Chapter 7.

A Supportive Financing Framework for Social Economy Organisations

by
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In recent years, social economy organisations have assumed an important position in Central and Eastern European. They have strengthened their role of representing citizens' interests and have been providing a myriad of activities to address the different needs of various groups in society. Governments and social economy organisations have worked together to develop laws that guide their establishment and operation. However, the laws that should enable social economy organisations to draw from different resources to implement their activities and support their sustainability remain a challenge. This chapter provides a comparative overview of the legal issues that require consideration in developing strategic policies for supporting the sustainability of social economy organisations. It discusses issues such as: the legal framework for the establishment and governance of social economy organisations; the extent to which publicly beneficial organisations are distinguished and supported; and, the effect of different resources on the viability of social economy organisations. The innovative approaches adopted by different countries to address the challenges in government funding are also explored. By analysing these issues the chapter aims to underscore the important role of the policy and legal environments for the viability of social economy organisations. It also emphasises the need to enable social economy organisations to use a diverse range of resources to support their activities and to allow them to undertake them in a creative and sustainable manner.

Introduction

Social economy organisations[2] have played a vital role in the establishment of stable models of democracies after the political transformations that have occurred in Central and Eastern Europe (CEE). They have not only successfully served as vehicles for expressing and representing citizens' needs but they have also addressed the immediate needs of their beneficiaries or target groups (such as women and children) by directly engaging in service provision, or lobbying for changes to government policies. Recognising the potential of these organisations, and their contribution to the public good, governments in the transitional countries have launched legislative reforms to facilitate their existence and their operations, and to regulate their relationships with stakeholders, so as to ensure their sustainability. Nevertheless, these organisations still face many challenges pertinent to the financial aspects of their sustainability. This is true especially for countries in South-East Europe (SEE) where foreign donors are a predominant source of funding, while the mechanisms for government support remain underdeveloped and non-transparent.

Having reviewed the regulatory frameworks that support the financial viability of the sector in the countries of the region, this chapter will provide a brief comparative overview of the basic legal issues pertinent to the registration of social economy organisations. In particular, the types of organisational forms found in the social economy, and the legislation governing the public benefit status of social economy organisations, which is a prerequisite for state support in most countries of the European Union (EU) will be examined. Financial sustainability is obviously critical for social economy organisations if they are to be able to meet their objectives. With this in mind, the chapter will explore the three major revenue sources for social economy organisations – income generation, direct government support, and philanthropy – and the legal and fiscal frameworks, and tax treatments that have an effect upon them.

By providing a general overview of the existing mechanisms which support the viability of social economy organisations, and outlining the successes and challenges found in regional examples, this chapter aims to convey the message that no one, single mechanism can serve as a panacea to the sustainability problem if introduced independently from the others. Indeed, it is necessary for governments and social economy organisations to work together to develop policies that can outline the most desirable approach to enhance the financial sustainability of the sector.

Framework laws as a basic factor for sustainability

An environment which seeks to enable the sustainability of social economy organisation presupposes, firstly, the right of citizens to associate freely in order to achieve common interests and needs; and, secondly, clear and well-defined rules that support their viability and functioning (Rutzen, Durham and Moore, 2004). To create the necessary conditions for social economy organisation to operate, the legal framework should contain rules which regulate the basic lifecycle of such organisations from registration to dissolution, including the type of activities that they can engage in and their governance structure.

The importance of provisions regarding registration, organisational form, governance and dissolution for the overall sustainability of social economy organisations should not be underestimated. They set a protective framework for the activities of social economy organisations and limit the ability of governments to interfere with their rights to be established and to operate freely. Generally, framework laws should determine basic rules for social economy organisations seeking to obtain legal entity status, but should not restrict informal activities of unregistered organisations. Mandatory registration contradicts the nature of citizens' association and inhibits the ability of citizens to perform ad-hoc or informal activities that benefit their local communities. The non-mandatory registration requirement is also in line with the internationally promoted idea of freedom of association as a basic constitutional right of citizens. Indeed, the obligation for mandatory registration was challenged before the Constitutional Court in Croatia, and as a result Croatia abolished this requirement (Golubovic, 2000).

Laws from Central East European countries generally recognise two main organisational forms of social economy organisations: associations and foundations.[3] Associations are membership-based organisations, which can be established for the mutual benefit of its members or for the benefit of the public or certain disadvantaged groups. The members of associations constitute the assembly as the highest governing body, although usually associations have another body (such as an executive board) that performs management functions.

Foundations require property dedicated to a specific purpose and are governed by a board of directors appointed by the founders. Some countries impose a minimum capital requirement for registration. Foundations can be defined as endowed grant-making organisations only (Czech Republic or Slovakia), or as both grant-making and operating foundations (Estonia or Hungary). As with associations, foundations can be established for private or public benefit.

In addition to the two basic forms, some countries have introduced other forms which are similar to associations. For example, Poland recognises "simple associations," which lack legal personality but are easier to form than other associations. Lithuania provides for the establishment of "community organisations," which are similar to associations but limit membership to individuals. Macedonia and Serbia allow for the establishment of "associations of foreigners" but limit the purposes they can pursue. Furthermore, the Czech Republic has introduced the "funds" which (unlike foundations) do not require an endowment and so they may use all of their property to pursue their statutory purposes.

A third organisational form has been introduced, for example in the Czech Republic and Hungary, which is non-membership based, and organisations that acquire it can engage more actively in income generating activities. "Public benefit corporations", in the Czech Republic, can be established for the purpose of providing publicly beneficial services. They may also engage in complementary operations (economic activities) if the income from such organisations does not negatively affect the quality, scope, and availability of the public services it offers.[4] However, they may not invest in the entrepreneurial activities of other people. The Hungarian "non-profit companies" are discussed below.

To limit arbitrary government decision-making, most of the countries have adopted rules that introduce a straightforward registration process, requiring basic documents (act of establishment, governing document and application form) and define narrowly the grounds for refusal. Although, the majority of Central East European countries have adopted acceptable grounds for refusal of registration (incomplete submissions, basic legal requirements not satisfied, or illegal activities), some laws still contain vague terms, which can be subject to discretion. For example, under Croatian law, if the activities of a fund or foundation are seen as "immoral" or the registration authority finds that the purpose "lacks seriousness", registration can be refused. This is currently being revised, and the Croatian Ministry of Justice is preparing a new draft Law on Foundations that will bring the regulation of foundations in line with good practices across Europe.

Limiting the grounds for involuntary termination is also an important factor which contributes to the creation of a favourable environment where social economy organisations can operate without the fear of discretionary government intervention. Even though laws throughout the region have adopted strict provisions for determining the cases of involuntary termination, some still tend to cause problems. For example, Slovenia allows the responsible ministry to dissolve a foundation if it decides that the changed circumstances make the continuation of the foundation unnecessary. This provision is problematic, as it gives registration officials a great deal of discretion as to whether to dissolve an organisation.

Apart from the registration and dissolution provisions, laws also set basic guidance as to the governing structure of the organisational forms, so as to facilitate and promote accountability and good governance. Associations are governed by their assembly, and foundations by a board of directors. In Hungary, public benefit companies are governed by owners or quota holders.

