

International Practices on Funding Civil Society Organisations

RESEARCH

OSCE PCU Project

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ABBREVIATIONS

CAF – Charities Aid Foundation

CEE – Central and Eastern Europe

CIS – Commonwealth of Independent States

CSDF – Civil Society Development Foundation

CSO – Civil Society Organization

CSR – Corporate social responsibility

ECNL – European Center for Not-for-Profit Law

ERNOP – European Research Network on Philanthropy

EU – European Union

ICNL – International Center for Not-for-Profit Law

JHU – Johns Hopkins University

NESsT – Nonprofit Enterprise and Self-sustainability Team

NGO – Non-Governmental Organization

NMS – New Member State

OMS – Old Member State

TOR – Terms of Reference

USAID – United States Agency for International Development

Executive Summary

This Study aims to present results of a comprehensive research of successful international practices that would be most applicable in Ukraine concentrating on the specific subjects of funding civil society by the state, local authorities, business and other sources as well as forms of contractual relations between state authorities and civil society organizations as required for the implementation of the research component of the project “Civil Society - International Best Practice Research”.

The Study provides a framework for understanding CSO finances and it analyses six European countries¹; three of them were subjects to complex contextual and technical assessment that have direct relevance to the Ukrainian situation, while the others provide useful models and examples. The countries included have introduced in the past decade one or more successful mechanisms to fund civil society, and as such, present good practices in ensuring sustainability of civil society organizations. The Study provides a comparative analysis of these models and mechanisms; presents the key elements in designing a successful institutional framework for CSO funding and finally, it offers recommendations for consideration by Ukrainian stakeholders.

Based on the research of international best practices from these six countries, the following findings are of key importance in developing an institutional framework for CSO funding in Ukraine:

- There is a need of a “from the vision to the mechanism” approach to link funding mechanisms to be introduced with the vision and purpose of CSO development: the legislator needs to determine what functions it envisions for the CSOs; then to develop the appropriate tools to achieve the results. Developing a strategy for CSO development is typically the primary element that envisions a clear role for CSOs vis-à-vis the government. However, preparing the strategy itself means little in terms of the impact of governmental measures. Equally (if not more) important is the relevance of the strategy to the desired impacts; and the relevance of funding policies to the strategy.
- There needs to be sufficient data and information available to make informed evidence based policy decisions in this field. This is important, as the CSO field is often neglected as a policy area and basic data are missing.
- There needs to be an ongoing and systematic effort to trace the practice and impact of the implementation of the strategy.
- The CSO sector cannot be financed through one main mechanism. Funding streams have to reflect the diverse functions, organizations and needs of the sector. There can be a

¹ Countries analyzed: Bulgaria, Croatia, Czech Republic, Germany, Hungary, Poland, the UK; Bulgaria was finally not included into the study for lack of evidences available for the purpose of the document.

different funding strategy for larger service providing and for small community based CSOs. Both direct and indirect means of support can be effective.

- The funding streams have to come from long-term sustainable resources (public and private) so that CSOs can predict the levels of funding and can plan long-term. Some creativity may be needed to identify those – but based on the findings of the research it is possible.
- The funding mechanisms should be complementary rather than competing; e.g. re-granting or intermediary organizations should not be in a competition with the CSOs they are supposed to support.
- While certain income sources are less significant in terms of the total revenues of the sector, their absence or presence can dramatically change the conditions for CSO sustainability (the principle of “less is more”).
- The strategy should take a long-term view (8-10 years) and consider a gradual development of the various mechanisms, building on each other (e.g., introduction of tax benefits after redefined public benefit status).
- It is essentially the culture and historic traditions that determine the behavior of taxpayers, CSOs and the state in any country. However, intelligent tax policy can capitalize on the opportunities presented by the ever changing environment and introduce incentives which can successfully change behaviors.
- Government needs to invest into the capacity development of the CSO sector. Even in the most developed countries, CSOs need support in delivering the expected increased contribution to the public good.
- Government should also ensure that there are resources that finance the ongoing development of the CSO sector – startups, innovations, service development etc. These are usually more effectively funded from private sources; where there is a lack of these, government can undertake this role or provide incentives to private actors to pursue it
- The challenge for governments in fiscal hardship is how to make private money work for the public good.

Building on the above findings, the Study recommends the following key steps in the development of an institutional framework for funding CSOs in Ukraine:

- A redefined public benefit status that can serve as the basis for several fiscal incentives.
- The creation of a fund to support civil society in order to boost the capacity of key CSOs and to catalyze local processes in CSO development.
- The (gradual) introduction of a normative system of financing CSOs that provide social services approved by the state.
- The introduction of a serious tax incentive to encourage the establishment of privately endowed public benefit foundations.
- The introduction of a “toll” on green-field and other investments, including privatization, which should be spent to support public benefit purposes; in addition to consider deductibility of a percentage of the turnover for donations.

- Increase, but most of all simplification and streamlining of the tax deduction for individual donors.
- Allowing full tax exemption of mission related economic activities of public benefit organizations, and a partial exemption of their unrelated economic income.

These recommendations are based only on the comparative research and analysis carried out within the framework of the project. The primary focus of the analysis was to map the feasibility of various models. In case there will be political decisions reached on any of the recommendations, the next phase will be the business planning of the chosen methods (e.g. to determine the fiscal consequences of the introduction of the mechanisms). Therefore, more research needs to be made to compile data and information that will allow the decision-makers to make informed decisions on the introduction of these mechanisms.

I. Introduction

This Research Study has been developed under the project “Civil Society - International Best Practice Research” with the view to assist policy- and decision-makers in Ukraine in developing a comprehensive financial support framework for the CSOs.

Over the past decade, an increasing number of countries in Western Europe, as well as Central and Eastern Europe (CEE) have undertaken a comprehensive evaluation of the roles and functions of civil society organizations (CSOs)². This was prompted primarily by the dual pressure of financial restrictions and an increasing level of contribution by CSOs to social and economic development.³ Whether the UK and Germany or Hungary and Croatia, governments have redefined their relations with the nonprofit sector to ensure a more efficient participation of CSOs in social service delivery and the advancement of government policies in many other fields from fighting unemployment to improving education. As part of this re-definition of the roles and responsibilities between the state and the nonprofit sector (as well as the private sector), various mechanisms to facilitate state financing of CSOs were introduced to support CSOs in addressing their social functions.

This Study aims to explore some of the working examples – good practices and lessons learned - in CSO financing from Europe, with a view to their applicability in Ukraine. CSOs have been playing an important role in the development of Ukraine in the past two decades. From providing assistance to the needy to providing expert advice to the government, they engage in a wide range of activities that benefit a larger or smaller part of the country’s population. CSOs are private, autonomous entities that until now have been financed mostly from foreign aid. This financing has proved extremely helpful in the first stages of the development of Ukrainian CSOs – but it is clear that it will not continue for a very long time. The sustainability of CSOs and of the valuable services they are providing will depend largely on whether the Ukrainian people and the Ukrainian government find them worthy of support.

There are already good examples of government support of CSOs both at the central (e.g. through government programs) and local levels (e.g. the practice of the “social order”)⁴. Furthermore, CSOs do engage in fundraising and economic activities to raise additional funding; and many CSOs enjoy the support of volunteers from their communities. However, in order to ensure CSO sustainability, a **strategic and systematic approach to CSO funding is needed**, which takes into consideration the needs of CSOs for optimal operation as well as the possibilities offered by the cultural context and the fiscal environment.

²For the purposes of this Study, CSOs are understood as private, independent, nongovernmental, nonprofit organizations, which primarily are organized in the form of civic associations and foundations, but also in other legal forms, such as nonprofit corporations or institutions, depending on the jurisdiction.

³See, e.g. Nilda Bullain and Katerina Hadzi-Miceva: *Recent trends in the public and self-regulation of accountability and transparency of nonprofit organizations in the EU*, European Commission, 2009

⁴The “socializakaz”, or social order is a relatively wide spread form of supporting CSOs at the local level through targeted small grant programs.

This Study aims to assist in the development of such a systematic approach by analyzing a number of successful international practices on a comparative basis that could be applicable in Ukraine. The research examines the specific subjects of funding civil society by the state, local authorities, business and other sources as well as forms of contractual relations between state authorities and civil society organizations. It also provides concrete recommendations for consideration to the Ukrainian decision-makers.

Framework for the Research

The following framework was developed for this particular research. The methods and characteristics of each type of interaction listed in the first and second columns have been assessed in connection with the thematic areas of the top row. For each country selected there is an analysis carried out according the same criteria listed in the table.

		Legal /Fiscal Framework	Historic/ cultural conditions	Country specific elements	Role of CSOs	Examples /Best Practices	Observations
Interaction with the state	Funding Mechanisms						
	Social contracting						
	Alternative financing						
Interaction with the private sector	Private giving-through institutionalized mechanisms						
	Private-corporate giving						
	Individual giving						
	Income generation						

Explanation:

- By funding mechanisms we mean direct budget support provided to the CSOs, primarily in the form of government grants but also subsidies and in-kind contribution, at both the central and the local level.
- By social contracting we mean the ways in which the government engages CSOs in the provision of welfare services, such as education, culture or social services, based a regulated competitive procedure.
- By alternative financing mechanisms we mean methods of government financing that cannot be categorized in the traditional schemes of grants and contracts, such as the so-called percentage mechanism, or endowment of foundations from privatization or other governmental income.
- Private giving through institutionalized mechanisms includes various forms of

foundations established to channel private resources to CSOs and other beneficiaries.

- Corporate giving encompasses a wide range of financial and non-financial support that companies provide to CSOs, as well as strategic partnerships and other forms of cooperation between the for-profit and nonprofit actors.
- Individual giving refers to a range of giving techniques by which individuals may provide financial and in-kind support to a CSO. We do not include volunteering in this research although it can be seen as part of individual philanthropy.
- Income generation refers to revenue of the CSO from membership fees, selling services and goods, renting space, investing assets and other economic or entrepreneurial activities.

The completed matrixes serve as synthesizing platform that makes the key characteristics of each country easy to compare. Based on this information, an analysis is made of the advantages and disadvantages or risks associated with the various funding mechanisms, considering also the contextual specificities; and conclusions and recommendations are drawn to assist their possible adoption in Ukraine.

Research methodology

Desktop research

During the research a review of currently available literature and information related to the financing mechanisms was conducted, in English, Hungarian, Czech and Slovak, including comparative studies and reports as well as materials related to the selected countries. This encompassed:

- national laws related to CSO funding;
- comparative legal analyses by expert organizations such as the International Center for Not-for-Profit Law and the European Center for Not-for-Profit Law;
- country indexes, reports and assessments provided by international organizations such as USAID, Civicus, Johns Hopkins University, European Network of Research on Philanthropy, European Foundation Center, among others;
- research reports and studies related to the various financing mechanisms;
- articles in relevant journals related to the topic, e.g. International Journal of Not-for-Profit Law, Alliance Magazine;
- statistical data where available.

A literature review is enclosed at the end of the Study.

Field visits

The expert of OSCE PCU carried out 5 trips to and within Ukraine where it met with over 225 individuals representing national CSOs, local government authorities and businesses and other stakeholders at regional forums to present research findings in the framework of the

“Developing Institutional Framework of Funding Civil Society in Ukraine” ExB Project. The forums organized in the form of roundtable discussions were held in Simferopol, Odessa, Kiev, Lviv and Donetsk. These forums were extremely important in understanding the context and selecting relevant examples and recommendations. They showed the existing cultural biases (e.g. a certain level of mistrust and/or prejudice among the different sectors) as well as shed light on important principles that policy development must keep in mind, such as the need to analyze the effect of concrete measures that the government is taking to on CSO development. Overall, the forums underlined the importance of participation in policy development, which will result in higher quality and more implementable policy recommendations.

Countries assessed

We proposed to undertake the research in a mix of countries that represent enough differences in their various models and but all have relevant aspects for possible adaptation in the Ukraine. The main criterion for the selection of countries was to have existing and well functioning mechanisms to support CSOs from public budgets; and/or mechanisms that encourage private philanthropy and own income generation through taxes and other innovative methods. Additional criteria included: Having a historical or cultural background that is similar to Ukraine at least in some aspects; representing both Eastern and Western Europe; and having enough data/information available for analysis.

Based on the above criteria, eight countries have been selected and examined, of which five are presented in the Study.⁵Four represent a continental European model of CSO sector development, in countries with a strong state orientation, therefore, they are akin to the Ukrainian historical-cultural context. In addition, the UK is included as a source of best practices and innovative ideas. Although they represent different levels of economic and CSO sector development as well as different stages in the development of the CSO funding system itself, in all the countries there are practices that can be considered for the current Ukrainian context.

Three countries have been analysed in-depth:

Hungary – Hungary has a nonprofit sector around the same size as Ukraine (65,000 organizations), and shares the past of socialism as well as the “bridge” position between East and West. Among the CEE countries Hungary has the most well developed system of government funding (at all levels); as a consequence, it also has the most lessons learned in terms of the actual operation of these funding mechanisms.

Croatia – Croatia is a small Balkan country but with similar cultural features to CEE states. Like Ukraine (and unlike Hungary), it received large amounts of foreign funding which also supported its CSOs; therefore the CSO sector in Croatia is currently more or less at the same level of development as in Ukraine. At the same time, Croatia offers a well functioning good practice mechanism to fund and help develop CSOs through a strategic approach.

⁵In addition to the countries presented, Bulgaria and Estonia were also examined.

Germany – Germany is in many ways a unique example due to its historical development; however, it resembles Ukraine culturally in its ongoing attempt to reconcile the interests of a progressive but strong central state, and bottom-up citizen initiatives. The recent initiatives in Germany to address the financial setbacks of the welfare state through increasing private philanthropic engagement offer an interesting example to Ukraine as well.

