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PubPol 671:

• Policy & Management in the  
Nonprofit Sector

**Lecture 3: Why Is There a Nonprofit Sector  
Anyway? (cont.)**

**Neel Hajra**



# Reports from the Field

- NGen Fellows work in DC
- SE MI Public Policy Council



# Note: Good Guest Lecturers!

- Governance
- Collaboration & Merger (maybe)
- Foundations
- Finance / Capital
- Policy making

# Next

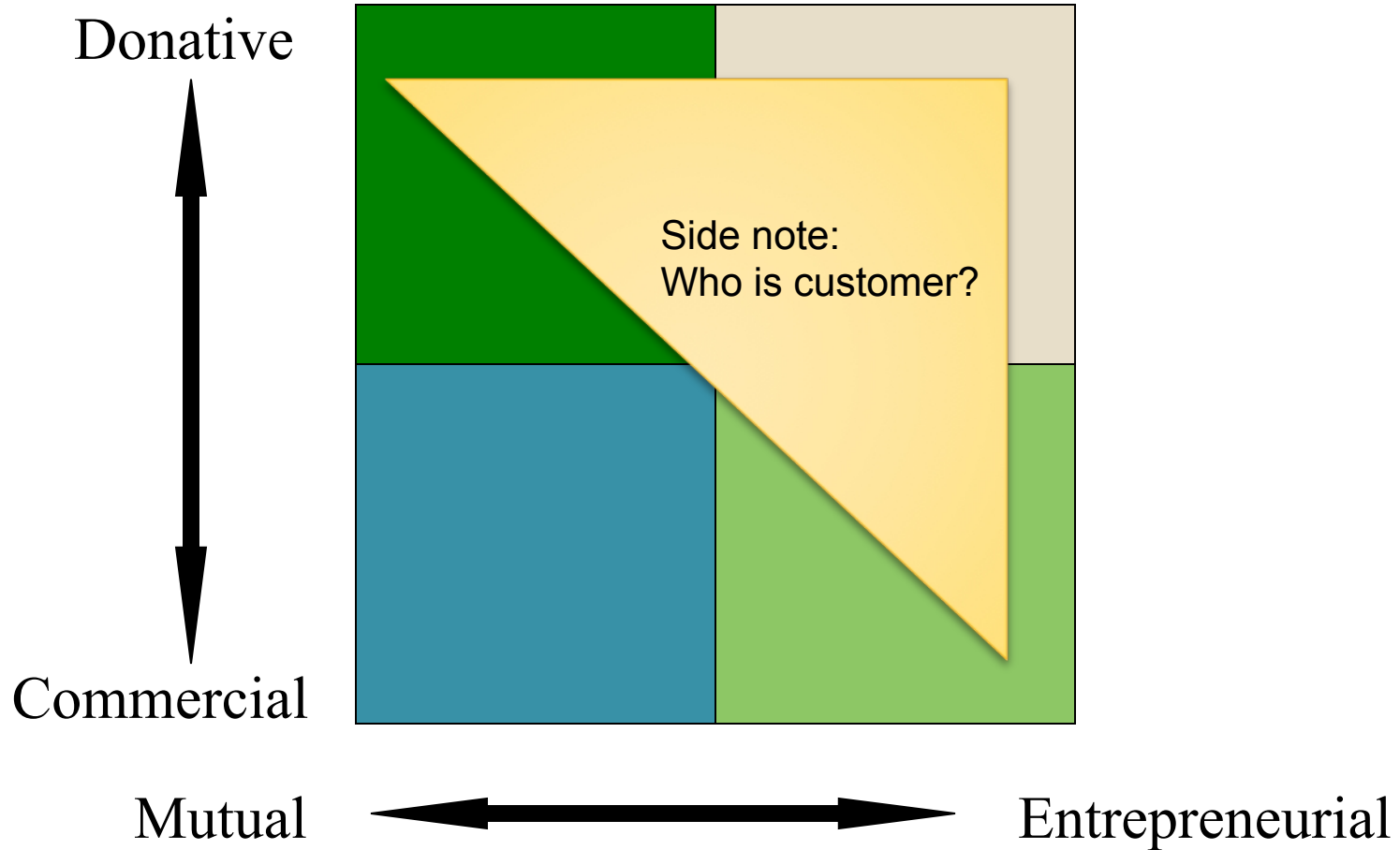
- Expansion on economic and political theory readings
- Synthesis into “three failures” theory
- Group exercise



