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THE PRIVATE NONPROFIT SECTOR:
FACTS IN SEARCH OF THEORY

OR

TOWARD A FIELD OF "INSTITUTIONALMETRICS"

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ABSTRACT

A model of the economy in which only private firms and governments allocate resources is oversimple. The "menu" of institutional mechanisms that can be selected to organize resources and distribute outputs includes more than these two choices, and the menu is changeable over time, as production costs and demand patterns change.

An "institutional mechanism" may be defined as a set of socially imposed constraints on behavior. The constraints may involve, for example, permissible methods of finance (e.g., "government" institutions may be permitted to use compulsory taxation, while ordinary private firms may not); they may involve permissible means of distribution of output (e.g., "public utilities" may not refuse to sell to any consumer, while an ordinary private firm may); and they may involve tax treatment (e.g., "nonprofit" private firms may be permitted to accept tax-deductible gifts, while other private firms may not).

Technological changes and expansion of knowledge are making the quality of many goods increasingly difficult for the consumer to judge. As a result, new arrangements--new mechanisms--are being sought to meet the growing demand for "trustworthy" institutions. But every institutional form has limitations. The process of economic change thus involves the growth of some institutional forms--presumably those that are most efficient in the handling of economic problems--and the decline of others.

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This is not really about the nonprofit sector. It is about the way economists have viewed the process of institution formation and behavior-- or, rather, how we have neglected that process.

With only occasional exceptions, economic theorists have focused attention on the private business sector, assumed to be profit-maximizing, and, to a lesser degree, on the government sector. That government and private business sectors have differential growth rates has been recognized in the "Wagner's Law" literature, which has sought to explain and predict the long-run variation and growth in the relative size of the public sector, but this literature has not taken us far toward understanding the reasons for the historical changes in the apparent importance of the two sectors.¹ In any event, the two-sector model implies that all market activity can be explained, and at the normative level can be evaluated, within a framework of only two options for organizing economic activity outside the household.

Institutional Choices

It is, however, too simple to postulate the existence of only two types of institutional arrangements for organizing market production and exchange--government and private for-profit. Dichotomies rarely, if ever,

exist in nature, and they are unlikely to exist in the economic world. Examining polar cases--such as government and business, or providers of pure private goods and of pure collective goods--is a useful beginning; but a continuum of market institutional types is more to be expected than is a dichotomy.

In addition, a one-dimensional continuum, ranging from the "purely private" producer to the "purely governmental," is less likely than a multi-dimensional continuum. That is, both the private business sector and the government sector are not single institutional types, but are classes of institutions. "Private" institutions may vary considerably in their behavior according to the type and particularly the "degree of collectiveness" of outputs--that is, the degree to which their products can be considered collective goods. Government institutions also exist in a wide variety of forms that may or may not all conform to a single behavioral model. Whether the behavior of such governmental institutions as regulatory agencies (e.g., Civil Aeronautics Board), independent governmental "authorities" (e.g., Port of New York), and agencies administering consumer-service programs (e.g., trash collection or welfare) can all be predicted from a single model is conjectural. My own guess is that it is possible, but that such a comprehensive model is far down the road, and that for now it is useful to think about typologies, and then to try to model each type of institution. As I say this, however, I want to emphasize that thinking about types of institutions is a halfway house on the road to a more general theory that conceives of continuous variables, with different types of institutions behaving differently primarily because they face different constraints and perhaps

different input prices, and possibly because their managers have different types of preferences.

Recent research has, in fact, followed the course of attempting to model particular types of institutions. There have been models, for example, of governmental administrative agencies and of legislatures, of "nonprofit" hospitals and of collectives.²

I have come this far without defining the terms "institution" or "institutional type" (terms I use synonymously). Indeed, it is difficult to find a definition in economic literature. The reason, I believe, is that economists, with few exceptions, have done so little to develop a theory of institution formation or behavior that there has seemingly been little need to define the term.³

The definition I propose is this: An "institution" is a vector of socially imposed constraints on behavior. We typically emphasize technological constraints in our theorizing about producer behavior. Yet no organization, no economic unit, private or public, market or nonmarket, is subject to technological constraints only. And since all organizations, at a given point in time, are subject to the same technological constraints, these constraints are not sufficient to explain the existence of many types of organizations, nor the swings in their relative importance through time.

