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THE ROLE OF THIRD SECTOR IN ECONOMIC CRISES

SUMMARY

The aim of this study was to present the role of third sector in economic crises with the particular case study of its role in the last economic crises in Europe.

The economic crises brought about a reduction of both government funding and corporate giving, also decline in income from philanthropy. Most responses from the third sector were reactive and passive in nature — reduction or freezing of wages, dismissal of workers, shutting down existing and delaying the beginning of new programs, and the reduction or cancellation of services. However some of the actions were more proactive. These can be divided into two groups. The first one is external in nature. Statutory activity of the third sector has focused on the introduction of programs and initiatives designed to counter the effects of economic crises and increasing the transparency of doing business, in particular financial operations. The second type of activity is associated with the still unappreciated role of the third sector as a business player. Nonprofit organizations can ameliorate the impact of an economic crisis by making efforts to maintain their activity despite zero or negative rate of return diversifying funding sources and entrepreneurship, increasing cooperation with other sectors (governmental and private).

Keywords: institutional changes; European Union; nonprofit sector; charities; independent sector; voluntary sector; social economy

JEL Classification: K1; K3; K4
INTRODUCTION

It is worth looking at the role of institutions in economic crises not just through the lens of the institution of state. Much has already been said about that. What is completely forgotten is the third sector and it too, in a crisis situation, can play a material systematizing, disciplinary and even leading out of the crisis and into growth role. When the crisis is overcome, it is likely the for-profit rather than nonprofit institutions that will be the driving force for growth. Traditionally they are backed by a bigger economic potential, they adopt faster and more dynamically to changing market conditions. Such is their role and such are the expectations of their closely tied beneficiaries, whom they are meant to serve and produce profits. However, in the period of stagnation and crisis, institutions of the third sector will survive longer since they are not expected to generate a profit and they are the ones that preserve jobs. This article is meant to answer the question as to what role nonprofit organizations can play in mitigating the impact of economic crises.

1. TERMINOLOGY AND METHODOLOGY OF RESEARCH

There would be no need to devote space in this article to definitions of institutions if they were understood as it traditionally happens in the new institutional economy, in which, following D. North\(^1\), they are defined as society’s rules of the game, limitations of human relationships invented by people; legal, administrative and customary relationships of the repetitive human interactions; systems of formal rules (defined, in terms of forms, i.e. set and written by man, for example legal norms, property rights) and the informal ones (undefined in terms of their form). However, in this paper institutions are understood as per the definition given by N. Acocella\(^2\), who emphasized that by institutions he understands not just the collections of principles which regulate in a permanent manner the relations within a certain group of entities (e.g. marriage, private property, the market), but also entities involved in the execution of these rules in practice and the resources necessary to do

so (e.g. the government, family, the mafia). According to D. North, that other definition of institutions also extends to the so-called “players”, i.e. organizations (financial institutions, state institutions, public institutions), such as political parties, government, agencies, churches, enterprises, clubs that operate within the framework of rules set by the institutions. These organizations are created consciously with a specific purpose in mind. It is that second meaning that will be employed in the discussion of institutions in this article and its purpose is to introduce the third sector as a whole and its individual organizations as players into that set since, characteristically, they are not listed as such even as an example.

The term third sector, transplanted from the English language, refers to the concept of dividing the socio-economic activity of modern democratic states into three sectors. In addition to the institution of state and public administration (the first sector) and private for-profit entities (second sector), there exist organizations which are neither geared towards making a profit nor are they part of the state structures, they therefore constitute the third sector. Other terms are also used in both everyday and in legal and lawyerly language, emphasizing those features of the organization, which it highlights itself or ones which draws attention specifically to that feature. Thus, there is talk of charitable organizations, or in order to emphasize their non-governmental nature, of non-governmental organizations (NGOs), social (civic) organizations, volunteer when one wants to highlight those, whose activity is based on work of the volunteers. Similarly, in other legal systems various names are used to describe organizations of the third sector: charitable organizations, non-profit organizations, voluntary sector or the independent sector.