An important aspect of social economy organisations is their internal democracy. Unfortunately, some framework laws in the region are vague, or silent, about governance structures, and even if the basic governing bodies are prescribed, their roles are not clearly defined (Wyatt, 2004). In Hungary, for example, the Law on Association provides that the bye-laws should reflect democratic principles. However, this is not further clarified and therefore registration judges interpret this provision in very different ways. While this had some positive effects, the "one vote per member" rule has been enforced through judicial practice, at the same time judges intervene unnecessarily in the organisational autonomy of the associations (Fülöp, 2006). For example, judges would require that the founding document includes details on how meetings are convened, by requesting that they contain the provision that all members must receive posted invitations for meetings (as opposed to emailing or calling them by phone), or by requesting that the founding document foresees the establishment of a committee to count the votes where decisions are made by a secret vote.

Generally it can be said that social economy organisations still need guidance and capacity building to strengthen their internal governance structures and perform their activities in a professional and responsible manner. A recent survey conducted in Bulgaria shows that "in more than one-fourth of the cases staff participate in the governing bodies" of the organisation, but that there are no clearly written responsibilities of the members of the governing bodies. At the same time, the "disloyalty […] of individual members, poor performance of responsibilities and [the] non-fulfillment of commitments" are often reasons for conflicts between the governing body and the Executive Director, according to the survey. In addition, a "regular financial audit is not a frequent practice…. Around one-third of them (31%) do not conduct such an audit at all, and 25% have […] occasionally" (Bulgarian Center for Not-for-Profit Law, 2006).

A similar survey in Hungary showed that social economy organisations do not have "a clear understanding of the differences between governance and management. This is reflected in the fact that 42% of respondents assign to board members the role of managing day-to-day operations, and 53% of management staff are voting members of the governing body.” Furthermore, social economy organisations “do not generally recognise cases in which conflict of interest is involved, and do not consider such situations improper or ineffective”. In terms of financial accountability, the survey found “that although 81% of respondents prepare annual reports, only 32% distribute the annual report effectively.” It is important to note that 68% of the respondents are public benefit organisations, who are required by law to publish their reports (Mura-Mészáros, *et al.*, 2002). This results in both poor accountability and low levels of transparency, which weakens the public image of social economy organisations. This, in turn, has an impact upon the ability of social economy organisations to mobilise financial or other support from government, individuals and business.

Most importantly, social economy organisations are greatly affected by the way framework laws regulate the type of activities they can engage in. There are two key issues that are usually part of framework laws and which are important when considering the financial viability of social economy organisations: 1) the permissibility of social economy organisations to engage in income-generating activities; and, 2) public benefit status as a prerequisite for state support. For example, when the government of the Czech Republic introduced the mechanism for endowments, it recognised that it needed to revise its Law on Foundations to make this instrument effective. In general, the amendments removed the prohibition on the investment of assets from endowments, and provided various mechanisms, and rules, for managing endowments (see below). Poland and Lithuania also sought to review their regulations when the percentage designation system was introduced, in order to ensure that the designation was effective and directed to activities that are of public benefit. As a result, only those organisations that have acquired public benefit status can now be recipients of the percentage allocation.

The legal framework and the sustainability issues pertinent to the ability of social economy organisations to engage in income-generating activities will be discussed in detail below. However, it is important to emphasise at this point that according to the John Hopkins Comparative Research Project, 53% of the income of social economy organisations in the surveyed countries is generated through fees for services, economic activities, investments and other income generating activities.[5] It is therefore crucial for the viability of social economy organisations that governments revisit their policies and improve framework laws to support engagement in activities which enable social economy organisations to sustain their statutory purposes.

Public benefit status

Public benefit status essentially distinguishes between organisations that are established for the mutual interest of the members, such as sailing clubs, from those whose activities benefit a larger community. Countries generally list the type of activities that are considered of public benefit and prescribe the criteria so as to further define the status. For example, in the Netherlands and in Poland public benefit social economy organisations are those that operate principally for public benefit purposes and provide services to a larger and undefined group of beneficiaries. Public benefit status can be conferred on social economy organisations either through provisions included in framework legislation (such as in Bulgaria and Romania), in separate public benefit legislation (Hungary, Lithuania, Poland and Latvia), but also implicitly through provisions in tax or other laws (Croatia and Slovakia as well as most Western European countries). While organisations that receive public benefit status are entitled to more benefits than others, in turn they are subject to greater supervision by the government and have to comply with stricter rules on accountability. The purpose of this scrutiny is to protect the public from possible fraud and ensure that the benefits these organisations get are not wrongfully used.

Governments generally decide to provide special benefits to public benefit organisations because such organisations serve more effectively the needs of local communities and society as a whole. By addressing social needs they complement, or supplement, the obligations of the state or provide services that are under-supplied. They often identify and respond to social needs faster than governments and are capable of delivering services more efficiently and directly. In addition, governments have an interest in supporting public benefit social economy organisations because in the provision of their services they raise additional funds, thus saving the state money and mobilising larger community support.

The benefits granted to public benefit social economy organisations generally come in the form of profit tax exemptions, exemptions from property, gift or inheritance taxes, customs duties exemptions, tax benefits to donors, preferred status for government funding and contracting or use of public property (ICNL, 1996a). Therefore, public benefit status is fundamental to the sustainability of social economy organisations because most countries in the region treat this status as a prerequisite for granting tax benefits or other types of state support. For example, France, Germany and Hungary allow only public benefit organisations to receive tax-deductible donations. In other cases public benefit organisations benefit from tax relief on their economic activities, such as in Hungary where public benefit organisations have a higher threshold of tax exempt income from unrelated economic activities. In some countries, such as Croatia, there may be no explicit status defined in law, but tax benefits are nevertheless only linked to public benefit purposes. Even foreign donors sometimes base their donation policy on the precondition that social economy organisations have received public benefit status or its equivalent.

Financial sustainability

A sound and appropriate legal framework is not only a precondition for the establishment of social economy organisations, but also has an impact on the democracy and governance of social economy organisations and on the activities they can engage in. By establishing the basic framework to allow social economy organisations to generate their own income, and by distinguishing those organisations that serve the public good, the legal framework is an integral part of all public policies affecting the financial sustainability of social economy organisations.

Sources for financial sustainability

Generally, there are three main sources of revenue available to social economy organisations:

- Government funding (central and local level).
- Income generating activities: fees for services, sales, membership fees, rents, investments, business ventures, etc.
- Philanthropy (financial donations and in-kind support from volunteers).

As noted above, according to the John Hopkins Survey, income generating activities constitute the largest source of revenue (53%), in comparison to government funding (35%) and philanthropy (12%) (Salamon, Sokolowski and List, 2003).

The relative importance of all three sources varies, depending on the local circumstances in each country. Accordingly, each country should decide which source to focus its attention upon, based on an assessment of the strategic priorities, the local conditions and the needs of social economy organisations. For example, the government of Hungary decided that it would need to increase the level of government support, compared to other policy alternatives. Consequently, in its strategy from 2002 it adopted this goal by setting a target of doubling the level of government support by the end of its term. To support this aim, it created the National Civil Fund as a grant mechanism, which distributes funds for operational costs to non-profit organisations. As a result, the funding allocated through various public mechanisms in Hungary exceeded 40% by 2005. However, while the priority at any give time may lean towards one source, it should be noted that an approach to only strengthen one revenue source will not alleviate the sustainability problem of the sector as a whole. Countries should consider ensuring that there is an enabling legal environment for social economy organisations to fully utilise all types of resources.

