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Do non-profits make a difference?

Evaluating non-profit vis-à-vis for-profit organisations in social services

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Abstract in English

This CPB Document provides a framework for the evaluation of non-profit organisations. This framework addresses the question under which conditions, and, if so, in what way non-profits should be stimulated. Essentially, in order to answer these questions, three steps can be followed: (i) identifying potentially relevant market failures that non-profits may aim to diminish; (ii) linking market failures to observed performance indicators for profits and non-profits; and (iii) use these insights to derive policy implications: should non-profits be stimulated? We apply the proposed framework to three sectors that are commonly labelled as 'social services': the care sector, the childcare sector and welfare-to-work services. All these sectors are subject to substantial informational problems regarding the quality of services. When surveying the literature, we find non-profit organisations only to make a difference in some specific cases. So far, there is no strong evidence that can be used as an argument to stimulate non-profit organisations in mixed markets. Moreover, such (targeted) policies may discourage donated labour and private donations, thus rendering them largely ineffective.

Key words: firm organisation, non-profit organisations and public enterprise, legal status.
JEL code: L22, L3.

Abstract in Dutch

In dit rapport ontwikkelen we een kader ter bepaling van de omstandigheden waaronder het zinvol is voor de overheid om niet op winst gerichte organisaties te subsidiëren of anderszins te bevoordelen. Dit kader omvat de volgende onderdelen: (i) mogelijke marktfalens identificeren als rechtvaardiging voor niet op winst gerichte bedrijven; (ii) deze marktfalens koppelen aan de relatieve prestaties van niet op winst gerichte versus op winst gerichte organisaties; (iii) om met deze inzichten passende beleidsimplicaties te formuleren. Het kader passen we toe op ziekenhuizen en kinderopvang- en re-integratieinstellingen. Deze sectoren zijn allen sterk gevoelig voor informatieproblemen, met mogelijk een lage kwaliteit van dienstverlening als gevolg. Uit de internationale literatuur blijkt echter dat niet op winst gerichte organisaties alleen in specifieke gevallen betere kwaliteit leveren en dus vanuit dien hoofde geen sterke argumenten zijn om niet winstgerichte bedrijven te bevoordelen vanuit de overheid. Dit kan zelfs averechts werken wanneer het de intrinsieke motivatie van werknemers bij deze organisaties ondermijnt.

Steekwoorden: non-profit organisaties.

Een uitgebreide Nederlandse samenvatting is beschikbaar via www.cpb.nl.

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Preface

Although their role and form have changed substantially, not-for-profit (NFP) organisations still serve as important delivery mechanisms of public services in the Netherlands. Advocates of NFPs argue that these act in the interest of society as a whole, that they have more public sector motivation than for-profit (FP) firms, and are better capable of meeting local needs than public organisations do. Examples include parental support in non-profit childcare organisations, or case-workers in the social sector that are intrinsically motivated to get less advantaged unemployed clients back to work. Opponents to NFP organisations however doubt the legitimacy of NFPs, arguing that the distinction between the profit and non-profit status has become largely irrelevant, both for its workers and its consumers.

This CPB Document provides a framework for the (economic) evaluation of NFP organisations. As such, CPB aims to contribute to the discussion on the pros and cons of NFPs, as well as the (regulatory) role of the public sector vis-à-vis NFPs. In the document, the framework that is proposed is applied to the hospital industry, child care and welfare-to-work services. For all these sectors, we are primarily guided by the international empirical literature, which is almost entirely based on data for North-America. The CPB document is published simultaneously with a CPB Memorandum that studies the evolution of the provision of childcare services by NFP and FP organisations in the Netherlands. We expect and hope this study marks the beginning of more empirical studies examining the conduct and performance of FP and NFP organisations in Dutch context.

This study has been written and coordinated by Pierre Koning, in close collaboration with a team of colleagues. Joëlle Noailly and Sabine Visser have contributed to sections 3.1-3.3 by providing literature reviews on the hospital industry and the child care sector, respectively. Gijsbert Zwart has contributed to section 3.4. Marko Bos (SER), Paul de Bijl, Raymond Gradus (Free University Amsterdam and Ministry of Social Affairs and Employment), Paul Grout (CMPO and University of Bristol), Jelte Theisens (Ministry of Economic Affairs) and Bert Tieben (SER) are gratefully acknowledged for comments on earlier versions of this study. Finally, we thank Peter Dekker and Bob Kuhry (SCP) for providing us with statistical information.

Coen Teulings
Director of CPB

Summary

A framework for the analysis of non-profits

In many countries, non-for-profit (NFP) organisations comprise an important part of the employment and production of workers. Although their role and form have changed substantially, NFP organisations still serve as important delivery mechanisms of public services. Advocates of NFPs argue that they may have more ‘public sector motivation’ than for-profit (FP) firms and are better capable of meeting local needs. Examples include parental support in non-profit childcare organisations or case-workers in the social sector that are intrinsically motivated to get less advantaged unemployed clients back to work. Opponents however doubt the legitimacy of NFPs. In particular, they argue that for both workers and consumers the distinction between profit and non-profit status is largely irrelevant. Like FPs, NFP organisations may encounter internal agency problems in monitoring their employees. These problems may even be larger than for FPs, since there is no market in ownership shares to prevent ‘managerial shirking’.

This CPB Document provides a framework for the evaluation of non-profit organisations. In particular, it addresses the question *under which conditions, and, if so, in what way non-profits should be stimulated*. Essentially, the framework that is needed to answer these questions consists of three steps: (i) identifying relevant market failures that non-profits may respond to or try to diminish; (ii) linking market failures to performance indicators for profits and non-profits; and (iii) use these insights to derive policy implications: should non-profits be stimulated? With this analysis, we combine recent advances in both theoretical and empirical economic analyses, so as to expose the legitimacy and effectiveness of non-profits. We apply the proposed framework to three sectors that are commonly labelled as ‘social services’: the care sector, the childcare sector and welfare-to-work (WTW) services. All these sectors are subject to substantial informational problems regarding the quality of services. Workers in these sectors may be intrinsically motivated to deliver social services. At the same time, the public interest in these sectors is substantial. In Anglo-Saxon countries, these markets are typically mixed, with both FP and NFP organisations.

In our analysis, we first characterise NFPs as potential ‘market failure correcting devices’, with asymmetric information, market power, (positive) externalities and distributional concerns as potentially relevant market failures. These market failures may trigger NFP organisations to act in the interest of consumers or society as a whole by providing higher quality of services and increasing the accessibility of services for consumers with a low income. The next question to be addressed is whether NFPs indeed make a difference with respect to the quality and accessibility of services. If not, the public sector may decide to use generic regulatory or

subsidy measures to combat market failures — irrespective of the legal status of service providers.

If NFPs make a difference and market failures are still important, there are three additional conditions that should be met in order to favour NFP organisations vis-à-vis FP organisations: performance outcomes should be hard to contract upon; subsidisation should not lead to substantial crowding out effects of donated labour and donations; and FP organisations should not be triggered to become NFPs, so as to extract subsidy rents. If these conditions are not met, standard regulatory measures that are not directed to a specific legal status should be carried out to correct for market failures.

The case of social services

When surveying the literature for the US and Canada on hospitals, child care and welfare-to-work (WTW) services, the key market failure is that of information asymmetry. In particular, service providers have the opportunity to skimp on quality aspects that are hard to monitor (‘moral hazard’). NFP organisations often consider the combat of these moral hazard problems as their primary goal — that is, they aim at providing better quality, which is in the interest of consumers. The evidence, however, suggests that NFPs only incidentally make a difference on quality. Thus, there is no strong argument here to favour organisations only because of their non-profit status. In contrast, there is some evidence that NFPs make a difference by providing services in specific markets — particularly with low competition — or to specific consumer types. This means that one of the most apparent aims of NFPs boil down to distributional concerns. If the government has similar (distributional) interests, this however is not an argument per se for favouring NFPs. Rather than that, subsidisation may take place by vouchers for specific consumer types. Particularly the accessibility of services by hospitals and child care organisations for low income customers is relatively well observable and therefore can be contracted on. Finally, and similar to FP organisations, NFPs seem susceptive to rents extraction. Generally, wages that NFP organisations pay are not systematically lower than FP organisations, efficiency costs are similar, and NFPs seem to respond equally to changes in competition. What this suggests is that donated labour and donations of NFP organisations — creating an advantage with respect to FPs — are not substantial, or are undone by inefficiencies.

Overall, for the three sectors under consideration the case for favouring NFP organisations by the government is weak: (i) NFPs do not seem to make a systematic difference in quality of accessibility of services; (ii) Residual market failures are often hard to substantiate; (iii) Some performance aspects of accessibility and — to a lesser extent — quality can be contracted upon, irrespective of the legal status of organisations; (iv) Public sector support for NFPs may crowd out private donations and donated labour; and (iv) Public sector support may trigger FP organisations to become NFP as well, but maximising rents extraction by other means than profit extraction. To conclude, the most apparent form of public sector intervention in mixed markets therefore is that of regulation. In particular, the public sector can increase market transparency and set quality standards, or subsidise the provision of services for particular consumer types or particular market types.

Policy implications

One of the basic policy lessons that follows from this — at least for social services — is that there is no obvious economic rationale for governments to subsidise or facilitate NFP organisations in favour of FP organisations. Essentially, this lesson also applies to the Netherlands, at least with respect to the child care and WTW-sectors. In both sectors, the primary goal of the government should be to increase the transparency of performance outcomes of (all) service providers, rather than relying upon the benevolence of NFP organisations exclusively. In the childcare sector, the recent liberalisation act seems well in line with this notion — NFP organisations are no longer subsidised by communities with exclusive contracts — albeit that the childcare market is still far from transparent. For the Dutch care sector, the policy implications of US studies should be interpreted with more care. Here, the major difference with the US is that *all* hospitals in the Netherlands are NFPs (FP hospitals are prohibited). The hospital market is not a mixed market, rendering the US evidence less relevant. In order to assess the impact of the entry of FP hospitals, the government could experiment by allowing some hospitals in some markets (or for some activities) to make profits. Next, performance outcomes relating to both the quality and accessibility of hospital services of FP and NFP hospitals can be compared. As an alternative, one may (already) compare hospitals with and without medical doctors and specialists that operate in partnerships where profits are allowed for.

