

# Government and Nonprofits: Turning Points, Challenges, and Opportunities

by Steven Rathgeb Smith

**B**ARACK OBAMA'S ELECTION AS PRESIDENT and his subsequent initiatives regarding the nonprofit sector have called attention to the relationship between government and the nonprofit sector.<sup>1</sup> Perhaps most notable, the Edward M. Kennedy Serve America Act of 2009 could fund up to 250,000 new AmeriCorps and VISTA volunteers, enabling thousands of nonprofit organizations across the country to employ stipended volunteers supported by the federal government. President Obama has also created a new Office of Social Innovation and Civic Participation to assist nonprofit capacity building and to support nonprofits with proven results. If enacted, health-care reform will affect countless large and small nonprofit health and social-welfare organizations. And the \$750 billion in stimulus money made available through the American Recovery and Reinvestment Act of 2009 is being distributed to nonprofits throughout the country, including many organizations that have suffered severe cutbacks in government funding as a result of the intensifying fiscal crisis in state and local government. Congress also continues to debate new regulations pertaining to nonprofit organizations, such as new legislation tying the tax exemption of nonprofit hospitals to specific levels of care for the poor.

In short, the sheer scale of the diverse policy initiatives under way has the potential to profoundly reshape nonprofit organizations. Yet previous administrations have also begun with a flurry of activity involving nonprofit organizations, only to have little long-term impact. Consequently it is useful to revisit history for insight on the potential impact of the Obama administration on nonprofit organizations and philanthropy.

This article offers a historical analysis of key periods in the relationship between government and nonprofit organizations, with particular attention to the lessons these periods offer to contemporary policy makers and nonprofits. The central argument is that the evolution of nonprofits' role in American society has reflected the shifting structure of the American state, which in turn has affected the advocacy and service-delivery roles of nonprofit organizations.

## Change and Continuity in the Historical Development of Nonprofit Organizations

During colonial times, churches and early nonprofit organizations, including universities and hospitals, were critical components of the social structure. But with its decentralization, limited resource base, and minimal role for the

federal government in domestic policy, the initial structure of the American state created powerful incentives for a distinctly local nonprofit sector with relatively little ongoing funding support from government. During this period, many nonprofits were associations and clubs rather than organizations providing services to the public.<sup>2</sup> Those nonprofits that did provide social and health services depended on a mix of private donations, fees, and modest public subsidies.

The late-nineteenth and early-twentieth century witnessed a steady expansion in nonprofit organizations engaged in providing services to the citizenry. Many of the more prominent and notable of these organizations remain with us today: Catholic Charities, the YMCA, Lutheran Social Services, the Salvation Army, Goodwill Industries International, and the Boys and Girls Clubs of America. These service agencies were established in a wave of new nationally federated organizations with chapters in local communities throughout the country.<sup>3</sup> Most local nonprofits were churches, social clubs, and associations such as the Masons, the Elks, and the Grange. Local charities that offered social, educational, and health services to the public comprised a relatively small part of the nonprofit sector and continued to rely

primarily on private donations, fees, and modest public subsidies. Indeed, many nonprofit agencies such as settlement houses and emergency assistance programs depended entirely on private charitable donations.

In terms of funding of nonprofit service agencies, the creation of the Community Chest—the forerunner of the United Way—was a watershed event in the early twentieth century. Started in Cleveland, the Community Chest quickly spread throughout the country. By the end of the 1920s, most communities of significant size had a Community Chest chapter. The Community Chest was essentially a membership organization of leading nonprofit service agencies in local communities; these agencies pooled their resources and solicited donations via payroll deduction through a combined campaign. For many agencies such as the YMCA and the American Red Cross, the Community Chest quickly became a major source of revenue.

During the Great Depression, these agencies were overwhelmed by demand, and some needed emergency relief funds. Many local nonprofits failed entirely or merged with other organizations. Of course the Depression dramatically altered the role of the federal government in many areas of American life, including income-maintenance programs such as pensions and welfare, as well as regulation. Surprisingly the involvement of government—particularly the federal government—in the regulation and funding of nonprofit service agencies remained limited or ephemeral for two reasons. First, many of the Depression-era programs that channeled funds through nonprofits were temporary and ended soon after the start of World War II. Second, the federal government assumed at least part of the responsibility for poor relief, freeing some agencies

from cash and in-kind support for poor people.<sup>4</sup> Consequently, during the late 1940s and 1950s, nonprofit agencies remained largely dependent on private donations (especially Community Chest funds) and fees. Some agencies, such as foster-care agencies, also received public subsidies for specific clients and services. The restricted character of nonprofit revenue sources meant that most agencies were relatively small and lacked extensive professionalization and infrastructure.<sup>5</sup>

In essence the many major New Deal initiatives of the 1930s failed to fundamentally alter intergovernmental relations regarding nonprofit service agencies. Consistent with the nineteenth-century period, public policy for social and health services was largely a matter for state and local government. To be sure, during the 1950s the federal government provided grant-in-aid support in policy areas such as child welfare and hospitals through the Hill-Burton Act of 1946, which authorized construction grants and loans. But these federal programs were quite targeted or limited, so most nonprofit service agencies such as the YMCA or local family service agencies were largely unaffected.

