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The Future of the Third Sector

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Introduction

The general thesis I wish to explore here is that the peculiar forms of contemporary national Third Sectors which, according to Salamon (1993) are currently spreading around the world arose in a unique historical moment and are unlikely to outlast that moment in history. It may indeed be true, as I and others have argued, that certain features of the contemporary Third Sector (particularly those I have labeled commons) are more or less permanent features of human community. (Lohmann, 1992) However, self-help and mutual aid groups, voluntary associations, social movement organizations and the like are not generally seen as the principal or defining characteristics of the contemporary Third Sector, Instead, the sector is seen as consisting of – and defined by – paid employment in tax-exempt "nonprofit", "voluntary" or "nongovernment" organizations, charged with vending services to defined and recognized clientele and supported partly or wholly by public funding. In brief, if this particular Third Sector configuration were to prove long-lasting, it must be deemed an entirely new form of public management by essentially private entities.

Failure Theory

Any conclusions about the permanency of change represented by the hegemony within the Third Sector of nonprofit organizations, however, must consider the unique national circumstances under which these organizations are arising in various nation states. In the case of the United States, for example, the rise of this putative Third Sector was a unique and momentary product of late 20th century American public life. Conditions are already developing to transform this particular configuration into something new, different, and perhaps unrecognizable. Thus, it is quite

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appropriate to ask whether there has been another transformation in the particular circumstances that brought the recent proliferation of nonprofit corporations and whether that change is sufficient to lead to the demise in the near future of the nonprofit sector as we have come to know it?

Something approaching a consensus appears to exist among American Third Sector scholars that the rise of a sector of more than a million nonprofit organizations and at least 40,000 donative foundations is due in large part to twin failures of government ("state failure") and business ("market failure"). These twin failures, together with the enduring characteristics of information asymmetry, the behaviorism of incentive theory and legal and ethical non-distribution constraints are the cornerstones of third sector theory in its present state.

The Nonprofit Sector Model

Viewing the Third Sector as a strictly contemporary phenomenon gives a hard edge to Peter Dobkin Hall's assertion that the American nonprofit sector came into being only in recent decades in the wake of the Filer Commission. (Hall, 1992) It seems clear that the term nonprofit sector as ordinarily used by researchers in economics, public policy, and the sociology of organizations is a largely ethnocentric term, indigenous to the English speaking, or Anglo nations of the United States, Canada, Britain, Australia and New Zealand, and to a lesser degree, the developed nations of the industrialized world.

Its export to the rest of the world is often treated as a straightforward issue of "technology transfer"; an approach that conveniently glosses over a number of complex and difficult cultural and political issues. It is from this First World base that Salamon (1993) has detected an international associational revolution in terms of the diffusion of American-style nonprofit corporations/organizations to the rest of the world.

Nonprofit sector is also a largely contemporaneous term, both in usage and in meaning, containing no explicit reference to the past, and no future connotations other than Whiggish continuity. Protests that charitable, philanthropic and associational activities existed prior to the Filer Commission miss the essential point: There may have been (indeed, there were) other related phenomena in other places and in other times, but the contemporary term Third Sector as it is ordinarily used does not extend to them. The terms Nonprofit and Third Sector, as they are currently used, do not purport to cover the entire history of human association in all human cultures, or the full scope of charity, philanthropy, self-help and volunteering in past, present or future. These terms are, and should continue to be, narrower references to particular, post-war national regimes.

The Nonprofit Sector is a socio-economic world of professionally staffed nonprofit organizations, legally organized as tax-exempt nonprofit corporations and operating on the basis of distributionally-constrained managerial entrepreneurship, and with revenue streams derived in significant degree from public-sector grants, contracts and transfer payments, just as its adherents suggest. It is also a world in which entrepreneurs who create and work for nonprofit corporations may choose to take advantage of available tax exemptions and to cloak their activities (whether authentically or disingenuously) in the rhetoric of charity and philanthropy. All of this offers no great mystery.

