

The Emerging Sector: In Search of a Framework

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Editor

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Foreword

When The Kahanoff Foundation first approached CPRN about this project in the spring of 1995, the nonprofit sector was still mostly invisible. People could identify with their favourite charity, community organization or professional association. But they had little or no conception of the size, complexity or diversity of the formal and informal activities that comprise the sector. Nor was there much talk about the important role that civic association can play in the health of a community and an economy. One reflection of that invisibility was the name – the nonprofit sector. It defines the sector by what it is not - not government and not commercial.

A lot has changed in two years. The charitable sector has figured as a player in the last two federal budgets. Governments are delivering more and more “public” services through charitable or nonprofit organizations. A Working Group set up by the Quebec Economic Summit has prepared an extensive plan to develop *L'économie sociale*. The sector itself has begun to think as a sector - mobilizing its leadership to begin to define, in proactive and forward looking terms, what the sector is. What is still missing is a brand name - is it the voluntary sector, the civic sector, the third sector, the social sector, or the independent sector? When the brand name is determined, we will be able to say that the sector has emerged as a social force that, in the eyes of some, parallels the market and the state. Hence our title, the emerging sector.

Our mission in this study was to use economic and other expertise to assess the existing knowledge base in the formal academic literature and in scattered data sources. We wanted to know the state of knowledge in order to identify the major gaps, to attract the interest of the research community to an underexplored topic, and, most important, to start a dialogue about the future role of the sector. That dialogue is needed in two parallel tracks: within the sector; and between the sector and its stakeholders in government, business, foundations, and the public.

To be blunt, the state of knowledge at this time is primitive. Our frameworks and data are perhaps at the level of the national economic accounts and the public sector accounts of almost a century ago. We have a lot of numbers and some interesting analytical studies, but they are incomplete. They yield an X-ray - a rough sketch of

the bare bones. What we need, in the longer term, is an MRI scan that displays the soft tissue of the sector - the ligaments that tie the bones together and the muscles that give them force and direction.

Thus we have subtitled the study *In Search of a Framework*. When you read the conclusions to the main paper, you will find an action agenda for the stakeholders, not a set of policy prescriptions. That action agenda demands new and rigorous thinking on the part of all the stakeholders, including the leadership of the sector itself. It also sketches the data development and research agendas that should mobilize the research community.

The structure of the volume is as follows. It begins with a contextual essay by Ronald Hirshhorn, the Project Director. Here Ron has woven together his gleanings from the wider literature on the sector, the technical papers commissioned for this project, and the discussion at a Roundtable held by CPRN in January 1997, with people invited from the sector, governments, and the research community. The remainder of the volume interweaves papers on the definition of the sector, summaries of the technical papers, and summaries of the discussion of each of those papers that took place at the Roundtable. The net result is a highly textured commentary on what we know, on what we do not know, on the controversies about how the sector should be taxed and supervised, and on why all concerned believe the sector is so important to the future well-being of Canadians and of Canadian society.

I want to say a word of thanks to The Kahanoff Foundation for initiating this work, to Ronald Hirshhorn for directing the research and writing this summary volume, and to the Advisory Committee, which met formally four times, read numerous drafts, and provided frank comments. And, last but not least, I want to thank the authors of the working papers. They all worked very hard to make sense of a tangled and incomplete information base and to respond to the comments of the Advisory Committee as well as peer reviewers. Their technical documents on the size and scope of the sector, the organizational and supervisory law, and the tax incentives for the sector will be published as CPRN Working Papers by the fall of 1997.

We have worked long and hard, but this is not the end. It is just the beginning of the beginning for all who can see the economic, social and civic potential of this emerging sector.

Judith Maxwell
President

Part I – Background and Introduction to Proceedings

by RONALD HIRSHHORN

Part I

Background and Introduction to Proceedings
by Ronald Hirshhorn

I Introduction

This publication reports on the results of a Roundtable on the nonprofit sector held in Toronto in January 1997. Some 35 participants, including representatives of nonprofit organizations, government officials and academics, gathered to consider the nature and contribution of nonprofits and to discuss three research papers that were commissioned by the Canadian Policy Research Networks (CPRN). (See Forthcoming CPRN Publications on the Nonprofit Sector at the end of this publication.) These papers on the size and scope of the Canadian nonprofit sector, organizational law applying to nonprofits, and the taxation of charitable giving are summarized in this volume. Comments by discussants on the three papers and summaries of the general discussion by participants at the Roundtable supplement the contribution of the authors and provide additional perspectives on these topics. The publication also contains two leadoff presentations on the definition of the sector, along with a summary of the subsequent discussion on this topic. This project was initiated and is being funded by the Kahanoff Foundation as part of its program to expand knowledge about the Canadian nonprofit sector.¹

Stressful Times

These are challenging times for the nonprofit sector. While voluntary organizations struggle with the immediate challenge posed by government funding restraints and rising demands for their services, the nonprofit sector as a whole is facing increased pressures to establish its identity and carve out its longer term role in relation to governments and for-profit providers of services.

The immediate source of stress is federal and provincial governments' efforts to get their own finances in order. Governments, which have been by far the most important funder of nonprofits, are under pressure to reduce their grants to the sector. At the same time, the voluntary sector is facing growing demands to address gaps resulting from inadequacies in government-provided social services. These gaps are painfully evident in many areas and are reflected, for example, in the growing ranks of urban homeless, the increasing pressures confronted by local foodbanks, rising levels of child poverty and stubbornly high rates of youth unemployment.

The downsizing of government does not always make life more difficult for nonprofits. Where this takes the form of contracting out or privatization, organizations may be adequately paid for their services or receive access to significant new revenue sources.² But as governments reform their policies and attempt to streamline their service delivery, it is becoming more important for nonprofits to define their own role in the scheme of things.

This large and difficult issue has confronted the sector and intruded into government policymaking in a variety of contexts. Plans to introduce workfare in Ontario, for instance, have given the voluntary sector in this province cause to reflect on the nature of its role. Is the participation of voluntary groups in a scheme that requires the placement of unpaid, "non-volunteers" compatible with the mission of these organizations? The Roundtable discussion revealed the discomfort that nonprofit organizations' increasing reliance on revenue from

gaming activity is also causing among some segments of the voluntary community. The increased importance of government contracts has led some nonprofit social service organizations to fear that they are losing their ability to serve as advocates for particular groups and philosophies.

A very different example comes from the establishment of not-for-profit corporations by the federal government for the delivery of a range of transport services. The new Canadian Airport Authorities, the Canada Ports Authorities, and Nav Canada, the corporation with responsibility for air navigation services, are commercial enterprises with authority to cover their costs through the imposition of user charges. These entities, which are far removed from the voluntary organizations that were the primary focus of interest at the Roundtable, again give rise to the fundamental question as to the relative advantages of nonprofit over government service provision. Is the downloading of such government responsibilities to the nonprofit sector in the broader public interest?

Along with the challenges posed by the changing role of government, the current context is being shaped by an emerging awareness of the importance of the third sector. The picture we have of the sector remains vague; problems of definition, classification and measurement continue to confound efforts to paint a portrait that comes close to what we have for the market and public sectors. Nonetheless, there appears to be an increasing sense that many of the activities that contribute to strong and vibrant societies are located within the third sector.

Some observers believe that an expanded role for the nonprofit sector is indeed desirable, if not inevitable. Peter Drucker foresees a major role for the third sector in addressing social needs that have not been effectively satisfied by the public or private sectors.³ In the emerging knowledge society, according to Drucker, the third sector will have major responsibility for creating human health and well-being, and for promoting citizenship and fostering community.

Jeremy Rifkin looks to the third sector to create opportunities for those who are victims of the job losses that he sees as a consequence of the new information and communications technology.⁴ Since fewer workers will be needed in the information age, new outlets must be found to take advantage of the energy and skills of those who have been replaced by technology. Rifkin sees the third sector filling this role, and puts forward a number of proposals to encourage and support the involvement of productive individuals in community activities.

New technologies are, at the same time, supporting the development of nonprofits by facilitating interaction among individuals. It has become easier and less costly for members of an association to communicate with one another. In addition to their impact on traditional organizations, new information technologies have fostered the emergence of diverse virtual groups – giving us, in the process, pause to reflect on the factors that define a community and the features that give meaning to the concept of organization.

Public discourse on the role of nonprofits, however, has also featured other contributions of a different nature. The public disenchantment with the performance of government that is clearly revealed in recent polls,⁵ has rubbed off onto other institutions in recent years. While

governments are facing demands to become leaner and smarter and to work more closely in partnership with other institutions,⁶ nongovernment institutions are now also confronting a more questioning and critical public. Academics and the media have raised concerns about overlap and duplication in nonprofit activities. Individuals are looking for greater assurance that their donations are contributing to the achievement of important social objectives. The adequacy of nonprofit reporting and the accountability of nonprofit managers and directors are gaining increased attention. There is also a recognition of the need to come to an understanding of the elements of effective management in nonprofits – a poorly understood topic on which, as Drucker states, “work is only beginning.”⁷

Focus of the Project

The adjustments being forced on Canadian society through globalization, the information revolution, and the aging of the population are clearly creating major new social needs and these, in turn, are creating new opportunities for the mobilization of charitable resources. In addition, policymakers are continuing to reassess various components of Canada’s welfare state and, in the process, to explore new possibilities for the division and sharing of responsibilities between the state and the for-profit and nonprofit sectors. How these developments will unfold depends in part on the sector itself – on its ability to develop strategies to successfully address its current financial difficulties, and to put in place longer term solutions that help maintain its independence and sustain public trust and confidence. They also depend on the formulation of an appropriate set of public policies. This latter challenge was a primary focus of the research initiated by CPRN.

Specifically, the research attempts to establish a framework for considering how tax policy and organizational and supervisory laws can contribute to a fuller realization of the potential social benefits from nonprofit activity. The development of a policy framework, however, presupposes some knowledge about the subject population. Part of the project, therefore, was aimed at using the best information available to sketch out what we know (and identify what we do not know) about the nonprofit sector – its size, its diversity, its financial resources and its benefactors. Ideally, policy should also be informed by an understanding of the appropriate role of nonprofits relative to institutional alternatives. This issue, which has received considerable attention by academics, was not the subject of a distinct study, but it was very much a part of the dialogue at the Roundtable. Important considerations relating to this, and the other main project topics, are highlighted in this introductory paper.

II What Are Nonprofits?

The first session of the Roundtable provided a sampling of some of the differences in perspective that commonly surround discussion of the nature and defining characteristics of the sector. These differences start with the issue of nomenclature. As Jacquelyn Thayer Scott points out, different labels – nonprofit, not-for-profit, voluntary, third or independent sector, “The Commons” – have their roots in different scholarly approaches to thinking about the sector. While, for example, sociologists have been attracted by the noncoercive aspects of participation in the “voluntary sector,” political scientists have focused on the potential benefits to pluralist democracies from the availability of an “independent” or “third sector.” By adopting the term “nonprofit” throughout the project, we have subscribed to the language of economists. In addition to these interdisciplinary differences, participants brought to the table their experience from involvement with different types of organizations, and their particular visions about the values and qualities the sector should exemplify.

For legislative purposes, and in much of the literature, nonprofits are simply defined as all private sector organizations that are prohibited from distributing profits to their stakeholders. This definition distinguishes nonprofit organizations from commercial enterprises that must satisfy owners who are entitled to whatever surplus remains after all expenses have been paid. It also confines the use of the term to “private sector” entities, thereby excluding government departments and agencies; and to “organizations,” as distinct from kinship groups, such as households.

The nondistribution requirement has operational advantages over other more ambiguous criteria, but it does not give expression to what many regard as the unique features of the nonprofit sector. At the same time, however, efforts to identify positive traits that distinguish nonprofits from other sectors have been problematic. For example, nonprofit activities are often seen to be characterized by values such as altruism and mutuality that contrast with the competitive and self-serving behaviour underlying for-profit activities. But as Paul Browne has pointed out, “such characteristics cannot be deduced specifically ... because many [nonprofit organizations] do not operate on particularly altruistic or mutualistic lines, and because altruism and mutuality can be found to a greater extent in families, and are by no means absent from government service, and may even emerge in business enterprises.”⁸

As was observed in general discussion during the first session of the Roundtable, the relevant boundaries of the sector are likely to vary, depending on the issue under examination. The set of organizations that are of interest will differ if the focus is on tax policy as distinct from governance and accountability, or voluntary and donative behaviour. To solve the “boundary problem,” therefore, it is necessary to establish criteria that relate to the issue under examination and, from among all organizations that meet the nondistribution requirement, to select that subgroup that reasonably satisfies the specified criteria.

Using this approach, researchers are likely to arrive at different answers to some troubling definitional issues. Hospitals and universities, for example, might reasonably be regarded as belonging to the public rather than the nonprofit sector because they rely heavily on

government funds and are subject to a significant degree of government oversight. Indeed, following this logic, one might conclude that the public sector should properly include not only hospitals and universities, but also those nonprofit organizations that depend on public contracts to such an extent that they are largely vehicles for the delivery of government services. However, using an alternative set of criteria corresponding to a different set of questions, and taking account of the contributions of volunteer labour, one might find that many hospitals and universities do use substantial private sector resources and face obligations to account to their private sector supporters that are similar in many ways to those of other charitable organizations.

Some criteria are more significant than others, in terms of their usefulness for understanding the distinct character of nonprofits. There is a significant literature (which we discuss in Section V below) suggesting that the nondistribution criterion can, in itself, go some way in explaining the existence and the unique character of nonprofit organizations. The distinction between member-benefit and public-benefit organizations noted in Paul Reed's paper is also likely to have a number of important implications. However, there is no universally correct way to impose order on the diversity that exists within this sector. The challenge is to assemble a detailed information base that will allow nonprofit organizations to be properly positioned within different analytical frameworks. There is a need to recognize that significant differences may exist among organizations of the same type, as well as between types of organizations (i.e., universities may differ significantly from one another). There is also a need to establish a system that can accommodate organizational change; as organizations evolve over time, we must be prepared to reclassify them and, if necessary, to adjust the boundary lines between the nonprofit and the public and for-profit sectors.

III The Size and Scope of the Nonprofit Sector

An extensive database is needed to adequately reflect the multidimensional nature of entities that reside within the nonprofit sector. Information is required on such factors as:

- **Sources of support:** the relative importance of private donations of money and volunteer time, government funds and earned income;
- **Beneficiaries:** whether the organization focuses on serving its members or the general public;
- **Size:** as indicated by revenue, and also the paid and unpaid resources available to the organization;
- **Activities:** the types of services provided by the organization and the resources devoted to providing each of the main services;
- **Legal form:** whether the organization is established as a corporation, an unincorporated association, or a trust; and
- **Organizational structure:** the number of establishments nationally and within each province, and the extent to which these operate independently.

The subclassification of organizations by function is an important initial step. Ideally, the database would allow us to probe the characteristics of nonprofits operating within fairly specific areas of activity.

Even a well-developed database of this sort may be unable to capture some potentially important distinctions among organizations. Along with information on government funding, for example, it is important to know how much of this is in the form of grants and how much in the form of contract payments, since these have very different implications. Individual organizations that depend largely on revenue from sales may have quite different relationships with their customers. For example, a day care centre serving a small group of parents with strong representation on the board operates in a very different environment than a local airport authority that is necessarily more removed from its clients.

Still, with information on the factors identified above, it would be possible to assess the importance of nonprofits overall and in various areas of activity. Researchers could attempt to understand how the interaction of various factors with the nondistribution constraint applying to nonprofits generally influences the character and performance of specific organizations. The database can also shed some light on the concept of civic involvement, which was a focus of considerable interest in the Roundtable discussion. Organizations that serve the public, as distinct from their members (i.e., “beneficiaries,” the second item in the above list) and that rely heavily on private donations of money and volunteer labour (“sources of support”), might be seen to be characterized by a high degree of civic involvement.

All of this is rather academic at this point in time, however, because current data allow very little mapping of nonprofit organizations. Even at the aggregate level, our information about the sector is extremely limited. Some researchers have tried to get a sense of the overall size of the sector, and their efforts suggest that the total number of nonprofit organizations in Canada may exceed 200,000.⁹ But Statistics Canada does not single out nonprofit organizations in its sector and employment surveys, and data from the public information returns available from Revenue Canada cover only the 74,000 nonprofits that are (or were, in 1996) registered charities. In addition to the very partial picture provided by existing sources, published Revenue Canada data contains some significant reporting errors that reduce its reliability.¹⁰

Because of data limitations, it has become commonplace for observers to focus on registered charities and to ignore other components of the Canadian nonprofit sector. The paper for CPRN by Kathleen Day and Rose Anne Devlin attempts to peer beneath the surface at those nonprofits that do not qualify or have chosen not to apply for registration and are, therefore, not entitled to issue donors with receipts for income tax purposes. Nonregistered nonprofits include recreational¹¹ and social organizations, boards of trade, and agricultural, educational, multicultural and arts organizations. As compared to charities, these organizations tend to be more dependent on the revenue generated from their own activities and membership fees, and to be less reliant on government grants and private donations.¹² Only those noncharitable nonprofits above a minimum size are required to file returns with Revenue Canada,¹³ and reporting has only been required since 1993. From available returns, Day and Devlin were unable to assess the dimensions of this subsector, but their analysis of Revenue Canada data indicates that noncharitable nonprofits are indeed a significant nonprofit component. The 4,500 organizations that filed returns in 1994 – a small proportion of all nonregistered nonprofits – had revenues amounting to almost 16 percent of the revenues of charities. As Day and Devlin point out, ignoring the noncharitable subcomponent leads to a serious underestimation of the size of Canada’s nonprofit sector.

The Charitable Subsector

Notwithstanding their limitations, Revenue Canada data on charitable nonprofits offer a useful starting point for an exploration of the sector. In 1994, 67,606 charities filed income tax returns. About 10 percent of these organizations consisted of charitable foundations rather than operating charities. Adjusted for adding-up but not underreporting errors in the Revenue Canada

data, the revenue of these registered charities was \$57 billion. Since financial totals are underestimated by available data, all we can conclude is that an amount in the vicinity of 10 percent of GDP passed through registered charities in 1994.

Table 1 looks at the distribution of registered charities according to the activity classification used by Revenue Canada. It can be seen that religious organizations constitute by far the largest proportion of registered charities. Organizations involved in health and education, however, receive the largest shares of revenue. Universities and hospitals, two types of organizations that are especially dependent on government, accounted for 42 percent of all the revenue reported by registered charities in 1994.

Table 1
Registered Charities, Numbers and Revenue, 1994

	Number of organizations		Revenue	
	Number	Percent of total	Billions of dollars	Percent of total
Welfare	11,505	17.0	6.6	11.6
Health	5,023	7.4	23.2	40.7
Hospitals	1,052	1.6	18.5	32.5
Other health	3,971	6.9	4.6	8.1
Education	10,518	15.6	18.5	32.5
Teaching institutions	2,561	3.8	14.9	26.1
Other education	7,957	11.8	3.6	6.3
Religion	29,308	43.4	5.4	9.5
Benefits to community	9,652	14.3	3.0	5.3
Other ¹	1,600	2.4	0.2	0.4
Total	67,606	100.0	57.0	100.0

¹ "Other" includes service club charitable corporations, employee charitable trusts and national arts service organizations.
Source: Kathleen M. Day and Rose Anne Devlin, *The Canadian Nonprofit Sector*, CPRN, 1997.

The data indicate, as one would expect given the uneven distribution of revenue, that most charities are relatively small. In 1994, only 7 percent of registered charities reported revenues over \$1 million, while almost half reported revenues of less than \$50,000.¹⁴ As Day and Devlin point out, however, these percentages are sensitive to reporting errors, which are likely to lead to an overestimate of the proportion of small organizations and an underestimate of large organizations.

The major contrasts between the hospital/teaching institution and religious organization categories – referred to as the two “poles” of the sector in the Roundtable discussion – and between these institutions and the rest of the charitable sector can be seen more clearly in Table 2. The financial data are subject to the problems noted above, while the information on volunteer

hours is based on reports from a small and, seemingly not very representative, subset of charitable organizations.¹⁵ Notwithstanding these limitations, the data does serve to highlight the very different characteristics of these three categories of nonprofits. Hospitals and teaching institutions account for a small number of all charitable organizations, but a major share of total remuneration paid to employees in the charitable sector. If an organization's payroll is used as an indicator of its size, then hospitals and teaching institutions are many orders of magnitude larger than other charitable organizations. By contrast, religious groups account for a large proportion of all organizations, but are far smaller on average than other charities. Whereas hospitals and teaching institutions derive the majority of their revenue from government and, as a group, rely very little on private donations and volunteers, religious organizations receive little direct support from government and depend heavily on donations and the support of volunteers.¹⁶

Table 2

Three Categories of Nonprofits, 1994 Snapshot

	Hospitals and teaching institutions	Organized religion	Other charities	Total
Number of organizations	3,613	29,308	34,685	67,606
Percent share	5.3	43.3	51.3	100.0
Worker remuneration (millions of dollars)	19,678	1,528	7,814	29,020
Percent share	67.8	5.3	26.9	100.0
Remuneration per organization (thousands of dollars)	5,446	52.1	225.3	
Percent of revenue from government	72.0	5.0	47.1	
Percent of revenue from donations ¹	1.9	57.4	12.7	
Volunteer hours, percent share of total reported ²	4.1	44.7	51.2	100.0

1 Includes gifts for which receipts were not issued. Excludes gifts from other charities.

2 Reporting of volunteer hours is not compulsory. These data are based on the 37 percent of filers that reported volunteer hours.

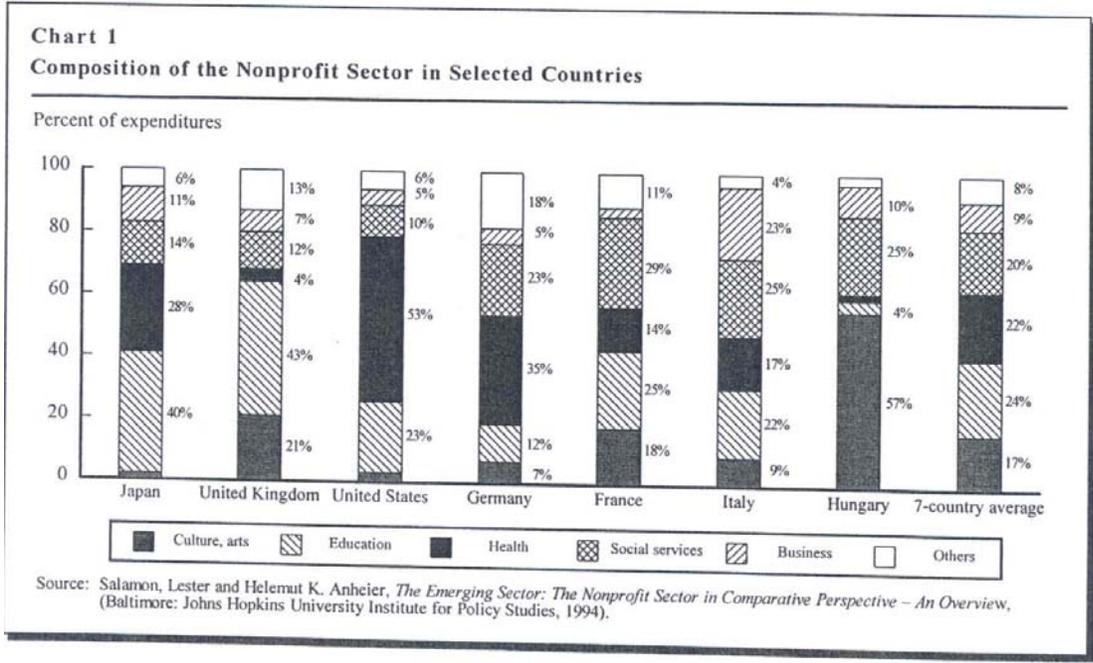
Source: Based on data in Kathleen M. Day and Rose Anne Devlin, "The Canadian Nonprofit Sector," CPRN, 1997.

Many Canadian charities can trace their roots back to early periods of history when voluntary organizations provided the main mechanism for the delivery of essential social services. Voluntary organizations, many with religious affiliations, played an early and important role in providing schooling and health care, relieving poverty, and helping youth.¹⁷ In the postwar period, as government launched a broad array of universal programs, private charity became a gradually less important means of financing social services. Samuel Martin has traced the growing role of government in underwriting the costs of "humanistic services" (health care, education, welfare, religion and culture); while in 1937, in the midst of the Great Depression, financing costs were divided equally between government and private individuals, by 1980 government was covering \$4 of cost for every \$1 financed by individuals.¹⁸ But the growing role of the public sector has not been accompanied by a diminution in the size of the voluntary sector.

The demand by individuals to have the interstices in government programs filled, and governments' own search for better ways of delivering publicly financed services, have fuelled the sector's continued growth.

Day and Devlin find that almost one-third of the charities that are active today have been registered since 1970 or earlier. At the same time, the number of charities has continued to grow rapidly. Since 1969, the number of registered charities in Canada has more than tripled. Between 1985 and 1994, entry into the welfare category was especially strong, and substantial numbers of new organizations were created to provide health and education. Jacquelyn Scott suggests that the formation of voluntary organizations is related to political ideology, and that the proliferation of voluntary associations that occurred in the late 1960s and early 1970s can be attributed to the strong attachment to pluralism over this period.

Notwithstanding the hazards of international comparisons, it is useful to look at Canadian data alongside that available for other countries. Expenditure data assembled by researchers at Johns Hopkins University¹⁹ show that patterns of nonprofit activity differ significantly among countries (see Chart 1). Health care, for example, is a much more important area of nonprofit involvement in the United States than in European countries with national health care systems. Based on its share of total charitable spending, nonprofit health care in Canada is less dominant than in the United States, but it is more important than in most European countries – including Germany where there is also a large number of publicly financed nonprofit hospitals. Education and research are particularly important nonprofit pursuits in the United Kingdom and Japan. In terms of their relative importance, Canadian nonprofit schools and universities rank below those in the United Kingdom and Japan, but above counterpart institutions in the United States and Germany. The relative importance of nonprofit social service providers is roughly similar in Canada, the United States and the United Kingdom. By comparison with these countries, Germany, France and Italy devote a much higher proportion of nonprofit resources to delivering social services.



It is not possible to compare the overall contributions of the charitable sector in Canada and in other countries. The usual problems in evaluating the output of activities for which market prices often do not exist are magnified in an international context. A second-best approach would be to compare the value of the resources used by the sector, but reliable data on inputs is also lacking. The Johns Hopkins data indicates that, based on their share of national employment, nonprofits, excluding religious organizations, are substantially more important in the United States than in Japan and the European countries in the study (France, United Kingdom, Germany, Italy and Hungary). While unpaid workers were excluded from this study, other data (discussed below) suggest that these workers were also relatively more important in the United States than elsewhere. Comparable employment data are not available for Canada. From the data provided by Revenue Canada on the remuneration paid by registered charities, we might surmise that Canada's charitable sector is somewhat smaller than that of the United States, but that the difference is not as large as the apparent gap between the United States and European nonprofit sectors.²⁰

IV Nonprofit Stakeholders

A variety of individuals and organizations have a direct interest in nonprofits arising from their contribution of financial and other resources. Stakeholders are most clearly defined in those organizations, such as corporate and family foundations, that have been created to administer private gifts. The funding source is also well defined in the case of charitable trusts. The law attaches importance to wishes of those who have created a trust for charitable purposes and the Crown and the courts will undertake to ensure the intent of the founding stakeholder(s) is carried out in perpetuity. Among more broadly based organizations, stakeholders can be most clearly identified in associations and other mutual organizations that are financed by members and usually provide services mainly for members. Other nonprofits tend to have more diffuse groups of stakeholders. These are likely to include patrons of the organization, and corporate and individual contributors of funds, in-kind gifts or voluntary services. Governments may provide grants or purchase services under contract, but, in addition, they have a responsibility to oversee the public stake arising from the tax preferences accorded nonprofits in general, and charities in particular.

Table 3 shows the relative importance of various direct sources of revenue for registered charities. It is apparent that it is not just hospitals and universities that are heavily dependent on government funding; all charitable organizations, with the exception of those classified in the religion and other categories, received the majority of their revenue in 1994 from governments. To underline the importance of this source, Day and Devlin show the challenge organizations would confront in attempting to offset a 5 percent government cutback; donations would have to increase by 16 percent for “welfare” charities, and by 30 percent for charities, such as libraries and museums, providing “benefits to the community.”

Table 3
Sources of Revenue, Registered Charities, 1994

	Donations	Gifts from other charities	Government funding	Earned income ¹ and fees	Total
	(Percent)				
Welfare	16.5	4.8	52.5	26.1	100
Hospitals	0.9	1.0	73.6	24.4	100
Other health	17.0	3.5	56.2	23.3	100
Teaching institutions	3.1	0.7	70.2	26.0	100
Other education	10.6	1.3	54.4	33.6	100
Religion	57.5	9.8	5.0	27.8	100
Benefits to the community	10.3	2.9	61.6	25.1	100
Other ²	37.0	0.4	20.8	41.8	100
All charities	11.3	2.6	60.2	25.8	100

¹ Includes investment income, capital gains and income from related businesses.

² “Other” includes service club charitable corporations, employee charitable trusts, and national arts service organizations.

Source: Kathleen M. Day and Rose Anne Devlin, *The Canadian Nonprofit Sector*, CPRN, 1997.

