



Institute for Policy Studies
Center for Civil Society Studies

**The Johns Hopkins Comparative
Nonprofit Sector Project**

Lester M. Salamon, Director

**DEFINING THE NONPROFIT
SECTOR: THE UNITED STATES**

by
Lester M. Salamon

JOHNS HOPKINS
UNIVERSITY

Working Papers
of the
The Johns Hopkins Comparative Nonprofit Sector Project

Lester M. Salamon, Director
Helmut K. Anheier, Associate Director

**DEFINING THE NONPROFIT SECTOR:
THE UNITED STATES**

Lester M. Salamon
Johns Hopkins University

1996

Suggested form of citation:

Lester M. Salamon. "Defining the Nonprofit Sector: The United States." *Working Papers of the Johns Hopkins Comparative Nonprofit Sector Project*, no. 18, edited by Lester M. Salamon and Helmut K. Anheier. Baltimore: The Johns Hopkins Institute for Policy Studies, 1996.

ISBN 1-886333-22-X

© The Johns Hopkins University Institute for Policy Studies, 1996
All Rights Reserved

Comparative Nonprofit Sector Project
Institute for Policy Studies
The Johns Hopkins University
Baltimore, Maryland 21218
U.S.A.

PREFACE

This is one in a series of Working Papers produced by The Johns Hopkins Comparative Nonprofit Sector Project, a collaborative effort by scholars in over twenty countries to understand the scope, structure, and role of the nonprofit sector using a common framework and approach.

The Working Papers provide a vehicle for the initial dissemination of the work of the Project to an international audience of scholars, practitioners and policy analysts interested in the social and economic role played by nonprofit organizations in different countries, and in the comparative analysis of these important, but often neglected, institutions.

Working Papers are intermediary products, and they are released in the interest of timely distribution of Project results to stimulate scholarly discussion, and to inform policy debates. A full list of these papers is provided on the inside of the back cover.

The production of these Working Papers owes much to the devoted efforts of our project staff, in particular Regina Rippetoe, as the program manager, and Wendell Phipps, the project's secretary. We also want to express our deep gratitude to our colleagues on this project, to the International Advisory Committee that is helping to guide our work, and to the many sponsors of the project listed at the end of this paper.

The views and opinions expressed in these papers are those of the authors and do not necessarily represent the views or opinions of The Johns Hopkins University, its Institute for Policy Studies, or any of its officers or supporters, or the series' editors.

We are delighted to be able to make the early results of this project available in this form and welcome comments and inquiries either about this paper or the project as a whole.

Lester M. Salamon
Project Director

Helmut K. Anheier
Associate Project Director

The Johns Hopkins University
Institute for Policy Studies

DEFINING THE NONPROFIT SECTOR: THE UNITED STATES¹

Introduction

The United States has perhaps the most self-conscious and highly developed concept of a distinctive nonprofit sector. In fact, the existence, indeed the profusion, of nonprofit organizations has been one of the defining features of the American experience at least since the early 1800s, when Alexis de Tocqueville declared it to be the major factor explaining how America was able to avoid the dangers of tyranny and barbarism despite its highly individualistic culture. "In democratic countries the science of association is the mother of science," declared the perceptive Frenchman, "The progress of all the rest depends upon the progress it has made" (de Tocqueville, 1845 [1945]:116).

Yet there is a certain irony in America's reputation as the paragon of nonprofit action. For one thing, while nonprofit associations and organizations have a long history in America, the notion of a distinctive nonprofit sector sharing common characteristics is a relatively recent, and still not fully accepted, concept. In addition, American attitudes toward such organizations have historically exhibited a certain ambivalence. On the one hand, such organizations are prized for their celebration of individual initiative. On the other, however, they run afoul of deep-seated populist sentiments against concentrated economic power and elitism.

Lacking a strong tradition of solidarity, either in the French sense of "fraternity" or the later continental socialist sense of working class consciousness, America's support for the nonprofit sector has actually been more problematic than current rhetoric might suggest. That the United States would develop a strong concept of an independent nonprofit sector was therefore by no means preordained. To be sure, such a concept finds support in traditional American values of individualism, hostility to centralized power, and separation of church and state. However, these values proved perfectly consistent with a pervasive collaboration between the public and private sectors throughout the colonial period and the first century of the nation's existence. Not until the latter nineteenth century, in fact, did the concept of a separate and distinct private nonprofit sector really emerge. It did so, moreover, as part of a broader effort that was then underway to establish an undisputed sphere of private business action unrestrained by the social and political demands being pressed through the state. In the process, the historic American practice of relying on voluntary organizations to meet community needs was transformed from a pragmatic necessity into a political ideology, which became, in the latter nineteenth and early twentieth centuries, a rallying cry for conservative opposition to the extension of government social welfare protections and a rationalization for formerly unparalleled concentrations of wealth. While this ideology of voluntarism elevated the image of voluntary, nonprofit institutions in American life, however, it also created a powerful mythology that continues to obscure key facets of the way these institutions actually function.

¹ Lester M. Salamon is the Director of the Johns Hopkins University Institute for Policy Studies.

Unraveling the true character of the nonprofit sector in the American setting thus turns out to be considerably more complex than is often assumed. To do justice to the topic, it is therefore necessary to look briefly at the historical and social context within which these organizations have developed, the legal framework that defines their basic structure, and the recent trends influencing their evolution. Only then will it be possible to assess the extent to which the "structural-operational definition" developed to examine these organizations in the context of comparative analysis actually applies to the American case.

Background: Toward an Ideology of Voluntarism

Early Ambivalence

That America would develop a powerful ideology of voluntarism as its distinctive contribution to the practice of social policy, and that this ideology would retain its vigor as a powerful basis for rearguard resistance to the extension of the modern welfare state, was hardly self-evident in the first hundred years of the nation's existence, or in the colonial era that preceded it. To be sure, a veritable profusion of associations made their appearance on the American scene early in the country's history. "We have societies for everything," James Walker, later President of Harvard College, thus reported ten years before Alexis de Toqueville's historic visit. "Scarcely a month passes in which we are not called upon to join, or aid, some benevolent association" (Walker, 1825:241). Nor did this penchant for voluntary association dissipate as the century wore on. To the contrary, it seems to have grown in force (Bremner, 1980).

Several factors seem to have accounted for this phenomenon. One of these certainly was the deep-seated hostility to royal power and centralized state authority that the religious non-conformists who helped populate the American colonies brought with them when they fled the Old World. Hostile to state power, they were inclined to do things for themselves. This sentiment was reinforced, moreover, by the spirit of individualism that quickly took root in the seemingly boundless open spaces of the New World. In a sense, the formation of voluntary associations offered a compromise between the extremes of rampant individualism and dependence on monarchical power. It provided a way to confront common problems while still retaining a significant measure of individual initiative.

The arrival of large numbers of new immigrants in the mid- and latter nineteenth century, moreover, added a further impetus to the formation of nonprofit associations: the impetus of communal identity and mutual aid. Nonprofit organizations formed along ethnic and religious lines provided vital mechanisms for newcomers to acclimate themselves to the American scene and cope with the challenges of urbanization and industrialization that were newly overtaking American life (Bremner, 1956; Katz, 1986: 62-3). They did so, moreover, with a spirit of self-help and mutual aid that simultaneously built pride and self-respect.

Powerful though these factors may have been in encouraging the growth of voluntary organizations in eighteenth and nineteenth century America, however, it is easy to exaggerate their

importance. For one thing, the impact of at least some of these sentiments on associational life was by no means wholly positive. Individualism, for example, can be quite corrosive of associational bonds. Alexis de Tocqueville, the Frenchman whose 1845 book, Democracy in America, first drew attention to the vital link between democracy and associations, himself recognized this when he acknowledged that “[u]nhappily, the same social condition [i.e. equality] that renders associations so necessary to democratic nations renders their formation more difficult among those nations than among all others” (de Tocqueville, 1845 [1945]:116). Individualism is thus something to be overcome in the formation of voluntary associations, not something to rely on.

What is more, individualism, hostility to centralized power, and ethnic identity were not the only impulses at work in early American culture. Side-by-side with these sentiments were strong currents of anti-corporatism, anti-elitism, and a penchant for popular control even of presumably private institutions that hardly encouraged the development of at least the more institutionalized portions of the charitable sector. To the contrary, as Peter Dobkin Hall has reminded us, private corporations and trusts were associated in colonial and post-Revolutionary America with the “corruptions of the Stuart monarchy and the Church of England” (Hall, 1987:3). Even esteemed educational institutions like Harvard College thus found themselves under attack as a consequence.¹ Democratic forces in many colonial and early state governments actively resisted efforts to incorporate eleemosynary or other institutions and denied courts the equity powers needed to enforce trusts. Thus, New York State passed laws limiting the ability of charitable institutions to build up endowments while Virginia enacted a statute transferring all property given for charitable purposes into the hands of county overseers for the poor rather than leave them for private institutions to manage (Hall, 1987:4-5).

To an important degree, therefore, associations flourished in the American setting *despite*, rather than because of, the prevailing culture. What gave impetus to the formation of associations, was not sentiment so much as pragmatism and necessity. Unlike Europe, society came into existence in America prior to the state. Americans therefore had to devise ways to provide themselves with essential services that other societies naturally relied on the state to supply. As James Walker explained:

Such is the distribution of property amongst us, and such the nature of our government, that individuals here can never hope to rival the splendid acts of princely munificence sometimes recorded of the old and immensely rich families of other countries; neither can we expect the same degree of legislative patronage. Much, therefore, of good that is effected elsewhere by private munificence, or royal and legislative patronage, can be effected here only by voluntary associations. It is idle to say of this, that it is not our best resource, for we have no other (Walker, 1825).

