Just What Do Nonprofits Provide?

C. Eugene Steuerle

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Does a nonprofit act in the public interest? Does it provide collective goods—support for the poor, education, community development, cultural goods—that might not otherwise be available by for-profit organizations alone? And is there any way to tell?

These are among the most important—and most difficult—of all issues surrounding the nonprofit sector. Tax policy, for instance, provides favorable tax treatment toward many types of nonprofits. What exactly does the public get in return? Today the question of public value plays out especially in debates surrounding the hospital sector. A number of nonprofit hospitals are converting to for-profit status, and communities are wondering if they have lost anything in the process. Meanwhile, Congress has toyed with whether remaining nonprofit hospitals deserve retention of their nonprofit status and whether some should be required to provide minimal amounts of indigent care. While there is no easy answer to these questions, some very useful information on the activities of individual nonprofits can be obtained by examining the uses and sources not just of funds but of all the resources of a nonprofit organization.

Sources of resources include:

- payments for resources provided;
- charitable contributions of money;
- return on net assets; and very importantly,
- charitable contributions of services (use of time and energy) provided at below-market cost, or at zero cost, by workers and supporters of the organization.

Uses of resources include purchases of inputs or intermediate goods and services such as:

- payments to service providers, both external and internal;
- rental payments for capital; and
- purchases of goods used within the organization either to provide services or as amenities to workers.

Finally, uses of resources include:

- final services and goods furnished to recipients or purchasers of the organization's activities.

For our purposes here, we ignore a few other possibilities, such as the production of intermediate goods and services by the nonprofit. Nonetheless, this type of balance sheet demonstrates that the nonprofit can produce some additional collective goods and services for society only if it has available to it some additional sources out of which those uses are financed. It is unlikely that the nonprofit will survive long if it charges more for its services than would for-profit organizations. Therefore, its vital sources for paying for collective goods and services are charitable contributions of money and time, including services provided at below-market cost. Also related are returns made possible by assets purchased out of past charitable contributions. Charitable contributions may also be received in indirect ways. For example, some charges for services could be excessively high if customers were willing to pay the excess cost as a way to contribute.

Take now a hospital that receives no charitable contributions. Assume that workers in this hospital are paid the same level of wages as in the for-profit sector. Then unless there is some return on endowment or net assets that get passed on to the public, it is highly unlikely that this nonprofit furnishes any more collective goods and services than a for-profit organization. State regulations might require that both types of hospitals provide some indigent care, but the payment of a common indirect tax in the form of a regulation would not by itself establish the case that a differential existed.

To give a simple example, a physician once explained to me what happened when he moved from one nonprofit hospital to another. In the first case, the physicians typically would review CAT scans of patients within the hospital at a modest charge. In the second case, they had figured out how to review these scans through an intermediary in an hour or so before showing up at the hospital and then getting the hospital to pay them at a very high rate so as to supplement their income. Both hospitals were nonprofits. But in the first case, the doctors acted less as profit-maximizers within the nonprofit institution, whereas in the second they succeeded in garnering higher amounts of resources for the same amount of work performed.

It is even possible for a nonprofit to provide collective goods and services, yet on net decrease total collective goods in society. Assume that hospitals draw charitable contributions away from soup kitchens, but that the higher share of charitable contributions inure to the benefit of service providers in the hospital sector than in the soup kitchens. Then conversion of a nonprofit hospital to a for-profit hospital could lead to fewer indigent care services by the hospital, but still be more than offset by a higher amount of collective services to feed the poor.

An accounting system requires balance. If there are no additional sources of resources, then there are no additional uses of resources, including production of collective goods and services. Measurement, however, is another issue. In particular, resources can be "added" or "subtracted" effectively through their more or less efficient use. If the profit-making motive, for instance, induces for-profit organizations to become more efficient more quickly, then there may be periods of time when conversion to for-profit status could increase net output at the same cost. Thus, a nonprofit hospital could pay its doctors less, yet, if the hospital is less efficient, not provide any more goods and services in total than a for-profit organization. Efficiency gains and losses are extremely hard to measure and, therefore, make it difficult to know precisely whether a nonprofit works in the public interest—as opposed, say, in the interest of its managers or professional workers.

Still, all is not lost. This type of accounting does provide limited knowledge for regulators and lawmakers. It tells them, for instance, that excessive salaries will likely reduce the charitable output of a supposed charitable organization. For researchers, it could help reveal more broadly what parts of the nonprofit sector on average are more likely to provide collective goods and services. Finally, and perhaps most importantly, it allows nonprofit organizations themselves to do internal assessments. They can test whether they provide more collective goods and services than otherwise would be possible by asking themselves forthrightly what additional sources make those actions possible.

Other Publications by the Authors

- C. Eugene Steuerle