis by Kerlin (forthcoming).
17. Grantmakers for Effective Organizations has a membership of 500 that seek to increase nonprofit effectiveness. See also the Human Interaction Research Institute database of capacity-building programs supported by foundations (<http://www.humaninteract.org>).

18. See Wing et al. (2004) for a discussion of nonprofit overhead and fundraising costs; also see Fremont-Smith and Cordes (2004).

19. See table 8.1 for a summary of conversions of post-secondary schools to and from nonprofit status.

20. Defining the public service or charitable activities that nonprofit hospitals must undertake to legitimize their charitable status has proven to be difficult and controversial. A hearing before the House Ways and Means Committee in 2005 explored the issues surrounding charitable status for hospitals (among others). A report by the Joint Committee on Taxation set out the issues (U.S. Congress, Joint Committee on Taxation 2005).

21. Chapter 4 argues that nonprofit tax exemption may be a government attempt to respect the sovereignty of the nonprofit sector: government takes a hands-off approach to taxing, and nonprofits are required to be hands off in terms of advocating for government subvention.

22. To counter this limitation, Representative Walter Jones introduced a bill in the U.S. House called the Houses of Worship Free Speech Restoration Act of 2005.

23. Todd J. Gillman, "Health Clubs Hit YMCAs' Tax Breaks," *Washington Post*, June 30, 1987.

24. The Government Performance and Results Act requires contractors to report on outcomes (See chapter 7).

25. Gene Steuerle and Joe Cordes are editing a volume on nonprofits and business that will examine the policy and practical issues in nonprofit-business relationships.

26. After a series of stories in *The Philadelphia Inquirer* criticized nonprofits for not contributing to the city's coffers, the city of Philadelphia required payments in lieu of taxes from the larger nonprofits within its jurisdiction (Borowski and Gaul 1993).

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