The range of socially imposed constraints is large, and the opportunities to develop new constraints and to impose new combinations of constraints-- that is, to form new institutions--is considerable. What we generally term "governmental" institutions, for example, are units that typically are constrained in the manner of distributing outputs; they must provide equal access to all "eligible" persons or organizations, where eligibility

is defined in terms other than willingness to pay. Our governmental units are also constrained as to what they can do with any profits they earn.

Private firms, by contrast, are less constrained in the use of profits, and they are free to refuse access to outputs to persons who are unwilling to pay the stipulated price. Private firms, however, are constrained from imposing certain penalties (e.g., incarceration or death) on employees or customers who violate the firm's rules. And such firms are constrained from using physical force to compel someone to give up something the firm desires. "Public utilities"--another type of "private" institution--are released from the antimonopoly constraints on most other private businesses, but the magnitude of their profits is constrained, as is their freedom to decide to whom to sell.

A nonprofit or philanthropic type of institution is constrained in what it can do with profit--it can only use profits to purchase inputs, a constraint similar to that imposed on government institutions--and it is also constrained as to the type of goods it can produce. For example, "tax-deductible" organizations, as defined under section 501 (C) (3) of the Internal Revenue Code, are limited in the extent to which they may engage in "lobbying." But such organizations can receive tax-exempt donations--that is, donors do not face the constraint to pay income tax on money they donate.

Through time, institutional forms--sets of constraints--are "invented," and some thrive while others die. The "corporation" is one modern economic-legal invention, an institutional type that has thrived. It is not

constrained to "die" with the death of any or all of its owners, by contrast with noncorporate business. It is constrained, however, to pay a special tax on its profits as if it were a person.⁴ We might note that since institutions' constraints are defined largely in the legal system, the literature on "law and economics" and on "property rights" constitutes contributions to theorizing about institutional formation and behavior.⁵

Economics of Trust

Depending on the nature of the economic problem, one or another type of institution is likely to have an advantage, in the sense of maximizing the difference between the benefits of dealing with that problem and the resource costs. To illustrate this point, I turn now to a specific economic problem in terms of which we can use the framework of comparative institutional efficiency: the problem of coping with asymmetric informational situations, in which one party to a transaction (typically, but not always, the seller) is systematically better informed about the commodity's relevant characteristics. Many of the institutions that have been invented in recent history seem to reflect a demand for institutions that can be trusted, institutions that can reduce the costs of searching for and processing (interpreting) information.

In the full-information case analyzed in the standard textbook, there is no problem of informational asymmetry and hence no need for either party to a transaction to trust the other. But there are other commodities, such as medical care and legal representation, drugs, and occupational health hazards, about which consumers or workers typically

possess relatively limited information, and find it costly either to obtain the information or to disregard the problem. Therefore, they seek mechanisms--and institutions--for providing trust in the providers of such commodities.

The demand for trustworthy institutions is especially important in the case of commodities about which it is either very costly for the consumer to acquire information or difficult for the consumer to evaluate the information even when it is available. Some effects of consumption may not be immediately discernible, but may result only from compound consequences over long periods of use, so that the consumer's ignorance remains even after repeated use of the commodity. In such cases the consumer is likely to turn to some "expert agent" to provide and to interpret the desired information about quality. This only pushes the need for trust one step further down the road, however, for the question arises whether the "expert agent" can be trusted to act in the consumer's best interest. The ill-informed buyer does not know how to determine whether the agent has acted in the buyer's best interest.