Between 1990 and 1994, government funding increased both in real terms and relative to other sources of funding. However, since government transfers to nonprofits grew very modestly, it appears that an increased portion of government funding over this period took the form of payments for services rendered rather than direct grants. The potential significance of such a shift is highlighted in Josephine Rekart's study of British Columbia's social service privatization over the 1983 to 1991 period. The study recounts the tensions that arose as voluntary organizations struggled to reconcile their increased reliance on government contracts with their perceived role as countervailing influences that identify, and attempt to address, deficiencies and inequities in government programs.²¹

Although donations are much less important than government funding, individual and corporate contributors have a significant financial interest in registered charities. Donations are the main source of revenue for religious organizations, and a major source of revenue for "other charities" such as service club charitable corporations. They are also an important revenue source for other types of organizations, and especially those providing welfare and non-hospital health services.

Data from individual and corporation income tax claims provide a further perspective on donations, but this data source excludes unclaimed and unreceipted donations. Assuming the omitted amounts are distributed in roughly the same proportion as recorded donations, individuals have accounted for about 80 percent of charitable donations in recent years; corporations have accounted for slightly under 15 percent of the total. Total individual contributions in real dollars followed a marked upward trend from 1970 to 1990. Real corporate donations fluctuated around a largely flat trend over the 1970s and early 1980s, but increased strongly between 1985 and 1989. (See discussion and Chart 2 in the Day and Devlin Summary in this volume.) Corporate donations are more responsive than personal donations to changes in economic conditions – suggesting that arts and cultural organizations that depend relatively heavily on corporate largesse must adapt to somewhat less stable funding. However, income is an important determinant of contributions generally, and the recession in the early 1990s was reflected in a decline in real giving by both corporations and individuals.

There is growing academic interest in understanding why individuals donate to charities and the factors affecting their contributions. Besides income, significant determinants of individual donations include age, marital status, education, religiosity, and the tax treatment of contributions.²² Some of these factors are more helpful than others in explaining the significant differences in average donations across Canadian provinces.²³ Religion may be one important explanatory factor; the province with the lowest average level of donations, Quebec, has the lowest proportion of Canadians who attend religious services weekly (15 percent), while the province with highest average donations, Manitoba, has the second highest proportion of regular service-goers (24 percent).²⁴ The data indicate that religious donors contribute more not only to religious organizations, but also to secular charities.²⁵ Differences in individual contributions could also reflect different perspectives across the country about the relative responsibilities of government and community organizations for resolving problems and providing needed social services.

Another issue meriting further study is the difference between the donative behaviour of individuals in Canada and the United States. Over the past two decades, Canadians have annually contributed between 0.50 and 0.70 percent of their income to charities. These figures are not fully comparable with more comprehensive U.S. estimates, which attempt to take account of donations not captured by Internal Revenue Service data. But after adjusting for this difference, contribution rates in Canada are still well below those in the United States, which range near, and in some years exceed, 2 percent of income.²⁶ Part of the explanation may lie in Canadians' traditional acceptance of a larger public role in providing income support and delivering social services. The behaviour of U.S. donors, and tax incentives to encourage their generosity,²⁷ may be rooted in a recognition that U.S. nonprofits fulfil a number of responsibilities that are addressed by government and financed by taxes in Canada and other countries.²⁸

Volunteers

Table 3 omits those important stakeholders whose gift involves a contribution of their own labour. A decade has now elapsed since the last major Canadian survey of volunteer activity. The 1987 survey found that 27 percent of Canadians engaged in organized volunteer activities, contributing 1 billion hours or the equivalent of about 6 percent of full-time workers in that year. Day and Devlin estimate that, using 1994 pay scales, this contribution would amount to 43 percent of the total 1994 wage bill of registered charities.

The 1987 survey found that middle-age groups (i.e., 35-54) are more likely to volunteer than youth and seniors, and women are more likely to volunteer than men.²⁹ The propensity to volunteer was also found to increase with levels of household income and education. Canadian and U.S. studies, which use regression analysis to isolate the independent influence of various characteristics, confirm the significance of the factors highlighted in the 1987 survey.³⁰

An alternative perspective is provided by the European Value Study, which surveyed voluntary involvement in 16 countries during 1991.³¹ This study attempts to measure membership and voluntary activity in a range of community, welfare, political and professional groups. It thus applies a somewhat broader definition than that used to measure formal volunteering in the 1987 Canadian survey. Compared to other countries, Canada is a highly engaged and volunteer-oriented society. The volunteer rate in Canada was slightly below the 47 percent rate for the United States, but it was well above that for all other countries. In Scandinavian countries and the Netherlands, the percentage of the population reporting that it volunteered ranged between 30 and 40 percent. In most other European countries, reported rates were between 20 and 30 percent.

The European Value Survey presents a number of other interesting results. Education, age, and religious practice all influence the propensity to volunteer. Attempts to isolate the influence of the latter variable indicate that higher levels of religious practice in the United States and Canada make an important contribution to explaining the higher levels of voluntary service in these two countries.³² The rate of secular volunteering in Canada and the United

States, however, is also very high.³³ Indeed, when religious volunteering is excluded, Canada's rate of volunteering (38 percent) is above that of all other countries, including the United States (which had a volunteer rate of 34 percent).

More information is required on the nature and extent of current voluntary activity by Canadians. When gifts of labour are taken into account, however, it is clear that individuals are far more important stakeholders than indicated by the data on financial donations. It would also appear that donation rates provide an exaggerated impression of the difference in commitment by Canadian and U.S. citizens to voluntary causes.

V The Raison d'Être of Nonprofits

Why do nonprofits exist? What factors underlie the demand for and supply of nonprofit services? Why are nonprofits concentrated in the service sector of the economy, and in the provision of particular services – i.e., health, education, social services, and cultural programs? To answer these questions it is necessary to move from the legal definition used above, which finds commonality in terms of what nonprofits are not (i.e., they are not profit-driven and not publicly-owned), to theories that look at what nonprofits are and explain why they are particularly well suited for particular types of activities. Given the diversity of nonprofits, no one theory can hope to provide the answers. Different types of nonprofits will have their own distinct advantages relative to alternative service providers, which might be government or for-profit firms, or even family and friends. Also, because we are looking at complex social and economic developments that cannot be fully dissected, the term “answers” must be taken loosely. The existing literature does not lead to definitive explanations, although it does yield important insights into the role of nonprofits. The following sections review some of the more influential theories of nonprofits and efforts to address various limitations of these theories. The latter is also a major focus of the remarks in this volume by Jacquelyn Thayer Scott.

Responding to Contract and Political Failure

Probably the single most influential theory on nonprofits emphasizes the inadequacy of private for-profit markets in certain areas where trust and reputation are particularly important.³⁴ Nonprofit day care centres are seen, for example, to have a role because they serve the needs of parents who are wary about the quality of service provided by for-profit firms.³⁵ Since the providers of nonprofit services cannot benefit financially from cutting corners, they have less incentive to take advantage of parents' inability to assess the quality of care being provided. The nonprofit day care centre is a response to the inability of the normal market contracting process to provide some segment of consumers with adequate assurance of fair exchange.

Contractual problems have been related to the development of nonprofits in other areas. For organizations such as Care Canada and the Salvation Army, the advantage of the nonprofit form is the assurance it provides to donors that their gifts are going towards a specified cause. Trust is important because it is very difficult to develop and enforce a contract between these types of organizations and donors who, for the most part, have no direct contact with the services they are helping to finance. With a for-profit firm acting as the intermediary between donors and recipients, it would be difficult to eliminate the suspicion that donations are being partly diverted to enrich managers and shareholders.

Similar contractual problems arise in the case of cultural organizations that depend for their survival on the contributions of a small group of dedicated supporters of their services. A for-profit theatre, for example, would have difficulty tapping into the demand of ardent theatregoers by charging higher ticket prices or soliciting contributions.³⁶ Supporters would necessarily be concerned that their contributions were benefitting the theatre's owners rather than advancing the cause of high-quality theatre. Indeed, a for-profit theatre that could take

advantage of the strong demand by particular consumers would have a strong incentive to raise more than what is needed to cover costs. The nonprofit form encourages donations by providing the theatre's supporters with a guarantee that their contributions are being used to finance the desired services.

These examples all illustrate situations where for-profit service provision may be problematic. The common elements are the importance of reputation and trust and the inability of for-profit firms to provide effective assurances that they can satisfy public expectations.³⁷ In such circumstances, provided that the value of more trustworthy behaviour is not offset by inefficiencies, nonprofits will have an advantage over for-profit providers. But where for-profit markets are not working adequately, another alternative is to resort to public provision. To explain why nonprofit, rather than public provision, has been chosen in some circumstances, contract failure theories have been supplemented by theories focusing on various forms of political and bureaucratic failure.

One theory points to the limitations of public provision for services in which public tastes are highly diverse.³⁸ Governments direct their activities at the median voter and do not address the needs of those individuals who prefer a level or quality of service that differs from the median. Nonprofits have a role, it is argued, in satisfying this unmet demand.³⁹

This theory has been used to explain why nonprofits provide not only commercial-type services, but also services that have certain collective attributes. This includes "public goods," such as cancer and heart research, in which it would be costly and undesirable to try and restrict benefits exclusively to paying customers.⁴⁰ It also includes activities such as the provision of welfare services, which incorporate an objective of income redistribution. While everyone has an interest in seeing that less fortunate individuals are helped to become productive members of society, many citizens may be inclined to "free ride" on the contributions of others if responsibilities fell entirely on private charities.⁴¹ But while nonprofits are ill-equipped to take over this responsibility, they can fill an important supplemental role by addressing inadequacies in public redistributive activities. Similarly, nonprofit primary schools are a response to the limitations of a system of public education. By meeting specialized, and sometimes controversial, needs, it has been argued that nonprofit organizations can be important political stabilizers. They can help give expression to the wide diversity of views that must be respected in a pluralist democracy.⁴²

Nonprofits have other advantages over government provision. Since they are less subject to bureaucratic rules and rigidities, nonprofits may be able to deliver services more efficiently than governments. These efficiencies will add to any savings that may be available because nonprofits enjoy lower labour costs. Nonprofits can impose fees to cover their costs in circumstances where it may be very difficult politically to charge for publicly provided services. Nonprofits can also facilitate experimentation in the introduction and delivery of new services. Experimentation is difficult for governments because of the political problems in introducing services on a limited basis, and in subsequently abandoning those activities that are found to be not worth pursuing.

What the Theories Do and Do Not Explain

Contract and political failure theories provide some useful insights into the pattern of nonprofit activity. They help us understand why we find nonprofits providing complex social and health services in which quality is difficult to judge. Evidence from various U.S. studies suggest that, consistent with contract failure theory, consumers are often sensitive to qualitative differences between nonprofit and for-profit services.⁴³ The median voter theory does not fully capture the complexity of public decision making. In Canada, governments have pursued initiatives on issues such as human rights that are difficult to understand by reference to the preferences of the median voter.⁴⁴ Nonetheless, the “failure” theories help explain the relative concentration of nonprofits in activities, such as private education and private charity, that augment government-provided services. The important role of associations and clubs also becomes understandable; these organizations allow those who share certain tastes to influence the provision of collective services in a way that would not be possible under government provision.⁴⁵

These theories shed light, as well, on the important role of nonprofit organizations as mechanisms for the delivery of public services. Governments contract with nonprofits to overcome various bureaucratic and political constraints associated with delivery of services through government departments. They may also contract with nonprofits because, like private consumers of services that are difficult to measure and assess, they value nonprofits’ reputation for trustworthy behaviour.

Theories of contract and political failure, however, focus solely on demand. They do not explain what gives rise to the creation of nonprofit organizations in the first place. Why are individuals who cannot benefit financially motivated to form a nonprofit organization? While research on the supply of nonprofits is at an early stage of development, work in this area usefully complements the demand side theories discussed above.

The Supply of Nonprofit Services

Studies have pointed to a variety of factors underlying the creation of nonprofits. Some nonprofit organizations are created by those who have needs that are not being met by governments or for-profit firms. Parents who feel that their children are being denied high quality education, for example, may cooperate to establish a nonprofit facility that responds to their shared need.⁴⁶ Some organizations are created by nonprofit entrepreneurs. One set of detailed case studies of U.S. nonprofits unearthed a wide range of entrepreneurial motivations and styles: artist, professional, believer, searcher, independent, conserver, power seeker, and income seeker.⁴⁷ Research has also focused on how nonprofits emerge within larger communities that have their own distinct norms and values. Communities of individuals, who may be united by their physical isolation, their ideology, or their distinctive lifestyles and culture, tend to have their own network of experienced activists capable of launching new organizations and of mobilizing support to challenge existing institutions.⁴⁸

A study of nonprofit organizations in various countries has highlighted the major role of religious groups in founding nonprofit organizations.⁴⁹ In the United States, religion has been described as the “godmother of the nonprofit sector.”⁵⁰ The promotion of religious beliefs has been behind the creation of most private schools and health care nonprofits, along with organizations such as the YMCA and the Salvation Army. In Canada, as well, most private schools and many of the most established nonprofit social service organizations have religious roots.⁵¹ The nonprofit form is attractive to those motivated by ideologies and beliefs, rather than profits; legal constraints limiting the redirection of nonprofit activities, tax preferences, and the enhanced trust that is associated with nonprofit status all help in the achievement of the founders’ objectives.⁵²

There have been few attempts to formulate theoretical models that analyze the behaviour underlying these observations. One of these contributions is a recent model that attempts to explain why individuals who desire a certain collective service might become nonprofit entrepreneurs. Since entrepreneurship involves a personal cost, individuals are inclined, in general, to wait for someone else to assume the role. The study shows, however, that the game to which this gives rise has a unique outcome, which will result in the entrepreneurial role being assumed and exercised early on by the individual who has the most to gain from the availability of the nonprofit service.⁵³

The development of supply-side theories is important not only because they amplify our understanding of the purpose of nonprofits, but because the characteristics of founders are likely to have an important influence on the subsequent direction and policies of an organization. A nonprofit that is created and subsequently controlled by a benevolent entrepreneur might be expected to operate very differently than an organization that has been founded by a religious group, or a nonprofit that has been established and is run by its members or major clients.

Economists are beginning to abandon the simplistic psychological assumptions used in traditional economic models and to take account of the role of benevolence and other motivations in the formation of many voluntary nonprofits.⁵⁴ Benevolence, or altruism, is seen by some to be the central characteristic distinguishing voluntary from for-profit activity. Samuel Martin, for example, regards “the tradition of service before personal gain” as a hallmark of the “humanistic” sector, which includes nonprofits in health care, education, welfare, religion and culture.⁵⁵ Once we allow for the satisfaction individuals derive from their commitment to a worthwhile cause, it is easier to see why they may become entrepreneurs rather than rely on others to bring about the desired change in conditions. Benevolent motivations can also help explain why nonprofits are concentrated in humanistic activities and not dispersed among all goods and services industries involving issues of trust and reputation. On the basis simply of contract failure theory, for example, we might expect to see a wide range of nonprofit organizations offering auto repair services.

To understand the supply side, there is also a need to examine government’s role in the creation of nonprofits. Besides facilitating the creation of nonprofits through financial assistance, governments have had a direct hand in the establishment of many of Canada’s largest nonprofit organizations, including many hospitals and universities, and charitable organizations such as the

International Development Research Centre and the National Arts Centre. The recent establishment of several new nonprofit corporations to take over the operation of major federal transport facilities has resulted in a significant expansion in both the size and scope of the Canadian nonprofit sector. Committed citizens have played an important role in the establishment of these entities, but the impetus has come from governments facing pressures to come up with new, and potentially more efficient and responsive, modes of service delivery.

The Benefits of Participation

Models of contract and political failure are open to another general criticism, which relates to their limited conception of the benefits of nonprofit activities. While these theories see the contribution of nonprofits mainly in terms of services that would not be adequately provided by the public or for-profit sectors, some regard the process of nonprofit production to be as important, if not more important, than the output itself. This expanded view is not relevant to all nonprofits, but it does apply to an important subset of nonprofit organizations that facilitate and promote giving, voluntarism, association, and citizen engagement. Paul Reed and Jacquelyn Thayer Scott's presentations in Part II elaborate on this aspect of the sector's contribution.

It has long been recognized that charitable behaviour gives expression to individuals' nobler impulses. The nonprofit sector is not primarily financed by charitable gifts, nor mainly dependent on volunteer workers. Moreover, individuals do not require nonprofit organizations to carry out charitable acts; benevolence often takes the form of acts of kindness towards friends, neighbours and family members. Still, charitable organizations are important vehicles for the expression of individuals' sense of morality and justice. They help individuals identify worthy causes and achieve the satisfaction that comes from association with these enterprises. At the same time, they benefit society by fostering an awareness among individuals of their role and obligations as members of a larger community.

The socialization role of nonprofits has been highlighted in recent studies documenting the importance of a nation's "social capital." The term social capital has been used to refer to "features of social life – networks, norms and trust – that enable participants to act together more effectively, to pursue shared objectives."⁵⁶ There is evidence that social cohesion and strong civic community contributes to good government and can have a significant influence on economic growth. In an important study, Robert Putnam found that differences between rapidly growing northern Italy and the less developed regions of southern Italy could be partly attributed to the stronger civic traditions in the north, which, unlike the south, benefitted from a dense, horizontally structured civil society of voluntary associations.⁵⁷ Francis Fukuyama has described how societies that are well endowed with social capital, such as the United States, Japan and Germany, have had an advantage over "low-trust" societies, which include China, France and southern Italy.⁵⁸ Fukuyama makes a convincing case for the existence of important links between an economy's social capital and its industrial structure. He observes:

Law, contract and economic rationality provide a necessary but not sufficient condition for both the stability and prosperity of

postindustrial societies; they must as well be leavened with reciprocity, moral obligation, duty toward community, and trust, which are based in habit rather than rational calculation. The latter are not anachronisms in a modern society but rather the sine qua non of the latter's success.⁵⁹

Social capital accumulates over time and reflects the effect of long-term historical and cultural trends that are rooted in a society's basic beliefs and values. At the same time, it has been recognized that social capital can diminish if countries do not encourage citizen engagement and support community participation. There is debate about how to interpret assorted evidence on changes over time in North American social capital. While, for example, Putnam has drawn attention to indicators suggesting a downward trend in U.S. sociability over the past couple of generations,⁶⁰ others have challenged his findings.⁶¹ It has been noted that, based on the European Value Surveys conducted in 1981 and 1991, volunteer activity, an important indicator of civic involvement, has been increasing in both the United States and Canada.⁶² While this is another issue that would benefit from better data collection and analysis, these are unlikely to detract from the larger message about the importance of social capital and the need for policies that are conducive to its long-term development.

Conclusion

Theories of contract and political failure provide important insights into the comparative advantage of nonprofits relative to alternative organizational forms. Where markets function reasonably well, for-profit firms are superior to other types of organizations at generating the needed incentives for efficient use of resources. Where universal participation is needed to provide services efficiently or equitably, governments have a strong comparative advantage. The mid-ground that can be beneficially cultivated by the nonprofit sector is partially indicated by the theories of contract and political failure. This territory is likely to be characterized by problems of trust and reliability and/or diverse preferences that can better be satisfied by independent groups than by governments. It intrudes into areas where government is the appropriate decision-making and financing body, but not the most appropriate organization for service delivery.

More recent efforts to explore the creation of nonprofits and to take account of the social benefits of citizen engagement can help to further isolate the appropriate locale for nonprofit activity. By understanding the motivations of founders, we can understand why nonprofits tend more towards particular types of activities. Supply-side theories can also shed light on the performance of nonprofits and help explain why the expected advantages from nonprofit provision have been more fully realized in some types of organizations than others. Recent research on social capital helps us better appreciate the contribution of certain nonprofit activities that may be beneficial not only because of the services they provide, but also because of the socially desirable behaviour they promote.

VI The Policy Challenge

Governments face different responsibilities corresponding to the different hats they wear in their relations with the nonprofit sector. First, as government per se, there is a responsibility to establish a legal framework that facilitates nonprofit activity. In the nonprofit, as in the for-profit sector, there is a need to establish rules of fair conduct and to put in place other framework laws that enable and support transactions among individuals. An important component of framework law is organizational legislation, which includes the federal and provincial corporation acts.

Second, as major stakeholders, governments have a responsibility to ensure that their commitments represent a wise use of public resources. This presents different issues where the government has provided a grant and where it has entered into a purchase-of-service contract with a nonprofit provider. Another distinct set of considerations arises where the public sector interest is a result of the special tax preferences accorded nonprofits.

A third responsibility of government arises from the judicially-recognized standing of the Attorney General to enforce proper administration of charitable property on behalf of the general public. This has its roots in English law, where the courts have acknowledged the role of the Attorney General to act on behalf of the sovereign who is *parens patriae*, or guardian, of the public interest in charitable property.

The research papers prepared for the project examine the challenges posed in each of these three general areas. The study of organizational and supervisory law by Ronald Hirshhorn and David Stevens looks at the problem of designing a legal framework that is responsive to the needs of participants and can facilitate nonprofit activities. This study also broaches the issues raised by the Attorney General's responsibilities for proper administration of charitable property, the third government responsibility identified above. The study of tax incentives by Scharf, Cherniavsky and Hogg considers the role of government as stakeholder where this is expressed through the tax system and takes the specific form of tax benefits aimed at reducing the price of charitable giving.

Organizational and Supervisory Law

Organizational Law

Organizational laws establish a framework of rules for the establishment and conduct of nonprofit enterprise that parties can adopt "off-the-rack." By developing standard form contracts that can be tailored to meet different requirements, governments reduce the costs founders of nonprofit organizations must incur in working out and implementing appropriate governance arrangements. Organizational law has the characteristics of a public good,⁶³ and the development of the needed legal infrastructure in this area for both for-profits and nonprofits has long been an area of government responsibility.

In designing organizational laws, governments should be guided by a sense of what

knowledgeable participants, who could negotiate without worrying about transaction costs, would themselves work out. But policymakers must do this with an awareness of the constraints that necessarily arise in attempting to apply laws of general application to a widely diverse group of organizations. Participants in nonprofit activities face different risks than stakeholders in for-profit enterprises who benefit from the discipline imposed on managers by capital markets and other market controls. In establishing controls to respond to this issue, however, governments must take care to ensure that they are not unduly undermining the ability of nonprofits to be innovative or to fulfil their important role as an outlet for the diversity that exists within Canadian society.

Hirshhorn and Stevens find that an application of these sorts of considerations leads to conclusions that differ in a number of respects from those incorporated in current organizational laws. They highlight three general areas where reforms are needed. First, there are aspects of the current approach that are at odds with the general objective of organizational law, which is to facilitate use of the nonprofit form. There are some unnecessary and undesirable restrictions in current law, such as the costly restrictions in some statutes on the borrowing and investment powers of charitable trustees and directors. Also, the suppletive features of current nonprofit legislation are not well developed; the enabling function of the law could be enhanced through the addition of draft bylaws and other optional provisions that offer guidance to those establishing governance arrangements to meet different organizational needs.

Second, there is a need for improved fiduciary safeguards that reflect the common interest of stakeholders in preventing fraud and preserving the high level of trust that supports use of the nonprofit form. Hirshhorn and Stevens argue for codified standards that would clarify the “duty of care” and the “duty of loyalty” of nonprofit fiduciaries (see box). Strict controls are proposed to avoid dangers of self-serving behaviour by fiduciaries of public benefit, as well as religious and private nonprofits, where there are no members to oversee the activities of the management and board. To strengthen enforcement, Hirshhorn and Stevens propose that stakeholders, including members and donors, and a public supervisory agency be given the right to sue managers and directors for breaches of fiduciary duty.

Proposals for Clarifying the Duty of Care and the Duty of Loyalty

The Duty of Care: Legislation should specify that fiduciaries are expected to apply a level of competence that is reasonable in view of their background and experience, and to exercise “due diligence” in attending to their responsibilities. This standard should apply to all nonprofits, regardless of their form or purpose.

Duty of Loyalty: There should be a codification of the requirement that fiduciaries act honestly and in good faith in the best interests of the organization.

Third, there is a need for improved information disclosure that will increase the

accountability of nonprofit managers and directors and contribute to more informed choices by nonprofit stakeholders. As with fiduciary safeguards, this is an issue of common concern that cuts across the differences between nonprofit organizations. Public reporting requirements currently exist under corporate legislation, various other provincial statutes (i.e., Ontario's *Charities Accounting Act* and Alberta's *Charitable Fund-Raising Act*), and Revenue Canada's public information filing regulations, but these all have serious limitations as vehicles for informing stakeholders. Revenue Canada's public information return, for example, is only available for charitable nonprofits, and provides highly aggregated (and, as noted above, sometimes inaccurate) revenue and expenditure data. Although there is a need to take account of the costs of increased disclosure for organizations and especially smaller nonprofits, Hirshhorn and Stevens argue that much greater transparency is possible and desirable.

Supervision and Coordination

The research for CPRN suggests that the amendment of nonprofit legislation needs to be accompanied by major institutional reforms. One problem is the lack of an effective supervisory body to enforce fiduciary standards and ensure adequate information disclosure. Revenue Canada is the one agency that devotes significant resources to monitoring, but it primarily focuses on the subset of nonprofits that are registered charities, and its interest in enforcing tax law does not fully coincide with stakeholders' interest in ensuring nonprofits are prudently managed.

A related, but somewhat more complex, institutional problem is due to the existence of multiple regulatory jurisdictions in Canada. While the federal government has significant influence because of its powers under the *Income Tax Act*, nonprofits are primarily under provincial jurisdiction. This has resulted in a situation where an organization may be recognized as having charitable status by one level of government but not another. National organizations must contend with the problems and added expense of complying with requirements imposed by Revenue Canada and by various provincial jurisdictions.

In contrast to the Canadian situation, the authors found the unified and effective approach to charity supervision in England and Wales highly appealing. While Hirshhorn and Stevens believe there is a need to also extend oversight to nonprofits that are not charities, they find that the Charity Commission for England and Wales is, in many respects, a useful model. By providing advice and support, ensuring adequate reporting, and implementing an effective monitoring program, the Commission is able to promote public confidence in England and Wales' charitable sector. The authors of the CPRN study believe, however, that a supervisory agency with somewhat more limited discretionary powers can effectively fulfil these same functions. In the Canadian context, they also recognize the need for provincial input into major policy decisions governing the supervisory agency's activities.

The establishment of a national nonprofit commission would rationalize administration by transferring responsibilities to the jurisdiction that has the largest interest in, and committed by far the most resources to, nonprofit supervision. Although Hirshhorn and Stevens think this

approach can be made acceptable to the provinces, they put forward an alternative option in which the administration and supervision of nonprofits would be coordinated through intergovernmental agreements. The federal government and the provinces would work out a common policy and administrative approach and agree on a reasonable division of supervisory responsibilities. In the author's view, either option would represent a significant improvement over the current "regulatory patchwork."

Self-regulation

While participants in the Roundtable were sympathetic to the need for a modernization of organizational law, many were concerned about the proposals for supervisory reform. Participants from the sector tended to share Gordon Floyd's preference for less reliance on public oversight and a greater emphasis on the development of self-regulatory mechanisms by groups of nonprofits or by those involved in specific sector activities (such as fundraising).

The term "self-regulation" has been applied to a variety of arrangements, extending from a highly restrictive regime of licensing, as exists in the legal and medical professions, to programs that focus simply on disseminating information to service providers and consumers. Between these two extremes are certification programs, in which special recognition is given to those organizations or individuals that satisfy established standards; and behavioral codes that are supported by efforts to ensure compliance by members of the relevant group or association. During the discussion in Session C, it was observed that the nonprofit sector lacks the maturity, in terms of governance and professional practices, that is characteristic of those groups that are delegated self-regulatory powers. Without such delegation, the sector could still adopt less restrictive approaches, including voluntary codes and, possibly, certification. From the discussion, it would appear, however, that much further thought is needed both about the content of such codes or standards and about the mechanisms through which they could be promoted. Questions raised in the general discussion about the effectiveness of voluntary codes and other proposed arrangements also need to be considered. Moreover, after considering these questions, it will still likely be important to address the issue of institutional reform; so long as self-regulation does not eliminate the need for a significant public role, the question raised in the Hirshhorn and Stevens paper as to how governments can achieve their supervisory objectives more cost-effectively remains relevant.

Tax Policy

In Canada, as in many other countries, tax incentives are provided to encourage donations to that subset of nonprofits whose activities are seen to be socially beneficial. Tax incentives offer a number of potential advantages over alternative means for supporting charities. They provide a mechanism for revealing taxpayer preferences since individual donors determine the financial support going to particular charities, unlike the situation with government subsidies. Also, as Scharf, Cherniavsky and Hogg point out in their study for CPRN, tax incentives tend to lever private contributions thereby increasing the revenue received by organizations. Most of the

empirical evidence reviewed by Scharf et al. supports this; these studies, which attempt to measure the “price elasticity of giving,” suggest that tax breaks to contributors will increase the revenues of charities by more than the loss of tax revenues to the federal government.

The appropriate balance between the use of tax incentives and the use of government grants was debated at some length in Session D of the Roundtable. The concerns of those who worry about an excessive reliance on tax incentives can be related, in part, to the discussion in the previous section pointing to the different functions filled by nonprofits. One of the main roles of nonprofit organizations is to assist in the delivery of certain “public” and “redistributive goods” that are properly financed by the state. A shift from grants to tax subsidies would be cause for concern if it meant that some activities that should be publicly financed are now being forced to compete for private funding.

