

A MISUNDERSTANDING? THE DIFFICULTIES WITH NON-PROFIT SECTOR UTILIZATION IN CZECHIA

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Abstract

This paper identifies the links between the concepts that determine the non-profit principles utilization barriers and advantages. Its aim is to analyse the sense and rationality of non-profit organizations in the context of their character and significance. Especially it focuses on the relevant theoretical issues of non-profit sector and human capital services, as well as an empirical example of Czech hospitals, which although suitable do not utilize this principle much. It is deeply rooted in the theory of public finance, social policy and human capital formation. It seeks answers to why the adoption of non-profit principles is so difficult in the Czechia and why for-profit principles still prevail, contrary to the practice in OECD countries, in Czech sectors that are key for human and social capital.

Key words: human capital, non-profit sector, public finance

JEL Code: J24, L30, I10

Introduction

In developed countries, there has been strong tendency during the development of market economy to make socially beneficial activities and provide services on non-profit basis since the industrial revolution has begun. As soon as capital reserves accumulated and market competition determined the character of many branches of economy like industry or construction, there has been demand to finance those areas, which cannot have been financed on those principles and still were needed for good living, like health care, education or culture (human capital sectors). Various forms emerged, starting from pure charity and ending in social enterprises whose goals are wider than just maximizing a profit for shareholders.

In the centrally planned economies, the situation was different. Since the government played significant role in the economy, it usually ran sectors like health care, education or even culture on its own, eliminating the issues, which were main causes for introducing the non-profit sector in the market economy. Of course, there was a demand for decentralization, more autonomy and not too hierarchical management structure, so some new forms of organizations more independent from the central government emerged, but in reality, no significant threats to the sectors that are typical for non-profit principles utilization were presented.

This situation seems to be a driving factor for non-profit sector adoption up to now. Gradual decline of centrally planned economies theoretically opened space for the non-profit organizations, but their significance and actual usability, e.g. in Czechia, in some sectors remains low. Simultaneously, the threats that affect sectors like health care, education or culture vastly arose, coming from imaginations about “invisible market hand” that will solve the problems of existence and development of those sectors in market environment. Also from reality of capital markets, since one of the advantages of the non-profit sector is resistance to market speculation (consistent with Keynesian theory of money demand) with money present/spent on those activities. Simply said, money allocated e.g. for health, education or culture should not systematically end on stock exchange or in hedge fund, both for ethical and financial reasons, because it cannot compete with other investment activities and can lead to socially ineffective results and decline of those branches in general.

From the issue described outcomes also this conference paper, which aims to enlighten the situation in non-profit sector adoption in Czechia.

The research methods used include theoretical analysis of human capital services financing and relationships schemes, public policy options considerations, comparative analysis, synthetic research and discussion-based approach.

During the research, the theoretical heuristics of these findings were filtered primarily in terms of their significance for analysis of the specifics of the human capital services. The results of the theoretical analysis could also help understand the causes for a number of more general problems in the Czech health services sector. This is also consistent with the nature of chosen research area that has been rooted in theoretical analysis of human capital services and social policy concepts – in this sense this paper can be seen as a continuing development and novelty contribution of this knowledge.

1 Theoretical assessment of various schemes of human capital services financing and provision

The theoretical background behind utilized concept include the approaches of public and social policy and the civil society (Potůček, 1997) and the economic analysis of the non-profit principle and things behind it (Arrow, 1963), (Akerlof, 1970). The position of the non-profit sector in society was clearly recognized by Pestoff (Pestoff, 1995). At the same time, this concept falls into the branch of social economy (Dohnalová & Průša, 2011). Significant

international research has been conducted in this area and the definitions of non-profit sector emerged from the cross-national comparison (Salamon & Anheier, 1997). These results are maintained and expanded up to now (Center for civil society, 2012).

Institutionally, the concepts of government and non-government owned, for-profit and non-profit based, publicly and privately financed organizations (Goulli & Frič, 2001) are useful for the topic. It is worth recognizing, that the classic economic classification approach of public and private goods is not enough for this approach, because it says nothing about how they are provided and financed in social reality. In this sense, also the approach of institutional goods classification is highly relevant (Bénard, 1985).

It is clear, though, that both private for-profit providers and public “hierarchical” providers of human capital services may suffer from “typical disadvantages”, meaning that they do not cover all needs required by reality. That is one of the reasons for the establishment and existence of the so-called third (civic, non-profit) sector (Zimmer & Prilller, 2004), which seeks to fulfil the goals of “social economics”.

Non-profit organizations strive for rational economic allocation the same way as other economic subjects do; however, they are not pushed by their owners to maximize profits and allocate them to shareholders or trade their stocks on the exchange. In addition, the non-profit principle guarantees that the money is kept in the enterprise of its origin; this is especially important for the human capital services, as empirically here a pressure for allocating money elsewhere is seen. It brings an important element of autonomous budgeting.

