
The economics of nonprofit organization: in search of an integrative theory

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Motivation 1

- Economic theories of NPO
 - Market failure (demand-side) theories
 - Supply-side theory
 - Two problems
 - Lacking integration between the demand-side and supply-side arguments
 - Missing integrative understanding of NPO
 - Lacking account of the institutional identity of NPO
 - Market failure explanation is applicable to the for-profit firm as well
 - Objective: to address these problems by using the theory of the social division of labor
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Motivation 2

- **Division of labor:** shift of productive activities from households to for-profit firms (Locay 1990)
 - Nonprofit organization does not fit into the scheme of the social division of labor in view of its:
 - nonprofit orientation
 - substantive definition of organizational goals (missions)
 - How does nonprofit organization relate to the social division of labor?
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The theory of the social division of labor

■ Main propositions:

1. Two mechanisms of gratifying human needs: exchange and self-sufficiency (i.e., production for own consumption (Demsetz 1997))
2. Exchange enables the social division of labor that improves productivity (Smith)
3. The social division of labor is constrained by a number of factors, such as the extent of the market (Smith); coordination costs (Yang and Borland 1991); availability of knowledge (Becker and Murphy 1992)
4. To the extent that the social division of labor is constrained, economic actors resort to self-sufficiency

□ Implication: self-sufficiency is characterized by:

- nonprofit orientation
 - substantive definition of organizational goals
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Implications 1

- **NPO embodies self-sufficiency with respect to the nonprofit mission**
 - Mission is the only object of self-sufficiency in NPO
 - No contradiction with NPOs' participation in market exchange in general
 - **The relevant constraints on the social division of labor:**
 - For market failure theories - coordination cost (Krashinsky 1986)
 - For supply-side theories – intrinsic value of an activity
 - A new constraint on the division of labor
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Implications 2

- **Difference in the market failure-addressing roles of NPOs and for-profit firms**
 - for-profit firms address market failure by facilitating market exchange in two ways (Williamson 1971):
 - Economizing on the cost of processing information
 - Aligning incentives
 - NPOs address market failure by replacing exchange with self-sufficiency
 - => difference between 'remediable' and 'non-remediable' market failures
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Implications 3: consistence with the major economic theories

Public goods theory (Weisbrod)	NPO embodies self-provision with public goods that can be produced neither by for-profit firms nor by government
Customer control theory (Ben-Ner)	NPO embodies self-provision with private goods that cannot be produced by for-profit firms
Supply-side theory (James, Young) and trustworthiness theory (Hansmann)	NPO embodies self-provision with intrinsically valued (ideological or leisure) activity

Conclusions

- The self-sufficiency view of NPO unifies the demand-side and supply-side arguments
 - NPO is an institutional form of self-sufficiency
 - NPO may be caused by various constraints on the social division of labor, corresponding to demand-side and supply-side theories
 - Institutional identity of NPO
 - While for-profit firms address market failure by facilitating market exchange, NPO replaces market exchange with self-sufficiency
 - Broader implication: self-sufficiency as an approach to transcend the contractual exchange logic in explaining institutions
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Thank you for your attention!
