



A Decision-Maker's Guide to the Third Sector

*A Handbook for
Central and Eastern Europe
and the Newly Independent States*

Public Sector

Business Sector

Third Sector





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I. Preface

Ten years ago when I attended Salzburg Seminar Session 252 on non-governmental organizations (NGOs), there were virtually no NGOs in Central and Eastern Europe. The very notion of creating an organization independent of the state was unthinkable. We have come a long way since then. Today, there are hundreds of thousands of NGOs, whose activities touch virtually every aspect of society through, for example, local clubs, community services, or political lobby groups. In Hungary alone, we have more than 45,000 registered NGOs. They have become as fundamental to the democratic process as the multiparty system and the free and independent press.

It is therefore in the interest of both political leaders and the business community to ensure the long-term sustainability of the third sector in our region of Europe. In order to do this, we require adequate legislation to protect the independence of NGOs. We need tax structures that encourage business and individuals to support NGO activities. We also need to ensure that NGOs are accountable both to those who support them, and to those they serve.

Last June, the Salzburg Seminar convened fifty individuals from Central and Eastern Europe, as well as the Newly Independent States, for a session proposed and developed by representatives from the region. The participants included senior advisors of government, members of parliament, business representatives, foundation heads, and NGO leaders. Emil Constantinescu, the President of Romania, was the keynote speaker. For three days, we reviewed strategies for the long-term sustainability of the third sector in the region, and at the end of these discussions outlined a series of policy recommendations. The following handbook is intended to help decision-makers better understand the nature of the third sector, and the reasons why NGOs are vital to the stability of the political and business environment in which they work.

Miklós Marschall

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The Long-Term Sustainability of the Third Sector in Central and Eastern Europe and the Newly Independent States

June 10–14, 1997

II. Keynote Address

My presence here, in Austria, at an international meeting devoted to NGOs may seem unusual, considering that I represent, at least theoretically, a social area which apparently is at the opposite end of the spectrum: the state, the executive power, with its bureaucracy and rules. But neither I, nor those who elected me as the President of Romania, can forget that I came to this position as representative of the civil society and not as a result of a regular political career. That is why I am on familiar ground here, among people with whom I share numerous ideas and concerns.

After a change in leadership, if there is not, from the very beginning, a clear philosophy on the relationship between the state and the civil society, there is an imminent danger that the new political class will forget where it came from and what its mandate originally was. It may simply replace the former centralized political class, by means of an inert and perfectly motivated bureaucracy, the same way a liquid takes the shape of a vessel into which it is poured, regardless of the form's quality.

Reform necessitates, first of all, a general sacrifice by the society that decided to embark upon reform in the first place, that is, a sacrifice not only by the people who are led, but by the leaders as well. Indeed, the whole reform process in Eastern Europe has demonstrated that the government that pursues reform by playing by the rules of the game will face the political consequences of a popularity crisis. And the less leaders communicate with their citizens, the more severe this crisis will be. In many cases, because of this erosion of image, two or more successive governments are necessary before reform can reach the stage when its benefits emerge.

In this context, it would be illogical, immoral, and useless to keep in atrophy social actors as important as NGOs, for fear of a more organized, and hence more difficult, response to hardships caused by reform. If we want to develop, in good faith, a healthy society, we must provide it with whatever it may need, antibodies included. The price the Romanians have had to pay for reform is too high to expect in the end only half of the results.

Secondly, it is important to emphasize that NGOs are not only the watchdogs of civil society, but also major and useful economic actors. They produce public goods of utmost importance for the functioning of a society, such as trust, honesty, and loyalty. These goods are included in what we call the institutional capital of society; they

contribute to its long-term functioning. Unfortunately, this contribution is often insufficiently acknowledged or appreciated, since official statistics do not reveal NGOs' substantial contribution to the production of intangible assets. In Romania, the fight against corruption and organized crime could hardly be conceived without the effective involvement of this active component of a civil society. NGOs are also valuable contributors to public service, which again cannot be quantified by the state or the private sector. Market surveys, environmental or communication reports, retraining of the unemployed, support for the disabled, and mass-media campaigns for consumers or voters are all areas in which the non-profit tertiary sector in Romania, and in other parts of the world, responds to public needs.