Recognizing the potential role of tax incentives only provides a starting point for an analysis of tax policy. There remain questions about what organizations should qualify for registration as “charities,” how much support should be provided through tax concessions; and how a system of tax incentives should be structured. There is also a need to consider how the proper use of tax incentives can be enforced.⁶⁴ The first two questions broach some of the larger issues that were touched on in earlier sections. An understanding of the role of charitable nonprofits, and a realistic sense of the adequacy of governance arrangements and accountability procedures within charitable organizations should inform decisions with respect both to the amount and allocation of government support.

Tax policy will also reflect policymakers’ efforts to keep up with changes over time in the role of the nonprofit sector. Measures introduced in the March 1996 federal budget⁶⁵ and the further encouragement of charitable giving in the 1997 budget,⁶⁶ for example, appear to stem from a recognition of the increased demands being placed on the voluntary sector. A similar perspective seems to underlie a recent report for Heritage Canada, which seeks to promote increased giving by providing higher tax credits for charitable contributions in excess of the amount individual taxpayers have given in prior years.⁶⁷ While many would agree that incentives for charitable giving should be enriched, some fear that recent tax changes are part of a larger policy reorientation that would see the voluntary sector being saddled with responsibilities that are appropriately financed by taxes and provided by the public sector. Michael Hall and Paul Reed have noted, for example, that those organizations that focus on the poor may be particularly vulnerable in an environment of government downloading because they have greater difficulty attracting private donations.⁶⁸ In addition, some observers have voiced concerns that funding measures may be of limited effectiveness if they are not accompanied by consolidation and rationalization within Canada’s voluntary sector.

The Determination of Charitable Status

The determination of what organizations qualify for registration is made by Revenue Canada on the basis of the definition of charitable purposes that has emerged over time through case law. Canadian courts have built on English case law and the charitable objects identified in early English statutes. The *Charitable Uses Act, 1601*, also referred to as the *Statute of Elizabeth I*, was never in force in Canada, but the list of charitable objects in the Act's preamble has had a major influence on Canadian policy. In 1891, in the *Pensel Case*,⁶⁹ Lord MacNaghten, drew on this Statute to develop four main categories of charitable purpose: the relief of poverty; the advancement of education; the advancement of religion; and other purposes beneficial to the community. These four classes continue to form the basis for the definition of charitable activities that is used by Revenue Canada to identify both charitable organizations and charitable foundations that qualify for registration. In addition, under the *Income Tax Act*, amateur athletic organizations and national arts service organizations may qualify for registration and be entitled to the same tax treatment as charities.⁷⁰

Some have argued that it is time elected legislators developed a modern definition of charity reflecting current Canadian views as to which activities convey significant public benefits and deserve support.⁷¹ In the Roundtable discussion, concerns about the limitations of the current definition of charity surfaced in the debate over the relative merits of grants and tax incentives.⁷² While, according to the theory outlined in Section V above, private donations supported by tax preferences should lead to the emergence of organizations that reflect the diversity of Canadian society, this may not occur if availability of tax preferences has been limited by the application of a relatively narrow definition of charitable activity. Some participants believe that the current definition applies a narrow vision of philanthropy that excludes significant minority communities, along with certain activities and cultures that are a part of multicultural Canada.⁷³ If a nonprofit agency or Commission was established, as proposed in Hirshhorn and Stevens' CPRN study of organizational law, one of its roles could be to help policymakers formulate laws and regulations specifying the requirements for charitable registration.⁷⁴

One of the subsidiary issues that could usefully be addressed by such an expert body is the limits to be set on advocacy activities by registered charities. The *Income Tax Act* was amended in 1985 to clarify that charities may engage in limited, nonpartisan political activities. These must be aimed at accomplishing the charity's purposes and account for no more than 10 percent of the charity's resources.⁷⁵ Controversy, however, continues to surround both the law and Revenue Canada's interpretation of political activities.⁷⁶ According to a recent study, the advocacy carried out by charities often involves promoting awareness of issues, and providing information and advice.⁷⁷ In addition, some organizations attempt to provide a voice for groups that traditionally have had difficulty getting their positions before policymakers. This is a difficult issue and, as noted in the Roundtable discussion, care must be exercised to ensure that the application of advocacy controls does not significantly impinge on charities' ability to effectively fulfil their role. The resolution of this issue should also take account of the

availability and adequacy of other government programs that are aimed at supporting groups that are disadvantaged politically and more generally achieving the benefits from broad-based political participation.

The Design of Tax Incentives for Charitable Giving

Alternative instruments to promote charitable giving can be assessed using the three common economic criteria of efficiency, equity, and simplicity. However, as Scharf et al. point out, the application of these criteria can give rise to complex issues and difficult trade-offs.

This is illustrated by a comparison of the U.S. system of tax deductions for charitable donations with the Canadian system of tax credits. While taxable income is calculated net of donations in a deduction system, in Canada, individuals and corporations apply a two-tiered income tax credit based on donations against their tax liabilities. Whereas Canadians itemize their donations, only about 30 percent of U.S. tax filers actually claim itemized deductions, with the majority taking advantage of the standard deduction allowed for charitable contributions. As Scharf et al. point out, a deduction system has appeal if one subscribes to the view that gifts do not constitute consumption and, therefore, should not be included in determining an individual's income base for tax purposes. The more traditional view, that gifts are a form of consumption, leads to the conclusion that Canada's current system of tax credits is appropriate on both equity and efficiency criteria. Under a credit system, middle and low income earners that donate more than \$200 receive greater tax relief than they would under a deduction system.

Another distinction between the U.S. and Canadian systems is in the treatment of gifts of appreciated property. In the United States, unlike Canada, gifts of appreciated property are exempted from capital gains taxation. This, along with a relatively high incidence of wealth accumulation, is viewed by some as a major reason why, historically, average private donations have been significantly higher in the United States than in Canada. The difference between the Canadian and U.S. systems will diminish as a result of measures introduced in the 1997 budget that reduce the proportion of capital gains that are subject to taxation in the case of donations of publicly listed securities.⁷⁸ However, the study by Scharf et al., which was undertaken prior to the 1997 budget, implicitly questions the wisdom of this reform. The authors favour a system in which income is taxed equally whether it is derived from appreciated property or from some other source. They find such an approach is desirable from an efficiency perspective since it does not influence the decisions of investors to sell or donate appreciated property. In terms of equity, it is desirable because it results in equal taxation for those with income from appreciated property and those with income from other sources.

On the other hand, the conclusions of Scharf et al. lend support to recent reforms that change the income limitations for charitable donations. As a result of measures introduced in the 1997 budget, the annual limit for donations to all charities is 75 percent of a donor's net income. Prior to the budget, the income limitation was 50 percent for most charitable donations, but 100 percent for gifts to the Crown and Crown foundations. The authors of the CPRN study find that this distinction between Crowns and other charities is questionable in terms of both equity and

efficiency. It created an unlevel playing field in which donors had larger incentives to contribute generous gifts to Crown foundations rather than other charities, while charities seeking major donations were encouraged to affiliate with organizations having Crown status.

While the 1997 budget levelled the playing field for donations, some major nonprofit organizations continue to receive favoured treatment under GST rules. All charities and qualifying nonprofit organizations receive a partial rebate for taxes paid on purchases of goods and services. However, the portion of federal taxes rebated is 50 percent for charities, as compared to 67 percent for universities and public colleges and 83 percent for hospital authorities. Scharf et al. question the appropriateness of applying such different rules.

VII Continuing the Research Process

The Roundtable discussions highlighted the diversity of views that exist on the nature and role of Canada's nonprofit sector, and the requirements for policy reform. While these differences partly reflect the varied backgrounds of participants, they also point to important gaps in our current state of knowledge. There was a clear sense among participants that we are still in the early stages of our exploration and that a sustained effort over time is required to build a solid base of knowledge about the nonprofit sector.

At the end of the day, participants were invited to offer their views on future research needs. From these comments and those made earlier by authors and discussants, it is possible to identify those areas where participants believe there is a need for a significant commitment of intellectual and financial resources.

Towards a Research Agenda

Data Development

A necessary starting point in the development of a knowledge base is to address the major data gaps identified in the paper by Kathleen Day and Rose Anne Devlin and highlighted in the comments by Michael Hall. Our ability to “size up” the sector is seriously hampered by the lack of information on nonregistered charities and the absence of reliable data on such basics as the finances, employment and activities of registered charities. More complete data are required on nonprofit organizations, and also on the activities of those who support the sector, including volunteers, individual donors, corporate contributors and governments. Some participants also argued for the commitment of resources to unearthing largely hidden information on informal organizations and informal contributory behaviour.

Day and Devlin offer a number of specific proposals to address existing data gaps (see Box 2 in their Summary). Some promising developments are underway in a few areas they identify. The Canadian Centre for Philanthropy and Volunteer Canada have now gathered the resources to initiate a pilot study of giving and volunteering. This initiative should ultimately lead to a much-needed update of the data available from the 1987 Statistics Canada survey of voluntary activity. Revenue Canada has redesigned its T3010 form and will be devoting increased efforts to ensuring the accuracy of the information filed using this form. In this regard, it is encouraging that the recent budget acknowledges the importance of providing Canadians with information about the activities of charities and commits additional resources to helping Revenue Canada satisfy this requirement. The other obvious source of information is Statistics Canada. Limited data on the sector are currently provided by Statistics Canada because most of the agency's surveys do not distinguish between for-profit and nonprofit organizations. The insertion of a question on profit/nonprofit status in the more relevant Statistic Canada surveys could go a long way to addressing current data requirements.

The Nature of Nonprofit Organizations and Civic Participation

As better data become available, it will be possible to develop more complete profiles of nonprofit organizations and those who participate in nonprofit activities. Participants in the Roundtable had somewhat different views on which organizations are members of the sector. With ample data, it would be possible to classify nonprofit organizations according to a range of criteria and to produce different descriptions of the sector that are meaningful in the context of various issues being addressed.

Aside from the issue of classification and measurement, there are important questions that arise about the influence of various factors on the performance of organizations and on the participation of individuals and firms in civic activities. In their study, Day and Devlin review some of the efforts by academics to understand the factors influencing donative and volunteer activity. There remain very large gaps in our ability to explain civic involvement and to understand the factors affecting the behaviour and performance of organizations. With respect to the latter, there is a need to undertake further research into the influence of both internal factors, such as the role and composition of an organization's board of directors, and the range of external factors that shape the environment within which organizations operate and strive to meet resource requirements.

The Role and Contribution of Nonprofit Organizations

While some Roundtable participants were disturbed by what they saw as the pressures to place voluntary activities within an economic framework, others believed that it was important to evaluate and document the contribution of nonprofit organizations to build support for the sector's role in managing the use of a significant share of society's resources. As part of the process of building a knowledge base, it is clearly necessary to invest effort in improving our understanding about why nonprofits exist and how they enhance the well-being of Canadians. To address these questions, however, researchers will need to painstakingly make their way along a number of avenues of inquiry.

One of the challenges is to arrive at a measure of the value of the services provided by nonprofit organizations. There have been attempts to develop aggregate measures of sector output, mainly by evaluating the contribution of paid and unpaid workers. An alternative approach would be to evaluate the actual outputs produced by nonprofit organizations operating in particular areas of activity. This is a larger exercise requiring much more detailed data, but it could ultimately lead to more realistic estimates of the contribution of the sector to the nation's overall production of goods and services.

As discussed in Section V above and as pointed out by Roundtable participants, nonprofit organizations do more than deliver services; they also have an advocacy role and they are an important component of a nation's social capital. We are only beginning to understand the nature and implication of these aspects of the sector's role. Evaluating the flow of benefits associated with these roles clearly poses a formidable long-term research challenge.

In assessing the contribution of nonprofit organizations, it is also necessary to understand why they are producing certain outputs. Are nonprofit organizations providing services that would not be produced by government or for-profit firms, or would not be provided as well by these other sectors? These are among the questions that were addressed in Section V above and have been the subject of significant interest to academics, especially in the United States. There is scope for more theoretical research in this area. There is also a need for detailed empirical studies, which would examine the behaviour and performance of Canadian nonprofits in the context of these theories and attempt, generally, to shed light on the comparative advantages of nonprofit provision in particular areas of activity.

Voluntary Standards

The design of voluntary standards involves the development of sector knowledge at a more applied level. While Roundtable participants differed in their views as to the appropriateness and adequacy of self-regulation in this sector, there was general support for the development of behavioral codes and standards by the sector or subgroups of nonprofits. The intention would be to promote higher standards of conduct and performance and, thereby, to increase public trust and confidence in nonprofit organizations.

A standards code might simply set out the rules that will give expression to basic ethical principles. These rules could clarify the fiduciary responsibilities of directors and officers, and spell out some related obligations that follow from the nondistribution requirement and the need to ensure the proper use of charitable contributions. A more ambitious behavioral code would attempt to identify those requirements that must be met to provide stakeholders with the assurance that an organization is well managed. The appropriate design of the latter code is a significant undertaking. There are examples to draw upon, such as the 9-point standards established by the National Charities Information Bureau in the United States,⁷⁹ but there is no consensus on what constitutes an effective approach in this area. A number of existing codes have been criticized for focusing on superficial indicators and not enabling stakeholders to get a reliable reading on whether individual organizations are achieving useful results and doing so efficiently.

Modernizing Organizational Law

The Roundtable discussion identified a few areas where further work is needed to pave the way for legislative reform. There was general agreement among participants that organizational laws applying to the sector are very much in need of modernization. The next stage in the process is to translate the proposals in the Hirshhorn and Stevens paper on organizational law and other studies, including especially the recent report of the Ontario Law Reform Commission,⁸⁰ into draft model legislation.

Another concern to many participants is the current approach to defining charitable status and registering charities for tax purposes. Here the issue is not outmoded legislation, but rather

the absence of legislation and the reliance on case law that some observers believe is not sufficiently responsive to the multicultural character of Canadian society and the changing role of philanthropy. A recently completed study for the Voluntary Sector Roundtable analyzes the treatment of charitable activity under the Canadian *Income Tax Act*.⁸¹ Other research is underway on the current approach to advocacy activities by charitable organizations,⁸² and on the social implications of the involvement of charities in commercial activities.⁸³ Further research is needed into these and other issues to formulate a process for establishing and administering charitable registration requirements that give expression to the public interest.

VIII In Search of a Framework

The nonprofit sector is an important component of our economy and our society. While there is much we do not know about the diverse entities that comprise the sector, there is a growing recognition that nonprofits satisfy a wide range of important needs and that they have a central role in creating the social capital that helps build strong societies. Most families are touched in some way by the activities of charities or other nonprofit organizations.

The Roundtable was not aimed at developing a consensus on the main issues affecting the sector. The discussion summaries in Part II reveal significant differences in the views of participants. If there was a common theme in the day's discussions, however, it was that further data development and research is badly needed to flesh out our understanding of the nonprofit sector. Participants were of a common view that increased efforts must be devoted to developing an information base and conceptual framework that can support those within the sector who are struggling with various strategic issues, as well as those within government who are responsible for formulating policy for the sector.

While the efforts of nonprofit researchers in various disciplines (including law, economics, political science, sociology and management) will be critical in the development of the required knowledge base, there is also a role for some of the main sector participants – governments, private funders, and the sector itself.

- Governments can make an important contribution, initially, by gathering the needed data and supporting conceptual and empirical research aimed at better integrating the nonprofit sector within our existing framework of economic accounts. Governments must also begin the task of redrafting organizational laws so that these can better fulfil their objective of enabling activity in the sector. The required legislative reforms would, among other things, eliminate unnecessary restrictions on nonprofits and clarify the duties of nonprofit fiduciaries.
- Private sector funders can contribute to the development of the sector by encouraging nonprofits to strengthen their management and governance and by demanding high standards of accountability.
- The sector itself needs to focus on some information gaps relating to the requirements for proper governance and effective accountability. If the sector is to take more responsibility for its own future – as many participants believed it should – it will need to turn its attention to the development of appropriate codes of conduct and to the problems associated with ensuring adequate compliance.

While Canadians have become more aware of the contribution of nonprofit organizations, our understanding continues to be largely based on assorted images that lack coherence. The guideposts that we require to give form and direction to our thoughts are still largely missing. As part of our preparations for a new century in which significant new forces are likely to impact on the relationship between citizens and the state, there is a need to work towards the development of an analytical framework that will help us understand the kind of nonprofit sector that can best contribute to making Canada a more prosperous, just and caring society.

Notes

- 1 As part of this program, The Kahanoff Foundation is also supporting the Social Services Project of the Canada West Foundation. A series of reports are being produced, examining various aspects of social service provision in Alberta.
- 2 Although organizations may be adequately compensated, a change from grants to contracts can increase administrative requirements and deflect nonprofits from their missions and client populations. (This is discussed later.) Also, a shift to contracting out is likely to favour larger, at the expense of smaller, organizations.
- 3 Peter Drucker, "The Age of Social Transformation," *The Atlantic Monthly*, November 1994.
- 4 Jeremy Rifkin, *The End of Work: The Decline of the Global Labour Force and the Dawn of a Post-Market Economy* (New York: Putnam, 1995).
- 5 Ekos Research Associates, "Rethinking Government," April 1995.
- 6 Ibid, p. XXIV.
- 7 Drucker, op. cit., p. 76.
- 8 Paul Leduc Browne, "The 'Third Sector' and Employment," Canadian Centre for Policy Alternatives, September 1995, (draft mimeo).
- 9 The number of nonprofit corporations in Canada in 1992 was estimated at 175,000 by Jack Quarter in *Canada's Social Economy* (Toronto: James Lorimer & Co., 1992). It has been suggested (see Kathleen Day and Rose Anne Devlin) that unincorporated associations account for about 25 percent of noncharitable nonprofits, thereby increasing the total size of the sector to over 200,000 organizations.
- 10 The two most serious problems are "adding-up errors," in which organizations have calculated totals incorrectly, and "order of magnitude errors," in which larger institutions (mainly hospitals and universities) have reported results in thousands of dollars rather than dollars as requested by Revenue Canada. Because of the latter problem, financial data for the health and educational categories, and for the charity sector as a whole, are underreported to an unknown, but potentially significant, extent. These and other problems are discussed in Appendix A of the "The Canadian Nonprofit Sector."
- 11 Some recreational associations, however, are registered. These account for just under 4 percent of all charities. Registered recreation organizations, like their nonregistered counterparts, receive the majority of their funding in the form of earned income and fees. The latter is highlighted in Canadian Centre for Philanthropy, *Research Bulletin 2*(1), February 1995.
- 12 From analysis of the T1044 forms available from Revenue Canada, it is possible to develop a more specific profile of those noncharitable nonprofits that have filed returns. As Day and Devlin point out, however, it is not clear whether, and to what extent, this information provides a biased and misleading representation of the characteristics of all noncharitable nonprofits.
- 13 Organizations must file a return if their revenues exceed \$10,000 or their assets exceed \$200,000, or if they have filed a return in the previous year.
- 14 Revenue is not necessarily the best indicator of size. If data were available on paid and unpaid employment, this, arguably, would provide a better indication of organizations' output.
- 15 The limitations of the data on voluntary hours are apparent from the discrepancy between these numbers and those reported in the 1987 voluntary survey.

- 16 The 1987 volunteer survey also found that religious organizations were the largest beneficiaries of volunteer activity, but the discrepancy was not as large as indicated by the Revenue Canada data. The 1987 survey indicated that religious organizations accounted for about 20 percent of total volunteer hours.
- 17 There is some discussion of this in Larry W. Smith, *Canada's Charitable Economy* (Toronto: Canadian Foundation for Economic Education, 1992).
- 18 Samuel A. Martin, *An Essential Grace* (Toronto: McClelland and Stewart, 1985).
- 19 Religious organizations have been omitted in these cross-country comparisons. Lester Salamon and Helemut K. Anheier, *The Emerging Sector: The Nonprofit Sector in Comparative Perspective – An Overview* (Baltimore: Johns Hopkins University Institute for Policy Studies, 1994).
- 20 While nonprofit employee compensation represents a somewhat higher percentage of GDP in the United States than in Canada, the U.S. data are based on a definition that is broader than Revenue Canada's definition of registered charities. The difference between the two countries is also overstated in available numbers because of the reporting errors affecting Revenue Canada financial data.
- 21 Josephine Rekart, *Public Funds, Private Provision: The Role of the Voluntary Sector* (Vancouver: UBC Press, 1993).
- 22 Day and Devlin review the empirical research that attempts to estimate the responsiveness of donations to changes in these factors. Information available on Canadian giving up to the mid-1980s are thoroughly reviewed in Allan Arlett, Phelps Bell and Robert W. Thompson, *Canada Gives: Trends and Attitudes towards Charitable Giving and Voluntarism* (Toronto: Canadian Centre for Philanthropy, 1988).
- 23 Data on average donations are downwardly biased, but there is no reason to believe that the degree of underreporting is worse in some provinces than others.
- 24 The percentages in brackets come from a recent Angus Reid study. The province with the highest rate of religious participation is Newfoundland, where 31 percent report that they attend religious services weekly. Angus Reid Group, *God and Society in North America*, October 1996.
- 25 This is discussed in Allan Arlett et al., *ibid.*
- 26 There is an attempt to adjust Canadian contribution rates for the purposes of comparison with the United States in Allan Arlett et al., *ibid.*
- 27 In particular, gifts of appreciated property are exempted from capital gains in the United States, but not in Canada. This has encouraged large gifts of wealth in the United States, and these have raised calculated average rates of giving.
- 28 This is not to suggest, however, that across countries generally, there is an inverse relationship between government social spending and the size of an economy's nonprofit sector. Although Japan devotes less proportionately to public social spending than the United Kingdom, it also has a smaller nonprofit sector according to the employment share numbers in the Johns Hopkins database. Sweden, a country with one of the greatest commitments to public welfare, also has an extensive and well-developed network of voluntary associations. The latter is described in John Boli, "The Ties That Bind: The Nonprofit Sector and the State in Sweden," in K.D. McCarthy et al. (eds.), *The Nonprofit Sector in the Global Community* (San Francisco: Jossey-Bass, 1992).
- 29 Doreen Duchesne, *Giving Freely: Volunteers in Canada*, (Ottawa: Supply and Services Canada), 1989, Statistics Canada, catalogue no. 71-535.
- 30 Empirical research on this topic is reviewed in Day and Devlin.

- 31 The European Value Survey is a component of the World Values Survey (WVS), which is coordinated by Ron Inglehart of the University of Michigan. Some of the WVS results are discussed in R. Inglehart and J. Granato, "The Impact of Culture on Economic Development: Theory, Hypothesis and Some Empirical Tests," *American Journal of Political Science* 40(3), August 1996. The findings of the European Value Survey are discussed in Andrew Greeley, "The Strange Reappearance of Civic America: Religion and Volunteering," 1996 (http://www.agreeley.com/CURRENT_ARTICLES.html)
- 32 Andrew Greeley, *ibid.*
- 33 High rates of secular voluntary service, however, also correlate strongly with religious membership and religious practice. See Greeley, *ibid.*
- 34 The main source for this theory is Henry Hansmann, "The Role of Nonprofit Enterprise," *Yale Law Journal* 89, 1980. Among other important contributions is Richard Nelson and Michael Krashinsky, "Two Major Issues of Public Policy: Public Policy and Organization of Supply," in R. Nelson and D. Young (eds.), *Public Subsidy for Day Care of Young Children* (Lexington, Mass.: D.C. Heath & Co., 1973).
- 35 The problem of evaluating service quality is complicated by the fact that the purchaser (in this case the parent) is not the direct user of the service. Similar problems arise in the case of nursing, residential care and educational services.
- 36 This is discussed in J. O'Hagan and M. Purdy, "The Theory of Non-profit Organisations: An Application to a Performing Arts Enterprise," *The Economic and Social Review* 24, January 1993.
- 37 Where this latter problem is effectively addressed through government regulation or self-regulation, the need for nonprofit provision will diminish.
- 38 This theory was a focus of discussion in the Roundtable discussion on tax policy (Part II) and it is revisited in Section VI below.
- 39 Burton Weisbrod, "Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy," in E.S. Phelps (ed.), *Altruism, Morality, and Economic Theory*, (New York: Russell Sage, 1974).
- 40 A "public good," as defined by economists, has two special attributes. It can be just as easily provided to many as to a single individual, since one person's consumption of the good does not interfere with the ability of others to enjoy it. Second, once the good has been made available, it is difficult to prevent some individuals from consuming it. The control of air pollution and national defense are frequently cited examples of public goods.
- 41 Free-rider problems can be effectively addressed by governments that have universal membership and special powers of compulsion.
- 42 J. Douglas, *Why Charity?* (Beverly Hills, CA.: Sage Publications, 1983).
- 43 This evidence is reviewed in Richard Steinberg and Bradford H. Gray, "The Role of Nonprofit Enterprise in 1993: Hansmann Revisited," *Nonprofit and Voluntary Sector Quarterly* 22(1), Spring 1993.
- 44 In the Roundtable discussion, participants pointed to the leadership role of the federal government in addressing issues such as domestic violence, sexual abuse and incest, in the late 1970s and 1980s. In the area of human rights, the federal government has been at the forefront of efforts internationally to protect the rights of women, children and people with disabilities.
- 45 Clubs also benefit from their ability to confine their services to members. Hence they are not subject to the free-rider problems that often beset nonprofits producing collective services.

- 46 The potentially important role of demand-side stakeholders as founders and controllers is discussed in A. Ben-Ner and T. Van Hoomissen, "The Nonprofit Sector in the Mixed Economy," *Annals of Public and Cooperative Economics* 62, 1993.
- 47 Dennis Young, *If Not For Profit, For What?* (Lexington: D.C. Heath Co., 1983).
- 48 Carl Milofsky and Albert Hunter, "Where Nonprofits Come From; A Theory of Organizational Emergence," prepared for the meetings of the Association for Research on Nonprofit Organizations and Voluntary Action, San Francisco, October 1994.
- 49 Estelle James, "The Nonprofit Sector in Comparative Perspective," in W.W. Powell (ed.), *The Nonprofit Sector: A Research Handbook* (New Haven, CT: Yale University Press, 1987).
- 50 Michael O'Neill, *The Third America: The Emergence of the Nonprofit sector in the United States* (San Francisco: Jossey-Boss, 1989).
- 51 See Larry W. Smith, 1992, op. cit.
- 52 The advantages of the nonprofit form for those providing ideological-type services and its appeal for consumers of these services are discussed in Susan Rose-Ackerman, "Altruism, Nonprofits, and Economic Theory," *Journal of Economic Literature*, Vol. XXXIV, June 1996.
- 53 Marc Bilodeau and Al. Slivinski, "Volunteering Nonprofit Entrepreneurial Services," *Journal of Economic Behaviour and Organization* 31(1), October 1996.
- 54 The need for models incorporating altruism is emphasized in Robert Gassler, "Nonprofit and Voluntary Sector Economics: A Critical Survey," *Nonprofit and Voluntary Sector Quarterly* 19, Summer 1990. Efforts to model altruism underlying charitable giving are described in Susan Rose-Ackerman, 1996, op. cit.
- 55 Samuel A. Martin, *An Essential Grace* (Toronto: McClelland and Stewart, 1985), p. 23.
- 56 From Robert D. Putnam, "Tuning In, Turning Out: The Strange Disappearance of Social Capital in America," *PS: Political Science and Politics*, December 1995.
- 57 Robert D. Putnam, (with Robert Leonardi and Raffia-ella Y. Nannetti), *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton: Princeton University Press, 1993).
- 58 Francis Fukuyama, *Trust* (New York: The Free Press, 1995).
- 59 Ibid, p. 11.
- 60 Robert Putnam, 1993, op. cit.
- 61 Andrew Greeley, 1996, op. cit.
- 62 According to the survey, Canada experienced a significant increase in volunteer activity over 1981 to 1991, but the change was smaller than in the United States.
- 63 The term "public good" is being used in accordance with the definition in note 40. With organizational laws, as with other public goods, there is a breakdown in market incentives, which prevents demand from being efficiently satisfied by private for-profit firms.
- 64 This issue significantly overlaps with the supervisory issues discussed in the previous section. For this reason, the

paper on organizational and supervisory law proposes that the monitoring and enforcement activities of Revenue Canada be integrated with the functions assigned to a new supervisory body.

- 65 Recent changes introduced in the 1996 federal budget involve: an increase in the annual limit on charitable donations from 20 to 50 percent of net income; an increase in the income limitation to 100 percent for charitable gifts willed to charities; and an increase in the income limitation to 100 percent on that portion of a donation of appreciated property included in the donor's taxable income.
- 66 The proposals include: the establishment of a limit of 75 percent of net income for the allowable amount of charitable donations (which represents an increase in the income limit for all charities other than the Crown and Crown Foundations); and, in the case of charitable donations of publicly listed securities, the reduction in the proportion of capital gains subject to taxation from 75 to 37.5 percent.
- 67 The proposal involves the establishment of a "stretch target" based on the highest contribution of each individual taxpayer in prior years; and an increase in the federal tax credit to 40 percent for donations in excess of the stretch target. This proposal, initially put forward by Scott Wilson in October 1995, is included in a recent report by the same author, "The Charitable Donation Tax Credit: Analysis of the 1996 Budget Proposals," prepared for the Voluntary Action Program, Canadian Heritage, June 1996.
- 68 Michael H. Hall and Paul B. Reed, "Shifting the Burden: How Much Can Government Download to the Nonprofit Sector?" Paper presented to the Annual ARNOVA Conference, Cleveland, Ohio, November 1995.
- 69 *The Commissioners for Special Purposes of the Income Tax Act v Pemsel*, [1891] A.C. 531.
- 70 While amateur athletic organizations were initially given special status because it was believed they could not qualify as charities, recent case law raises questions about this interpretation. National arts service organizations were provided with special status under the *Income Tax Act* in 1991. To qualify for registration, an arts organization must meet the conditions established by the Department of Canadian Heritage.
- 71 The problems with the current approach are discussed in a background paper by Arthur Drache, "The Voluntary Action Directorate: Rethinking the Mandate," prepared for the Department of Canadian Heritage, 1995.
- 72 Besides questioning the impact of tax incentives, some participants seemed to be arguing that the "median voter" hypothesis about the nature of government spending also needs to be qualified. The implied argument is that the political calculus of decision makers is more complex than indicated by the theory of political failure discussed in Section V; politicians are influenced by their perception about what is "right," in terms of the public interest, and this will sometimes lead to unpopular decisions and outcomes that depart from the preferences of the median voter.
- 73 This point is elaborated on in a note prepared by Don Mc Rae. He notes that non-Western European communities, that have a shorter history in this country and greater difficulty relating to the guiding principles set out in early English law on charity, have not been as successful in achieving charitable status in Canada. Among the activities excluded under the current definition of charity are: the promotion of race relations, many facets of multiculturalism; and the promotion of a specific ethnic culture. There are indications that some non-European concepts of high culture are not accepted. Also, current Canadian practice does not easily accommodate gifts in kind, which is a popular form of philanthropy among new communities whose members have limited financial resources.
- 74 The commission could also determine the requirements for tax exemption. The emphasis should be on separating out those essentially commercial nonprofits that are in no way deserving of the subsidy associated with their tax-exempt status.

