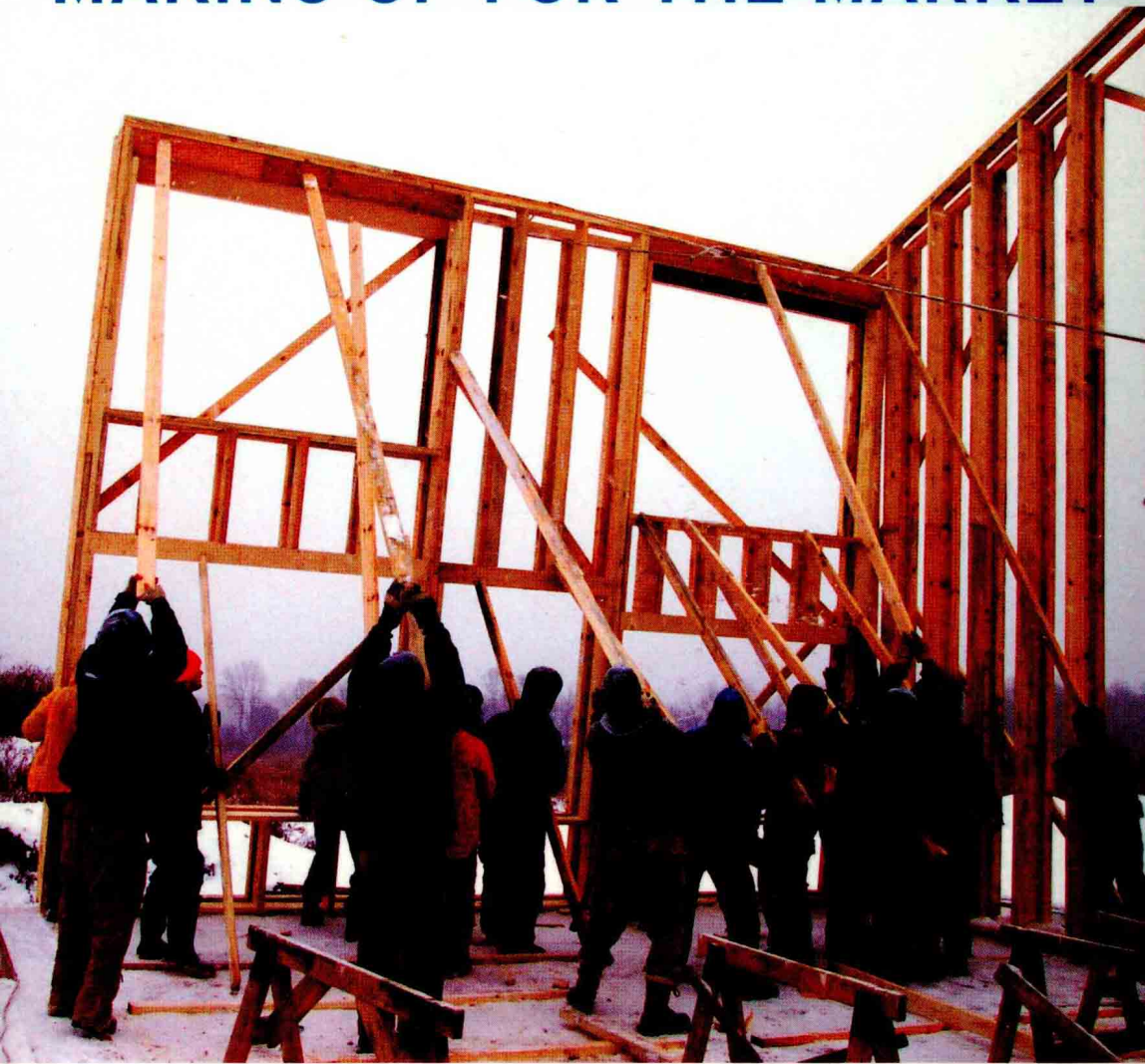


# **THIRD-SECTOR DEVELOPMENT**

**MAKING UP FOR THE MARKET**



**CHRISTOPHER GUNN**

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**THIRD-SECTOR  
DEVELOPMENT**