First, creating possibilities for using diversified funding resources is important to support the existence and to foster the flourishing of different types of organisations. Not all social economy organisations will have easy access to all resource revenues as the potential to receive funding from a source might depend on the field of their activity (Table 7.1). The John Hopkins Survey illustrates that, at the global level, social economy organisations active in the health and social service fields benefit the most from government funding. Social economy organisations engaged in culture, education, regional development, environment and advocacy rely mostly on economic activities, while religious organisations and those involved in international development receive most of their funds through philanthropic giving.

Table 7.1. Sources of income and types of activities

Government Funding	Economic Activity	Philanthropy
Health *	Advocacy	Religion
Social services	Environment**	International development
	Education	
	Regional development	
	Culture	

Notes: * Social service: 44% government funding, 37% economic activities, 19% philanthropy
** Environment: 42% economic activities, 30% government funding, 28% philanthropy

Source: John Hopkins Survey, 2003

Second, all resources complement each other. For example, the ability of environmental social economy organisations to engage in income-generating activities and to raise funds through private donations increases their income, which in turn matches the support they receive from the government. This is especially important for the government in cases where it contracts out tasks to social economy organisations to help implement state policies or deliver services.

While this division is relative, and the share of each source to the sustainability of social economy organisations differs from country to country, and also across regions, it reinforces the importance of the need for governments to promote different sources of funding and to remove the obstacles which hinder the development of financial maturity within civil society.

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While this division is relative and the share of each source to the sustainability of social economy organisations differs from country to country, and also across regions, it contributes to the understanding that it is crucial for governments to recognise the significance of promoting different sources of funding and to remove the obstacles which hinder the financial maturation of civil society.

Income generating activities

An important factor which helps measure the supportiveness of the legal environment towards social economy organisations' viability is the permissibility of social economy organisations to engage in income-generating activities, including membership fees, sales, fees from services, investments or renting property. Economic activities may be defined as "regularly pursued trade or business involving the sale of goods or services" (ICNL, 1996b). Income from donations, gifts, passive investment, occasional activities which can result in a generating income, such as fundraising activities usually do not fall under the definition of economic activities as described above because these are not conducted through a market-type transaction.

Income generating activities are considered the most important source of social economy organisation financing, particularly in those countries where support from foreign donations is declining and where private philanthropy has not yet developed to the point where it is sufficient to support the activities of the sector, and also where the mechanisms of public funding are opaque. Allowing social economy organisations to generate their own income could lead to an increased level of effectiveness in programme implementation and to better quality and more diverse services. For example, charging fees for services and products raises the expectation of beneficiaries as to their receipt of a higher quality of service. This triggers the institutional mindset of social economy organisations, which become more aware about the needs they aim to address and the value of services they provide to their beneficiaries. In addition, the ability to engage in income generating activities encourages social economy organisations to consider services that they could not otherwise provide for, with other funding sources. Finally, the ability of beneficiaries to choose the service provider raises competition among social economy organisations, which leads to better quality services and enhances the effectiveness of their work (ICNL, n.d.).

State policies, and a favourable legal environment, play an important role in the ability of social economy organisations to generate income from economic activities to support their non-profit purposes. When regulating economic activities the following issues are generally considered: a definition of what constitutes economic activities; criteria of what is permissible, and to what extent; and, the tax treatment of any revenue generated.

Since economic activities involve a financial or market-type transaction and serve an economic purpose, states have adopted safeguards against misuse of this opportunity. Most fundamental is the non-distribution principle, which essentially ensures that such income is not distributed to the members or associates of the organisation. In addition, the laws require that all income generated must be used to support statutory purposes.

Most countries have set additional criteria that determine the ability of social economy organisations to engage in economic activities. Croatia allows social economy organisations to engage in economic activities to the extent it is necessary, and only in those activities that are detailed in the statute, the legitimacy of which will have been reviewed by the registration authority in advance. However, the lack of clear criteria regarding what is considered to be an economic activity is one of the problems in effectively implementing this provision. Country specific legislation differs regarding the extent to which social economy organisations are allowed to engage in economic activities. Bosnia, Bulgaria, Romania and Slovenia permit only activities "related to the mission" of the organisation, for example, in the case of those social economy organisations that assist people with disabilities selling a publication on the issue would be permitted.

Of all Central East European countries, it is only in Macedonia that social economy organisations cannot engage directly in economic activities and are required to establish a subsidiary (such as a limited liability company) if they want to do so. Under the current judicial interpretation of the law, educational social economy organisations cannot sell a book to help cover printing costs. In practice, social economy organisations engage in economic activities regardless of this prohibition, which undermines the rule of law. In addition, these activities are unregulated and, as a practical matter, untaxed, even if the activities are unrelated to the organisation's mission. The Macedonian Ministry of Justice is currently drafting amendments to remove this prohibition and allow social economy organisations to directly engage in economic activities, without the requirement to establish a subsidiary, which should address such problems.

The third important issue associated with the economic activities of social economy organisations is the tax treatment of the income from such activities. Tax exemptions are generally considered to be an indirect form of government support to social economy organisations, and thus are distinguished from the permissibility of social economy organisations to engage in economic activities, which is addressed in framework laws. The tax treatment of economic activities will be addressed in detail below.

The ability of social economy organisations to generate income and conduct their activities effectively is also dependent on their capacity to develop services that can generate such funds, to create self-financing business models or to utilise the skills necessary to sustain such activities. One approach, which appeared as an answer to the latter point, is the establishment of social enterprises. Social enterprises are business ventures with primarily social objectives whose income is reinvested for community purposes.[6] Social enterprise projects seek to empower social economy organisations to operate income-generating ventures and to make a social impact (Moore, 2004). The U.K. government recognised that "by using business solutions to achieve public good […] social enterprises have a distinct and valuable role to play in helping create a strong, sustainable and socially inclusive economy" (Cabinet Office, n.d.). In 2002, it launched a three-year strategy to support these initiatives by setting the following three outcomes: firstly, creating an enabling environment for social enterprise; secondly, making social enterprises better businesses; and, thirdly, establishing the value of social enterprise. The potential impact of social enterprises on economic and community development has triggered some countries, such as Slovakia and Hungary to adopt similar models.

For example, in Hungary a non-profit social enterprise that generated its income primarily from economic activities (such as by selling handicrafts made by local unemployed people and reinvesting the income in the development of the community) had limited opportunities to operate in a sustainable manner. Either it could have assumed the form of an association, in which case it would not have been allowed to conduct business activities as a primary activity and therefore the potential to grow as a business would have been limited. Alternatively, it could have assumed the form of a public benefit company, which requires starting capital and some kind of agreement with the local government, or another government agency, that proves that this organisation is conducting public benefit activities. In 2006, the public benefit company form was discontinued and as of 1 July 2007 there is the possibility of any for-profit legal form (currently six types exist in the Hungarian Company Code) to assume a non-profit status. Such non-profit companies will be entitled to request public benefit status under the same conditions as associations or foundations. This expands significantly the possibilities of business activities being conducted as social enterprises, because it will enable organisations, like the one described above to, for example, register as a small company, conduct economic activities as a primary activity, grow its business according to market needs and yet remain a non-profit organisation and – eventually – claim tax exemptions if it acquires public benefit status as well.