- 75 In a 1987 Information Circular, Revenue Canada interprets the requirements in the Act as “requiring that approximately 90 percent of a charity’s financial, physical and human resources be devoted to its charitable programs and activities over a program cycle.”
- 76 See, for example, Gordon Floyd, “Viewpoint – The Voluntary Sector in Canada’s New Social Contract: More Responsibility But No Voice?” *The Philanthropist* 13(2), February 1996.
- 77 Paul Leduc Browne, *Love in a Cold World?*, Centre for Policy Alternatives, 1996.
- 78 The income inclusion rate will decline from 75 to 37.5 percent for donations of securities to charities other than private foundations. This measure is to be reassessed in five years.
- 79 The National Charities Information Bureau (NCIB) is an independent organization founded in 1918 with the objective of promoting informed giving. NCIB standards relate to: board governance; the organization’s statement of purpose; adherence to the stated purpose; information provision; financial activities and disclosure; use of funds; annual reporting; accountability through financial statement reporting; and annual budget preparation.
- 80 Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ministry of the Attorney General, 1996).
- 81 Frances K. Boyle, “‘Charitable Activity’ under the Income Tax Act: Definition, Process and Problems,” background paper prepared for the Voluntary Sector Roundtable, January 1997.
- 82 Kernaghan Webb, “Charitable Tax Status and its Relation to Advocacy by Interest Groups,” draft report, 1996. This is part of a larger study on public interest groups being financed by the Donner Foundation and mainly undertaken at the Faculty of Commerce, University of British Columbia.
- 83 This is being undertaken for CPRN by Brenda Zimmerman of York University.

Acknowledgments

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Part II – Roundtable Proceedings

Session A

Defining the Nonprofit Sector

Defining the Nonprofit Sector

Remarks by *Jacquelyn Thayer Scott*
President and Vice-Chancellor
University College of Cape Breton

We are assembled here today to talk about the Nonprofit Sector – how to define, measure and govern it, and what privileges it should be accorded. When I look at the expertise that has been brought to this agenda, I am rather humbled. I am, as well, a little bit intimidated by the challenge of attempting to define the sector in my allotted 15 minutes! When I queried Judith on my responsibilities, she – ever gracious – gave *carte blanche*, and a few valuable suggestions.

Consequently, I have chosen in this opening presentation to play the role of “mural painter” – to make broad brush strokes across a large and inviting hoarding, leaving others – more conscientious and disciplined – to fill in the foreground and detail. I suspect Paul will be among the first to provide useful correctives, in his role as statistician, giving a more photographic rendering of my largely impressionistic landscape.

So let us begin by taking this discussion back to first principles. Why does the Nonprofit Sector exist? Why is it necessary, if it is? Why does it perform certain roles? Why should we support it as an element of civilized society? A very brief historical review may be helpful, because nonprofit activity has been around for a very long time, and in many forms. The ideal visual aid here would be one of those old classroom friezes – the type that ran around the top of the blackboard, depicting in linear and graphical form the history of the world or the evolution of humankind. Not having one on hand, I ask you to create the mental image.

From the beginning, the historical and archaeological record indicates that humans developed social mechanisms for meeting their needs and reducing the risks for long-term survival. When we were huddled in caves and in huts along riverbanks and coasts, it was the family and the clan to whom we turned for mutual aid and assistance – a mode of support that has never been abandoned, and with which many contemporary politicians have become enthralled. Later, as groupings of hunter-gatherers or early farming ancestors became larger, the tribe became a source of voluntary action and succour – the ties that bind not necessarily being those of kinship but rather relating to a more sophisticated group loyalty. More complex agricultural societies evolved more complex systems, such as the feudal system of the Western Middle Ages with its mutual, if unequally beneficial, responsibilities between lord and serf. For travellers – and others not bound to the land – monasteries and similar institutions provided basic food and health care to those in need. With the growth of market towns and coastal trading centres, guilds, tongs and other mutual protective and benefit associations replaced or supplemented the ministrations of family, lord or church.

More organized charity, as we have come to know it, is a recent Western phenomenon, historically speaking (although a quite sophisticated system of civic charitable institutions for the aged, orphans, the sick, et al. existed in Byzantium at the height of its empire). The occasion for such change was the Reformation in England, the country’s emergence as a major trading power. When the Roman Catholic monasteries were dissolved, replacement institutions were necessary to perform the charitable tasks they had previously offered to the wider community. And, without monks and nuns to staff and manage such entities, new social vehicles were required. Thus came the *Elizabethan Poor Laws* of 1601, which authorized a new method of charitable management and, for the first time, attempted to define the public goods that the society of the time valued. You may be interested to know that what Elizabethans felt constituted the public good included:

... relief of the poor; maintenance of sick and maimed soldiers and mariners, poor chiefly by reason of war; schools of learning, free schools, and scholars in universities; repair of bridges, ports, havens, causeways, churches, seabanks, and highways; preferment of orphans; relief, stock or maintenance of houses of correction; marriages of poor maids; assistance to young tradesmen, handicraftsmen, and persons decayed; relief or redemption of prisoners or captives; and aid to the poor in meeting their property-tax obligations.¹

It is no surprise, then, that similar notions of public purpose crossed the Atlantic with British immigrants to Canada and the United States. Community charity for the relief of the poor and orphans, and for the construction of hospitals, occurred in the Maritimes and rural Ontario as early as the late 1600s. In Quebec, Crown and Church worked together from the early days of the French colony to provide similar services, funded through

public alms collection in each parish and grants from the Crown. Following Confederation, and prior to World War I, many national associations were established for charitable and mutual benefit purposes, principally to assist with the settlement of new immigrants (e.g., the YMCA, et al.) and to promote the development of national policy and the formation of policy positions by pluralistic groups (e.g., the Canadian Manufacturers Association, ethnic mutual aid societies, et al.). Not all of these groups were founded for noble purposes. Their purpose, Prang (1986) says, was to provide a “Christianizing and Canadianizing” program in response to Anglo-Saxon concerns about the influx of foreign-born immigrants.

The 1920s saw the founding of many national associations with specific interests that were best pursued in a national forum – ranging from the Canadian Chambers of Commerce, to the Canadian Authors’ Association, and the Student Christian Movement. Between 1880 and 1930, a substantial number of scholarly and educational associations were formed to serve particular disciplines and institutions. By the 1930s, the impact of the Depression had caused formation of so many local charities that the umbrella community chest or “Red Feather” fundraising campaigns and allocation systems were established in major cities.

Many associations had a significant effect on building the infrastructure of Canadian political communication. The Canadian Radio League played a major role in the establishment of public broadcasting, and its members later reorganized to support the formation of the National Film Board (NFB). Both the CBC and the NFB worked actively with the Canadian Association for Adult Education to further adult education. Many voluntary organizations submitted briefs on the working of Canadian federalism to the Rowell-Sirois Commission, which had such a profound impact on the development of Canada’s welfare state from the 1940s to the mid-1970s.

With the building of the social welfare state, many new charitable organizations and associations were formed, which is reflected in the strong growth in numbers of organizations from the 1960s onwards. Many of the new groups established during the 1980s represented multicultural and ethnic interests, self-help, health-care and poverty concerns, and environmental advocacy. And, of course, the Coalition of National Voluntary Organizations was formed in 1974, at the height of government welfare state activity.

The 1980s brought some of the first scholarly efforts at measuring nonprofit and voluntary activity in Canada, including the massive Ross and Shillington (1989) survey. There are papers to follow on this topic.

As you can tell from this very brief reprise, change has been constant throughout the history of Canada’s Nonprofit Sector – true today, as yesterday. Groups were formed for different reasons, with differing funding resources, and performed different roles. Which brings us full circle to “why – and to what purpose?”

This fundamental question has been a nagging one for those scholars who attempt to define and study the sector. For example, just look at the sector’s varying names: Nonprofit, Not-for-Profit, Voluntary, Third or Independent Sector, and “The Commons.” Examined closely, each has a subtly different meaning, and different underlying assumptions about its constituent parts and behaviours.

“Nonprofit” tends to be the nomenclature of the economists, most of whom have attempted to define this sector and its activity within the theoretical framework of market economics. Their assumption is that market behaviour motivates all human action – supply and demand, labour and capital, utility. The market governs all productive activity, and government’s economic role is to create favourable conditions for market growth and to act as a kind of minimalist traffic cop over what ensues. If a nonprofit sector exists – which such economists cheerfully acknowledge – it is only because of market failure or aberrant market behaviour. If these imperfections or failures in the market could only be “fixed,” such sectoral activity would not occur because it would not be needed. This view of the nonprofit sector as a residual in an imperfect world was a dominant scholarly view during the 1970s and 1980s and it is not surprising that it finds fertile ground when spread

among neo-conservative politicians of all national stripes. One more enlightened economist, Roger Lohmann, traces this residual nomenclature straight back to Adam Smith's concept of unproductive labour, and says "it is animated by a central concern for what might be termed the appropriate uses of the surplus product of an affluent society."²

"Not-for-profit sector" is really a further refinement of the economists' work. It has been employed chiefly by lawyers and accountants seeking to differentiate between mutual benefit associations – like the Canadian Manufacturers Association or the Chambers of Commerce – and "other-oriented" charities. For them, "nonprofit" describes an eleemosynary form of governance, in which the directors of the limited corporation are subject to a nondistribution constraint, but the activities of the association may directly benefit its members as a result of lobbying, provision of services, etc. "Not-for-profit" describes a similar form of governance, but in which the intention is to provide benefit to those who are not directors or members – to achieve a more general public good.

"Voluntary sector" is the language of the sociologists, for whom the central defining characteristic of what we are generally calling the nonprofit sector is that participation in it is not coercive – even that it depends, to a greater or lesser extent, on the provision of volunteer labour to accomplish its purposes. In popular terms, it might be traced to Alexis de Tocqueville's early comments on colonial life in America, in which he expressed amazement at the number of associations the colonists had formed – what Lohmann calls intermediate institutions "animated by a central concern for the individual and social consequences of uncalculated and uncoerced participation in organized social endeavours within social society."³ Most sociologists, while championing the term "voluntary," are not quite as enamoured with the "altruistic" halo that sometimes accompanies that word. Many, like Mancur Olson (1971), see participation in this sector as a self-serving activity, in that it creates a society in which the citizen's interests are best served.

"Third sector" or "independent sector" is principally the vocabulary of the political scientists, several of whom have read too many economists. This view accepts the market assumption that there are three sectors – the private/business/commercial sector, the public/government sector, and the nonprofit/third/ independent sector. A defining characteristic of the latter is that it operates "independently" of the market and of government. Those of us who have worked in this sector and find it to be quite competitive, and dependent upon resources from both government and the private market, may have some trouble with this view but, to be charitable, the "independence" to which these social scientists refer is seen to be more a desirable state of mind and a legal description than a practical truism. Similar to the sociologists, most political scientists see this sector as self-serving, in a collective sense. For example, Robert Dahl (1982) argued that this sector represented one of the merits of pluralist democracies: voluntary organizations present a mechanism through which conflicts of values, interest and views can be accommodated, if not resolved. The balance that is achieved among competing groups, he argues, exerts a stabilizing and conservative influence. James Douglas (1987) counters that balance is not always achieved through diverse, pluralistic competition because wills may be contradictory. Still, he adds, these diverse groups represent an opportunity for social experimentation, some of which will result in public social policy.

"The commons" is the newest addition to the vocabulary of this sector. Crafted by Roger Lohmann, it represents an effort to move away from residual theory. He is not concerned with all nonprofit organizations, or with any legal category but, rather, with donative associations, organizations, and groups engaged in unproductive (to use Smith's term) or volunteer labour, whether or not they are incorporated, recognized by the state, tabulated in national data, or made up of paid employees. He offers a number of criteria for inclusion in the commons but, to summarize, "commons" are social spaces outside the home and away from family and independent of political states and economic markets. They depend upon voluntary labour for common goods, created through self-interested and altruistic pro-social behaviours, which may be philanthropic, charitable or mutual in nature. "Mutuality and fairness find expression in explicit preference for the values of satisfaction,

proportion, contextualism, conservation, and prudence and the social responsibility of the leisure classes.”⁴

When you think about it, the hegemony of the market economists in defining this sector has been surprisingly strong – well, perhaps not so surprising, given their hegemonic effect on other sectors as well. But both political scientists and, to a lesser extent, sociologists have struggled definitionally to move away from the economists’ assumptions of residualism. Lohmann’s efforts are the most dramatic and, however preliminary, refreshing. He “recognize(s) that, fundamentally, the total social product of a society is not simply measured by its gross national product.”⁵

You may have noticed in my brief description that the question of “why” the sector exists permeates the analysis of all these scholars, whatever their disciplinary base. One factor, which my necessarily simplistic historical and scholarly reprise neglected, is the role of religious belief and values in motivating pro-social behaviour that is altruistic. In the Western and Mediterranean worlds – which dominate our own historical development – each of the three great desert religions has valued charitable and philanthropic behaviour as part of the individual’s spiritual journey. Maimonides was responsible for codification of an eight-level hierarchical class of “degrees of charity” within Judaism. *Zakat*, the principles of charity within Islamic law, are the result of centuries of scholarly and spiritual study. Similarly, the Christian gospels and Pauline letters encourage charitable behaviour to those less fortunately placed, and admonish the mean-spirited and greedy. In both Canada and the United States, a majority of financial donations flows through religious institutions into direct charitable activity.

Which brings us back to the roles and functions that the formal nonprofit sector performs. Most of these can be intuited from that earlier historical review. Perhaps the best known role is that of *provision of services*. Whether as a contractor to government or in their own right, nonprofits have long delivered both tangible and intangible products to their clients: food, shelter, health care, counselling, education, opportunities for collective worship, etc. This has been both the sector’s glory and its bane, definitionally speaking. On the one hand, it is altruism and/or mutual aid at its best, fulfilling spiritual duty and collective civic responsibility. On the other hand, much service delivery has been seen as economically unproductive to politicians who pay too much attention to economists. If it does not create new wealth, of what possible value is it? *Ergo*, of what possible centrality is the nonprofit sector?

A second role played by the nonprofit sector is that of *advocacy*, broadly defined. This may take the form of public education about mental retardation, AIDS, the abuse of children or animals, or an environmental concern. Or it may consist of direct advocacy to improve the economic or social conditions of a particular disadvantaged group, or to change practices or laws that are seen to be unjust or in conflict with the public good. During the past 40 years, this has been a growing segment of activity within this sector. And, again, you can see where this is not an attractive role for the sector in the eyes of many politicians.

A third role is *mediation*. Through associations, individuals come together in neighbourhoods or across geographical boundaries to work through issues and develop a consensus or work out a compromise. Perhaps the classic example of this role, in Canada’s historical version of pluralism, is the role nonprofit organizations have played in the conduct of royal commissions or commissions of inquiry. Traditionally, it was nonprofit groups that built the public opinion leading to the governmental initiative, and then it was nonprofit groups that testified before these commissions and audited their performance.

These three roles of the nonprofit sector are not, of course, mutually exclusive. Many organizations are involved in all three types of activity; others have performed more than one sequentially.

Having talked about the views of others with respect to the parameters and roles of the nonprofit sector, I hate to leave a podium without inflicting my own opinion upon the gathering. Both a political scientist and a management theorist by training, my views lack the simple purity of some others. You may judge them to reflect

the blurred vision of our times or simply as a reflection of my own confusion – but here they are.

I certainly do not see the nonprofit sector as a residual: it is an important component of any affluent and civilized society, providing a mechanism for constantly clarifying collective values, allocating resources for desired activities and purposes, and mediating the blunt edges between the lives of the individual and the state. Associations provide an opportunity to test the individual's voice for resonance with others, to develop democratic skills in social negotiation and governance, and to wrestle with the impacts of changing circumstances that impact upon particular locations or groups.

While not residual, it is interdependent – in mathematical terms, a dependent variable. While conservative with respect to preserving common values, the sector can offer flexibility of response to changing needs and circumstances. In other and more lengthy venues, I have argued previously that the governance concerns of nonprofit organizations are interactive with changes in the public philosophy of the state.

In this postindustrial era, we may acknowledge many identities for ourselves within a complex whole. A Canadian citizen living in Toronto may have a sense of what Canada “is” and “feel Canadian,” but still differentiate what it is to be an Ontarian from a British Columbia or to have Scotch-Irish roots rather than a Chinese ethnic heritage. Part of that national or regional identity is grounded in the public philosophy of the state or what we believe to be the common good and civic duty.

Along with Jon Van Til (1988), I believe there is an interactive relationship between political ideology and voluntary action. For example, voluntary associations, particularly those concerned with self-help and service volunteering, proliferate when the dominant ideological component of the public philosophy is pluralism. In Canada, the number of registered charities increased by nearly 50 percent during the 1980s, with growth concentrated in the first five or six years of that decade. Earlier records charting increases during the financially heady late 1960s and early 1970s are not available, but anecdotal evidence suggests the rate of group formation was higher then. Once formed, those organizations then acted as the political ideological value base expected of them. They have been competitive, sometimes duplicative, and have used media attention to assist in their task of mediating between constituency and legislators. Their organizational structures over time became increasingly centralized and bureaucratized, to rationalize competing internal interests and to mobilize resources for “efficient” action. They focused upon acceptable socio-political goals (e.g., training the unemployed, working with children in crisis, rather than pressing for significant tax or redistributive reforms) that promote enhanced freedom for their constituencies through broadened accessibility and equality of opportunity.

What, then, happened to voluntary associations when the ideological balance within the public philosophy began to shift? The neo-conservative political ideology characterizing the Reagan and Mulroney years provides a case in point. Both men believed fervently in rule by the elite – that “what’s good for business is good for the country” – and that government should leave the marketplace as unfettered as possible. Human nature is competitive, and governmental intervention that buffers or blocks the marketplace encourages inefficiency and laziness. Most social service activity should be a private matter, among families or at the local community level; the goal of government is to increase productivity and competitiveness and to reduce unemployment, since economic well-being will resolve most endemic social problems.

Not surprisingly, a principal goal of both men was to reduce federal contributions to social programs. Indeed, the most common voluntary association response in Canada and the United States to the neo-conservative shift was – surprise! – to attempt to reflect the values inherent in the revised public philosophy. Nonprofit managers crowded university and private-sector management training programs. “Marketing” became an acceptable term, and agencies hired fundraising and development consultants; entered “co-marketing” arrangements with the business sector; merged with other nonprofits or diversified their services; and developed fee-for-service products targeted to the middle class and those able to pay. In short, nonprofit and voluntary associations increasingly began to act like private-sector entrepreneurs. All of this led to what Ferris and Graddy (1989) have described as “fading distinctions” among the nonprofit, government and for-profit sectors (see also Kramer, 1990). Questions have been raised about the uniqueness of the sector’s role and functions and the degree to which these should be supported.

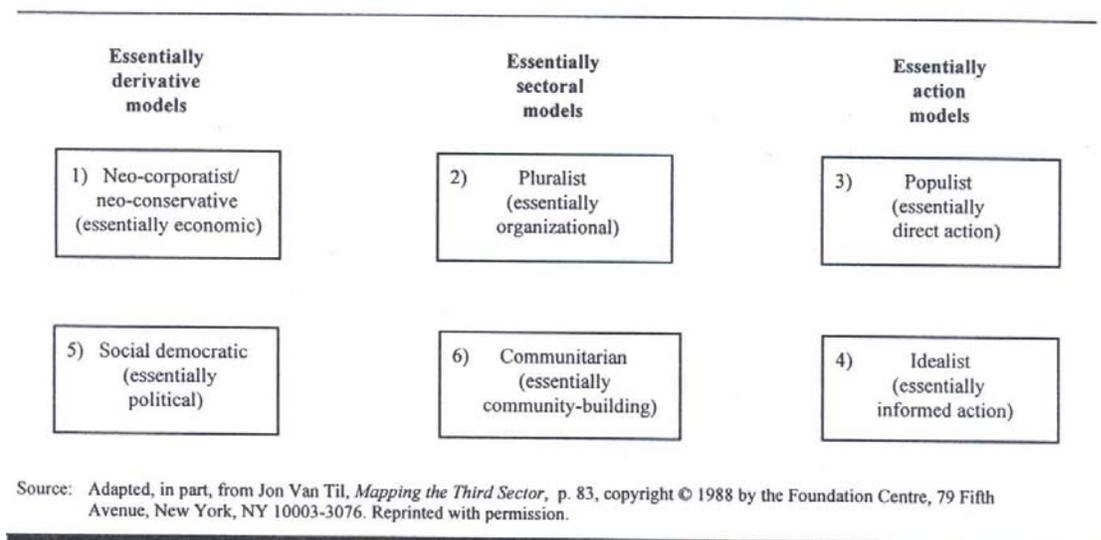
As Van Til’s model predicts, voluntary activity becomes less politically significant in the neo-corporatist or neo-conservative state. Ralph Kramer (1990) was prescient in stating that voluntary agencies in the 1990s were likely to be viewed by government as little more than substitute service providers or public agents, and be accorded little or no policy participation role.

But the times they are a’changin’ once again, if all those polls out there are right. Canadians are no longer “buying” the neo-conservative vision in its entirety. Yes, they want unity and order, but they also place strong values on access and active participation, and have a deep distrust of the elite and large institutions. Yes, there is pluralistic recognition of individual rights and competing interests among groups, but there is evidence we also value community rights and responsibilities. Yes, there is support for a social safety net and equality of opportunity for the disadvantaged, but importance is also placed on localized determination of community good and individual responsibility for participation in civic life. Canadians recognize that large institutions – especially large corporations – are an integral part of our existence, as is the globalization of practically everything. But some new means must be found to spur participation at the local, operational level of daily life, and to shape public policy decisions.

Such a new public philosophy of the state – closest, perhaps, to the communitarian view of the world – would value a nonprofit sector as a place for common talk, decision making and work, aimed at achieving creative consensus within the social economy. Interest groups, factions and coalitions do not disappear, but their goals are subordinated where necessary to a pre-eminent, and jointly determined, common good. The simple model in Figure 1 provides a conceptual map of the relationship among democratic variants and voluntary action.⁶

Figure 1

Six Models of Voluntary Action



Source: Adapted, in part, from Jon Van Til, *Mapping the Third Sector*, p. 83, copyright © 1988 by the Foundation Centre, 79 Fifth Avenue, New York, NY 10003-3076. Reprinted with permission.

In the pluralist philosophy of the state, the voluntary organization's focus is upon membership, constituency and functional program direction. Whose interests does it represent? Where do these interests fit within the societal balancing act? Into what socio-political niche does the organization and its programs fit?

In the neo-conservative philosophy of the state, the voluntary organization's focus is on management: control, marketing and entrepreneurship. How efficient is it? How effectively does it "get its message across" in the fundraising marketplace? How closely does its operating style match those of successful organizational entities in the private sector? Does it have a competitive and cultural "edge"?

In the communitarian paradigm, the voluntary organization's focus is on governance and the values of its mission. How permeable are its decision-making processes? How does it gather and consider environmental scanning information? What is its capacity for co-production; collaboration and cooperation with clients, other informal and formal voluntary groups, and private- and public-sector interests? What are the values that govern its administrative and program operations?

The *board* assumes great importance in the voluntary organization that successfully interacts with its environment in a communitarian philosophy of the state. For that philosophy acknowledges the importance of values and actively determined ideas of the common good. If, in a socially fragmented society, a need remains for legal and organizational mechanisms that enable us to accommodate the needs of strangers, the organizational entity of the "charity" retains its utility. But to stimulate the values of active participation by citizens in community problems, the notion that board members of voluntary organizations occupy their positions on behalf of the community must achieve more than symbolic acknowledgement.

In a pluralist era, the voluntary board's principal role is to represent and advocate for public policy favourable to the interests of the organization's members or clients. The board's success is directly related to its capacity for "winning" over the interests of other groups, or achieving favourable policy compromises. In a neo-conservative era, the voluntary board's principal role is fundraising and oversight of organizational management. The board's success is directly related to the financial resources it is able to attract for the organization, and to the organization's reputation for efficiency and sound management.

The voluntary board in a communitarian-like public philosophy is to assure that the organization is a venue for community problem solving, for common talk, decision and action. Its strategic posture must look more outward than inward. Planning becomes a more interactive process with community members, whether through focus groups, "town hall meetings," intergroup consultations, or a mixture of these and other methods. A cooperative, rather than competitive, world view and a desire for connectedness and good use of *community* resources (not just its own organizational resources) will encourage the board to seek out opportunities for collaboration with other service providers, co-production with clients and neighbours, and partnerships with those from other sectors.

My example has been so lengthy that you may have lost track of the original point, so let me state it once more: the nonprofit sector is not residual. It is an

important component of a total social system, especially in a democracy. It is interdependent with other sectors and organizations, and has proved, in pluralist and neo-conservative eras, to have been an adaptive mechanism for responding to change. As we move forward toward a changing future – one not grounded in the fortunes of the nation-state – its local, regional and global roles will become more important still, though differently expressed.

If it is to be of use to us, we must think carefully about the changes required in the sector's next evolution – and not become so pummelled and exhausted by changes to an individual organization's fortunes that we fail to recognize the role the sector plays, as a whole, in building and maintaining a civilized society.

Notes

- 1 Smith, J. Kellum Jr., in William G. Bowen, Thomas I. Nygren, Sarah E. Turner and Elizabeth A. Duffy (eds.), Prologue to *The Charitable Nonprofits* (San Francisco: Jossey-Bass, 1994).
- 2 Lohmann, Roger A., *The Commons: New Perspectives on Nonprofit Organizations and Voluntary Action* (San Francisco: Jossey-Bass, 1992), p. 44.
- 3 Ibid., p. 44.
- 4 Ibid., p. 273.
- 5 Ibid., p. 85.
- 6 The short length of this paper precludes full and appropriate explanation of the political theory underlying my arguments. Readers interested in being more thoroughly confused may contact the author for additional references and information.

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Defining the Nonprofit Sector in Canada: What Questions Should We Be Asking?

Remarks by *Paul Reed*

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I have been asked to speak briefly about defining the nonprofit sector, and brevity will be well served by beginning with an analogy.

In the late 1960s, two Canadian petroleum geologists, Jim Gray and John Masters, developed a new perspective on the geological sources of petroleum products. At the time, their ideas were clearly outside the boundaries of conventional oil-patch thinking. They proposed that methane hydrate was an extensive underground material, a significant source of natural gas, and located in geological structures (down-slope, in deep basins) where according to prevailing theory one would not expect to find combustible carbon compounds. Their high-cost, risky exploration in northeastern British Columbia during 1973-75 resulted in discovery of the rich Elmworth field, which continues today to yield hundreds of millions of dollars' worth of natural gas every year. Gray's and Masters' reconceptualization, pooh-poohed at the time, not only fundamentally altered the theoretical framework of petroleum geology, but has turned otherwise barren, uncharted, and useless expanses of territory into carefully mapped, valuable, and consequential areas of economic activity.¹

Accumulating evidence suggests there may be a somewhat parallel phenomenon in the social science field: the nonprofit (or third, or independent, or intermediate, or voluntary) sector. Where until a decade ago there was neither scholarly nor governmental nor general public interest in this portion of Canada's social terrain, it is today a widening focus of attention. Increasing numbers of Canadians believe it may be a previously unrecognized source of valuable social energy and benefit that merits exploration on a far greater scale than heretofore. And while there are a number of particular reasons for this, the common underlying element is, I believe, a fundamental shift in how we perceive and understand our society.

The CPRN Nonprofit Sector Project, the result of a vision shared by Judith Maxwell and by Shira Herzog of The Kahanoff Foundation, is a more distinctive and more significant event than may appear at first glance. While it has the typical form of a collaborative social science research initiative, it is unusual by virtue of its subject, its perspective, and its size. In the social science community in Canada, only a handful of researchers are engaged in studies, all of them short-term, low-budget, and piecemeal, of nonprofit behaviours or organizations; the CPRN study is visible and distinctive by contrast. Further, while most nonprofit sector studies in Canada are focused on a particular aspect of the nonprofit world, the CPRN initiative seeks both a broader and a more systematic understanding of what comprises the nonprofit sector, what is its place in our society, and how it should be treated in public policy.