Moreover, the fact that these contemporary national Third Sectors have largely become the domain of organizational entrepreneurs should surprise no one familiar with the history of public management. Such entrepreneurs have been attracted by a broad range of public transfer payments to create charitable, philanthropic, volunteer, and other programs. Incentive theory is one of the bastions on which entrepreneurial Third Sector ideology was built, and public transfer payments offer a particularly attractive set of incentives. In fact, declines in available transfer payments to nonprofit corporations can be considered one of the surest predictors of future declines in this Third Sector.

Alternative Futures

I have tried in various ways during the past decade to articulate the view that the Nonprofit Sector conceived in this manner, is simply one of several subclasses of a larger and more enduring category of human voluntary association over time and across cultures. Because this larger class of associations has no generally accepted name, I sought to apply the term commons. From this vantage point, the formal, nonprofit, professionally-staffed organizations in the current Third Sector are one of the members of a larger class of social organizations which also includes hunting, gathering and war parties of primitive cultures; the confraternities and guilds of medieval Europe; the scientific academies of the 17th century, the coffeehouses of 18th century London to which Habermas (1989) traces the origins of modern publics, the voluntary associations observed by Tocqueville, the voluntary agencies of the late 19th and early 20th century, the waqfs of the Arab world, Buddhist monastic organizations, (Lohmann, 1995a; 1997), Maori morais, Central American fiesta organizations (Brass, 1986;Smith, 1977), and many more examples.

Just as we have no generally accepted name for this larger class of organizations that includes nonprofit organizations, we similarly have no name for the larger classes of culture complexes or regimes in which they are embedded. Extending the terms Nonprofit or Third Sector indiscriminately to the entire class of organizations or to the class of regimes merely serves to mask over very real differences between them and the specific, contemporary regime of the nonprofit sector and lead to no end of confusion and pointless debate.

Unlike the American voluntary associations cited by de Tocqueville or the European confraternities of medieval Christendom, the contemporary nonprofit organizations of the Third Sector, do not strike me as particularly definitive members of this larger class nor as constituting a particularly definitive regime. (That is to say, neither is an ideal type in the Weberian sense.) Because of their origins in the failures of state and market in the welfare state "mixed economy", both may be thought of more accurately as marginal phenomena or amalgams; admixtures of characteristic traits of state, market and commons.

The contemporary Nonprofit Sector deserves to be seen, as Hall suggests, as a new and distinct phenomenon. To fully accept this view, however, is also to recognize that the contemporary Nonprofit Sector should be seen as a secondary institutional phenomenon. One simply cannot have it both ways: If the third sector is as its adherents present it, a product of the recent moment, then it is also not a foundational social and political complex like the family, state, market or civil society. Our collective social life has not been fundamentally transformed by the emergence of this third sector in the way, for example, that it was by the historic emergence of the political state or the market. Instead, the third sector represents a socio-economic complex located at the margins of contemporary state and market civil society. It is an expression of contemporary civil society which survives largely because of protection and subsidy by the state and the apparent attractiveness of its attractive economic incentives it creates in certain (e.g., labor) markets.

From this vantage point, this American Nonprofit Sector looks less and less like any type of enduring social reality, and more and more like a macro-social episode. It may be a unique macro-event in the post-war world resulting perhaps from post-war economic growth; the restless idealism of the Kennedy years; a male-WASP political elite in decline; the baby boom-inspired need to expand employment opportunities; the interest-group liberalism of national politics; the growth of health care spending; the backlash against government, combined with healthy doses of opportunism toward the traditional legal backwaters of state nonprofit law and the arcane complexities of corporate tax law, together with large measures of adventurism, chicanery and innovation.

The Decline and Fall of The Nonprofit Sector?