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## Preface

**E**conomic development is a pressing issue for poor communities in this wealthy nation. This book is about a different path to achieve that development. Investments from the private, for-profit sector have already bypassed poor communities, and any government assistance those areas have received has not been enough to ignite development. Another set of options is available, and it involves communities building the non-profit and cooperative portions of their economies. Through organizations of what can be called “the third sector” jobs can be created, goods and services can be produced and delivered, and surplus from which to build can be retained and reinvested in the communities.

The terrain of this book is the United States. I use the term *third sector* as a label for organizations in the economy that are neither traditional for-profit businesses nor government agencies. They have similarities to what in international development work are called “nongovernmental organizations” (NGOs), but they are more than aid agencies. U.S. domestic third-sector organizations are well known in their familiar forms of hospitals, universities, social service agencies, and charities, and each of these organizations can contribute to development. Less familiar is a new generation of entrepreneurial nonprofits, cooperatives, and credit unions that have as one of their objectives building stronger local economies. While the book begins with an overview of the entire nonprofit world, its subject is these development-oriented organizations.

Chapters 1 through 3 provide a survey of the third sector and tackle the question of why development is a problem in a country with the resources and wealth of the United States. The focus is economic, but for some readers it may be considered political as well, since it has to do with class and inequality, among other issues. This is, then, a study in one aspect of local political economy. Before turning to profiles of organizations doing the work described here, basic criteria for assessing development are discussed in chapter 3.

Chapters 4 through 10 provide profiles of over twenty-five organizations that are contributing to development across the United States. They include nonprofits that have approval from the federal government to receive donations that are tax-deductible for the donors and other nonprofits without that privilege. They also include a mix of different kinds of cooperatives. I argue in the opening chapters that these organizations have important elements in common. Most importantly for place-based development, they tend to be grounded in local economies. These organizations can be launched with energy from social entrepreneurship and capital raised from a variety of sources.

No claim for a new holy grail will be made. There are shortcomings to use of these institutions, which are only as trustworthy as the people responsible for them. They require financial resources in a capitalist economy that starves them of capital for structural as much as (or more than) ideological reasons. Compared with the bigger players in the game, capitalist firms and governments, the third sector is small. Chapters 11 and 12 deal with public policy issues concerning this sector and how they might play a role in reshaping the direction of national social, political, and economic development.

One reason to pay greater attention to the third sector is that it is the fastest-growing part of the U.S. economy. At the national level it now makes up approximately 10 percent of economic activity—somewhat more if counting employment, somewhat less if counting the value of economic transactions. In some regions, cities, and communities the third sector is a far greater economic factor. For instance, a study published as this book was being completed shows that in the New York City economy the third sector (defined more narrowly than in this book) accounted for 11.5 percent of economic activity in the city and 14 percent of its employment (Seley and Wolpert 2002, 29–31). The study shows that during the 1990s in New York City nonprofit organizations were the fastest growing source of jobs. Their share of employment now outranks the city's signature financial, insurance, and real estate (FIRE) sector (32).

Why is this phenomenon so little known? First, it must be said that there is much literature on nonprofit organizations, numerous accomplished researchers are studying the field, and the Association for Research on Non-profit Organizations and Voluntary Action (ARNOVA), which is made up of professional and academic researchers, is dedicated to it. Although it draws on this literature, this book begins with the question of development, especially where it is lagging in both rural and urban settings, and looks to see what new approaches using these organizations might have accomplished. Some of my prior writing has dealt with the world of cooperatives. The portion dealing with development has focused on what Hazel Dayton Gunn and I have called "alternative institutions of accumulation," alternatives to first-sector businesses. For healthy parts of the economy the process of capital accumulation goes on routinely. In poorer areas something else has to jump-start the process and keep the surplus, the newly generated capital, in the communities and available for reinvestment. This is the role that some dynamic third-sector organizations can play, along with their other generally good work. The organizations and the process are what this book is about.