From the analysis, we conclude that the non-profit condition is not a sufficient condition for 'making a difference' on quality or accessibility. This observation — i.e. the absence of any systematic proof that NFPs make a difference — in turn may discourage the provision of donated labour and private donations. The success of NFPs relies upon the existence of clear organisational missions that are actively given account for. This means they inform customers on the quality of services that have been provided, as well as the specific markets and client groups they want to focus on. Otherwise, there is a large risk that — particularly for larger organisations — the distinction between FP and NFP status becomes largely anachronistic.

As a final remark, it should be stressed that our arguments against favouring NFPs by the government are not an argument against NFPs. Instead, from our analysis we conclude that NFPs in fact can make a difference vis-à-vis FPs, particularly in markets where competition is low and/or when there is not many regulatory measures being taken by the government. In these markets, NFPs are probably are capable of attracting intrinsically more motivated workers.

More specifically, the virtues of NFPs are probably highest when market failures are substantial, and hard to be resolved by the government. But again, this is not an argument per se to stimulate NFPs, as one cannot (only) rely upon the legal status of these organisations, and this may even weaken performance.

1 Introduction

1.1 Research question

In many countries, not-for-profit (NFP) organisations comprise an important part of the employment and production of workers. As a percentage of the economically active population, Salamon et al. (2003) find the Dutch non-profit sector to be the world's largest (14.4%). The origins of the Dutch non-profit sector lie way back in the past, when many organisations were founded by institutions or private individuals. Later on, these mostly charitable organisations gradually transformed into professionalized welfare institutions (see e.g. Veldheer and Burger, 1999).

Although their role and form have changed substantially, NFP organisations still serve as important delivery mechanisms of public services. Advocates of NFPs argue that rents are used to the interest of society as a whole, that they have more public sector motivation than for-profit (FP) firms and are better capable of meeting local needs. Examples include parental support in non-profit childcare organisations or case-workers in the social sector that are intrinsically motivated to get less advantaged unemployed clients back to work. Following this line of reasoning, the 'Commissie Wijffels' stresses the importance of fostering and stimulating private NFP organisations (Ministerie van Justitie, 2006; Wetenschappelijk Instituut voor het CDA, 2005). Opponents to NFP organisations however doubt the legitimacy of NFPs.[1] In particular, they argue that for both employees and consumers the distinction between profit and non-profit status has become largely irrelevant. Like FPs, NFP organisations may encounter internal agency problems in monitoring their employees. These problems may even be larger than for FPs, since there is no market in ownership shares to prevent 'managerial shirking'.

For policy makers, assessing the role of NFPs is certainly nontrivial. One may argue that NFPs are just a fact of life, and should be treated similar to private FP organisations. Still, the formal missions of NFPs often show strong similarities with those of the government. NFPs generally aim at increasing the quality and accessibility of products, which may be an argument to stimulate NFPs, e.g. by favourable tax conditions. At the same time, one should be aware that the non-profit condition is not a sufficient condition to warrant social goals. There is a risk that rents provided by the government induce NFPs to raise wages, create inefficiencies, or even crowd out private donations or donated labour.

[1] In this discussion, the Dutch Social and Economic Council (SER) nuances the role of FP and NFP status (SER, 2005). Similar to NFPs, FP organisations may also adhere to public goals. And similar to NFPs, FP organisations then have to give account for these goals. This calls for good governance structures, regardless the legal status of organisations.

At present, policy debates on the organisation of 'public' services in the Netherlands are twofold. First, there is a persistent discussion on allowing for the distribution of profits in sectors where profits in principle are prohibited. For the Netherlands, examples here include the hospital and education sector (see e.g. Dijkgraaf et al., 2006). Second, when considering mixed markets, there is a debate on the distinctive roles of both FP and NFP organisations, and — related to this — the usefulness of favouring non profits, particularly by tax exemptions on the surpluses that NFPs may make. In the Netherlands, the share of FP organisations in the childcare sector and welfare-to-work sector has grown steadily in recent years. This raises the question whether increased FP shares reflect higher cost efficiency of FPs vis-à-vis NFPs, or an increase in the importance of market failures by lower quality levels that are provided.

This CPB Document provides a framework for the evaluation of non-profit organisations. In particular, it addresses the *question under which conditions, and, if so, in what way non-profits should be stimulated*. Essentially, the framework that is needed to answer these questions consists of three steps:

(i) Identifying potentially relevant market failures to which NFPs may be in response;

(ii) Linking market failures to performance indicators for profits and non-profits; and

(iii) Use these insights to derive policy implications: should non-profits be stimulated?

With this analysis, we combine recent advances in both theoretical and empirical economic analyses, so as to expose the legitimacy and effectiveness of NFPs. We apply the proposed framework to three sectors that are commonly labelled as 'social services': the hospital sector, the childcare sector and welfare-to-work (WTW) services. These sectors are all subject to substantial informational problems that may undermine the quality and accessibility of services. Furthermore, organisations in these sectors — both FPs and NFPs — are often large, with substantial professional standards that have to be met by their employees. Moreover, competition between organisations in these sectors can be large, raising questions on the extent to which NFPs can make a difference here. It is interesting to see whether NFP organisations can facilitate intrinsically motivated workers in such a setting.[2]

1.2 Methodological aspects

In this study, we adopt a *welfare economic perspective* of NPFs: we present a framework so as to investigate and define the conditions under which NFP organisations are beneficial for

[2] This contrasts to so called 'expressive functions' (see Salamon et al. (2003)), which involve activities for the expression of cultural, religious or policy interests and beliefs, and where volunteer work is the dominant provider of labour.

society and formulate and evaluate policy options that may of may not facilitate and stimulate NFPs to increase societal welfare. The key question here is whether such policies can be targeted at NFPs as a specific organisational type, or that more general (regulatory) measures are needed.

Obviously, the value of the framework we propose lies in its applicability to real life cases. We therefore have selected three sectors to do this: the hospital industry, childcare and welfare-to-work (WTW). More specifically, the choice of sectors can be summarised by the following keywords: public interest, professional standards, mixed markets, and empirical evidence:

Public interest

In this study, we focus on sectors where services are provided with substantial public interest: all sectors under consideration are plagued by substantial information problems regarding the quality of services that are provided. In this setting, the government either aims at services to be sufficiently accessible, or to warrant minimum quality standards. NFPs may have similar goals, and thus the government may decide to stimulate and facilitate these organisations.

Professional standards

We focus on sectors in which organisations have to meet various professional and educational standards that are set by the government. This means that NFP organisations cannot rely upon voluntary work as an important provider of labour. This contrasts to e.g. ideological or religious organisations, where voluntary work is the dominant provider of labour. When professional standards are important, the workforce of both NFP and FP organisations is dominated by paid workers, the possible difference between NFP and FP being that NFP workers are more intrinsically motivated.

Mixed markets

In all three sectors ― and for many countries ― both FP and NFP organisations operate as providers of services (‘mixed markets’). This means that FPs and NFPs in principle are competitors. There also may be mixed markets where public organisations provide services as well. In the Netherlands, this holds particularly for the education sector, where private education organisations are allowed for some market segments. Here, policy debates relate to the choice in which market segments private organisations should be allowed to operate and whether they should be allowed to operate on a level playing field, rather than relating to the legal status of these organisations (NFP versus FP). In this study, however, we abstract from these issues and concentrate on markets where private FP and private NFP organisations prevail. In this setting, the public sector takes regulatory measures, rather than providing services itself.

Empirical evidence

For the Netherlands, empirical evidence on the relative performance of NFPs vis-à-vis FPs is virtually absent. So far, in the international literature most evidence is based on data from the US and Canada. When surveying the literature, we therefore concentrate on these two countries, particularly for the care sector. Obviously, from these results we cannot make inference that can be fully translated to the Netherlands. Still, we believe that insights from the literature provide useful guidance on the determinants of the performance of NFPs, as well as the relative importance of legal status in explaining market outcomes, compared to e.g. the level of competition or the impact of regulatory measures by the public sector.

In what follows, we explain and apply the proposed framework — that is, sections 2 to 4 address the three consecutive steps for three sectors under investigation. Section 5 concludes.

2 The origin of NFPs; market failures

2.1 Some statistics and institutional matters

In the Netherlands, NFP organisations are either foundations or associations. Here, the key distinction is that associations consist of individual members, and foundations do not. Both of these organisations are treated similarly by the fiscal authorities (see text box). Table 2.1 reports the importance of NFP organisations for various (service) sectors, measured in terms of the total amount of national income that is devoted to them.

Table 2.1 GDP spending on various social services sectors in 2002 (billion euro), stratified according to NFP, FP and public organisations

Sector	Spending (bln)	For-profit	Not-for-profit	Public
Government administration	13.0	0	0	100
Defence	6.1	0	0	100
Police, justice	9.0	0	5	95
Fiscal authorities, social insurance	8.5	0	20	80
Education and research	26.1	0	37	63
Care	53.4	6	58	35
Culture and recreation	15.2	18	48	34
Social organisations	3.0	0	100	0
Infrastructure	17.1	0	1	99
Public transport	4.3	55	0	45
Environment	7.0	60	0	40
Public housing	12.9	25	75	0
Total 'social services'	175.6	20	39	41

Source: SCP (2006)

Table 2.1 makes apparent that NFP organisations are important in the administration of fiscal and social insurance, education and research, the care sector, the cultural and recreational sector and in public housing. In most of these sectors, however, NFPs do not compete with FPs. Instead, they are either predominantly publicly financed (fiscal and social insurance, education and research, care) or are social organisations that benefit from volunteer work. With regard to the first observation, the Dutch NFP sector can be characterised as joining a *welfare partnership* in which the state finances welfare services but relies heavily on private civil society organisations for their delivery (Salamon, 2003). It is only the care sector, the cultural and recreational sector and the public housing sector that can be characterised as mixed markets, with FP as well as NFP organisations.