However, for the purpose of this paper let us stay with the term “third sector” and let us assume that it includes the many very different organizations: foundations, associations, social organizations which resemble associations but are registered on the basis of separate regulations, church and religious organizations, self-governing business organizations, organizations of employers, trade unions.

The third sector is primarily the subject of analyses by sociologists, who follow carefully its manifestations and wonder about the factors and barriers to growth for this type of organization and the manifestation of a civic society. To these studies it is worth adding and indeed one should add the legal elements. Only such an approach will allow a complete recreation of third sector’s role in crisis, when the first sector, the state sector has failed and the second, private one, was halted precisely by the crisis.

Historic conditions for nonprofit’s growth in legal comparative frame in countries of the so-called old and new EU and empirical studies over
the actions and projects of nonprofit institutions conducted in connection with the economic crisis of 2008, demonstrated what kind of impact institutions of the third sector may have to mitigate the impact of that crisis and the impact they may have in the future. The analysis was conducted on two levels. The first one was defined in this study as an external one, that is simply as projects which are being carried out by nonprofit organizations in connection with the crisis, that is in order to better research its causes and sources and more specifically to increase the transparency and honesty in the way the other sectors conduct their activities, particularly with respect to all types of financial operations. The second level researched was the proprietary, internal activity of the nonprofit organizations. The third sector itself conducts operations, including business activities, which are preserved on the market even longer during the crisis and the employees engaged in those activities have a chance to retain their jobs longer. In its activity the third sector should serve as an example of honest business, including in issues such as capital management and in doing business only with transparent financial institutions, whose resources come from a known source.

2. NONPROFIT’S POLICIES AND ACTIVITIES AGAINST CRISES

In times of crisis the scale of unsatisfied social needs is growing while the available financial resources, both public and private ones, shrink. While an economic crisis causes the decline of economic activity, it does not have to lead to stagnation of institutions of the civic sector; on the contrary it can promote social legitimization of its activities. Nonprofit sector organizations are becoming more needed in a crisis but are able to “do less” when it comes to the provision of social services and the involvement of financial expenses. They can, however, design new solutions, focusing not only on some of the symptoms but on tackling the root causes of the financial crisis. Financial crisis is a window of opportunity for non-profits to create a watchdog system to rein in financial speculation and provide civil society’s oversight of markets.

Organizations of the third sector have plenty of experience in operating under the conditions of contractual weakness, arising above all from the strong information asymmetry. Consequently, they have developed the modes, rules, sets of procedures which lead to, at the very least actions on behalf of the par-

ty which taken on more risk (less informed and one investing its own resources), if not leveling the information asymmetry altogether and thus increasing the transparency of such situations. It is these mechanisms that can be utilized perfectly in times of crises\(^4\). Nonprofit sector can provide the much-needed resources to build the necessary infrastructure so that civil society can bridge the information asymmetry and effectively monitor business.

Whether it happens or not, that depends on the approach of specific society and the legal system to the third sector. In a crisis the role of the third sector cannot be reduced merely to the development of a civic society, i.e. to having the people perform various actions together, regardless of the result of these efforts. Since state institutions, including control and supervisory ones, have failed, its role is also no longer reduced to that of relieving the state in the performance of public functions (the subsidiarity theory). In an economic crisis, the third sector’s role is perceived mainly according to the theory of pluralism, which highlights autonomous activity and heterogeneity of the society. Role of the third sector is seen not so much as being complementary (as in the subsidiary model), but in creating a counterweight to the state and a field for self-realization of various social initiatives independently from the state. The role of social organizations is precisely to complement the state’s actions in controversial areas and by their very nature minority-focused ones and perform control functions in others, especially where the information asymmetry is the greatest\(^5\).