In addition, investment income also provides an essential source of revenue for social economy organisations and many countries impose additional requirements and limitations on the distribution and the accumulation of capital to ensure that such income is spent in pursuance of their objectives. Slovenia and Macedonia generally treat almost all investment income as taxable, while Hungary and Poland provide exemptions for public benefit organisations.

When considering the opportunities and mechanisms for income-generation as a financial resource for social economy organisations, it is important to take into consideration the local economic situation and also the trust in the quality of services provided by social economy organisations, as factors which determine potential. For example, due to the high tax burden it might be more difficult for social economy organisations to run economic activities in Hungary than in Slovakia. Or if the social economy organisations provide good quality services citizens might be more willing to choose to pay for the services that social economy organisations offer, as opposed to the same type of services offered by other providers. Clearly, the economy must be strong enough to support the self-financing efforts of social economy organisations. It is also important to assess the stage of development of the sector in order to determine the most appropriate strategies that will enable social economy organisations to utilise various opportunities.

Government funding

Governments support social economy organisations financially either directly, by allocating resources from the state budget line, or indirectly, by granting benefits to social economy organisations. In the latter scenario the government is reducing the amount of income that it would have otherwise collected. Some Central East European countries have adopted the percentage mechanism, which goes beyond the traditional forms of government support. Recent data shows that the amount of government funds available to social economy organisations in Western Europe varies from 29% of the total civil society organisation revenue in Sweden and 35% in Norway, to up to 77% in Belgium and Ireland. In Central East Europe government funding represents between 20% and 30% on average from the overall income from the sector (Salamon, Sokolowski and List, 2003).

The interest of governments in supporting social economy organisations through funding mechanisms cannot be measured only by the amount of funding that it makes available to social economy organisations. The rules that regulate the distribution and monitoring of the use of funds should also be considered. Specifically, social economy organisations around South-East Europe have difficulties accessing government funding due to a range of reasons. These difficulties include the lack of transparency in the implementation of funding mechanisms, a lack of professionalism in contracting and grant-making, the fact that there are no clear criteria for accessing funding, and because the decision-making process on grant-making has become politicised. In addition, there is no effective monitoring mechanism to oversee the use of funds and ensure accountability by the social economy organisations that have received them. For example, recent research in Macedonia revealed that the government distributes annually EUR 4.1 million from various budget allocations, however only a limited number of social economy organisations benefit from these funds mainly because of the lack of clear criteria both as to who can receive them and procedures on their allocation. Therefore, when discussing government funding mechanisms it is also relevant to consider the implementation of such mechanisms which determines the effectiveness of the system.

Direct funding

Government funding can be distributed through several traditional forms: subsidies, grants, procurement, *per capita* fees or vouchers. These funds can be distributed from central level budget (through the parliament, ministries, lotteries, privatisation proceeds, public funds and foundations) or through the budgets of local governments (see Bullain and Toftisova, 2005).

Forms of direct support

From the mechanisms of government funding, subsidies and grants are the most common form used throughout the Central East Europe region. In our terminology subsidies serve as general support to the activities of social economy organisations, they are not linked to a specific project and can be used to cover general operating expenses, whereas grants are allocated to support the implementation of a given project which falls within the government's programmes. Subsidies are generally distributed to social economy organisations whose contribution to government policy implementation is considerable and may therefore serve as a general indicator of the public sector's recognition of civil society (Bullain and Toftisova, 2005). Funding through subsidies is usually given to major international agencies (such as the Red Cross), national interest representation groups (such as Associations of Pensioners), major service-providing organisations, and a very few advocacy organisations. Grants, on the other hand, are generally awarded through an open tender-type application process and can provide funding for a range of targeted activities, from the delivery of social services (such as in Germany, Croatia and the U.K.) to the implementation of programmes from the country's international development aid obligations (as in Sweden, Denmark and Germany) (Bullain and Toftisova, 2005).

The procurement mechanism regulates the government purchase of goods and services delivered by the social economy organisations. The challenge of this mechanism is that social economy organisations generally bid together with other service providers, such as businesses, and may be unable to meet technical requirements (such as collateral) or achieve the high standards usually set by governments. Some countries, such as Bulgaria, have amended their legislation to remove the prohibition on the participation of social economy organisations in procurement procedures. Others have created specific mechanisms, such as the public benefit contract in Hungary which has created two categories of public benefit status: the "normal" public benefit organisation and the prominent public benefit organisation. The public benefit contract is a special contract that "prominent" public benefit organisations can sign with a state agency to provide public services. The contract entitles them to the special public benefit status and the additional tax and other benefits (Bullain and Toftisova, 2005). Generally, social economy organisations engaged in social service delivery are most likely to benefit from this mechanism.

Third party payment schemes, common in Western Europe, such as per capita fees and vouchers are not yet widespread in Central East Europe, but have proved to be useful mechanisms of public support mainly for social service delivery social economy organisations. Per capita fees or normative support systems, which are common in Hungary, essentially mean that social economy organisations seek reimbursement from the government based on the volume of services they have provided. Social economy organisations that deliver services in areas such as healthcare or education are the beneficiaries of this system. The voucher mechanism, which was introduced in the Czech Republic, allows municipalities to provide vouchers for the services that fall within their obligation and leave the decision to the citizens to choose their provider. Aside from the fact that these two mechanisms are a form of financial support, they also prompt social economy organisations to compete with service providers from other sectors (public and private), which contributes to higher quality service delivery and ultimately to increased accountability.

Sources of direct support

Of all examples of sources of public support in the region it is worth emphasising two models: 1) the use of privatisation proceeds; and, 2) the creation of a public fund for the support of civil society. Both are important because they have been introduced as a result of concerted government efforts to strengthen the third sector through the adoption of innovative instruments. The former has proven to be successful generally, while the effects of the latter are yet to be assessed.

The distribution of privatisation proceeds to foundations was introduced in the Czech Republic as a result of the privatisation of state-run enterprises. The Czech Government allocated one percent of these privatisation proceeds to a Foundation Investment Fund, which then re-distributed the funds to local foundations in the forms of endowments. The purpose of this mechanism was to assist with the establishment of endowments as a secure resource base for social economy organisations. Foundations must keep the endowment within a certain legally prescribed minimum (EUR 16 000) but may use the rest above that minimum to pursue investment opportunities to achieve their statutory goals (Thomas, 2003). In 2002, EUR 27 million was distributed to 64 foundations, which at that time represented one-third of all foundations in the country (Kalousova, 2003).

Following the introduction of this mechanism, the government introduced changes in the legal and tax systems to create rules for the good management of the endowments and to enhance the ability of foundations to maximise their potential. The amendments introduced several investment possibilities as they provided for a wide range of investment instruments for foundations. At the same time rules for safe investing were introduced, as was the possibility of the professional management of endowments by financial institutions, tax-free capital gains were permitted, and an easier registration procedure was also introduced. Currently, 375 foundations are registered in the Czech Republic, with the value of their endowments exceeding over EUR 80 million (Kalousova, 2003). This instrument also led to improved co-operation among foundations, which pooled their endowments to establish a joint investment portfolio designed specifically for this purpose.