In the table, the three sectors under investigation — hospitals, child care and welfare-to-work — are part of the care sector. In 2002, about 165,000 workers (in full time equivalents) were employed at hospitals.[3] Of these, a small fraction consisted of voluntary work (22 thousand workers in 2002, mostly part time). In the child care sector, in 2002, and again expressed in full time equivalents, about 32 thousand workers where employed. At that time, organisations with a NFP status dominated the market[4], employing a negligible amount of voluntary work ─ that is, only 100 full time equivalents in 2000. From this, we conclude that voluntary work is not very important in the hospital and child care industry.

The fiscal treatment of NFPs in the Netherlands

In the Netherlands, the NFP status of organisations comes with some (potential) fiscal advantages. Obviously, the most important of these is the exemption from *corporate taxes* on surpluses that NFPs make. Fiscal authorities may deviate from this rule if they doubt the official mission of the NFP organisation. Next to this, there are three more aspects that are distinct from the fiscal treatment of FP organisations, particularly for small NFP organisations:

- NFPs are, up to a maximum amount of about 70 000 euro, exempted from *sales taxes*.
- In order to be exempted from taxes for the reimbursement of expenses for voluntary work, up to a maximum of 700 euro per year, voluntary work is authorised only in a NFP setting.
- NFPs are exempted from taxes on donations when ‘beneficial to society’. This means that organisations should not only be NFP, but also give account on their goals, as well as the rewards for the board of governors. Information on the specific organisations that are registered as ‘beneficial to society’ is not publicly available.

2.2 The economics of NFPs

There are two main structural features that distinguish NFP organisations from FP organisations: (i) the ‘non-distribution-constraint’ and (ii) the absence of owners (Hansmann, 1980; Glaeser, 2002). The ‘non-distribution-constraint’ states that there are strict limits to the appropriation of the organisation’s surplus in the form of profits for those who run and control it, such as its members, founders or governors. This contrasts with FPs, where shareholders are the residual claimants. Here, the owner is a shareholder whose aim it is to get a high return rate. Instead, NFPs are not accountable to any owner or shareholder, but are expected to benefit beneficiary stakeholders ─ that is, individual consumers, or society as a whole ─ by providing products on favourable terms. In this sense, NFPs can be regarded as ‘failure correcting devices’ that allocate more effort to the quality and the accessibility of their products.

Donated labour is regarded as one of the key ingredients for the success of NFPs. NFPs are better capable of carrying out their missions when they attract workers that are, at least to some extent, intrinsically motivated to fulfil these missions. Stated differently, this means managers and workers are not driven by monetary incentives only, but also by the wellbeing of their beneficiary stakeholders ─ i.e. they are willing to work beyond their strict job description and

[3] Here, statistics on employment and voluntary work are obtained from CBS-Statline.

[4] By now, FP organisations dominate the Dutch child care sector. We return to this issue in the next section.

donate extra effort than what was explicitly contracted. Following this line of arguing, one may expect wages to be lower in NFP than in FP organisations, with voluntary (unpaid) work as the most extreme form of donated labour.[5] We also may expect NFPs to receive more private donations than FPs do. Thus, the provision of donated labour and private donations can be considered as a mechanism explaining why NFPs actually can make a difference over FP firms.

Donated labour is the most influential argument of economists for public or NFP provision, particularly in sectors where quality aspects of output are hard to contract upon (Francois, 2001). The very lack of residual claimants or profit motive provides a valuable commitment to the worker at the same time: it tells that, in principle, there is no individual or group standing to gain from converting donated effort into extra profit for themselves. Nobody higher in the organisation has an incentive to cut back on elements of service provision because nobody in the organisation will gain by doing so.

The Non-profit's dictionary

Donated labour: workers that are willing to work beyond their strict job description and/or donate extra effort than what was explicitly contracted. Non-for-profit organisations are more likely to attract donated labour, as the non-profit constraint commits these organisations not to expropriate worker efforts to lower costs and increase profits.

Mission: not-for-profit organisations are usually organised around a given mission – e.g. providing good quality or serving specific target groups. This helps to attract donated labour and donations.

The non-profit or non-distribution constraint:: non-profits cannot distribute any profits to anyone who exercises control on the firm, such as its members, founders or governors. Instead, surpluses have to be reinvested in the organisation and in principle can only be dedicated to the organisation's mission.

Non-for-profit (NFP) organisations: private organisations that are characterised by (i) their non-distribution-constraint and (ii) the absence of owners.

Ideally, the non-distribution-constraint of NFPs acts as a plain signal to potential providers of donated labour. When profits are prohibited, firms can credibly commit to public goals, thus attracting workers that support these goals as well. In practice, however, the interaction between the non-profit status and donated labour is nontrivial. NFPs often have problems in formulating concrete missions, or worse, its management may be inclined to exploit the incontractability of their activities.[6] Stated differently, the formal restriction on the appropriation of profits is a necessary, but not a sufficient condition to favour the beneficiary stakeholders. Instead of improving the quality and accessibility of services, the management and workers of NFPs may

[5] In contrast, Francois (2002) argues that labour donation mechanisms may be hampered by workers that want to free-ride on the effort of their co-workers, anticipating that they are willing to donate labour in their place. NFPs may combat this problem by offering higher ('efficiency') wages, thus reducing such moral hazard problems.

[6] Obviously, FP organisations may also have problems in formulating concrete missions, and act accordingly. In this process, however, they will experience the pressure from their residual claimants.

use other mechanisms for their own interest, for instance by increasing wages or decreasing the number of working hours. We return to this issue, and other potential, related inefficiencies in more detail in Section 3.3.

2.3 NFPs as failure correcting devices

In the literature, there is a variety of market failures providing an opportunity for NFPs to outperform FPs. In the following, we list four of them that are most prevalent in explaining the rationale of NFPs: (i) asymmetric information, (ii) externalities, (iii) market power and (iv) distributional or merit good concerns.[7] In this list, distributional and merit good arguments can be labelled as equity concerns, which therefore would not be characterised as market failures in a narrow sense (i.e. an efficiency argument). For all market failures, we do not only assess their importance, but also whether there is a potentially strong role for NFPs as well.

Asymmetric information and agency problems

The delivery of services often comes with substantial so called ‘moral hazard’ problems: as many quality aspects are hard to observe by consumers, producers may be inclined to reduce the quality of their services. In the literature, the moral hazard argument, or ‘contractual failure’, is often mentioned as the major rationale for NFPs (see e.g. Hansman, 1980). Particularly in the social services sector, doctors, nurses, case-managers and nursery school teachers are better informed on the quality of services they provide than consumers. Thus, the non profit status may act as a signal that service providers will not exploit their informational advantage and act in the interest of consumers. Generally, the long term consequences of service interventions are hard to measure and contract upon — in particular the future effects on health (hospitals), cognitive and social skills (child care) and the durability of new jobs (WTW). Related to this, it is difficult to determine the *net effect* of service providers, that is, the extent to which they influence outcome variables, or factors that are beyond their reach. This is particularly relevant to the WTW-sector. Here, re-employment rates are driven by a variety of factors that WTW-firms cannot control — for instance the business cycle.

Asymmetric information problems may not only result in quality problems, but also limit the accessibility of services. Such mechanisms — which in the literature are referred to as ‘adverse selection problems’ — typically occur in the insurance and lending industry, where insurers and bankers are, to a large extent, unable to differentiate between the individual risks of consumers. Given a certain premium rate, only high risk individuals are likely to buy insurance. Thus, insurance may not be profitable, leading to underinsurance. Within the context of the three cases of interest, adverse selection is particularly important in the care sector, where insurers

[7] In the literature, the (quasi-) public good argument is often mentioned as one of the key market failures. Within the context of (social) services, however, this argument is not relevant.

bear the individual health risk of consumers. Without any intervention, the market is likely to lead to underinsurance against health costs. NFPs however have limited power to counteract the adverse selection problem fundamentally; attracting ‘bad risks’ only would be too costly to survive. Instead, adverse selection problems here call for a regulatory role for the public sector ─ for instance by establishing a universal acceptance obligation for insurers. Obviously, NFPs still may in fact aim at improving the (financial) access to health services for specific target groups, but this argument mostly stems from equity concerns, rather than efficiency arguments.

Asymmetric information often coincides with so called ‘agency problems’: consumers are often not the actual decision maker in buying services, and public sector representatives do not have strong incentives to keep expenses low or to provide sufficiently high quality. In the Netherlands, WTW services are at the cost of the social benefit administration. Within this setting, consumers often have limited capacity for choice and are not the actual decision-maker. Instead, it may be that health insurers or case-managers decide upon the costs and type of services that are provided. This reduces the information asymmetry vis-à-vis service providers, but publicly financing social services may also result in ‘agency problems’, implying that consumers and public sector representatives do not have strong incentives to keep expenses low or to provide sufficiently high quality. Thus, agency problems may magnify moral hazard problems or result in lower efficiency. NFPs may instead be less inclined to take advantage of agency problems than FP organisations.

Externalities

The production and consumption of products may have unintended consequences on parties other than the consumer that cannot be reflected in individual prices. With respect to the social services sector, these so called externalities are mostly positive, in the sense that the provision of services does not only benefit the individual consumer, but also other individuals. Similar to public organisations, positive externalities may be a rationale for NFP organisations to exist. That is, NFPs may facilitate managers or workers that are intrinsically motivated to internalise externalities.

When regarding the three cases externalities may form a rationale for NFP provision for WTW services in particular. If WTW trajectories indeed reduce unemployment levels, this may lead to a reduction in crime. The evidence suggests that labour market programmes for the unemployed may be effective for some types of instruments and for particular types of individuals. Generally, job counselling and monitoring are instruments that are found to be cost-effective.[8] Additionally, there is a growing body of literature that addresses the effects of unemployment

[8] See De Mooij et al (2006) for a recent survey on the effectiveness of WTW activities.

on crime and nuisance. At present, there is consensus that unemployment indeed causes crime and nuisance to increase, but not on the order of magnitude (e.g. Raphael et al., 2001).[9]

For the childcare sector, various studies do find a positive relation between the quality of childcare and the cognitive and social development of the child (Blau and Currie; 2004). This however does not necessarily point at externalities, as it may be that similar outcomes are achieved when children are raised at home. The case for tax externalities seems much stronger, i.e. the use of child care is commonly accompanied by additional labour supply, thus increasing tax revenues. Still, this is not a sufficient argument for (local) NFPs, as these tax revenues accrue to the national level. Thus, tax externalities can be used as an argument for child care tax subsidies at the national level as well.