For "high trust index" commodities--those for which the cost of information is high and the cost of not being informed is also high--what mechanisms do consumers employ in the pursuit of trustworthy institutions, and how efficiently do the various institutions function? Among the institutions that are sometimes claimed to deal with the trust problem are various forms of government regulatory agencies (such as the Food and Drug Administration), government direct-service agencies (Postal Service), control by private professional associations (e.g., in medicine, law, and public accounting), and the private "not-for-profit"

type of firm (which, interestingly, is especially prominent in the hospital, nursing home, and education industries). Without the development of some such institutions that command trust, markets in some commodities may simply disappear or may fail to develop at all (see, for example, the work of Akerlof on the market for used car "lemons").⁶

There are, in short, many institutional types that have been proposed as trustworthy. But all have limitations. Governmental regulatory agencies have been attacked for being "coopted," for coming under the domination of the very organizations they are allegedly established to control.⁷ Government direct-service agencies have been charged with inefficiency.⁸ Even the "watchdog," Nader-type organizations-- another institutional innovation, but this is in the nonprofit sector-- have been subjected to criticism regarding how well, and even whether, they actually protect the "public interest."

Is there a special role for private, "nonprofit" institutions in the provision of trust? It may be true that one of the functions of the non-profit form of institution is to provide commodities that are so complex that the buyer is unable to judge their quality; hence the buyer needs to trust the supplier. Such reasoning suggests two hypotheses, both of which seem amenable to research.

1. As a matter of fact, do consumers have greater "faith" in non-profit organizations than in for-profit organizations? (It needs to be borne in mind, of course, that if consumers do have greater faith in the nonprofit institution, this might drive the for-profit organizations out of the industry, in which case they would not be observed to exist.)

This question might be examined by using data from opinion polls and

questionnaires of such government agencies as the Federal Advisory Commission on Intergovernmental Relations; the latter, for example, has consistently found that public confidence ("trust"?) in the federal government is highest, followed by local and, always lowest, state governments.

2. Aside from the question of whether consumers actually do have greater faith in nonprofit producers (of at least some commodities), a second question is whether they are justified in having such faith. Do "nonprofit" organizations behave differently than their for-profit sector counterparts, and if they do, is the difference in behavior such as to warrant greater or less trust on the part of consumers? This question is complex; it requires, as a preliminary, research into how the extent of "trust" might best be measured.

The trust problem may also be viewed as a transactions cost or information cost problem: The consumer is not certain what he is buying, and that fact lowers the price that a risk-averse person is willing to pay for a good. This formulation suggests that the trust problem is in no way a new one, nor is it one that economic agents and institutions have ignored. Examples abound of private producers who produce information that reduces uncertainty and, hence, reduces the reliance on trust. Indeed, to some extent this is what advertising and the establishment of a "brand name" reputation achieves. As long as the competitive mechanism works "reasonably well," those producers who lie in sending informational messages make less profit than do those who are honest, but this mechanism requires repeat purchases, learning from experience, and low-cost exchange of information across consumers.

Casual observation suggests that institutions outside the private business sector--governmental and private nonprofit--are being relied on increasingly as instruments of trust. Whether this apparent shift away from reliance on private business is warranted is an important, researchable question. What are the circumstances in which one type of institution is superior to another as an agent of trust, "superior" in terms of economic efficiency and also distributional equity? Little is known.

An interesting illustration of the handling of problems of trust is the governmentally sanctioned constraint on the freedom of lawyers and doctors to supply certain information to consumers. I refer to restrictions (e.g., through legislation and professional ethics codes supported by legal sanctions) on doctors' and lawyers' advertising and supplying of information about prices. One of the reasons the consumer must trust doctors and lawyers is the existence of these restrictions, which force the consumer to utilize less information than would otherwise be available. But consumers must trust doctors and lawyers (and other sellers) also because the sellers' activities are technically complex--that is, it is difficult for consumers to know what would have happened if the consumer did not receive the medical care or did not receive the legal representation. Indeed, it is precisely this technical complexity that initially was held to justify the informational restrictions--the argument was that consumers could not use the information in their own self-interest. Demand for trust, in short, may be due partly to legal and institutional constraints that are set up by the government, as well as to technical conditions of the commodity or service involved.

There are reasons to believe that the demand for more trustworthy types of institutions is growing, although there are forces operating in both directions. Consumers are generally becoming more sophisticated buyers as educational levels rise, and thus the demand for trust diminishes. Nonetheless, the growing technical complexity of market goods and the growing awareness of potential hazards are increasing the demand for trust. Whereas consumers of private goods have felt, in the past, reasonably confident that they could judge the quality of many goods, it is now the case that, for example, the possible carcinogenic or other hazardous characteristics of many goods (and occupations) have made consumers (and workers) less confident. A person may feel quite capable of judging the taste of Brand X canned tuna, but may feel quite inadequate to determine whether it contains mercury. As technology advances, consumers appear to be increasingly ill-informed about some relevant characteristics of goods. Private-type goods (canned tuna) are taking on more of a collective-good component (information about mercury content).