Reflecting these pragmatic origins, early American nonprofit institutions lacked the purity that is now often ascribed to them. To the contrary, they blended public and private roles in ways that defy categorization. Private corporations were granted state charters on condition that they perform

public functions and, often, provide for a degree of public control. Even many of the commercial corporations established during the colonial era and the first half century after independence--such as banks, turnpike companies and railroads--were viewed as essentially *public* institutions (Hartz, 1948). In the case of eleemosynary institutions, such as colleges and hospitals, the sense of public purpose was even stronger. Such institutions were conceived to be part of the public sector since they served essentially public purposes. Consistent with this, they were supported in important part by governmental subsidies and often included public officials on their governing boards. Well into the mid-nineteenth century, for example, the Yale College board included the Governor of Connecticut and six members of the Connecticut legislature, and similar patterns were evident in other such institutions (Whitehead, 1973; Stevens, 1982).

As new nonprofit organizations surfaced to cope with the growing social and economic needs of the post-Civil War era, moreover, this widespread collaboration grew apace. A survey of seventeen private hospitals in 1889, for example, revealed that 12 to 13 percent of their income came from government (Stevens, 1982). This pattern was even more evident in the field of social services, where hundreds of mutual aid societies and children's agencies--many of them ethnically and religiously based--surfaced in the 1870s and 1880s. A study of 200 private organizations for orphan children and the friendless in New York in the late 1880s showed, for example, that twice as much of their support came from taxpayers in the form of government grants as from legacies, donations, and private contributions (Warner, 1894:337). Nor was this practice restricted to New York. To the contrary, a turn-of-the-century survey found that as of 1901 public subsidization of private, charitable institutions was in evidence in all but two territories and four western states (Fetter, 1901/02:376).

In short, reliance on nonprofit organizations and associations was widely viewed as a necessity in nineteenth century America, but not yet a virtue. Americans turned to associations in pragmatic fashion to address challenges they could not handle individually, but they retained a healthy skepticism toward the institutional embodiments these associations took, denying them corporate status and restricting their ability to assemble self-perpetuating assets without a corresponding guarantee of their "public" character and dedication to public purposes. Instead of a rigidly demarcated nonprofit sphere, what existed instead was an easy-going blending of public and private action that nicely matched the twin sentiments of anti-statism and anti-corporatism then in vogue.

The Advent of Voluntarism as an Ideology

Between the end of the Civil War and the Great Depression, however, a sharp shift occurred in this generally pragmatic attitude. Instead of a practical adaptation to the circumstances of non-statist America, reliance on charitable institutions was elevated into a high moral principle, and ultimately a political ideology. In the process, the widespread practice of government-nonprofit collaboration was overlaid by a pervasive paradigm of conflict stressing the inherent tensions between the nonprofit sector and the state.

What accounted for this shift was the broader series of social, economic, and political changes that accompanied America's transformation from a rural-agrarian society into an urban-industrial one. Crucial to this transformation was the emergence of the joint stock company as a powerful instrument for amassing economic power and effecting change.² Armed with this instrument business leaders proved able to accomplish prodigious feats that ultimately convinced them that they no longer needed the state to advance their economic goals. To the contrary, the state and the notions of "democratic capitalism" with which it was all too often associated at the time came to be seen as a definite hindrance to the promotion of business interests. Accordingly, it became imperative to liberate the corporate form from the public controls and expectations that had attended its use up until then. This, in turn, required the invention of a separate "private sector" sharply differentiated from the public sector and free of its democratic constraints (Hartz, 1948; Nielsen, 1979).

This project of invention dominated American political and economic discourse from the end of the Civil War to the end of World War I. Most important for our purposes, moreover, it embraced not only the private *for-profit* sector, but also the private *nonprofit* one. Just as private business interests sought to banish government from its involvement in the economic sphere, so they sought to accomplish a similar goal in the field of charitable endeavor. Nonprofit organizations came to be defended not simply as useful supplements to public action, but as superior vehicles for meeting public needs. In pursuit of this agenda, new nonprofit organizations were formed in such fields as education, health, charity care, and the arts; and efforts were launched to free those already in existence from public influence and control (though rarely from public support). What is more, new doctrines were developed to justify separation between the two.

In the field of care for the poor, for example, a new doctrine of "scientific charity" emerged. According to this view, the root causes of poverty and distress lay in the bad habits and sloth of the poor. Because public agencies tend to provide aid too indiscriminately and unconditionally, they actually encourage pauperism. Private charity, by contrast, can deal with the root causes of pauperism by restricting assistance to the truly deserving and coupling it with the personalized moral suasion needed to induce the poor to overcome their vices (Bremner, 1980:32-3 202-3; Katz, 1986:64-84). In the face of widespread economic dislocation resulting from rapid urbanization and industrialization in the latter nineteenth and early twentieth century, therefore, charity advocates, armed with this doctrine, became ardent opponents of the extension of government poor relief. In the depths of the 1873 depression, for example, charity leader Louisa Lee Schuyler advised New York State officials to *reduce* the levels of public assistance outside of almshouses lest they encourage an inflow of paupers and recommended that responsibility for coping with the needs of the poor be thrown instead "entirely on existing private charity" (Schuyler, 1873). Similar arguments were used to terminate "outdoor" poor relief not only in New York City, but in Brooklyn, Buffalo, Indianapolis, Philadelphia, and Chicago as well (Bremner, 1980: 200).

Contributing to this new faith in the virtues of voluntarism and private charity, and to the concept of an inherent conflict between the nonprofit sector and the state that accompanied it, was a massive growth of personal fortunes and the propagation of a new "gospel of wealth" about what

to do with the resulting riches. As articulated most forcefully by steelmaker-turned-philanthropist Andrew Carnegie, this gospel married Social Darwinism with Christian concepts of charity to make it a religious (and social) obligation of those whose natural superiority enabled them to amass great wealth to contribute this wealth to improve society (Carnegie, 1889). These developments made it possible to imagine that private charity might truly serve as a substitute for public action in providing for public needs, and a superior substitute at that.

How much the resulting set of ideas was motivated by sincere belief in the superiority of private voluntary institutions and private charitable effort as opposed to governmental assistance, and how much it was motivated by a desire to enforce work discipline, resist pressures for mandatory expansions of government social-welfare protections, and rationalize growing disparities of wealth is difficult to say. Very likely all of these factors were at work. What is clear, however, is that a powerful ideology of voluntarism took shape that posited an inherent conflict between the nonprofit sector and the state and put the nonprofit sector forward not as a supplement to the state but as an alternative to it. In the process, the ideal of voluntarism was thoroughly politicized, emerging by the latter nineteenth century as the principal rallying point for resistance to expanded public aid to cope with the growing poverty and misery that rapid urbanization and industrialization were creating. Not only did the ideology of voluntarism come to suffuse the contemporary policy debate, moreover; it was projected backward in time to create a fanciful image of historic separation between government and the nonprofit sector that could help justify the new view. Although the separation portrayed in this image finds little support in the historical record, it nevertheless quickly became part of national folklore, obscuring reality for decades to come (Nielsen, 1979: 25-49).

In short, the concept of a distinct nonprofit sector was a late nineteenth century invention in America, and one with powerful--and ultimately highly effective-- political overtones. By creating a potent ideology of "voluntarism" and investing it with mythic status as the best and true expression of the American character, conservative forces effectively held the state at bay for two generations despite deteriorating social and economic conditions, and despite the clear inability of private philanthropy to live up to the expectations claimed for it. That this was possible is a tribute to the hold of the ideal of individualism and opportunity on the American psyche, to the harsh politics of ethnicity that impeded the development of a true workers' movement in America to challenge the hold of the prevailing economic powers-that-be, and to the reputation for corruption that unfortunately enveloped many public institutions during this period. Whatever the cause, by the early twentieth century the notion of voluntarism and the vast network of institutions it had nurtured had become a highly politicized and profoundly conservative force in America, "the great American substitute for social action and policy," as historian Roy Lubove has described it. "[V]oluntary institutions," notes Lubove, "failed to respond to mass needs, but thwarted government efforts to do so" (Lubove, 1968:2).

Myth vs. Reality in the Great Society Era

Not until the Great Depression of the 1930s and the resulting Democratic electoral victory of 1932 was it possible to break the hold of this powerful social myth and establish a national system of basic social welfare protections. The resulting New Deal breakthrough, though significant, however, was far from complete, either programmatically or conceptually. Programmatically, the New Deal social protections left immense gaps both in coverage and in basic program design. Conceptually, the ideal of voluntarism remained firmly lodged in the pantheon of American symbols, available for resurrection when circumstances required.

When poverty was “rediscovered” in the 1960s, therefore, occasioning powerful new calls for federal involvement, the resulting response had to be largely indirect. Instead of establishing a system of direct federal assistance to supply the services considered necessary to allow individuals to break the cycle of poverty in which they were thought to be entrapped, the federal government was obliged to rely instead on state and local governments, and private nonprofit groups. The era of the Great Society of the 1960s and 1970s was not, therefore, an era simply of massive expansion of the federal government, as it has come to be portrayed. Rather, what expanded was a pervasive partnership between government and the nonprofit sector, thus returning to a pattern with deep roots in the American past.³ By the late 1970s, in fact, nonprofit organizations were delivering a larger share of *government-financed* human services than all levels of government combined, and government support had outdistanced the support these institutions received from private charitable donations by a factor of almost two to one (Salamon, 1987:99-117; Salamon, 1995). In the process, the American nonprofit sector underwent one of the most dramatic expansions in its history, growing substantially in both size and scope. This expansion took place, moreover, not *in spite of* the growth of government, as the “paradigm of conflict” would have us believe, but in large part *because of* it.