For hospitals, a similar line of reasoning applies: externalities may exist, but there is no apparent role for NFPs here. Typically, externalities of hospital services occur when diseases are infectious. By curing or preventing infectious diseases, these benefits do not exclusively accrue to the individual patient. The presence of such externalities may be an argument to subsidise various treatments or medicines. In modern Western countries, however, this role is usually taken care of by the public sector.

Market power

Firms may derive market power from scale advantages, for instance when local markets where they operate are characterised by regional monopolies. In principle, NFPs are less likely to exploit market power by raising prices and reducing the delivery of services than FPs are. As a result, market power as a rationale for NFPs — particularly in small and isolated communities — is connected to the distributional concerns argument. This holds for both the provision of child care and hospitals. For WTW-services, the market power argument is less strong, as scale advantages are far less important here (see e.g. CPB, 2000).

Distributional concerns

NFPs are often driven by a mixture of distributional and paternalistic concerns. NFPs may aim at a sufficient (physical or financial) access to services or a minimum provision of services for all consumers under all circumstances (i.e. health care). This means that NFPs focus on the provision of services in specific (isolated) areas and for specific target groups. In contrast to FPs, NFP organisations may have less incentives to “cream-skim” the most profitable consumers or activities. For instance, NFPs may provide reasonably priced child care or health facilities for low income families. Similarly, NFPs may help unemployed workers with bad

[9] Raphael and Winter-Ebmer (2001) argue that a substantial portion of the reduction of property crime during the 1990s in the US is attributable to a decline in the unemployment rate. For violent crime, the evidence is considerably weaker.

labour market prospects. Note that these arguments may also be a reason for public sector intervention (i.e. general tax allowances), thus reducing the scope for NFPs.

2.4 Summing up

Table 2.1 summarises the main market failures that may or may not be used as a rationale for NFPs. In the table, we first address the importance of failures (indicated by "+") for the various sectors. Second, we address the question whether NFPs may have a specific advantage compared to public sector organisations, particularly in organising and attracting donated labour and donations at the local level. We indicate this by an additional "+".

Table 2.2 Most relevant market failures for three cases[a]

	Child care	Hospitals	Welfare-to-work
Asymmetric information and agency problems	++	++	++
Externalities	+	+	++
Market power	++	++	0
Distributional concerns	++	++	++

[a] "+" indicates market failures; "++" indicates market failures as a (strong) rationale for NFP intervention

Table 2.1 makes apparent that the three sectors are all subject to information problems, which may be aggravated by agency problems, in particular in the hospital and WTW sector. Thus, NFPs can make a difference here vis-à-vis FPs by acting (more) in the interest of their consumers and providing better quality on aspects of that are hard to observe. Externalities may also be a rationale for NFP intervention in the three social services sectors. This rationale is strongest for the WTW-sector, where the benefits of such intervention accrue to the local level. Finally, distributional concerns and — related to this — market power of service providers may be an argument for NFP intervention, particularly when the role of public sector intervention as a redistribution device is limited or market power of FP organisations would be too strong otherwise.

3 Step (2): Do non-profits make a difference?

3.1 From market failures to performance indicators

In the previous section, we have argued that four market failures can be used as a rationale for NFPs to exist: informational asymmetries, externalities, market power and distributional concerns. These market failures provide NFPs with the opportunity to make a difference vis-à-vis FPs. Within this context, "making a difference" implies that NFPs may outperform FPs on some aspects: costs and efficiency, quality, quantity (accessibility), or its focus on specific consumers or (local) market segments.

Table 3.1 presents the connection between the market failures and performance indicators. The table makes apparent that performance differentials between NFPs and FPs can mostly be linked to more than one market failure, and inversely:

Table 3.1 From relevant market failures to performance indicators

	Efficiency	Quality	Accessibility	Focus on specific consumer types	Focus on specific market segments
Asymmetric information		×	×		
Positive externalities	×		×		
Distributional concerns				x	×
Market power	×	×	×		×

First, information asymmetries may cause a reduction in quality aspects that are hard to observe. In principle, consumers would have been willing to pay higher prices for services of higher quality, but information asymmetries hinder this process, thus causing welfare to be lower. NFPs may counteract this by providing a higher level of quality.[10] Second, positive externalities result in prices that ─ at the societal (welfare) level ─ are too high, and a number of delivered services that is too low. The conventional way to combat this problem is by subsidising the production of services. As NFPs have a non-profit condition, they can use rents to 'subsidise' the production of services as well, by keeping prices low and maximising quantities, rather than profits. Third, distributional concerns deal mostly with the provision of services to low income families, or market segments where the provision of services is limited. NFPs may thus give priority to specific income groups, or set up firms in specific market segments. Fourth, and related to this, in markets where FPs have substantial market power, production, efficiency and quality may be non-optimal ─ or, stated differently, in a standard competitive market consumers would have benefited from a higher level of utility of these

[10] Note that we abstract from adverse selection problems as a rationale for NFP intervention here. As we have argued in the previous section, public sector regulation is needed for adverse selection problems to be solved fundamentally

services. Overall, NFPs in principle may outperform FPs on almost all relevant performance indicators: quality, prices, and the provision of services in particular areas.

Static and dynamic efficiency

In the framework we propose, the efficiency of services is more or less implicitly defined as 'value for money' — i.e. the quality level that consumers want is provided at minimal costs. This definition is commonly referred to as 'static efficiency'. Within this context, 'dynamic efficiency' relates to the activities of employers to invest in the future quality and efficiency of services.

Investments in the future quality of services may hamper static efficiency, at the benefit of dynamic efficiency — the management (both of FP and NFP organisations) has to achieve the right combination of static and dynamic efficiency, so as to provide an optimal efficiency level. When assuming steady state outcomes of this process, comparisons between FPs and NFPs can be based on quality and cost levels, as the underlying combination of static and dynamic efficiency levels is then irrelevant.

Combining these outcome indicators, NFPs can have various mission statements — "providing quality", "helping the disadvantaged", or "enhancing the production of services" — and aim at making a difference on these aspects vis-à-vis FPs. Here, providing better quality mostly stems from asymmetric information problems, whereas accessibility — i.e. low prices, higher quantities, particularly for target groups — is mostly associated with externalities, market power and distribution concerns as relevant market failures. In order to make a difference, NFPs have to have rents at their disposal, and subsequently use these to the wellbeing of their consumers. Such rents may basically originate from three sources: private donations, donated labour and tax exemptions.

In what follows, we survey the empirical literature that addresses that relative performance of NFPs: do they actually make a difference? In particular, we link the various market failures discussed in the previous section to specific performance indicators. So far, the literature on the relative performance of NFPs seems limited to the US and Canada. In our survey, we therefore restrict most of our attention to these countries.

3.2 Do NFPs make a difference?

3.2.1 Hospitals

The hospital industry is subject to many market failures. As we discussed in the previous section, there are three relevant market failures here that may be particularly relevant for the mission of NFPs: (i) asymmetric information; (ii) distributional concerns; and (iii) market power. First, hospital services are subject to informational asymmetry: patients cannot judge the quality of the services that are provided, which reduces the incentives of hospitals to produce high quality. These moral hazard problems may be aggravated by agency problems — that is, the patient has limited capacity for choice since he is often not the actual decision-maker, resulting in low incentives for hospitals to provide high-quality care and inefficiencies. Second, distributional concerns mostly boil down to the issue of accessibility of care. Third, since hospitals often have a regional monopoly, they may exploit market power, causing prices too become too high and the provision of services too low.

There is a large literature in the US that addresses the difference in quality between FP and NFP hospitals, mostly in terms of their mortality rates.[11] Overall, there appears to be no systematic difference in quality. Recently, Eggleston et al. (2006) have identified various factors that explain the diversity of results that are found in the literature.[12] First, the unit of analysis is important: studies using data at patient level generally find no differences between the quality of FP and NFP, while studies using aggregated data at the hospital level generally find that NFP perform better. Second, quality differentials between FP and NFP hospitals are strongly related to the period of investigation. In particular, after 1990 authors generally find no differentials between the organisation types. Eggleston et al. (2006) argue that this result stems from a recent convergence among ownership forms, and better controls for unobserved heterogeneity in patients. They also stress that recent studies take better account of the role of competition. That is, increases in competition between hospitals of the last decades may well explain the convergence between FP and NFP hospitals.

Regarding cream-skimming and access to care, the evidence is mixed. Here, most of the literature falls down to the question of whether FP and NFP hospitals pursue objectives that differ from profit maximisation. If NFP hospitals effectively aim to maximise profits, they will tend to drop non-profitable services and cream-skim the most profitable patients, similar to FP hospitals. Sloan (2000) analyses hospital conversions in three US states. He finds that switching from the NFP to the FP status has decreased the probability that a hospital runs potentially unprofitable programs, like AIDS prevention, community health, and rehabilitation programs. This study, however, suffers from substantial selection effects, i.e. hospitals that converted to FP organisations are likely to be hospitals with poor financial performance in the first place. Cutler and Horwitz (2000), who also address conversions from NFP to FP hospitals, find that "having FP hospitals in the market appears to cause NFP hospitals to adopt the same moneymaking measures employed by FP hospitals". Duggan (2000) analyses the response of FP and NFP hospitals to financial incentives, induced by a policy change aiming at improving quality of care for the poor. He finds no difference: both cream-skimmed patients by avoiding

[11] Studies that find the quality of NFP hospitals to outperform that of FP hospitals are: Outler and Horowitz (2000), Sloan et al. (1999), Gray and McKerney (1986). Reverse results are found in McClellan and Staiger (2000) and Marmor et al. (1986).
[12] Another meta-analysis has been done by Devereaux et al. (2002). They looked at 15 studies involving more than 26000 hospitals. They find that FP hospitals were associated with increased risk of death, suggesting that NFP hospitals perform better than FP hospitals. This study has been, however, severely criticised by Eggleston et al. (2006); they argue that the studies used overlapping data from the same patients and same hospitals.