If we take into account all these aspects, it is clear that the choice to support NGOs is at the same time a choice to support democracy and a market economy. Thus, the results of these two choices explicitly pursued by reform match the public interest; a guarantee that neither the state, nor commercial companies can prejudice the citizens' interest without being penalized. Moreover, supporting and listening to NGOs necessitate understanding the role of social capital within post-communist countries, without which development and modernization cannot be conceived. Because, in the final analysis, the long-term performance of a society will be measured by the quality of the institutional and social fabric, that is, the institutional and social capital.

It is very clear to the new political power in Romania, established after the November 1996 elections, that a viable NGO sector is out of the question unless a cooperative pact is made between the political sector with its bureaucratic apparatus on the one side, and the non-profit sector on the other. This is why, for the first time, on a very short-term basis, both the Presidency and the Romanian Government have set up special bodies designed to promote the relationship and dialogue with NGOs. Today, this process is being furthered at both the national and local levels.

The self-support of the non-governmental sector in Romania, as a specific case in the Central and Eastern European region, is an issue to be settled not only through political will, but also by improving the management of these organizations. Their situation remains a delicate one. Because they are socially useful, these organizations are of real interest for the state. But their genuine independence from any state structure must be preserved and developed.

*Emil Constantinescu, President of Romania
Salzburg Seminar, June 10, 1997*

III. The Third Sector: What Is It? Why Does It Matter?

“Shifting from the centralized economy to the free market entails a deterioration of the living standard, and consequently, social unrest that is not necessarily targeted against reform, but which endangers both its substance and pace. The interests of those who bear the impact of the economic changes may find a most efficient protector in the structures of civil society.”

Emil Constantinescu,
President of Romania

Democratic states will not survive on free elections alone. The vitality and endurance of democracies depend on an on-going conversation between individuals and government, between citizens and their representatives. A strong civil society provides a forum for continuous participation beyond voting. The activities of civil society make up a powerful “third sector” that builds social stability, pluralism, public trust, and respect for the rule of law. The enduring result: stronger, healthier democracies.

The range of such organizations is vast, and in different countries it includes different types of organizations. It is generally agreed upon that volunteer service organizations; charities; sports clubs; foundations; special interest groups; and associations operating in the fields of healthcare, the environment, culture, and philanthropy belong to this sector. Sometimes churches, universities, and even trade unions and cooperatives, are considered third-sector organizations. They are non-governmental, not-for-profit organizations, each driven by their own particular social, religious, or ethical mission aimed at promoting citizen participation and civic initiatives. In a democratic society, the third sector is distinctly different from the other two sectors: the public sector, that is, the government, provides both national security and social welfare for its citizens; the business, or private, sector consists of corporations and businesses whose primary goal is to generate profits.

An Economic Force

The third sector can help ease the difficulties that accompany ambitious economic and political transitions. Third-sector organizations contribute tangibly to the economy in the form of services and employment. In many cases, these organizations provide a public benefit or “public good” beyond any measurable economic impact.

The Power Shift

The decentralization of state activities throughout Central and Eastern Europe and the Newly Independent States has allowed for the increasing involvement of third-sector organizations in services formerly provided by the state. This “power shift” to the third sector represents part of a worldwide trend wherein the third sector’s role is expanding.

A Channel for Social Concerns

Third-sector organizations also play important roles both as representatives of citizens’ concerns, and as providers of information. Through “advocacy,” these organizations make decision-makers aware of these concerns; in doing so, they influence the making of public policy. Third-sector organizations can also help channel social and economic pressures effectively and peacefully.

“Democracy is a system based on trust in human responsibility. This responsibility, however, has to be constantly nurtured and cultivated. The state should not believe that it alone knows better than anyone else what the society needs. It should trust its citizens and enable them to share in a substantial way in exercising the responsibility for the condition of the society. To this end, it should offer them a wide range of opportunities for engaging in public life and developing diverse forms of civic coexistence, solidarity and participation.”