Nevertheless, so powerful has the continued hold of the ideology of voluntarism and its accompanying paradigm of partnership been on American thinking that this development largely escaped notice until relatively recently, and even then has been greeted with considerable suspicion.⁴ One reason for this is that both those on the political Right and those on the political Left have had reason to downplay the reality of partnership and retreat to the paradigm of conflict instead.

For those on the Right, belief in an inherent conflict between government and the voluntary sector has remained a potent instrument for fending off further extensions of the modern welfare state. Indeed, this cultural icon gained a new lease on life as a result of the bureaucratic excesses of twentieth century totalitarianism, which seemed to validate conservative warnings about the consequences that too great a reliance on the instrumentalities of the modern state would have on the survival of voluntary institutions (Nisbet, 1962). So strong were the blinders that this ideology fastened on conservative thinking, in fact, that a major project on “mediating structures” at the American Enterprise Institute in the mid-1970s could surface as its major recommendation the suggestion that government should make use of private, nonprofit groups to deliver publicly financed

social services without ever recognizing the massive extent to which the programs of the Great Society were already doing exactly this (Berger and Neuhaus, 1977).

But those on the political Left have had their own reasons to operate within the prevailing paradigm of conflict. With conservatives idealizing the voluntary sector and demonizing the state, liberals found it necessary to discredit voluntarism and private philanthropy in order to justify state involvement. This process was already well along during the Progressive era at the turn of the century, as reformers attacked the practice of government subsidization of private charities not on grounds that it undermined the independence of charities but on grounds that it “gave over the defenseless to the care of the irresponsible” and squandered resources needed to establish a modern, public system of care (Warner, 1894:354). With Herbert Hoover championing voluntary action as the solution to the Great Depression, advocates of federal intervention intensified their attacks, thus effectively surrendering the symbols of voluntarism and nonprofit action to conservatives and accepting a paradigm that made it seem necessary to oppose the nonprofit sector in order to support an expansion of governmental aid. When the Great Society turned massively to nonprofit organizations to deliver new federally funded social service programs in the 1960s, therefore, few on the left were willing to acknowledge, let alone defend, the resulting partnership lest it inadvertently lend support to the conservative position about the virtues of voluntary action. Indeed, during the 50 years of liberal ascendancy, from the election of Franklin Delano Roosevelt in 1932 to the election of Ronald Reagan in 1980, the nonprofit sector essentially disappeared from the nation’s policy discourse, as attention came to focus instead on the dramatic expansion of the state. Judging from either the public or scholarly attention it attracted, one could easily have concluded that America’s voluntary sector largely ceased to exist sometime around the early 1930s and had not been heard from since. Even the emergence during the 1960s and 1970s of a progressive new voluntarism in the form of consumer, environmental, civil rights, anti-war and related public interest movements hardly altered the widespread neglect to which the nonprofit sector qua sector was treated during this period. It thus remained possible for Ronald Reagan to reclaim the banner of voluntarism without contest in 1980 and ride to power promising to help the nonprofit sector by rescuing it from the harmful intrusions of the state.

In short, the nonprofit sector has come to be viewed in America through a powerful social myth. This myth idealizes the nonprofit sector and demonizes the state. In the process, it obscures central realities about each and denies the possibility of fruitful collaboration between the two. This myth has persisted, moreover, in the face of massive growth in cooperation between nonprofit organizations and government agencies at all levels. The result is an awkward duality in American thinking about the nonprofit sector and a lack of legitimization of one of the central features of modern American society. Not surprisingly, clear comprehension of this sector, even in America, has suffered as a consequence.

Types of Nonprofit Organizations

Terminology

Given the somewhat contested position of the nonprofit sector in American political history, it should come as no surprise that considerable disagreement exists about the appropriate terms to use to refer to the organizations that comprise it. Each of the many possible terms carries a bit of political baggage because it highlights one facet of the operation of these organizations while throwing others into the shadows. Each is therefore at least partly misleading.

Nonprofit. Perhaps the most general of these terms, and the one that will be used here, is *nonprofit organization*. This term is probably the most neutral since it emphasizes the most basic defining feature of this set of organizations: the fact that they do not exist to generate profits for their owners or directors. However, this term is also rather negative, identifying this set of organizations in terms of what they are *not*, rather than in terms of what they are. What is more, in a culture that measures success in terms of profitability, it somehow suggests failure. Finally, it is not, strictly speaking, accurate since it falsely conveys the impression that these organizations cannot generate profits when in fact it is not the *generation* of profit but its *distribution* to owners or directors that is prohibited. A more precise rendering would therefore identify these organizations as *not-for-profit* rather than simply *nonprofit*.

Charity. A more popular term for referring to nonprofit organizations is *charities* or *charitable organization*. This is the term encountered most often in the press and in popular accounts. Its great appeal is that it identifies this set of organizations with aid to the needy, which is the common definition of "charitable." In addition, it emphasizes the support these organizations receive from private donations. In both respects, however, this term is problematic. In the first place, as will become clear below, the term "charitable" has a special technical meaning derived from English common law that goes well beyond care for the needy. It embraces arts, culture, education and other activities as well that, while contributing to public welfare, do not necessarily target the poor. Using the term "charitable" to refer to this sector thus creates a false, if pleasing, image of what this sector really embraces. In addition, while private contributions are important to this set of organizations, they are hardly the only, or even the major source, of support. On both counts, therefore, the term *charitable* creates as many problems as it solves.

Voluntary. A third term sometimes used to refer to the range of organizations under consideration here is *voluntary organizations*. More common in the U.K. than in the U.S., this term emphasizes the important role that volunteers and voluntarism play in the life of these organizations. As such, it conveys the same positive image of the sector as does the term "charitable." However, this too is more a prescriptive than a descriptive term since much of the activity of the organizations to which it is applied is actually carried out by paid staff, not volunteers.

Independent. The same is true about a fourth term increasingly used to refer to this set of organizations: *independent sector*. This term emphasizes the special role such organizations play as a counterpoise to the state and a vehicle for independent citizen involvement in social and political life. In practice, however, as we have seen, while the nonprofit sector does function outside the administrative structures of the state, it is hardly independent of the state. To the contrary, it is engaged in a widespread, and generally quite productive, partnership with government in a wide assortment of different spheres. Not *independent sector* but *interdependent sector* would therefore probably describe the reality of state-nonprofit relationships more accurately in the American context, but the term *independent sector* nevertheless still has great political attractiveness and prescriptive appeal.

Tax-exempt. Finally, the nonprofit sector is often referred to as the *tax-exempt sector* in the United States. This term is probably the most accurate in technical terms since, as will become clear below, it is largely through the tax laws that these organizations have come to be legally defined in the United States. In particular, the federal tax code identifies some twenty-six different classes of organizations that are entitled to exemption from federal income taxation. The problem, however, is that the idiosyncracies of American tax law make this a difficult term to use in cross-national work since it does not really identify a conceptually coherent set of institutions.

Legal Status

Given the ambiguities of the available terminology, it is useful to look a bit more closely at the legal treatment of nonprofit organizations in the American setting. This treatment is naturally shaped by certain underlying features of the U.S. legal structure, most notably its combination of a common law legal system with a written Constitution and its federal governmental structure featuring a sharing of power between a national government and fifty state governments that have their own elected officials and their own sovereign authority. These circumstances make the legal position of the nonprofit sector in the United States far more complex and disjointed than the significant size and scope of this sector might suggest. No single body of law guarantees the existence of this set of institutions or defines its treatment in law. Nor is the right to form such organizations explicitly guaranteed. The closest one comes to an explicit guarantee of the right to form nonprofit organizations is in the First Amendment to the U. S. Constitution, which guarantees citizens the right to free speech and to assemble peaceably to petition the government. In addition, the national constitution prohibits government interference with religion, thereby implicitly granting religious organizations an inherent right to exist. Beyond this, nonprofit organizations are governed by a multitude of separate state and national laws relating separately to incorporation and taxation.

Unifying this somewhat disjointed set of legal provisions, however, is a deep-seated philosophic conviction that has developed over the course of U.S. history about the inherent right of Americans to form private associations and assemble private resources to pursue a wide variety of peaceful ends. This conviction, which reflects the deeply ingrained American aversion to concentrated governmental power, has been firmly enshrined in case law and in a variety of concrete

legal provisions granting special tax and other advantages to such private organizations. Though not explicitly guaranteed in basic laws, therefore, the overwhelming sense enshrined in the history of legal development in the United States is that the formation of nonprofit organizations is a right inherently available to citizens rather than a privilege to be bestowed, or withheld, by governmental authorities.

Legal Form

Reflecting this basic legal status, nonprofit organizations can take any of three different legal forms in the United States: (1) unincorporated associations; (2) corporations; or (3) trusts.

Unincorporated Associations. Formally, any group of people can form themselves into an association and function as a nonprofit organization in the United States without any governmental approvals. As such, they can establish a bank account, accept contributions, and provide services. Assuming that they do not exist to distribute profits to their officers and directors, and that they adopt a set of basic rules spelling out the governance of their organization and the procedures that will be used to dispose of any assets upon dissolution, moreover, they can even claim exemption from the national income tax, and, by implication, from related state and local taxes as well. Beyond that, assuming that their purpose is “charitable” in the special meaning of the law, such unincorporated associations can even offer their donors deductions from tax obligations for contributions made to the organization. For much of the nation’s history, in fact, nonprofit organizations functioned in precisely this way, as unincorporated associations operating as tax-exempt entities, but without official certification to this effect from the tax authorities. In fact, many academic and professional societies, as well as some clubs, continue to do so today.