The demand for some individual, agency, or institution that can be trusted is growing, not only in the fields of medical care and legal representation but--just to note a few other areas--in schooling, in the certification by C.P.A.'s of corporate financial statements, and in the rating of municipal bonds (this last issue has become prominent in New York City's financial crisis). As trust-providing institutions grow in importance, so does the need for economic analysis of the process of their development and change, and their effectiveness.

The recent literature on "screening," "filtering," and "signalling" reflects a growing interest among economists in the consequences of imperfect--

and more specifically, asymmetrical--information.⁹ One issue that has received little attention in this literature is the question of how one does, and should, decide whether or not to believe any particular information signal. Several examples may illustrate, but not resolve, the issue.

1. In recent months there have been a number of bankruptcies of retirement homes that were organized as instrumentalities of churches. Elderly people had paid out large sums of money for lifetime contracts for retirement living at these homes, and many people who did so attested that they were influenced significantly by the fact that these retirement homes were run by a church--which could be trusted. Some of the individuals stated explicitly that they would not have paid out their "life savings" to a commercial enterprise, but that they felt they could trust in the church--a nonprofit institution--to honor its contracts. As things have turned out, however, such trust seems to have been excessive.

2. With the mail-order selling of college degrees, in the private business sector, trust, interestingly, is not a matter that concerns either the buyer or the seller, for they are equally well informed about what they are doing. Rather, what seems to be the problem (market failure) is that the public--including, in particular, employers--are relying on the "signal" that a person who has a college or postgraduate degree has some kind of scholarly attainment when, in fact, the degree may reflect nothing more than the payment of a fee. The public trust in the meaning of a college degree is thus being eroded as those who know how the degree was obtained take advantage of the fact that third parties find it costly to obtain this information and incorrectly trust that the degree has meaning.

This seems to be a classic externalities case, in which a fully informed buyer and a fully informed seller achieve private equilibrium by imposing external costs on third parties. The external cost in this case involves the debased meaning of the college degree signal and, hence, the need to turn to, or invent, other more trustworthy institutional sources of information for determining the productivity of individuals.

3. Labeling of meats in grocery supermarkets involves problems of trust in both the government and the private, for-profit institutional sectors. Consumers find it difficult to judge the differences between, for example, "choice" quality meat and "good" quality meat. As a result, meat inspectors and meat market buyers have considerable opportunity to take advantage of their superior knowledge and the trust that consumers have placed in them, for their own personal gain. An inspector could, for example, collude with a meat market buyer to mark "good" meat as "choice"; to do so would permit the supermarket to charge a higher price than would be the case if the meat were accurately labeled, and that increase price could be split between the supermarket buyer and the inspector. Of course, this simple narrative does not take into account the fact that if consumers could detect a difference between the taste of the choice and good meat, they would presumably feel that they were overpaying for the quality of meat that they received, no matter how it may have been labeled; the supermarket chain that did the cheating would suffer in the long-run, as consumers left for competitors. How quickly such a long-run adjustment occurs, however, is a key fact about

which little is known. The longer that period of adjustment--that is, the more difficult it is for consumers to detect quality differences--the less satisfactory is the private market as an institution for providing trust. It might be added that if the characteristic involved is that of taste only, consumers may be much more able to make distinctions than if other dimensions of quality such as nutritional value are at issue.

These examples illustrate "failures" of institutions in the public sector, the for-profit sector, and the nonprofit sector. It is clear that no institutional mechanism is free of problems. No institutional mechanism is fully satisfactory as a device for dealing with informational asymmetry and the accompanying problem of deciding whom to trust.

Institutional Competition

In short, as I suggested earlier, some institutional form will generally be more efficient than others in dealing with any particular problem--whether it is trust or some other--at a particular point in time. There is, thus, a process of competition among institutions to determine the domains over which each is the most efficient. Over time, the menu of institutional forms is itself a variable, as new institutions are invented or evolve.