In 2003, the Hungarian Government established the National Civil Fund with the aim of providing a mechanism for institutional support to social economy organisations. Essentially, the National Civil Fund supplements the funds social economy organisations receive via the percentage allocation, by match-funding the funds that are designated to social economy organisations. 60% of the resources of the National Civil Fund are allocated to social economy organisations to support operational costs. In addition, funds from this source also support development programmes, including research, education and international representation. The Fund is administered by a Council and a number of regionally based Colleges. The Council is the strategic decision-maker, which sets the priorities of the Fund, divides the resources among the various purposes and develops other rules of functioning. The Colleges are regional bodies deciding about concrete grant proposals. Social economy organisations elect their representatives to sit on the Council and the Colleagues. In the first year a total of EUR 28 million was distributed to support the operational costs of over 3 500 organisations.

Whilst the introduction of the National Civil Fund was accompanied by great enthusiasm from social economy organisations, the first year of distribution saw the Fund confront significant criticism, which raised concerns as to the real effect of the Fund. This was due to the lack of carefully planned implementation mechanisms. It was revealed that in conceptualising the National Civil Fund the government had not considered a concrete overall strategy to develop the sector. Even the participation of social economy organisations in the decision-making processes raised controversy over potential conflicts of interest. It was found, for example, that social economy organisations connected to members of the Colleges were always awarded the full amount sought while other organisations often received less funding than requested. The Minister of Youth, Family and Social Affairs, Kinga Göncz, called the attention of the National Civil Fund's Council, the highest governing body of the Fund, to such controversies.

The implementation of the National Civil Fund was based on application requirements which appeared to be too burdensome and rigid. As a result of complicated and poorly designed application forms, between 70 and 90% of the applications were rejected. The Ministry responsible for overseeing the distribution ultimately had to intervene to allow for a broader interpretation of the strict formal requirements so as to permit for a higher number of applications to be considered. Consequently, the decision on the distribution of the funds came later than expected, leaving social economy organisations with only a month to spend the allocated funds, which originally were designed to cover costs for over a year. At the same time, the substantive requirements were rather broad and with no strategic focus. Thus, it is questionable whether the implementation of the National Civil Fund actually acted to assist and support the reform of social economy organisations and to strengthen them institutionally (USAID, 2004). Although the funding potential of this mechanism is considerable, its impact on general financial sustainability in the longer term largely depends on the willingness of the government and the Governing Council of the Fund to learn from the challenges in the first year and to revisit the goals they have set to achieve in order to improve the effectiveness of the system. For the second year they successfully developed a clearer and more user-friendly application system but did not address other issues which could have helped the Fund achieve its purpose, such as the criteria for the types of projects that would be supported.

Indirect forms of support

Indirect support most often appears in the form of tax benefits, use of municipal property or providing services at a reduced cost. The support is considered "indirect" because rather than distributing public funds, governments do not collect the revenue that they would otherwise be entitled to. Indirect support is associated mostly with the implementation of the activities of the organisation. Therefore the legal framework issues discussed above, namely the permissibility of economic activities and public benefit status, are important considerations for governments in shaping their policies on indirect support.

The issue of tax benefits is emphasised as the most important because it is directly connected to the amount of generated income that social economy organisations can utilise in the pursuit of their objectives. Tax benefits can appear in the form of an exemption from certain types of income from profit tax. Almost all countries exempt from taxation the income from membership fees, grants and donations. There is a general consensus that all social economy organisations, regardless of whether they serve mutual or public benefit purpose should be exempted in this case. However, in some countries, such as Bulgaria, mutual benefit organisations are subject to tax on donations (ICNL, 2003).

Tax benefits are also associated with income from investments, real estate and customs. Furthermore, the Value Added Tax (VAT) treatment of the activities of social economy organisations is an important consideration in discussions on their ability to operate and financial viability. For example, the Macedonian VAT Law provides an exemption only for the supply of services and goods by social welfare institutions, and not social economy organisations. This poses a serious burden on the ability of social economy organisations to financially manage social service activities.[7] Even the 6th Directive of the European Commission on VAT does not provide clear guidance on how to treat social economy organisations, and the rules in the new member states vary accordingly.

The ability of social economy organisations to utilise the income from economic activities is not unlimited and is subject to taxation in some countries, although the tax treatment differs from country to country (Table 7.2). Some look at the purposes for which funds derived from economic activity are put to use ("destination of the income test"). Consequently, if the income is used to promote public benefit purposes then it will not be taxed, as in Poland.

Table 7.2. Taxation of economic activities of social economy organisations in Central East Europe

Prohibits direct engagement	Macedonia
Not subject to tax	Bosnia and Herzegovina
Fully taxed	Albania, Bulgaria, Slovenia
"Relatedness" test	Estonia, Latvia
"Destination of income" test	Poland, Kosovo
Hybrid test / tax thresholds	Czech Republic, Hungary, Romania, Slovakia, Serbia, Montenegro

Source: John Hopkins Survey, 2003.

Another approach is to exempt income from economic activities only when it results from "activities related to the purpose" of the organisation ("relatedness test"). For example, in Latvia income from unrelated activities is taxed. Some countries, such as Czech Republic, Hungary, and Serbia and Montenegro have introduced a tax exemption cap in addition to one of the methods mentioned above, so that only income which exceeds a certain threshold is subject to taxation. Hungary combines the relatedness test with the threshold method by introducing a certain limit of exemption for income from unrelated activities. Consequently, all economic activities that are included in the statute of the organisation as supporting the mission are not subject to taxation. However, in addition to the related activities social economy organisations are also allowed to engage in commercial (entrepreneurial) activities which are unrelated to the mission. The income from these activities is taxed only if such income exceeds the threshold. Accordingly, all social economy organisations may benefit from tax exemption on the income from commercial activities which does not exceed

10% of the total income or HUF 10 million (~EUR 41 000). Finally, some countries fully tax the income social economy organisations earn from economic activity, such as in Albania, Bulgaria and Slovenia (Hadzi-Miceva, 2006a).

Percentage mechanism

The percentage mechanism is a relatively new example of state support to social economy organisations. It was first introduced in Hungary in 1997 and although several countries in the region have gladly embraced it, its effect is still being debated. The percentage mechanism is a form of tax allocation as it allows taxpayers to designate a portion of their paid tax to one or more specific organisations. After Hungary introduced the so-called "One Percent Law", Lithuania, Poland, Slovakia and most recently Romania have adopted similar legislation (Bullain, 2004). In addition, based on the Central East Europe experience, a local municipality in Japan has also introduced this mechanism.

Generally, there are two key objectives behind introducing this mechanism: 1) to increase the pool of resources available to social economy organisations; and, 2) to help to develop a philanthropic culture among taxpayers. The level to which these objectives are being met is difficult to assess, however, its potential impact on the sustainability of the sector is questionable.

There are several concerns expressed by policy makers, social economy organisations and experts in terms of the capacity of this mechanism to increase resources. First, this mechanism can be utilised only by taxpayers, and in addition, only by individual taxpayers (expect Slovakia where companies can also designate the percentage). Therefore, the potential group of "donors" is limited. Although all taxpayers can designate the funds with no cost for themselves (as they are basically re-allocating the tax amount that they would otherwise need to pay to the government) only 35% in Hungary use this opportunity. The same figure was true for Slovakia during the first year of implementation. In the second year, Slovakia increased the percentage from one to two percent and also allowed companies to designate. As a result around 42% of the individuals and almost 94% of companies re-allocated the two percent. However, in countries like Georgia or Macedonia where the population, and therefore the number of taxpayers is also small, the culture of paying taxes is still developing and the income tax rate is low, this mechanism might not bring the amount of resources that social economy organisations both need, and aim, to attract.