Incorporated Organizations. While nonprofit organizations are formally permitted to exist without incorporating, most such organizations in practice have sought corporate status in recent decades. The reason for this is that corporate status limits the liability that directors and officers bear for the acts of the organization. In addition, federal tax statutes stipulate that entities claiming tax exempt status must pass an “organization test” to demonstrate that they are truly an organization and not a “formless aggregation of individuals,” and incorporation is one convenient and sure-proof way to do this. Finally, incorporation eases the way to securing an official certification of tax exempt status, which provides added assurance to potential donors about the availability of tax deductions for their contributions.⁵ For all these reasons, most of the more formal components of the American nonprofit sector--e.g. schools, colleges, universities, hospitals, museums, libraries, day care centers, social service agencies, and even advocacy groups--are thus likely to incorporate.

Corporation laws in the United States are the preserve of state governments. This means that the specific details of corporate structure and obligations differ from state to state. State corporation laws govern both nonprofit and for-profit corporations, moreover, though separate laws typically exist for the latter. The principal difference between the two relates to the allocation, or “inurement,” of any profits derived from the operation of the organization. The for-profit corporation is operated for the benefit of its owners; any profits earned are privately inured, i.e. they are passed through to

those who hold an ownership share in the corporation. Unlike the for-profit corporation, a nonprofit corporation is not permitted to distribute net earnings to those who control and/or financially support the organization. Rather, any such net earnings must be plowed back into the purposes pursued by the organization.

To incorporate under state laws, nonprofit organizations must generally file an Articles of Incorporation and a set of Bylaws with the Attorney General of the state which is the organization's primary place of business. These documents spell out the purposes of the organization, indicate its adherence to the rules against private inurement, identify the incorporators and the organization's principal address, and detail the rules the organization will use to govern itself and dispose of any assets upon dissolution.

Trusts. Nonprofit organizations can also be *trusts*. A trust is essentially a body of assets dedicated to a particular purpose. Trusts are established by declarations of trust or trust agreements that place the assets in the care of a trustee. A trust is a common form of nonprofit organization where an entity is created out of the estate of a decedent, where the assets in the estate are to be used for essentially charitable purposes in the special meaning of the law, and where the resulting entity has a single purpose (e.g. financing scholarships). Many foundations are established as trusts, as are most employee benefit funds and all political action committees. However, the trust form does not provide the shield against personal liability that the corporate form does.

Types of Tax-Exempt Organizations

Although any organization that identifies a purpose other than that of distributing profits to owners or directors can normally qualify for nonprofit status under state law, a second, and somewhat more difficult, test of nonprofit status in the United States is the ability to pass muster in terms of the federal tax laws, which define a set of organizational purposes that qualify an organization for exemption from federal income taxes. Since these taxes are generally higher than state taxes, and since many states follow federal usage in their own tax treatment of nonprofit organizations, federal tax exemption has become the effectively operating defining feature of nonprofit status.

The definition of nonprofit status under federal tax law is fairly broad, however. This is so because the federal tax code stipulates more than 25 different classes of organizations that are exempted from federal income taxes based on the purpose the organization pursues. Included here are organizations as diverse as title-holding companies, war veterans organizations, and black lung trusts (see Table 11.1).

These various types of tax-exempt organizations can be grouped into two broad classes, however: (1) primarily *public-serving* organizations, also known as "charitable organizations"; and (2) primarily *member-serving* organizations. This distinction, which is based primarily on the purposes the organizations pursue, finds reflection in the way these two types of organizations are treated in the tax code. In particular, while both types of organizations are exempted from taxes on the

organization's own income, all but one sub-class of the public-serving organizations are entitled as well to receive contributions from individuals, foundations, and corporations on which the donors can claim tax deductions. The principal rationale for this is that the activities in which these organizations are engaged, because they are principally of public benefit, are likely to relieve government of burdens it would otherwise have to bear. Collecting taxes on the contributions these organizations receive would thus be counterproductive. Generally speaking, among those most familiar with the nonprofit field, the term "nonprofit sector" is reserved for these public-serving organizations whereas the broader term "tax-exempt sector" is used when both types are referred to.

Table 11.1
Types of Tax-exempt Organizations under
Section 501(c) of the Internal Revenue Code

Tax Code Number	Type of Tax-exempt Organization
501(c)(1)	Corporations organized under an act of Congress
501(c)(2)	Title-holding companies
501(c)(3)	Religious, charitable, scientific, literary, educational, public safety, etc.
501(c)(4)	Social welfare organizations
501(c)(5)	Labor, agricultural organizations
501(c)(6)	Business leagues
501(c)(7)	Social and recreational clubs
501(c)(8)	Fraternal beneficiary societies
501(c)(9)	Voluntary employees' beneficiary societies
501(c)(10)	Domestic fraternal beneficiary societies
501(c)(11)	Teachers' retirement funds
501(c)(12)	Benevolent life insurance associations
501(c)(13)	Cemetery companies
501(c)(14)	Credit unions
501(c)(15)	Mutual insurance companies
501(c)(16)	Corporations to finance crop operation
501(c)(17)	Supplemental unemployment benefit trusts
501(c)(18)	Employee-funded pension trusts
501(c)(19)	War veterans' organizations
501(c)(20)	Legal services organizations
501(c)(21)	Black lung trusts

Source: U.S. Internal Revenue Service, 1990

Primarily Public-Serving Organizations

Most of the primarily public-serving nonprofit organizations in the United States qualify for tax-exemption under one section of the Internal Revenue Code, Section 501(c)(3). They are therefore often referred to as “501(c)(3) organizations.”

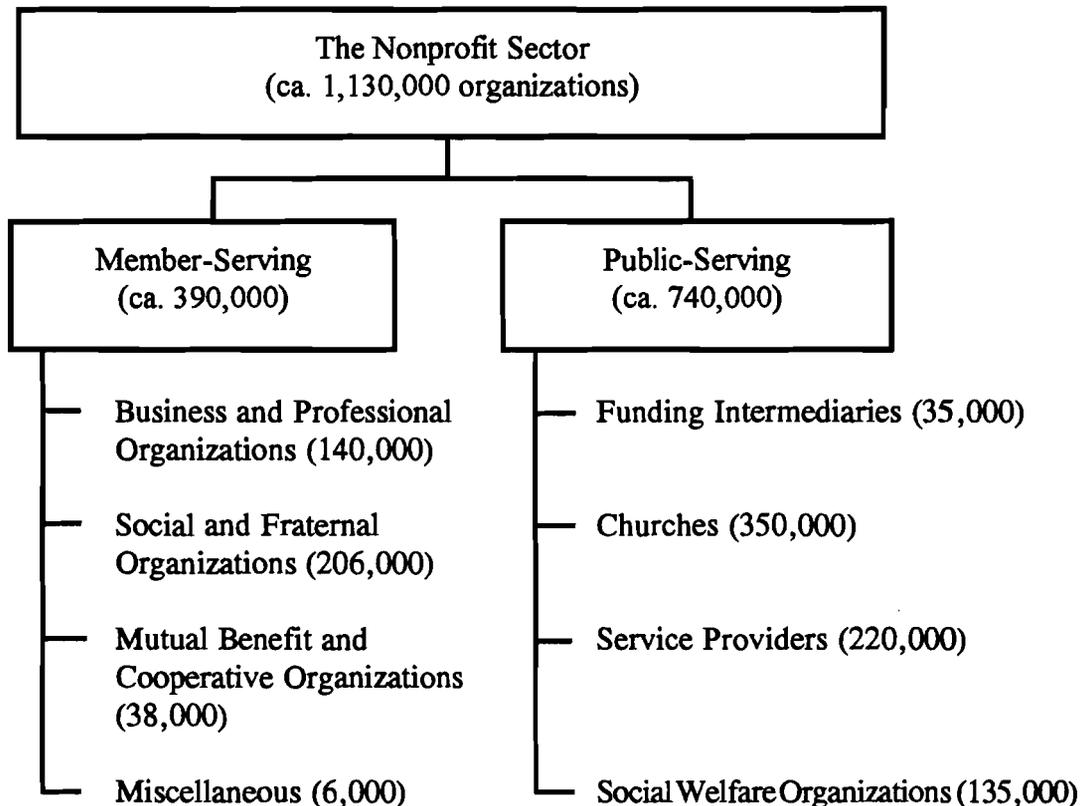
Section 501(c)(3) of the U.S. Internal Revenue Code defines a broad set of purposes under which organizations can claim exemption from federal income taxes. Some of these purposes are enumerated in the law while others are included by implication through the use of the term “charitable” derived from the English common law tradition. The enumerated purposes include religious, scientific, educational, and literary purposes, testing for public safety, prevention of cruelty to animals, and fostering national or international amateur sports. The implied purposes embrace a much wider variety of activities that fit the English common law definition of “charitable,” which has come to embrace at least four types of purposes: the relief of poverty, the advancement of education, the advancement of religion, and a catch-all “other purposes beneficial to the community.”⁶ Section 501(c)(3) thus covers an immense range of public-benefit organizations, indeed most of what in common parlance is thought of as the heart of the nonprofit sector, including colleges, universities, hospitals, social service agencies, day care centers, nursing homes, environmental groups, civic associations, orchestras, museums, and many more.

Among these 501(c)(3) organizations, it is possible to distinguish three major subgroups, as reflected in Figure 11.1.