The optimal division of economic activity or control among various public and private-sector institutions also varies. Changes in individual patterns of demand for collective and private-type goods, changes in technology, and changes in the relative prices of inputs may each affect the optimal mix of institutions just as they affect the optimal mixes

of outputs and inputs. The growing complexity of medical-care technology, for example, has seemingly combined with the rising level of public education in many countries to diminish trust in the ability of the decentralized private medical-care market to provide efficient and equitable levels and patterns of medical care; as a result we perceive an increase in legal attacks on contemporary institutions--on individual physicians and hospitals (medical malpractice suits) and on physicians' associations (the Federal Trade Commission has instituted charges against the American Medical Association [AMA] to halt various noncompetitive practices).

Recall that the AMA, as well as the American Bar Association, which is also under attack by the FTC, illustrate a form of private sector institution. These professional associations have not been constrained in the past to refrain from monopoly practices, and they are still permitted to restrict entry through licensing, using practices closed to most other private institutions.

Research on Private Nonprofit Institutions

In the remainder of this paper I will sketch some elements of a theory of the private nonprofit sector. As I noted at the outset, the theories of the for-profit business sector and the government are, while far from ideal, considerably more advanced than the theory of private nonprofit institutions. I do not have a comprehensive theory to present--only some elements. First:

What is the nonprofit sector? This is a complex, multifaceted question on which I can only touch briefly here. If we define nonprofit

organizations as those considered tax-exempt by the Internal Revenue Service, the nonprofit sector includes churches and synagogues, schools and colleges, organizations engaged in cultural and historic activities, health, sports and social activities, civil rights, legal aid, advocacy and political activities, farming, professional associations, trade unions and trade associations, mutual organizations, and still others. There are some 800,000-1,000,000 such organizations now--not counting foundations--up from 600,000 in 1973, when they were about 5% of the 13 million corporations, partnerships, and proprietorships in the United States.

I have estimated the aggregate revenue of these organizations, by source of revenue, based on a random sample of 432 tax returns.¹⁰ Soon I will obtain a computer tape on all 800,000 firms, but for now the sample-based estimates are the best I can muster. The \$530 billion of revenue of nonprofit organizations in 1973 (Table 1) constituted a whopping 18% of the nearly \$3,000 billion of total revenue for all corporations, partnerships, and proprietorships. The activity level of nonprofit institutions is far from trivial.

To many people, the essence of a nonprofit organization is its financial dependence on contributions, gifts, and grants. For my entire sample, however, only 11% of all revenues were from this source. The bulk of revenue--66%--came from dues and assessments, and sales accounted for 23% (Table 1, column 4). The variation of each revenue source across "industries," however, is marked. Contributions, gifts, and grants provided 49% of the revenue of health organizations (column 2), and virtually none of chamber of commerce budgets (not shown in Table 1).

Table 1

Revenues of Institutions in the
Voluntary, Nonprofit Sector, United States, 1973

Source of Revenue	Type of Organization						All Nonprofit Organizations	
	Education (1)		Health (2)		Cultural (3)		(4)	
Sales and receipts	\$61.0 ^a	65%	\$31.0	94%	\$0.5	45%	\$121.0	23%
Dues and assessments	19.0	21	0.2	1	0.1	9	350.0	66
Contributions, gifts, and grants	13.0	14	2.1	5	0.5	45	60.0	11
Total revenue	93.0	100	33.0	100	1.1	100	531.0	100
% of total revenue for all nonprofit organizations	18%		6%		0.2%		100%	
N	67		32		34		432	

^aIn billions of dollars.

My analysis of nonprofit institutions leads to the examination of an input that does not appear on financial statements, is not included in Table 1, and is trivial for the private business sector and probably also for government institutions--but not for the tax-deductible, "philanthropic" type of institution. I am referring to volunteer labor. In the period 1965-73, the amount of volunteer labor grew much faster than the labor force; the total labor force grew less than 20% but the number of person-hours of volunteer labor doubled. The 5 billion hours of such unpriced labor in 1973 was the equivalent of 2.5 million full-time, full-year workers. And if it were valued at, say, \$3 per hour, the \$15 billion of such donations-in-kind would be one-fourth as large as the total donations in cash, \$60 billion (Table 1). Table 2 shows, for 1965, the distribution of volunteer time, by subsector.