The second limitation of the mechanism is that it allows only a minimum amount, either one or two percent to be designated. Contrary to philanthropic giving, the "percentage cake" available to the social economy organisations has a given size and cannot be increased. Consequently, it is not only that the amount of available funding is limited, but also the receipt of a larger portion by one social economy organisation reduces the amount available to others. At the end only a small cluster of organisations (such as those who run the best marketing campaigns) really benefit from the mechanism. In addition, the overall amount may be quite small compared to other sources of revenue as the economy develops. In Hungary, for example, funds flowing from this mechanism have been estimated to be less than one percent of the total revenue of the social economy sector.

The effect of the mechanism on philanthropy cannot be easily assessed, as there are no comprehensive research results which can show whether it achieves its second objective. It is important to note that the mechanism was originally perceived as a mechanism for philanthropy; consequently some refer to it as "percentage philanthropy" (Bullain, 2004; Wyganski, 2004). This led to a misperception of the mechanism by both the public and the government. While the mechanism has increased the level of awareness about the importance of civil society among citizens, it has not necessarily resulted in increased financial contributions by individuals (notably, the percentage of private contributions by individuals in Hungary has been declining). On the contrary, according to some accounts this mechanism might have created a feeling in some individuals that they have done their share in society by "giving" a percentage of their taxes and there is no need to give more. Studies in Hungary have found that the same pool of the population (including those with higher incomes, higher levels of education, those living in urban areas, and women) who already donate more often than others, and who volunteer more often than others, are those who designate their one percent. This raises the question as to whether their philanthropic behaviour would be the same regardless of the percentage mechanism, given that they appear to be more socially aware and willing to give anyway.

Of most concern, however, is that the introduction of this mechanism has had an adverse effect on traditional incentives for philanthropy such as tax deductions, including leading to their abolition in Lithuania. Social economy organisations in Poland were successful in lobbying the government to postpone the decision on whether or not to abolish tax incentives after the mechanism was introduced. Although tax incentives are not the prime motive behind philanthropic giving, the example of Slovakia shows that they should not be underestimated. Specifically, even though almost all companies and a high number of individuals decided to designate the two percent, the amount of funding that was distributed to the social economy organisations was still less than the amount that social economy organisations had received through traditional philanthropic forms.[8]

Despite the challenges in implementation, this mechanism does have significant advantages for the social economy organisations, the taxpayers and governments. Most importantly it has proven to raise the awareness of taxpayers as to the existence of social economy organisations; encouraged individuals to identify the social issues important to them and which they are willing to support, and; played a key role in social economy organisations seeking to reach out to people and ask for support. In addition, it has proven to be a good mechanism that can be utilised by local and smaller social economy organisations, notably in Hungary, because they relate more closely to their local communities. Accordingly, it is easier to convince taxpayers in a local community to designate their percentage to their local social economy organisation. However, in terms of its effect as a resource, that is the actual amount of funds that can be raised, the mechanism has had a bigger impact on the larger and more service oriented social economy organisations who operate at a national level. These organisations are better skilled at communicating, can more easily obtain resources to support professional media campaigns and thus attract a larger number of taxpayers.

The mechanism also creates competition among social economy organisations and other beneficiaries, thereby contributing to their professionalism, improving their communication with stakeholders and generally enhancing their image. In terms of taxpayers, the percentage laws provides them with the possibility to decide as to how a certain percentage of tax money is spent, thus decentralising and de-politicising the decision making process. It also increases awareness of the importance of civil society. In turn, governments benefit because they are able to more effectively monitor the needs of their society. In addition, it should not be forgotten that a portion of the designated funds do return to the state budget in the spending process, specifically through VAT.

Although the percentage mechanism seems to be gaining popularity in countries of Central East Europe, the lessons from its implementation should not be ignored. These examples reveal that even if social economy organisations and governments estimate that the mechanism can significantly contribute to the sustainability of the sector, the other, potentially negative factors should also be considered. Most importantly, they illustrate that should this mechanism be introduced, it ought to complement and not replace other existing mechanisms, as in itself it will not be the remedy for the financial viability problem.

Philanthropy

Although according to the John Hopkins global study the share of philanthropy is relatively small in the income of the non-profit sector (12%), it is of central importance to social and economic development in transition societies. The level of philanthropy is an indicator of domestic support for social economy organisations, which is seriously needed in an environment where social economy organisations have been largely supported by foreign funding. In addition, it is an indispensable source for certain types of organisations, such as advocacy organisations, who, on the whole, would be less likely to receive support from government sources due to the types of activities they engage in. Support through philanthropy can take the form of monetary or in-kind contributions. In both cases public policies and the legal framework play an important role.

Government support for philanthropy

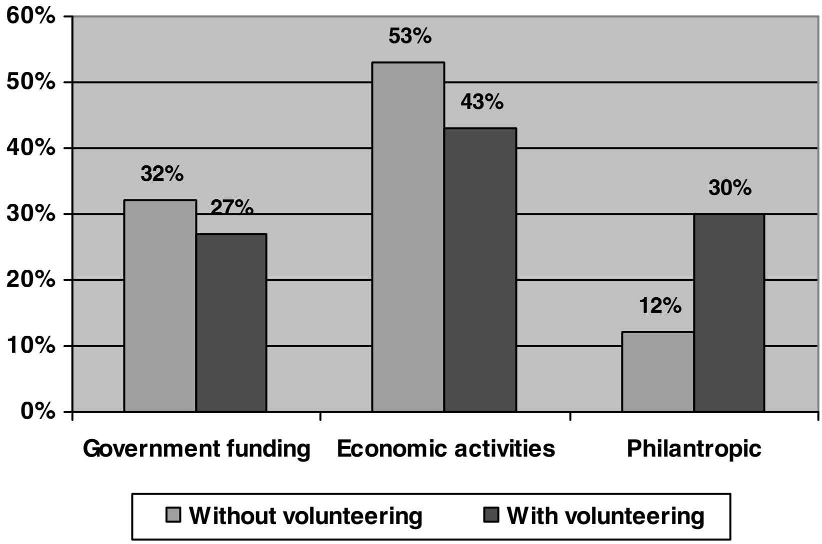
Governments aim to promote or support philanthropy by creating tax incentives in the form of tax deductions or tax credits.[9] By allowing individuals and corporations to receive a reduction in taxes in return for contributions to social economy organisations, governments empower them to commit resources to goals which benefit society. The example of Slovakia, where the relationship with the percentage law indicated that funding from private donations constituted a significant portion of the sector's revenue, shows that the importance of this form of support cannot be easily disregarded. While tax benefits are not the primary motivation behind private giving, they play a key role in the donor's decision as to how much to give, and in what form, and also have an influence upon the culture of giving (Bullain, 2003).

Tax incentives are also a form of indirect support and, as such, are sometimes dependent on the type of activities and purposes of the social economy organisations. Thus, most countries of the region have decided to allow tax deductions, or credits, only for donations given to public benefit social economy organisations (as in Hungary and Estonia) or to those social economy organisations who are engaged in services which are considered of public benefit (as in Croatia).