### **Government and the Nonprofit Sector: A New Relationship**

Many scholars, policy makers, and practitioners have noted the dramatic shift in the relationship between government and the nonprofit sector during the 1960s with the War on Poverty and the new federal role in social policy. Three key developments stand out as major breaks with previous policy: First, the federal government provided ongoing funding support for local nonprofit service agencies through grants to state and local governments that then contracted with nonprofit organizations or through new direct federal grants to local nonprofit

agencies. Second, this new funding allowed and encouraged the creation of thousands of new nonprofit agencies outside the existing networks of established Community Chest agencies. Third, funding programs were accompanied by a new regulatory authority that provided the basis for a more assertive evaluation role for government vis-à-vis the nonprofit sector.

The influx of federal funding rapidly changed the government-nonprofit relationship. Many long-standing agencies that had previously depended on Community Chest funds became substantially dependent on government funds. Entirely new nonprofits such as Community Action agencies and community mental-health centers were created. And state and local governments invested in new capacity to manage the expansion of contracts to nonprofits.

This restructured government-nonprofit relationship was controversial. Many scholars and nonprofit executives feared that government funding would undermine the distinctive character and autonomy of nonprofit agencies. Many policy makers worried about the potential loss of accountability for public funds as an increasing number of services were contracted out to private, largely nonprofit agencies. Many political conservatives were concerned that the reach of the federal government had become too extensive. This concern was an important factor in the election of President Ronald Reagan, whose platform promised a smaller federal government. Early in his administration, Reagan won passage of new legislation that devolved responsibility for many federal social programs to the states and substantially cut federal funding.

During the early 1980s, these reductions in federal funding led many nonprofits to cut their programs, sometimes quite severely. Over time, though, many

nonprofits compensated for lost funding by tapping new federal government programs, refinancing their programs by taking advantage of growing federal programs such as Medicaid, or increasing their private donations and earned income. The expanded use of vouchers, tax credits, and bond issues to fuel the overall growth of nonprofit social and health agencies also reflected the growing diversity of government funding sources. Created by legislation in 1986, the Low Income Housing Tax Credit, for example, has been a major factor in the growth of nonprofit low-income housing organizations throughout the country. So too the enactment of welfare reform in 1996 led to greater demand for nonprofit services, as cash assistance to the poor—now called Temporary Assistance for Needy Families—became more conditional and difficult to obtain. Additional services were also required to assist individuals still receiving cash assistance to find employment.

The financial crisis has presented difficult financial challenges for many nonprofit agencies. But many of the policy and management issues facing nonprofit organizations that provide public services reflect the evolution of the government-nonprofit relationship over the past 40 years. The dramatic growth in government contracts with nonprofits has vastly increased the number of agencies, with many new specialized agencies producing greater fragmentation in services and daunting new challenges in terms of governmental management of an increasingly complicated service system.

As a result, government managers have more incentive than ever to expect higher levels of accountability from nonprofits, especially from agencies providing services with public funds. Moreover, many newer nonprofit agencies are modest in size and face serious constraints in their capacity to respond

to increased performance expectations while undertaking advocacy and public education on behalf of their agencies. For these reasons, many newer—and older—agencies have sought to participate in the policy process through coalitions and other intermediary associations in support of agency goals, especially given the recurrent budget crises in state and local government and the difficulty of raising private donations.

### **AmeriCorps, Community Service, and Public Policy**

While the growth of government contracting that began in the 1960s continues to affect the nonprofit sector, another important development was Congress's creation in 1993 of AmeriCorps and the Corporation for National and Community Service. The precedents for AmeriCorps date to the 1960s, with the establishment of the Peace Corps and VISTA, and then, in the 1970s, with the creation of ACTION. But these programs were relatively modest in scope. President George H. W. Bush inaugurated his now well-known Points of Light campaign to champion volunteer and community initiatives around the country, though direct federal support for this effort was small.

But in 1993, the launching of AmeriCorps and the Corporation for National and Community Service placed the federal government squarely in support of community service, service learning, and a more extensive role for nonprofits in helping their communities. The establishment of the Corporation partly freed voluntarism and community service from its dependence on private funding and smaller-scale state and local efforts, as was the case with new federal grants and contracts with nonprofit agencies for social and health services.