# Hansmann Focus

- Economic theories premised on non-distribution constraint (and “fair compensation constraint”)

# Matrix: Funding and Control

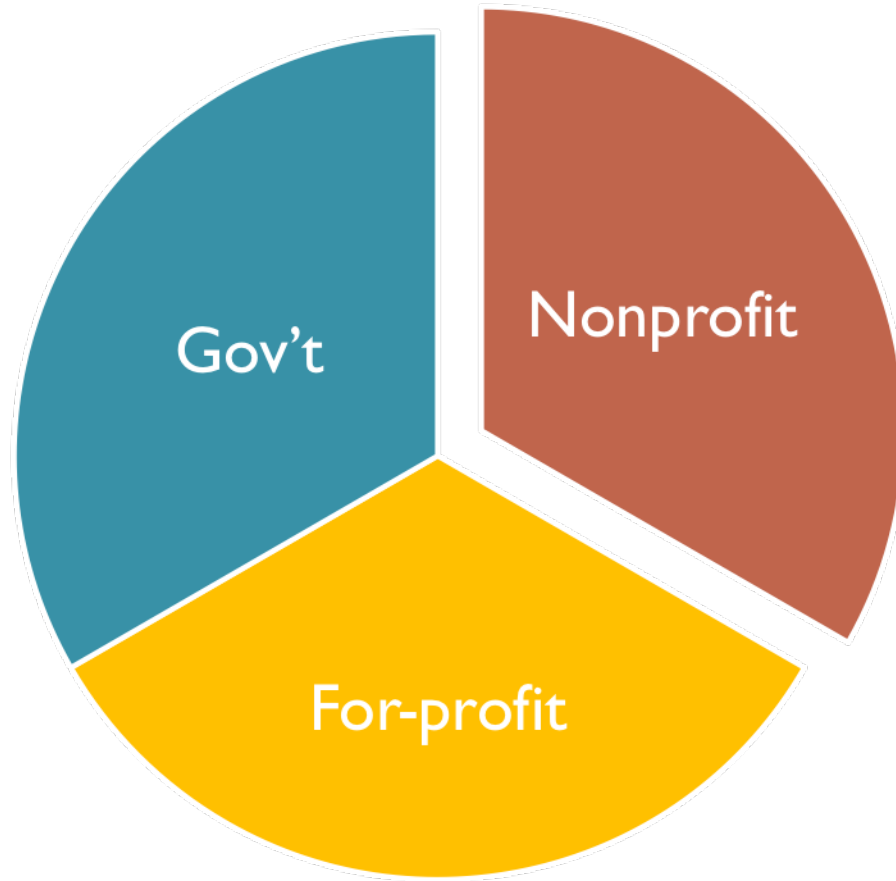






# Market & Government Failures

# A Market Share Perspective



# Failure I: Under-Provision of Collective Goods

- **Pure public good:**
  - “nonrival”
  - “nonexcludable”
  - e.g., national defense
- **Market fails because:**
  - Everyone free rides
- **Government fails because:**
  - Responds primarily to broad and political needs
- **So nonprofits respond by:**
  - Providing public goods (“collective goods”). A gap-filling role.