United Kingdom – The UK is a common law country and as such, it has different practices and historical roots than continental European countries. However, it has always been the leader in introducing good practices in regulation, philanthropy and entrepreneurship, which served as a model for Western Europe and CEE. If not all the practices, the principles underlying the practices should be examined and followed.

Czech Republic – The Czech Republic has in many ways followed a different route than its neighbors in CSO development. This led to introduction of practices that may prove more effective than the “typical” CEE solution (e.g. the introduction of a domestic grant-giving foundation sector or vouchers in social contracting).

Structure of the Study

The Study consists of five main Chapters following the Introduction.

Chapter II provides a framework for understanding the financing mechanisms for CSOs. It: (a) describes the different European models of CSO sector development, and their relationships with the state; (b) provides an overview of the financial viability of the CSO sector; (c) presents a mapping of resources to assess income sources of CSOs; and (d) describes in more detail the specificities of the three main categories of CSO income: public funding, private funding and earned income.

Chapter III includes the most important general findings its author identified through the comparative research, in relation to the effectiveness of CSO financing mechanisms. These represent learning points from the countries analyzed and provide a background understanding for the country chapters.

Chapter IV consists of five sections, each provide a detailed analysis of a country (Hungary, Croatia, Germany, UK, Czech Republic), based on the research framework described above.

Chapter V summarizes the key conclusions based on the country descriptions and provides a basis for the recommendations.

Chapter VI provides concrete recommendations for the consideration of Ukrainian policy-makers.

II. Understanding the Financing Framework of CSOs

II.1. Models of CSO sector development in Europe⁶

The European scene is not unilateral in terms of the development of CSOs and their embeddedness within their societies. Based on cultural traditions⁷, religious traditions, legal and fiscal framework, global and regional role⁸, etc. various states follow a rather individual approach in terms of what is current and envisioned role and function of CSOs.

In terms of the current assessment this question is going to be the major challenge for Ukraine as well: **what is the vision for the role of the CSO sector in the development of the country?** The answer to this question may influence choices of relevant mechanisms of funding. It will be also critical to decide, how much role the state will want to or will have to play in this development process and how much role other sectors and stakeholders should play. This section aims to provide some examples of how European countries have approached the role and financial sustainability of CSOs.

While there is wide range of CSO financial sustainability models applied in various European countries, we can find the common factors that are necessary to assess before the models themselves are being analysed. The legal framework is rather influential in terms of how widespread certain mechanisms are (such as tax incentives to promote new philanthropy in e.g. Germany – see below). Historical and cultural traditions can be as influential in a positive (general level of individual giving and individual responsibility within the Dutch population⁹) as in a negative direction (such as general expectation of the public in Hungary towards the state to provide generous services as it used to be during the period of socialism¹⁰). Obviously the economic and political situation in the countries will also have influence on the activities of CSOs as well as their interaction with various players (in countries that are economically

⁶This section is based on information from the European Center for Not-for-Profit Law (ECNL), including a draft study under publication “*Public Financing of Non-governmental Organizations in Europe*”. The information has been provided by Nilda Bullain and Katerina-Hadzi Miceva from ECNL. Quotes are taken with permission from the authors.

⁷For example, in the UK the charity sector goes back to several hundred years and the first charity legislation was adopted in 1601 in order to protect private property that was dedicated to a public purpose.

⁸For example, former colonial states have a greater inclination to encourage CSOs to undertake a role in international development.

⁹<http://www.giving.nl/>, GINPS data

¹⁰Figyelő – Hungarian weekly, issue 50/2010, Gábor Lambert The characteristics of Hungarians and willingness to re-start

stronger there is a decreasing tendency of violation of human rights like in those in a worse economic situation¹¹).

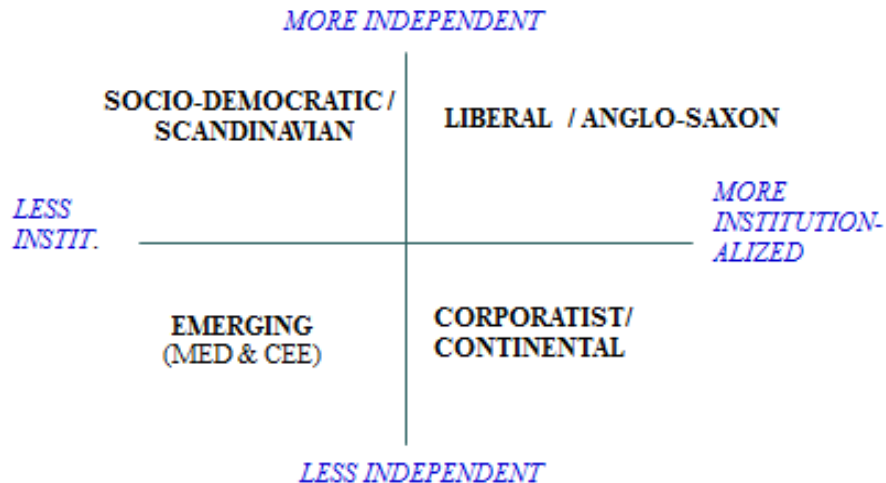
The following section analyses various European models from the point of view of two key aspects, the level of independence and the aspect of institutionalization. The European Center for Not-for-Profit Law (ECNL) model to categorize CSO sectors by these characteristics was chosen to make the choice of the Ukraine specific interventions easier.

The scale of *independence* is related to the autonomous self-governance of CSOs vis-à-vis the government or other actors (e.g. church, political parties); reflected in the CSOs capability to mobilize themselves and their constituencies, obtain financial support needed to carry out their mission, ability to deliver services that are not or partially subsidized, develop competitive expertise etc. In essence, it refers to the extent to which CSOs are able to set priorities and operate based on needs and their mission rather than based on priorities set by the government or other power structures.

Institutionalization refers to the capacity of the nonprofit sector to undertake projects and services for the government, i.e. the potential of the sector to be a reliable and accountable partner to the government in providing public goods and services. This includes for example, the number of registered organizations, their average budgets, the proportion of CSOs who are of public benefit, their physical infrastructure as well as their human and financial resources etc.

¹¹Inglehart, Ronald F. and Christian Welzel. 2005. Modernization, cultural change, and democracy : the human development sequence

European Models of CSO Sector Development



Source: European Center for Not-for-Profit Law

Corporatist (Continental): in this model CSOs are actively involved in the provision of social services and may be the main providers - as in the case of Germany where the principle of subsidiarity entails the primacy of community-based services. At the same time the state undertakes financing of the services in whole, typically through third party payments or subsidies to major providers and their interest groups. State funding thus represents well over half (usually 55%-75%) of the income of the sector. Therefore the CSO sector is highly institutionalized and also highly dependent on the government for ongoing support. Since the government also needs the CSO sector, there is a kind of interdependence, termed “hierarchical interdependence” by ECNL¹², between the two sectors. A variation of this model is in France where the government also only recently started to revise its policies of subsidizing the CSO (associational) sector for its function of “solidarity”, introducing grants and contracts based on performance in delivering projects and services.

Liberal (Anglo-Saxon): this is a model typical of Anglo-Saxon countries (in Europe, primarily the UK; see also Canada), although elements of it, especially the principle of contracting has spread to the continent (e.g., Netherlands). In this model, CSOs are also highly involved in social services’ provision, however, they are less dependent on the state. Even though they receive financing through contracts, they have strong roots in the communities; and their own assets, philanthropic and self-generated income make them able to keep also a strong advocacy role. The relationship between CSOs and the state is

¹²“Public Financing of Non-governmental Organizations in Europe” ECNL (under publication)

based on the so-called Compact, an overall policy agreement, and contracting plays a key role in delivering social services as well. In the liberal model the principle of the best value service delivery¹³ makes the CSO sector very professional and competitive. Various models of management, accountability and transparency standards are applied, sophisticated management schemes are widespread to increase trust and confidence of all stakeholders. While there is a significant level of public financing applied in these countries (35-55%), the level of other resources is high which makes the sectors more relevant in terms of partnership for the government.

Social-Democratic (Scandinavian): this is the typical model in Scandinavian countries. Here, the state is the main service provider; CSOs there are not typically involved in provision of social services but rather fulfill “expressive” functions (i.e. cultural, sports, hobby organizations that primarily serve their members’ and their communities’ interests). Even though almost everything in welfare provision is financed and delivered by the state, in contrast to the “statist” model of the former Soviet bloc, there is a high level of social capital and engagement in civil society (volunteering reaches the highest levels in Europe in these countries). The relationship between the two sectors can be characterized by the “live and let live” philosophy and consequently a low level of public funding of CSOs (25-35%). At the same time citizens and CSOs are extensively and directly involved in policy making both at local and central levels (increasingly through IT tools). In regards to institutionalization these sectors are less established, as they don’t need massive operations that are needed for services, while due to inclusive democratic practices there is less need for such capacity even in case of advocacy operations.

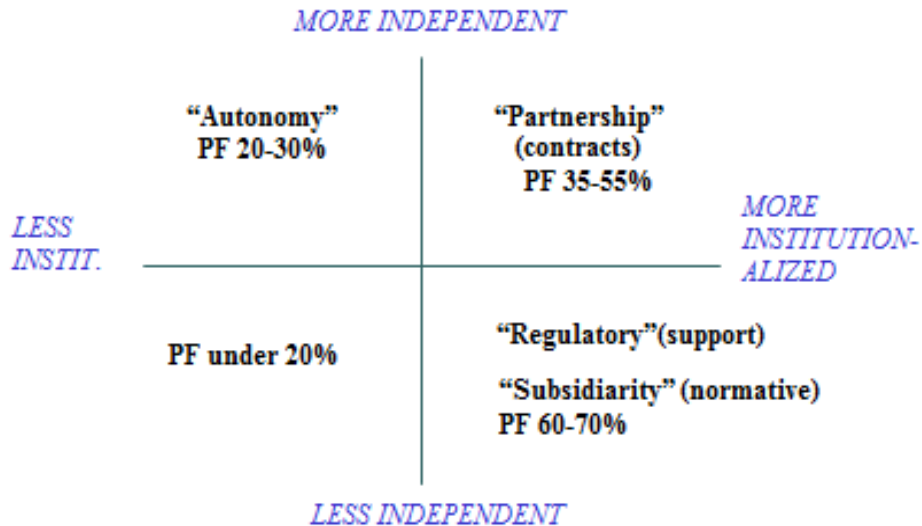
As can be seen, the two more independent European models, the Scandinavian socio-democratic and the liberal Anglo-Saxon have a major difference between them. In the liberal model countries the CSO sector is ready not only for recognizing the particular need but has a certain capacity to satisfy the need as well. In the Scandinavian Model it is the primary role of the state to satisfy justifiable needs, the CSO sectors tend to be more of a watchdog and advocacy character, their funding is strongly based on private giving and membership support.

Emerging (Mediterranean and CEE): in the Mediterranean countries (e.g. Greece, Cyprus, Portugal) and most Central and Eastern European countries the relationship between the state and CSOs is still evolving. It has been characterized by low levels of public funding; either neglect of CSOs or dependency relationships; traditions or nepotism or political interest in funding and involvement of CSOs in service provision. Welfare models are typically residual as well as rudimentary as much of the care remains with the family and

¹³ Sample definition from the UK,, Under best value, each local authority has a duty to "make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness". This improvement involves consideration of costs, making the most of money spent, and making sure that services meet the needs of communities and authorities' priorities." <http://www.idea.gov.uk/idk/core/page.do?pageId=5184420>

social nets. However, as the countries' economy and CSO sector develop, they will be likely to converge towards one of the other three models.¹⁴

Relationships and public funding



Source: European Center for Not-for-Profit Law

II.2 Financial viability of CSOs in Europe

Regardless of their field of activity, effective CSOs are managed based on similar operating and organizing principles, which in general resemble those of businesses. Strategic focus and long term planning enhances better impact and strategic use of funds; systems and well defined management are guarantees for effectiveness and reduced risk for the donors; a predictable and financially solid operation entails less fluctuation and increased quality of work. In most of the old EU member states such systems are generally more developed, while in the case of new member states there is a lower level of institutional readiness for effective operation by CSOs – even when significant development has taken place.

¹⁴E.g., Hungary and the Czech Republic seem to be moving towards the corporatist model; while Estonia and Slovakia tend toward the liberal model, and Slovenia and Latvia towards the Scandinavian model.

Several new member states have realized this weakness of their third sectors and over the last decades invested systematically into the development of their civil societies. Why have they done so? In these countries CSOs contributed to resolving serious social problems such as homelessness, unemployment, disability care or child protection. CSOs set up services where the state did not have the capacity to do so, and they developed innovative models that proved more effective than existing services. CSOs often undertake social innovation in the fields of education, child care, disability care, elderly care, etc, taking over the risk of the reform initiatives for the central and local governments. The government then often helped scale up and disseminate successful innovations: the services become the basis for mainstream governmental reform. In sum we can say that investments into the development of civil society have been made most often with a view to increase effectiveness and efficiency of state provided services nationally and locally.

Furthermore, in some cases, e.g. in the case of Croatia, the government also appreciated the importance of developing civil society in terms of active citizenship, recognizing that conscious and active citizens are vital for peaceful democratic development. Thus, the vision of the Croatian National Foundation for Civil Society Development reads: *“Through its activities the National Foundation strives to achieve active citizenship in the development of a modern, democratic and inclusive society in the Republic of Croatia.”*¹⁵

There are yet other motivations for governments to have developed their governmental strategies towards CSOs and to have introduced various mechanisms to increase CSO infrastructural capacity. Countries that are further from the EU accession do so usually to increase external funding for state services (as CSOs can attract a significant volume of private funding to match service delivery costs); in case of countries in the pre-accession phase as well as among those that are already members there is a strong motivation to have relevant infrastructure and capacity (including CSOs) to successfully access and absorb European funds (in case of members the success ratio of applicants may help states to win more or at least equal funding from the EU budget than their contribution is).