Why is there a nonprofit sector? Why do people donate--whether in cash or in kind? I do not know why; neither do I know why people choose to devote their limited resources to any other specific items of consumption or investment. What I do know, however, is that donations to "philanthropic" organizations--which I see as nongovernmental providers of collective goods--cannot be explained by tax incentives alone, for several reasons.

First, tax deductibility merely lowers the private cost of giving; it does not eliminate the cost so long as the marginal tax rate is less than 100%. Second, much giving does not benefit from tax incentives, since 85% of all taxpayers now do not itemize. In addition, gifts to non-tax-deductible organizations should not be overlooked. Common Cause, the Sierra Club, and Ralph Nader's Public Citizen are not tax-deductible

Table 2
Volunteer Time by Subsector, 1965

Subsector	Percentage of Total Hours	Hours Worked (in hundred millions)
Hospital	9.2	2.39
Other health or medical	8.0	2.13
Education	21.6	5.62
Social or welfare	19.8	5.15
Recreational	5.3	1.37
Civic or community	12.7	3.31
Youth activities: Scout	12.6	3.27
Other	7.3	1.90
Other	3.5	0.90
Total	100.0	26.0

[501 (c) (3)] organizations, because they engage in lobbying; yet they receive substantial sums in contributions.

Third, giving to "philanthropic" nonprofit institutions predates income and wealth taxation. Most of the great foundations in the United States were established prior to the emergence of tax incentives. And even in sixteenth-century England, private, nonprofit organizations were providing funds for such wide-ranging collective activities as schools, hospitals, public (nontoll) roads, fire-fighting apparatus, public parks, bridges, libraries, care of prisoners in jails and charity to the poor-- in short, for the gamut of nonmilitary goods and services that we identify today with government institutions. Voluntary giving even included support for "houses for young women convinced of their folly."¹¹

These fragments of evidence are consistent, incidentally, with my focus on the collective-goods activities of some, though by no means all, nonprofit organizations. The nonprofit sector is, I believe, not a single institutional form but a class of heterogenous organizations, varying enormously in the degree of collectiveness of the goods they provide.¹² Table 3, which proxies the conceptual "degree of collectiveness" by the percentage of total revenue coming from gifts and grants, suggests the enormous variation across such "industries" in their means of financing and, I believe, in the nature of their outputs.

Donations--gifts and grants, whether in cash or kind--can be viewed as private individuals' purchases of collective goods. If we are to understand organizational behavior, we thus need to model "donations functions" just as we are accustomed to model "demand functions." That is, we need to

view any private organization as confronting both of these revenue functions, and as being free to choose between providing more collective goods and tapping the donations function, or providing more private goods and tapping the sales-demand function. Some "firms" choose one, some the other, and some choose to combine both sources of revenue and, thus, to provide both types of goods.

How does the collective-good part of the nonprofit sector behave? We know little about this. I do not dismiss the argument that many "nonprofit" organizations are actually profit-maximizers in disguise; some may simply pay above-market salaries to managers who are, in effect, receiving profits. Indeed, I believe the argument applies widely, at the very least to organizations that provide no significant amount of collective-goods outputs and receive essentially no contributions or gifts.

What is in doubt, however, is whether a profit-maximization model also applies to those nonprofit organizations that are heavily dependent on donations and that provide largely collective-type goods and services. Before I turn, however, to one piece of evidence, I want to call attention to an interesting fact: The published literature on models of nonprofit organizational behavior focuses on specific industries: primarily on models of hospitals, but also on schools or departments within schools.¹³ In our more traditional theorizing about the behavior of private business firms we have, fortunately, not developed a distinct theory for the steel industry, another for the baking industry, and yet another for retail department stores. Similarly, in the nonprofit area we need more general, not industry-specific, models. My hypothesis is