Vaclav Havel,
President of the Czech Republic,
CIVITAS Conference

IV. What Makes the Third Sector Sustainable?

The Three Components of Sustainability

The quality, strength, and endurance of the third sector depend on the environment in which these organizations must operate. The three components to promoting a healthy third sector are:

- A. Legislation and the Legal Environment
- B. Funding and Resources
- C. Organizational Structures and Responsibilities

A. Legislation and the Legal Environment

The sustainability of third-sector organizations requires a comprehensive legal philosophy to deal with that sector specifically. As noted in a recent World Bank report, “Laws permitting NGOs to be established as legal persons play a crucially important role in making the freedom of association, protected by international and constitutional law, real and meaningful.” The following principles provide further guidelines:

1. How Laws on NGOs Can Help or Hinder the Third Sector:

- NGOs require laws that protect their independence and long-term sustainability.
- Too much legislation can hinder the development of a vibrant third sector. Excessive attention to legal details, without a comprehensive legal philosophy, makes compliance difficult for third-sector organizations. Nevertheless, NGOs benefit from a legal framework that discourages abuse of third-sector status. Criminal organizations posing as civic institutions damage the public’s trust in the third sector as a whole.

2. *Encouraging Dialogue*

Legislators should consult with third-sector organizations in drafting and applying appropriate legislation. Open communication and cooperation are crucial in satisfying the needs of both the public sector and the third sector.

3. *Contracts*

Central and local governments often contract third-sector organizations to provide social provisions for the public. However, contracting by governments of NGOs requires fair competition, clear procurement laws, regulation, and accountability.

4. *From Registration to Termination*

Legislation should deal with the entire life cycle of a third-sector organization, from registration to termination, dissolution, or liquidation. This includes:

- **The Process of Registration:** Registration or application procedures should remain simple, transparent, consistent, inexpensive, and accessible to all members of society.
- **Termination, Dissolution, or Liquidation:** Third-sector organizations should have exclusive authority to terminate operations, and dissolve or liquidate assets (unless there is evidence of criminal activity). In the event of dissolution, state funds, tax benefits, or public donations collected by third-sector organizations should be distributed to other third-sector organizations with similar missions.

5. *Navigating the “NGO Waters”*

A third-sector legal framework should include a classification system to help make sense of the third sector. A classification system helps to determine the tax status of various charities and organizations providing public services. Questions to ask when classifying NGOs:

- **Public Benefit or Mutual Benefit?** Most existing legal systems classify third-sector organizations as either public benefit or mutual benefit. Mutual-benefit organizations provide goods or services only to the organization’s members. Public-benefit organizations offer goods or services to society as a whole. Levels of direct and indirect public support can then be indexed according to relative levels of the public good provided.

- **Related or Unrelated Business Activities?** Some organizations may raise funds through non-taxable activities directly related to their mission. Others raise money through unrelated, and thus taxable, commercial activities. The sole fact that an organization is involved in commercial activities does not exclude it from the third sector. Nonetheless, the amount of related, or unrelated commercial activity can be used to help determine the tax status or type of organization. Published annual reports are also useful in helping people better understand an NGO's activities.
- **Accountability and Transparency?** A third-sector "conscience" is vital for a strong, democratic society. Like corporations, public-benefit organizations are accountable to the public they serve, to their members, and to their funders. State agencies can assist by setting a minimum standard of accountability requirements, but most reporting regulation is best left to the third sector itself. By setting strong, self-imposed accountability requirements, the third-sector can establish a basis for public trust and legitimacy. At the minimum, these requirements should include annual reports of finances and activities to the organization's governing body, members, and funders, as well as to state agencies.

Human Rights and the Third Sector

The basic freedoms of association, peaceful assembly, and speech are internationally regarded as rights. These rights are guaranteed by the constitutions of most nations. The following provisions of international law outline these basic human rights:

- *Universal Declaration of Human Rights (1948): Articles 19 and 20 refer to the right of individuals to "peaceful assembly and association," and the "right to freedom of opinion and expression."*
- *International Covenant of Civil and Political Rights (1966): Signed and ratified by over 135 countries. Articles 21 and 22 guarantee the rights to peaceful assembly and freedom of association.*
- *European Convention on Human Rights (1950): Articles 10 and 11 guarantee freedom of expression and freedom of association.*

B. Funding and Resources

Third-sector organizations must look to a variety of sources in order to sustain themselves financially. Third-sector organizations derive funding through:

1. cooperation with government and business;
2. income-generating activities;
3. individual giving;
4. domestic and international foundation support; and
5. partnerships.