A unique set of historical circumstances over the past two decades caught the attention of students of the nonprofit sector in economics and the management disciplines and proponents of voluntary action in sociology, social work and political science and fostered attempts (still incomplete and open-ended) to develop convergent, multi-disciplinary paradigms of the nonprofit sector. Subtle but important disciplinary and theoretical differences in unit of analysis (corporation, organization, association, group, etc.), time frame (specious present, past, or in this case future), intent (pure research or practice) and other issues were set aside as immediate contemporary concerns were explored.

The is room here for the positions of Salamon, Hall and Smith: (Hall, 1992; Smith, 199X) While voluntary action may fluctuate across time, it is as an essential characteristic of the human condition even more fundamental than, and underlying, market trading or political states and will always be with us to one degree or another. By contrast, the Third Sector and the resulting questions over nonprofit behavior and nonprofit organization result from a unique historical configuration which arose out of the particular political circumstances which Theodore Lowi has characterized as interest group liberalism (1969) and, more recently, late Second Republic decadence (1994). Michael Sandel (1996) has characterized this as the rise of the Procedural Republic. Robert Samuelson (1995) sees it in terms of the rise of a pernicious political culture of "entitlement" in which citizens (in a reversal of the famous call to public service issued by President

Kennedy in 1960) ask not what they can do for their country, but rather what their country can do for them.

At this time, it is not at all difficult to visualize a relatively large number of present and foreseeable conditions leading to the demise of substantial portions of this American Nonprofit Sector. Unfavorable tax rulings, cuts in public subsidies and tighter enforcement of tax-exempt status are just three of a broad range of circumstances which could easily bring such a change. Nonprofit corporations are easily created. They just as easily disappear. If enough of them disappear, so apparently does the sector, at least as it is presently conceived. In the remainder of this paper, I want to concentrate on a number of factors and forces associated with the creation of the Third Sector that are currently pointing toward its demise.

Government Failure

In the usual constructions, one of the factors out of which the contemporary Third Sector of nonprofit organizations is said to have risen is government failure. (Salamon, 1987) However, most accounts of these failures are not very specific about what particular failures of government were actually involved. Let us attempt to be somewhat clearer:

Institutional failure is a rather peculiar basis from which to begin theorizing the Third Sector, as I noted in an article a number of years ago. (Lohmann, 1989) However, once such a course is set, it is somewhat disingenuous not to clearly identify the specific market and state failures that gave rise to the armada of nonprofit organizations which currently dominate the third sector. For example, welfare state theory is premised upon the failure of market mechanisms to protect the wellbeing of workers and consumers. And, in turn, it was perceived failures of public management that have given rise to the sustained assault by the new right upon government institutions of all types. So much seems clear.

Is seems equally clear that the original ‘sector’ of American voluntary associations which Tocqueville observed in the North America of the 1840’s was also subject to institutional failures. We might summarize these as the failure of medieval European systems of aristocratic patronage, and church-sanctioned community and charity organization to take hold in the new world. Much of what Tocqueville observed amounts to a report of his sense of wonder that associations of commoners in everyday life could occur without aristocratic protection and beneficence or the institutional legitimation of church or state. This form of argument is inherently tautological. In this same sense, virtually any type of social change can be reconstructed as the failure of conditions in effect prior to the change.

It was not any particular parliamentary, legislative or judicial failures or ineffective public management, nor recognition of any such failures by reform or study commissions, to which we can properly trace the rise of nonprofit organizations in the American third sector of the 1960's and 1970's. In the first instance, it was the legislative *successes* of President Lyndon Johnson in the wake of the Kennedy assassination that both created the diverse discretionary grant programs and devised the legal apparatus whereby nonprofit "community" groups could apply for and received public funds independently. (Unger, 1996).

In a second stage of privatization, the administration of Richard Nixon later extended this same eligibility to private, for-profit groups. A vast range of pseudo-markets were thereby created in which large groups of service-consumers are aided in purchasing health, social and other services from large groups of commercial vendors through public subsidies from a single faux-buyer: the federal government.