Religious Congregations. The first distinct type of charitable nonprofit organization in the United States is the religious organization, or religious congregation. Promotion of religion is included as one of the enumerated purposes eligible for tax exemption under Section 501(c)(3) of the U.S. Internal Revenue Code and is also one of the implied purposes covered by the term “charitable” in the English common law. However, because of the constitutional prohibition against governmental interference with religion in the United States, religious organizations--in the sense of organizations engaged in the practice of religion--have a special status in U.S. law, including nonprofit law. In particular, such organizations are exempted from the formal requirements to incorporate or to register for tax-exempt status. Rather, they are automatically considered to be tax-exempt charitable corporations whether or not they formally incorporate or register. In addition, they are formally exempt from the requirement that other nonprofit organizations face to report annually on their finances. The one stipulation is that they truly be engaged in the practice of religion, which, under IRS rules, means that they must have some set of beliefs and some set of rituals.⁷

Foundations and other Financial Intermediaries. A second distinguishable subset of charitable or public-benefit nonprofit organizations are the numerous financial intermediaries that exist within this sector. What sets these organizations apart are not the purposes they pursue but the way they go about them. Unlike service organizations, the principal function of the financial intermediary organizations is not to carry out programs or deliver services but to channel financial resources to

Figure 11.1
Major Types of U.S. Nonprofit Organizations



Source: Adapted Salamon, 1992:13. Data on member-serving organizations from U.S. Internal Revenue Service, 1990. All data for 1989.

other organizations that do. Included here are *federated funding organizations* like the United Way or the American Cancer Society, which raise money from the public to support a range of other organizations engaged in particular activities (e.g. providing social services, fighting cancer or heart disease, or promoting the arts). Also included, however, are private *foundations*, which distribute grants to other nonprofit organizations from pools of assets granted to them either by individuals (*independent foundations*) or corporations (*corporate foundations*).

Although foundations have long had a distinct function within the American nonprofit sector, they were generally not legally distinguished from other 501(c)(3) organizations until 1969, when the U.S. Congress imposed a variety of restrictions on these organizations in response to concerns that wealthy individuals were using the charitable foundation as a vehicle for evading inheritance taxes. The key distinguishing feature of foundations as defined in this law is that they receive their income and assets from a single source, unlike other charities, which receive income from multiple private

and public sources.⁸ Foundations so defined are prohibited from certain kinds of financial transactions that might constitute self-dealing, and are required to pay out a minimum of 5 percent of the value of their assets each year in grants or other “qualifying distributions.”

Charitable Service Organizations. The balance of the 501(c)(3) public-benefit nonprofit sector consists of charitable service organizations, or “public charities” as they are formally identified in the law. Included here are private universities, schools, hospitals, clinics, orchestras, art galleries, museums, environmental groups, civic associations, social service agencies, day care centers, community development organizations, and many more--indeed, most of the organizations commonly thought of as comprising the public-benefit portion of the nonprofit sector. These organizations deliver services, provide information, educate the public, advocate on behalf of particular causes, provide management and financial assistance, and engage in dozens of other “charitable” activities.

Social Welfare Organizations. Aside from the three types of public-benefit nonprofit organizations identified above, a fourth type is authorized under section 501(c)(4) of the Internal Revenue Code. Known legally as “social welfare organizations,” these organizations pursue purposes similar to those pursued by all charitable nonprofit organizations. However, they pursue them in a particular way--i.e. primarily by seeking to influence the legislative process. While such legislative “lobbying” is a permissible activity for all charitable service organizations, 501(c)(3) organizations are prohibited from devoting a “substantial” share of their energies to it, which has been interpreted to mean no more than 20 percent of their expenditures. Charitable nonprofit organizations primarily engaged in such lobbying activities are therefore obliged to organize under a different section of the tax code. As such, their donors are not eligible to receive tax deductions on their contributions. The general concept here is that the state should not subsidize, even indirectly, efforts to influence its own policies.

Member-Serving Organizations

Beyond the primarily public-serving organizations classified under sections 501(c)(3) and 501(c)(4) of the Internal Revenue Code are a variety of essentially member-serving and related organizations that are also entitled to tax exemptions, but under other subsections of the tax code. Generally speaking, these organizations are vehicles through which individuals can pursue any of a number of common interests, whether social or economic. They thus contribute to social and civic life or promote mutuality. Because members already reap benefits from these organizations, however, contributions to them are not deductible in computing the members’ own income tax obligations. Broadly speaking, four more or less distinct types of such member-serving organizations can be identified:

Business and Professional Organizations. In the first place, member-serving nonprofit organizations include a number of business and professional associations, such as business leagues, chambers of commerce, trade associations, and boards of trade (IRC §501(c)(6)), labor unions and

agricultural groups (IRC §501 (c)(5)), and local associations of employees (IRC §501(c)(4)). These organizations all exist to promote some common business or professional interest of their members.⁹

Social and Fraternal Organizations. A second type of member-serving organization is essentially *social* and *fraternal*, rather than business, in orientation. Included here are social and hobby clubs (IRC §501(c)(7)), homeowners' associations (IRC §528), fraternal beneficiary associations, fraternities and sororities, and veterans associations,

Mutual Benefit Organizations. Organizations serving a *mutual or cooperative* purpose constitute a third class of tax-exempt member-serving organizations. Included here are group legal service organizations, teachers retirement funds, black lung benefit trusts, mutual insurance companies (IRC §501(c)(15)), cemetery companies (IRC §501(c)(13)), credit unions (IRC §501(c)(14)), and farmers' cooperatives (IRC §521).

Miscellaneous. Finally, there are a variety of miscellaneous types of tax-exempt organizations. Included here are certain instrumentalities of the United States, title holding companies, and political parties (IRC §527).

Basic Dimensions

Because of the large number of unincorporated and unregistered nonprofit organizations in the United States, it is difficult to gauge the size of this sector with precision. In all likelihood the number of organizations exceeds 2 million. As reflected in Figure 11.1, just the organizations registered with the Internal Revenue Service, or eligible for registration as religious bodies, numbered over 1.1 million as of 1989.¹⁰ Of these, the largest component by far are the public-serving organizations, which represent 65 percent of the total. Included here are approximately 350,000 churches, 220,000 charitable service organizations, 135,000 social welfare organizations, and almost 35,000 foundations and other financial intermediaries. The remaining 35 percent of the organizations are member-serving. This includes over 200,000 social and fraternal organizations, 140,000 business and professional organizations, and approximately 38,000 mutual benefit and cooperative organizations.

As Table 11.2 shows, these 1.1 million organizations represent a significant economic force in the United States. Taken together they had operating expenditures of close to \$400 billion as of 1989. This is the equivalent of 7.4 percent of the American gross domestic product. Of this total, member-serving organizations accounted for approximately 16 percent and public-serving organizations for 84 percent. Clearly, the more numerous public-serving organizations also tend to be larger than the business, social, and mutual organizations that comprise the member-serving component of this sector. These figures would be even larger, moreover, if the volunteer input to this sector were considered.

As Table 11.2 also shows, the largest component of the American nonprofit sector in terms of expenditures is the health component, especially private, nonprofit hospitals. Just over half of all hospitals in the United States are private, nonprofit institutions, and these tend to be huge institutions. Taken together hospitals and other health providers account for over 40 percent of all nonprofit expenditures. Right behind the health subsector in terms of size is the education and research component of the nonprofit sector. Most important here are colleges and universities. Half of all higher education institutions in the United States are private nonprofit institutions, and although they tend to be smaller than the state colleges and universities, they nevertheless account for 20 percent of all nonprofit expenditures (Salamon, 1992: 60, 73).

Table 11.2
Current Operating Expenditures
of U.S. Nonprofit Organizations,
by Type of Organization, 1989

Type of Organization	Amount (in US\$ billions)	Percent of Total
MEMBER - SERVING	\$ 62.0	16%
PUBLIC - SERVING	\$327.1	84%
Foundations	1.4	--
Religious	31.1	8
Health	165.2	42
Education/Research	76.9	20
Social and Legal	35.8	9
Civic and fraternal	10.2	3
Arts and Culture	6.4	2
International	—	—
TOTAL	\$389.1	100%

Source: U.S. Bureau of Economic Analysis, 1991. Hodgkinson, Weitzman, et. al., 1992. Nonprofit Almanac, 1992-1993.

Other components of the nonprofit sector are smaller in relative terms. Yet they nevertheless contribute significantly to the nation's social and economic life. Thus, the nonprofit sector includes virtually all of the nation's symphony orchestras, 70 percent of its museums and art galleries, and two-thirds of its social service agencies (Salamon, 1992: 93, 84). So, too, virtually all of the major

social movements that animated American society during the 1960s, 1970s, and 1980s emerged through the nonprofit sector. This includes the civil rights movement, the environmental movement, the consumer movement, the women's movement, the gay rights movement, and the conservative movement.

In short, whatever its history and whatever the neglect it has endured, the nonprofit sector remains a vital presence in American social and economic life. It functions, moreover, not simply as a symbol of a mythic golden age of voluntary action but as a tangible presence delivering important services in a wide range of fields and a mechanism through which individuals and groups can exercise initiative in the pursuit of public and mutual purposes. Finally, it is not an isolated presence. Rather, nonprofit organizations interact extensively with both for-profit businesses and government at all levels in carrying out their public purposes.

Key Issues

The significant place that nonprofit organizations hold in American life is by no means assured, however, despite the rich tradition such organizations embody. To the contrary, this sector has recently been coping with a variety of challenges that could well alter its historic position and role. Three of these challenges deserve particular attention here because of the light they shed on some of the central dynamics affecting the evolution of the nonprofit sector's role in American society.