Some countries followed a rather creative approach in their support for civil society development, which represented significant innovations even compared with the old member states. These include the Czech endowment model, the Hungarian percentage designation scheme, or the Estonian or Croatian National Civil Fund concepts, all of which are described in this Study. The document also aims to analyse to what extent these approaches truly contributed to the strengthening of civil society and how effectively they contributed to achieving the relevant and targeted results.

The governmental support for CSOs also addresses a key problem, namely the lack of institutional or administrative funding (funding that the CSO can use to pay its running costs, such as salaries and rent, and the costs of organizational and service development, e.g. IT, staff training, fundraising etc.). In most NMS but also other European countries, the project based restricted funding is the most typical, while the level of unrestricted funding is rather

¹⁵<http://zaklada.civilnodrustvo.hr/category/180/subcategory/182>

low.¹⁶ Such funding could come from any of the sources, however there are impediments: the lack of transparent and effective giving mechanisms – in case of governmental and municipal donors; the lack of widespread philanthropic culture in case of individuals; the low level of corporate citizenship - in case of businesses. The low level of such funding is a key struggle for most CSOs as unpredictable changes in the environment (e.g. changes in taxation, frequency of calls for application, reporting requirements, etc. may result in financial losses that the less-or non-solvent CSO have difficulties to finance).

Another problem from the point of view of CSO sustainability in the new member states is a general public expectation towards NGOs¹⁷ and CSOs¹⁸ that they have to provide services for free, work for their organizations on a volunteer basis or below the average wage. Usually the public opinion is less accepting of competitive salaries (even in the public sector) despite the tendency that the first CSOs to have contractual relationships with their governments and corporate sectors beyond charitable giving have been those with very specific know-how and high quality expertise. In order to enhance the sustainability of CSOs, it will be necessary to achieve a shift in public opinion towards a more nuanced view of CSOs and their needs.

II.3. Mapping the Funding Sources for CSOs

The following chart lists most potential funding sources for CSOs. A general principle applies here: the more balanced the income from various sources of a given CSO is, the more sustainable it is.¹⁹

¹⁶Restricted funding refers to funds that can only be used in relation to the funded project and which is therefore not suitable to fund administrative and development costs; while unrestricted funding has no such limitations.

¹⁷Lester M. Sallamon: *Global Civil Society: Dimensions of the Nonprofit Sector* (with S. Wojciech Sokolowski and Associates), Volume II

¹⁸ World Bank definition: „the term civil society to refer to the wide array of non-governmental and not-for-profit organizations that have a presence in public life, expressing the interests and values of their members or others, based on ethical, cultural, political, scientific, religious or philanthropic considerations. Civil Society Organizations (CSOs) therefore refer to a wide of array of organizations: community groups, non-governmental organizations (NGOs), labor unions, indigenous groups, charitable organizations, faith-based organizations, professional associations, and foundations”

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/CSO/0,,contentMDK:20101499~menuPK:244752~pagePK:220503~piPK:220476~theSitePK:228717,00.html>

¹⁹ Based on the analysis of several thousands (appr. 15.000) of CSOs who participated in CSDF Hungary's programs over the past 15 years, it can be concluded that ideally a CSO should have income from at least 6 different sources, with a minimum of 10% from each.

CSDF Resource Map

Income Sources		Domestic			International		
		Restricted	Unrestricted	Total	Restricted	Unrestricted	Total
State Support	Central						
	(Regional)						
	Local						
Private Support	Institutionalized (charitable donors)						
	Corporate Donors						
	Individuals						
Earned income	Governmental Contracts						
	Municipal Contracts						
	Corporate Contracts						
	CSO Contracts						
	Incomes from financial transactions						
	Membership Fees						
	Other Earned Income						

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Each of the sources in the Table might be characterized by different parameters. One general distinction is whether the source is domestic or foreign. From the side of the CSOs this may mean a very different modus operandi and fundraising-communications strategy.

Foreign sources can include foreign governmental and private sources. These two are usually referred to together as “international donors”.²⁰ However, from the point of view of the CSO, raising funds from bilateral and multilateral funding agencies, i.e. government sources, requires a somewhat different approach than raising funds from foreign private donors (e.g., foreign foundations).

Private foreign donors tend to develop less but longer-term relationships. At the same time, accessing foreign governmental funds (such as EU funding) requires a high level of administrative capacities, project and financial management systems that are compatible with the donor requirements. The strategic approach usually is more important in this case than bureaucratic requirements. In case of such donors mostly the „elite” of CSO sector has access and capacities of accessing these funds.

In general, it is rather challenging in the case of foreign funding, for the CSO to comply with a dual legal and fiscal system, including a dual reporting scheme so as to be in line with the national regulations as well as with the donors’ home country regulations.

²⁰ In the case of re-granting programs like Pact, NDI, OSI etc., it can be debated whether they should be categorized as foreign or domestic. As long as decisions are made by local experts within the country, we consider them domestic sources.

Domestic funding is usually attractive for a broader spectrum of CSOs as there are no language barriers²¹, the conditions might be culturally easier to follow and the initial fundraising investment is usually shorter. However, the sources may be rather limited. In the following, we focus on domestic sources only.

In relation to the vertical scale of the chart, there are three major categories included: governmental sources, private sources and earned income. These three types of sources are quite different in terms of how they affect CSO sustainability and in how the CSO needs to behave in order to successfully raise the funds.

State support includes all forms of financing CSOs from public funds, whether at the central or local level. This includes grant support, contracts and third party payment schemes (see section II.4.). It could be argued that governmental contracts are in fact earned income for the CSO as they represent fees for services supplied by the CSO to or on behalf of the government. However, the practice of government funding in CEE has shown that a) there is no clear distinction between grants and contracts and so CSOs are often supported by contracts rather than grants when the function of support is in fact project or institutional funding; and b) even when there is a fee-for-service relationship behind the contract, in almost every case the CSO will need to comply with the terms set by the government, i.e. there is not much opportunity to set prices, deadlines or other contractual terms. In short, while technically government contracts (including municipal contracts) may be seen as earned income (fees for services), in practice, the CSO is not free to set the terms of its service and in fact needs to fundraise in similar ways to obtain a government contract as to obtain a government grant.

Private funding includes three main types of sources: institutional funding, i.e. private foundations; companies and individuals. We include the so-called percentage mechanism²² as a funding source under individual funding, even though it is actually public funds that are being transferred to CSOs. The reason is that this source “behaves” like private giving: it is the – individual or corporate - taxpayer who decides on whether and to whom to “give” his or her tax assignment. Therefore the CSO has to raise the tax percentage in a similar way as asking for a donation from the company or the person.

Regarding earned income, there are many forms of it but most of all they comprise of the fees for services and goods that the CSO charges to its customers. Furthermore, it can include e.g. rent for space leased, income from investments, income from license fees and many others. It is important to note that this type of income behaves in a slightly different way than the type where the CSO is asking an outside source (i.e., the government, the international donor, the company or a private individual) for support. Here the CSO has a tangible and immediate value to offer regardless of its mission – even when the service or good offered for sale is

²¹ EU and other foreign funds often accept English or French proposals only, the communication related to project is also expected to be in these languages. Most CSOs still lack staff and volunteers fluent in such languages.

²²The percentage mechanism enables an individual or corporate taxpayer to assign 1 or 2% of its taxes to a qualifying NGO. This mechanism has been introduced in Hungary, Slovakia, Poland, Lithuania and Romania.

directly related to the mission. Therefore the “behavior” of this type of source is much closer to the regular market mechanisms and it requires different management skills to make it profitable and sustainable.

Also in this category there is a special source, namely the membership fees, which could be questioned based on the logic above as membership fees are usually not associated with market based for-profit operations. However, from the point of view of managing and raising the income, membership fees are similar to other fees for services: they also reflect a *quid-pro-quo* situation in which the member pays in exchange for becoming part of an association that has something to offer. Of course, there are many problems in practice with membership fees, but that does not change the basic relationship between the CSO and its members.

From the point of view of CSO sustainability, all three main types of sources have their added value as well as their challenges. State support is often seen as a stable large scale source especially if the funding model is determined by law or decree. The tendency to bureaucracy is the highest here, as various sets of requirements are applied to ensure a transparency of the use of public funds. The largest difficulties traditionally appear when European funding is re-distributed by a national state or quasi-state distribution mechanism where double set of bureaucratic requirements are applied (those of the EU and national level ones). It typically finances mainstream operations rather than innovations and high risk pilots, as the expectations with public funding doesn't allow for such actions.

Private funding is usually more flexible. In emerging CSO markets this usually represents the source that might be used for fast response, tailored assistance and finance higher risk projects, e.g. less developed or start-up CSOs often have such donation first on their track record. On the other hand, raising funds especially from individuals is still difficult for most CSOs due in part to a lack of skills and in part to a lack of belief in the effectiveness of asking people for money. Yet, the experience from developed countries shows that the single most reliable source of funding for an NGO that can help ensure long term sustainability is the support of committed individuals: people who believe in the organization.

The question of earned incomes is trickier. Earned income can help a CSO finance its administrative or developmental needs and as such plays a very important role in CSO sustainability. In fact, in most countries earned income represents the major part of the income of the CSO sector. However, in countries where the state controlling mechanisms are not functioning well and/or there is a high degree of tax avoidance, the CSO enterprise form might be misused by some players for the tax exempt status as hidden businesses, which is a general fear from the side of the legislator. On the other hand, in most of the NMSs as well as OMSs relevant measures were introduced to eliminate the risks of such dealings. Other forms like membership fees, interest earned²³, etc. usually represent the most flexible funding source in the financial scheme of CSOs.

²³ In the Czech Republic there is a specific investment scheme to deal with CSO investments (Balancovany Fond Nadaci) – Pioneerinvestment

II.4. State Financing of CSOs²⁴

There are three main mechanisms used to finance CSOs by the state in European countries. This can happen through providing *direct budgetary support*, i.e. subsidies or grants; *contracting out* a service; or providing so-called *third party payments* (see Table I.). The purpose of each of these forms is somewhat different. Grants and subsidies are usually used to promote implementation of a government policy, and they often serve also to support the organizations receiving the funds. In the case of contracting, the government “orders” a specific service, ideally through a procurement or another competitive tendering mechanism. In the case of third party payments, the government essentially delegates the provision of the service to an outside provider based on set prices, quality and other criteria.

Direct budget support

The most widespread form of financing CSO activities is that of providing **direct budget support**. The two main forms of monetary support are subsidies and grants (there can also be in-kind support provided, e.g. premises to house the service).²⁵

Subsidies are dedicated for certain civil society organizations, often provided as institutional support. In the case of subsidies there is usually no competition and the recipient CSO is entitled to the support as defined in a law. In many countries of Europe and the CIS subsidies are given to different unions as representative organizations of social groups, e.g. Union of Blind People, Union of Deaf People and others, due to historical reasons. (It has to be noted that the subsidy model is less favored from the point of view of transparency and accountability of public funding, as it lacks open and fair competition as well as any performance measures accompanying the funding that would ensure “value for money”.)

Grants are a form of support to CSOs from the state or local budgets. In contrast to subsidies, grants usually imply competition for funding. CSOs are typically funded to carry out a specific project which has strictly listed activities, deadlines for execution and an itemized budget, i.e. reporting is based on whether money was spent in accordance with the proposed budget. In the case of grant-making, the state sets out a certain amount available for the CSO grant projects under certain conditions. The government states only the goals, not the means; in fact it invites the CSOs to come up with the best ideas on how to achieve the goals. Many CSOs can apply and several may win grants for their projects. CSOs will structure their costs according to the grant application form, usually differentiating between direct and indirect

²⁴This section is based on information from the European Center for Not-for-Profit Law (ECNL), including a draft study under publication “*Public Financing of Non-governmental Organizations in Europe*”. The information has been provided by Nilda Bullain and Katerina-Hadzi Miceva from ECNL. Quotes are taken with permission from the authors.

²⁵Read more: alternative state funding in Hungary

costs of the project. CSOs, grant-inners, are accountable to the government (like in the case of any other donor).

Contracting / service procurement

The other main form is procurement, or contracting a CSO. In this case, rather than a donor-donee relationship, there is a relationship between contracting parties. The purpose here is to provide a concrete government service with the help of the CSO. In this case, the government knows exactly what needs to be done, sometimes even to the detail of procedural specifications (e.g., minimum standards of the service), and is looking for someone who will deliver the service at the highest quality and for the lowest price, so CSOs have to compete with other providers. Therefore, while there is usually (and as a matter of good practice) a tender procedure, CSOs are supposed to provide bids (not applications) and there is only one winner. The cost structure of the bid is usually based on fees for some kind of unit (e.g., a fee is charged per beneficiary or per day) and the fee includes both direct and indirect costs.

Third party payments

Another way of transferring social services to non-state providers is the so-called **third party payments**.²⁶ In the third party payment scheme, the government is the “third party” who pays for the cost of the service provided by the CSO to the beneficiary – either directly to the CSO as in **per capita** payments, or through the beneficiary, as in voucher payments. These amounts are also paid for performing a government service; however, the terms of these contracts are very concretely specified in the law. In this case, the government determines a certain type of service (e.g., day care provision for the homeless), as well as the standards and costs of this service. Thus, the service fee is not a subject of negotiation or bidding but regulated in law. Thereafter, every provider who meets the conditions or criteria set in the law will receive a set amount of compensation after every client beneficiary they provide for. (When a CSO meets the conditions they may also receive a license to perform the service.) In this arrangement indirect costs are usually not included in the service fee and there is a general overhead percentage calculated which may be fully or partially paid to the organization.