## Acknowledgments

**B**ecause this book reflects, and reflects on, the work of many people in third-sector organizations, it is to them that I owe my first thanks. Their commitments and inventiveness are described here, and I thank them for the time spent with me explaining their successes, failures, and aspirations. The two years of empirical work that went into the book were a pleasure because of conversations along the way with these remarkable agents of change.

Teaching at a liberal arts college (plural in the case of Hobart and William Smith) means that one's research and teaching often overlap. Before this book began to take shape I was able to initiate a course called Third Sector Economics. Thanks to the students who ventured into this new offering, to Hobart and William Smith for the environment and support to develop new courses of this kind, and for summer research funding to carry out some of the fieldwork for the book.

I frequently get to share ideas on local economic development issues with a remarkable group of faculty and students in the Department of City and Regional Planning at Cornell University. I began talking about the role of nonprofits, cooperatives, and credit unions in development with them several years ago, and those conversations helped stimulate what follows. My thanks to many occupants of West Sibley Hall for their ongoing engagement with these issues.

My greatest debt in this project is to Hazel Dayton Gunn. In addition to

her own work she has been actively engaged as this book unfolded, responding with a fine critical eye and ear to the ideas, accompanying me on many site visits, and vetting draft material. To Hazel I am deeply indebted in so many ways.

Last, when I pitched the idea of this book to Cornell University Press, I received a very enthusiastic response from Frances Benson. She encouraged the project from the beginning and supplied an important part of the title. Many thanks, Fran. Thanks as well to Pat Coate and Ange Romeo-Hall for helping to polish the manuscript into the form that follows. Any remaining mistakes are of course my responsibility.



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## The Third Sector

**T**he capitalist economy succeeds and fails, often at the same moment. Where it performs well it tends to be embraced as the only viable way to organize material affairs. Economic growth is capitalism's strength; problems such as income inequality and environmental degradation are troublesome but are often seen as manageable with growth or technological innovation. Where capitalism has yet to work its growth magic people in relatively poor communities and regions have two options: wait in the hope of being seen as attractive to capital or do something different. This book is about pursuing the second option.

Neither capitalist nor public, the *third sector* is the third element in the mixed economy of the United States. It consists largely of private organizations that act in the economic arena but that exist to provide specific goods and services to their members or constituents. These organizations act neither to enrich "owners" nor to provide high income to top executives. Some are used to protect entrenched interests, and others are used to do social good.

Nonprofit organizations fall into two broad categories: some serve only their members, and others perform a broad array of public services. The first group includes social clubs, political parties, labor unions, business associations, and cooperatives. In the United States they are typically incorporated under Internal Revenue Service 501 status and are exempt from federal and some local taxation. Nonprofits that meet public service criteria

include religious organizations, social service providers, art and cultural organizations, foundations, and educational institutions. The fact that they serve public needs beyond their membership or create public goods can enable them to apply for U.S. IRS 501(c)(3) status. Contributions to 501(c)(3) nonprofit organizations are tax-deductible to donors, providing incentive for monetary donations to those institutions.

Table 1.1 contrasts the third sector with the first and second sectors, the two larger players in the economy: the private, for-profit sector; and the public sector. The *first sector* is the heart of the U.S. economy. Its most numerous organizations are small businesses, but its most important organizations by almost all other measures are large corporations. For-profit corporations exist to enrich those who provide them with equity capital, and in return those organizations provide people with goods, services, and jobs. The *second sector* consists of government organizations at the state, local, and federal levels. Government is (ideally) under democratic control and exists to do the business of its citizens. In general terms the relative proportions of economic activity by each sector in the United States are as follows: first, 65 percent; second, 25 percent; and third, 10 percent.