There is reason to believe the CPRN project is an early event in an emerging trend. Until the late 1980s, the nonprofit sector was an academic backwater, received scant attention from government, and received only the rarest of public discussion. It was generally seen not as a coherent or consequential component of the social order but as an agglomeration of disparate individuals and organizations engaged in "doing good" in various ways. As its moniker says so clearly, it continues to be conventionally defined in terms of what it is not – a residual entity lying outside the important spheres of social consequence. Things have been changing of late, however: today the study of nonprofit phenomena is enjoying growing respectability in academic circles, the volunteer and charitable domain has been specifically referred to in two recent Throne Speeches, and judging from the rising incidence of media coverage of events and issues in the nonprofit sector, it has become a subject

of pervasive public interest.

It is only a hunch at this point, but I believe that the remarkable rise of the nonprofit sector to prominence on the social horizon is the result of a deep shift in our worldview – a shift that sees our social order resting not only on competitive markets and effective governments but also on indigenous cooperative action, both organized and informal, in support of values or benefits that transcend self-interest. It is most evidently and extensively in the nonprofit sector that we see this indigenous cooperative and contributory behaviour; the momentum to document and understand this sector is fuelled, I think, by an urge to identify what energizes such behaviour and what consequences arise from it.

The current nomenclature, definitional boundaries, and taxonomy of the nonprofit sector are flawed to the point of seriously limiting development of theory, data, research – and ultimately, reliable knowledge. This underbrush needs to be cleared away if we are to have the necessary base for long-term measurement, description, and analysis of the sector. It would be useful to approach the task of definition and classification not only by applying conventional scientific practice but also by asking two questions as test probes: What is distinctive about the nonprofit sector, as a whole and each of its components, in Canada? and What difference do the sector and its separate components make; why is it significant and why should it be taken seriously?

The Nomenclature Problem

The term “nonprofit sector” has come to be the most commonly used descriptor by default; it seems to be more generic than such alternatives as third sector, independent sector, voluntary sector, intermediate sector, among others. It is inadequate on several grounds, however. It rests on a law-specified class of organization that is framed in terms of what it is not (i.e., not profit-making); thus it is a residual rather than positive label and neglects nonorganizational elements. Roger Lohmann’s 1989 article “And Lettuce is Non-Animal” very effectively ridicules this state of affairs. More importantly, this label does not adequately convey some of the other fundamentally distinguishing characteristics of the sector such as indigenous and informal action oriented to advancing a greater good than self-interest. Until we move toward a more effective definition of the sector (i.e., are able to make a more reasoned case for what entities should be included and which excluded), the nomenclature issue cannot be resolved. I will return to this later in my discussion.

Drawing the Boundaries: What Criteria Should We Use?

It is a central element of the scientific canon that taxonomy – definition and classification – sets the terms of perception, analysis, and ultimately, conclusions and discourse. Because it establishes the framework within which inquiry proceeds, appropriate taxonomy is pivotal; this means identifying the importance of differences and similarities among entities so as to create classes or groupings of traits such that a) *within-category* similarities (or differences) are greater (or less) than *between-category* similarities (or differences), and b) relationships among categories can be specified in terms of the patterns of similarities and differences. Although classifications of the nonprofit sector and its component have been prepared (the most detailed is Salamon and Anheier [1992] with some 300 entities), they take the form of inventories rather more than taxonomies.

There are several reasons why definition and classification of nonprofit sector entities remain unsettled. One is the inherent difficulty of sorting multidimensional entities. The principle in mathematics that there can be no unique linear ordering of vectors has its parallel in social science; it becomes a matter of judgment, and ultimately consensus, as to which dimensions should be given precedence. A second reason is the difficulty in slicing a continuum of phenomena into discrete categories that satisfy as far as possible another cardinal rule of

taxonomy – mutual exclusivity (or nonoverlap) of categories. One challenging continuum that involves the nonprofit sector is what we might call “span-of-interest orientation,” which ranges from individual self-interest pursued via cooperative economic action (e.g., membership in a nonprofit cooperative), through restricted membership group interest (found in such forms as unions and other occupational interest groups), to unrestricted membership affinity-based group interest (e.g., social, cultural, and sports associations), to a full, unrestricted public interest orientation (such as activities and organizations concerned with protecting the environment).

Another less recognized reason for difficulty in setting definitional and classification boundaries is that different taxonomic criteria serve different purposes variably well. I would argue, for example, that the nonprofit criterion is useful principally for issues of regulation and governance, but that it has much less value for social science (measurement and analysis), social policy (social capital, social infrastructure), and public information purposes.

It is not difficult to identify a significant number of ways by which the domain of nonprofit organizations and activity can be characterized beyond those I mentioned earlier, *viz.*, consisting of activity intended to benefit a person or persons beyond oneself and one’s close associates, with this activity extensively engaged in informally (not through organizations) as well as formally. Where it is done through organizations, they are overwhelmingly small, local, with a low level of formal structure, substantially self-organizing, and based on consent and cooperation rather than hierarchical authority or competition.

The economics of nonprofit activity and nonprofit organizations are unlike those in any other domain. Resources are procured not via competitive exchange processes but uniquely through asymmetric reciprocity – i.e., contributory behaviour (see Reed, 1993). Because many of the goods and services produced through nonprofit activity are not monetized (i.e., assigned market value in dollars), a large proportion of the total resource input provided by individuals takes the form of unpaid time and labour rather than money. At the same time, the sector receives a far larger proportion of its aggregate revenue (nearly two-thirds) from government than does any other sector. Integral to the distinctive economics of the nonprofit sector is the absence of a rationality or utilitarian calculus for maximizing the effects of nonprofit activity; this, however, is accompanied by a significant level of social entrepreneurship directed toward producing public benefit of some kind. This ensemble of characteristics is found in no other domain of our society, even in partial combinations. As a whole it sets a distinguishing boundary around the nonprofit sector and provides a basis for classification within. It has obvious ramifications for the conventional nonprofit definition that I will return to in the closing portion of my remarks.

What Is Distinctive about the Nonprofit Sector?

The defining boundaries of any phenomenon can be set not only in terms of some set of traits but also in terms of a distinguishing essence. There exists such a feature in a large portion of the nonprofit sector that I believe is conceivably its most distinctive and influential: the ethos that underlies behaviours and organizational forms. The components of this ethos are, *inter alia*, an orientation toward general amelioration, motivation that rests on some ideal or moral principle, and a sense of mutuality, trust, and common cause among people engaging in nonprofit activity. David Horton Smith, a keen observer of the nonprofit sector, has remarked in an unpublished manuscript that “the nonprofit sector ... is not about money or property. It is about people’s time and their attitudes, voluntary spirit, emotions, ideologies, purposes, even dreams.” As well, the sector’s structural features carry a distinctive essence that derives from this ethos; its organizations have modes of operation, governance, and accountability that reflect the concern for a greater good, mutuality, trust, and cooperative or contributory

action.

While the array of a dozen-odd traits of nonprofit activities and organizations is sufficient to give the sector clear distinctiveness, a great portion of that distinctiveness is imparted by the simple but unique ethos whose essence is an orientation to providing a pro-social good through asymmetrically reciprocal action, which is ordered primarily by the two principles of mutuality and indigenous social organization. (This includes but extends beyond Lohmann's (1992) framing of the sector in terms of concern for the commons.) Because of the close interconnections among definition, boundary operationalization, and taxonomy, and because we have so little reliable factual knowledge of this ethos, the set of traits will likely be of greater use in establishing two systematic classification schemes for the sector's behaviours and organizations.

What Does the Nonprofit Sector Do that Makes It Significant? What Difference Does It Make?

It is a standard question in taxonomy: What differences do the defining differences make? While we can identify some of the explicit roles and functions of the nonprofit sector (provision of services, advocacy, and mediation, as Jacqueline Thayer Scott has just noted), we do not have a confident grasp of the full range of functions, particularly the more implicit ones, nor do we have any reliable knowledge of their respective impacts. Among these implicit functions are remedying (some) injustices; providing mutual aid; affirming values, beliefs and ideals; rebalancing maldistributed resources; providing offsets to formal rights and responsibilities; supporting social innovation; reproducing grassroots social structures; providing the mechanisms of communication and consent that are essential conditions for democratic social order; and generating normative and infrastructural social capital.

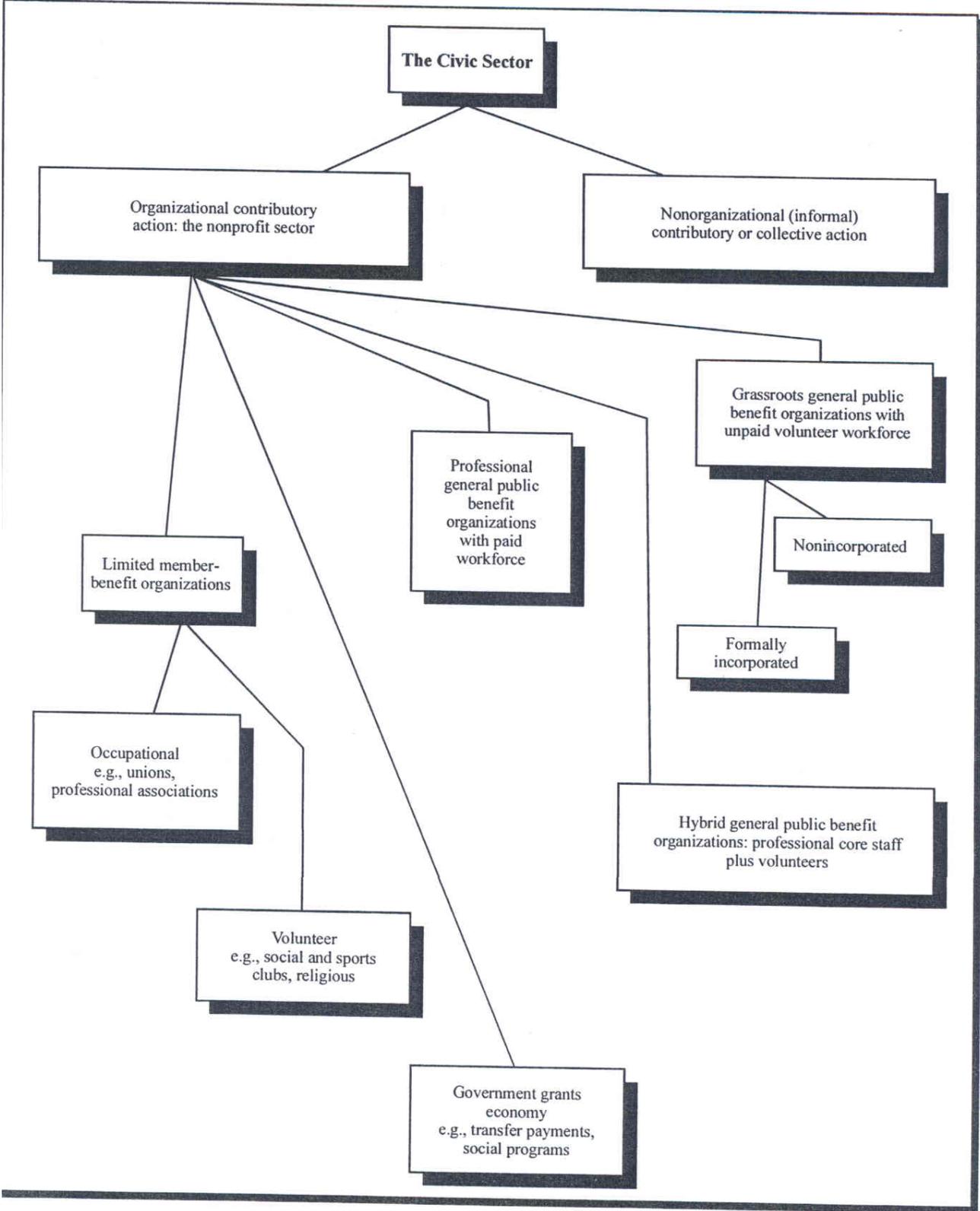
Understanding what differences the nonprofit sector makes will help in placing its definitional boundaries, but that understanding is also needed to help make an empirically grounded case for the importance of the sector's place in Canadian society.² It will be, I think, one of the most pressing areas of information need in the coming months and years.

To End

One of the implications of my abbreviated discussion of these issues concerns nomenclature. What label would be a better descriptor than nonprofit sector? Having rejected such terms as communal sector and social economy, my own mild preference is for "civic sector" because it entails activities and social structures concerned with contributory behaviour and benefits beyond individual advantage. It is my hope that a serious search process for a better, more widely supported name will be initiated sooner rather than later.

A second implication concerns the sector's boundaries. Specifically, selected entities, which are currently included in the nonprofit sector but which do not fit many of the differentiating criteria I have suggested, should, for social science and social policy purposes, be deleted. Two such cases are cooperatives and credit unions, which function solely or principally for economic purposes, and a large portion of the universities, schools and hospitals component because they are for most intents and purposes extensions of government. Likewise, consideration should be given to including certain entities that are currently excluded; the grants economy and informal nonorganizational forms of nonprofit activity are two examples. See the figure on the civic sector, which is a coarse-grained schematic rendering of the main components under a revised definition of the nonprofit sector.

There are, I believe, many Canadians who hunger for a renewed vocabulary and philosophy of public life that will give renewed substance and vigour to our public discourse, to our collective identity, to our institutions and processes of governance. Evidence of this abounds – in the Spicer Citizens’ Commission, in numerous polls (such as the Ekos “Rethinking Government” study and the Angus Reid “Social Contract” survey), and in the actions and words of many individuals during and after Quebec’s 1995 referendum. There is a strong but unarticulated sense that our social infrastructure is in serious need of repair, that our major institutions cannot be counted on to do the job. There is a view, still quiescent, not only that the civic sector may hold considerable potential for energizing the needed renewal, but that ultimately the health of our market and state sectors may depend far more than we realize on the health of the civic sector. Only if this sector can be understood will Canadians acknowledge and support it. Mundane and tedious though it may be, strengthening the definition and classification of the sector is an unavoidable task in building the knowledge base that is a sine qua non for such understanding.



Notes

- 1 “Although naturally occurring methane hydrate may harbour the largest untapped reservoir of natural gas on earth, the material properties of this ephemeral compound are not yet well understood,” (*Science*, 1996, p. 1771).
- 2 The standard argument for the sector’s importance is that it accounts for at least \$86 billion annually, approximately one-eighth of our GDP. Such reasoning, when disaggregated, loses some of its punch; Canadians spend less each year per household on charitable donations than on lotteries and gambling, and total expenditure in doughnut shops amounts to 50 percent of the \$3.4 billion in declared charitable donations annually.

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Discussion Summary

Ron Hirshhorn noted the difficulty of identifying the defining characteristics of the nonprofit sector. The attributes highlighted in the papers by Jacquelyn Scott and Paul Reed – a voluntary spirit, an ethos of giving, a community focus, etc. – pertain to an important subset of nonprofits, but they are not distinguishing characteristics of the overall sector. Nonprofits include not just community groups and self-help organizations but large national organizations with professional staff, hospitals, universities, local airport authorities and Nav Canada, the new nonprofit manager of Canada's air traffic system. Nonprofits encompass a far more diversified group of organizations and a more complex set of issues than suggested by the discussion in the papers. **Paul Reed** responded that there was a need for a taxonomy that subscribed to the standard rule that within-group similarities must be greater than between-group similarities. Organizations like Nav Canada have more in common with commercial entities such as IBM than with organizations like the Kanata Lakes Community Association. There was a need to work towards a classification system that distinguishes voluntary groups from organizations that are either businesses in disguise or public sector institutions in disguise.

Arthur Drache offered a different interpretation based on his view that the term “nonprofit” is only meaningful in the context of the income tax system. The fundamental distinction, in his view, is that while for-profit organizations distribute profits in the form of dividends, nonprofits never distribute their profits. This nondistribution characteristic is the critical distinguishing factor rather than differences in activity, because commercial and noncommercial organizations may be involved in very similar activities. From his experience in the religious sector, **Carl Sulliman** saw the practical importance of the tax definition, but the result, in his view, was to lump together a host of very different institutions.

To **John Gregory**, the appropriate definition depends on what you want to know. For some purposes, the distinction between organizations that do and do not distribute their surplus is important. If the exercise is directed at understanding how certain civic values that are important to society can be protected, however, then we might move towards a definition of the sector that is closer to that proposed by Paul Reed rather than Arthur Drache.

Following on this, **Jacquelyn Scott** proposed a two-tier definition. The first tier would be based on governments' desire to distinguish nonprofits for tax purposes. But there is a need to look at other definitions that correspond with other purposes. This requires coming up with some way of further categorizing the broad group of organizations that are nondistributive. Jacquelyn thought it might be useful to look at this problem in the same way doctors look at how to diagnose a disease such as Lupus. There are something like 12 characteristics associated with this disease, and a patient that has 8 of the 12 symptoms is considered to have Lupus. Similarly, Jacquelyn thought it might be possible to list the possible defining characteristics of civic-oriented behaviour, and then identify those organizations that have a sufficient number of these characteristics to be considered members of the civic sector. The advantage of this approach over one that simply excludes certain organizations, such as universities and hospitals, from the definition, is that it allows for taking account of differences within particular subsectors, as well as changes over time in the characteristics of organizations. To illustrate this last point, Jacquelyn noted that her own institution (University College of Cape Breton) was directly dependent on more than 250 direct service volunteers and, hence, had civic attributes that are not shared by some other colleges or universities. While **Ron Hirshhorn** thought this was a useful suggestion, he emphasized that considerable data would need to be assembled and analyzed to classify organizations properly. In Ron's view, there is a danger in moving too quickly towards a narrow definition of the sector before the necessary data had been collected and interpreted.

David Elton listed a number of different bases for classifying nonprofit organizations. These include: their taxation, their legal form, their sources of money and other resources, and the values they promote. **Paul Reed** reiterated his views on the importance of the latter criterion. What distinguishes members of the sector, in Paul's

view, is the absence of a calculus of utility; individual participants in nonprofit activities do not seek advantage or benefit for themselves, although they may seek advantage for members of their group or for an undefined collectivity that may consist of society or mankind as a whole. This is what sets the civic sector apart from the state, the market and the household sectors.

Values may change over time, however. This was highlighted by *Carl Sulliman*, who is concerned that organizations that have traditionally depended on philanthropy are becoming increasingly reliant on the revenues from gaming activity. Carl believes that Ontario's decision to use the nonprofit sector to implement workfare also poses a challenge to the traditional values espoused by the sector. While Carl is concerned about how gaming revenue impacts on the meaning of nonprofit activity, *Paddy Bowen*, who is on a committee advising on the allocation of gaming revenue, has seen the reverse problem; namely, the difficulty of determining how gaming revenues should be distributed among a community that does not know how to define itself.

These definitional problems were seen by some participants to pose a challenge to the nonprofit community. *Michael Hall* suggested that there was a need to come to an understanding not only of the characteristics of nonprofit organizations, but also of their objectives and accomplishments. In Michael's view, this type of information is needed to replace the current tendency to describe the sector in terms of what it is not, with a positive approach that focuses on what it is. *David Armour* thought the community must articulate those values that are at its core and that are nonnegotiable. The challenge is to find the values and ethos that underlie nonprofits' role as value-based movements and enable these organizations to proclaim that they are different from other sectors. This may require an understanding of how organizations got started. David noted, for example, that the United Way, at its core, is not as a fundraising entity but a community-building organization. Similarly, *Sally Horsfall* thought the sector must develop a sense of pride as part of the process of establishing its identity. She observed that, historically, the so-called "third sector" was really the first sector.

Arthur Drache believes the underlying values that have been emphasized in the discussion are closely related to the nondistribution characteristic of the sector. A critical factor in the behaviour of donors, volunteers, and patrons of nonprofits is the knowledge that none of the revenue the nonprofit organization receives is going to end up in somebody's pocket by way of dividends. It is because nonprofits satisfy this destination test that, in Arthur's view, we see asymmetrical reciprocity and other positive emotional responses by individuals to the appeals and offerings of nonprofit organizations.

Sally Horsfall suggested that there may be a number of organizations who do not distribute profits but who pay their chief executive officers very lucrative salaries and compensate their board members, much as for-profit organizations. At the same time, many values held by the sector are also held by those in government and in corporations. There is, therefore, a need to be cautious in identifying what distinguishes nonprofits from other organizations. One aspect that has not received sufficient attention, in Sally's view, is the sector's important advocacy role, its contribution to promoting people who cannot promote themselves. She proposed that the community begin the process of definition by identifying key principles; defining characteristics or criteria would emerge from these principles.

Jacquelyn Scott believes there are some particular problems hampering the discussion of the civic sector in Canada. First, the influence of the economists' framework, with its notion of utility based on monetary valuation, has made it difficult, in her view, to understand the role and contribution of civic activities, which are largely not valued in the marketplace. Second, she lamented the lack of a well-developed language for addressing civics – including such concepts as the public good, social ethos, community values – in this country. Whatever the language problems, however, *Carl Sulliman*, believes that the importance of a civic society

cannot be understated. From Carl's broad perspective, a civic society is a tolerant, caring society where individuals have a strong sense of their fiduciary duties, of their obligation to volunteer for community activities, and of their responsibilities as citizens of a democratic state.

Al Hatton thought the discussion highlighted the complexity of the issues confronting the sector and the need for a series of processes that would allow the nonprofit community to gradually develop a consensus on its roles and values. Al believes that progress on such fundamental issues is needed for the sector to enhance its credibility and to gain public acceptance that it has a legitimate role in helping to solve society's problems.

Session B

Measuring the Nonprofit Sector

The Canadian Nonprofit Sector

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I Introduction

Although the activities of nonprofit organizations span a multitude of sectors, affecting virtually everyone at one point or another, little is known about their role in, and potential impact on, the Canadian economy. How important is the nonprofit sector? What is the contribution of nonprofits to particular sectors of the Canadian economy? How dependent are these organizations on various funding sources? How is the sector likely to react to cutbacks in government provision of social services? In order to shed light on such questions, we analyzed all important data sets pertaining to the size, scope and characteristics of the nonprofit sector in Canada.

In this study, we investigate, first, the activities of nonprofit organizations. We then look at individual and corporate donations to nonprofits. Third, we explore, insofar as the available data allow, the relationship between government and the nonprofit sector in Canada. In our conclusion, we highlight the most serious gaps in the collection of nonprofit data and raise some questions for future research.

II A Profile of Nonprofit Organizations in Canada

In keeping with Revenue Canada statistics, which are the primary source of data on nonprofit organizations in Canada (see Box 1), we distinguish between registered charities and “other nonprofit organizations.”

1 Registered Charities

As of the end of April 1996, 74,027 registered charities were active in Canada – more than double the number registered in 1969. Over 40 percent of active charities were religious in nature. Welfare organizations were the next most numerous (18 percent), followed by educational organizations (16 percent) and organizations classified as providing benefits to the community (15 percent).¹ In terms of numbers of new registrations, since 1985 the welfare category has been the leader, although new registrations in the areas of health and education have also tended to be relatively high. In 1994, about 9 percent of active charities were classified as foundations, organizations that focus on collecting and distributing funds as opposed to delivering programs.

Box 1 **The Revenue Canada Data Set**

Revenue Canada Statistics, which are the primary source of data on nonprofit organizations in Canada, distinguish between registered charities and “other nonprofit organizations.” All registered charities must submit an annual information return (form T3010) to Revenue Canada, and since 1993 other nonprofits have faced a similar filing requirement (form T1044). We obtained from Revenue Canada the complete set of responses to form T3010 for the period 1989 to 1994 and some summary statistics derived from the T1044 data.

Since these data sets are the only available sources of information on the activities of nonprofit organizations in Canada, it is unfortunate that they are subject to serious reporting errors. Although information in the T3010 form on the numbers of registered charities undertaking various activities is quite reliable, the same cannot be said for the financial data, which are subject to systematic underreporting by some organizations. The totals for financial variables thus underestimate the correct values for charities, perhaps by a wide margin.

While T1044 information is to be submitted by all other nonprofit organizations with revenues exceeding \$10,000 or total assets over \$200,000 (along with those organizations that filed in any previous year), there is no way to verify that all relevant organizations are indeed filing. In fact, it would appear that available Revenue Canada data are only capturing a small subset of the noncharitable nonprofit sector.

In 1994, the total revenues of registered charities, measured in 1986 dollars, exceeded \$45 billion. About 59 percent of this revenue appears to have been generated by two categories of charity, hospitals and teaching institutions.² Despite a poor economic climate over the 1990-94 period, charities experienced some growth in real (i.e., measured in 1986 dollars) revenues.

Interestingly, donations represent a relatively unimportant source of revenue for charitable organizations overall, accounting for only about 11 percent of total revenues in 1994. Government funding constitutes the most important revenue category, accounting for 53 percent of total revenues in 1990, and over 60 percent in 1994. But not all charities are heavily dependent on government funding – charities in the religion category receive only 5 percent of their revenues from this source.

By far the most important component of expenditures is spending on charitable programs. The T3010 data, uncorrected for underreporting, indicate that spending on charitable programs constituted 66 percent of total expenditures in 1994. Remuneration of employees appeared to account for almost 60 percent of spending on charitable programs. However, a surprisingly high proportion of charities, over 30 percent, did not report any spending at all on charitable programs. The reported results must be viewed in the context of this and other anomalies in the data on expenditure components.

2 Noncharitable Nonprofit Organizations

It has proven to be almost impossible to obtain an accurate count of the number of noncharitable nonprofit organizations in Canada. Two attempts to do so are worthy of particular note. During the period 1986-87, Don Mc Rae of the then Department of the Secretary of State for Canada interviewed knowledgeable persons in each province and concluded that there were about 60,000 such organizations in Canada at that time. More recently, in his book *Canada's Social Economy* (1992), Jack Quarter concluded that in 1992 there were about 175,000 nonprofit corporations in Canada. This estimate was based on “information provided by the appropriate department in each of the provinces, territories and the federal government” (note 2, Chapter 3, p.183).

Subtracting the 66,000 or so registered charities from this figure leaves him with an estimate of well over 100,000 noncharitable nonprofit organizations.

However, few of these organizations file T1044 information returns with Revenue Canada. In 1993, for instance, only 3,880 noncharitable nonprofit organizations filed information returns; in 1994 this number grew to 4,490. Clearly, the count obtained using Revenue Canada data differs by orders of magnitude from what one might expect on the basis of other evidence.

Despite their poor coverage, the T1044 data indicate that the subset of noncharitable nonprofit organizations that filed form T1044 brought in about \$7 *billion* in revenue per annum, an amount equivalent to about 1 percent of GDP in 1993 or 1994. It also amounts to almost 16 percent of the total receipts reported by charities on form T3010. This finding suggests that noncharitable nonprofit organizations comprise a fairly significant portion of the nonprofit sector in Canada.

The T1044 data also suggest that the composition of revenues of noncharitable nonprofit organizations differs from that of charities. By far the largest share of the receipts of the noncharitable nonprofit organizations included in the sample (51 percent) is attributable to the sales and revenues generated from the organizations' activities. Membership fees and dues constitute the second largest component of revenue at 21 percent, while grants from the three levels of government make up a substantial 14 percent of the total receipts. By contrast, gifts contribute only 1 percent of receipts. Clearly, like registered charities, the noncharitable nonprofit organizations that filed form T1044 rely more heavily on government support than on private donations.

III Private Sector Contributions to Charities

1 Individuals

Individuals can contribute directly to the nonprofit sector by donating time and/or money.

Volunteer Activity

The major source of information on voluntary donations of time continues to be the Volunteer Activity Survey (VAS) carried out by Statistics Canada in 1987 and focusing primarily on formal volunteer activities – i.e., volunteer work carried out within a formal organization. On average, 27 percent of Canadians, or 5,337,000 people, engaged in organized volunteer activities in 1987. An even higher proportion, 66 percent, engaged in informal volunteer activities.

Important differences in volunteer participation rates exist between different population subgroups. There are marked differences in participation rates across provinces, with the lowest rate of participation in formal organizations (19 percent) found in Quebec, and the highest participation rate (40 percent) found in Alberta. In addition, women have a higher propensity to volunteer than do men. Both men and women demonstrate a greater propensity to volunteer as both household income and education level increase.