The ***voucher mechanism*** is a method of third party payment as well. It focuses on the choice of the beneficiaries or clients. In this system potential beneficiaries receive vouchers that entitle them to use certain services free of charge. The beneficiaries are the ones who choose

²⁶There is some debate in the terminology relating to this concept as most CIS and CEE governments consider it a subsidy rather than a compensation (i.e. payment) for services provided. This determination stems from the Soviet times when government provided exclusively subsidy type support to both lower levels of government and non-governmental entities. In many countries legislation still refers to this type of payment as a subsidy support. In our view, however, the ‘third-party payment’ terminology needs to be promoted in order to help change the way government views non-state providers.

to which service provider they go to. There is usually a preliminary approval of all specialists who are licensed/approved to provide these services. Based on the vouchers collected by each provider, the state transfers a fixed fee for each client served.

Main forms of public financing of CSOs

	Grants and support	Procurement and contracting	Third party payments
<i>Aim</i>	Implementation of government policy	Providing services to the government	Providing a gov't service
<i>Terms of contract</i>	Set by the government	Set dominantly by government	Set by law
<i>Key selection principle</i>	Best ideas and project plans	Highest quality at the lowest price	Fulfillment of legal requirements
<i>NGOs funded</i>	Several applicants	One bidder	Several licensees
<i>Cost structure</i>	Project budget	Fee based budget	Budget according to regulations
<i>Indirect costs related to the activities</i>	Percentage of project budget	May be fully covered in fees	General overhead % set by law

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II.5. Private Funding of CSOs

The importance of private and (within that especially individual) funding is often underestimated by both governments and CSOs. The general directions countries in CEE have been taking was towards increasing the public funding of CSOs and improving a little the conditions for private funding, without much consideration to its potential impact.

One reason why the government should be concerned with the possibilities of CSOs to raise private funds is social innovation. From both government and CSO perspective there is a need for unrestricted or less restricted funding for social innovation. This is especially relevant in countries in transition, where the welfare system has to be transferred into a model that is more efficient, qualitative and also of a personalized character. Such social innovation has a high level of risk (in the early phases comparable to risk of venture investments) and is usually financed by private sources, where the possibility of failed attempts is more acceptable. In case the results are demonstrable, the model is easier to adopt by the state welfare system. This happens on many occasions and thus, the government benefits from the

fruits of private funding of CSOs. While in Ukraine currently it is foreign donors who undertake the risk and responsibility of funding social innovation, domestic potential needs to be built by the time they start leaving the country.

The other important aspect where private funding plays vital role is financing advocacy and expert groups that are monitoring and reflecting on policymaking and its impact. This is a vital function to any modern state (as these groups often substitute for missing or not well functioning systems within the state) and it can be partly financed from state sources²⁷. However, besides taxes collected and used to finance the functions of the state, private funding might should be considered as additional responsibility taken by individuals, companies and private donors that is materialized in additional volunteer contributions. This is important so that policy analysis remains independent.

When discussing private funding we have to make a clear distinction between corporate funding, charitable institutional funding and individual donations.

In terms of corporate funding the two main categories to analyze are **institutionalized** and **non-institutionalized** funding mechanisms; and there is also a principle difference between **ad-hoc** and **strategic** giving.

Charitable institutional funding might be of **domestic** or **foreign** origin as well as might be categorized as **re-granting**, **sinking funds** or **endowed funds**.

Individual giving may be categorized by frequency: **one time** or **regular/planned** giving as well as by the size of the donations like **small donations** and **large gifts**.

Corporate funding

In terms of corporate funding there are various motivations of companies to give. It is noteworthy that available reports do not consider financial motivations such as tax benefits as the primary factor in making the decision to give. Emphasizing responsibility towards society, personal motivations of the leaders/owners are more frequent answers. While the statements of reasons given in a survey might be largely influenced by the public perception on companies and general expectations towards them, there is an increasing volume and quality of such donations Europe-wise.

Institutionalized corporate grant making

Over certain volume of donations and in cases the company perceives grant making as a strategic intervention, corporate donors tend to institutionalize their grant making in forms of in house policies, tendering procedures, or setting up a separated grant making unit or an administrative body within the corporation.

These options are often steps of development taking place over years. There are a number of advantages of institutionalized grant making that companies come to realize over time: there

²⁷ Boris Strecansky, *Obcianskaadvokácia a mimovládneorganizácie*, 2006

is larger transparency of expectations of the donor; funding streams are more predictable; and in the end companies can better link such activities with their communications and branding.

Corporate foundations represent a special category within the framework of institutionalized corporate grant making. On the one hand there is an accusation that these foundations are to pursue the interest of the company and to serve the benefits e.g. of employees; on the other hand there is a much more typical pattern, when actually the company can support cases that are not fully or at all in line with their business interest. In the second case the company is acting as a socially responsible player but also not harming its own business interest (e.g. support of the Roma issues is not necessary helping the company's market interest within the public at large in CEE, still the company can deal with racism by distancing the support through a corporate foundation). Such Foundations often utilize CSO experience, by subcontracting preparation of the decision making to CSOs, or involving them as expert board members, that results in smart "know-how import".

Non institutionalized forms of grant making

The non-institutionalized form is more typical in case of corporate players, which either don't have large volumes of funding or don't consider it as a strategic intervention in case of their markets. The main motivation in such cases to donate is some level of connection with the case. Such non-formalized grant-making may also long be term (e.g. local shop owners supporting local schools, cultural events repeatedly for years) and often there is a high level of accountability – especially at the local level – , as the donation is given based on previous experience. In case there is no such prior connection, then emotional aspects, psychological factors, good timing, etc. determines whether the donation is agreed.²⁸ Therefore, when SMEs suffer financially, like during a crisis period, that makes a significant impact on the performance of local CSOs incomes as well.

As in most countries the procedures of claiming tax credits is rather simple²⁹ usually there is no separate incentives or administration systems for institutionalized or non-institutionalized funding. From the CSO perspective it seems to give more guarantees if the funding is done through an institutionalized channel, since it helps defining goals in a better way, and to think strategically – counting on the company's long term support.

There is another big difference between understanding the ways and importance of grant making between western and local organizations, especially in the early stages of market economy development. Based on experiences from CEE local companies learned in a couple of years how to incorporate such activities into their business, while western donors practically entered the market with models in which charitable giving was part of their business model.

Charitable institutionalized funding

²⁸Kuti, Eva ed. *Vállalati adományozás Magyarországon Tanulmányok 2005* (Corporate giving in Hungary)

²⁹ In case of Hungary the CSO has a right to issue a statement, how much was donated by which company, the company can use this simple statement to submit to the tax office

Re-granting

In most European countries the model of re-granting to CSOs exists but in CEE it had a vital role in the development of civil society. In old member states re-granting is usually related to government funding and is used as an attempt to make state funding more independent from the state (such organizations are often semi-independent so –called “arms length” agencies). In Eastern Europe they were created and funded mostly to have relevant distribution mechanisms in channeling foreign funding to recipient countries for projects of national and local interest. A new “class” of so-called intermediary organizations were created, which are seeking grants to pursue their strategies in the form of giving sub grants. They don’t usually have endowments; in business terms they provide services to larger international donors by identifying the need and distributing grants to address them.

After the decline of funding available from the western charitable donors most of these organizations struggle to stay alive and some have closed – even though the needs continue to exist. There was a network of re-granting foundations set up to distribute funds before the EU accession in the new EU member states – after the accession, some of these organizations became redistributors for EU funding at the national level (Structural Funds, Norwegian and Swiss funding mechanisms)³⁰. In countries like Hungary a local network of resource centers was created with the same intention, but it was difficult to justify the cost of another interim player towards the foreign donors (since there were not enough funds to redistribute locally, the size of the country does not require such de-centralization, and their know-how advantage was not significant compared to central, national systems).

Another, hopefully more sustainable such example is the network of community foundations where the funds are sought for both internationally, nationally and locally, strongly involving local businesses, municipalities, CSOs and citizens. Unlike most re-granting organizations, some of these foundations have built an endowment, which serve the long-term local needs.

Endowments

Classical charitable grant making with endowments has an advantage compared to other types of funding, as the funds distributed are secured long term. Examples from both “old” Europe and “new” Europe show, that such funding significantly contributes to the sustainability of the sub-sector they are supporting as the reliability of the strategies of these funds as well as well as ongoing availability of sources makes the CSOs become more long term and impact oriented. Both German and the Czech model analyzed below are interesting examples from two totally different cultures.

Sinking funds

Sinking funds represent an interesting model of charitable giving. Sinking funds mean that the donor, or donors, establish a fund to be spent down (distributed in grants) over a longer period

³⁰Forexample, inRomania, the Civil Society DevelopmentFoundation (FDSC) manages part of theSocialFund, whileintheCzechRepublicthesamefoundation (NROS) became thenationalcontracting partner for civil societydevelopmentrelatedfunds.

of time, typically 10 years. The funds are calculated to be enough to finance the program over the given period of time. In case there is a significant but – seemingly - resolvable societal problem, by determining the amount needed to deal with the challenges as well as determining a realistic time frame needed to achieve results, it is possible to calculate the volume of funding needed.

Examples from around the region include the Trust for Civil Society in Central and Eastern Europe (CEE Trust); the Baltic-American Partnership Fund, the Balkan Trust, the Black Sea Trust. These Trust Funds have been established with pooled funds of several western charitable donors, sometimes including also bilateral ones (USAID). As can be seen, these are mostly regional constructs, and have been part of the “exit strategy” of donors: after they discontinued their own program, they could still contribute to the support of their former grantees and to the achievement of results in the areas funded. (The idea was created in response to the claim from NGOs that there is “unfinished business” in building democratic societies in the region when the donors were already planning to leave.)

Sinking funds are interesting from CSO point of view as the impact required is usually clearly defined, the funds are available for a relatively longer term, still, it motivates and pushes all players to achieve results in the available period of time. Although the current examples are regional, this idea can well be adapted to a national level as well.

II. 6. Individual funding

Fundraising needs investment

In order to understand the nature of individual giving from a regulator’s point of view we would like to introduce the so called “Donor Pyramid”. This pyramid of individual donors shows how CSOs can think about and handle their individual donors. It has five levels:

1. At the bottom are the people who have not yet given to the CSO but are potential givers, e.g. due to their place of living, age, gender, area of interest etc.
2. On the second level are people who already gave once or twice occasionally.
3. On the third level are people who became regular givers, i.e. they are making a donations almost “automatically” in regular time periods. In the West this is mostly done through direct debits from the individuals’ bank accounts, but in Eastern Europe regular giving is more often done through postal payments. In any case, we are here talking about people who respond positively to the fundraising calls of the CSO and keep the CSO in their mind every time they give.
4. A fourth level is that of major gifts, i.e. donors who are very committed to and deeply trust the organization, and who contribute with a significant amount of money.
5. Finally, there are people who leave their legacy to the CSO (bequests).

The general idea is to start from the bottom and through various forms of communication make individuals become more and more committed and more reliable in terms of financial commitments. It is important to understand that only regular givers will ensure real sustainability to CSOs. However, nobody becomes a regular giver without first being asked and having given once. Therefore, the CSO has to invest in the first two levels and then also in maintaining communication with the top three levels. Without doubt, this costs money even if it is done at a very basic level. As a donor is moving up on the chart the Return on Investment (ROI) is increasing more and more.

Pyramid of individual donors



From the regulators point of view it is important to understand that such donor cultivation equals to the customers relationship building in the corporate sector. The investment is really high and predictability of its return is crucial. While in the business world such costs are easily justifiable, the general expectation towards CSOs is that they don't spend "too much" money on their communications and fundraising. However, given that a very low percentage of the expenses is often seen as "too much", this is not a realistic expectation for a sustainable CSO.

Understanding the fact that individual fundraising is a short term high cost - long term high return investment, may help creating a legal and fiscal framework that promotes such giving.

In countries with a higher level of individual giving the quality of CSO provided services is higher, as the funds donated by individuals well complement public funding, giving the flexibility to the service providing CSO to invest in higher standards; raise matching funds; and compensate for potential losses (such loss can be, e.g. if the government contract does not cover all the overhead costs of the NGO, which is quite typical case).

There is also a significant difference in observing the level of accountability and transparency between countries with higher level of individual giving and with those with the lower one. In

case a CSO has to communicate and maintain relations with a higher number of constituents, they are more motivated to remain transparent and accountable even if the level of expertise of an individual donor on the cause is often lower than the same expertise with the governmental specialized donor. This is because through the individual donors there is a better level of constant monitoring and expectations for improving performance of the CSO.

In short, broad individual support of CSOs may result in a higher level of accountability, transparency and service quality than rigorous government regulation.

In order to enable CSOs to invest in fundraising, **government should not impose any specific percentage of administrative costs**, neither by law, nor by defining a ceiling in its grants and contracts. Administrative costs are different for every CSO and there is essentially no “industry standard” about them even in Western Europe or the US. In fact, there has been research that showed that lowering administrative costs due to donor pressure led to weaker performance. The best policy in relation to administrative costs is to ask CSOs to make public both the rate (percentage) and the method of calculating it.

From no-giving to regular giving

In CEE countries, the philanthropic culture is still in the making and the biggest question is how to develop it to a level where it can sustain a strong CSO sector.

The highest cost related to professional fundraising from individuals appears when the CSO is trying to segment and target potential donors (those who are as yet non-givers). Any technique and method applied here (like direct marketing campaigns, advertisements, street collections, etc.) have to target larger audiences to achieve some results as (1) only a portion of people will find the specific cause appealing (some prefer to give to children, some to animals etc.); and (2) even if people can associate themselves with the cause, there may be technical barriers to getting engaged (such as difficulties with the payment or action in the moment they receive the message, etc.).