The role of public management failures is somewhat more complex in the American case. For some time now, politicians and journalists have been blaming "bureaucrats" for many of the ills of the world. However, it was not the putative evils of bureaucracy, but rather constitutional limits and the characteristics of budget politics of the federal bureaucracy during the 1950s and 1960s that gave rise to the organizational third sector. (Wildavsky, 1967)

One plausible approach is to argue that the most significant governmental failure was the inability of federal bureaus (such as those reorganized into the Department of Health, Education and Welfare during the 1950 s) to muster sufficient support in the Congressional budget process and Constitutional limits which restricted the abilities of these same bureaus to develop and administer service programs of their own . In the post-war decades during which the Third Sector is said to have arisen, these same federal agencies could not look to state and local government for support. As Lowi (1994) notes, American state and local governments were during that time collectively the traditionalist bastion of the very same "old order" (i.e., traditionalist) conservatism which formed the base for opposition to these federal programs.

Anyone who was alive at the time surely remembers the role of southern governors, legislators and local governments in leading the opposition to civil rights reforms, for example. Institutional racism in this sense did not come from the people, but directly from state and local government. How, then, could progressive forces introduce and institutionalize change with protectors of the existing order in every city hall, courthouse and state capital? At least part of the answer was to be found in the resurgence of the doctrine of local community and specific, newly (and under state laws, easily) created nonprofit corporations which could be (and was) used to by-pass the traditionalist state-local political structure entirely. To some extent, this configuration continues: It was the state governors who led the recently successful initiative for “welfare reform”, for example.

As the Johnson Administration demonstrated clearly with the Community Action Phase of the War on Poverty, grants and later contracting out the actual delivery of services to nonprofit organizations could by-pass the opposition and create an instant constituency of supporters for any program from which funds can be distributed. In the name of "the community" similar by-passes were arranged through the Elementary and Secondary Education Act, Community Mental Health Centers Act, Older Americans Act and other legislative acts of the Great Society. Throughout the period during which the Third Sector is said to have arisen, this strategy for compensating for budget and program failures that began in the precincts of H.E.W. was passed from federal agency to agency, even reaching such bureaus as the U.S. Forest Service and the Environmental Protection Agency. In this way, hundreds of thousands of nonprofit organizations compensated for this particular set of government failures and created one important core of the nonprofit sector profile as it is currently understood.

I am tempted to believe that something of the same forces are at work in Great Britain, partly because of the parallel administrations of Thatcher-Reagan and Clinton-Blair. On C-Span recently, I watched your prime minister in a ‘town meeting’ on crime in the Worchester Town Hall extol the virtues of localism and ‘community action.’

Perhaps we might conclude from this that the most general failures of government which give rise to the contemporary national third sectors are failures to know what to do and how to muster the political capital to do it in the areas of social policy. In this familiar scenario, politicians escape into flights of rhetorical excess. They leave the actual working out of policy in areas such as families, housing, social care arrangements to the negotiations between public bureaucrats and nonprofit administrators.

While this iron triangle strategy was highly successful in the short run, it has also had certain side effects. According to Lowi (1994) it succeeded in shifting the balance of power between federal and state governments and disrupting the community base of old order conservatism. This is one of the enduring discontents with "big" government known collectively as the conservative revolution which has been largely responsible since 1980 for threatening and undermining the funding base of these same government bureaus and their Third Sector constituents. Half the recent American presidents (Carter, Reagan and Clinton) are former governors. Another side effect, noted by Unger (1996) was the transformation of opportunities into entitlements which is at the core of the current crisis of the American welfare state.

Among other things, focus on these particular government failures explains why privatization which in other nations has been largely an issue of the transfer of public assets to private owners has, in the United States, been seen more as a quest for new (nongovernmental) support for the Third Sector. This analysis also explains the otherwise curious reluctance of so many of those seeking to define the Third Sector in the United States to include the grassroots , voluntary association, fund-raising, social movement and other dimensions of the conservative revolution within the domain of the Third Sector. This conservative revolution may, in fact, successful constrain future development of the Third Sector in either of two ways by establishing a new regime dramatically limiting the powers and expenditures of government, or through the less ambitious oppositional role of placing severe practical limits on spending increases and new programs. In this way, conservatism does not need to win to succeed: Either way, the public revenue streams which form the life-blood of what Wolch (1990) has termed the shadow state are undercut. Thus, the very forces that for several decades made of the nonprofit sector a way of overcoming the particular government failures of federalism, traditionalism and bipartisanship may in the future result in the undoing of the sector.