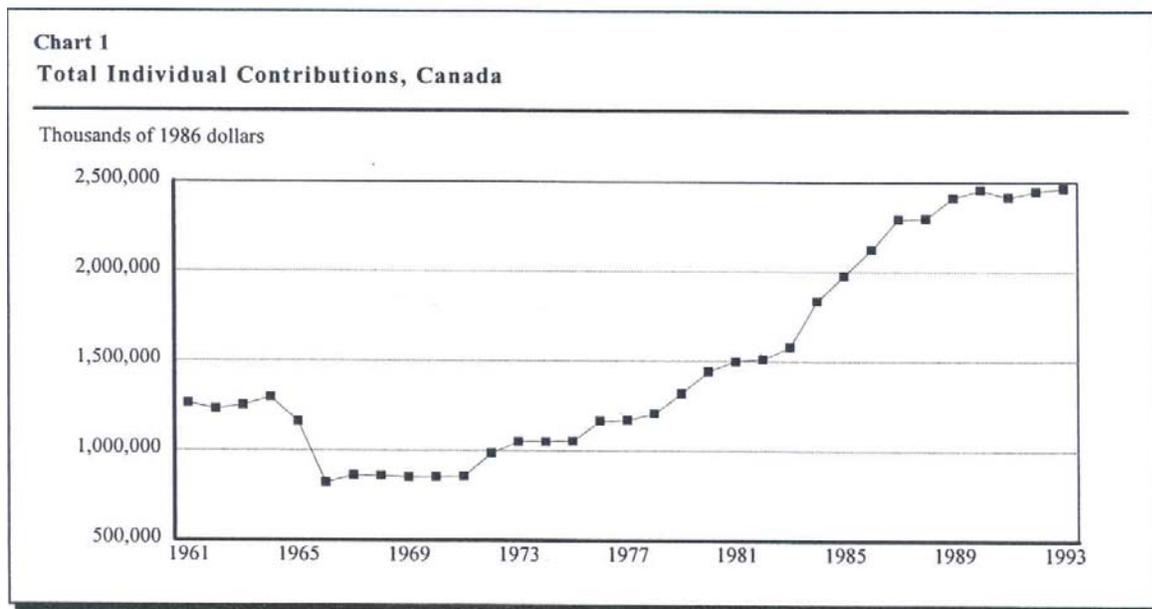
In total, Canadians are estimated to have supplied some 1 billion hours of volunteer work in 1987 – equivalent to the amount of work supplied by 6 per-cent of all full-time workers in Canada in that year. Assuming that volunteer hours in 1994 were equal to those in 1987, and using the 1994 average hourly wage for service industries of \$12.47, we estimate the value of volunteer time (in 1994 dollars) to be \$13 billion.

Studies of volunteering in Canada and the United States confirm that both the propensity to volunteer and hours of volunteer work tend to increase with income, education level and the presence of older children; and fall with the presence of young children and with the tax price of charitable donations of money, holding everything else constant (Menchik and Weisbrod, 1987; Brown and Lankford, 1992; Vaillancourt, 1994; and Day and Devlin, 1996). Thus, as the cost of donating money falls, donations of both money and time will increase. In other words, tax deductions or credits for charitable donations of money may have the beneficial side effect of increasing donations of time as well.

Donations

Chart 1 provides estimates of the total real monetary contributions of individuals derived from the taxable returns of Revenue Canada from 1961 to 1993. Because these returns provide information only on contributions for which receipts were issued (except for the first \$100 up to 1984), they somewhat underestimate the actual value of such gifts in Canada. The substantial dip observed in 1965 is the result of a change in the way churches in Quebec provided receipts for donations from individuals. Contributions took a perceptible jump upwards in 1971-72, perhaps as a consequence of the major reform of the tax system that was implemented at that time. The only other tax policy changes worthy of note, during the 1961-93 period, were the elimination of the \$100 standard deduction for charitable donations (in 1984), and the replacement of the charitable donations deduction with a tax credit (in 1987). Neither of these changes seems to have had a perceptible effect on donations.

As is the case with volunteering, there are marked differences in average giving across provinces. Quebec residents give less on average than do individuals in the other provinces – about \$100 (1986 dollars) in 1993. Individuals in Manitoba and Saskatchewan have been the most generous over the past few years – giving, on average, about \$240 and \$230 in 1986 dollars, respectively, in 1993. In Canada as a whole, the ratio of donations to income remained higher in 1993 than in 1975, despite relatively slow income growth in the early 1990s.



Supplementary information on the characteristics of donors is available in a special compilation of taxation data for 1986 and 1987 prepared by Revenue Canada (Voluntary Action Directorate, 1991). This report supports the notion that average contributions rise with income. By far the largest share of donations is given to religious groups – over two-thirds of all reported donations in 1986 and 1987; the next largest category of recipient is organizations that provide welfare-related services (10 percent). Charities involved in education were allocated about 9 percent of donations, followed closely by those involved in the health area. Community groups and “other” groups each received about 2-3 percent of total contributions.

Most of the empirical work that examines individual donations of money uses data from the United States; only four papers³ have analyzed the determinants of monetary donations using Canadian data. The work in this area focuses mainly on the tax and income elasticities of donations (Feldstein, 1975*a* and *b*; Feldstein and Clotfelter, 1976; Feldstein and Taylor, 1976; Boskin and Feldstein, 1978; Hood, Martin and Osberg, 1977; Feenberg, 1987; and Kingma, 1989). Interestingly, the U.S. studies have typically found that donations are fairly insensitive to changes in income. However, only two of the four Canadian papers support this finding. The other two papers, namely those of Kitchen and Dalton (1990) and Kitchen (1992), find individuals’ contributions to be rather responsive to income changes. Significantly, both the U.S. and Canadian studies typically find that individual contributors are sensitive to changes in marginal tax rates, suggesting that charities could benefit significantly from a more favourable tax treatment for donations.

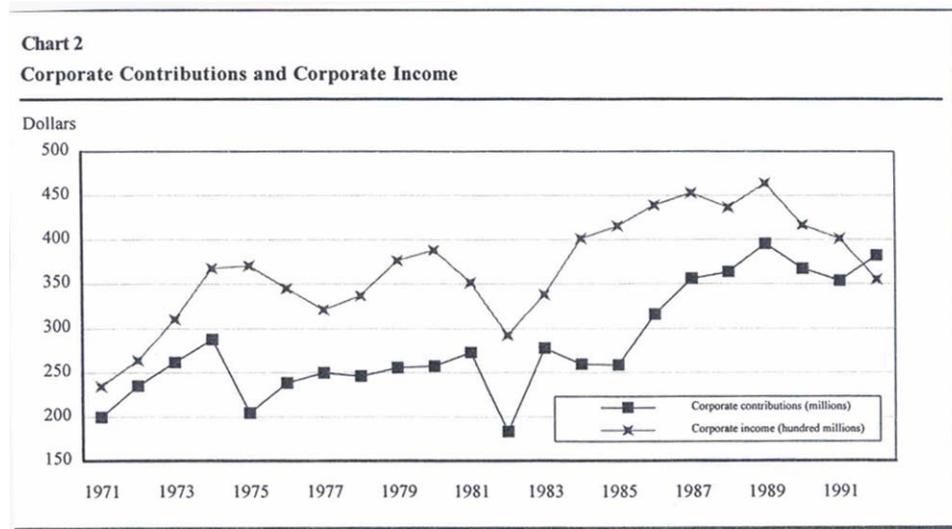
2 Corporations

Data on corporate contributions come primarily from two sources: corporation taxation statistics – available

for the postwar period; and annual surveys conducted by the Canadian Centre for Business in the Community (CCBC), formerly known as the Institute for Donations and Public Affairs Research (IDPAR), of the Conference Board of Canada – available from 1990 to 1994. The taxation statistics provide a temporal picture of the received financial contributions claimed as a tax deduction by Canadian corporations. The CCBC data set provides supplementary information on actual donations and the characteristics of donor firms, based on surveys of a sample of Canadian corporations.

Chart 2 graphs total real corporate monetary contributions and real corporate income according to taxation statistics for the years 1971 to 1992. Corporations contribute about 13 percent of the total donations received by all charities from the private sector or about 21 percent of donations to nonreligious charities.⁴ Corporations also tend to give much larger gifts to charities than do individuals, with the average corporate contribution in 1987 being well over \$5,000 as compared to about \$180 for individuals in the same year. However, as Chart 2 shows, corporate donations appear to be much more sensitive to changes in corporate income than are individual donations to changes in personal income.

While the CCBC results are based on a sample that may not be perfectly representative of Canadian corporate behaviour at large, they provide a useful additional look into the nature of corporate largesse. Over the five-year period of this data set, the allocation of donations to different beneficiary areas remained fairly stable. Over a quarter of the financial contributions of firms went to education in all of these years, about 20 percent went to social service organizations and another 20 percent to health related groups. Arts and culture organizations receive about 13 percent of corporate financial largesse, followed by “other” groups (12 percent) and civic causes (8 percent).



The CCBC data set also reveals that donations vary considerably by industry and asset size. For example, in all five years, the average total contribution per company was highest in the banking industry and second highest in the beverage and tobacco industry; primary metals industries, petroleum products, and transportation and communication industries were also big contributors. These differences may be related to differences across industries in the average size of firms, as average contributions tend to rise with asset size.

The CCBC surveys are the only source of information about corporate gifts in kind in Canada. The 1994 survey asked respondents about the type of gifts they gave to various recipients. Of the 67 firms that donated gifts in kind, 78 percent gave goods, 45 percent gave services, 60 percent encouraged volunteering and 46 percent loaned personnel (Rostami, 1995, p. 7). Again, we find that the top three recipient sectors are social services (83 percent), education (64 percent) and health (60 percent). The same CCBC survey reports a 14

percent increase in the number of personnel “loaned” to charitable organizations over the previous year. Clearly, the contribution of the corporate sector is much more important than is suggested by an analysis of their financial donations.

Virtually all of the economic research on corporate charitable giving is empirical in nature. Studies for the United States have typically found donations to be quite responsive to changes in tax rates but rather unresponsive to changes in income. Thus, according to these results, the magnitude of charitable donations are significantly affected by tax policy, but not by the level of profits.

Only two empirical studies of corporate giving have been undertaken using Canadian data. One study, by Jones and Laudadio (1991), focuses on the impact of market structure of corporate donations, concluding that market structure may indeed be an important determinant of corporate giving. The second Canadian study, by Day and Devlin (1994), uses micro-level firm data from the 1990 to 1992 Canadian Centre for Business in the Community (CCBC) surveys. This study finds that corporate giving is very insensitive to income changes, despite the cyclical fluctuations apparent in Chart 2. This finding may be an artifact of the short time span covered by the data set; there is a need for further study of the impact of tax concessions on corporate giving in Canada.

IV Government and the Nonprofit Sector

The implications of government cutbacks for the nonprofit sector in Canada are potentially enormous. Many Canadians may be looking to the nonprofit sector to fill some of the gaps left behind by governments. But is the nonprofit sector capable of expanding as government retrenches? Although we cannot provide a definitive answer to this question, we can shed light on some important background issues.

To give a rough idea of the relative sizes of government and the charitable sector, we computed the ratio between charitable sector total expenditures as reported on form T3010 and consolidated government spending net of debt charges. Table 1 presents the results. Hospitals and teaching institutions were excluded from the charitable sector for the purposes of this calculation. Charitable sector spending amounts to over 7 percent of government expenditure in the areas of welfare and education, and over 9 percent of government spending on health.

As an alternative measure of the relative size of the charitable sector, we can compare total remuneration as reported on form T3010. Total remuneration paid to employees in the charitable sector, excluding hospitals and teaching institutions, was about 10 percent of public sector remuneration in 1994, and about 2 percent of wages and salaries in the economy as a whole. These shares have steadily increased since 1990.

Table 1

Charitable Sector¹ Expenditures as a Percentage of Current Dollar Government Expenditures

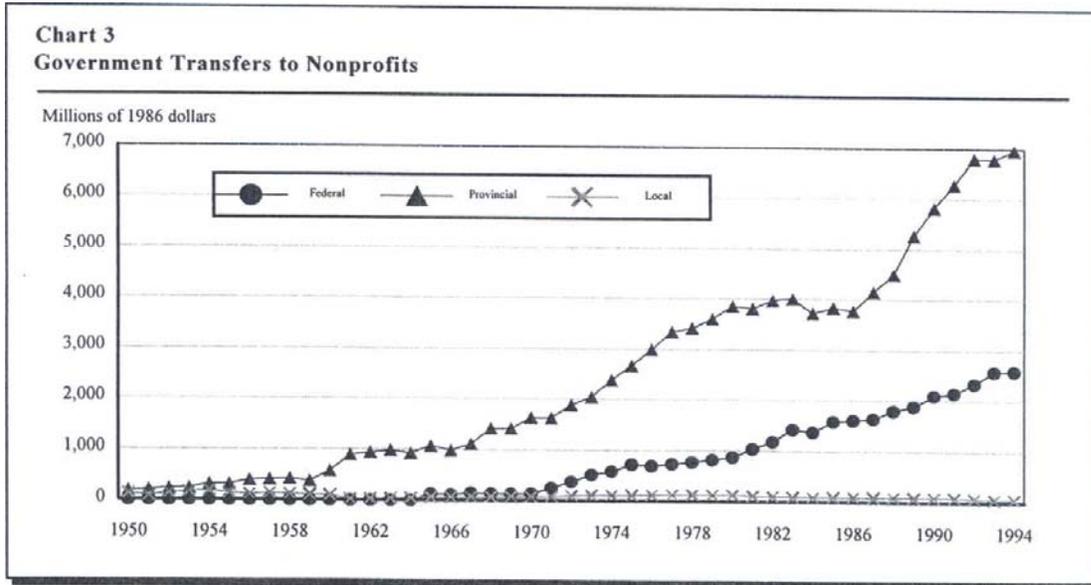
Year	Consolidated government expenditure				Total
	Welfare	Health	Education	Other	
1990	7.1	7.1	6.9	6.6	6.9
1991	7.2	7.6	7.0	7.2	7.2
1992	6.7	7.9	7.0	7.3	7.2
1993	6.9	8.0	7.3	7.1	7.2
1994	7.1	9.3	7.6	7.2	7.6

1 Hospitals and teaching institutions have been excluded from the charitable sector.
Source: Revenue Canada and CANSIM.

Governments in Canada have a long history of providing funding to the nonprofit sector. The evolution of these transfer payments since 1950, in constant dollars, is shown in Chart 3.⁵ Provincial governments in Canada have shown the most initiative in this area; since 1953 their share of total grants to nonprofit organizations has exceeded 60 percent. Not surprisingly, the growth rate of grants to nonprofit organizations has slowed since 1990.

Earlier it was noted that the charitable sector as a whole derives a high proportion of its revenue from government. If government cutbacks result in a significant reduction in transfers to charitable organizations, these organizations could find themselves in severe financial difficulty. If a decline in government funding to welfare organizations of, for example, 5 percent had occurred in 1994, donations would have had to rise by 16

percent in order to offset the revenue loss. To offset a similar cut in government funding of organizations in the category benefits to the community, a 30 percent increase in donations would have been required.



While only 31 percent of Canadian charities actually received government funding in 1994, even those organizations that do not rely on government funding may be hurt by government cutbacks. If government funding cutbacks cause some organizations to pursue private sector donations more aggressively, the resulting competition for donations will hurt those organizations that rely heavily on this revenue source. The net impact of funding cuts depends on the responsiveness of donations to government expenditures. The empirical literature on this crowding-out issue, most of which pertains to the United States, is mixed. It is clear, however, that charities should not expect private sector donations to rise to fully offset any decreases in government funding (Abrams and Schmitz, 1978 and 1984; Schiff, 1985; and Kingma, 1989). Instead, some organizations may actually experience a *decline* in private sector donations, rather than the converse.

Another facet of the relationship between government and the charitable sector is the nature of the funding relationship. Unfortunately, we were unable to find any data on the extent to which funding takes the form of service contracts rather than direct grants. If government cutbacks take the form of increased contracting out to the nonprofit sector, then government funding of the sector might actually increase. The nature of the relationship between government and the sector, however, would change fundamentally.

V Conclusion

For some reason, Canada seems to have lagged far behind other industrialized nations in the study of its nonprofit sector. But as government cutbacks begin to make themselves felt in the form of reductions in services to ordinary Canadians, questions about the nonprofit sector's contribution to the Canadian economy and its relationship with government have begun to arise. These questions need to be answered so that we can better anticipate the effects of proposed government spending reductions on the economy and on the services available to Canadians.

Existing information indicates that charities and other nonprofits are indeed an important component of the

Canadian economy. It suggests that the charitable sector has continued to expand over the recent period. We know something about the general functions of the diverse organizations within the charitable sector, and the factors that influence giving and voluntary activities by individuals, and contributions by corporations. The data highlight the dependence of charities on government funding and the significant role of charities in traditional areas of public sector activity, such as education and health.

To extend our understanding in these and other areas, and to provide more definitive answers to questions that have been raised about the prospects of the sector, better data are required. The limitations of the currently available database are significant – we do not even know exactly how many nonprofit organizations exist in Canada. While Revenue Canada has been collecting data on registered charities for many years, these data badly need to be verified in some fashion. Better data exist on individual and corporate contributions of money, but only for those donations for which tax receipts are issued. Very little information is available about other types of giving, such as gifts in kind and volunteer work.

We hope that in the near future, both governments and other funding agencies in Canada will turn their attention to the collection of more and better data on the nonprofit sector. Our recommendations in this regard are summarized in Box 2. Already Revenue Canada is planning to implement in 1997 an enhanced review process for the information returns submitted by registered charities. A similar review process needs to be established for the information returns filed by other nonprofit organizations. In the meantime, the overhaul of the existing Revenue Canada data set on registered charities would allow trends in the sector to be studied now, rather than 5 to 10 years when new survey results become available.

Box 2 Recommendations Regarding Data Collection

Charities

- Overhaul existing T3010 data on registered charities
 - verify reported data
 - improve organization of data
 - make data set readily accessible to researchers
- Improve quality of data on expenditure components
 - standardize bookkeeping practices to facilitate accurate reporting of fundraising costs, administration costs and program expenditures
 - collect more details about remuneration
- Distinguish between corporate and individual donations
- Distinguish between government contracts and grants
- Collect data on employment
- Encourage charities to keep better records of volunteer activities

Noncharitable Nonprofits

- Enforce T1044 filing requirement for non-charitable nonprofit organizations
- Improve quality of T1044 data
 - verify reported data
 - publish summary statistics regularly
 - collect more details about remuneration
- Collect data on employment
- Encourage noncharitable nonprofits to keep better records of volunteer activities

Individual Giving

- Repeat the Volunteer Activity Survey on a regular basis
 - ask individuals about monetary contributions
 - collect information on respondents' income
- Modify Family Expenditure Survey
 - provide more details on areas of giving
 - ask respondents about volunteer activities
- Append questions on volunteer work to Labour Force Survey
- Publish information on areas of giving in *Taxation Statistics*

Corporate Giving

- Periodic surveys of corporate giving
- Publish information on areas of giving in Corporation Taxation Statistics
- Collect information on gifts in kind

Government Funding

- Statistics Canada should collate information on government funding
- Expenditure statistics should distinguish between service contracts and grants

Notes

- 1 Revenue Canada allocates charities to categories based on their stated major purpose at the time of registration.
- 2 The actual proportion may be either higher or lower, depending on whether underreporting is more or less common within these categories than among charities as a whole.
- 3 Hood et al. (1977), Glenday et al. (1986), Kitchen and Dalton (1990), and Kitchen (1992).
- 4 Corporate donations usually go to nonreligious charities.
- 5 Grants to hospitals and postsecondary institutions are not included.

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Comments

by *Michael Hall*
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The paper that Rose Anne Devlin and Kathleen Day have written is a sizable document, combing basically every available data set about the sector – and certainly all government data sets about the sector – and presenting their results. After I read the paper, what came to mind was the Latin motto from my undergraduate university, *nunc cognasco ex parte*, now I know in part. I was pretty comfortable with that as a motto as an undergraduate – I felt I could achieve that level of knowledge – but I am less comfortable about that when we are talking about the state of knowledge for this sector and, more particularly, the state of available government statistics on the sector.

As the authors have demonstrated, when one has finished sifting through all the available data, we have only a partial and incomplete understanding of what the sector is all about. We cannot even answer the basic question, “How many organizations are there?” I have taken years of statistics, but, with all my training, I cannot even count the organizations in the sector because no one is providing the numbers for me. So we do not even now how many nonprofit organizations there are and I think that is kind of appalling.

Nevertheless, the authors have made a good case for the importance of the sector, albeit in economic terms. But I would echo their comments about the need to speak in economic terms. When economic thinking is the current *Zeitgeist*, you have to speak in economic terms; you cannot speak in a different language until people are ready to understand that language. So I believe we need to make an economic argument, in addition to the values arguments and the other arguments that I think we can well make.

The economic case that has been made for the importance of the sector, however, is clearly not reflected in the government’s approach to collecting information on the sector. To get a complete understanding of the sector, we need information in two areas: we need to understand the characteristics of the organizations and their activities, and we also need to understand two key resources that are peculiar to this sector, that is, donations of volunteers’ time and donations of money. So we need to know what organizations are doing and we also need to know what the public is doing with regard to those organizations.

Let me just outline what we have available to answer our need for understanding in those two areas. With regard to organizations and their characteristics, we have three sources of data. First, we have data that registered charities and a limited number of other nonprofits submit to Revenue Canada, which forms, I think, a large part of the Day and Devlin paper and is fraught with problems – you will see some of them documented in the paper itself.

I will share with you just one example of the problems with these Revenue Canada data on organizations. I had a conversation with a Revenue Canada official who had conducted a pilot project to verify the accuracy of the T3010 returns and found that 40 percent of the returns had errors in terms of expenditure items. I pleaded for this information to be made available, but this is not something that Revenue Canada is happy to advertise. Revenue Canada data come essentially from forms filled out by volunteers, based on very rough guidelines. Different people fill out the forms in different years, and Revenue Canada just collects them and reports the results. Officials do not check the forms; they do not even check if the arithmetic is correct. So it is a real problem.

The second source of information is the occasional surveys of the sector that are undertaken. Some of these are financed by government, such as a recent survey on the employment prospects in the sector financed by Human Resources Development Canada. At the Centre for Philanthropy, we have conducted a survey of fundraising practices, which was funded by The Kahanoff Foundation. These types of surveys provide glimpses

of what is happening in the sector, but they are usually incomparable: they tend to use different classification systems and different methodologies and one cannot synthesize them to derive a general picture of what is happening.

Third, we have Statistics Canada, which collects a host of information on economic activity in the country, but does not give us anything that we can use to understand the economic contributions of the sector because it focuses on the activities of different industries and does not explicitly distinguish between for-profit and not-for-profit enterprises. I think one of the distinguishing features between the nonprofit and the for-profit sector is the fact that in the not-for-profit sector we must rely on Revenue Canada for all of our information, while the for-profit sector gets its information from Statistics Canada. So, the sector is at a disadvantage, being forced to rely on Revenue Canada, which has been mandated to collect data but does not care about the quality of the information it is collecting.

The present state of data collection is such that we still do not know key things about the sector. We do not know the types of activities that nonprofit organizations engage in. The paper by Day and Devlin shows the number of charities there are in health and the number in welfare, but this just classifies organizations by their purpose at time of registration; it says nothing about what they are actually doing 30 years later in the field. And many organizations undertake several activities. Revenue Canada data provide no information about what kinds of good activities are being carried out by the sector. We do not know what contributions nonprofits are making in terms of such things as: the services they provide, the employment opportunities they offer, and their contribution to the development of social capital. We do not know the role of volunteer labour and the ability of organizations to leverage the resources they obtain. We had a comment about the unique capacity of the sector to leverage resources. Can nonprofits do more with less resources than other sectors because of the volunteer component? I do not know; I would hope so, but there is certainly no evidence to suggest that one way or the other.

The second piece of critical information concerns the two key resources of donated time and money. And again, as the authors have shown, most of our information about donations of money comes from Revenue Canada personal tax forms, and all that tells us is how much people claimed on their tax forms. Many donations are not claimed, such as donations in collection cans, small donations made at the door, or other donations for which receipts were not obtained. We have a major underestimate of charitable giving when we rely on tax data. Moreover, we do not know anything about why people are giving or to what causes they are giving. All we have is a simple, dry statistic that has almost no utility other than as an overall benchmark of whether giving is going up or down.

Our understanding of contributions of volunteer time comes from a single study done in 1987, which we are still using 10 years later. That is our main piece of information about what volunteers are doing in the country. And that is a sad statement, I think, about the importance that our sector has in terms of the government's data collection efforts.

So, on the volunteer side, we have no idea why people are volunteering their time; what they are hoping to achieve; what organizations they are supporting; whether different segments of our population are participating more or less; what is happening with our youth; and what is happening with different ethnocultural populations – no information at all.

Our understanding of the contributory behaviours of corporations is similarly lacking. Here too, what we have is a simple number on a tax form.

However, I think this paper has done a good job of showing what the government is overlooking and of demonstrating the need for the government to get more serious about the sector and about its own responsibilities for data collection. The authors make a good case that the government is overlooking a vital component of

our society and our economy – and it is an economic argument. As Rose Anne Devlin pointed out, the lower-bound estimate for the contribution of the sector to GDP is 4 percent. At the Centre for Philanthropy, we estimated in 1993 that the contribution was about 12 to 13 percent for charities – we are not as conservative as Day and Devlin have been. The sector employs about 9 percent of the labour force, according to estimates from the Centre and recent estimates from the Canadian Centre for Policy Alternatives. If we focus for a moment on assets, there are \$62 billion in assets in charities. If you look at co-ops, which is one other component of the nonprofit sector, that is another \$100 billion in assets. So there is a huge amount of economic activity going on that is not well understood and not well appreciated.

The sector is “nontrivial” in terms of its size and scope and, moreover, it is growing. As the paper shows, it has doubled in size in the last 17 years. This is not a phenomenon restricted to Canada. In the United States, the nonprofit sector has grown at a faster rate than the business sector or the government sector over the past 20 years. Evidence indicates that this phenomenon is occurring elsewhere. This growth, as the paper shows, has occurred partially as a result, or probably as a result, of increasing contributions from all sectors of society; increasing contributions from individuals – if you look at the time trend, it has been growing and growing, although slowing a little bit lately; increasing contributions from corporations – which modulates with the business cycle, but overall has trended upwards; and increasing contributions from government. So there is some consensus that we have something worthy of support.

We have heard people grappling with terms to describe the sector today – the independent sector, the third sector, civic sector, first sector. How about the invisible sector, because that is the way it feels to me when I try to look for the sector in our government statistics. Why is there no concern for a sector that is of such apparent magnitude and such an important player in our society? I can only speculate. First, I suspect it is because government does not see any opportunity to obtain revenues from the sector and, based on strictly utilitarian values, is not that interested in it. I think we have probably not made a convincing case, as Paul Reed mentioned, about the contribution that we are making, either in economic terms or in other terms, such as the contributions in the provision of human services or the development of social capital that forms the underpinning of our economic lives and lives in our community. I would suggest it is also perhaps the way we have defined ourselves: defining ourselves in terms of our legal and economic characteristics – whether or not we distribute profits, whether we are registered or not as a charity – rather than our functional characteristics. We do not describe our sector by what it does, what it accomplishes or what its purposes are, but rather by what it is not – that is, not-for-profit. And in these economic times, that means we are sitting in the back seat when economic activities are valued so highly.

Let me close by observing that government has, in the past, responded to the need for information on a variety of aspects of our social and economic life. I would argue that the public good would be well served by the development of better information on the nonprofit sector. Our current understanding is most certainly flawed; it is based on only partial information and much of that is of questionable quality.

Discussion Summary

In response to a question by *Sally Horsfall*, Rose Anne Devlin clarified that the study was based on Revenue Canada definitions; “noncharitable nonprofits” included all nonprofit organizations that did not qualify for charitable status and hence were not registered by Revenue Canada. These organizations take different organizational forms and some, but not all, noncharitable nonprofits are corporations.

There was some discussion of the study’s treatment of the interface between the government and nonprofit sector. While government accounts for about 60 percent of the revenue of registered charities, it was pointed out that these expenditures do not enter into calculations of the contribution of the government sector to GDP. Hence it is appropriate to include government-financed activities in attempting to evaluate the output of the nonprofit sector; this will not result in double counting. *Jacquelyn Scott* noted the importance of distinguishing religious groups, which receive relatively little government funding, from other organizations, which receive a high percentage of their revenues from government. *Shira Herzog* suggested that a bipolar situation existed, with religious groups that receive little government support on one side and hospitals and universities that are heavily dependent on government funding on the other. What most people loosely associate with the charitable or voluntary sector falls in between these two poles. Shira noted, however, that churches, which do not receive much funding directly from government, do receive indirect government support through the charitable tax credit. Government and the taxpayer are therefore implicated even in “self-sufficient” organizations, which derive much of their revenue from their own fundraising activities.

Don Mc Rae and *Jack Mintz* commented on the importance of the work the authors and others are doing on the question of whether government spending “crowds out” private sector charitable activities. Jack referred to recent research indicating that government grants are complementary to private giving for research-oriented universities, but partly substitutable for other universities. Don referred to anecdotal evidence from the United States pointing to the complementary relationship between government spending and fundraising; reductions in government funding in the United States threatened the infrastructure that organizations required to effectively fundraise and recruit volunteers.

Rose Anne confirmed that the data in the report on volunteer activity, which are based on the 1987 Statistics Canada Volunteer Activity Survey (VAS), pertained to formal volunteering. *Sally Horsfall* suggested that the importance of informal voluntary activity (in which a majority of those responding to the VAS also engaged) needed to be highlighted; these activities are part of what constitutes civic society. Informal volunteering, however, may differ in important respects from formal volunteering.

Shira Herzog suggested that the interests, motivation and objectives of those who volunteer informally tend to be far different than those who are involved with organizations that have a political, advocacy or even a community, agenda.

Jack Mintz thought that using average service sector wages to evaluate volunteer activity would lead to an underestimate; many upper income individuals sit on boards and are generally active in voluntary activities. Rose Anne explained that, in this exercise, they purposely aimed at producing a conservative estimate. *Paul Reed* argued that, rather than being conservative, there was a need to persuade Canadians that the nonprofit sector is not a residual and largely marginal component of our society. Data on the incidence or extent of involvement of Canadians can help establish the importance of the nonprofit sector, although it is also necessary to go beyond this and demonstrate the sector’s impact and beneficial effects.