The term *third sector* is used broadly here to denote a mix of nonprofit and cooperative economic organizations and their activities.<sup>1</sup> For reasons to be discussed below, this is the fastest growing of the three major sectors in the U.S. economy. Cooperatives have been part of the economic and social history of the United States for over a century. They are best known in their consumer cooperative form but are still often unrecognized as representing a unique kind of business. For example, shoppers at Recreational Equipment Incorporated (REI) may not think about what sets this supplier of outdoor equipment and clothing apart from others, and the nation's more than seventy million credit union members may rarely recognize that they are being served by their own financial cooperatives. Workers' cooperatives have a long history in this country as well, especially in the plywood industry, but this form of co-op is even more obscure than the others.

Nonprofit organizations, while more familiar to many people than cooperatives, have received little attention in the economics and business literature, and they have only become a field for academic attention in recent decades. Mention nonprofits to most people and they think of their religious institutions, clubs, or the United Way. Many are surprised to hear of the more entrepreneurial side of this sector—for instance that the Green Bay Packers of the National Football League is a nonprofit organization. Irony abounds in the fact that the New York Stock Exchange—bastion of

**Table 1.1** Sector Characteristics

Characteristics	Third Sector (Nonprofits and Co-ops)	Second Sector (Government)	First Sector (For-profit Corporations and Small Businesses)
Ownership	Private organizations and their members	Public	Private individuals and first- and third-sector organizations
Funding	Donations, grants, revenues, and loans	Taxes, revenues, and loans	Equity from investors; loans; retained earnings
Motivations	Serve general public or members	Provide public goods and services	Profit (return on investment)
Dispersion of net income	Retained for operations or asset development	To public coffers	Dividends to stockholders or retained earnings for growth
Dispersion of net assets if dissolved	Generally to other nonprofits; some conversion to private and for-profits (e.g., hospitals)	To other public agencies; to public coffers after privatization	Sale within private sector
Earnings taxed?	Generally not; yes in the case of for-profit subsidiaries and cooperatives	No	Yes
Property taxed?	Generally not; yes for for-profit subsidiaries and cooperatives	No	Yes, except when abatements are provided
Create jobs?	Yes	Yes	Yes
Range of compensation	Low to high	Moderate	Low to very high
Attract volunteer unpaid labor?	Yes	Limited	No

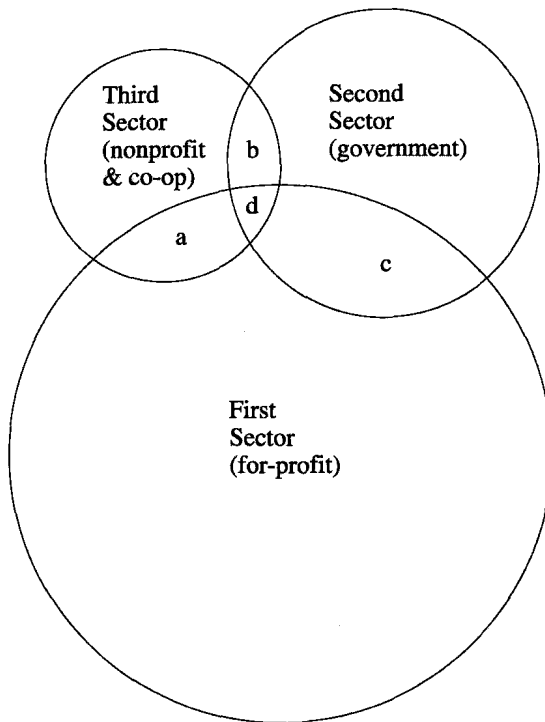
capitalism—is a nonprofit association. How it fits into the nonprofit world will be made clear in chapter 2. Internationally efforts to foster development and deliver humanitarian aid through the use of nongovernmental organizations (NGOs)—nonprofits—are better known.