Throughout the Clinton presidency, the Corporation was politically

embattled and in danger of elimination. Nonetheless, the Corporation survived and has undertaken an assertive role in the government-nonprofit relationship that differs substantially from its contracting and regulatory functions. The Corporation and AmeriCorps have funded thousands of AmeriCorps volunteers who have in turn worked in various community organizations, providing staff support to local agencies in an extensive range of service fields, from social welfare to the environment to early-childhood education. In the process, AmeriCorps volunteers have generated support for local organizations that has proved useful in fundraising and in generating broader-based community support.

Another long-term effect of the Corporation and AmeriCorps is their direct and indirect support of new nonprofit organizations based on a social-entrepreneurship and community-service model, such as City Year, Teach for America, Citizen Schools, the Harlem Children's Zone, and YouthBuild. Many of these organizations have partnerships with public agencies, foundations, and corporations and actively seek growth and deeper program impact, aided in part by foundation grants and AmeriCorps funding for volunteers. These organizations are also major backers of the Edward M. Kennedy Serve America Act of 2009.

In general the newer nonprofit organizations that have close working relationships with AmeriCorps and the Corporation differ significantly from nonprofits that contract for public services. Over the past 25 years—and until the financial crisis—the big growth areas in contracting were in services such as home health care, foster care, community care for the developmentally disabled and the mentally ill, low-income housing, community development, and child care. The agencies providing these services are primarily professional,

staff-driven organizations with relatively few volunteers. Some of these services are highly complex, involving many types of professionals and the legal system. Consequently it is much more difficult to engage these organizations in community-service activities. The newer community-service agencies also tend to be staff-driven organizations but rely heavily on volunteers for their direct-service activities.

### Nonprofit and Public Policy: The Challenge Going Forward

The growth of government contracting, social entrepreneurship, and community service, combined with the financial crisis and a new presidential administration that supports local community organizations, puts nonprofits and government at an important historical moment. Government support for community service and volunteering is at an all-time high. Interest among young people in AmeriCorps, the Peace Corps, and service-oriented nonprofits such as Teach for America is growing. The billions of dollars in stimulus funds may help nonprofits at the local level launch new initiatives or continue existing programs. Nonetheless nonprofit service agencies face management and political challenges as they cope with an increasingly turbulent and competitive environment.

Consequently government and the nonprofit sector must assertively respond to this environment by rethinking existing policies. The Obama administration and state and local governments should take advantage of this broad popular support for voluntarism and recognize that the nonprofit infrastructure requires an ongoing investment and commitment from government and private funders. The Corporation in particular has provided direct support for thousands

of volunteers but generally does not support the infrastructure and capacity of nonprofit organizations themselves. The risk is that without a vibrant nonprofit infrastructure, AmeriCorps volunteers might fail to maximize their value to their communities. This infrastructure support also requires nonprofits to structure their governance to promote outreach and broad-based community and political support.

Moreover, there are tens of thousands of community-based nonprofits providing important services that are not likely candidates for extensive funding through the Corporation for National and Community Service programs. These agencies provide an array of services—from home care to welfare-to-work—and need sustained public and private support, even if their services are specialized and local. For their part, these agencies must invest in good governance, transparency, accountability, and engagement with the policy process on behalf of their agencies and their clients. Foundations and private donors can aid this effort by supporting coalitions and associations of nonprofits, along with local nonprofit organizations whose primary missions are advocacy, public education, and citizen engagement.

Policy makers should also work to establish structured, ongoing forums for the resolution of issues of mutual concern between government and the nonprofit sector, such as funding levels, rates, regulations, and new program initiatives. This effort could include a federal office or commission on nonprofit organizations as well as less formal settings to discuss important policy and governance issues.

Significantly, the combined effects of extensive contracting and widespread interest and participation in community service means that now more than ever, citizens—either as service recipients or

deliverers—will engage with a nonprofit organization supported by government rather than with government itself. Consequently, government has an obligation to ensure that nonprofit services are provided equitably and adequately so that citizens can achieve full social and political citizenship. This effort requires an engagement of nonprofit representatives in the policy process at all levels of government and an “investment” approach by government and nonprofit organizations that emphasizes accountability and results as well as sound governance and community engagement.

### ENDNOTES

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2. Gerald Gamm and Robert D. Putnam, “The Growth of Voluntary Associations in America, 1840-1940,” the *Journal of Interdisciplinary History*, vol. 29, no. 4, spring 1999, 511-557.
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4. Andrew Morris. “The Voluntary Sector’s War on Poverty,” *Journal of Policy History*, vol. 16, no. 4, 2004, 275-304.
5. Steven Rathgeb Smith and Michael Lipsky, *Nonprofits for Hire: The Welfare State in the Age of Contracting*. Cambridge, MA: Harvard University Press, 1993.

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