Relations with Government

Perhaps the central challenge facing the American nonprofit sector at the present time involves the sector's relationship with the state. As we have seen, the tremendous growth that American nonprofit organizations experienced in the 1960s and 1970s was due in substantial part to the support they received from government. Constrained by continuing hostility to the expansion of the federal bureaucracy but facing new demands arising from the rediscovery of poverty and from the civil rights, disability rights, environmental, and consumer movements of the time, the federal government turned extensively to private, nonprofit organizations to help it respond, often stimulating the creation of nonprofit institutions where none existed. The upshot was a massive partnership between government at all levels and private nonprofit organizations that vastly extended the size and scope of nonprofit action. By the late 1970s, government assistance accounted for more than 30 percent of the overall operating revenues of nonprofit charitable service agencies; and in some fields, such as social services, it reached almost 50 percent. By comparison, private charitable giving by individuals, corporations, and foundations accounted for less than 20 percent (Salamon, 1992:26).

Important though government support became to the fiscal health and dynamism of the nonprofit sector, however, it remained somehow suspect and under-valued even within the sector. This was due in part to a gross lack of basic information about the scale that government support had attained. It was also due to the regulatory constraints and paperwork demands that government

support brought with it. Most important, however, failure to appreciate the widespread pattern of government-nonprofit cooperation established in the 1960s and 1970s was caused by the continued hold of the ideology of voluntarism on American thinking about the nonprofit sector. With its stress on the inherent conflict between the nonprofit sector and the state, this doctrine failed to prepare observers to see the reality that developed before their eyes.

By the time Ronald Reagan assumed the presidency in 1981, there was still consequently little understanding or appreciation among political leaders or the public at large about the important role that nonprofit organizations were playing in the operation of the Great Society social programs of the 1960s and 1970s, or how crucial a role the partnership with government had become to the fiscal health of the country's nonprofit sector. What made this particularly troublesome, moreover, was the fact that this partnership, for all its contributions, also had serious operational problems that reflected the speed and lack of planning with which it had been constructed. Rather than address these problems, however, the Reagan Administration retreated to earlier conservative arguments and proposed to help the nonprofit sector chiefly by getting government out of its way (Salamon, 1986). The result was to subject major components of the nation's nonprofit sector to significant fiscal strain. Outside of the health field, in fact, federal support to nonprofit organizations declined by one-fourth in the early part of the decade and did not return to its 1980 level until the early 1990s, by which time a new conservative tide was gaining strength to mount another attack on this crucial source of nonprofit dynamism and growth.

Far from a stable and valued relationship, therefore, the significant ties between the nonprofit sector and government remain highly contested in contemporary America, with considerable ambiguities on both sides. This has made it difficult for nonprofit organizations to hold their own in the face of a growing conservative tide. Indeed, nonprofit organizations have found themselves smothered in conservatives' embrace, as right-wing defense of the nonprofit sector has come to be used as a rationale for eliminating crucial support on which the nonprofit sector has come to depend.

Marketization and Commercial Competition¹¹

One response that the nonprofit sector has made to the resulting strain has been to turn toward sources of income it can more reliably control. In practice, this has meant a dramatic increase in reliance on commercial sources of support, chiefly in the form of fees and charges for the sector's services. Between 1977 and 1989, for example, such commercial income accounted for most of the growth that the nonprofit sector experienced, not only in the fields of health and education, where it has traditionally held sway, but in the fields of social services and civic action as well (Salamon, 1993:24). In other words, while the nonprofit sector became somewhat less dependent on government during the decade of the 1980s, as conservatives hoped, it did not become more philanthropic; rather, it became more commercial.

As nonprofit organizations have turned more heavily toward "paying customers," however, they have found themselves in increasing competition with for-profit businesses. For-profit firms

were attracted into the human service field during the 1960s and 1970s by the same growth of government spending that fueled the growth of the nonprofit sector. In addition, the target population for certain social and human services broadened considerably beyond the indigent, as women entered the work force and lifespans lengthened, creating demands for day care, elder care, and related services. Since many of the new claimants for social services had resources to spend on them, market demand was created for many of these services, and for-profit as well as nonprofit firms moved to meet it. As of 1977, therefore, for-profit companies already accounted for 57 percent of the nation's day-care centers, 23 percent of its other social service agencies, 10 percent of its long-term care hospitals, and 13 percent of its short-term hospitals (Salamon, 1993:21). During the latter 1970s and the 1980s, however, the for-profit role in these fields exploded even further. Thus, while the number of nonprofit hospitals declined by 3 percent, the number of for-profit ones increased by 28 percent. In the rapidly growing field of home health, for-profits went from less than half of the establishments in 1977 to almost 70 percent in 1989. And similar developments were evident in other fields (Salamon, 1993:28-33).

The upshot of these developments has been to intensify the competition nonprofit organizations face not only from other nonprofits, but from for-profit organizations as well. Flushed out of their traditional role of providing care for the needy, in other words, nonprofit organizations are increasingly finding themselves engaged in difficult competition with for-profit firms in the commercial arenas in which they are consequently forced to operate.

Challenge to Tax-exempt Status

This situation has naturally begun to raise questions about the rationale for the tax-exempt status that nonprofit organizations enjoy. Echoes of these complaints began to surface in the early 1980s when small business interests began challenging nonprofit entry into commercial business activities. Under U.S. law, nonprofit organizations are obliged to pay taxes on so-called "unrelated" business activities, i.e., business activities that are unrelated to the tax-exempt purpose of the organizations. Small business representatives charged, however, that the Internal Revenue Service was too lax in its administration of this Unrelated Business Income Tax (UBIT) requirement.

As competition has intensified between nonprofits and for-profits in the core fields of nonprofit activity, however, even more fundamental challenges have been raised to the whole concept of tax exemption. Local governments, in particular, have become increasingly aggressive in seeking tax revenues from nonprofit organizations in order to close revenue gaps that have grown increasingly serious at the local level. Such efforts are thus particularly in evidence in Pennsylvania, New York, New Hampshire, Oregon, Colorado, Maine, and Wisconsin. A recent study in Pennsylvania, for example, found that at least two-thirds of the state's counties are actively seeking taxes or payments in lieu of taxes from nonprofit organizations. In a particularly celebrated 1994 case, an Appeals Court in Pennsylvania overruled the more than 350 years of legal development that had firmly implanted the idea that education is an inherently "charitable" activity and ruled that a private, nonprofit college no longer qualified for charitable status under state law because only a small fraction of its students were

poor. These and other challenges suggest the confused state of popular understanding of the nonprofit sector in the United States and the extent to which popular support for charitable institutions has eroded.

U.S. Nonprofit Organizations in Comparative Context

Given the distinctive history and complex legal structure of the nonprofit sector in the United States, it should be clear that the American definition of the nonprofit sector is in important respects historically, rather than conceptually, determined. Certain types of organizations have been granted tax-exempt status that might not qualify for this status if a strict conceptual standard were enforced. What is more, legal definitions do not line up well with popular conceptions. Thus most people identify the nonprofit sector with "charity" in the sense of assistance to the needy when in fact the legally defined "charitable" portion of this sector extends well beyond that. One of the great potential advantages of a common definition is that it will make it possible to correct for some of the idiosyncracies of local usage and formulate a conceptually more defensible concept of what this sector should embrace.

To what extent, then, does the structural-operational definition of the nonprofit sector developed for cross-national comparative purposes, as outlined by Salamon and Anheier (1996), fit the American case? What facets of the U.S. nonprofit scene does this definition adequately handle and what facets does it overlook or obscure? How adequate, therefore, is this definition for analyzing the American case and comparing it to the situations elsewhere?

To answer these questions, we examine each of the five basic dimensions of the structural-operational definition and assess how well it applies to the U.S. nonprofit scene. As will become clear, the general conclusion that flows from this analysis is that the nonprofit sector demarcated by this definition fits American realities quite well, though it includes some elements that fall beyond what most popular accounts would include in this sector.

Formal

The first criterion of the nonprofit sector identified in the structural-operational definition is that the entities included be in some sense "formal" or "structured." This is to differentiate the nonprofit sector from mere ad hoc collections of individuals or informal family groupings.

Generally speaking, this criterion applies quite well to the American setting, so long as "formal" is not interpreted to mean "officially registered" with any governmental body. As we have seen, the formation of nonprofit organizations is considered to be a basic right in America, not a privilege that is granted or withheld by governmental authorities. Organizations can thus come into being and function effectively as nonprofit entities without securing the approval of any governmental body, and thousands, perhaps millions, of them do. Even the tax exemption available to such organizations when they are engaged in any of a wide variety of exempt activities is not viewed as

something that is “granted” by the tax authorities. Rather, the function of the Internal Revenue Service is merely to “recognize” the organization's entitlement to the exemption (Hopkins, 1987: 616). Organizations therefore do not have to apply to the IRS for tax-exempt status. So long as they fit the purposes stipulated in law, they can operate as if they are exempt until they are challenged. However, IRS regulations stipulate that eligibility for tax-exempt status is restricted to *organizations* and is not available to “formless aggregations of individuals” (U.S. Internal Revenue Service [n.d.], IRM 7751: §315.1, 315.2, 315.4(2)). In practice, this means that the entity must have an organizing instrument, some governing rules, and regularly chosen officers. In short, the organizational requirement of the structural-operational definition fits the American requirements quite well: permitting unregistered and unincorporated entities but stipulating that they nevertheless have some organizational reality to them.

Private

The second stipulation in the structural-operational definition is that the entities considered part of the nonprofit sector be organizationally and structurally separate from the state. Here, again, so long as “private” and “nongovernmental” are not interpreted to exclude organizations receiving significant financial support from the public sector, this condition fits all but one class of American tax-exempt organizations--i.e. §501(c)(1) organizations formed under an act of Congress. Beyond this, nonprofit organizations in the United States are governed by private boards of directors and are considered part of the private sector. Indeed, as we have seen, separating the nonprofit sector from the public sector was a major thrust of national political struggle from the late nineteenth through the early twentieth centuries, and nonprofit organizations jealously guard their “independence” from state organs.