Medicaid and uninsured patients and both used the extra revenues to increase their financial assets, not to improve quality of care. By contrast, Horwitz (2005) finds that both types of hospitals pursue different objectives and that FP hospitals are more profit-seeking than either NFP or public hospitals. When combining the insights from various studies, it appears that the accessibility of services provided is driven by competition in markets: both NFP and FP hospitals are more likely to offer profitable services and less likely to offer unprofitable services when competition is high. Still, when competition is low, NFP may make a difference by providing services for uninsured patients (see Dijkgraaf et al., 2006).

Overall, the picture that emerges is that NFP hospitals do not make a systematic difference vis-à-vis FP hospitals. It is only in markets with relatively low competition that NFPs may provide a higher level of accessibility of services, particularly for uninsured patients.

3.2.2 Child care

Information asymmetries in the childcare sector are a natural consequence of the fact that the primary recipients of the service are young children who often lack the cognitive skills to fully assess and communicate shortcomings in quality. Parents will gather information about the quality of services through various channels (i.e. the behaviour of their child, the reputation of the childcare provider and visits to the childcare facility). Still, as they simply cannot be physically present when the service is rendered, a residual information asymmetry will always remain. Childcare providers may therefore have an incentive to exert less effort on quality, especially on those aspects of quality that are hard to observe. The pivotal question is whether the non-distribution constraint shields NFPs from this inclination to shirk. Similarly, as we also argued in the previous section, NFPs may be more inclined to provide child care in isolated markets or to less affluent consumers. Childcare suffers from the danger that, as quality comes at a cost and parents face liquidity constraints, social stratification in childcare might occur, with children from high-income families receiving high quality childcare and children from low-income families receiving low-quality care.

For the child care sector, the empirical literature distinguishes three aspects of quality: (i) structural quality, which concerns the basic quality of the childcare environment (e.g. furnishings, fire safety and group size); (ii) process quality, relating to the service itself, i.e. teacher-child and peer interactions; and (iii) quality in child outcomes, i.e. the contribution of childcare to the emotional, social and cognitive development of the child. Structural quality is generally easy to observe (and regulate!). Empirical studies mostly find that NFPs on average provide a higher level of structural quality (Mocan (1995), Sundell (2000) and Cleveland and Krashinsky (2004, 2005)). Obviously, process quality of childcare services is more difficult to observe than structural quality, and therefore the NFP advantage should theoretically be larger here. The evidence here is however more mixed.[13] Whereas Canadian studies tend to report a significant positive NFP differential (Cleveland and Krashinsky (2004); Japel et al. (2005)), the most recent and comprehensive US studies do not (Morris and Helburn (2000), Blau and Mocan (2002)). The degree of regulation may be important in determining the extent to which NFPs and FPs can behave differently. In particular, Morris and Helburn (2000) and Blau and Mocan (2002) find a positive NFP differential only in the state with the least stringent regulatory framework. Also market size seems of importance here: Cleveland and Krashinsky (2005) find that a NFP advantage only materialises in markets with sufficiently high demand. Presumably, in (homogeneous) markets with low demand, NFPs are forced to compete with FPs on price, limiting their ability to offer higher quality (at higher costs). Finally, the third aspect of childcare quality, i.e. quality in child outcomes, is most difficult to observe, as the effect of high quality childcare on child development may take considerable time to materialize and is difficult to measure. Sundell (2000) finds no significant differences in child outcomes between NFP and FP childcare providers. Overall, the empirical results on a NFP advantage in providing high-quality childcare are rather ambiguous.

Distributional concerns also feature in the market for childcare. Most studies indeed find that NFP childcare organisations are on average more likely to serve low-income families (Krashinsky (2005), Whitebook et al. (1990), Morris and Helburn (2000) and Blau and Mocan (2002)). Whitebook et al. (1990), however, find that the relation between family income and mode of childcare provision is not straightforward ─ i.e. linear. While children from low-income families are more likely to attend NFP childcare centres than children from middle-income families, the same holds true for children from high-income families. High-income families in the sample were most likely attracted by the higher average quality offered in the NFP centres. Oddly, both high-income *and low-income* families displayed a higher willingness-to-pay than middle-income families. The only study to dissent is Japel et al. (2005). They find that children with a less favourable socio-economic background are more likely to attend *FP(!)* daycare centres. In addition, they find that while in FP centres the quality of service varies with the socio-economic status of its clientele (i.e. children from low-income families received the lowest quality of care), this phenomenon does not occur in NFP centres. This last observation again lends credence to the idea that NFPs are less likely to compromise on quality when faced with a less affluent clientele.

[13] Quality that is hard to observe, is naturally also hard to measure. In order to compare levels of process quality, economists use a scale that was designed by child psychologist, which measures the level of various aspects of quality during onsite visits by professional observers called the Early Childhood Environment Raring Scale (ECERS) or Infant- and Toddler Environment Rating Scale (ICERS).

Do NFP organisations (still) make a difference in the Dutch childcare market?

NFP and FP childcare providers do not always compete on a level playing field. Prior to the introduction of the 2005 Childcare Act, municipalities played an important role in shaping the local childcare provision through subsidy relationships with predominantly NFP organisations. The 2005 Childcare Act ended these relationships. Under the new regime, the provision of childcare is determined by demand factors only, i.e. childcare vouchers for parents, thereby creating a (more) level playing field for NFP and FP childcare providers.

Noailly et al (2007) compare the provision of childcare under the old regime (in the period 1999-2001) with the provision of childcare after the introduction of the 2005 Childcare Act (in 2006). They observe the following developments:

- Compared to the period 1999-2001, the provision of childcare in 2006 has shifted towards areas with higher purchasing power and away from less urbanised areas.
- In 2006, FPs account for a larger number and share of all childcare facilities.
- The fall in the provision of childcare by NFP facilities has been especially pronounced in areas that had no FP childcare provision prior to the regime change.

The last development suggests that the difference between FP and NFP providers is small: in the absence of the municipal subsidies, NFPs do not appear to have an advantage as they are no longer viable in areas that have insufficient demand. Related to this, NFP organisations no longer seem to make a (substantial) difference compared to FPs by operating in areas with lower income groups and less urbanised areas.

Obviously, for a full comparison of the behaviour and performance of FP and NFP childcare providers in the Netherlands it is essential to analyse whether they provide the same quality of service at the same prices. So far, this information is not necessarily publicly available.

Summarizing, there is no clear systematic evidence in the empirical literature that NFP childcare providers are more trustworthy in producing high quality childcare. Remarkably, the only difference between FP and NFP providers that emerges from the literature regards aspects of quality that are easy to observe and regulate. As in the case of hospitals, direct competition between NFPs and FPs inhibits the extent to which the two organisational forms may behave differently. With respect to differentiation or accessibility of care, there are some indications that NFP are more willing to service low-income markets.

3.2.3 Welfare-to-work

Similar to the health care and child care sector, information asymmetries are probably the most important market failure in the WTW-sector. In most OECD countries, the public sector is the major customer of WTW-services, aiming at getting benefit recipients back to work. Here, the key question is how the government can protect the collective interest when private organisations take care of WTW activities. The non-profit-condition may be one way to ensure: (i) WTW activities to result in durable jobs, and (ii) WTW organisations not to cream skim unemployed clients with a priori good prospects of finding work. First, the durability of jobs is of particular interest for society as a whole, as benefit savings are to be discounted over a sufficiently long time horizon. Second, cream skimming is inefficient when WTW trajectories are useful for disadvantaged workers, but the effort on this group is minimised. Opposition to cream skimming may also come from equity grounds: irrespective of the (net) efficiency gains or losses of WTW activities, NFPs may argue that priority should be given to disadvantaged workers. Thus, cream skimming and distributional concerns are closely related within the context of WTW services, and therefore should be treated jointly.

If NFPs make a difference on the quality of services vis-à-vis FP organisations, we would expect the net effectiveness of NFPs to be higher ─ that is, WTW-services should result in higher re-employment rates or higher wages at placement. So far, there is little empirical evidence that specifically addresses this issue, with Heinrich (2000) and Stoll et al. (2003) as major exceptions. Heinrich (2000) studies the effectiveness of 637 local service providers of JTPA[14]-activities in the US over the period 1994-1994. These service providers can be classified as public non-profits (14%), private non-profits (65%) and for-profits (21%). When comparing the outcome variables ─ wages, job placements ─ no systematic differences between organisation types are found. In the short run, at the moment of termination of a program, FPs seem to outperform NFPs, but these differences do not last when considering the first post-program quarters. Stoll et al. (2002) study the outcomes of 'Community Based Organisations' (CBO's) ─ a specific type of NFPs that is relatively strongly rooted in local areas ─ in the Boston area of the US. In this study, CBO's seem to perform better than other NFPs and FP organisations in terms of job placement rates. In terms of placement wages, however, CBO's perform less. We therefore conclude that in the US, NFPs are not consistently more effective or ineffective than FP organisations.

The second argument for NFPs may be rooted in cream skimming. Heckman et al. (2002) analyse cream skimming in WTW services in great detail. They argue that it is associated with modest efficiency gains or losses only.[15] This means that combating cream skimming must come from distributional concerns. Heinrich (2000) however does not find any systematic differences between organisation types here: for instance, in the period of investigation, FP organisations were more likely to serve welfare recipients, clients with basic skills deficiencies, but less likely to serve high-school dropouts. In addition, FPs were even somewhat more likely to provide more intensive types of training services to participants. In contrast, Stoll et al. (2002) do find evidence that CBO's in Boston train participants with more 'barrier characteristics' than other. Still, one may argue that these CBO's are not representative for NFPs in general.

[14] Job Training Partnership Act. As of 1998, the JTPA has been replaced by the Workforce Investment Act (WIA).

[15] See also Koning (2005) for a discussion on the importance of cream skimming in the provision of WTW-services.