## Failure 2: Overexclusion from Excludable Collective Goods

- **Allocative inefficiency**
  - Excluding consumers from goods that can be provided without detriment to others (pareto efficiency)
- **Market fails because:**
  - Market limits access to paying customers
- **Government fails because:**
  - Insufficient provision, regulation, or subsidy
- **Nonprofit responds by:**
  - Enabling better price discrimination and cross-subsidy

# Failure 3: Contract Failure

- **Trust**
  - Difficulty assessing quantity or quality of service (e.g., Haiti!!)
- **Market fails because:**
  - Incentive to “cheat”
- **Government fails because:**
  - Insufficient enforcement, regulation, or monitoring
- **Nonprofits respond by:**
  - Trust through non-distribution

# Wyclef!

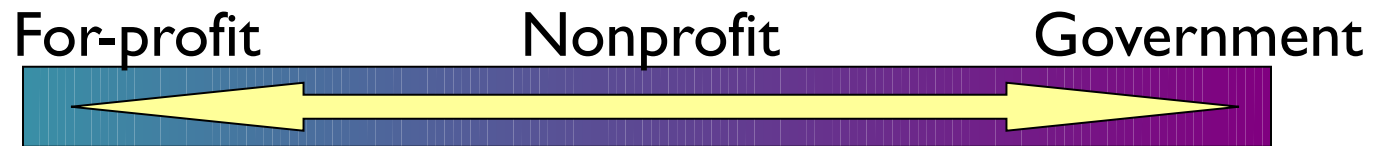


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# Side note: Agency and inputs

- Easley and O'Hara
  - When outputs are not policeable, nonprofits more efficient due to higher accountability via tax and corporation law authorities:
    1. Compensation: fair compensation constraint
    2. Allocation of purchase price: non-distribution constraint
    3. Effort: minimal observable



Low Accountability Mechanism  
(Low Bureaucracy)

High Accountability Mechanism  
(High Bureaucracy)



# Other Economic Theories



# Subsidies Theory

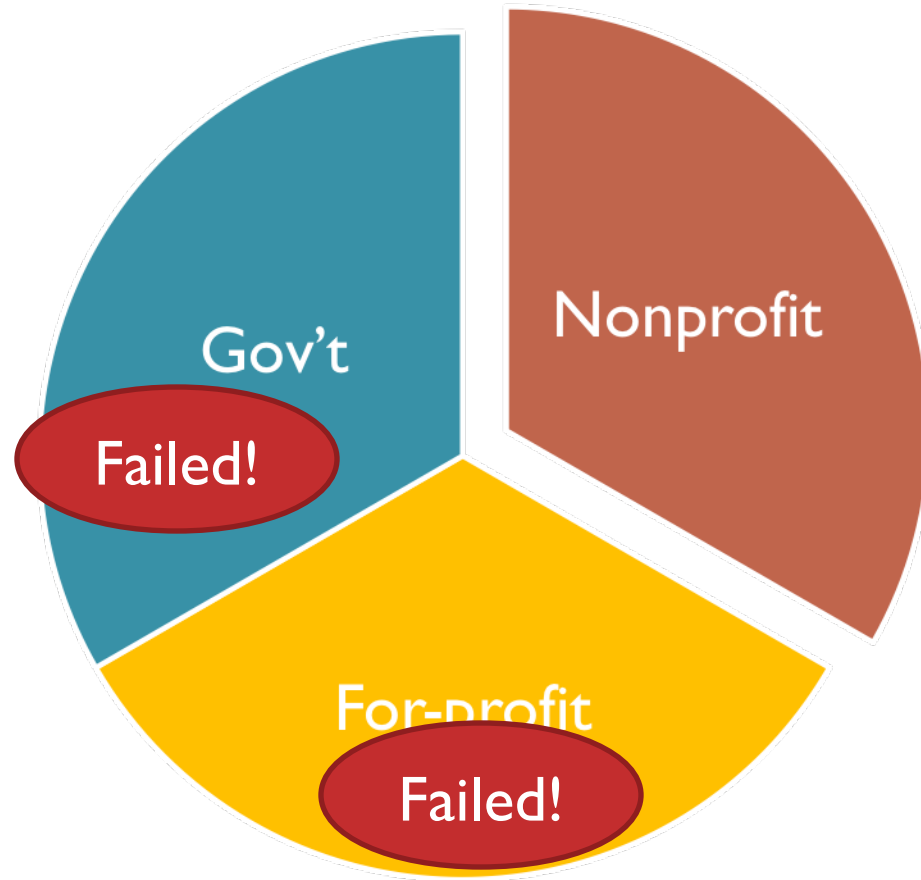
- Tax exemptions for organizations and donors, postal rates, bond financing
- Enhances market share
- But always balanced by other constraints (e.g., attracting capital, compensation constraint, etc.)