In case there is a successful fundraising act, there is already a high probability that the donor has affection towards the cause. By sophisticated communication strategies, such donors are then targeted to become regular givers, to agree to a planned regular donation.

Once achieving the level of the planned regular giving, such funds become easy to calculate and income more predictable compared to e.g. the results of a governmental call for applications. The individual sums are obviously significantly lower and for this reason a high number of small donors is needed, but the so called “donor lifecycle” is calculated in years³¹, as opposed to the usually one year “lifecycle” of governmental grants.

The government can encourage this process with the individual CSOs in two main ways:

³¹ The donor lifecycle is the length of time during which one donor keeps supporting the same organization. In case of Hungary the time a donor involved in a planned giving scheme spends supporting the organization is on average 6-7 years and increasing.

- **Tax policy**, e.g., providing a higher level of benefit to donators who give regularly; and
- **Capacity building**, i.e. support through grant programs the spreading of professional fundraising (importantly, such program has to enable the import and adaptation of foreign experience: Western experience to get acquainted with the most up-to-date techniques and CEE experience to understand the adaptation processes).

Major gifts and Bequests

In case of major gifts donors usually there is a long term donation history and therefore a well built relationship between the donor and the organization, before a commitment to a larger, usually specifically focused major gift donation is made.

Bequest or legacy is a special category. While in western countries, especially in North America such donation from average individuals represents an income source multiplying every year, in CEE countries usually such donations are accidental - but not rare. In the West, CSOs sensitively but consciously communicate to their donors about such opportunity; while in CEE CSOs are usually shy and feel inappropriate to ask for a major gift or a legacy. Regardless, people do give, which signals that there is willingness among the population to express their commitment to the cause and to the organization through a serious financial pledge. The German case below describes a European model that includes elements of dealing with legacies in a sensitive but socially beneficial way.

Needless to say, a major gift or a bequest greatly enhances CSO sustainability. It enables the CSO to make longer term plans, invest in infrastructural development, create a reserve fund, or scale up its services and reach more beneficiaries.

Government can endorse the idea of making major gifts and bequests through tax policy:

- by exempting such donations from gifts and inheritance taxes; and
- by allowing a special tax benefit above a certain value of the donation.

II.7. Earned Income of CSOs

Earned income refers to types of income which derive from an “economic activity” of the CSO (also called entrepreneurial, business or trade activities). Essentially it means sale of goods and services that are conducted with regular frequency or continuity. In the section below we will not explore all the possible ways of generating earned income by CSOs, we will rather elaborate on the ones that to our best knowledge already exist in Ukraine.

Membership fees

In an optimal case membership fees are a relevant tool to assess membership cultivation of the given organization. Obviously members of a business association can allow themselves to

charge higher membership fees than an association of parents with children with disabilities who have to fight for equal opportunities.

There are significant differences between certain groups of CSOs with membership in terms of their approach to the membership fees. While highly specialized and focused organizations for representing certain interest groups as well as most of the trade unions treat membership fees as their members' strategic investment and commitment to the cause, for various reasons (especially in CEE countries) other significant groups of membership organizations don't consider it as an important income source. On the one hand they consider that "people don't have the money to pay the membership fee". (This is actually only true in very limited cases when members come from the most marginalized populations.) On the other hand, there is also a governmental behavior in background to this attitude, as governments and municipalities often prefer to talk to bodies with the largest member support. Therefore CSOs are interested to claim the biggest membership possible in an effort to show legitimacy. That's why CSOs often fail to collect membership fees or set it at a nominal level, not at one that represents a significant part of their budgets. Paradoxically though, if membership fees are not a significant source of income for the association, its leadership will have less motivation to be accountable towards the members (and more towards external donors and the government).

By insisting on "representation" as the main criteria to allow CSO participation in decision-making, government incentivizes less democratic and less sustainable practices in membership building in CSOs.

Service fees

CSOs often offer their experiences or expertise to their peers. Project planning, proposal writing advices or any direct business services are typical in such category. This opportunity is open to a large number of CSOs because the simplest know-how to "sell" is the experience. Although there is a general expectation that such experiences are shared for free, in case the CSO is able to develop its know-how further, it will often find its own market.

Professionally developed know-how in any field represents a bigger and bigger value as many donors invest into the development of the organization and its programs over the years. When such know-how becomes relevant for policymakers, new markets are opening up with corporate clients as well as the public sector.

Goods sold

Charitable production and sales of goods seem an attractive opportunity for many CSOs. T-shirts, branded and creative mugs, etc. are the most often promoted income generation ideas. The fact is –at least based on CEE experience, that production and sales of such goods rarely contributes significantly to the incomes of the organization. In the end it is a highly competitive market and even the "passion brand" segment³² of it (most CSOs operate with

³²A passion brand is a brand that people identify with and it creates not only a positive impression but also ownership and loyalty in customers. In case of passion brands, people not only buy the product because it is good quality or reliable but because they express their belonging and identification with the values that the

such ambitions) is penetrated. To be successful requires special marketing skills and often investment; usually there are only a handful of CSOs that can achieve that in a national market.

Another typical area of goods production is supported employment where there is a subsidy from a donor to produce the goods (for example setting up a workshop for people with learning difficulties). While this type of income can represent a bigger share in the CSO's budget, it is important to acknowledge that it is subsidized, i.e. the risk is shared by a donor. Such production is usually much more beneficial in PR terms – but it will only help the sustainability of the CSO if it is developed to be viable in the market without the subsidy.

When supporting production of charitable goods, e.g. through supported employment, government and donors need to make sure that there is a mid-to-long term business plan that will enable the CSO to maintain the production with a decreasing level of subsidies.

Renting of premises

One of the assets CSOs are increasingly taking advantage of is the offices or premises where they operate. As a typical example, those who offer capacity building services also offer space and equipment for rent. As internally it might be relatively easy to reschedule work (e.g. setting days for working from home) and free up space for trainings and workshops, more and more CSOs use this opportunity.

License fees

Some organizations with a well recognized brand may “sell” their name and logo for corporate use. Companies that want to get associated with good causes and can utilize the market benefits of licensing often pay high amounts to get permission from CSO brands. This type of income is unrestricted, and it is also recognition of the achievements of the organization, as the main reason the company is choosing such partners is the fact that significant part of the population is of high opinion of the given CSO.

Taxation of earned income

The most important issue when talking about tax policies regarding earned income is the **definition of “economic activities”**. Every country defines this term in its own way, reflecting the national circumstances. While there are some typical common elements, e.g. that the activity is conducted in exchange for payment or that it is conducted regularly; there are also many “gray areas” that leave room for national interpretations.

For example so-called thrift-shops or charity shops, which sell only donated materials, and outlets that operate on volunteer labor will in some jurisdictions be considered an economic activity, while not in others. Similarly, some forms of fundraising, e.g. selling branded T-shirts or charity postcards can be considered economic activity in one country but not in an-

brand represents. Due to the possibility of identifying with their cause nonprofits are ideal candidates for passion brands.

other one. Another ambiguous example is the charging of fees for services that are “intrinsically connected”³³ to the public benefit purposes of certain CSOs, such as tuition fee in a school or admission fee in a museum. Revenues from passive investments (e.g. bank interest) are also a questionable item. There is no blueprint in terms of deciding which of these activities should be considered as economic and therefore potentially subject to tax, but it is important to address them for legal clarity.

Once the definition is made, the question of what tax policy to apply comes into play. European countries take five main approaches:³⁴

- Generally taxing all profits
- Not taxing any income from economic activities
- Taxing according to the destination of the income
- Taxing based on whether the activity is related to the mission of the organization
- Taxing above a certain threshold

Tax all profits: the main argument for full taxation of NPO economic activities is that if they are not taxed they may gain an unfair competitive advantage over for-profit organizations. (E.g. tax-free profits may also enable NPOs to maintain lower profit margins on their economic activities, which could even be used to reduce prices on goods and services below levels which are competitive, or even sustainable, on the part of for-profit organizations.) Full taxation is easy to administer and it minimizes the potential for abuse by organizations attempting to take advantage of NPO tax preferences. For this reasons, this approach is mainly used in countries where there is still a high level of corruption, i.e. Albania, Bosnia (Republika Srpska), Bulgaria. However, in most European countries there is some level of tax exemption ensured for CSO economic activities, and potential abuse is dealt with through other legal means.

Full exemption(no taxation): this approach is again only used in a few jurisdictions, e.g. Cyprus, Bosnia (Federation) or Croatia where CSOs as legal entities are not subject to income tax at all, and therefore also not subject to tax on their profit income. It has to be said that this approach leaves ample room for abuse.

Most countries apply some “intermediary” solution. This means that they recognize the importance of providing tax benefits for economic activities of CSOs. Such recognition has several reasons, including:

- CSOs often lessen the government’s burden to provide similar services. The government is compensated for the loss of tax revenue by its relief from this financial burden, and by the benefits resulting from the promotion of the general welfare.

³³ICNL/ECNL/MCIC paper reference

³⁴Id

- CSOs are often able to provide needed services at a lower cost and higher quality than for-profit organizations, which are bottom-line driven.
- Taxing NPOs depresses the development of the NPO sector. “This is a particularly apt argument under a tax regime which requires NPOs to pay tax on economic activities even when they are related to their public benefit purposes. In the latter case NPOs are limited in their ability to financially sustain their operations. Such an approach also fails to provide incentives for NPOs to engage in public benefit activities involving an economic component (e.g., an association for the blind selling walking canes) since these activities would be subject to full taxation.”³⁵

As to argument that giving CSOs preferential tax treatment results in unfair competition with the for-profit sector, it has been argued that empirically such concerns are largely unfounded and the negative impact on the for-profit sector overestimated.³⁶

Destination of income approach: in this legislation, any income used for statutory or public benefit purposes is tax exempt; all other income is taxed. This is the case in Poland. It is based on the premise that tax exemptions should only subsidize activities which benefit the public, so only income actually spent in furthering statutory or public benefit purposes should be tax exempt. The main criticism of this approach is that it allows and even encourages NPOs to engage in income generating activities completely unrelated to their goals, and as such it creates unfair competition. While the US abandoned the destination of income approach due these problems, this seems not the case in Poland where the CSO sector is still weak and is in need of unrestricted resources.

Relatedness approach: This approach looks to the *source* of the income. Under this approach, NPO income is tax exempt if it derives from economic activities sufficiently related to the statutory or public benefit purposes of the organization. Generally the activities that are considered as unrelated to the statutory goals will be taxed same as other entities. This is the approach used in the US, and in CEE by Latvia. This is certainly the most “fair” method of determining when tax exemption is justified. However, it is also the most difficult to implement because the tax authority has to make a decision as to which activities are related or not to the mission or a public benefit purpose. For example, in case of an environmental CSO, selling awareness raising books on the protection of nature at various related events can be considered as related to its mission, but what if the CSO publishes attractive albums and sells them through commercial bookstores?

³⁵ ICNL-ECNL-MCIC

³⁶ „First, small businesses are often able to avoid profit taxes by means unavailable to NPOs. Large salaries and expensive offices may allow small businesses to substantially reduce paying income tax. Indeed, several countries have abolished small business profits tax due to their failure to collect. Second, small businesses are eligible to receive loans from lending institutions, whereas NPOs are generally ineligible for loans. Third, economic activities in which NPOs take part generally fall in the province and jurisdiction of the not-for-profit sector and therefore do not compete with for-profit entities. This is especially true when a country uses the “relatedness” approach to NPO tax exemption.” ICNL-ECNL-MCIC paper

“It is difficult to draft laws or regulations which adequately codify the concept of “relatedness” and guiding principles must often be established on a case-by-case basis. After a body of decisions or norms concerning application of the rule exists, this is likely to be a less serious problem. But for countries in a state of transition, where guidelines for the not-for-profit sector are still being established, the concept of “relatedness” creates a degree of uncertainty concerning the tax treatment of income.”

Threshold approach: this approach places a ceiling on NPO tax exemptions in monetary terms, percentage terms, or both. Usually this approach is combined with another approach (and is also called a hybrid approach). For example, the Czech Republic, Serbia, and Montenegro combine this approach with the destination of income approach, while Hungary and Slovakia combine this with the relatedness approach. This is also a fair approach as it restricts the amount of tax free profits an NPO may generate and thus, alleviate fears of unfair competition or incentives for for-profit organizations to use the CSO form as a cover. For the government it is also advantageous as it can use it to limit the losses of tax revenue; and it is usually relatively easy to administer (although, as this approach is usually combined with another approach, administrative difficulties may remain). At the same time, this approach acknowledges the importance of earned income and provides justified tax benefits to CSOs.

Some examples (from 2007)

- For example *Hungary* combines the relatedness test with the threshold method by introducing a certain limit of exemption for income from unrelated commercial activities. As mentioned above, all economic activities that are included in the statute of the organization as supporting the mission are not subject to taxation. Income from commercial/entrepreneurial activities (those that are unrelated to the mission) is taxed only if such income exceeds the envisioned threshold. For example, all NPOs, regardless of whether they acquired public benefit status or not, may benefit from tax exemption on the income from commercial activities which does not exceed 10% of total income or 10 million HUF (€38,892). Further, the Hungarian law also creates two categories of public benefit organizations, which are entitled to higher percentage of the exemption. Thus, organizations that have acquired public benefit status are exempt for commercial income that does not exceed 10% of total income or 20 million HUF (€77,785), and those who have obtained status of prominent public benefit organizations are exempt up to 15% of total income.
- In *Czech Republic*, income from economic activities related to the statutory purposes of an NPO is subject to a reduced tax. All related income is exempt from income tax up to CZK 300,000 (€11,203). In addition, revenues (i.e., incomes minus related expenditures) at the end of fiscal year over this amount are reduced before taxation by 30% or CZK1 million (whichever is less) if the proceeds are used for public benefit purposes.