In practice, however, while organizationally and structurally separate from government, nonprofit organizations are heavily influenced by government policies. For one thing, as we have seen, government support to the nonprofit sector has historically been quite extensive in the United States, and it has grown massively in the period since 1960. Inevitably, this has brought significant elements of the nonprofit sector within the orbit of government programs and exposed them to the rhythms and requirements that government funding inevitably entails. In some cases, in fact, government has stimulated the creation of wholly new nonprofit corporations. This was the case, for example, with the hundreds of local Community Action Agencies created in the 1960s as part of the federal government's War on Poverty. Elsewhere nonprofit organizations operating with public funds have found themselves bound by government regulations pertaining to equal opportunity, handicapped accessibility, environmental protection, workplace safety, protection of human subjects, and sexual harassment. Some analysts have bewailed this circumstance as an undue intrusion of government control that has undermined the basic character of the nonprofit sector (Smith and Lipsky, 1993). Most empirical assessments indicate, however, that nonprofit organizations have managed the trade-offs involved in receipt of government support reasonably well and have managed to retain a considerable degree of discretion and autonomy in the process (deHoog, 1985; Salamon, 1995). What is most important for our purposes here, however, is that the structural/operational

definition, by defining the nonprofit sector in terms of its basic *structure* rather than in terms of its *sources of support* accommodates the American realities quite well.

Non-Profit-Distributing

The *non-profit-distributing* criterion of the structural-operational definition also fits the American circumstances reasonably well. As we have seen, the “private inurement” test is a fundamental basis for a grant of a nonprofit corporate charter under state corporation laws. Even for unincorporated organizations, however, the federal tax laws stipulate that to be exempt from federal income taxes, an organization must be operated in such a way that “no part of [its] earnings inures to the benefit of” the organization’s officers or directors and the organization’s founding documents must stipulate this. More generally, the tax laws specify that the entity must be organized exclusively to carry out one of the specific purposes articulated in the law as entitling it to tax exemption, though “exclusively” here has come to mean “principally.” To the extent that business activities or the generation of profits are a principal purpose of an organization, therefore, the organization would disqualify itself for tax-exempt status.

It is worth noting here that the term “non-profit-distributing” in the structural-operational definition is more precise than the term “nonprofit” often used to refer to this set of organizations in the United States. “Nonprofit” suggests that these organizations do not, or are not permitted to, earn profits in the sense of an excess of receipts over expenditures. In fact, however, U.S. nonprofit organizations are permitted to earn profits, and many do. Indeed, under U.S. law, nonprofit organizations are even permitted to operate businesses that are unrelated to the tax-exempt purposes of the organizations. Three conditions attend these business activities, however: first, any profits generated from such businesses are taxed at the same rate as are profits from any for-profit business; second, the net profits after taxes must be used only to promote the tax-exempt purpose of the organization and not be distributed to the organization’s officers or directors; and third, the business cannot be the principal purpose of the organization.

Certain practical problems nevertheless attend the application of this non-profit-distribution condition. One of these has to do with the distribution of profits not in the form of dividends but in the form of salaries and other benefits. Although U.S. law limits nonprofit compensation to levels considered “reasonable and customary,” this is a slippery standard that has caused difficulties in practical application.

Even more difficult is the treatment of the entire class of member-serving organizations. As noted above, numerous such organizations are included within the U.S. tax-exempt sector even though they are operated principally for the benefit of their members. U.S. law gets around this by stipulating that the benefits must accrue to particular individuals by virtue of their position in the organization in order to be considered a violation of the non-profit-distributing restriction. Many organizations that would fail to fit the popular conception of a nonprofit organization, which carries with it the sense of general public benefit, nevertheless thus qualify as nonprofit organizations in legal

terms. Under the non-profit-distributing condition of the comparative definition, at least some of these would be excluded--particularly mutual benefit organizations and cooperatives that are essentially engaged in business activities. However, business and professional associations would be included even though they fall outside the circle of 501(c)(3) charitable organizations that most people have in mind when they think of nonprofit organizations in the U.S.

Self-Governing

The provision in the structural-operational definition restricting the concept of the nonprofit sector to organizations that have their own internal mechanism for self-government fits the American case extremely well. As noted earlier, one of the basic requirements for tax-exempt status in the United States is that the entity pass an "organizational test." Central to this is a showing that the organization has developed a set of formal procedures for its own internal governance, including designation of governing bodies and methods for selecting trustees, choosing officers, and disposing of assets upon the organization's dissolution. Although no prohibitions exist about placing government officials on the boards of nonprofit organizations, this practice is nowhere near as common now as it was in the first hundred years of the nation's existence and, at any rate, does not commonly convey control over the organization's internal decision-making to public authorities, as is the case in some other countries (e.g. Japan).

Voluntary

The fifth key requirement in the structural-operational definition is that the organizations included in the nonprofit sector embody some meaningful degree of voluntary involvement. This criterion works along with the non-profit-distributing requirement in the definition as a proxy for the concept of "public benefit," which is extremely difficult to define cross-nationally. The general thrust of the argument is that if organizations are able to attract volunteers and to operate without the promise of distributing profits, they must have some public purpose attraction to them.

"Voluntary" as used here has two different meanings, however: first, that volunteers be involved in the operation of the organization, either as members of the board or as personnel assisting the organization in carrying out its mission; and second, that participation in the organization not be coerced or mandatory.

Generally speaking, both of these meanings fit the American case. However, there are important caveats to enter with respect to both.

So far as volunteer involvement is concerned, voluntarism is a highly regarded value in American society and volunteer activity is widespread. Thus, according to recent surveys, over half (54 percent) of Americans over the age of 18 reported volunteering and about two-thirds of this volunteer activity went to support tax-exempt organizations (Hodgkinson, Weitzman et al., 1992:65,71).

Impressive though these numbers are, however, they must be approached with a degree of caution. In the first place, notwithstanding the value attached to voluntarism in American culture and the myth of voluntarism that has come to surround the nonprofit sector, there is no formal requirement that nonprofit organizations be operated exclusively, or even chiefly, by volunteers. By custom, the boards of such organizations are normally volunteers but it is legally permissible to compensate even board members for their work. As the U.S. Tax Court put it: “[t]he law places no duty on individuals operating charitable organizations to donate their services; they are entitled to reasonable compensation.” (World Family Corporations & Commissions, 1983). More generally, organizations are free to utilize or not utilize volunteers, and it is quite common even for charitable organizations to operate entirely with paid staffs. One of the major criticisms of the growth of government funding, in fact, is that it diminished the reliance of organizations on volunteers and made it possible--in some cases necessary-- for them to engage professional staff. Perhaps reflecting this, volunteer input is hardly distributed evenly within the American nonprofit sector. To the contrary, well over 40 percent of all volunteer time is dedicated to religious organizations. By contrast, health and educational organizations, which account for 44 percent and 22 percent of all paid employees, respectively, absorb only 11 percent and 9 percent of all volunteer time (Hodgkinson and Weitzman, et al., 1992:120). The American nonprofit sector thus contains at least two relatively distinct sets of organizations, one of which is still heavily volunteer based and the other of which makes relatively modest use of volunteers except for a thin stratum of volunteer board members at the top. Since the structural-operational definition requires only that there be at least some meaningful degree of volunteer involvement, even if only at the board level, most charitable nonprofits and a significant portion of the balance of the tax-exempt sector probably meet the definition. However, in the minds of many this is a rather attenuated definition of volunteer participation.

With respect to the other meaning of voluntary--i.e. non-mandatory--the situation is more complicated. At least some types of tax-exempt organizations have compulsory membership. This is the case, for example, with labor unions in cases where a “union shop” has been established, or with professional associations that perform licensing functions for the profession. Such organizations would likely be excluded from popular conceptions of the nonprofit sector in the United States anyway, however, even though they are formally tax exempt. American usage would thus be consistent with what the structural-operational definition prescribes.

Summary

In short, the structural-operational definition of the nonprofit sector described earlier works relatively well in demarcating a distinctive set of organizations from among the welter of purposes identified as tax-exempt in American law. The nonprofit sector so defined relates well to popular conceptions of this set of organizations, moreover. The principal deviation from common usage is the inclusion of most of the member-serving organizations within the nonprofit sector. This runs counter to the legal treatment, which draws a sharp distinction between “charitable” organizations, which operate for general public benefit; and all other nonprofit organizations, which serve a variety of collective, but more narrowly focused, group purposes. It also runs counter to popular

conceptions, which tend to restrict the concept of the nonprofit sector to a subset even of the formally "charitable" organizations (i.e. those serving the poor or supported mostly by charitable contributions). This popular conception is probably excessively narrow, but most Americans would likely find the sector portrayed by the structural-operational definition a bit too broad. Though broad, however, it is certainly workable within the legal parameters applicable in the United States.

Conclusion

Voluntarism and nonprofit action are thus firmly rooted in American tradition. In the absence of a capable state, Americans early developed a habit of self-reliance and a penchant for voluntary association to meet common needs. This habit was reinforced by a strong ethos of individualism and by a deep-seated philosophical hostility to centralized government. At the same time, it was tempered by anti-corporatist sentiments and by suspicion of undue concentrations of economic power as well. During much of the colonial era and the first hundred years of the nation's existence, these competing impulses were reconciled by forming hundreds of associations but then requiring that these associations pursue public ends and work hand-in-hand with public authorities, often with the aid of publicly generated revenues.