The United States has a larger third sector than most other nations, for complex reasons that will be discussed throughout this book. Traditionally this has been the “caring” or “voluntary” sector responsible for social conditioning through religious, educational, and civic organizations and through philanthropies. But from this tradition a new breed of nonprofit and noncapitalist organizations has emerged that can serve communities facing needs created by capital’s failure, neglect, or flight. The innovative use of these noncapitalist (and nongovernmental) organizations to stimulate development concerns more than just economic development, as it also intersects with current needs to revitalize communities and enhance civil society. Third-sector organizations are providing these needs in numerous fields of activity in all parts of the country. Diverse examples include arts organizations that help revitalize depressed downtown or industrial areas; credit unions that bring financial services to people whose only other local options are the pawnshop and loan shark; and child-care providers who organize their own company as a cooperative in order to provide both better care and better jobs.

## Hybrids and Migration

The three sector designations used in this book provide a picture of the U.S. mixed economy, but that picture is unrealistically static and strictly delineated. Movement of resources takes place between these sectors, and organizations migrate between them. In addition important hybrid organizations incorporate features of two and even all three sectors.

Some of this overlap and ambiguity are captured in Figure 1.1, in which the three sectors appear as overlapping circles. The overlapping of third-sector and for-profit worlds, area “a” in the diagram, is exemplified by the for-profit subsidiaries of nonprofits, such as a real estate development project, and by the charitable foundation of a for-profit corporation. Area “b” is the hybrid world of third- and second-sector (governmental) operations, illustrated by the example of local development organizations that operate under the auspices of, and for, county or city development projects. Public, private-sector partnerships illustrate area “c” hybrids, which commonly



**Figure 1.1. The three sectors and hybrid segments of the economy.**

carry out local development and sometimes operate the new assets resulting from that development. The diagram has been constructed with an additional point of overlap, area "d," among all three sectors. While it is not common to find an organization that fits this space on the diagram, joint ventures between organizations in all three sectors make it relevant. In addition some of the more dynamic third-sector cases (to be encountered later in the book) demonstrate overlap and cooperation between the third and both other sectors.

Organizational migration between sectors occurs when a nonprofit organization converts to for-profit operation or when a cooperative is sold to private investors. Public-to-private migration occurs through the sale of public assets in the practice known as privatization. Migration between the second and third sectors takes place when public hospitals are converted to nonprofit operation. Funds and personnel also migrate among the three sectors. The point is that the economy is dynamic and fluid not just in its ability to

grow but also in the combinations of organizations, funding, and tools it uses to get results.

## Unheralded Initiatives

Why have people heard little about growth of the third sector and development initiated by it? There are several reasons, and one is that a more entrepreneurial third sector is a relatively recent phenomenon that has gained momentum in the past few decades. Prior to approximately 1975 this sector was dominated by the traditional charities, universities, clubs, and religious organizations that remain its largest components.

Another part of the answer to the question is that the third sector is a pastiche—a collection of organizations that are usually defined by their *not* being of the larger two sectors but that are otherwise varied in nature. Historically the nonprofit, voluntary sector has not generally been associated with organizations such as credit unions and cooperatives, which have been accounted for in small categories of their own. This continues today with some cooperatives referring to themselves as part of a fourth sector. However, credit unions are quite simply financial cooperatives, and cooperatives do not exist to make profit in the usual sense of the term. If a co-op makes a surplus (sometimes called profit) in any given year, it is either used for new investment in that co-op or returned to its members. No outside stockholders await their dividends or capital gains from owning shares of cooperatives. Lenders to them get interest but no managerial control. By adding these private, nonprofit organizations to an already eclectic group based on a neither-nor definition, a sector comes into view in a way that highlights new strategies for locally based development. Communities and individuals have recently recognized and acted on these options, and the results of their entrepreneurship deserve wider recognition.