The present American Third Sector is, in these rather distinctive senses, almost certainly a product of government failures.

Correcting Market Failures

The second major dynamic said to be responsible for the historic rise of the Third Sector is market failure. In at least one important respect, paid employment, there almost certainly has been no failure at all; the nonprofit sector appears to function more or less normally in the national labor markets. Unlike voluntary associations, clubs, social movements and other actors in voluntary action, the nonprofit organizations of the Third Sector are, therefore, in at least one important respect inherent parts of the overall market structure of national economies. Theoretical focus on nonprofit production has generally understated the importance of this particular factor. Thus, the continuation of paid staff employment in future nonprofit organizations is one measure of the continuing success of the sector in staving off market failure; not an indicator of such failure.

Another anticipated market failure may have largely failed to materialize at least in part because of the rise of the Third Sector. In fact, one of the largely unsung accomplishments of the Third Sector may have been its role in absorbing the demographic surplus army of (high school and college graduate) baby-boomers who entered the labor market during the period of rapid growth of the Sector. Earlier expectations of a glut of workers entering the labor force in the baby boomer years proved largely unfounded. While general expansion of the economy is, no doubt, the most important reason, the creation of new jobs in those million nonprofit corporations has to be given a measure of credit as well.

In at least three other distinct but equally important senses, the very market failures which are said to have resulted in the rise of the Nonprofit Sector could in the future bring nonprofit organizations fully back into the marketplace. One pair of such market failures is the failure of organizations delivering specialized, consumer services as diverse as hospitals, opera and ballet companies, and museums to be sufficiently competitive in consumer and capital markets to attract sufficient investment to underwrite operations and returns on investment. For example, high culture has generally been much less successful than middlebrow and pop culture in the entertainment marketplace. The American Symphony Orchestra League, for example, is one of many nonprofit industry groups looking closely at their market position, both in labor and capital markets. Like many other nonprofit industries, symphony orchestras have generally been unsuccessful in pricing their products high enough to cover costs and generate profits, yet low enough to attract broad customer bases.

An unrelated third market failure that appears only in retrospect is the inability or unwillingness of capital markets to respond to basic demographic changes in society. These include the declining youth market in the wake of the baby boom and the rise of elderly consumers and the identification and definition of other new classes of consumers. Public funding of nonprofit service industries in these cases has served to demonstrate both that potential untapped markets existed and to define entirely new markets.

Despite the vaunted adventurism and allegedly restless entrepreneurial spirit of private enterprise, venture capitalists often proved to be remarkably unimaginative during the formative period of the nonprofit sector. Thus, for example, it was only after the efficacy of a series of specific service products like hospice, home health care or meals on wheels were defined, refined and market-proven by nonprofit vendors that private, commercial delivery of such services begin to emerge. Even today it is still unclear whether some of these markets (e.g., nursing homes and home health care) could be sustained on a purely private, competitive basis, or whether public third-party funds are necessary to sustain pseudo-markets for these services. (Where the latter proves to be the case, of course, much of the current rhetoric for privatization American-style simply disappears.)