Towards the end of the nineteenth century, however, the easy-going pattern of government-nonprofit cooperation that had characterized the early years of the country was challenged by a new orthodoxy stressing the virtues of voluntarism as an *alternative* to the state in meeting human needs. This orthodoxy politicized the idea of the nonprofit sector and created a powerful social myth that has obscured clear thinking about the actual operation and role of the nonprofit sector in American life ever since.

Against this backdrop, a careful re-examination of the nature of the American nonprofit sector is very much in order. Such a re-examination can usefully be done in comparative terms, moreover, to get outside the sterile ideological perspective from which this topic is often approached. For this to be possible, however, it is essential to begin with a clear understanding of what this sector embraces and how it is defined. Hopefully the discussion here will provide a useful step towards this goal.

Endnotes

1. Protests were thus lodged at town meetings in Massachusetts during debates over the ratification of the Constitution about the practice of providing public grants to Harvard College on grounds that Harvard provided insufficient information on its use of these funds and was unresponsive to public needs in its educational philosophy. See: Nielsen, 1979:33.
2. A joint stock company is a legal entity created by state charter and empowered to enter into contracts and act as an economic person, thus shielding its investors from personal risk for the entity's activities.
3. For a broader discussion of the practice of "third-party government" of which the government-nonprofit partnership is a part, see: Salamon, 1981: 255-75.
4. Not until 1981 was a full accounting of the extent of government support of private nonprofit organizations developed. See: Salamon and Abramson, 1981:255-75.
5. Formal evidence of tax-exempt status is also a virtual necessity to secure foundation grants since foundations are required by law to pay out a minimum share of their asset value each year to such eligible tax-exempt organizations.
6. For additional elaboration on the English common law definition of "charitable," see Chapter 10 of *Defining The Nonprofit Sector: A Cross-National Analysis*, forthcoming from Manchester University Press, 1996.
7. Although churches, synagogues, mosques and other religious bodies are not formally required to register as tax-exempt organizations with the Internal Revenue Service, many nevertheless voluntarily choose to do so for many of the same reasons that other nonprofit organizations do--to secure clear assurance of their charitable status and to provide protection against personal liability for directors and officers.
8. In addition to the two types of foundations mentioned here there are at least two other types: first, *operating foundations*, which deliver services directly in addition to making grants; and *community foundations*, which are grant-making institutions supported not by a single donor but by a number of donors in a particular community who choose to leave their bequests to a common community institution for the promotion of charitable objectives. Community foundations have considerably more favorable tax status than the independent foundations.
9. To the extent that an organization exists to promote a particular business, as opposed to the common interests of a type of business, it would be classified as a for-profit organization and not entitled to tax-exempt status. Similarly, some professional associations can qualify for charitable status where they are principally engaged in activities that serve a broad public interest rather than primarily the interests of the members of the profession. Thus bar associations and medical societies

are commonly classified as business leagues by the Internal Revenue Service whereas organizations representing economists, historians or other learned professions can often qualify for 501(c)(3) charitable status.

10. Because of the special position of religious organizations in American law, the exact number of registered nonprofit organizations is difficult to determine. This is so because some religious congregations register with the Internal Revenue Service even though they are not required to. The 1.1 million figure recorded here is thus a net figure that takes account of the estimated portion of churches listed in the *Yearbook of American and Canadian Churches* that are already included in Internal Revenue Service listings of 501(c)(3) organizations. No reasonable estimate exists of the number of unregistered and unincorporated nonprofit organizations.

11. This section draws heavily on Salamon, 1993:16-34.

References

- Berger, Peter and John Neuhaus. *To Empower People: The Role of Mediating Structures in Public Policy*. Washington: The American Enterprise Institute for Public Policy, 1977.
- Bremner, Robert H. *From the Depths: The Discovery of Poverty in the United States*. New York; New York University Press, 1956.
- Bremner, Robert H. *The Public Good: Philanthropy and Welfare in the Civil War Era*. New York: Alfred A. Knopf, 1980.
- Carnegie, Andrew. "Wealth," *North American Review* 148 (1889):653-64.
- deHoog, Ruth. "Human Service Contracting: Environmental, Behavioral, and Organizational Conditions," *Administration and Society*. 16 (1985):427-54.
- de Tocqueville, Alexis. *Democracy in America* [1845]. The Henry Reeve Text as Revised by Francis Bowen. Volume II, New York: Alfred A. Knopf, 1945.
- Fetter, Frank. "The Subsidizing of Private Charities," *American Journal of Sociology*, (1901/02):371-6.
- Hall, Peter Dobkin. "A Historical Overview of the Private Nonprofit Sector," in Powell, 1987: 3-26.
- Hartz, Louis. *Economic Policy and Democratic Thought: Pennsylvania 1776-1860*. Cambridge, MA: Harvard University Press, 1948.
- Hodgkinson, Virginia A., Murray S. Weitzman, Christopher M. Toppe, and Stephen M. Noga. *Nonprofit Almanac, 1992-93: Dimensions of the Independent Sector*. San Francisco: Jossey-Bass Publishers, 1992.
- Hopkins, Bruce. *The Law of Tax-Exempt Organizations*. 5th ed. New York: John Wiley and Sons, 1987.
- Katz, Michael. *In the Shadow of the Poorhouse: A Social History of Welfare in America*. New York: Basic Books, Inc., 1986.
- Lubove, Roy. *The Struggle for Social Security*. Cambridge, MA: Harvard University Press, 1968.
- Nielsen, Waldemar. *The Endangered Sector*. New York: Columbia University Press, 1979.

- Nisbet, Robert. *Power and Community*. 2d edition. New York: Oxford University Press, 1962.
- Powell, Walter W. *The Nonprofit Sector. A Research Handbook*. New Haven: Yale University Press, 1987.
- Salamon, Lester M. *Partners in Public Service: Government-Nonprofit Relations in the Modern Welfare State*. Baltimore: Johns Hopkins University Press, 1995.
- Salamon, Lester M. "The Marketization of Welfare: Changing Nonprofit and For-Profit Roles in the American Welfare State." *Social Service Review* 67 no.1 (1993):16-39.
- Salamon, Lester M. *America's Nonprofit Sector: A Primer*. New York: The Foundation Center, 1992.
- Salamon, Lester M. "Partners in Public Service: The Scope and Theory of Government-Nonprofit Relations." In Powell, 1987, 99-117.
- Salamon, Lester M. "The Nonprofit Sector: The Lost Opportunity," in John Palmer and Isabel Sawhill eds. *The Reagan Record*. Cambridge: Ballinger Publishing Co., 1986, 261-286.
- Salamon, Lester M. "Rethinking Public Management: Third-Party Government and the Changing Forms of Public Action." *Public Policy*, 28 (1981):255-75.
- Salamon, Lester M. and Alan J. Abramson, *The Federal Budget and the Nonprofit Sector*. Washington, D.C.: The Urban Institute Press, 1981.
- Salamon, Lester and Helmut K. Anheier, *Defining The Nonprofit Sector: A Cross-National Analysis*, forthcoming, Manchester: Manchester University Press, 1996
- Schuyler, Louisa Lee. In Bremner, 1980.
- Smith, Steven Rathgeb and Michael Lipsky. *Nonprofits for Hire: The Welfare State in the Age of Contracting*. Cambridge MA: Harvard University Press, 1993.
- Stevens, Rosemary. "A Poor Sort of Memory: Voluntary Hospitals and Government before the Depression." *Millbank Fund Quarterly/Health and Society*, 60, no.4, (1982).
- U.S. Bureau of Economic Analysis, *Survey of Current Business*. Washington: U.S. Government Printing Office, 1991.
- U.S. Internal Revenue Service, *Annual Report*. Washington: Internal Revenue Service, 1990.

U.S. Internal Revenue Service. *Exempt Organizations Handbook*. (IRM 7751)

Walker, James. "Associations for Benevolent Purposes," *Christian Examiner*, II (1825). In Bremner, 1980.

Warner, Amos. *American Charities: A Study in Philanthropy and Economics*. New York: Thomas Y. Crowell, 1894.

Whitehead, John S. *The Separation of College and State: Columbia, Dartmouth, Harvard, and Yale, 1776-1876*. New Haven: Yale University Press, 1973.

World Family Corporation v. Commissioner, 81 T.C. 958 (1983), quoted in Hopkins 1987.

THE JOHNS HOPKINS COMPARATIVE NONPROFIT SECTOR PROJECT

The Johns Hopkins Comparative Nonprofit Sector Project is a systematic effort to analyze the scope, structure, financing, and role of the private nonprofit sector in a cross-section of countries around the world in order to improve our knowledge about this sector, enrich our theoretical understanding of it, and provide a sounder basis for both public and private action toward it.

The project utilizes a comparative, empirical approach that relies heavily on a team of local associates in the target countries and involves a network of local advisory committees.

Project work began in 1990 in 13 countries and now extends to dozens of countries spanning all the regions of the world. Additional countries are also being targeted for inclusion in the project in the future.

THE JOHNS HOPKINS CENTER FOR CIVIL SOCIETY STUDIES

The *Johns Hopkins Center for Civil Society Studies* seeks to improve understanding and the effective functioning of not-for-profit, philanthropic, or "civil society" organizations in the United States and throughout the world in order to enhance the contribution these organizations can make to democracy and the quality of human life. The Center is part of the Johns Hopkins Institute for Policy Studies and carries out its work through a combination of research, training, and information-sharing both domestically and internationally.

Center for Civil Society Studies
Institute for Policy Studies
The Johns Hopkins University
3400 North Charles Street, Wyman Bldg., 5th Floor
Baltimore, MD 21218-2688, USA
Phone: 410-516-4523
Fax: 410-516-7818
E-mail: cnp@jhu.edu
Project Web site: www.jhu.edu/~cnp
Center Web site: www.jhu.edu/~ccss