From these findings, we may conclude that NFP WTW-providers do not systematically make a difference to FP organisations, or public offices. Still, NFPs are often favoured in contracting processes (Heinrich, 1999). Moreover, NFP organisations may receive tax-deductible donations and are often exempt for local property and sales taxes. Generally, it seems NFPs cannot effectively use these advantages by favouring their clients, or specific groups of workers.

3.3 Rents and rent extraction

When combining the insights from the empirical literature, the picture emerges that NFPs do not systematically make a difference with respect to FP social service organisations. It is only in specific circumstances and for specific services that NFPs serve different market segments or provide services with higher quality. In particular, for the three markets under investigation, we only find some evidence for a wider accessibility of services for specific groups and higher quality when regulatory measures by the public sector are virtually absent or when competition is low.

In order to interpret these results, our primary interest lies in the non-profit-condition of NFPs. In particular, the empirical results can be interpreted in two ways: (i) NFPs do not attract a substantial amount of donated labour; or (ii) (ex ante) rents of NFPs are lost by managerial inefficiencies ('rent extraction'). Both explanations may be interrelated: if NFPs are susceptive to inefficiencies, individuals may be less willing to donate labour. Particularly when inefficiencies are associated with vague missions, high wages or extensive emoluments, the provision of donated labour becomes discouraged. In practice, the efficiency of NFPs can be hampered by the relatively strong position of its management and workers, as they lack the control of shareholders ('managerial shirking'). NFPs often operate in markets where quality is hard to measure, and mission statements hard to define. In contrast, FP organisations have one goal that is undisputed: the maximisation of profits. Also, the dynamic efficiency of NFPs — i.e. their capacity to attract capital for innovations — is hampered by the absence of shareholders. In contrast to FP organisations, NFP organisations rely upon donations and private equity only, thus limiting their ability to attract new capital (Gradus and Bovenberg, 2001).

Basically, there are three ways to empirically expose possible inefficiencies or rents extraction in NFP organisations: (i) the analysis of wage differentials; (ii) comparing costs and efficiency measures in general; and (iii) analysing the response of NFPs to changes in competition. We now discuss the evidence on these three items.

(i) Wage differentials

Compared to FP organisations, NFPs may have an advantage in attracting donated labour. In its most extreme form, NFPs employ voluntary workers, thereby reducing their (labour) costs substantially. When workers expect the organisation not to extract the surplus that is associated with lower wage costs, they may accept lower wages than in a FP setting. There is however another specific feature of NFPs with opposite effects: as NFP organisations lack the control of shareholders, its management and workers may be tempted to increase wages. Thus, the theoretical net impact on wages is ambiguous.

When considering the social services sectors, wage comparisons between FP and NFP organisations are mostly directed towards hospitals and child care organisations. Ruhm and Borkoski (2000) find FP hospital workers to have similar wages as NFP hospital workers. In contrast, Roomkin and Weisbrod (1997) do find differences between the two types of organisations, but this concerns the relative importance of fixed and performance related pay, rather than the total wage sum that is paid. In the child care sector, the vast majority of studies suggests that, after controlling for job and education types, wages are higher in the NFP sector (Mocan, 1995; Mocan en Terkin, 2000; Blau en Mocan, 2002; and Cleveland en Krashinsky, 2004). Cleveland and Krashinsky (2004), however, argue that the NFP wage premium can be explained by higher quality of services provided. This means that workers in NFP organisations provide a higher quality of services, which is rewarded by higher wages. In a way, this is surprising: it suggests that NFP workers — similar to workers in FP organisations — are driven by financial incentives.

So far, the literature shows no convincing evidence that NFP wages are systematically lower than in FP organisations. Instead, it seems that NFP organisations are equally susceptive to rent extraction.

(ii) Costs and efficiency

Similar to wage payments, cost and efficiency measures can be informative on the rents and rents extraction of NFP organisations. In particular, lower cost levels and high efficiency levels point towards higher rents — particularly as a result of donated labour — whereas the opposite suggests rents extraction to be dominant. For the care sector, there is an extensive literature that addresses the efficiency of hospitals. In a recent meta-study, Shen et al. (2005) review this literature as from 1990. They argue that sufficient controls at the level of patients, hospitals and market characteristics are needed for a fair comparison between NFP and FP organisations. In such a setting, little differences between the organisation types are found. Similarly, Mocan (1995) and Blau en Mocan (2002) find no cost or efficiency differentials in the child care sector. Therefore, again the picture emerges that FP and NFP organisations are not that different after all.

(iii) Market conduct and competition

In markets with limited competition, FP organisations have the opportunity to extract rents by raising prices and (thus) lowering the quantities of services that are provided. As we argued in the previous section, NFP organisations may counteract this by not exploiting their market power, but acting in the interest of consumers. One way to test for this is by relating FP-NFP differences to the extent of competition in particular markets ─ that is, to assess the response of NFP and FP organisations to changes in the level of competition. Suppose for instance that there is a merger between large service providers. Then, the question is whether FPs and NFPs do (or do not) exploit the rents that come with this merger. Empirical research on this question has been initiated by Lynk (1995), who analysed a merger between the two largest NFP hospitals in Grand Rapids, Michigan. Lynk used a conceptual model to argue that the 'cooperative' board of directors would not raise prices. Melnick et al. (1999) however find ownership status not to influence pricing responses of merging hospitals. Consistent with this, Dranove and Ludwick (1999), Keeler et al. (1999) and Simpson and Shin (1997) all find that NFP and FP hospitals set higher prices in less concentrated markets. Thus, the evidence seems to favour the idea that FP and NFP hospitals are both susceptive to rents extraction.[16] Hansmann (1996) even characterises the non-profit form as "largely anachronistic" in the hospital industry, with the large share of NFP hospitals to be attributable mainly to capital embeddedness.[17]

For the other two sectors under investigation, the evidence on the conduct of FP and NFP organisations is much thinner. Heinrich (2000) finds both types of WTW organisations to respond equally to incentive schemes ─ that is, both FP and NFP organisations in the US showed a similar increase in re-employment rates when performance incentives in service provider contracts were included. This suggests that moral hazard problems are equally important for the two organisation types; without such incentives, FP organisations do not exploit this more than NFPs. James and Rose-Ackerman (1986) and Rose-Ackerman (1996) also doubt NFPs to be dissimilar: NFP organisations are not viewed as more trustworthy, and are equally or even more susceptive to internal agency problems. Moreover, often consumers cannot distinguish the organisational form itself.

3.4 Interaction and spill-overs

Until now, we have argued that ─ when regarding the three social services sectors ─ NFPs do not systematically seem to make a difference on various performance outcomes. Loosely

[16] In a broader study, David (2005) argues that FP and NFP hospitals have largely converged, particularly regarding the size of both types of organisations.

[17] There is also no evidence that the management of NFP hospitals follows explicit objectives of caring for non-profitable patients. Mistead (1999) finds most compensation plans for executives of NFP health care organizations not to include goals or provision for providing community benefits. Brickley and Van Horn (2003) find no evidence that NFP hospitals provide explicit incentives for their CEOs to focus on altruistic activities.

speaking, this finding is mirrored by the evidence for rents extraction. Presumably, NFP workers offer more donated labour than in a FP setting, but this does not necessarily translate into lower wages, higher efficiency, or other different responses with respect to changes in competition. In this sense, Hansmann (1996) even characterises the status difference as "largely anachronistic".

The observation that FP and NFP organisations do not have different conduct or performance outcomes can be used as an argument not to stimulate NFP organisations. This line of reasoning, relies upon the implicit assumption that the conduct and performance of FP (NFP) organisations is not affected by the presence of NFP (FP) organisations. Or, stated differently, that there is no interaction between the two organisational forms. If however quality effects spill-over from NFP to FP organisations ─ that is, FP organisations increase their quality in response to the presence of NFP organisations ─ this may be welfare improving. At first sight, quality differences may then be small or even negligible, but the mere presence of NFPs raises the overall level of quality in a particular market.

Interaction effects between the two organisational forms have received relatively little academic interest. One exception that focuses on mixed markets in which NFPs and FPs coexist, is the analysis by Grabowski and Hirth (2001). These authors test two alternative hypotheses on the effect of NFPs on their for-profit counterparts in the nursing home sector. The first hypothesis is that FP en NFP organisations operate in different market segments, thus ruling out any spill-over effects. The second hypothesis is that positive spill-over effects occur, basically as a result of heterogeneity among customer types ─ that is, some are more or less informed on the quality of services than others are.

The first hypothesis of Grabowksi and Hirth is that NFP organisations focus on the high quality segment of the market, while leaving lower quality segments of the market to their FP competitors. The argument for this would be that NFP organisations have a competitive advantage over FPs in delivering high quality. This advantage may originate from a managerial preference for higher quality, as well as a staff that values providing high quality and is willing to donate labour to this end. Thus, the effective costs in this market segment can be lowered below the costs of pure profit maximisers. This picture ties in with the analysis of Lakdawalla and Phillipson (2005), who argue that firms with objectives that differ from profit maximisation, such as a preference for high output or high quality (altruism), may be interpreted as benefiting from reduced marginal costs. Such 'profit-deviators' will enjoy a competitive advantage over for-profit firms, since their altruism makes them willing to sell at a lower price. Now, if consumers are sufficiently capable of recognising quality, and value it accordingly, NFPs will dominate the higher segment of the market and crowd out FPs. Conversely, in the low quality segment where donated labour will be less prevalent, FPs will dominate. Thus, it is basically the amount of donated labour that raises the average quality level in mixed markets. This means that spill-over effects are absent.

The alternative hypothesis analysed by Hirth and Grabowski is that there are quality spill-overs from NFPs to FPs. Here, the key argument is that some consumers are worse informed on quality that others. In a purely FP market, higher shares of ill-informed, quality- unresponsive consumers provide higher incentives to shirk on quality. We have argued earlier that the non-distribution constraint, conversely, allows NFP organisations to credibly commit to high quality. As a result, ill-informed consumers are most likely to be drawn towards the NFP organisations, relying on the fact that their informational disadvantage will not be exploited here. This in turn lowers the share of poorly informed consumers that remain for the FP sector. Due to this composition effect, the penalty on quality shirking increases, thus resulting in higher quality of FP organisations as well. In this sense, such effects can be labelled as spill-overs.