The sectors that are involved in human capital acquisition, maintaining and utilizing (human capital services) usually have an important share of non-profit organizational forms in the national economy. This does not imply that this share should grow indefinitely or replace other organizational forms, but it is worth noting that the approach often seen in the Czech discourse of choosing the “one optimal” organizational form for those sectors is not empirically seen in OECD countries.

From the economic point of view, human capital services providers can be classified into four categories and can draw on various sources of financing. That is shown in Table 1.

Table 1 – Relationships between the financing and provision of human capital services

Financing method/Provider	Public	Volunteer	Private	Informal
Tax – public funds	Hierarchic command structures, internal quasi-	Services bought by the government – external quasi-market		Subsidies/support

	market			
Voluntary solidarity		Charitable support to volunteers	Payment of services for clients	
Employers		Support for volunteer organisations		Support for human capital services
Private	Payments for public services	Payments for the services of volunteers	Market exchange	
Individual non-cash help	Voluntary work in the public sector	Volunteers taking part in services		Help from the family, friends, neighbours

Source: Wistow (2005), adapted by author for Czech conditions and human capital

First, there is the interaction between public providers and public funds, which functions on the principle of hierarchic structures. That paves the way for motivational and monitoring strategies based on an organisational/command mechanism, but these have one fundamental drawback, especially as regards individuals' decision-making: they do not function autonomously, particularly with regard to economic rationality. It therefore cannot be assumed that people will follow these strategies of their own volition or that they will behave according to these strategies if some existential pressure is placed on them. These strategies presuppose two basic links – to knowledge of the logic and mechanisms of the system's working and to the participating entities' value systems and motivational preferences. In Czechia, this is the far largest part of the human capital services financing; moreover, in the past when the budgetary and contributory organizations dominated it was the only way to finance and organize possible.

In the case of the organisational/command mechanism, effectiveness is thus achieved by defining and subsequently monitoring goals and rules. An external entity is necessary to define these rules and subsequently monitor whether the practical exercise of a particular activity genuinely corresponds to them. It is also a good idea to define certain indicators that can be used to monitor, perhaps indirectly, the quality and costliness of the performed activities. As the character of services is not primarily determined by an individual's effective demand, accessibility and quality standards have to be defined.

However, economic theory and experiences with centrally planned economies reveal these approaches' general limitations. For that reason, principles of cooperation, plurality, competition and quasi-competition in the public sector are being increasingly asserted in contemporary public economics; in certain cases, these principles can provide effectiveness better than directive allocation and central planning. The distribution of funds to non-profit entities is also the subject of analysis. Optimisation thus becomes a question primarily of the

effective use of a defined quantity of public funds. Preserving public funding for certain goods and services and simultaneously improving the effectiveness of allocations in the public sector with the help of the latest findings of public economics is part of the subtext of these allocation schemes. One outcome is that the allocation of public funds in the first row of the table is shifted towards other providers that will be able to use them more effectively than the state and its organisations.

Second, there is market exchange, i.e. the interaction of private funds between the supply and demand sides. In the market mechanism, competition controls whether a certain entity is behaving rationally in economic terms. In other words, the activity of one entity acts as a control as to whether another entity is ineffective in its activity. In this context microeconomic theory provides a detailed apparatus for analysing benefit, price fixing and rational use of production factors and also describes various deformations in the competition environment cause this mechanism of the indirect control of the rationality of allocation to fail (e.g. monopolies, various oligopolies etc.). The price system works as an information system for participating entities.

Analysis of goods in the field of human capital services has already led to the deduction that each of the said types of interaction has its disadvantages. For that reason, we usually find in practice a broad range of combinations of human capital sector providers. These can be classified into the boxes of the above table.