Table 3
Index of Collectiveness, 1973-75

Type of Organization	Collectiveness Index (C)	Sample Size
Cultural	90	28
Religious	71	32
Public affairs	47	29
Social welfare	41	50
Agricultural	41	50
Educational	34	33
Legal, public administration, and military	20	50
Veteran, hereditary, and patriotic	12	45
Athletic and sports	11	28
Honor societies	9	51
Scientific, engineering, and technical	6	51
Ethnic	3	37
Labor associations and federations	3	70
Trade, business, and commercial	2	58
Health	2	35
Hobby and avocational	1	20
Chambers of commerce	0	27
All types	20	684

that there are two key elements in a more general model of an institution. They are: (1) on the demand side, the character of its revenue function--especially the donations function (for private providers of collective goods); and (2) on the supply side, the nature of managers' utility functions as they involve the willingness to trade off pecuniary rewards for satisfaction with the organization's outputs.

Here is some evidence regarding the preferences of "managers" of different types of institutions, and the behavioral implications of those preferences. Persons completing law school have various job choices, of which I focus here on two: private law firms and "public interest" law (PIL) firms. The latter are, at least ostensibly and in the eyes of the IRS, nonprofit--constrained in the uses to which their revenue may be put (it may not be paid to "owners").

In recent research I have tested the hypothesis that a systematic sorting process operates so that lawyers who are income maximizers gravitate to the law firms in the private business sector, while lawyers whose preferences lean more toward achieving "public-interest," collective-goods goals gravitate to the nonprofit PIL institution.¹⁴ If this sorting occurs, a behavioral model of nonprofit, collective-goods institutions might well include variables reflecting differences in the preferences of managers in this sector compared with the private business sector.

Briefly, what I have done is this. From a national survey of lawyers, directed by Joel Handler at the University of Wisconsin Law School, I estimated an earnings function for lawyers in private law firms. Then I used that equation, together with the characteristics of the public

interest lawyers, to predict what they would earn if they were working for private firms. The hypothesis was that their predicted earnings would exceed their actual PIL earnings because they were willing to accept lower pay in order to engage in the kinds of public interest activities to which this kind of institution is constrained. The findings were consistent with the hypothesis; potential earnings were 41% greater than these lawyers' PIL earnings.

Other evidence from the lawyers' survey disclosed that the lawyers were aware of their opportunity costs--indeed, they estimated them at 43%, a figure amazingly close to my estimates. Nor did the PIL lawyers expect to make up later in life the earnings they were sacrificing now, and our evidence is that they are right in not expecting later pecuniary benefits: 70% of those who left PIL work went to relatively low-paying jobs--in teaching, legal aid, or government--and only 19% went to private practice.

If the preferences of lawyers in different institutional settings vary, we might expect their firms' behavior to vary also. Lawyers in the private and PIL firms were asked about the most important criteria affecting their choices of cases to handle. Several significant differences appeared.

1. Nearly twice as large a percentage of PIL lawyers as private lawyers reported that "novel questions of law" were one of the "three most important criteria" affecting their selection of cases. This criterion was listed as one of the "three most important" by 86% of PIL lawyers and 46% of private lawyers.

2. PIL lawyers reported being considerably more interested in the "chance of success" when selecting cases. Sixty percent of PIL lawyers, but only 48% of private lawyers regarded this as one of the three top criteria.

3. PIL lawyers reported being far less interested in the "ability of client to pay" as a criterion of case selection. Only 4% of PIL lawyers put this among the three most important criteria, while 50% of private lawyers did so. Whatever the reason, the for-profit and nonprofit types of institutions do appear to behave differently. These are tidbits of evidence. Much more research is needed in this "infant" area.

The nonprofit form of institution is of growing importance and it calls out for more attention by economists, to understand and predict its behavior, and to judge its efficiency and its distributional consequences. Even more broadly, the time has arrived for a new effort, using modern tools of economics, to understand institution formation and behavior. We may not be quite on the verge of establishing an Institutionalmetrics Society, but research in this area should prove fruitful and exciting.

NOTES

¹See R. Bird, "Wagner's 'Law' of Expanding State Activity," Public Finance 26 (1971):1-26. For more recent reflections on the expanding public sector see T. Borcharding, ed., Budgets and Bureaucrats: The Sources of Government Growth (Durham, N.C.: Duke University Press, 1977).