- In *France*, earnings from economic activities are exempt from tax, provided that they are not distributed and that other features are present to distinguish the organization from a commercial entity. Specifically, NPOs with annual revenue exceeding € 60,000 are eligible for tax-exempt status if: (1) management does not have a financial interest in the NPO; and (2) the NPOs do not compete with the commercial sector.²⁰ NPOs with annual revenue below € 60,000 can receive tax-exempt status only if (1) not-for-profit activities are their predominant activities and (2) they do not distribute any income or assets to any private interests.

- In *Germany*, public benefit organizations (PBO) may carry out business activities. Profits are free from corporate and commercial tax, as long as the business activities are necessary to pursue the PBO's statutory public benefit purposes (education, health care etc.). The same is true for charitable and church related purposes. Tax privileged purposes are listed in the law. In order to benefit from tax privileges, PBOs have to pursue these purposes and have to follow the principle of disinterestedness as defined in the law: they may not have as a prime aim the acquisition of income, they may use their resources only for statutory objectives, they may not distribute profits and may not pay disproportionately high salaries. They must use their resources within the year following the acquisition of the resources, but may build reserves within the margins mentioned in the law. Additionally, the organization must be set up exclusively for purposes that will make it eligible for tax exempted status and may compete with for-profit organizations

- In *Slovakia*, NPOs are generally exempt from taxation on income from statutory activities. The non-statutory economic activities of NPOs are taxed at the general income tax rate, except that income from selling NPO property is tax exempt below SKK 300,000 (€ 8,935).

III. General Findings

Importance of a strategic approach

Many European countries analyzed have developed some kind of long term action plan to reflect on the relationship of the CSO sector with the state and other societal players. In some cases it was done in a form of a strategy (Hungary, Croatia), in other cases in a form of a “compact” between the government and CSOs (UK) or the Parliament and CSOs (Estonia).³⁷ However, preparing the strategy itself means little in terms of the impact of governmental measures. Equally (if not more) **important is the relevance of the strategy to the desired impacts; and the relevance of funding policies to the strategy.**

The case of Hungary offers relevant learning. While the country’s legislators created pieces of modern supportive legislations, in some cases really unique ones, the strategy was created many years later (1998 and 2003 respectively), and focused largely on developing a centralized structure of government support for CSOs, without considering the broader vision of their role in society and the local communities. Although Hungarian public sector support to CSOs was historically one of the highest in Eastern Europe, the estimated impact has been relatively much smaller than that in less financed CSO sectors. (See country report on Hungary.) As there has been essentially no assessment of the impact, it is hard to find objective and clearly identifiable evidence as to the reasons. However, it is likely that the decline of the once inspiring Hungarian model is strongly related to the lack of a single overarching long-term concept on the role of CSOs in the development of the country.

In contrast, in the UK there has been both a compelling vision on the role of the voluntary (CSO) sector vis-à-vis the government, and an ongoing and systematic effort to trace the practice and impact of the implementation of the Compact.³⁸ The latter resulted in new policies and practices strengthening the implementation of the strategy that proved effective for both the government and CSOs.

One example is the efficiency of funding voluntary organizations (CSOs). The Compact encouraged local governments to increasingly contract with voluntary organizations in the delivery of public services. A study has been conducted to assess the extent and impact of this

³⁷ Bullain, N. And Toftisova, R.: *A Comparative Analysis of European Policies and Practices of NGO-Government Cooperation*. In: *The International Journal of Not-for-Profit Law (IJNL)*, Volume 7, Issue 4, September 2005

³⁸ See for example: *Hearts and minds: Commissioning from the voluntary sector*, National Audit Commission, July 2007 (available at <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/heartsandminds.aspx>); *Research Study into the Compact and Independence*, Commission for the Compact, September 2008; *They are Champions: The role and impact of Local Compact Champions*, Commission for the Compact, July 2009; *Compact Baseline Survey 2009/10 - A study of the levels of awareness, knowledge, understanding and use of the Compact among Government and Non Departmental Public Bodies*, Commission for the Compact, July 2010 (all available at <http://www.thecompact.org.uk/information/100023/140293/research/>).

practice.³⁹ It recommended that Treasury publish guidance to the government funders, to clarify what is and is not permitted under Government Accounting as it applies to the voluntary and community sector. The cross cutting review found that often there is a lack of consistency in the interpretation of Government Accounting Rules, and a widespread perception that so-called “Treasury rules” are inflexible.

The Government realized that getting the funding relationship right is increasingly important if the financial stability of service delivery organizations is to be assured, and so that government can look confidently to the voluntary and community sector to deliver services.⁴⁰ It therefore published the guide: *Improving Financial Relationships with the Third Sector: Guidance to Funders and Purchasers (2005)*. This set out four key points, messages:

- Stability in the funding relationship: moving from one year funding to longer-term funding arrangements where appropriate.
- Timing of payments and the balance of risk: recognizing that payment in arrears often results in the third sector bearing the upfront costs of borrowing and the risks that this entails;
- Full cost recovery: ensuring that funding bodies recognize that it is legitimate for third sector organizations to recover the appropriate level of overhead costs associated with the provision of a particular service; and
- Reducing the burden of bureaucracy: streamlining access and performance management requirements for multiple, and often very small, funding streams.⁴¹

The performance of public funders in implementing these and other recommendations was subsequently tracked in a number of studies. In the most recent Compact Baseline Survey Report (2010), the funding practices of governmental funders were also analysed. An example of success is the issue of full cost recovery, which has long been championed by the voluntary sector in the UK and was supported by a wide range of awareness raising and capacity building programs. As a result, in the 2010 report 58% of governmental bodies and non-departmental public bodies (both significant actors in contracting CSOs) reported that they “sometimes” (23%) or “always” (35%) apply the principle of full cost recovery in their funding programs; placing it among the most widely implemented funding principles in the Compact.

Less is more?

³⁹*The cross cutting review of the Role of the Voluntary and Community Sector in Service Delivery*, HM Treasury, 2002

⁴⁰http://webarchive.nationalarchives.gov.uk/http://www.hm-treasury.gov.uk/spending_review/spend_ccr/spend_ccr_guidance.cfm

⁴¹*Improving Financial Relationships with the Third Sector: Guidance to Funders and Purchasers*, HM Treasury, May 2006, pp 5-6

Related to the importance of a strategic approach is the principle of “less is more”. **While certain income sources are less significant in terms of the total revenues of the sectors, their absence or presence can dramatically change** the conditions for the general sustainability of the CSO sector.

The targeted approach both in case of the Croatian and Estonian state fund to assist development of the CSOs clearly shows that a strategic approach makes even a smaller investment beneficial. This doesn't mean that the types, quality or quantity of sources would be necessarily satisfactory; it merely speaks to the importance of a strategic choice.

Private individual giving is a less developed source in CEE countries. Yet it is evident how much more professional are those CSOs that have larger individual donor bases in their communications, know-how development or advocacy work. These organizations learn the concepts of stakeholder and results focus through the development of private fundraising. Even though the income from individual giving is much smaller than that from other sources, the image of CSOs (“CSO brands”) and their professional capacity is influenced largely by these funds.

The 1% mechanism has a similar effect, although maybe not always the effect that was planned: in Hungary, while the income from the 1% designations represents only 2-3% in the total income of CSOs, it has played an unparalleled role in raising awareness about the existence and work of CSOs among the general public. (At the same time it was planned that it would significantly increase the role of private donations, which it did not seem to achieve.) (See Hungary country report.)

The Hungarian example may be educational in terms of setting priorities as well. While the Hungarian financing model is very diverse and takes into consideration many aspects of societal life, the fragmentedness of goals and strategies makes the complex and in details well thought through system less functional.

A sustainable origin of funding

An important part of a successful approach to support civil society is to ensure sustainable sources of funding for the sectors. In the times when budget cuts are necessary due to economic reasons it is especially hard to relinquish funding for CSO support. Experience shows that with some creativity it is possible to identify funding sources that do not burden the annual budgets through direct spending but rather mobilize additional resources – whether from the governmental or private sector.

There are two important aspects of “sustainability” of an income source:

- Its guaranteed availability over the long-term, and
- Its ability to make grant decisions independently - based on needs of the CSOs and their beneficiaries (rather than based on governmental priorities).

Fundraising experts agree that the most sustainable source of income for CSOs is that raised from individual donors. Their commitment is to the organization, it is reliable and will last for

long years. Private grant-giving foundations are another long-term and reliable source of income responsive to the needs of CSOs. Such community funding and charitable giving by individuals and corporations was most typical in the US and other Anglo-Saxon /liberal model countries till the end of the 20th century, but in the past two-three decades continental European practices started to follow this pattern as well (obviously to a different level in OMSs and NMSs).

Governments try to increase and motivate private philanthropy through different methods. Two of the examined countries offer interesting models to ensure that independent private grant giving foundations put their capital to work towards the long-term development of society.

- In Germany significant tax credits were offered to private individuals to contribute to the endowments of existing or new foundations. This is rather similar to the pattern of the US family foundations tradition, with the difference that in case of Germany this scheme was motivating not only for the traditionally wealthy but for the new generation of the upper middle class as well.
- In the Czech Republic the use of 1% of the privatization income to endow hundreds of CSOs across the country represented a creative approach and a great use of the opportunity raised by the transition from a state owned economy into the private economy. These funds still work in the interest of the country and from the CSO and citizens perspective became independent funding as the state doesn't have the right to determine for what and how the funds are being used, except maintaining and monitoring measures of responsible investing.

In two other countries, namely England and Croatia lotteries offer long-term support for CSOs. While there are many controversial issues involved in lottery funding – from moral considerations to questions of efficiency – it is undoubtedly a widespread form of government support to CSOs.⁴² It is easier to devote some part of the usually highly profitable lottery income to support CSOs than to designate annual budget funds for this purpose; and at the same time, it will be a sustainable source that can be managed independently.

Whether through private or governmental schemes, it is important to ensure that there is long-term independent funding available for CSOs. This type of funding is the one that remains flexible and responsive to community needs; and importantly, it finances social innovation and financially risky social investments. Government funding is risk-averse; in lack of a reliable, flexible and long-term income source, the key added value of the CSO sector: its

⁴²Other countries using lottery schemes to support and promote CSOs include Finland, Ireland, the Czech Republic, Macedonia, the Netherlands and others. For more see Katerina Hadzi-Miceva-Evans: *Lottery Proceeds as a Tool for Support of Good Causes and Civil Society Organizations: A Fate or a Planned Concept?* In: IJNL Volume 12, issue 4, November 2010. http://www.icnl.org/knowledge/ijnl/vol12iss4/art_5.htm

ability to develop innovative solutions to complex social problems and its ability to cater for the needs of the most marginalized, will quickly disappear.

Balancing the outreach of support

A typical dilemma in government funding for CSOs is the breadth of the outreach: should government support encompass the widest possible range of CSOs, or should it focus on just a smaller segment that is considered important to the government? The reason to reach out broadly is usually to support CSO sector development as such (in order to enhance democratic development or increase CSO capacity to assist in resolving social problems). The reason to concentrate the outreach is to make more effective use of the limited resources that are available.

Practice shows that there is no solution that meets the interest of every CSO - the Hungarian NCF is a case in point. It has tried to build “consensus” among too many CSO stakeholders, to the effect of leaving just a little to everyone. Spreading the support widely will inevitably result in smaller amounts of assistance for each CSO, which at one point is likely to lose its relevance.

The challenge in the Croatian model, which tends to focus on the more established CSOs, is that it may make the CSOs feel “too comfortable” and loyal to their main funding source, without the need to look for community and individual support. This is particularly a problem in CEE where such sources are underdeveloped and where CSO development would benefit greatly from the potential of private giving.

While there is no blueprint to this dilemma, the following can be recommended:

- It is wise to invest in the direct funding and capacity building of CSOs that are of “strategic” importance to the state and to CSO development (e.g. state service providers, CSO support centers, CSOs with special expertise etc.);
- At the same time, the government can multiply the outreach of its support through indirect incentives such as tax benefited donations, tax incentives for economic activities, supporting the creation of independent grant-giving entities etc.

IV. Country Specific Findings

IV.1. Hungary

		Legal/Fiscal Framework	Historic/ cultural conditions	Country specific elements	Role of CSOs	Examples/Best Practices	Observations
Interaction with the state	Funding mechanisms	Supportive –neutral	Strong state orientation; issues in transparency of funding. Relative acceptance of CSOs by the public.	Widest range of public financing forms in NMS. National Civil Fund and other state funds supporting CSOs.	Recipients; sometimes (NCF) decision-makers.	Volume and variety of forms in state funding. Funds' policy to lower expectations if lower budget approved. Public benefit status as transparency requirement.	Lack of strategic approach; high concentration of government funding with quangos. PBO status lacks implementation. Bureaucratic burdens and technical conditions undermine best value principle.
	Social contracting	Supportive	Innovative approaches, especially related to employment. CSOs increasing role in services provision until recently. Church providers privileged.	Normative support for service providing CSOs and church providers according to volume of services. Various effective other models on municipal level.	In principle, service provider and contracting partner – in practice still recipient.	Normative support based on clear legal mechanism. Measuring Social Return on Investment (SROI) can show the value created by CSOs.	Increasing quality expectations not matched with adequate level of funding. Discrimination of CSOs vis-à-vis churches.
	Alternative financing	Neutral	Post-socialist unutilized buildings transferred to CSOs. CSO funding in Hungary highly politically tainted – 1% mechanism as a way to depoliticize decision-making.	Property donations to trade unions and NGOs. In the late 90ies. Percentage tax designation scheme for CSOs was first in the CEE region.	Recipient; in case of 1% also active promoter	Restriction in amounts of direct budget subsidies. Percentage scheme: despite several problems, a good way to create links between CSOs and constituencies.	Such methods often associated with political influence and some cases corruption. New flat tax will reduce 1% income.
Interaction with the private sector	Private giving through institutionalized mechanism	Neutral	Foreign donors worked through re-granting organizations. Long-term investments made into professionalization of CSOs, social innovation.	Small foundation sector - the focus of Western donors on creation of an indigenous grant-making sector came late.	Recipient-strategic partner	Strategic investment into hard-to finance causes such as Roma, human rights. Flexible, CSO-friendly funding conditions.	Private foundations gave less than 7% of CSO income, but their significance was much higher. Due to lack of such funding it is now hard to raise funds for startups and service development.