Concern that the study may provide a misleading impression of the size and importance of the sector was also expressed by *Paddy Bowen*. Paddy thought the 4 percent, which Kathleen Day and Rose Anne Devlin put forward as a minimal estimate of the sector’s contribution to GDP, not only underestimated but insulted the sector. The problem was attributed not only to error-filled and fundamentally flawed data, but also to the

limitations of the tools of economic measurement. However, *Don Mc Rae* contended that, along with social arguments outlining the need for public support of the voluntary sector, there was also a need for economic arguments that employed data on the size, scope and reach of the voluntary sector. *Michael Hall* agreed that the sector must make economic arguments if it is to talk to governments in a language governments understand. In addition, *Kim Scharf* pointed out that economics is not as narrow as some suggested. Economists are interested in measuring both the resources used in the voluntary sector and the social value of voluntary activities; a proper evaluation of the social benefits of nonprofit activity is not, as some thought, outside of the framework used by economists.

Part of the problem, as noted by *Shira Herzog*, is deciding what should be measured. Should hospitals, universities, and advocacy groups, for example, be included within the boundaries established to measure the voluntary sector? Another problem, as *Jack Mintz* observed, is deriving values for activities that are not traded and do not have market prices. Jack suggests that nonprofit activities would amount to much more than 4 percent of GDP if the value of volunteer time was incorporated in the estimate.

Participants had different views on how to fill gaps in available data on the nonprofit sector. *David Elton* took issue with Kathleen Day and Rose Anne Devlin's proposals for more and better government surveys. He thought this would be an expensive endeavour for government, and that, through the application of user-pay, the cost would ultimately be passed on to the sector. *Arthur Drache* argued that, instead of expanding Revenue Canada's T3010 forms, there is a need to better target those who must file this form and provide public information. He noted that public disclosure was introduced, not to assist researchers, but to provide information to donors, and that this latter such as a small church with no outside donors. Revenue Canada's primary interest is in the financial statements that organizations file, not the T3010s, and so it is not surprising that these public returns contain inaccuracies. Arthur noted that enforcement of the T1044 filings is especially difficult because Revenue Canada has no knowledge of all the noncharitable nonprofit organizations that are subject to this filing requirement.

Jack Mintz disagreed with Arthur, contending that there is an important issue of accountability. Charities that are registered and receive a tax benefit should file information, and possibly comply with other mechanisms, to show that they are accountable for their use of public resources. Disclosure can contribute to the positive public image charities require to raise funds. *Michael Hall* argued that government has an obligation to gather information on the nonprofit sector in the same way that it gathers information on other sectors and tracks other forms of social and economic behaviour. There is a public interest in obtaining such information and, contrary to David Elton's contention, it should be government that pays the costs of data collection. Michael was concerned about imposing a greater burden on the volunteers who fill out T3010 forms. He believed Statistics Canada should be doing more to obtain needed data on the nonprofit sector.

Rose Anne Devlin also disagreed with Arthur Drache's comments. She argued that data should be collected not just for researchers, but for the benefit of all who are interested in the sector. In the meantime, Statistics Canada could provide a service by reporting the data that it already gathers on the sector in a more useful way. Rose Anne expressed sympathy for Paddy Bowen's concerns that the "4 percent" estimate would be used without attention to the qualifications in the paper. Part of the solution may be to draw attention to alternative estimates that may provide a better indication of the sector's relative size and importance. She noted, for example, that the wages of charitable sector employees and the imputed value of volunteer labour amount to about 10 percent of the value of all wages and salaries in the economy.

Session C

Nonprofit Organization Law

Organization and Supervisory Law in the Nonprofit Sector

Summary by
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I Conceptual Issues

Organizational laws comprise part of the legislative infrastructure through which governments support and facilitate nonprofit activity. The establishment of any organization involves a complicated set of contractual arrangements. It is difficult and costly to work out a set of agreements that limit the uncertainty faced by stakeholders and reduce the potential for costly conflicts down the road. Well-designed organizational laws reduce the transactions costs associated with development of adequate arrangements. They provide the parties with contract terms they can adopt “off-the-rack,” incorporating the general terms that knowledgeable individuals would have bargained for if transactions costs were not a constraint.

To design an appropriate legislative framework, it is necessary to take account of the special characteristics of the nonprofit sector, as well as the limitations of organizational law, along with other laws of general application. In terms of the sector, what stands out, first, is its extraordinary diversity. Legislation must be able to accommodate organizations pursuing very different purposes and doing so through a wide variety of organizational forms and structures. A second important characteristic of nonprofits relates to the fact they do not have owners with a financial interest in the performance of the organization. Nonprofits do have stakeholders, who include donors, volunteers, beneficiaries, and governments. Those who bear the costs of inadequate performance, however, are not as clearly defined in nonprofits as in for-profits, and the exercise of control by these participants is accordingly more problematic. Organizational laws must be crafted with a view to the additional safeguards that may be required in these circumstances.

The response to these issues must be conditioned, however, by an understanding of what can reasonably be achieved through laws of general application. Since policymakers must design legislation to meet the needs of a wide variety of organizations with very different organizational and governance requirements, they cannot mandate optimal governance arrangements. Organizational law must be designed with a view to those issues that are of concern to a broad range of nonprofit stakeholders.

Based on the general purpose of organizational law, and the characteristics of nonprofits, we believe policymakers should give special attention to three broad objectives. First, there is a need to emphasize the enabling characteristics of organizational law. Unnecessary and inappropriate requirements in the law should be eliminated, and there should be a greater emphasis on optional provisions that offer guidance to those establishing governance arrangements. Second, legislation must give recognition to the special importance of fiduciary safeguards. All stakeholders have a strong interest in the prevention of fraud and misrepresentation and in preserving the trust and goodwill that is associated with the term “nonprofit.” Third, there is a need to promote improved information disclosure. This will increase the accountability of nonprofit managers and directors, and contribute to more informed choices by nonprofit stakeholders at large.

To develop an overall framework that facilitates and encourages nonprofit activities, it is also necessary to reform the institutions responsible for enforcing nonprofit legislation. Supervision can be made more efficient and effective. The limited public sector resources available for addressing the needs of this sector need to be better utilized. Institutional reforms are also needed to establish a more stable and certain policy environment for participants in nonprofit activities.

II Laws Governing Organizational Form

Surprisingly little attention has been devoted in Canada to the design of organizational laws. While some advances have been introduced in Quebec’s new civil code on unincorporated associations, Saskatchewan’s reformed nonprofit corporation law, and British Columbia’s *Society Act*, these stand out as exceptions. Canadian courts and

public administrators have had to address many problems involving nonprofits on an ad hoc and piecemeal basis. The legislative framework that has evolved from this process does not adequately enhance or enable activity in the sector; provide the clear and stringent fiduciary safeguards that are needed to encourage public confidence in nonprofit activities; or result in the information disclosure that is needed to promote accountability. What has emerged is a “patchwork quilt” rather than a coherent framework that reduces uncertainty and minimizes compliance costs for nonprofits.

A first step in designing organizational laws is to identify the main types of nonprofit organizations. The law should be sensitive to distinctions based on:

- 1) legal form (principally the trust, the corporation, and the unincorporated association);
- 2) function (principally the foundation and the operating organization);
- 3) purpose (principally, religious, public benefit, political and mutual benefit); and
- 4) sources of financing (principally, private gifts, member contributions, public donations, and government financing).

Such differences affect the proper design and application of organizational law, and they should be reflected in reforms aimed at enhancing the enabling and protective role of organizational law.

Enhancing the Enabling Features of Organizational Law

There are a number of ways to improve the enabling features of organizational law. First, there is a need to address unnecessary and undesirable restrictions that have resulted from provisions, as well as omissions, in the legal framework. This applies to the following issues:

- In general, restrictions limiting access to the three legal forms (the trust, the corporation, the unincorporated association) are undesirable. In this regard, the current requirement in some provinces that charities apply for approval of letters patent of incorporation should be eliminated. Restrictions intended to limit the state’s involvement to the enforcement of only charitable-type trusts, however, are reasonable since the state should not be called upon to enforce trusts that provide no public benefit. It is important, however, that a suitably broad and modern definition of “charity” is employed.
- Unincorporated associations face serious difficulties as a consequence of their lack of civil capacity. Unlike corporations, unincorporated associations cannot, in their own name, own property or receive gifts of property, sue and be sued, and be bound by and benefit from civil obligations. This omission in the law needs to be remedied. Associations could be recognized under the law as legal entities for the purposes of civil capacity or, alternatively, the Quebec approach, based on a concept of partnership, could be adopted.

- Some statutes contain cumbersome and costly restrictions on the investment choices, and borrowing powers, of charitable entities. In Ontario, for example, the Public Trustee requires that all charities be restricted to investments authorized for trustees. These restrictions inhibit the dynamism of the sector, and they are poor substitutes for the establishment of standards clearly specifying the general obligations of fiduciaries.

A second way to enhance the enabling and facilitative aspects of organizational law is to include a broad range of suppletive provisions that organizations can tailor to their specific needs. Very little thought is given in the older corporations statutes to the organizational needs of nonprofits with active members, and there are no statutory provisions governing the internal affairs of associations, only a modest caselaw. Draft model articles and bylaws could be used to provide much needed guidance to nonprofits founders on various matters of internal governance. This includes the rights of members, the status of honorary members, the range of permissible governance structures, the transferability of memberships, and requirements for calling and organizing meetings.

Third, the law could be reformed so that fundamental changes are more suitably regulated and can be more easily accommodated. This problem has primarily applied to charitable purpose trusts where changes in purpose are highly regulated, but the issue has implications for corporations and unincorporated associations. The courts have been prepared to modify a charitable purpose trust only where the purpose established by the founder has become impossible or impractical. Moreover, the court is obligated to modify the trust as close as possible to the original intention. Under a more flexible framework, there would be greater scope to modify charitable purpose trusts where this is seen to be in the public interest. An expert body could develop principles that help give expression to the public interest in this area. In the next section, we discuss the relevance of this issue for corporations and unincorporated associations. A similar approach should govern fundamental changes in these forms of organization.

Strengthening Fiduciary Safeguards

The law governing the duties of charitable and other nonprofit fiduciaries is confused. At the root of this confusion is a fundamental divergence in perspective. While some courts regard all charities, regardless of their organizational form, as being subject to the fiduciary duty rules that govern trustees, others decide fiduciary matters with primary emphasis on organizational form. Courts adopting this latter perspective look to the fiduciary law governing directors of corporations, trustees of trusts, and principals of unincorporated associations for their doctrinal inspiration. Addressing this problem is important to preserve trust in nonprofits and to encourage good people to accept the risks of leadership in the sector.

The solution is to codify standards governing the duty of care and the duty of loyalty of nonprofit fiduciaries. Under the duty of care, fiduciaries should be expected to apply a level of competence that is reasonable in view of their position and background, and to exercise “due diligence” in attending to their responsibilities. The law should explicitly allow for fiduciaries to delegate some decision making to qualified experts. The standard of care should be the same for all nonprofits, regardless of form or purpose. In formulating the duty of loyalty, policymakers can follow the example of modern corporate statutes, which require that fiduciaries act honestly and in good faith in the best interests of the organization.

In public benefit, religious and private nonprofits, where there are no members to oversee the activities of the management and the board, strict controls should be enacted that avoid any possibility of fiduciaries

gaining financially from their position. Remuneration for serving as a fiduciary in these organizations should be prohibited. A transaction between the organization and any of its fiduciaries should be allowed only after an independent government agency has carried out a review and found that the transaction is fair and reasonable, and in the best interests of the nonprofit.

To strengthen fiduciary safeguards, organizational law should also explicitly and clearly prohibit all distributions in the case of public benefit and religious organizations. In mutuals, distributions should be prohibited during the continuance of the organization. These are perhaps obvious requirements, but this is another area where nonprofit corporation law is currently unclear.

Fiduciary performance can be improved and fiduciary accountability increased by enhancing the rights of members of nonprofit organizations. Members could be given the right to sue derivatively for breaches of the duty of loyalty and to sue for compliance. These rights could also be extended to classes of nonmembers, such as donors, or classes of donors. To protect organizations from frivolous and vexatious suits, a public agency or a court could be given discretionary power to determine whether standing is to be awarded. Further, there is merit in providing a supervisory agency with the same right as members to sue derivatively for breaches of fiduciary duty.

In contrast to the situation applying to charitable purpose trusts, organizational law is relatively lax regarding changes in purpose by nonprofit corporations and associations. Like the founders of charitable trusts, however, donors need assurance that their gifts are being used for the purpose intended. Accordingly, explicit controls, similar to those applying to purpose trusts, should govern changes in purpose by nonprofit corporations and associations. Members and certain nonmembers should have the right to require fiduciaries to comply with the objects of the organization. At the same time, it is reasonable to maintain, as modern corporate statutes do, that acts are not void because agents have exceeded their delegated powers.

III Supervisory Law

Effective supervisory law can help build public confidence in the nonprofit sector. It supports the protection afforded members and donors by case law and organizational law. In addition, supervisory agencies can play a supportive role and be an important source of information and advice for nonprofit managers and directors.

The challenge is to design efficient and effective supervisory arrangements that can be implemented within the Canadian federation. The formulation of policy to respond to this challenge should be informed by an understanding of the strengths and weaknesses of existing supervisory arrangements:

- More resources are devoted to the administration of the charity provisions of the *Income Tax Act* than to any other supervisory activity involving nonprofits. While tax officials' interest in ensuring that charities comply with tax law overlaps to a substantial degree with stakeholders' interest in ensuring that nonprofits are prudently managed, the two are not identical. Revenue Canada ignores some issues that are of concern from a fiduciary perspective. The supervisory role of tax officials is undermined by other factors, including: their emphasis on charities, as distinct from nonprofits in general; the inadequacy of their efforts to promote information access; and the limited remedies at their disposal to address problems.

- Ontario has gone further than other provinces in attempting to monitor and enforce the proper use of charitable property. The Ontario Public Trustee administers provincial legislation, notably the *Charities Accounting Act* and the *Charitable Gifts Act*, and exercises the general powers of a guardian emanating from the sovereign's role as *parens patriae*. The Public Trustee has played a particularly important role when there have been no identified beneficiaries to ensure that gifts are applied to their intended purpose. The Trustee, however, has limited resources to devote to the general monitoring of charities, and it does not have the capacity to assist nonprofit managers or to support stakeholders who are in need of increased information. Moreover, the independent approach pursued by the Ontario Trustee has highlighted the general deficiencies of a system in which organizations operating in different jurisdictions are subject to different and sometimes conflicting requirements.
- The Charity Commissioners for England and Wales provide an interesting contrast with Canadian experience. This regime provides a model of a relatively unified and coherent approach to charity supervision. With their mandate and resources, Commissioners are able to effectively monitor charities and also to provide information and advice aimed at promoting improved administrative practices. The English system also gives recognition to the importance of ample information disclosure by charities. The very broad powers delegated to the Commissioners, who are nonelected officials, do, however, raise some potential concerns.
- Finally, we can draw on the experience of those jurisdictions that have concentrated their supervisory activities on the regulation of fundraising. Fundraising is attracting increased public attention due, in part, to the growing competition for donations and the greater use of professional fundraisers. The problem for regulators is that fundraising costs depend on a number of factors, and high fundraising costs (generally measured as a percentage of donations), do not necessarily reflect inefficiency. In the United States, the courts have struck down a number of state attempts to control fundraising costs, noting that these laws are ill-designed to prevent fraud and that they may unfairly discriminate against organizations with necessarily high fundraising expenses. Alberta's new *Charitable Fund-Raising Act* (CFA) establishes some minimum basic requirements for the registration of charities and the licensing of fundraisers but focuses mainly on enhancing donor's rights. While the attempt to improve information disclosure is commendable, the CFA's requirement that fundraising costs be made available at the point-of-solicitation does not take account of the potentially misleading nature of information dispensed in these circumstances.

A New Approach

Supervisory policy that is designed with a view to the general objectives of organizational law and the strengths and weaknesses of existing regimes would have certain characteristics. These relate, first, to the role of supervisory policy. An efficient and effective supervisory framework would: enable nonprofit activity, promote high fiduciary standards, and lead to significant information disclosure. The supervisory body (or bodies) would play an enabling role by informing and advising nonprofit managers and encouraging high standards of corporate governance. It would promote confidence in nonprofits by helping to ensure that fiduciaries comply with their obligations. It would develop reporting requirements that balance the need of stakeholders for ample information against concerns about the costs of information filing to organizations, and especially smaller nonprofits.

In putting together the elements of such a system, policymakers can draw on experience in England and

Wales, where Commissioners have established a centre of information and expertise that is well positioned to monitor charities and offer support to participants in charitable activities. They can learn from the strengths and weaknesses of Revenue Canada's efforts to provide stakeholders with access to information on the activities and financial position of charities. And they can build on the desirable features of Alberta's efforts to control fundraising, including its experience in licensing professional fundraisers.

A second aspect of an efficient and effective framework is a high degree of policy coordination. This would create a more stable and certain environment for organizations, while also contributing to a better use of the limited public sector resources available for nonprofit supervision. Coordination can be achieved through intergovernmental forums and administrative agreements. As in other policy areas, such as the environment, governments could work out a common approach and come to a reasonable division of responsibilities for administration and enforcement. Alternatively, provincial governments could delegate their supervisory responsibilities to a national nonprofit commission, while retaining the right to be consulted on certain significant policy matters. The commission could play a role similar to the Charity Commissioners for England and Wales, although its discretionary powers would be more circumscribed and it would be required to engage in consultations in certain important areas of policymaking. Either a national commission, or a cooperative intergovernmental approach towards nonprofit supervision would represent significant improvement over the current situation.

To realize the benefits of a coordinated approach, it is necessary to integrate nonprofit supervision with the supervisory activities of Revenue Canada. Some activities carried out by Revenue Canada, including the registration of those organizations whose purposes are charitable, could be assumed by the nonprofit commission or by a secretariat representing federal and provincial governments. At the same time, the new supervisory body (or bodies) should build upon the reporting and disclosure systems already established for tax purposes.

Public sector supervisory arrangements also need to be coordinated with the self-regulation undertaken by the sector itself. High standards of governance, and the development of the specific performance measures and outcome assessments, which provide the underpinnings for a system of effective accountability, are ultimately dependent on the efforts of participants in the sector; they cannot be mandated by governments. Notwithstanding the potential weaknesses of voluntary codes, a serious commitment by nonprofits to self-regulation could allow governments to reduce the public sector resources devoted to supervisory activities.

IV Conclusion

There are major shortcomings in the existing framework of organizational and supervisory laws applying to the nonprofit sector. Current laws do not enhance or enable activity in the sector; they do not provide the clear, stringent fiduciary safeguards that are needed to build public confidence in nonprofit activities; they do not provide the information disclosure that is necessary to promote effective participation by stakeholders and accountability by nonprofit controllers; and they do not work in unison to establish a clear, coherent policy environment that minimizes uncertainty and economizes on the resources required for administration and for compliance.

The current picture is more one of a valuable social activity occurring in spite of the law that was meant to encourage and enhance it, not because of it. At this point in time, where the third sector is being increasingly called upon to fill gaps in the system and provide new social services, the inadequacies of the legal framework are especially apparent. Reform is needed, we think urgently, to produce a set of organizational and supervisory laws that are balanced, responsive, clear and coherent.

Acknowledgments

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Comments

by *Gordon Floyd*

Director, Public Affairs

Canadian Centre for Philanthropy

I wanted to start by thanking CPRN for its whole initiative on the nonprofit sector and for inviting me to be part of it. I guess what we are calling the nonprofit sector is increasingly being referred to by another label, the one that I prefer, which is civil society. I will be using those two labels interchangeably as I speak.

I am especially happy about this initiative because the study of civil society seems to me to have largely been relegated to the margins of academic and political thought and discourse in Canada. We, and virtually every other developed country in the world, have tended to see only the public and private sectors, governments and businesses, as legitimate representatives of collective interests. This bipolar analysis of our societies has been modified only since the 1930s or so by the occasional addition of labour as the third party in a tripartite system. It is only since the end of the cold war and the collapse of governments that, I guess, were spawned initially by Marxist ideology, that labour's role as the third force in our society has started to be eclipsed by the broader notion of civil society. With the birth of post-cold-war efforts to create responsive and tolerant societies in eastern Europe and elsewhere, we are starting to understand the importance of civil society – with its elements of collective action, empowerment, solidarity and active citizenship – as the basic building block for democracy. This awareness has been strengthened in Canada by the experience of our NGOs working overseas, many of which have shifted the focus of their development work from offering aid to fostering self-sufficiency. As they have done so, they have recognized, and have brought the message back to Canada, that community needs are often most effectively met by civil organizations, not by governments or businesses. This is especially so for communities whose needs are peripheral to global politics and trade, which is clearly the case in most parts of the developing world and is increasingly the case for many communities, even in a G-7 country like Canada.

All this is to say that our thinking about the role and importance of civil society, or the nonprofit sector if you prefer, is very much in transition. The nature of civil society itself is in transition: assuming tasks previously performed by governments; creating virtual organizations on the Internet; tackling global issues like child labour; and filling the vacuums created in communities as both public and private sector players “go global.” It will soon be accepted wisdom, I hope, that the nonprofit sector is as vital to Canadians' welfare as are the public and private sectors. Like the third leg on a milking stool, the civil sector is essential to the stability of our society. Also, it is independent from the other two legs. The milking stool's civil society leg has its own point of contact with the ground because it has a distinctive rationale and role, and it has its own connection to the milking stool's platform because it has its own system of stakeholder accountability. It is not, in any way, subservient to the government leg of the stool.

There is no question, as Mr. Hirshhorn and Professor Stevens have identified, that nonprofits in Canada require better organizational law. In my view, the report correctly identifies most of the deficiencies in the current regime, such as the lack of national coordination, the inadequacy of information access, and the absence of practical remedies for stakeholders seeking redress for breaches of fiduciary duty or duty of loyalty. Their analysis of the obstacles facing the framing of organizational law for this sector is refreshing for its recognition of the need to accommodate diversity and dynamism within civil society. Their emphasis on enabling provisions, the removal of unnecessary legislative restrictions and the provision of guidance through draft model articles and bylaws, all seem designed to nurture a strong, independent and accountable civil sector. Their proposed fiduciary safeguards, such as a codified standard for duty of care and restrictions on remuneration and distributions, would establish legal limits that ensure the integrity of the nonprofit sector, without violating its autonomy.

I also liked the proposal to enhance the rights of members, donors and other stakeholders to sue for breaches of fiduciary duty or duty of loyalty.

So far, so good. Then we come to the discussion about a supervisory agency, a government body, whose purpose would be to “ensure that fiduciaries comply with their obligations.” The rationales offered for this big brother approach to accountability are: first, that the recipients of the public goods delivered by most nonprofits are unable to enforce accountability; and second, that self-regulation by this sector cannot provide adequate safeguards, in particular from fraud, to civil society stakeholders. I will not dwell on the irony of this second rationale at a time when governments are replacing government regulation with self-regulation in such fields as automobile sales, elevator inspections, travel agencies, and in many aspects of natural resource exploitation. While the authors admit that “the development of specific performance measures and outcome assessments, which provide the underpinnings for a system of effective accountability, are ultimately dependent on the efforts of participants in this sector,” they cling to the view that nonprofits need significantly more government oversight than most parts of the private sector and, indeed, most parts of the public sector. In their final sentence before their conclusion begins, the authors state that “a serious commitment by nonprofits to self-regulation could allow governments to reduce the public sector resources devoted to supervisory activities.” But what if the commitment to self-regulation extended to governments themselves, and, instead of constructing a new supervisory framework over the next 10 years, they focused, and we all focused, on helping nonprofits enhance their governance and accountability mechanisms within the civil society? It seems to me that that route, much more than a new charities commission that is primarily supervisory, and only incidentally assistive, would move us towards a civil society in Canada that is as strong as the other two legs on our milking stool.

In the discussion that follows, I would be delighted to play with some ideas and thoughts about how self-regulation can happen more effectively in the nonprofit sector. It seems to me that we give a level of trust to corporate directors in the private sector that we are not prepared, at this point, to even contemplate for directors and trustees in the nonprofit sector. This to me is an anomaly that we need to correct if we are, in fact, going to have a sector that is autonomous and accountable.

One area that I have thought a lot about and did not even dare to touch when I was putting my notes together, is the area that you address in the report of fundraising regulation. There too, it seems to me that there is room for some protective legislation; but the only solutions that are really going to mean anything, and are going to be sufficiently adaptable to the diversity within the sector and sufficiently flexible to meet the range of assurances that donors and others need around fundraising, are those that are developed and administered by the sector itself.

Discussion Summary

Sally Horsfall voiced support for the self-regulation proposed by Gordon Floyd. A province-wide consultation she had just completed in Ontario indicated that this was the sector's preferred approach to addressing concerns raised in the paper. *David Armour* agreed with this conclusion.

Participants offered different views on what is involved in implementing a system of self-regulation. *Gordon Floyd* distinguished between self-regulation within organizations and self-regulation at the sectoral or subsectoral level. Within organizations, enforcement of fiduciary standards would benefit from a codification of the duties of care and loyalty, as proposed in the paper by Ron Hirshhorn and David Stevens. The organizational law reforms proposed in the paper would give nonprofit stakeholders defined benchmarks, which could be used to assess the performance of directors and as a basis for suing directors who breached their fiduciary duties. At the group level, there is a need for the establishment of codes of behaviour, such as the comprehensive code of ethics established by the Canadian Council for International Cooperation (CCIC). There is potential for general behavioral codes within subsectors, and also for standards applying to particular issues such as fundraising. Gordon believes the sector can enforce these codes at least as effectively as Revenue Canada or a charities commission.

Paddy Bowen noted that there are various models of self-regulation within the nonprofit and other sectors, and she proposed that these be studied. Some useful approaches within the sector were highlighted by *David Armour*. The Society of Fundraising Executives, for example, has developed a code of ethics, which, among other things, discourages the use of payment systems in which fees are a percentage of collections. David believes that there are opportunities for the greater use of ethical standards by organizations and professionals working within the sector. He also believes the sector can do more to promote and protect the rights of donors and volunteers. This consumer rights approach is reflected in the statement of donor principles adopted nationwide by the United Way. An expanded application of this approach would aim at providing donors and volunteers with a clear understanding of the standards of conduct that can be generally expected from the organizations to which they contribute time or money.

Some of the complexities in implementing a system to promote integrity, transparency and accountability were discussed by *Carl Sulliman*. Transparency and accountability among voluntary organizations are currently very uneven, and Carl feels it would be useful to develop a system that achieves more consistent results among the diverse organizations that enjoy tax-exempt status. If the chosen route is a system of self-regulation, however, this does not necessarily mean an absence of legislation; the self-regulating professions operate within a statutory framework under which the relevant professional bodies are delegated certain disciplinary powers.

Shira Herzog emphasized the complexities arising from the diversity of the sector. Rather than attempting to devise one set of standards for the disparate group of organizations that are within the sector, she believes subsectors of organizations with similar characteristics should be left to develop their own standards and regulate themselves. There is a problem, therefore, in attempting to address this issue in the context of the current very broad boundaries that are used to identify nonprofit organizations. Shira also thought attention should be given to complex process issues that must be addressed to pave the way for the development of self-regulatory arrangements that are universally acceptable. In the view of *Susan Carter*, the diversity of the sector argues for a broad approach, which recognizes the range of different issues but also the variety of possible remedies. The latter fall along a continuum that includes legislation and supervisory frameworks that are government-initiated at one end, and education to increase donor and public awareness at the other end. In between are various codes and standards, with different methods of application and possibly involving the use of sanctions, where these are appropriate.

The view that self-regulation offers a complete answer to the sector's problems was also questioned by *Don Mc Rae*. He noted that there have been fundraising scandals involving organizations that subscribe to the CCIC's code of ethics (singled out by Gordon Floyd). While self-regulation can play a role in some areas, Don thinks the sector

must think in more concrete terms about what it means by accountability and self-regulation. He believes it is also important to give attention to some of the other problems identified in the Hirshhorn and Stevens paper, including the inadequacy of nonprofit corporate legislation across Canada and the lack of coordination among jurisdictions implementing policies addressed at the sector. **Robert Weist** highlighted one of the troubling aspects of federal nonprofit corporate law: while, under business law, incorporation is virtually a matter of right, under nonprofit law, each and every letters patent must be examined to ensure it meets the requirements of the Act. The process of examining corporate applications, which takes less than an hour under business law, takes two weeks and often longer under nonprofit law.

Like Susan Carter and Don Mc Rae, **John Gregory** thinks it is important to examine the relevant issues within a broad framework. The starting point is to identify what is broken and what we are trying to fix. One approach is called for where the basic problem is inadequate transparency, for example, and a different approach is needed if the major concern pertains to problems in detecting misuses of charitable funds. When the problem has been identified, it is possible to compare various possible solutions. Self-regulation has appeal where sectors are sufficiently mature in their own governance structures and profession

alism that we can trust them to carry out the regulation. John thinks that, in the case of nonprofits, it is difficult to say that there is a sector, let alone a mature sector. There is no obvious “self” to whom one could delegate regulatory authority. The question then arises as to whether anything is needed except codes of ethics. The clarification and harmonization of organizational and supervisory law proposed in the paper by Ron Hirshhorn and David Stevens could help create a legal structure under which people can operate comfortably. Beyond that, it is necessary to determine whether the system is still broken to the point that some public body is needed to supervise the sector and/or promote and assist the sector. Mechanisms are available to create a harmonized supervisory body within Canada, but John believes the need and the political will for such an initiative need further demonstration.