With respect to quality of nursing homes, Hirth and Grabowski find no evidence for the first hypothesis, where a higher NFP market share would lead to concentration of FP in the lower quality segments (i.e. market segmentations). In contrast, they find quality in FP nursing homes to be positively related to the market share of NFPs, which confirms the spill-over hypothesis. Still, similar results are not obtained for the overall quality level in markets, whereas Spector et al. (1998), also focussing on the nursing home industry, find no support for any spill-over effects. Overall, we thus may conclude that the evidence for spill-over effects from NFP to FP organisations is inconclusive.

We have argued earlier that spill-over effects can be welfare-improving. The question therefore arises whether ─ if such effects are important ─ this calls for any government intervention. In particular, one may argue that subsidising NFP organisations increases the share of NFP organisations, thus giving greater pressure to FP organisations to increase quality. Still, such policies are not likely to be well targeted to increase quality. Here, the main reason is that the amount of donated labour within a particular market is likely to be fixed, or even may be discouraged by public support (i.e. ‘crowding out’ effects).[18] From this perspective, the number of workers in the market that value quality highly may even decrease as a result of such intervention. Therefore, within the framework of Grabowski and Hirth, spill-over effects are not a strong argument for stimulating NFP organisations.

3.5 Summing up

When regarding the three sectors of interest, we may well conclude that there is no systematic difference that NFP organisations make with respect to FP organisations. This finding is

[18] We return to this issue in the next section.

mirrored by the literature on relative inefficiencies and rents extraction in NFP organisations — that is, wages and efficiency levels are similar to those in FP organisations, and NFP organisations respond similarly to changes in the overall level competition in markets. This means that there is no strong argument for subsidising NFPs in particular, as this is likely to lead to additional rents extraction as well. Also, if e.g. quality effects of NFP organisations spill over to FP organisations — thus removing ex ante differentials in the quality of services between NFPs and FPs — there is no strong reason for government intervention.

It is only in specific circumstances and for specific services that NFPs serve different market segments or provide services with higher quality. For the three markets under investigation, we only find evidence for a wider accessibility of services for specific groups and higher quality when regulatory measures by the public sector are absent or when competition is low. If the government adheres to these activities, the question arises what specific instruments are most suitable to stimulate these activities. In particular, should subsidies or regulatory measures be directed to the activities of organisations ('generic' policies), or should they be targeted at the legal (non-profit) status of organisations specifically? We address this issue in the next section.

4 Conditions for government intervention

4.1 Instruments

The previous sections provide us with a coherent framework along which the potential strengths and weaknesses of NFP vis-à-vis FP organisations are assessed. We now move to the implications of these observations for policy. Basically, there are three clusters of policy measures that may favour NFP organisations:

- Tax exemptions or lower tax rates, e.g. regarding the provision of private donations, expenses associated with voluntary work, or (labour) costs of NFPs in general. Most importantly, NFPs in the Netherlands are in principle exempted from corporate taxes on their surpluses.
- Favouring NFP organisations in public contracting processes, or in subsidisation rules. For instance, one may think of the provision of WTW activities, where public bodies act as contractors. At present, however, the room for public bodies to favour NFPs in contracting processes is limited to small amounts only (below € 30,000). As an alternative, specific subsidies — e.g. by municipalities to childcare organisations — may also be restricted to organisations that do not make profits.
- Only allowing for NFP organisations to exist within particular markets. Examples of these sectors in the Netherlands include hospitals and schools.

Obviously, the degree of public sector intervention varies substantially between the three measure types, with the third as the most extreme. In markets with a high public interest — particularly the care sector — prohibiting FP organisations at least for some service types is common in some European countries. In the market for child care and WTW-organisations, the policy debate is mostly concentrated on tax exemptions and the contracting processes of public bodies. Here, markets are mixtures of FP and NFP organisations, and — in the case of WTW-services — supplemented by public organisations.

Although market types and relevant instruments may vary substantially, the basic conditions that are relevant for any type of intervention that is specifically directed to NFP organisations are in principle universal: (i) NFPs should make a (systematic) difference on (some) performance measures; (ii) residual market failures are important; (iii) performance outcomes are largely incontractable; (iv) public intervention should not crowd out donated labour too much; and (v) FP organisations should not switch into NFP organisations if these are subsidised. We now discuss these four conditions in detail.

4.2 Condition (i): Making a difference

As we have shown earlier, proving that NFPs indeed make a difference in some aspects is not an easy job. The general picture that emerges for our three cases is that NFPs do not make a systematic difference on performance compared to FP organisations. Still, in order to support them, the government should rely upon the fact that NFPs use the advantages of their non-profit status exclusively by making a difference, particularly when it comes to the quality level or accessibility of services that are provided. Rents should not be directed to higher wages, or other inefficiencies that are not to the benefit of consumers and/or society as a whole. When NFPs indeed do make a difference, for instance on quality aspects that are hard to measure, this suggests that additional rents are (also) directed to the wellbeing of consumers. If not, there is no strong reason to believe that public goals are served by targeting NFP organisations in particular.

4.3 Condition (ii): Residual market failures

Supposing that NFPs are effective in combating market failures, the next question is with respect to the importance of residual market failures ─ that is, market failures that are not (sufficiently) solved by NFPs. If residual market failures are present, NFPs in principle may further diminish the consequences of these market failures. For instance, think of NFP hospitals that indeed make a difference by providing specific services that are not cost effective but beneficial for society ─ e.g. for equity arguments. Now, if the public sector wants to extend the range of these services, it may encourage NFPs (as well as FPs) to do so.

In the literature, the complex connection between NFP performance and the size of residual market failures is hardly addressed. In a way, this is not surprising, as there is little evidence of NFPs making a difference in combating market failures anyhow. There is some evidence however that points at the exchangeability of public sector regulation and the performance of NFPs. In the child care sector, as we have discussed in the previous section, Mocan (1995) finds NFPs to provide better quality in North Carolina, where quality regulation was little compared to other states. Thus, in this case the size of (residual) market failures is (partly) determined by the (absence of) public sector intervention. This raises the question whether regulatory measures for all organisation types are to be preferred over (tax) subsidies that are targeted at NFPs.

4.4 Condition (iii): Incontractability

When considering the three types of social services ─ care, child care and WTW ─ we have concluded that NFPs generally do not provide services with better quality. It is only in some cases that NFP organisations distinguish themselves from FP organisation by focusing on specific market segments or consumer types, e.g. segments with low competition or low income families, respectively. When such distributional concerns are supported by the government, NFPs may be subsidised for this. This, however, does not mean that NFPs should effectively be stimulated just because of their non-profit status. Instead, as the target groups ─ for instance disadvantaged workers ─ are well observable and can be contracted upon, the government may consider subsidisation by the target group itself, rather than NFP status. Similarly, subsidies may encourage the provision of services in areas with low physical access, and regulatory measure may aim to increase competition. For larger organisations providing (network) services, (local) governments can also formulate Universal Service Obligations (‘USOs’) in geographical areas to ensure services to be sufficiently accessible for consumers.[19] Thus, when subsidies or USOs are suitable instruments, there is no further rationale for governments to rely upon the legal status of organisations for performance outcomes that can be contracted upon.

If the degree of incontractability is high, the effectiveness of regulatory measures may be limited. Then, under the assumption that conditions (i) and (ii) are fulfilled (i.e. NFPs make a difference; residual market failures do matter), this may be an argument to subsidise NFPs. Still, it should be noted here that this scenario is not very likely. First, when e.g. quality of services is hard to contract upon, it is difficult to show NFPs provide better quality than FPs anyhow. Second, in case of high incontractability, the government may (also) opt for a more extreme policy intervention, namely by the public provision of services.[20]

4.5 Condition (iv): No crowding out

So far, we (implicitly) have assumed that NFP subsidies encourage the production of services by NFP organisations. This means that donated labour and donations for NFP organisations are exogenous. This, however, is at odds with the evidence. Instead, ‘crowding out’ effects occur: when the government decides to subsidise the provision of services or NFP organisations, or provides these services itself, employees and donators perceive that less donated labour and private funding is needed, respectively. In the US literature, there is strong evidence for crowding out effects, particularly regarding the relationship between government funding of public goods and private contributions to the provision of these goods (Glaeser and Schleifer, 2000). For the Netherlands, there are no studies that analyse crowding out effects on the level of individual workers or donors. Still, at the macro level one may argue that crowding out effects are important, as the government funding of NFPs in the Netherlands is substantial compared to other OECD countries, whereas private donations are among the lowest.

[19] USOs are traditionally associated with utility industries, such as the postal services, telecommunications, electricity, and water. See De Bijl et al (2006) for a survey study on the design issues that come with the organisation of USOs.

[20] In the current setting, we abstract from this option and concentrate on (mixed) markets where only FP and NFP organisations operate.

4.6 Condition (v): No re-labelling

If NFPs are successful in attracting donated labour and donations, this may create substantial rents. Glaeser and Shleifer (2000) argue that in such situations completely self-interested entrepreneurs may (also) opt for the non-profit status. Even in the absence of tax advantages, donations and donated labour would flow to these entrepreneurs. Consequently, the accompanying rents are, at least for some part, likely to be spent in the interest of the entrepreneur, or ─ using a broader context ─ that of the management as well.

David (2005) is one of the few studies that specifically addresses the decision of (new) entrepreneurs to adopt the FP or NFP status.[21] He argues that changes in tax codes and demand- and population growth have encouraged NFP hospitals in the US to switch ownership type. In particular, the cost advantage that was associated with the NFP status has declined, raising the share of FP hospitals. From this, we may conclude that tax advantages are one of the driving factors explaining the adoption of the NFP status. Although the evidence on this is still largely anecdotal and unexplored, it may well be that the child care sector in the Netherlands has experienced a similar change. Until 2005, NFP child care organisations were strongly linked to community councils, who favoured particularly NFP organisations in the contracting process. At present, individual parents are fully free to choose the child care organisation they want, rendering the former advantages of the NFP status for a large part useless (Noailly et al, 2007).