Earned income	Private-corporate giving	positive-neutral	Increasing volume of corporate giving in general. Low level of consciousness of customers that would put pressure on companies to follow more responsible practices.	Used to have generous tax deductions for companies supporting PBOs and for long term giving. In-kind donations VAT free.	Multiple roles: recipient-strategic partner-supplier	General purpose grants, emergency support, flexible and fast funding to partner CSOs. Good cases: decentralized decision-making; bank clients decide on CSO support from profits.	More limited areas for support but one of the most flexible sources of income. Local companies are willing to give like multi-nationals but less strategically.
	Individual giving	neutral-not supportive	After 1989 public expectation to receive services for free survived. This influenced the culture of giving: everything welfare related should be free and unconditional.	Traditional fundraising methods not overregulated but strict data protection rules. Technical barriers. Recently decline of giving.	Initiator-recipient (not paternalistic relationship with donor)	Despite relatively low level of individual donations, their total was 6-7 times higher over the last years, than the income from 1%.	1% system was successful in making people think about whom they want to support but may weaken individual commitment needed for true philanthropy.
	Income generation	supportive-neutral	Always a large part of CSO income. Non-profit companies a flexible form to provide market-like services.	CSOs engage in many forms of economic activities. Membership fees regarded not important by most of the CSOs.	Initiator-service provider.	Legislation on economic activities exemplary; allow CSOs to invest into strategic development.	Income generation linked to areas where state delivery is not cost effective, e.g. specialized employment services.

Basic data on Hungarian nonprofit sector (2009):

There have been 66 145 nonprofit organizations in Hungary in 2009. 57,865 (87,5%) of these can be categorized as „classical” NGO, i.e. independent private not-for-profit organization. The rest are interest representation organizations (e.g. trade unions) and quasi-NGOs (e.g. nonprofit companies and public foundations established by the state). From among the classical NGOs, 22,122 are foundations and 35,743 associations. 48% of NGOs have public benefit status, meaning that they can be seen as more transparent and file annual reports. Almost 90% of NGOs reported some kind of financial activity in 2009, so there is a low percentage of fully inactive organizations.

Financial data on the Hungarian CSO sector

In 2009, the “classical” Hungarian CSOs (associations and foundations) disposed of over 418,4 billion HUF (1,494 billion EUR), which was 37.5% of the total income of the nonprofit sector (thus, the income of the whole nonprofit sector including trade unions, professional associations, nonprofit companies and quangos amounted to over 1,1 trillion HUF or 3,9 billion EUR). The almost 1,5 billion EURO income of the „classical” NGOs came in largest

part from the state (35%), about 24% from private funding and about 26% from own income related to their mission; finally 15% of this income was a result of business activities (non-mission related economic activities).

Within the private funding, companies contributed 52,5 billion HUF (over 187 M EUR), which is distributed among 12 447 NGOs (or 18,8% of NGOs). Individuals donated over 20,2 billion HUF (72,4 M EUR), which was received by 8 727 NGOs (or 13,2%). Domestic nonprofit organizations (e.g., foundations) provided for 2.1% of the income of the whole sector, totaling 23,5 billion HUF (over 84 M EUR), and benefitting 17 397 organizations or 26,3% of all NGOs. Foreign support has grown from 2007 to 2009, the statistics documented about 44,2 billion HUF (close to 158 M EUR) of foreign support but this reached only 2 329 NGOs, or 3,5% of the sector.⁴³

It may be interesting to point out that the single source that reaches the most NGOs is the 1% tax designation: in 2009, 25 389 NGOs received a designation, which is 38,4% of the sector. The next largest outreach for a source was central government support, reaching about 28% of NGOs. At the same time, however, the total amount of the 1% designations (10,4 billion HUF or 37,3 million EUR) represents not even one percent (0.9%) of the total income of all nonprofit organizations in Hungary. If we take government sources altogether (including the tax designations), almost 64% of NGOs have some kind of governmental income (compared to 45% that receive private funding, 55% that have mission-related own income and 48% that have income from business activities).

Government funding mechanisms

Historic-cultural context

As a key feature in Hungarian civil society one must mention its strong orientation towards the state. This is true both financially and culturally. Financially, government funding has been dominant in the income of the CSO sector in Hungary since the mid-nineties. Its share in the sector's income grew from 13% in 1993 to 44% in 2007 (and started reducing somewhat to 42% by 2009).

Culturally, regardless of whether they currently receive or not funding from the government, there is a general expectation among NGOs that they should; and beyond funding, a general expectation that the government (state) should do things in order for the situation to change. This attitude is often also reflected in the way they aim to achieve their mission, for example through lobbying for a change in the law rather than grassroots advocacy, or getting endorsement from the local government rather than local entrepreneurs. The strong government orientation is of course not unique to CSOs: it is a common feature of Hungarian society.

⁴³It is not clear, however, whether this is to be considered private as it may include e.g. the Norwegian mechanism which is governmental funding.

By 2011 there is a general acceptance of the CSOs – especially foundations – as doing „good deeds” in society. This is largely due to the 1% law and an increased attention by the media towards promoting social causes in the recent years. At the same time, CSOs are often seen as political vehicles of parties; or as „do-gooders” that are not so important for solving the problems of the country.

Forms of public financing are widely available – probably the most forms are applied among the NMS. This includes grants, contracts and normative support at both central and local levels and through various channels: ministry funds, autonomous funds and public foundations, local government funds etc. After the EU accession a part of the funding from the EU budget (Structural Funds) also became available for CSOs through national distribution channels.

However, there is also a certain lack of transparency and accountability in the distribution of public funding. As an example, the National Civil Fund has been repeatedly condemned for its favoritism (favoring CSOs related to the members of the regional decision-making bodies) by the State Audit Office and by the competent Ministry as well as the media. There have also been serious problems in delayed contracts and payments from the Structural Funds that endangered the ability of even larger CSOs to deliver the services they contracted for.

For a long time there has been a lack of capacity of CSOs to lobby and advocate for more transparent, and more strategically targeted public funding. More recently, there has been an improving level of cooperation between expert CSOs and governmental-municipal partners in improvement of the financial framework.

The current government aims to reform CSO financing: on the one hand they announced that they aim to make it more transparent and accountable; on the other hand there will be serious cuts in the public funds available for CSOs.

Country specific elements

One specificity of Hungary is the National Civil Fund, which provides institutional and program support to NGOs. It is an autonomous Fund established through law, with elected CSO representatives in its 11 national and regional decision-making bodies. Every year it receives the amount equal to the total amount of the 1% of taxes that the taxpayers designated to CSOs.

Another noteworthy fund is the National Employment Fund that has been financing CSOs activities that created workplaces for the past two decades.

Since the introduction of the Structural Funds, re-granting mechanisms are concentrated in one state run quango, the European Social Fund Nonprofit Ltd. As one of the few exceptions, the Norwegian and Swiss Civil Fund NGO segment has been distributed through an independent re-granting consortium composed of private foundations.

Role of CSOs

CSOs are primarily seen as recipients of public funding. At the same time, the CSOs in the national and regional decision-making bodies of the National Civil Fund from the majority of members, therefore they are also decision-makers.

Examples, best practices

In general, the high level of government funding ensured that CSOs were not left without resources after foreign donors left; and thereby it ensured that they can continue to cater for the ongoing needs in society. Regardless of the problems, the engagement of government in funding CSOs at all levels and in many various forms has to be seen as exemplary.

An important policy of the NCF and National Cultural Fund includes mechanisms binding the donor to lower expectations if the approved project budget has been significantly cut.

The public benefit status of NGOs is relatively well defined and in practice government funding is often linked to the status, which is used as a transparency and quality requirement in public funding.

Observations

There seems to be a lack of a strategic approach in terms of the wished results and impact. The problem seems to be not so much the volume of funding but rather how it is spent. According to some development professionals, the Hungarian NGO sector has been spoilt by the fact that some level of governmental funding has always been available for the kinds of things that should be normally funded from community resources. As an example, the National Civil Fund has been supporting small town, even village level organizations with 1000 – 2000 EUR grants for institutional support (i.e. to support the NGO's existence). At the same time, the government has been cutting on the normative support to NGOs that provide crucial government services to needy populations. As a result, small NGOs become oriented on governmental funds and lose incentives to raise money from the community, while major NGOs get in a financial crisis and have to abandon quality service to their clients. So there is a total misplacement of the resources even though there has been plenty of funding for the sector.

There is also a disproportionately high level of funds distributed amongst a small group of organizations that are in most cases established by the state/local government.⁴⁴

PBO status does not always provide enough guarantees for transparent operation of CSOs due to the lack of strict monitoring and supervising provisions; but it is still one of the best attempts to find a balance between benefits and obligations of CSOs.

Bureaucratic burdens and technical conditions particularly in tenders related to the structural funds are often against good practices and the best value principle (e.g. Too high own

⁴⁴ These quasi-NGOs used to be called public benefit companies, now simply called nonprofit companies, account for the major part of the governmental funding of the broad nonprofit sector (this includes not only classical associations and foundations but also e.g. trade unions, other interest representation groups and quasi-governmental organizations).

contribution⁴⁵, conditions related to the volume of the budget, no multi-year project financing etc.).

Social contracting

Historical-cultural context

Social contracting has been in existence since the early-nineties in Hungary. On the one hand, there was a lack of municipal funds and services while there was a huge need created with the transition from socialism into capitalism. On the other hand, many NGOs had an important role in catering for services of needy groups and were leaders in social innovation. As a result, governments at the central, and gradually also at the local level have acknowledged the importance of NGOs in delivering services. Legislation has helped this process by creating special mechanisms to contract NGOs at the local level from central state support (normative support)⁴⁶. Local civil society strategies and “compact”-type agreements have also proliferated between 1998-2008.

Most recently, however, this trend seems to reverse. Already the previous government started cutting the normative support for NGOs as a result of budget restrictions due to the economic crisis; the current government also has an ideological motivation to support church providers over NGO providers and therefore continues to make it extremely difficult for NGOs to run local social services. Experts report that several NGO run services are being transferred to church denominations in order to avoid closing down.⁴⁷

Throughout the past two decades, Hungarian NGOs came up with innovative and effective solutions to distinct social issues. Examples include many fields from early childhood development to homeless care to rehabilitation; the most significant examples are probably in the field of employment. While many of these have remained at the local or pilot level, others have been slowly gaining place more broadly – e.g. through professional associations, and sometimes the government took up the model and financed country-wide application (e.g., home care for the elderly or a special methodology for integration of people with mental disabilities into the mainstream labor market). This resulted in tangible benefits for society, the state and the providers themselves.

Country specific

At the central level, the normative support is specific to Hungary, this is provided to CSOs that receive a license to run public services. Along with CSOs and the governments’ own public service providers, church organizations and institutions maintained by a regional association of local governments are also in this “market”. (However, CSOs are in the worst

⁴⁵ In most cases 10-20 %

⁴⁶ This means that if an NGO undertakes responsibility for a service that is a government obligation by law, and it meets certain standards, the government transfers a calculated per capita support to the organization.

⁴⁷ In Hungary, the Vatican has a special agreement with the Hungarian government that stipulates that the government will support church run services to the same extent it would support its own public services (including primarily schools and social services but also e.g. cultural or health services). By implication this is also applied to other „historical” churches; but not to NGOs.

position among the service providers in terms of their financing and sustainability.) Quality assurance requirements in various fields of service provision are typical.

At the municipal level, there are various effective models ranging from annually repeated grants to CSOs to long-term service contracts. CSOs are more often engaged in service provision through these forms than through the restrictive normative support. Larger municipalities created a fund to support CSOs to engage in service provision as well.

Role of CSO

CSOs are in fact service providers and contracting partners to the government. However, due to the generally paternalistic nature of state-CSO relationships, they are more seen as recipients of support even when the quality of their services is well recognized.

Examples, best practices

The normative support that is based on legally defined and “automatically calculated” financing mechanism for those who comply with the license conditions, is a good practice for financing social services as it responds to customer choice. (Beneficiaries can choose between public, church or CSO providers and those beneficiaries who chose the nonprofit provider will also be guaranteed the service.)

A CSO best practice in social contracting is a foundation that started to measure its *Social Return on Investment (SROI)*⁴⁸. Based on results monitored over several years, it turned out that the clients assisted by the foundation will be employed on the average within 6 months, will remain employed in the same place longer and will find new employment faster than similar programs run by state agencies. All in all, every one Hungarian Forint (1 HUF) invested in the activities of Salva Vita resulted in 4,77 HUF in return over a period of five years (e.g., in savings or income generated).⁴⁹ This calculation gives proof to the government about the value created and gives a strong argument to continue investing in this organization even if the government changes.

Observations

The normative support can in theory be a good tool to create equal conditions among providers from different sectors. However, this is not the case in Hungary where CSOs are provided a lower level of support (on the average 60-70% of what public and church providers receive). At the same time quality expectations are constantly increasing and CSOs have to comply with the same standards as fully funded providers. As such, this is a hidden discrimination of independent providers, reflecting the discomfort of the public sector with “opening up” the social services market.