Volunteer support for philanthropy

In addition to the monetary donations, the contributions by volunteers are also considered a significant part of philanthropy – "It isn't just the money; philanthropy is time and mental work, and it's all tied in together" (Ostrower, 1995). Thus, as the Johns Hopkins Survey points out, philanthropy contributes the least to the overall income of the sector (Figure 7.1). However, if the value of volunteer contributions is added to the philanthropy, its share in the "civil society revenue pie" increases and thus places philanthropy in second place (in comparison to the 43% from economic activities and 27% from government funding). The value of volunteers' increases philanthropy from 12 to 30% (Salamon, Sokolowski and List, 2003).

Figure 7.1. Contribution of each source subject to volunteering



Source: John Hopkins Survey, 2003.

This shows that the volunteer contribution, if calculated based on average salary for fields where volunteers are engaged, is twice as large as donations. Volunteers are an important human resource for social economy organisations and an indispensable part of civil initiatives. To illustrate this in numbers, according to the John Hopkins Survey volunteers represent approximately 43% of civil society workers in the surveyed countries. To bolster volunteering and remove legal impediments to volunteering, countries throughout the EU, such as Spain, Portugal, Poland, Czech Republic, Lithuania and Hungary have adopted laws governing volunteering, while Croatia, Macedonia and Serbia have drafted laws that regulate volunteering (Hadzi-Miceva, 2006b). The mobilisation of volunteers can also be a consideration in granting government or municipal funding to social economy organisations. This is one of the criteria for receiving municipal funding for social service provision in some cities in Croatia.

The economic situation is also a factor to be considered when assessing the potential of philanthropic giving, similarly to the case of economic activities. In addition, the local tradition of giving, and the image of social economy organisations, as well as the development of the skills necessary to reach out to the local community and mobilise their support, are equally important considerations when devising a strategy for supporting the financial sustainability of the sector.

Conclusion

Governments and social economy organisations around the region have recognised that they can support the sustainability of social economy organisations through the creation of a sound legal environment that enables opportunities for diversified funding resources to develop and to be accessed. The successes and challenges of various legislative initiatives have shown that it is not sufficient merely to address the general sustainability issues. Countries need to identify the key problems and to prioritise legislative tasks if they aim to create a solid ground for long-term sustainability.

Primarily, the legal framework needs to be enabling for all revenue sources. We have seen that not all social economy organisations benefit from one source only. As the examples showed, social service organisations rely more on government support, while advocacy organisations benefit from philanthropy and self-generated income. Consequently, none of the three main sources (government funding, income-generating activities and philanthropy) are going to provide an effective solution for the sector if considered independently.

Furthermore, the different levels of economic development of the countries, the diverse needs of social economy organisations and the stage of development of the sector are important factors that need to be taken into account. Thus, in creating public policies and deciding on state strategies for support of the sector, governments should undertake a holistic approach and look at all factors. If they decide to apply models from other countries, governments need to conduct careful analysis of the local circumstances and consider the possible implications of introducing them. Finally, governments should work in partnership with social economy organisations and seek their input in the process of creating public policies and deciding on priorities for legal reform. Only through concerted and jointly undertaken efforts, and the inclusion of all stakeholders, can the reforms achieve the desired results.

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Notes

1. Copyright of this Chapter is held jointly by the OECD and the European Center for Non-Profit Law.

2. For the purposes of this chapter, social economy organisations refer to the basic forms of non-profit, non governmental organisations in the region: associations and foundations. The term will also embrace other legal forms that exist under country framework legislation, such as public benefit companies in Czech Republic.

3. Co-operatives, another form of social economy organisation which is widely in seen in Western Europe, are not particularly utilised in Central and Eastern Europe because of its previous use, notably by the state. Accordingly, they are not examined in this Chapter.

4. Article 17, ACT No. 248/1995 Coll. of 28th September 1995 on Public Benefit Corporations and on the change and amendment of some laws.

5. The study included 16 advanced industrialised countries and 14 developing countries from Africa, Asia and Latin America, and five countries from Central and Eastern Europe, including the Czech Republic, Hungary, Poland, Romania and Slovakia (see Salamon, Sokolowski and List, 2003).

6. Although it has to be clarified that social enterprise is not a legal form in most CEE countries. In fact it can take any legal form, non-profit or even for-profit, that exists in the country (*e.g.*, as associations, foundations, non-profit corporations, co-operatives).

7. In Serbia, the VAT Law required social economy organisations to pay VAT on the import of humanitarian goods and claim a rebate. Due to the lack of financial resources to pay the VAT, custom officials often ship back the donated goods. As a result of joint efforts by domestic and international NGOs, the government amended the law in July 2005 to exempt the import of humanitarian goods from VAT. For more see: www.ecnl.org.

8. See www.rozhodni.sk.

9. Tax deductions allow the donor to reduce all or part of the money that has been contributed to a social economy organisation from the taxable income, thus diminishing the tax base upon which tax will be calculated. Through tax credits the donor deducts part of the donated amount from the total amount of tax liability.

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Antonella Noya

Antonella Noya is a policy analyst with the OECD LEED Programme, where she has been working since 1997. She is responsible for LEED activities on social inclusion at the local level and Manager of the OECD/LEED Forum on Social Innovations. Prior to joining the OECD, Ms Noya was for several years a lecturer in Industrial Relations and Labour and Trade Union Law at the LUISS University in Rome, where she also worked as a manager in the Legislative Directorate of INTERSIND (the former employers' association for state-owned business). Parallel to this she did part-time work for leading Italian research centres.

At the OECD, Ms Noya has developed new areas of work, including: the role of the non-profit sector in local development, the role of culture in local development, asset-building for low-income people, social innovation, and community capacity building. Within this framework she has organised international conferences and study missions and coordinated studies and international reports. She is the editor and co-author of several OECD publications.

Ermanno Tortia

After graduating in economics at the University of Turin in 1995, Ermanno Tortia pursued Masters degrees in London and Rotterdam in institutional economics and the philosophy of economics, before completing his doctorate in Bologna, on labour managed firms. Since 2001 his research interests and activities have been in the field of industrial relations, human resources management and organisational innovation. From the beginning of 2004 Dr Tortia has been employed at the University of Trento as a researcher working on governance and labour relations in non-profit organisations and co-operative firms.

Glossary

Civil society

Civil society may be defined as a space or arena between households and the state, which affords possibilities of concerted action and social organisation. Thus, it encompasses all voluntary associations of citizens, whether politically motivated or active or not (although the term carries an implication of political consciousness and activity): business, labour, non-governmental organisations, churches, special interest or purpose groups. These elements are the constituents of civil society, but none can individually be representative of it. Business is often excluded, although the OECD does include it, given that channels of communication between traditional organised business and labour and government are generally well established. Most frequently the term is used interchangeably with “NGOs” where the term “NGO” refers specifically to activist groups, although these are simply one category of civil society as a whole.

