Author(s): Neel Hajra, 2010

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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

Donative

Commercial

Mutual

Entrepreneurial

Side note:
Who is customer?

Neel Hajra
Market & Government Failures
A Market Share Perspective
Failure 1: 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!

Source: Harrywad, Wikimedia Commons
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

<table>
<thead>
<tr>
<th>For-profit</th>
<th>Nonprofit</th>
<th>Government</th>
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<tbody>
<tr>
<td>Low Accountability Mechanism (Low Bureaucracy)</td>
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<td>High Accountability Mechanism (High Bureaucracy)</td>
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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…

Gov’t Failed!

Nonprofit

For-profit Failed!
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

No Sector Is "First"

Voluntary Failure

Gov't Failure

Market Failure
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.”

Harlem Children's Zone talk at University of Michigan, 2010
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