Another obvious reason for the obscurity of this sector is that people live in a society (the United States especially) that has spent the past two decades emphasizing the primacy of the private for-profit sector and its use for development. The mantra of markets and privatization has been reinforced by the collapse of state-based socialism internationally and by powerful ideological campaigns at home. (These campaigns were of course often assisted by think tanks of the political right—nonprofits all.) Entrepreneurship has been celebrated in small businesses, dot.coms, e-businesses, and other forms, but rarely has the celebration taken account of new third-sector, and

more social, forms of entrepreneurship. Since the accepted rationale for entrepreneurship is that it can make you rich, why pay attention to a form that won't?

One other reason for the obscurity of initiatives in the third sector deserves mention. Most of the cases presented in subsequent chapters highlight organizations and initiatives that are small (by Fortune 500 company standards) and local. Even if they have received national attention—and some have—it has generally been fleeting. They may matter enormously in their communities or even regions, but they do not have the national or global impact of, for instance, a new Microsoft. Why then discuss them as tools for development? The answer is simple: they create jobs, build linkages that encourage other start-ups, provide goods and services, and improve peoples' lives. This is development. And unlike organizations of transnational capital, these initiatives tend to be grounded in place. As communities seek stability in a world of change created by ever more mobile capital, this is a valuable contribution to development that can last.

## Problems in the Third Sector

While this book applauds third-sector development, it does not idealize it. Associating terms such as *caring organizations*, *charities*, *trust-based organizations*, and others with nonprofit organizations can be misleading. People who manage nonprofits or serve on their boards know all too well the struggle these organizations face to meet their obligations to their communities and their staffs. They may not be the best employers in town, despite their mission statements, and they can go astray ethically or in choice of ventures. They are generally dependent on donations, and hence they may be subject to the whims of major donors. They can be hierarchical or dominated by one key individual. On balance they show some of the same positive and negative attributes of the organizations making up the two more dominant sectors. That does not preclude their being useful and sometimes downright inspiring.

This book is being written at a time when the news is full of scandals in the first sector. Corporate America is reeling from evidence of corporate wrongdoing, accounting malfeasance, and damaged reputations. The third sector has had its share of the same kinds of problems, but its smaller scale has meant that it did not gain as much attention in the news. Still, large problems have been visible. For instance, the disasters of September 11, 2001,



were followed by a meltdown in the reputation of a nonprofit on which the nation depended to recover: the American Red Cross. Its decision to set aside some of the funds donated for victims of the September 11 attacks angered the public and led to the resignation of Dr. Bernadine Healy, its CEO. Subsequently the organization has come under heavy public and official pressure to be more open about its operations and finances (Strom 2002). In New York in early 2002 the vice president of the Local Initiatives Support Organization, a large and respected community development organization, was indicted for embezzling \$1.8 million from one of the organization's subsidiaries (Pristin 2002). In Virginia, Jerry Falwell has attempted to use his nonprofit ministry to develop and build a large retirement community, Liberty Village, which would exclude gays and lesbians. Foundations provide shelters for private wealth because they supposedly operate for the public good, but their history suggests that some simply function as mouthpieces for their founders' views of the world (Dowie 2001).

Third-sector organizations are of this world, not of some idealized realm. They can be used for good and bad, and they require careful guidance. Since most of them operate with donated funds, they sometimes face censure from the public at large in the form of dwindling financial support. They also require some regulatory oversight, a topic discussed in chapter 11.

## Local Initiatives in Global Context

People in this country have *almost* reached the point where writing about local economic initiatives is not dismissed as "useless because we live in a global world." We do live in such a world, but many a community is not being served well by the global economy. Rather than waiting for capital's sun to shine on them or trying to outbid their neighboring communities to entice capital to favor them with new investment, people who live in poorer communities—those missing the blessings of the global economy—may decide to take action for themselves. Because few individuals in these communities have the resources to step forward and take on the traditional role of private entrepreneur, collective action may be the answer. It can take public-sector form, and historically it has, even in the United States.<sup>2</sup> However, trends of recent decades (privatization, tax revolts, and strained local public budgets) have made this strategy more difficult. Public initiatives that can aid development, such as provision of adequate and high-quality public goods (e.g., education and transportation), should be part of any local