# Consumer Control theory

- Mutual benefit organizations
- Control to avoid exploitation
- Reaction to monopoly

# Still more “failure” to consider...



# Voluntary Failure theory (not in readings!)

- **Philanthropic insufficiency:** Under-donation because of free rider concerns (of individuals AND government)
- **Philanthropic particularism:** Focus on specific subgroups yields gaps and redundancies
- **Philanthropic Paternalism:** Clients don't vote for nonprofits like they do for government!
- **Philanthropic Amateurism:** Tendency to rely on less credentialed workers, particularly for moral (vs. technical) issues

# Three Failures Theory





**Next: Political Theories**

# Managing Free Riders

- Services can remain voluntary until supporters' contributions no longer have significant impact
- “State action is voluntary action made universal”

# Categorical Constraint

- State distribution of benefits must be seen as equitable
- Voluntary sector has no such constraints
- Gap filler!



# Categorical Constraint: Diversity

- Greater diversity of social provisions
- Supplemental public good
- Nonprofits are 'first casualty of totalitarianism' (Douglas)

# Categorical Constraint: Experimentation

- Diversity
- Flexibility (e.g., abandonment)
- “Balance is not necessarily a desirable objective”
  - Enable unpopular and eccentric
  - Policy implications?
- Note – Office of Social Innovation



From today's Ford School Event: "Harlem Children's Zone is effective at increasing the achievement of the poorest minority children. Taken at face value, the effects in middle school are enough to close the black-white achievement gap in mathematics and reduce it by nearly half in English Language Arts. The effects in elementary school close the racial achievement gap in both subjects."

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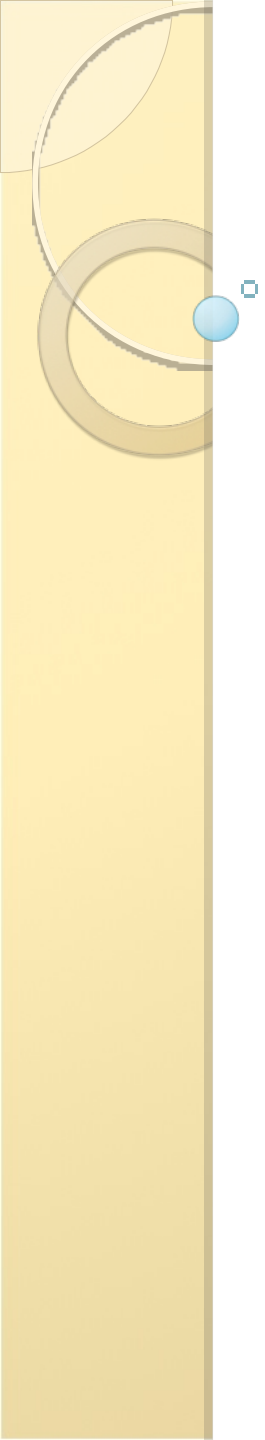
# Categorical Constraint: Bureaucratization

- Public/political accountability add bureaucracy to government
- Nonprofits: market mechanism accountability



# Political Nonprofits

- Promote democratic ideals
- Facilitate compromise and make it harder to achieve



**So What?**



# Policy

These competing theories are the building blocks for:

Understanding

Making

Defending or Attacking

Role of the sector!



# Management

- Informs strategy and decision-making
- Informs role of organization within community/society
- Informs the interplay with other two sectors: complementary strengths, competitive (dis)advantages