1. Cooperation with Government and Business

The activities and responsibilities of the three sectors often overlap. Third-sector organizations increasingly compete with or replace services provided by government or private business. Private business increasingly seeks to engage in community service, and philanthropic and charitable activities: the principal goal of most third-sector organizations. Although funding itself is important, partnerships with government and private business allow each partner to complement the strengths of the other, and to achieve mutual goals.

Commitment Matters More Than Money

One should not underestimate the value of volunteer labor. Beyond a simple transfer of money, the service of volunteers, in-kind-gifts, and other non-financial forms of support also remain important to the sustainability of the third sector. Contributions of time, knowledge, and experience can, in the long run, be worth more than direct financial assistance. Both partners should share human resources; cooperation is the key.

2. Income-Generating Activities

Since government agencies and NGOs are partners in public service, they often cooperate and coordinate the delivery of services through government contracts and grants to NGOs.

Revenue Structure of Hungarian, Romanian, and Russian NGOs in 1995

	Hungary	Romania	Russia
Government Grants	21%	4%	20%
Earned Income	58%	13%	15%
Other	—	9%	3%
Private Support:	21%	74%	62%
<i>Corporate Support</i>	8%	7%	50%
<i>International Support</i>	6%	56%	10%
<i>Individual Giving</i>	7%	11%	2%
Total	100%	100%	100%

Statistics on the percentage contribution of each of these sources to the third sector reveal a significant discrepancy within the region. For example, while Hungary is no longer dependent on international support, it is obvious that Romania still relies heavily on this source of income. The public sector usually contributes the most, but, in some cases, third-sector organizations raise nearly twice that amount through their own income-generating activities. In Russia, NGOs benefit from strong corporate support.

Source: Charities Aid Foundation – Russia, CIVICUS: World Alliance for Citizen Participation, and the Civil Society Development Foundation – Romania

3. Individual Giving

Individual giving can provide a potentially significant source of funding. Third-sector organizations raise funds from individuals in a variety of ways, including special fundraising events (raffles, balls, lotteries, auctions), door-to-door and telephone solicitations, direct mail, and television fundraising campaigns. Volunteer services allow third-sector organizations to accomplish results comparable to the other sectors, but with lower budgets. Through legal measures, such as tax breaks for donors or foundations, legislators can help to encourage individual giving.

4. Domestic and International Foundation Support

In the years following the political changes in the region, international support was crucial to the formation of many new organizations dealing with human rights, tolerance, environmental issues, and advocacy. Now, however, exaggerated expectations are often attached to funding from abroad. Thus, very few third-sector organizations, and usually only the largest, receive international financial support. Long-term sustainability of the third sector in the new democracies will require that organizations seek funding from domestic, rather than international, sources. Raising money domestically will require different strategies than those used to solicit international assistance. This is a challenge not only for third-sector organizations; all sectors of society, including legislators and the media, need to start looking inward and adjust their strategies to become more effective fundraisers at home.

5. Partnerships

- **A Trained, Educated, and Connected Work Force:** Third-sector organizations attract well-educated, ambitious, and enterprising individuals. Because of the nature of their work, third-sector organizations interact globally. The staff often has extensive international contacts and resources at their disposal. Many people trained in the third sector are eager to apply their skills to the business and public sectors.
- **Knowledge of the Market and Constituents:** Many third-sector organizations work at a grass-roots level. Because of their close contact with the community, they have specific knowledge of what consumers, or voters, really want. Third-sector organizations can share much of this powerful information with their partners in government or private business.
- **A Premium on Loyalty and Trust:** Not motivated by profits, bureaucracies, or votes, third-sector organizations can bring with them a great deal of public loyalty and trust. At the very least, they bring with them the support of their members and the population they serve.

The Hungarian 1% Tax Law

In December 1996, Hungarian Parliament passed a law allowing taxpayers to transfer the maximum of one percent of their personal income tax (about 4 billion HUF) to non-profit organizations and nation-wide cultural institutions. Taxpayers themselves decide which eligible organizations will receive one percent of their personal income tax. While one percent constitutes only a small part (less than 10%) of the whole public support received by the Hungarian non-profit sector, it is important because its distribution is dramatically different from any other mechanism of public support. Local, grass-roots organizations, which are usually overlooked by large, state grant-making institutions, now receive financial support from the citizens who are the beneficiaries of their institutions.