²See, for example, M. Olson, The Logic of Collective Action (Cambridge: Harvard University Press, 1965); J. Buchanan, "An Economic Theory of Clubs," Economica 32 (1965):1-14; W. Niskanen, Bureaucracy and Representative Government (Chicago: Aldine-Atherton, 1971); A. Breton, The Economic Theory of Representative Government (Chicago: Aldine-Atherton, 1974); R. Foster, "Economic Models of the Hospital," Hospital Administration 19 (1974):87-96.

³Two exceptions are: G. Bjork, Private Enterprise and Public Interest (Englewood Cliffs, N.J.: Prentice-Hall, 1969), particularly chapter 2, and especially L. Davis and D. North, Institutional Change and American Economic Growth (Cambridge: Cambridge University Press, 1971).

⁴For an interesting perspective on the evolution of the corporate form in this country, see A. Miller, The Supreme Court and American Capitalism (New York: The Free Press, 1968).

⁵There exist several good collections in this area. Among them are: E. Furubotn and S. Pejovich, eds., The Economics of Property Rights (Cambridge, Mass.: Ballinger, 1974); H. Manne, ed., The Economics of Legal Relationships (St. Paul, Minn.: West Publishing, 1975); B. Ackerman, ed., Economic Foundations of Property Law (Boston: Little Brown and Co., 1975).

⁶G. Akerlof, "The Market for Lemons," Quarterly Journal of Economics 84 (1970):488-500; R. Zeckhauser, "Uncertainty and the Need for Collective Action," in R. Haveman and J. Margolis, eds., Public Expenditures and Policy Analysis (Chicago: Markham, 1970).

⁷L. Kohlmeier, The Regulators: Watchdog Agencies and the Public Interest (New York: Harper and Row, 1969). For some initial attempts at detailed modeling of the regulatory process, see S. Peltzman, "Toward A More General Theory of Regulation," Journal of Law and Economics 19 (1976):211-40.

⁸D. Davies, "The Efficiency of Public vs. Private Firms: The Case of Australia's Two Airlines," Journal of Law and Economics 14 (1971): 149-166; R. Spann, "Public Versus Private Provision of Government Services," in T. Borcerding, ed., Budgets and Bureaucrats: The Sources of Government Growth (Durham, N.C.: Duke University Press, 1977).

⁹M. Spence, "Job Market Signalling," Quarterly Journal of Economics 87 (1973):355-74; M. Rothschild, "Models of Market Organization with Imperfect Information: A Survey," Journal of Political Economy 81 (1973):1283-1308; K. Wolpin, "Education and Screening," American Economic Review 67 (1977):949-58.

¹⁰A more detailed report may be found in B. Weisbrod and S. Long, "The Size of the Voluntary Nonprofit Sector: Concepts and Measures," in Research Papers Sponsored by the Commission on Private Philanthropy and Public Needs, Vol. 1 (Washington, D.C.: Department of Treasury, 1977).

¹¹R. Nelson, An Address to Persons of Quality and Estate, on Ways and Methods of Doing Good (1715), cited in B. Gray, A History of English Philanthropy (London: Frank Cass and Company Ltd., 1905), p. 5.

¹²The concept of "collectiveness" in the nonprofit sector is more fully developed in B. Weisbrod, "Private Goods, Collective Goods: The Role of the Nonprofit Sector," presented at the Conference on the Nonproprietary Sector, University of Miami Law and Economics Center, May 1977.

¹³See, for example: F. Levy, "Economic Analysis of the Nonprofit Institution-The Case of the Private University," Public Choice 4 (1968):3-18; J. Newhouse, "Toward A Theory of Nonprofit Institutions: An Economic Model of A Hospital," American Economic Review 60 (1970):64-74; M. Pauly and M. Redisch, "The Not-for-Profit Hospital as a Physicians' Cooperative," American Economic Review 63 (1973):87-99.

¹⁴B. Weisbrod, in collaboration with J. Handler and N. Komesar, Public Interest Law (Berkeley: University of California Press, 1978), especially chapter 5.