Co-operative

A co-operative is an association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. Examples of co-operatives in Europe can be traced back to the 19th century. The International Labour Organisation has recently (2003) suggested that co-operatives should be based on the values of self-help, self-responsibility, democracy, equality, equity, and solidarity and share the principles of: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and, concern for the community, which were identified by the International Co-operative Alliance in 1995. A co-operative includes one or more kinds of users or stakeholders: 1) consumers who use the enterprise to acquire products or services (such as a retail co-operative, housing, healthcare or day-care co-operative); 2) producers (such as independent entrepreneurs, artisans, or farmers) who use the enterprise to process and market the goods or services they produced, or to buy products or services necessary to their professional activities; and 3) workers who use the enterprise to secure their employment and control their working conditions. Co-operatives operate democratically (one person, one vote) through two bodies (general meeting of the members or delegates, and the board of directors, which is composed of members elected at a general meeting). The delegate structure may be required to reflect the size of the organisation or the distance covered by the co-operative. The co-operative's start-up capital usually comes from co-op shares purchased by members. Since 1980, special co-operatives, known as social co-operatives, have become more widespread in OECD member countries.

Foundation(s)

Foundations are philanthropic organisations, organised and operated primarily as a permanent collection of endowed funds, the earnings of which are used for the long-term benefit of a defined geographical community or non-profit sector activity. Foundations operate as grant-making institutions, and also as providers of social, health and cultural services. It thus provides a significant link between the private and non-profit sectors, acting as a recipient of private capital and a funder of non-profit organisations. Foundations are tax-exempt, incorporated, not-for-profit, organisationally autonomous, and cannot be controlled directly or indirectly by government at any level, corporations, associations and their members, or individuals). Because they occupy a unique and central place in the non-profit sector, the development of foundations will strongly affect the future of the sector as a whole.

Mutual organisations/societies

A mutual organisation is an organisation owned and managed by its members and that serves the interests of its members. Mutual organisations can take the form of self-help groups, friendly societies and co-operatives. Mutual organisations exclude shareholding as they bring together members who seek to provide a shared service from which they all benefit. They are widely represented in the insurance sector.

Non-profit sector

The best known definition, while not commonly shared, particularly in European countries, is undoubtedly that supplied by the Johns Hopkins University in Baltimore (*www.jhu.edu/~cnp/*). According to this definition, the sector includes organisations which are voluntary, formal, private, self-governing and which do not distribute profits, such as hospitals, universities, social clubs, professional organisations, day-care centres, environmental groups, family counselling agencies, sports clubs, job training centres, human rights organisations and others. In fact, entities belonging to the non-profit sector can vary from country to country according to national history and tradition. The term non-profit, born in the USA, refers mainly to the absence of profit distribution. This is substantially different to the European approach of "social economy", which includes co-operatives. However, this difference is less significant when investigated through empirical research. C. Borzaga and J. Defourny (*The Emergence of Social Enterprise*, 2001, Routledge, London) argue that the distribution of profits is in any case limited by internal and external regulations in co-operatives and mutual organisations in European countries.

Social economy

The term "social economy" first appeared at the beginning of the 19th century in France. It was, nevertheless, only at the beginning of the 20th century that it began to be employed to indicate various entities aimed at improving collective working conditions and individual lives. This concept is now also used by Anglo-Saxon countries to refer to the production of goods and services provided not solely by the non-profit sector, but also, in some cases, by private enterprises with shareholder agreements that force the majority of shareholders to agree to social objectives undertaken by the firm. Among the organisations belonging to the social economy, one can find associations, co-operatives, mutual organisations and foundations. This type of economy is essentially regulated by the stakeholder principle, which stands in stark contrast to the notion of shareholder capitalism. The "social economy" is a broader concept than the non-profit sector, as it is less strictly bound to the non-distributional constraint, according to which organisations cannot legally redistribute their surplus to their owners (see also "Third sector").

Social enterprise

An organisation form which has flourished in recent years, many definitions of social enterprise exist. Apart from academic definitions, and those elaborated by international organisations, which are built around general criteria, definitions used within countries are specific to the national understanding of the phenomenon of social enterprises. Increasingly countries are developing legal definition of social enterprises. Generally, this concept refers to any private activity conducted in the public interest, organised with an entrepreneurial strategy and whose main purpose is not the maximisation of profit, but the attainment of certain economic and social goals, and which, through the production of goods and services, brings innovative solutions to problems such as social exclusion and unemployment (see *Social Enterprises,* OECD, 1999). In this way, social enterprises combine the entrepreneurial skills of the private sector with a strong social mission that is characteristic of the social economy as a whole. Social enterprises are part of the thriving and growing collection of organisations that exist between the private and public sectors. They come in a variety of forms including employee owned businesses, credit unions, co-operatives, social co-operatives, development trusts, social firms, intermediate labour market organisations, community businesses, or charities' trading arms. They mainly operate in two fields of activity: the training and integration into employment of persons excluded from the labour market, and the delivery of personal and welfare services.

Solidarity economy (économie solidaire)

The idea of the solidarity economy is mainly used in France and Canada (Quebec), and is also widespread in Latin America. It has different meanings according to the geographical context in which it is used: in the South American context, it mainly refers to fair trade and the popular economy, in Quebec it is linked to cooperatives, non-profit enterprises as well as to community economic development (*mouvement économique communautaire*) and in Europe to solidarity initiatives, mainly, but not exclusively, in the proximity services. Sometimes the term is used in association with the term social economy (as in Quebec) and sometimes in opposition to it, notably where the social economy is seen as composed of established organisations, while the solidarity economy mainly refers to non-established citizens' initiatives aimed at experimenting with new paths of economic development. In the European context, examples such as the fair trade movement are developing inside the sector, together with innovative forms of financial/non monetary-exchanges based on reciprocity.

Third sector

The concept of "third sector" is often used as a synonym to the non-profit sector and, more recently, also to "social economy", particularly in European literature. The term was chosen to reflect the idea that the sector assembles these otherwise disjointed entities, and that it sits between the public and private sectors and follows unique social goals and internal organisational rules. Its mode of financing is mixed, as it can seek both private and public funding. The idea of establishing a distinct "third sector" has given rise to many hefty debates, which have centred upon the danger of using the third sector as a residual sphere or "dumping ground" for those individuals excluded from the private and public sectors. To avoid the danger of social polarisation, the third sector should not merely be seen as an alternative route or juxtaposition to the public and private sectors, but as an interactive and reflexive component of economy and society. Others have argued that the boundaries of the third sector cannot be established with certainty, and for this controversial reason the European Commission preferred the use of the term "Third System".

Third system

The term "Third System" was first utilised by the European Commission in 1997 and refers to the economic and social fields represented by co-operatives, mutual companies, associations and foundations, as well as all local job creation initiatives intended to respond, through the provision of goods and services, to needs for which neither the market nor the public sector appear able to make adequate provision. On the initiative of the European Parliament, in 1997 the European Commission introduced a new pilot action entitled "Third System and Employment". The aim of the action was to explore and enhance the employment potential of the "Third System" with an emphasis on the areas of social and neighbourhood services, the environment and the arts (http://ec.europa.eu/employment_social/publications/2002/ke4502555_en.html).

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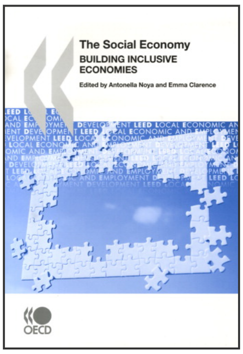

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