Paul Reed observed that one of the most important distinguishing features of the sector is the unique degree to which it relies on trust, legitimacy and credibility. In assessing the need for proactive policies, it is necessary to understand that the risks of misbehaviour are substantially higher for this sector than for others. There is a need to know the extent of wrongdoing in the sector and whether it is a bandaid-sized or surgery-sized problem. But any misbehaviour that becomes public undermines the goodwill on which the voluntary organizations depend and can have an enormous impact on the overall sector.

Ron Hirshhorn agreed that the crucial role of public trust and confidence must be considered in designing policies for the sector. Nonprofits have an implicit contract with stakeholders under which they are obligated to devote all the funds they receive towards the achievement of specified objectives. Nonprofits must be seen to be adhering to this agreement if they are to sustain the confidence of stakeholders, and to preserve their reputation as trustworthy organizations that can be relied upon for certain functions that would not be entrusted to for-profits, and in some cases governments. Self-regulation is one route to promote and protect the reputation of nonprofits for trustworthy behaviour, but the evidence from other sectors suggests to Ron that it is very difficult to achieve effective self-regulation in sectors with a large number of small, very diverse organizations; self-regulation works best where there are small numbers of players who can watch over each other. The question then becomes: Can you develop a low-cost effective policy in this area? Ron believes the Charity Commission for England and Wales provides a useful model in this regard and a useful contrast with Canadian experience. While Canada does not have the same centralized bureaucracy, this does not mean we have a low-cost approach. In fact, Canada currently has a very complex system in which most organizations must incur the costs of complying with the filing and reporting requirements of a number of jurisdictions and the uncertainties arising from multiple and often unclear policies. And yet, despite its costs, Ron believes the current system is not effective in promoting trust and confidence in the sector. It is the search for a less costly and more effective alternative that led to the proposals in the CPRN paper. Ron noted that he and David Stevens were also influenced by a recognition that punitive remedies can be counterproductive in this sector. There is a need for an approach that is geared to flagging potential problems early on and encouraging

preventative measures. In this area as well, the experience of the Charities Commission was thought to be instructive.

David Stevens reiterated that there is a need for solutions that take account of the different kinds of organizations in the sector. Those differences make a significant reliance on self-regulation inappropriate. Government is currently involved in regulating the sector, but the current regime is inadequate, incoherent and costly. There is a need, therefore, to identify the mandate underlying the current regime and to determine how that can be given coherent policy expression and be effectively implemented by somebody who is interested in fulfilling the mandate. David does not think that Revenue Canada has that interest. The Office of the Public Trustee in Ontario, in his view, does not have either adequate resources or the appropriate statutory mandate.

In response to a question by *Robert Weist* about what we can learn from foreign models of organizational law, David Stevens indicated that American developments have the most to offer. Along with model law produced by the American Bar Association (ABA), there have been interesting legislative developments in nonprofit law in California and New York. While England and Australia have lagged behind, David thinks it might be interesting to look at the European experience. A basic problem is that, historically, nobody thought seriously about how to design corporate law that responds to the particular needs of the sector.

Session D

The Taxation of Nonprofits

Tax Incentives for Charities in Canada

Summary by

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Recent decades have witnessed rapid growth of the voluntary sector, both in Canada and elsewhere, as an alternative and supplement to government provision of social services. Although the Canadian tax system has adapted to this new reality, there may be a need to reconsider some aspects of the current Canadian approach in the context of appropriate economic criteria.

This report examines the economics of taxation as it applies to the charitable sector. It reviews the theoretical arguments for according charities special tax treatment, assesses the state of empirical knowledge on the impact of tax incentives, and examines the design of appropriate tax rules. Particular attention is given to the challenge of designing a system that incorporates appropriate incentives for charitable giving. Using economic criteria, tax incentives for charitable giving in Canada are examined and compared with various features of the U.S. tax system. The paper also identifies other aspects of tax treatment of charities in Canada that raise significant economic issues. These include the manner in which the GST is applied to charities, and the issue of local taxation.

1 The Special Treatment of Charities

Governments support charities through both tax incentives and subsidies. Tax incentives are a general source of support for all organizations that qualify as charities. An important advantage of tax incentives is that they are likely to generate greater revenue for charities. A subsidy of \$1 costs the public treasury \$1 and yields the charity the same amount. A tax break to a potential donor of \$1 would still cost the treasury \$1, but is likely to lead the donor to contribute more than \$1. The tax concession is thus likely to be more effective in achieving a certain transfer target in terms of net revenue.

A number of empirical studies have attempted to document the favourable revenue effect of tax concessions. Research on this issue is contained within a significant literature devoted to testing the influence of various factors, such as the price of giving, income and age, on private charitable giving. In general, empirical estimates tend to suggest that tax concessions are an effective means by which to increase charitable donations from both individuals and corporations.

2 Criteria to Guide the Design of Tax Incentives

Accepting the role of tax incentives, the question remains: What type of tax incentives? What criteria should guide the design of tax rules pertaining to charitable giving? Economists commonly employ three criteria: efficiency, equity and simplicity. The tax system should be efficient, in the sense that it contributes to the overall objective that society's resources be put to their best use. It should be equitable, by providing both for equal treatment of equals (horizontal equity) and the equal treatment of individuals in different circumstances (vertical equity). And the tax rules governing charitable giving should be simple and easy to administer. In analyzing current Canadian tax rules and assessing options for reform, it is necessary to carefully balance the trade-offs involved in pursuing these three objectives.

3 Issues in the Design of Tax Incentives

i) A Credit vs. a Deduction System

While Canada encourages giving by offering a two-tiered tax credit against charitable donations, the United States allows individuals to deduct donations from their taxable income. It can be argued that, on economic and equity grounds, a correct definition of the income tax base requires the exclusion of donations from taxable income. If one

subscribes to this view, a deduction system like the one employed currently in the United States, should be adopted. Although a credit might have some advantages on efficiency grounds, there is no strong indication that empirically, this is an important consideration. Thus, with respect to efficiency, a deduction system can be argued to be preferable, and it could be administratively simpler.

On the other hand, if one subscribes to the view that donations constitute tax expenditures by governments, then the current credit system is appropriate on both efficiency and equity grounds. In terms of its incentive effects, a deduction in place of the donation credit would provide identical incentives for individuals with low incomes that make small donations (below \$200), and high income individuals that make large donations, but middle and low income earners making large donations would have more incentives under the current two-tiered credit. Note that any incentive differences would disappear under a flat tax.

ii) Income Limitations on Charitable Giving

The amount of donations for which the charitable tax credit can be claimed is subject to an income limitation. Prior to the 1997 budget, this limitation was 100 percent for gifts to Crown agencies and gifts of appreciated property, versus 50 percent for other types of donations. This different treatment of different types of donations was questionable in terms of equity and also had efficiency implications.

One efficiency dimension with respect to this past regime is that it provided a disincentive to large 50-percent-type gifts relative to 100-percent-type gifts of appreciated property.¹ This was because a donor of a generous 50-percent-type gift may have been forced into a position of excess credits, implying that the present value of tax credits was lower than it would be if the gift had been of a 100 percent type; which acted as a disincentive to making 50-percent-type gifts.

In the past, donors have also had larger incentives to contribute generous gifts (of any type) to a Crown agency rather than any other type of organization. This could also have had undesirable efficiency implications, and could have created further distortions in incentives: for example, institutions that sought generous donations might have tried to affiliate themselves with organizations such as universities in order to obtain provincial Crown status.

Therefore, there were strong equity and efficiency arguments to subject all donations to the same income limitation. Offering the same income limitation for all types of gifts would also be simpler to administer. In accordance with these arguments, the 1997 budget has eliminated the distinction between Crown agencies and other charities. A 75 percent income limitation is now to be uniformly applied to all charities.

One could argue that the limitation should be increased to 100 percent on all types of donations, instead of 75 percent. This could lead to more donations made from capital, although it could result in some individuals paying no tax in a given year, which may be politically less acceptable.

iii) Tax Treatment of Capital Gains

Sometimes donors make gifts of capital property that have accrued capital gains or capital losses. Prior to the last budget, donors would receive a credit for a gift of property, but they were still subject to a tax on any capital gains (unless the gift was a donation of cultural property). Under this approach, income is taxed equally whether the income is derived from appreciated property or from some other source. Furthermore, when investors are making the decision to sell or donate appreciated property, their decisions are not distorted at this margin. Thus this system of taxing capital gains created no disincentive effects for investment decisions and, specifically, it did not distort incentives with respect to donation decisions.² As a result of the 1997 Budget, only 37.5 percent of the capital gains on gifts of publicly traded securities are to be included in taxable income. These new provisions create distortions

that are not justified.

4 The Charitable Credit vs. the Political Credit: Should the Playing Field Be Levelled?

Since it is desirable, in terms of equity, to apply the same tax treatment to different types of donations, should charitable and political donations be subject to the same rules? Currently, this is not the case. The federal political credit is calculated on a sliding scale, with a maximum \$500 credit resulting from a contribution of \$1,150. Small donors to political parties hence get greater tax relief than small donors to charities, whereas large donors to political parties get less relief for political contributions than they do for donations to charities. The main rationale underlying this limitation is to encourage broad-based political participation and constrain large lobbyists from exerting excessive political influence. Furthermore, truly levelling the playing field, while maintaining broad-based political participation, could also require a reduction in the incentive to give large donations.

Nevertheless, from efficiency, equity and simplicity points of view, the difference between the tax treatment of political donations and the tax treatment of charities could be viewed as undesirable. All gifts, whether to charities or political parties, should, in principle, be treated on the same basis. However, one could equally argue that the need to redress imbalances in ease of political access between diffuse and concentrated interests is a sufficient reason for the discrepancy.

5 Protecting the Public Interest in the Use of Charitable Funds

i) General

A tax relief for donations to charities effectively amounts to a matching grant on the part of the government: if an individual donates \$1 to a charity and receives a tax relief of 20 cents, the cost of the donation is only 80 cents; the remaining 20 cents received by the charity come from a reduction in tax revenues, a cost that is effectively borne by the government. The size of the matching grant implicit in a system of tax relief, however, is bound by the prevailing rate of taxation or credit. Once this limit has been reached, the only possible way of strengthening incentives is to move to a system of explicit matching grants. Although this would clearly represent a further burden on public budgets, from an economic point of view it is simply a natural extension of a regime that grants a 100 percent tax relief.

Viewing tax incentives as a system of matching grants underscores the government's responsibility to ensure registered charities meet those qualifications that are seen to define the public interest. Any expansion in the level of public support to the voluntary sector may have to be accompanied by a tightening of the criteria for eligibility, and by increased levels of scrutiny on the use of funds.

ii) Business and Political Activities by Charities

Should the rules governing the commercial and political activities of charities be made more or less flexible? Charities in Canada are allowed to undertake “related” business activities and this has been interpreted to include any enterprise operated by volunteers or any enterprise that is ancillary to the activities of a charity (i.e., a hospital gift shop). Permitting charities to also pursue unrelated business activities would provide them with additional sources of funds, allow them to be more viable and autonomous, and reward entrepreneurship and innovation in the voluntary sector. This would also allow the government to distance itself from the demands of charities, as these would be better able to fend for themselves. Such a change would require more flexibility in the rules governing the registration of charities.³ On the other hand, looser controls raise the possibility of creating an unfair disadvantage for certain commercial firms and individuals, which would disrupt the efficient operation of markets – this possibility could arise when charitable activities are undertaken in parallel with market activities.

There have also been calls for tightening the rules that prohibit charities from pursuing political activities. However, it is generally impossible to determine whether a charity is undertaking a charitable activity or a political activity since the two may be closely related: for example, collecting funds for the support of environmental protection programs could be viewed as a political activity. Refining the definitions of charities and imposing more controls on their activities would also involve further layers of complexity in the tax system, and claim additional resources for monitoring and enforcement.

6 Other Issues in the Tax Treatment of Charities

i) The Application of the GST

Since Canadian charities and nonprofit organizations do not operate on a for-profit basis, they may have a limited ability to pass any input taxes on to the beneficiaries of their goods or services in the same way that for-profit enterprises can.⁴ The current treatment under the GST recognizes the special situation of charities and nonprofit organizations, and grants a rebate for taxes paid on purchases of goods and services, but it may be more appropriate to zero-rate charitable goods and services altogether.

Under current GST rules, however, this rebate granted to charities is only partial, and the portion of federal tax rebated to charities is different from that granted to some other types of institutions (for example, it is currently 50 percent for charities versus 67 percent for universities and public colleges), which may not be warranted on either equity or efficiency grounds.

GST credit relief for charities could be expanded and aligned to the relief granted to other public service bodies. It should be noted, however, that nonprofit organizations are subject to less control than charities, narrowly defined, and can frequently levy membership charges on the user of the service. They may also carry on activities that are more commercial in nature than those of charities. Full zero-rating may thus not be appropriate for them.

ii) Local Taxation

Local governments in both Canada and the United States have started to question the tax-exempt status of charities. Municipalities are increasingly viewing these organizations as an untapped source of much needed revenue. In the United States, there has been backlash in a number of municipalities. In Pittsburgh, for example, nonprofit hospitals and universities have been successfully persuaded to contribute annual payments of \$1 million dollars to the municipality in lieu of local taxes. In Washington, DC, local activists are putting pressure on local

government officials to collect property taxes from charities that are situated on valuable city lots.

As a result of a revision to its *Municipal Government Act*, Alberta municipalities can now tax the property of nonprofit organizations. Other governments are considering similar legislation. As Canadian local governments acquire more financial autonomy and come under increased budgetary pressure because of cutbacks in provincial support, tax-exempt charities are likely to become an increasingly tempting target. To address the threat of local taxation, a reallocation of taxing powers or a coordination between federal, provincial, and local authorities may be required.

7 Conclusion

More research is required on the impact of various provisions in the tax system on charities, and on individual and corporate contributors. While existing empirical studies on the determinants of giving provide a useful base upon which to address these issues, further research is needed to solidify our understanding of the linkages between tax incentives and the behaviour of individuals and corporations.

Ultimately, any options for tax reform are difficult to assess in isolation, and must be evaluated within the overall framework of the tax system. In this respect, simplicity may be the most important consideration. Tax systems in modern industrialized economies such as Canada are complex, and the resources devoted to tax administration and compliance are substantial. Simplification is thus becoming a central issue in the broader debate on tax reform.

Existing information suggests Canadian tax practice towards charities is in line with best practice in other developed countries, and in particular the United States. However, some aspects of Canadian policy need to be reconsidered. Recent tax measures have removed some, but not all, of the troubling inequities within the system. There are questionable differences between the tax treatment of monetary gifts and gifts of appreciated property; and in the GST credit relief provided to charities and to other public service institutions. The concern that local governments will tax charities without adequate consultation and coordination with the other levels of government also needs to be addressed.

Notes

- 1 Given that few individuals contribute more than one half of their income, this phenomenon is unlikely to be empirically relevant.
- 2 The previous system was discriminatory, because of the 50 percent income limitation: generous gifts of appreciated property were subject to full capital gains taxation, but the limitation on income meant that the donor was unable to obtain immediate tax relief for the donation. This is not a current concern, since the 1996 budget effectively increased the income limitation to 100 percent on gifts of appreciated property.
- 3 Note, however, that although on paper Canadian organizations may appear to have less flexibility in this respect than their U.S. counterparts, in practice, existing rules have been given a rather broad interpretation and, consequently, there is ample scope for Canadian charities to pursue business-related activities (Drache, A.B.C. [1995], *Canadian Taxation of Charities and Donations*, Scarborough: Carswell).
- 4 This will generally be true when a nonprofit organization or charity has limited funding, offers a service for free, is subject to fee limits or is not in a position to decrease service levels. Otherwise, where a fee is charged, there may be an opportunity to recover all or a portion of any increased costs through a fee increase and, therefore, pass on the GST to consumers.

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Comments

by *Arthur Drache*

Solicitor

Drache, Burke-Robertson, Buchmayer

I have some criticisms of both the organization and content of this study. In terms of the arguments in the paper, one major area of disagreement is on the merits of a deduction system relative to the current system of tax credits. Canada only moved to a credit system for charitable contributions in 1988. In typical fashion, the credit system was introduced by the Minister of Finance with no public discussion. Initially, I hated the system, but I have become a convert. The credit system is complex and the average taxpayer does not understand it, which is a serious problem. But, as compared to a deduction system, a credit system is more beneficial to most taxpayers; with the exception of the first \$200, the credit system gives the same relief as the deduction system to the top marginal taxpayer, and more relief to bottom and middle marginal taxpayers. So the top marginal taxpayer is no worse off, but the taxpayers from lower income groups are better off, as compared to their counterparts in the United States who are subject to a deduction system. In addition, a credit system is infinitely more flexible than a deduction system. This is illustrated by a recent proposal to introduce “stretch credits” that would greatly increase the charitable credit for donations over a base, determined by the amount of an individual’s previous donations. This type of innovation would not be possible under a deduction system.

I have become convinced that the adoption of tax credits has been one of the major improvements to our charity tax system. This has nothing to do with the correct definition of income for tax purposes, the rationale used in the paper to support the use of a deduction system. Rather, the relevant question is “Do you want a system that gives added relief to taxpayers at the bottom end, while offering the same relief as under a deduction system to taxpayers at the top end?” I doubt that the Department of Finance thought about the definition of income when they decided to shift over to a credit system.

With respect to the income limitation on charitable donations (which has been considerably relaxed in recent budgets), there is an important consideration that is not addressed in the paper. Major donations generally involve contributions out of capital; most people – some baseball players being a possible exception – do not make donations of \$100,000 or more out of their income. So, under the current approach, we have a mismatch: an income test is applied to donations coming out of capital. Once it is recognized that capital is accumulated after-tax income, logic suggests that donations out of capital should be entitled to carry-back provisions. The taxpayer who is making a donation out of capital should be allowed to apply part of his donation against his taxation payments three to five years back. I would have thought this is one of the things the authors of this study would have wanted to look at.

Comments

by *Kevin O'Grady*
Tax Policy Officer
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I believe that the examination of tax incentives for charitable donations is important. Over the past year, as a follow-up to the announcement made by the Minister of Finance in the 1996 Budget, we have been reviewing charitable tax incentives through consultations with groups such as the Voluntary Sector Roundtable and the Canadian Centre for Philanthropy. Most of these consultations focused on the discussion of alternative policy options and the identification of new initiatives that could be introduced. I think it is worthwhile to look at the design of tax incentives from a more theoretical perspective, and this paper, I believe, can make an important contribution to this broader review.

However, in a broad policy context, theoretical considerations such as efficiency, equity and simplicity, have to be weighed against other considerations; such as the need to ensure that, on the one hand, charities have sufficient funds to undertake the important work that they do, and, on the other hand, the cost of the charitable donation tax incentives fits within the government's overall fiscal strategy. We have had previous opportunities to comment on this paper, but we do have further comments to make about the most recent draft.

Now, I am an economist and also a tax policy specialist. As a result, I have a tendency to talk at great length about the intricacies of the tax system – which is why I do not get invited to many parties. I am going to leave most of my technical comments for a letter to the authors of the paper. It is important, however, that the outstanding technical problems are addressed so that they do not undermine the more important theoretical discussion in the paper.

In terms of more general comments, there are a few points that I wish to raise. The paper discusses the merits of tax incentives relative to grants and argues that one of the advantages of tax breaks is that they are likely to spur private giving and result in additional revenue for charities. I think there is a counter argument. With direct grants, governments control where the money is going, whereas, with tax incentives, it is donors who decide which charities receive funds. The latter alternative, in which donors make the decision, is not always going to lead to an optimal distribution of funds from a policy context. This issue requires a broader philosophical discussion than would be appropriate within the scope of this paper. However, I think it would be useful to make some mention of this philosophical debate so that readers of the paper are aware that that issue is out there.

With respect to the GST, my colleagues in the Sales Tax Division asked me to pass along some comments. Currently, as Scharf et al. noted, the government provides a partial rebate of GST paid on goods and services purchased. The paper suggests that it may be more appropriate to zero-rate charitable goods and services. The reason for the current approach using a rebate mechanism is that it is very difficult to define exactly what constitutes charitable goods and services. Hence, following the logic in the paper, it might make more sense – and I am not advocating this – to propose a full rebate instead of a system of zero-rating. This way, we would avoid all the problems involved in defining charitable goods and charitable services.

That brings us to the question of why we do not provide a full rebate, only a partial rebate. When the rebate was introduced with the GST, the intention was to ensure that charities would not end up paying more tax than they had previously paid under the manufacturer's sales tax, which the GST was replacing. The intention was not to provide a total exemption. The GST, after all, is a tax on goods and services, not a tax on income or on profits; therefore, just because charities do not operate for the purpose of generating profits is not an argument for providing them with a complete rebate under the GST. At any rate, that is the Department of Finance's view, with which the authors may not agree.

I would also like to raise one point with respect to business-related activities. Charities are not prohibited from business-related activities, only from unrelated business activities. They are allowed, of course, to undertake any business activities related to their operation. Oxfam is permitted to import goods from the third world, for example. The existing definition of “related business activities” is very broad and I do not think too many charities have been restrained by it.

Under the current application of the law, activities such as hospitals operating gift shops and parking lots, commercial endeavours that are really ancillary to the charitable service being provided, are allowed. The government has received submissions from many business groups that are concerned about this issue. The interests of these groups need to be taken into consideration; businesses have a legitimate concern that they may be facing unfair competition from charities and not-for-profits that are able to use their tax exemption to gain a market advantage.

Discussion Summary

The issue of whether tax preferences or subsidies should be used to support charitable activity became a central focus of discussion. *Rose Anne Devlin* took issue with the suggestion (which she thought Kevin O'Grady made) that grants are preferable to tax subsidies owing to the better ability of governments than individuals to decide which charities should be funded. She argued that individuals vote through their charitable dollars, supporting those activities that most closely correspond with their vision of the world. The services governments tend to provide and subsidize are those that respond to the interests of the median voter. Allowing individuals to donate to organizations of their choice, on other hand, leads to a diversity of organizations catering to individuals with a variety of needs, values and beliefs. From her experience working in the sector, *Paddy Bowen* has developed a very different perspective. She talked about her involvement with very important programs for street kids and HIV positive children and others that would not survive without government support. Because of the inadequacy of charitable contributions and because people give mainly to those causes they understand and to which they can relate, she feels that government must play a role in identifying social problems that need to be addressed.

Rose Anne agreed there is an important role for government. Her intention was simply to point out that the approximately 10 percent of revenues that charities receive from private contributions may play a valuable role at the margin. This prompted a response from *Don Mc Rae* who thought the theory Rose Anne was putting forward was incomplete. Governments have sometimes played an important role by identifying causes that are in the broad public interest and intervening in ways that are unpopular at the time. Government grants may help achieve worthwhile goals that would not be supported by people who vote with their charitable donations. Don pointed to the particular issues of sexual abuse and incest. The federal government played a key role in highlighting these problems in the 1970s and 1980s, when other groups were not addressing them. However, *David Armour* indicated that the United Way and many other foundations see themselves as also having a responsibility to develop balanced funding policies that support unpopular causes; this is not the sole responsibility of governments. Funding organizations recognize that, if it was up to donors, many important charities would not get funded and many important services would not get the degree of support they require.

Some participants were concerned by what they interpreted as arguments for increasing the role of grants and reducing the role of tax incentives. *David Elton* asked participants to recall the morning's discussion, which indicated that religious organizations are the major recipients of charitable donations. If government grants were to replace donations, churches would suffer a major loss in revenue. But this is all abstract speculation, in David's view, because governments are not likely to offend middle-class voters by telling these individuals they no longer trust the way they spend their charitable dollars. Public policy is moving in the opposite direction at this point in time. *Arthur Drache* talked about the risks faced by those organizations that are reliant on government funding. Many organizations that were dependent on government funding have been victims of recent cutbacks. Arthur pointed to two ways organizations have responded to the increased danger of government cutbacks: they have come together in umbrella groups to press for tax incentives that would help them increase their revenue from nongovernmental contributions; and they have developed new sources of revenue, mainly by engaging in business activities. What the charitable sector needs, in Arthur's view, is the correct tools to allow it to take care of itself.

Paddy Bowen, whose earlier comments sparked this debate, subsequently clarified that she was simply reacting to what she saw as the implied suggestion that donors are morally, or otherwise, better able than government to determine which organizations and causes should be supported. She acknowledged, however, that there is a need for a mixed approach that involves a role for both individuals and government.

Moving from this general discussion to a consideration of current tax policy, *David Armour* drew attention to a number of important issues identified by Kim Scharf and her colleagues. He agreed that the unlevel playing field created by the 50 percent annual income limitation for some donations and the 100 percent limitation for others is a concern. (As noted in the revised summary paper by Kim Scharf and her colleagues, this issue was addressed in the 1997 Budget that came out after the Roundtable.) David thinks the consequences are becoming more serious as we

enter a period where there are increasing numbers of upper-middle-aged and elderly individuals with relatively low incomes but with high net worth and an ability to make large capital donations. The impact of this policy distortion may soon be visible in Canada. Another source of unevenness arises from the different rules applying under the GST. David indicated that he cannot understand why hospitals and universities should be entitled to a 65 percent rebate, and other charities a 50 percent rebate. In his opinion, these inequities highlighted in the CPRN paper need to be looked at very carefully over the next few years.

Susan Phillips observed that the backlash by local governments against the tax-exempt status of charities, which is discussed in the Scharf et al. paper, is not simply a U.S. development; the debate over local taxation is already underway in Canada. Alberta revised its *Municipal Government Act* in 1994 to allow for the taxation of nonprofit property and Ontario is considering a similar policy reform.

On the fundamental question of whether enhanced charitable tax credits lead to increased giving, *David Armour* pointed to the findings of some commissioned public opinion research. Like the empirical studies cited by Kim Scharf and her colleagues, they suggest that higher tax credits would lead to increased giving. While most donors reported that they would not give more in response to an increase in the tax credit, more generous donors indicated that they would be inclined to increase their contributions. On the basis of such evidence, groups like the Voluntary Sector Roundtable have pushed for an enhanced charitable tax credit.

To *Gordon Floyd*, the discussion of tax incentives should logically follow a discussion about principles and philosophies. Gordon related how his own experience in discussing the technical issues with Finance officials and others over a period of about six months had impressed upon him the importance of establishing an adequate context. In his view, this required that prior decisions be made about such basic questions as: whether, as a principle, we want to encourage more Canadians to donate; whether, as a principle, we want charities to be more self-sufficient and less dependent on government funding; whether a larger proportion of revenue should be coming from corporations; and whether we should be tapping into pools of wealth to finance charitable activities, as opposed to relying largely on contributions made out of annual income.

While agreeing that society must seriously debate such questions, *Shira Herzog* believes that such a debate is properly focused on those organizations that are situated between the two poles that were referred to in the morning's discussion. With inclusion of the two poles, represented at one end by religious institutions and the other, hospitals and universities, all the numbers are skewed and all the discussion is skewed. In Shira's view, it is only after these organizations have been excluded from the picture that society can engage in a debate about values, the principles Gordon talked about, the relationship of government to the community, and how to empower the community to work more effectively.

Specific features of the tax system may say a lot about the way society has chosen to address some of these broader questions, as was illustrated by *Susan Phillips*. She noted that Kim Scharf and her colleagues had emphasized the benefits of simplicity in assessing alternative rules governing the political activity of registered charities. But these rules have a critical influence on the role of the sector as a vehicle of citizen engagement and advocacy. The real issue, according to Susan, is not one of tax complexity, but of how the sector is to be defined and whether advocacy is to be seen as one of its core functions. In this connection, *Carl Sulliman* talked about recent objections Revenue Canada has raised to what it sees as aggressive advocacy by the churches. Carl sees the response of individuals to societal needs in the context of spiritual, psychological and ethical factors that have roots in the Judaeo-Christian and other world faiths; and he finds government initiatives that threaten such responses by people of conscience in an open democracy repugnant.

Kevin O'Grady clarified that, by raising the question of how government should use any funds it may have available to support the charitable sector, he was not making a case for grants instead of tax incentives, but simply pointing out that there is a choice, and the resulting policy issue merits some discussion. He also conveyed his view that, notwithstanding the concerns raised by Gordon Floyd, the discussions between the Department of Finance and the sector over the last year had been very useful.

Kim Scharf noted that the purpose of the paper was not to probe the details of the *Income Tax Act*, but to provide a baseline study examining what the economic literature can tell us, conceptually and empirically, about important features of Canada's approach to the taxation of charities. The study also attempts to look at whether there is anything we can learn from U.S. experience. The subject matter of the paper is vast and complex and, within the scope of this study, it was not possible to do more than highlight those features of Canadian tax policy that require closer examination.

Kim thought the discussion that had occurred over the relative merits of tax incentives and grants usefully illustrated the sorts of broad, difficult-to-resolve questions that arise as one begins to ask some basic questions about tax policy. Grants are favoured by those who believe governments should control where tax money should go, and opposed by those who believe individuals should exercise spending control. These differences in view partly reflect ideological differences. They are also influenced by individuals' views about the significance of certain practical issues. For example, in a system based on explicit grants, governments must be able to measure the social desirability of various activities and to identify those worthy, and those not worthy, of support. The establishment of an acceptable decision-making system within government could be a big problem.

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Forthcoming CPRN Publications on the Nonprofit Sector

Organization and Supervisory Law in the Nonprofit Sector, Working Paper No. CPRN|01, by Ronald Hirshhorn and David Stevens

The Canadian Nonprofit Sector, Working Paper No. CPRN|02, by Kathleen M. Day and Rose Anne Devlin

The Taxation of Nonprofits, Working Paper No. CPRN|03, by Kimberley Scharf, Ben Cherniavsky and Roy Hogg

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