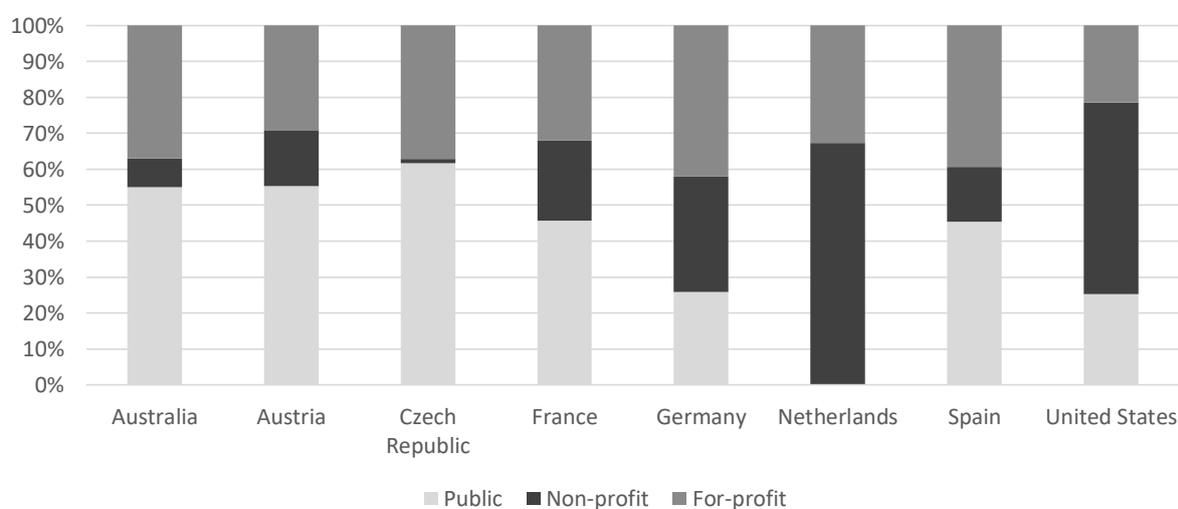
We have already shown that the economic and social specifics of the human capital acquisition and services mean that providing them on a market basis, i.e. as the outcome of the intersection of market supply and demand, is only one of the alternatives. The typology of social services financing and providers therefore implies the plural nature of this sector.

It is clear, though, that both private for-profit providers and public “hierarchical” providers of social services may suffer from “typical disadvantages”, meaning that they do not cover all needs in the field of human capital services, and do not do so because of the economic characteristics of the way they function. That is one of the reasons for the establishment and existence of the so-called third (civic, non-profit) sector (Zimmer & Prilller, 2004), which seeks to fulfil the goals of “social economics”. Its aim is to address social problems and achieve social goals by ensuring that a wider range of actors, including non-profit organisations, plays an active role. Definitions of social economics in the relevant literature vary, mainly as regards which organisations are included and which are not. The provision of human capital services indubitably ranks among the goals of social economics, however.

2 Empirical example of Czech hospitals

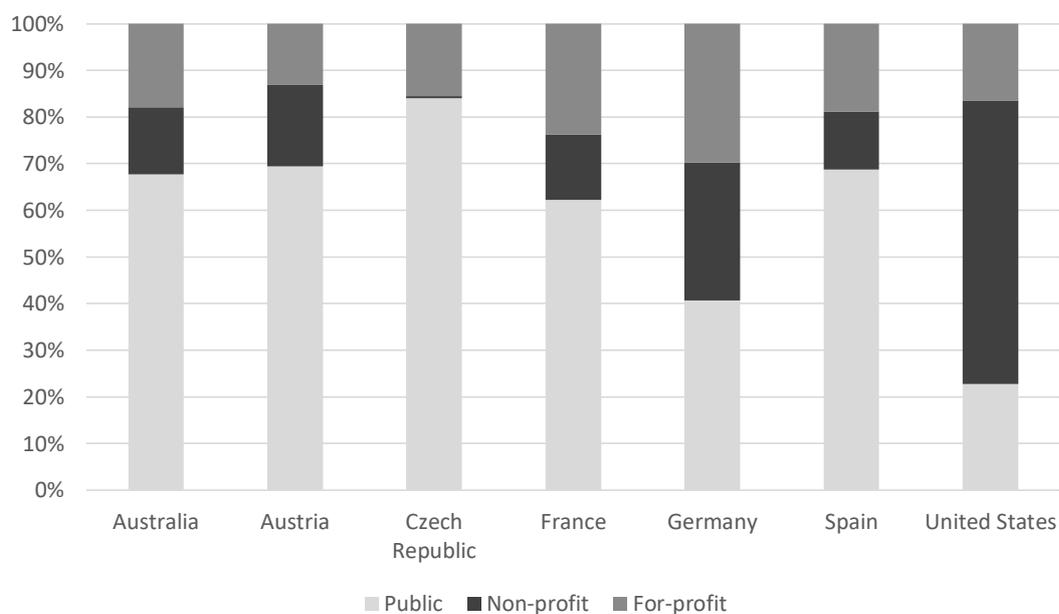
The statistical data shows that while in the OECD countries there is a real pluralism in organizational forms of hospitals, most prominently manifested in the American health system, which has the highest proportion of non-profit structure. An interesting example of "good practice" is the Mayo Clinic, one of the major hospitals in the USA, which utilizes non-profit principle. The Czech Republic has so far retained public ownership of the controlling interest of hospitals and additionally there are private hospitals, however, the pressure to modernize the structure can be perceived. Other countries are between these two extremes; at the same time, it is interesting to point out that in Western Europe the actual number of non-profit hospitals (as an institutional form, Fig. 1) is in some cases higher than it would seem from Fig. 2. That is because they tend to have a lower number of beds per facility (are "smaller") than large hospitals in the public domain. In the Netherlands, private non-profit hospitals dominate and public hospitals are not present statistically; unfortunately, the data for the number of beds is not available.