Service Marketization

In any event, all three of these types of market failures seem to point directly to the eventual demise of the present Nonprofit Sector through processes resulting in corrections of the specific market failures which led to the rise of the sector. We hear a great deal today about the role of venture capital in the computer software and information processing industries. Less clear has been the role of public funding of the Third Sector as a distinctive form of public venture capitalization of new markets. What is involved here might be seen as a three-stage process, labeled with the inelegant term "marketization." The marketization process begins with public venture capitalization (grants and contracts to nonprofit organizations) and leads to increasingly clear product definition and private market formation. Public funding of the Third Sector has provided the initial capitalization for a staggering variety of products and services, many of which simply disappeared after an initial subsidy ran out, but others of which were clarified into distinct consumer products currently being marketed privately in newly emergent markets. Much of the private market in child day care services, for example, is following the patterns set out by the federally subsidized Head Start program.

For at least some of the goods and services capitalized through the grant funding operations associated with state failure , the next step is oblivion. Generally speaking, the rhetoric of demonstration projects , innovation and social change surrounding public programs for the past three decades has tended to ignore or downplay their role in marketizing new services.

One interesting aspect of this phenomenon which nonprofit administrators have generally failed to heed is the way in which parallels between market success and support for public funding can adversely affect public as well as private support. It is not only the useless, pointless and trivial which can fall victim to this process, however. If, in the long run, a market fails to coalesce around a product created in this way, not only is its marketability impaired. The very fact of its failure in the marketplace casts new doubts on its continuing legitimacy as an object of public support as well. Thus, the success of some museums and symphony orchestras in using public funds to leverage commercially successful events may put additional pressures on others use of public funds to support experimental or other non-commercially viable events. If enough people don t want to buy tickets, it is said, how worthy can the event be? In much the same vein, the commercial successes of some initiatives in health and human services have placed increasing pressures on all service providers to ignore, neglect or under-serve the poorest, most difficult and riskiest patients and clients and are eroding the long-term legitimacy of efforts to work with these groups.

However, some ideas that receive funding are sufficiently practical, useful or interesting that they attract widespread interest and result in the formation of actual product markets where none previously existed. There may be no clearer case of this than federally funded Meals on Wheels, a small program of a few million dollars first introduced under Title III of the Older Americans Act. By the late 1960 s, home-deliveries of food, whether raw or prepared, had almost ceased in the U.S. But consumers whose parents or grandparents received prepared, home-delivered meals probably formed the original core of the market for home-delivered pizzas, which has since broadened out into home, hotel, office and athletic field delivery of an amazing variety of food products on a strictly commercial basis.

Similar observations can be made about products as diverse as the Jeep and Hum-Vee to freeze-dried ice cream. Markets have also emerged in recreation services for older people, homemaker and home health care services, and other examples where the market potential was recognized only after the product was defined or marketized by publicly funded programs.

Conclusion: Nonprofit Obsolescence?

Close examination of the government and market failures which are credited with leading to the rise of the Nonprofit Sector shows that both sets of failures are proving to be, to some degree, self-correcting. Thus, the governmental failures of budget constituency and limits on service provision which led to the rise of interest group liberalism (Lowi, 1969) and the shadow state (Wolch, 1990) that we know as The Third Sector also led eventually to Reaganomics, the Gingrich revolution of 1994, and the protests against tax exemption, charity fraud and other questions which leave the long term existence of The Sector very much in doubt.

There may, in fact, be something of an iron law at work here that points to the inevitable demise of the Third Sector, or at least, major portions of it. Public subsidy of nonprofit activity in the Third Sector form of specific responses to capital and product market failures of seemingly desirable objectives may set off a series of marketization dynamics resulting in the eventual commercialization of that product or service. Marketization may also undermine the long-term legitimacy as other, similar objects of public support which are not a commercial success. Either way, the third sector loses in the end: If a product or service created by public subsidy of the Third Sector is successful commercially, there is no need for continued support of its nonprofit production, and if it is not commercially successful, how can continued public support be justified?

Thus, if one looks to the government and market failure arguments as the source of the particular configuration of nonprofit enterprise we currently call the third sector, one can also see that the very forces that led to the rise of the third sector are currently pointing toward its decline. Such a decline, if it occurs, is a process that can be expected to unfold along lines dictated by state and market forces, and have little if anything to do with developments in the commons.

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