Consequently, the role of the sector’s external activities in mitigating the effects of economic crises can be roughly grouped into three categories: 1) research initiatives aimed at rethinking financial and economic framework both nationally and internationally; 2) advocacy campaigns aimed at promoting transparency; and 3) projects to support ethical investment.

Let us follow several specific and characteristic initiatives in these groups. Within the first group the following initiatives deserve a particular attention: – the New Era Economics program of the Institute of Public Policy Research, in UK\(^6\), the New York-based Institute for New Economic thinking\(^7\), New Economics Foundation\(^8\) — all of them to promote the need to complex approach in new economy — economy after crises and to run high quality,

\(^6\) Institute for Public Policy Research, (22.04.2016).
ground-breaking research that shows what is wrong with the current economy and how it can be better;

– the High Pay Commission, investigating the salary gap in the public and private sectors⁹;

– the Financial Transparency Coalition¹⁰, group that brings together civil society and governments around the world to advocate around six policy areas for financial transparency — public country-by-country reporting of sales, profits, and taxes paid by multinational corporations; public registers of beneficial ownership of business entities; automatic cross-border exchange of tax information; open data; ensuring that the institutions making international standards are equitable; holding the enablers of illicit financial flows accountable. This last issue costs developing countries nearly a trillion dollars each year¹¹;

– Die Initiative Neue Soziale Marktwirtschaft (the Initiative New Social Market Economy — INSM)¹² — a cross-sector, cross-party NGO that supports fair competition, entrepreneurial freedom, redistribution of wealth, equality of opportunity and a responsible policy of generational equity. It is funded by the employers’ associations of the metal and electrical industries. The initiative supports the trend of new social economy in Germany¹³.

Within advocacy campaigns aimed at promoting transparency following campaigns had been initiated:

– the Bretton Woods Project¹⁴ promoted by ActionAid to monitor the policies of the World Bank and the IMF — this project officially promotes itself as critical voices on the World Bank and IMF;

– the Tax Justice Network, fighting against tax havens;

– the Washington-based Bank Information Center¹⁵ — to protect economic, social, cultural, and environmental rights; monitor high-risk or otherwise problematic projects throughout the world financed by Multilateral Development Banks (MDBs) like the World Bank Group, and to organize

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¹⁰ The Task Force on Financial Integrity and Economic Development.
workshops on issues like access to information and coordinate on project monitoring with civil society partners around the world;
– the Fair Pay Network\textsuperscript{16}, advocating for decent and proportional salaries;
– the British research and advocacy network Corporate Watch\textsuperscript{17};
– the initiative Corporate Europe Observatory\textsuperscript{18}, focusing on the power of lobbies at the European level.

Within promoting ethical investments III sector has always been active and the crisis has led to the creation of numerous international projects, such as:
– Your Ethical Money\textsuperscript{19} — which is an independent, nonprofit recourse on ethical money;
– the groundbreaking charity that promotes Responsible Investment by pension funds and fund managers Fair Pensions\textsuperscript{20};
– and finally it is worth mentioning the rapid and direct response of the third sector to the crisis, namely the Social Business Tour, conducted by Erste Stiftung initiative\textsuperscript{21}, which took place from May to October 2010, the Tour offered information and encouraged the sustainable initiatives of social enterprises in six capitals from East and Central Europe (Belgrade, Bratislava, Bucharest, Budapest, Prague, Vienna)\textsuperscript{22}.

Although often focusing on specific issues and only marginally on financial transparency and accountability, some of these initiatives are becoming interesting “incubators” to test the feasibility of an international watchdog movement of financial markets. What is also important is that they also promote international cooperation on several levels, not merely at the level of nonprofit organizations, but also collaboration with the governments of various countries and with the entire public sector in general.