- **Less Pressure on Government:** Third-sector organizations can help ease the pressure on government by providing services when and where the government officials are unable. Third-sector organizations can often provide services at higher quality and lower cost than the public or business sectors themselves. At the very least, they provide a cost savings because people volunteer their time and expertise.
- **A Healthy Third Sector Equals a Healthy Economy:** Much evidence suggests a significant correlation between a strong civic sector and the strength of a nation's economy. Third-sector organizations offer competition to public and private-sector organizations, which encourages increased efficiency and, consequently, cost savings.

C. Organizational Structures and Responsibilities

Less than a decade ago, Central and Eastern Europe and the Soviet Union were a one-sector world. Civic activism was equated with dissidence or subversion. Special interest or cultural groups were subject to state control. By working to overcome the lingering distrust of civic activism, the third sector will strengthen trust across all three sectors, creating an environment in which third-sector organizations can evolve along democratic lines. More can be done, however, within the third sector itself. Here are some guiding principles:

- **Quantity Does Not Always Mean Quality:** The sustainability of the third sector will depend on the environment that third-sector organizations create for themselves. Contemporary history provides several examples of societies in which democracy has failed despite an abundance of third-sector organizations. “More” does not always mean “better.” Quality and diversity are integral to a balanced civil society. The third sector’s role in strengthening democracy is crucial, but only if the third sector can shape itself along democratic lines. Civic activism that fails to respect and strive for democratic values can lead to weaker, not stronger, democracies.
- **Umbrella Organizations and Intra-Sectoral Cooperation:** While the diversity of interests represented by third-sector organizations should reflect the diversity present in society, the third sector can accomplish more if it identifies its shared goals and works cooperatively. Umbrella organizations may make inter-sectoral communication, between the third sector and the public sector, more effective. Although many organizations are still distrustful of umbrella organizations, conglomeration and cooperation based on mutual goals may allow for better quality and more efficient, consistent service.
- **Professionalism and Knowledge of Other Sectors:** All sectors in the new democracies are in transition. Likewise, all sectors are equally new to democracy, and to free-market economies. Third-sector organizations will improve their relations and their fundraising potential if they make an effort to learn about, and learn from, the other sectors. Developing professional skills and conduct in dealing with government and private business will ultimately increase the third sector’s productivity and efficiency.

- **NGOs, the Media, and Public Perception:** The third sector is often subject to intense scrutiny by the media and the public at large. Abuses by individual NGOs can serve to reinforce prejudices against the third sector in general. These challenges to the public image require high standards of accountability, self-regulation, and ambitious public relations campaigns. Third-sector organizations can improve relations with the media by making special efforts to inform newspaper, radio and television journalists of their activities.

V. The Future of the Third Sector

On the eve of a new millennium, the influence of the third sector in society will not be easily ignored. Society is redrawing its sectoral map and is discovering that the third sector and the people and services it provides constitute a significant political, economic, and social force. By promoting civic activism and creating alliances with businesses and governments, the third sector strengthens the environment in which democracies can take root and flourish. While the third sector's activities are promising, a healthy civil society cannot, and will not, survive without the support of the business and public sectors. By investing in the third sector, legislators and the business community will be investing in the future.

VI. Appendix

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Resource Centers

The following two centers can provide information on the third sector, NGO activities, and other regional resource centers. Information on their resources, publications, and activities can be obtained upon request.

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Did you know...

- that in 1996, Slovak newspapers published more than 11,500 articles on third-sector issues? 
- that one out of every five Romanian organizations is sustained exclusively on volunteered time and resources? 
- that since 1989, the Czech Republic has adopted three new laws and more than a dozen amendments concerning non-profit, non-governmental organizations (NGOs)? 
- that in the last five years, more than 200 new NGOs were created in Tajikistan? 
- that the third sector employs more people than the mining industry today in Hungary? 
- that more than 1000 NGOs are registered in Belarus? 
- that Bulgarian NGOs serve more than 3.8 million people? 
- that more than 150,000 NGOs are registered in Russia? 
- that more than 500 not-for-profit organizations were founded or re-established in the first year of Estonia's renewed independence? 
- that 94% of all existing NGOs in Poland were established after 1989? 