Figure 1 – Share of number of hospitals (regardless of size) in different organizational forms, selected OECD countries, 2013



Source: OECD (2016).

Figure 2 – Share of number of beds in hospitals having particular organizational form, selected OECD countries, 2013



Source: OECD (2016). Data for Netherlands not available.

At the end of 2014 originated in Czechia new initiatives to reform inpatient care, which now have form of the legislative proposal (MZ ČR, 2016). The explanatory report is based on the fact that there are currently missing in the Czech law legislation forms the legal entity whose activities would be guided by the principles of non-profit, and could effectively develop its business as a provider of health services and at the same time sufficiently protected her property. The proposal has included the following key elements:

- approval of the Ministry of Health with establishing of non-profit health organizations, compulsory conversion of existing state hospitals
- exemption from income tax
- obligation of public health insurance contract with the non-profit health organization
- concept of university hospitals and their administration with the participation of academic bodies

At the government level, Ministry of Health emphasizes the advantages of the proposed legislation within the meaning of the universal character of the Act (the organization that qualifies can become non-profit health care organization), self-management and good governance practice, transparent way and better position of the resulting organization in terms

of their classification as services of general economic interest (Czech Republic, 2015). There is therefore within the limits of the methodological considerable efforts and significant arguments for the creation of new organizational and legal form of hospitals, which would allow solving many of the problems in the context of development over the last 20 years.

Even if we consider the successful conduct of the legislative process (can be left to the government after next election because of the available timeframe, however), the practical implementation is still unclear. The conflict between the concepts of the hospital as a commercial business or organization providing the necessary services (and some state influence, or the public interest in its functioning) is still strong. First part of the participants believe that financial responsibility and balance of gains and losses is a key factor of economic rationality and describes the distortion of competition caused by different modes of health care providers in relation to health insurance. The second part stresses that the absence of profit motives and business-optimization practices lead to better outcomes for both patients and staff.

Conclusion

It seems that non-profit sector has been suffering from significant misunderstandings in the Czech context. The first misunderstanding is that non-profit sector is seen as economically irrational, reminding that every economic activity should strive for “positive” (profitable) balance. In this view, non-profit sector is reduced to charity, to activities that cannot be run as a business and thus making the contradiction between “economic” and “social” issues. This is consistent with narrow understanding of social policy, but we know from theoretical analysis that this contradiction is only one of the dimensions of social policy that apply in market economy. Moreover, large majority of non-profit organizations does normal economic operation and budgeting, which means that their managers do want to achieve good economic balance, just their incomes and not fully market-driven. They live in standard reality of market economy, but to fulfil the purpose of their existence, they cannot rely on market demand for their services only.

The second misunderstanding is that non-profit sector is prone to fraud, money black holes and misuse of subsidies and support. While this of course can happen and Czech reality often proves so, when done properly, non-profit sector is able to avoid those negative phenomena as well as the other sectors of economy. Therefore, its base philosophy and mechanism is not wrong, actually, it even provides clear signalling ways to the partners for the purpose and mechanisms used in particular organizations. That is why e.g. in health care, even in market

economies and liberal social models like USA, were non-profit hospitals preferred as an institutional form by health insurance companies during contracts. Similar is the example of health insurance companies in Netherlands (where liberal health care financing scheme with partially nominal premium is present), which although being private, in majority operate on non-profit principle (reinvestment of profits into the business/decreasing prices), the same is true for their hospitals.

The third misunderstanding is that non-profit sector requires subsidy from government budget (taxpayers) to run, or worse, to exist. This can be true to some extent and in some sectors, it is more frequent, but when done properly, there are good economic reasons to do that and in this sense it can be economically rational at least to vast extent. They include financing externalities, providing solidarity, giving positive motivation to citizens or doing valuable activities that are not “seen as profitable” by the commercial activities at certain time. Of course, it is good to support things and organizations that are able to exist on their own, just with some degree of support and in this sense, the structure of a budget of non-profit organization is very important.

Of course, non-profit principle is not miraculous cure for human and social capital sector and from the international comparison; we can see that it occupies only some (although sometimes significant) share in the “typical” branches. However, when the government is unwilling to take action and engagement in some goods/services provision and organization, and private sector is unable to find a reasonable market demand to run businesses there, often the room for non-profit sector clearly opens. As an important advantage, we can see that it is more resistive to speculative motive than common business activities, which are often run with direct return-on-investment (ROI) approach driven by owners.

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