\textsuperscript{17} Corporate Watch, http://www.corporatewatch.org (22.04.2016).
\textsuperscript{18} Corporate Europe Observatory, http://corporateeurope.org (22.04.2016).
\textsuperscript{22} Ibidem.
3. PROPRIETARY ACTIVITY
OF NONPROFIT INSTITUTIONS DURING A CRISIS

3.1 BUSINESS ACTIVITY OF NON — PROFIT INSTITUTIONS

Organizations of the third sector were allowed to conduct business activities, not without reservations, both legal and social, or more properly the legal ones were the result of social objections\textsuperscript{23}. For years it was believed that organizations of the third sector should not be involved in business activity. This, of course, was done to ensure doctrinaire purity of the construct, but due to the very practical consequences associated with the fact that nonprofit organizations are granted a number of legal privileges, including fiscal ones. In order to obtain and then retain those privileges, an organization must remain nonprofit, otherwise it would constitute an unfair competition for organizations which operate openly on a for-profit basis, which may not take advantage of public privileges.

The economic crisis has accelerated that the business activity of third sector turns out to be in many respects more durable and more resilient to crises than the activities of for-profit organizations. An argument is raised that conducting such activities does not violate the nature of nonprofit institutions, whose essence is not that they are not turning a profit, but rather that profit is not the superior or the sole goal, but is instead subordinated to the achievement of another goal. That very feature allows the business of a nonprofit to survive market gyrations. Any kind of a profit gives them the basis for growth or at least surviving while the same rate of return in a for-profit institution — especially due to expectations of their investors, shareholders and all other beneficiaries able to claim payment of their funds, would even be the basis for the withdrawal from business activity.

The advantage of the third sector in a crisis is also that, which in the second sector is the source of defeat in business — that is limited flexibility. When demand falls, nonprofit organizations have much lower chances to reduce their market share than the for-profits, precisely because they are less flexible and slower to react to market changes. They stay on the market longer because, due to different basic goals, even a zero rate of return is often sufficient for them. Of course they close some projects, limit others and more often and on a wider scale use the work of volunteers, but it is precisely that, which allows them to survive.

\textsuperscript{23} Still not in all the European countries or even the EU — in Austria for example it is inadmissible for a foundation to conduct a business activity.
The thing that also makes nonprofit organizations resilient to crises is also the type of activity they conduct in the first place, particularly in business. The choice of the subject of activity of nonprofit organizations has a different significance than the selection of activity in a for profit organization. In the case of enterprises, the expected income has a material significance and with respect to nonprofit organizations, it is the achievement of some superior goal. In a crisis this activity geared towards profit-making loses out much faster than the one focused on achieving a specific goal. It turns out then, that nonprofit institutions can be more durable on the market and therefore conduct their activity and maintain jobs for a longer period of time; more on this is in point 5.

3.2. ETHICAL BUSINESS ATTITUDES OF THE NONPROFITS

Nonprofit organizations can also support exiting from the crisis by their attitude in all of their activities, both economic ones and those focused on the achievement of their statutory goal. This consists of the supporting and promoting the fundamental value of ethical investment and that is transparency in two aspects: the way in which resources are being accumulated (“where does the money come from?” “was it generated ethically?”) and in administrating their endowment and capital. It is the third sector where cooperation exclusively with ethical banks, using pension funds to promote social welfare investments, and demanding full transparency and accountability on the part of their banking counterparts should be basic and unquestionable rule. By rethinking their internal and external functioning, including their own salary policies and housing and representation expenses and their investment policies (and making all of this public), nonprofit organizations can already make first steps to reshape the financial system. Whether concerned exclusively with social welfare issues or some other areas, these changes should be part and parcel of any public-benefit organization.