4.7 Summing up

The five conditions mentioned above make apparent that any form of government intervention that is specifically directed to NFP organisations may be blocked by various mechanisms. Essentially, all these mechanisms diminish the fraction of e.g. rents earned through tax advantages that is spent on the quality or accessibility of services: such advantages may be spent on inefficiencies (conditions 1 and 5); residual market failures are not very important or can be solved by standard regulatory policies (conditions 2 and 3); or donated labour and donations may be discouraged as a result of it (condition 4).

There is no systematic evidence that NFPs in particular sectors, at least for the US, make a difference. In addition, there is evidence for crowding out effects and for the NFP status to be driven by rents considerations. Thus, one may doubt the effectiveness of any form of intervention that is specifically directed to NFPs. Instead, if the government wants to pursue the

[21] As we have shown earlier, there is also strong evidence that NFP organisations use part of their rents for better working conditions, higher wages and other benefits. This means that there is a potential for NFPs to use rents to the interest of the management and employees. Thus, the NFP provision of services can be a substitute for FP provision of entrepreneurs

interest of consumers, the imposition of quality standards or subsidies for specific market segments or consumer types is more suitable.

5 Summary and conclusions

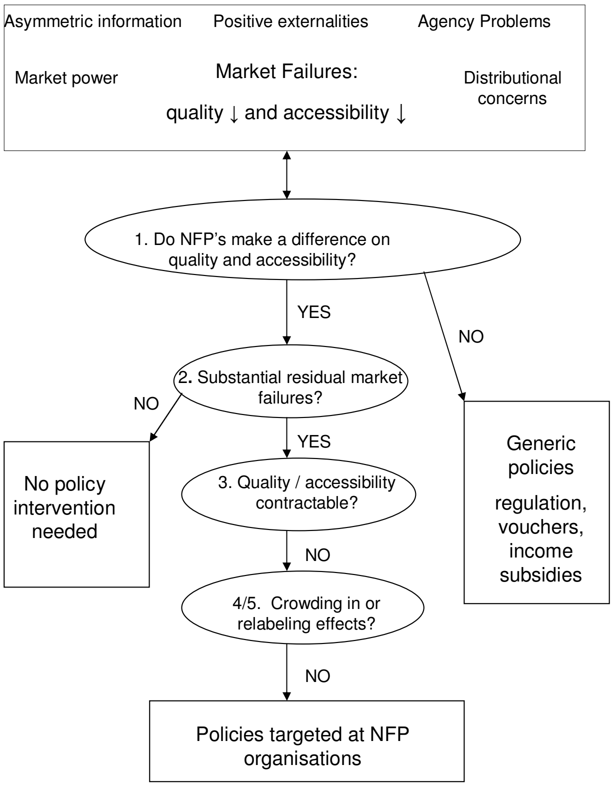
One framework for analysis..

This study provides a framework to assess the conduct and performance of NFP vis-à-vis FP organisations. Related to this, the framework helps us to formulate the relevant questions that need to be answered in order to evaluate the use of policy measures favouring NFPs in particular. The framework can be applied to a variety of markets where both organisation types are active. In particular, we have addressed three markets that can be characterised as 'social services': the hospital industry, the child care sector and welfare to work (WTW) sector. In these sectors, the provision of services requires a substantial degree of professionalism. This contrasts to so called 'expressive functions' that typically have a NFP status. At the same time, the public interest in these sectors is substantial (i.e. substantial information problems), and markets are typically mixed, with both FP and NFP organisations.

The figure below summarises the route to be taken in order to answer the key question we formulated in the introductory section: "*Under which conditions, and, if so, in what way should non-profits be stimulated?*" To start with, we characterised NFPs as 'market failure correcting devices' (section 2). In the figure, the standard list of market failures is presented: asymmetric information, (positive) externalities, market power and distributional concerns. These market failures may trigger NFP organisations to act in the interest of consumers or society as a whole by providing higher quality of services and increasing the accessibility of services for consumers with a low income. Now, the next question to be addressed is whether NFPs indeed make a difference with respect to the quality and accessibility of services (section 3). If not, the public sector may decide to use generic regulatory or subsidy measures to combat market failures ─ irrespective of the legal status of service providers. Obviously, the most extreme policy response of the government is to provide the services itself.[22] If the answer is positive, we next address the importance of residual market failures. If market failures are still substantial, there are three additional conditions that should be met in order to favour NFPs vis-à-vis FPs: performance outcomes should be hard to contract upon; subsidisation should not lead to substantial crowding out effects of donated labour and private donations; and FPs should not be triggered to become NFPs so as to extract subsidy rents. If these conditions are not met, more standard regulatory measures that are not directed to a specific legal status should be carried out to correct for market failures.

[22] As we have argued in the introductory section, we abstract from mixed markets where the public sector is also active as a provider of services. To get more insight in the issues relating to the choice of public sector intervention for the education sector, see e.g. chapter 6 of Appelman et al (2003).

Figure 5.1 The framework for analysis: generic policies or specific policies needed for NFPs



.. applied to three sectors

When surveying the literature for the US and Canada on hospitals, child care and WTW services, the key market failure is that of information asymmetries. In particular, service providers have the opportunity to skimp on quality aspects that are hard to monitor ('moral hazard'). NFP organisations often consider the combat of these moral hazard problems as their primary goal ─ that is, they aim at providing better quality, which is to the interest of consumers. The evidence, however, suggests that NFPs only incidentally make a difference on quality. Thus, there is no strong argument here to favour organisations only because of their non-profit status. Instead, in order to raise quality levels, government intervention will be more effective by regulatory measures that apply to all service providers.

When surveying the literature, there is only evidence that NFPs make a difference by providing services in markets with low competition or to specific consumer types. The first finding calls for policies to increase competition (e.g. by increasing market transparancy), rather than favouring NFPs. With respect to the second finding, the most apparent aims of NFPs seem to boil down to distributional concerns. If the government has similar interests, again this however is not an argument per se for favouring NFPs. Rather than that, subsidisation may take place by vouchers for specific consumer types. Particularly the accessibility of services by hospitals and child care organisations for low income customers is relatively well observable and therefore can be contracted on. Thus, again policies that (further) increase accessibility can be generic, in the sense that they apply to all organisations that focus on accessibility.

NFPs are, similar to FP organisations, susceptive to rents extraction. Generally, wages that NFP organisations pay are not systematically lower than FP organisations, efficiency costs are similar, and NFPs seem to respond equally to changes in competition. What this suggests is that donated labour and donations of NFP organisations ─ creating an advantage with respect to FPs ─ are not very important, or are undone by inefficiencies.

Overall, for the three sectors under consideration the case for favouring NFP organisations is weak, which becomes apparent when listing the five conditions: (i) NFPs do not seem to make a systematic difference in quality of accessibility of services; (ii) Residual market failures are often hard to substantiate; (iii) Some performance aspects of accessibility and ─ to a lesser extent ─ quality can be contracted upon, irrespective of the legal status of organisations; (iv) Public sector support for NFPs may crowd out private donations and donated labour; and (iv) Public sector support may trigger FP organisations to become NFP as well, but maximising rents extraction by other means than profit extraction. Similar to markets with FP organisations only, the most apparent form of public sector intervention in mixed markets therefore is that of regulation. In particular, the public sector can increase market transparency and set quality standards, or subsidise the provision of services for particular consumer types or particular market types. Stated differently, it seems that the difference between NFPs and FPs in the social services sector is largely anachronistic, whereas the level of competition between firms ─ FP and NFP ─ is far more important in determining market outcomes.

Policy implications

One of the basic policy lessons that follows from the literature ─ at least for social services ─ is that governments should not subsidise or facilitate NFP organisations substantially, as there is a variety of mechanisms that weakens the power of such measures. Essentially, this lesson also applies to the Netherlands, at least with respect to the child care and WTW-sectors. In both sectors, the primary goal of the government should be to increase the transparency of performance outcomes of (all) service providers, rather than relying upon the benevolence of NFP organisations exclusively. In the childcare sector, the recent liberalisation act seems well in line with this notion ─ NFP organisations are no longer subsidised by communities with exclusive contracts ─ albeit that the childcare market is still far from transparent regarding the quality of services.

For the Dutch care sector, the outcomes of the US studies should be interpreted with more care. Here, the basic difference with the US is that all hospitals in the Netherlands are NFPs (FP hospitals are prohibited). Thus, the hospital market is not a mixed market, rendering the US evidence less relevant for the Netherlands. In particular, the increased competition that results from the introduction of FPs may ─ when the quality control of hospitals is still insufficient and the reputation mechanisms is not active yet ─ result in substantial risks of rent seeking behaviour (see e.g. Janssen et al, 2006). Still, it should be noted here that hospitals in the Netherlands are not fully free from profits. In many hospitals, medical doctors and specialists do not have paid employment, but operate in partnerships where profits are allowed for. One way to test for the impact of profit motives is therefore to compare hospital types. Similarly, the government could experiment by allowing some hospitals in some markets (or for some activities) to make profits.

Essentially, the formal mission of NFPs can be summarised as ‘making a difference’. From the analysis, we may conclude that the non-profit condition is not a sufficient condition for making a difference, in the sense that the quality or accessibility of services is better safeguarded than by FPs. This observation ─ or, stated differently, the absence of any proof that NFPs make a difference ─ in turn may discourage the provision of donated labour and private donations. It thus seems that public goals are best served by NFP organisations that clearly signal their missions and that ─ perhaps even more important ─ actively give account of their activities (see e.g. SER, 2005). This means they inform customers about the quality of services that have been provided, as well as the specific markets and client groups they want to focus on. Otherwise, there is a large risk that ─ particularly for larger organisations ─ the distinction between FP and NFP status becomes largely anachronistic.

As a final remark, it should be stressed that our arguments against favouring NFPs by the government are not an argument against NFPs. Instead, from our analysis we conclude that NFPs in fact can make a difference vis-à-vis FPs, particularly in markets where competition is low and/or when there is not many regulatory measures being taken by the government. In these markets, NFPs are probably are capable of attracting intrinsically more motivated workers. More specifically, the virtues of NFPs are probably highest when market failures are substantial, and hard to be resolved by the government. But again, this is not an argument per se to stimulate NFPs, as one cannot (only) rely upon the legal status of these organisations.

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