4. THIRD SECTOR AS AN EMPLOYER

The role of nonprofit institutions in mitigating effects of economic crises is also associated with the significance of these institutions as an employer. However, in this field there are still very significant differences visible, even within the European Union, between countries of the former socialist block and the “old” democracies of Western Europe. The most comprehensive studies of the third sector globally have been conducted since 1995 as part of the John
Hopkins Comparative Nonprofit Sector Project. As part of this program it was determined that the third sector engages between 14.4% and 0.4% of the economically active part of the population of individual countries (the survey was conducted in 35 countries), of whom between 40% and 80% are working for pay and 20–60% are volunteers. The third sector is bigger in economically developed countries (on average it engages 7.4% of the employees) and is significantly smaller in the developing countries (1.7% of the employees engaged). It is invariably a huge employer in countries with a long-term tradition of the development of civic society. In the Netherlands, Belgium, the US, the UK, Norway and Sweden, the third sector accounts for respectively 14.4%, 10.9%, 9.8%, 8.5%, 7.2% and 7.1% of paid, economically active part of the society. Meanwhile, in countries such as the Czech Republic, Hungary, Slovakia, Poland and Romania, it is only 2.0%, 1.1%, 0.8%, 0.8% and 0.8%.

Even after a generation since the fall of the Berlin wall, there is still a gap between the strength of the third sector between old and new member states of the EU, which shows that whilst civil society can emerge as a spectacular catalyst for change, growing it is a long-term process.

Within the group of post-communist countries it is also important that the number of nonprofit organizations using paid work is as low as in the 1980’s, when this sector was just emerging. Nonprofit organizations have not held out against the economic crisis in those countries. Compared to 1997, paid work was offered by a much lower number of organizations surveyed. The share of organizations possessing any kind of paid staff in Poland fell by 8%, while the share of organizations having staff employed on the basis of regular contracts of employment fell by as much as 16%. Organizations are unable to retain salaried staff and are therefore only using paid work based on temporary job contracts — hence the increase in the percentage of organizations that were only employing staff based on temporary project contracts and commission contracts (an increase by 9 percentage points). According to the state at the end of 2012, only 39% of organizations surveyed have used any kind of paid work — 22% were hiring staff based exclusively on temporary contracts and just 17% had at least one salaried employee. Differences

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in the scale of the use of paid work clearly show the heritage of the 50 years of totalitarian governments in Central and Eastern Europe. Boosting the significance of the third sector as an employer should be a priority for new EU countries, in times of crisis it could prove to be a more reliable employer than private entrepreneurs.

Combining the discussion in this and the previous chapter one must also notice that third sector organizations can mitigate effects of crises also through their very presence on the market, they conduct business activity, employ staff based on temporary contracts, collaborate with other entities regardless of what they do.

5. RESULT OF RESEARCH

Summarizing the theses of this article it should be emphasized that the most important input of third sector to fight the crises is when it makes use of it’s convening capacity to connect experiences and provide a neutral locus for interaction, networking, and cooperation both internationally and nationally, also at the regional and very local level. By getting involved, directly or indirectly, to support civil society’s action as a watchdog of the financial sector and sustain a full-fledged social movement, third sector may help citizens keep finance in check starting from very local up to international level. However it has to be underlined that nonprofit organizations are actors of civil society only up to the extent, to which democratic societies allow them, creating a specific legislative framework and financial background.

CONCLUSIONS

The role of third sector organizations in a contemporary economy in general and the mitigation of the impact of economic crises in particular is graver and more serious than would typically be ascribed to them. A critical civil society will be able to introduce such rules for the operation of the third sector that will retain a proper balance in relation to the first and second sector. Nonprofit organizations should be seen as a guarantor of transpar-

ency and good governance. These, in turn, are the two core values needed for the development of responsible financial institutions, strengthening social welfare and, ultimately preventing future and mitigate the existing economic crises. Plans for risk management, crisis response, and crisis communication can mean the difference between going under and getting back on track. While many of the steps required in the development of such plans are useful for coping with crisis, others are good practices even under normal circumstances. This means for the most being fiscally responsible, establishing strong communication policies, protecting employees and volunteers, and creating an efficient managerial structure. Final conclusion is also that closing the gap between countries with long democratic tradition and new EU countries is bound to be a slower process as a result of the crisis.

BIBLIOGRAPHY