⁴⁸ SROI is a method developed initially by US and UK academics and nonprofits to be able to monetize the value creation of nonprofit organizations. This foundation called Salva Vita has been the first one to undertake such assessment in Hungary and to the best of our knowledge, in the whole CEE region as well.

⁴⁹ http://salvavita.hu/index.php?menu_id=1210&topmenu=1200&oldal_id=1210&oldal_tipus=text

At the same time, CSOs generated high quality, good value know-how in service provision that got integrated in state provided services; specialized services they developed were made broadly available as well as valued by majority of the general public.

The government seems not to understand that it needs the CSO service providers to continue generating this know-how and improving effectiveness of services. There seems to be a lack of understanding of the sustainability of services. There is also a lack of measuring the satisfaction of beneficiaries / clients receiving CSO or public or church based services.

At the same time, the plurality of the forms in which the government engages CSOs in service provision – apart from the normative system – and especially in the local level has created ample opportunity for CSOs to assist communities addressing their basic needs.

Despite the current difficulties faced by the CSOs in this system, it remains one of the most progressive models for social contracting in the NMS.

Alternative financing

Historical-cultural context

After the collapse of communism, national federations and other CSOs which were the successors of the party-organizations (e.g., federations of the disabled, of elderly, of women, of writers and journalists etc.) remained utilizing the buildings that were assigned to them before. In 1998-2000 these and other buildings have been transferred into the property of the CSO that has been using it or that proposed to utilize it in the future.⁵⁰ This was a one-time program conducted through tender procedures over two years, without any specific feasibility or impact assessment.

Another factor to mention here is the political nature of government funding to CSOs. Since the change of the system, every government has favored certain groups of CSOs over others and this has been evident also in the amount of state support they received. (E.g., pioneers versus scouts, Christian women's groups versus liberal women's groups etc.). In the mid-nineties, the Parliamentary Committee that was deciding over CSO support got to a stall as they could not compromise on these preferences. This was when a group of MPs, the then Minister of Culture and CSO experts came up with the idea of the percentage mechanism – this was supposed to de-politicize government support by turning the decision over to the taxpayers. Other factors, such as the low level of private giving and the need to increase the resources for CSOs were also considered at the introduction of this idea (which initially would have concerned only cultural organizations).

Country-specific

Then transfer of property to CSOs was a special feature of the Hungarian policy towards civil society. While churches and trade unions could reclaim former properties, CSOs were provided the opportunity to take their “share” of restitution. However, this act did not result in

⁵⁰Law on transfer of certain state properties

a wide-reaching endowment of CSOs; only a few hundred received properties and many of them were not able to maintain it properly.

Hungary also provides direct budget support to some National Associations and umbrella organizations; however the possibilities for this are by now severely restricted. A Ministry cannot spend more than 20,000 Euros in support of any one foundation without a tender procedure; and it has to obtain approval of the Cabinet of Minister to include any association into its budget for direct subsidies.

The percentage designation scheme for individuals is a Hungarian “invention” as it was the first in the CEE region to introduce it. This scheme allows taxpayers to designate 1% of their tax dues to a qualified CSO, and another 1% to a church or an annually specified government purpose. There is much analysis to be done regarding the % scheme, but here we would only mention two main points:

- On the positive side, it clearly helped to create more connections between CSOs and the public at large. It was a reason for CSOs to reach out to people and explain what they are doing.
- On the questionable side, its effect on the development of “traditional” or “real” philanthropy is still not clear. Research made thus far was not able to establish a causal relationship, while more and more empirical evidence points to the conclusion that in the long term (i.e. over 10 years) it may hinder rather than help the development of a philanthropic culture.

Role of CSO:

In the case of alternative financing, CSOs are essentially recipients of the public funds; however in case of the % system they are actively promoting themselves to the public and are therefore more than “passive” recipients of property or grants.

Best practices:

Although there are many issues and criticisms towards the percentage scheme, if introduced in the proper context and at the proper time, it can help develop an understanding of the importance of CSOs among the population and in creating linkages between CSOs and their constituencies.

The restriction in the amounts that can be expended to support CSOs without a tender is also to be considered as good practice in CEE.

Observations:

Transfer of property ownership, even if the process and conditions were regulated by law was associated with political influence and in some cases corruption.

In case of building support timing is critical. In Hungary, in most cases they were donated or provided for a long term lease in periods when it proved difficult for the CSOs to maintain the property (while they were banned from selling it for a number of years).

The new governmental initiative to introduce a flat tax will dramatically change the situation regarding the 1%. The volume of tax paid by individuals will decrease, while the number of individuals who will have tax to designate will increase. Altogether, a 30% reduction in tax income is expected, which may severely affect those CSOs that are more dependent on income from the percentage mechanism.

This points to the fact that the “real” or “traditional” individual giving scheme is still the most reliable source of income in the long term and that a governmental source – however innovative – can never be a substitute to the support of committed individuals.

Private institutional funding

Historical-cultural context

In Hungary, unlike in many other countries in the region, foreign donors were not directly established in the country; rather they chose, or helped establish, a Hungarian foundation for re-granting their funds. There have been not more than 10 such re-granting foundations in the mid-nineties and about half of them closed or minimized its grant-making program after the original donors left the region. (Including the Hungarian Soros Foundation, which was the first of the Open Society Foundation network in CEE, and whose closure in 2007 was a symbol of the end of an era of private foreign funding.)

During its “glory”, such funding was used the most for social innovation, for piloting and mainstreaming innovative services, and projects tailored to special beneficiary groups. It has been the main funding source to invest into capacity building and professionalization of CSOs, helping to strengthen them often throughout several years. (In comparison, the currently available institutional support from the NCF has to be spent within a few months each year.) Another advantage of western private donors has been that they were for the most part politically neutral and also seen as such (with the exception of the Soros Foundation, which was accused of intervening into political dealings)⁵¹.

Domestically “born” private grant making foundations in Hungary are still in the early stage of development. Their number is gradually increasing but there is only a handful of philanthropic individuals that have established foundations. These support typically contemporary artists or talented poor children, i.e. people rather than organizations (CSOs). The culture and understanding of supporting CSOs among the newly rich is not yet developed.

⁵¹ In case of US based foundations a condition to receive the most beneficial 501C3 status

At the same time there is an increasing number of corporate foundations that support CSOs and civil society more broadly (see below).

It should be noted that in Hungary there is no separate legal form for grant making and operating foundations; and there is no incentive for a donor to make an endowment. Therefore, there are practically not more than 2-3 domestic grant making foundations that have been endowed and on whose support CSOs can count on in the longer term.

Country specific

The first phase of focused programs of Western development donors into the creation of an indigenous grant-making sector came late in Hungary. Essentially, donors started building endowed foundations from the re-granting/implementing organizations only when they were already leaving. This resulted in limited success in endowing them and also a limited range of areas they kept supporting.

Role of CSO:

Unlike the governmental agencies, private funders saw CSOs not only as recipients but also as strategic partners in helping them achieve their own long-term goals. That is also why they tried to take responsibility for helping CSOs as long as they could with institutional support and flexible program grants.

Best practices, examples

The volume of strategic investment into advancing causes that are hard to finance from the “philanthropic market” is a good practice example of Hungarian institutional donors. These have included supporting causes such as the Roma, civil liberties, human rights and rights of marginalized groups etc. Although there has not been much impact measurement of these programs, they have clearly filled a gap in addressing needs that other donors did not undertake.

CSOs also praised the grantee-friendly, flexible, non-bureaucratic funding mechanisms of these foundations. For example, there was usually no or minimal own contribution required or if required, in most cases volunteer work was accepted. Flexible funding in important areas left space for a trial-and-error approach and slow accumulation of the results bottom-up, a more natural way for social change than government ordered policies.

Observations

The lack of a variety of donor models and diversity of strategies contributed to the fact that the Hungarian CSO sector became somewhat “uniform” (i.e. most CSOs have a similar income base, relying to a large extent on various forms of government funding and own income). While in last decade of the 20th century Hungary and its CSOs belonged to the top innovators of CEE, this advantage has diminished in the first decade of the 21st century. CSOs are today more implementers of governmental programs than innovators in their respective fields.

Although the volume of donations of private philanthropic foundations was never higher than 7% of the total revenue of the NGO sector, its significance was much higher. Many CSOs and in some cases also smaller community organizations receiving such support were able to develop their know-how and capacity to the level that they became relevant suppliers and partners for both companies and government. Most CSOs that have had the capacity to attract and implement EU programs came from the ranks of organizations “built” with the help of foreign donors.

Due to the lack of such funding, it is currently difficult to launch CSO startups, to invest in service development, and to build an organization strategically. Although corporate foundations are slowly learning the “art of grant making”, they will likely remain funding more popular causes, so the gap in the lack of independent domestic grant-making institutions is still being felt.

Private corporate

Historical-cultural context

The volume of corporate giving and institutional corporate giving in general has been increasing. In general, like in other CEE countries, there is more emphasis on PR and brand building but the classical charitable giving and CSR has been increasing as well. The most recent data of the Statistical Office are from the year 2009, which show that income of the CSOs from corporate support increased by 20% since 2007. Therefore, interestingly this form of support has not been affected by the crisis as badly as CSOs were expecting it.

A recent research by the Hungarian Donors Forum has the following results:⁵²

- 70 out of the top 200 companies responded to their survey
- 10 % of these give under 1 million HUF (3,500 EUR) and 14% give over 100 million HUF (app. 357,000 EUR) per year
- 45% do not plan to increase their giving budgets in 2011, while 20% plans to do so.

There has always been and still is a low level of consciousness of the customers that would put pressure on companies to follow more responsible practices. Hungarians have been repeatedly shown to be most sensitive to price, disproportionately so as compared with other European countries (quality, accessibility and other factors come much lower, not to mention environmental and social responsibility).⁵³

Western owned companies were the first to establish more developed grant making schemes and corporate foundations on the national level. However, a research in 2005 showed that 67% of domestic companies actually give although not in a structured or professional way⁵⁴;

⁵²Reference research, Oct-Nov 2010

⁵³Kuti, Eva ed. Vállalatiadományozás Magyarországon Tanulmányok 2005 (Corporate giving in Hungary)

⁵⁴Id

while SMEs play a vital role in community level support. Thus, ad-hoc giving is still more typical than strategic giving; but the willingness is seemingly there.

Country-specific

Hungary had provided generous tax deductions for companies that supported public benefit organizations and legislation also provided incentives for longer term support. 150% of the donation to the maximum of 20% of taxable income could be deducted for a one-time support of public benefit organizations; and in case of a four year commitment to give the same or larger amount, 150% of the donation could be deducted up to 25% of taxable income every year. If the supported CSO was not of public benefit status, up to 100% of the donation could still be deducted under the same conditions. This tax scheme has been very progressive and it helped spread the culture of giving among Hungarian companies.⁵⁵

However, in the past few years (since 2008) these benefits have been cut significantly, leaving only a very small group of CSOs (those who are “prominent” public benefit organizations and have a contract with a governmental agency) as eligible to receive a tax deductible donation.

In-kind donations are free of VAT, which has been a contentious issue as well.

Role of CSO:

CSOs are perhaps most well recognized by the corporate donors: especially when having an established philanthropic or CSR strategy, they can be in the role of a recipient as well as a supplier or a strategic partner.

Best practices:

Corporate donors often provide general purpose grants or unrestricted emergency support to their partners (e.g., in case of changes in the law that is causing significant cash-flow problems). Support, in general is flexible and responsive to the needs of the grantee and the beneficiaries; usually there is no own contribution required.

There are good practices in decision-making: in some cases the decision-making on the grants is decentralized (e.g., employees of a local division have their own budget and can decide whom to support). Another interesting initiative is by the first Ethical Community Bank in Hungary (MagNet Bank), which launched a Community Giving Program, in which the clients of the bank can decide together which NGOs (from a pre-selected list) will receive 10% of the Bank’s annual profits. The Bank also has a special service package for foundations and associations, something that NGOs have been long waiting for in the Hungarian market of financial services.

Observations

⁵⁵There has been no targeted impact research in this respect; however, when the benefits were discontinued, CSOs reported a clear decline in the willingness of companies to support them. It is not clear, however, if this was due to the tax change solely or also to the beginning of the financial crisis.

Although the scope of corporate support is limited (only in certain fields and to certain CSOs), it remains one of the most flexible sources of income for CSOs. Also, the Hungarian example shows that domestic companies find CSO support just as important as multinationals; however, they lag behind in establishing planned giving programs that would make their support more accessible and more reliable for CSOs. Whether ad-hoc or institutionalized, companies are usually the fastest decision making donors of CSOs.

Individual giving

Historical-cultural context

Hungary, for historic reasons, had been running a generous, expensive welfare system before 1989. Since the quality of services was relatively high, the public expectation to receive high quality services for free survived even after the system change. This had significantly influenced the culture of giving: everything welfare related should be free and unconditional. As a result, people were not ready to support CSOs in providing welfare services for a long time.

Individual donations in Hungary were on the rise throughout the nineties but only at a very modest rate that actually put this mechanism behind government and corporate giving in terms of its share in CSO sector income. In the most recent trend, individual giving is already declining: the amount of money received by NGOs from private donations fell by 20% from 2007 to 2009. This could be explained by several factors: (1) the economic crisis and that people have less to give; (2) the decline has already been a tendency though not as sharp, in the mid-2000s, and (3) by 2009 all the tax benefits for donations from private individuals have been discontinued. Over the past 4 years, the government has gradually cut the previously existing tax credit on donations to public benefit organizations. Although the credit itself was not a major benefit (100% of the donation up to 30% of the tax but with a fixed ceiling of circa 200 Euros), it might have mattered to those who used to take advantage of it.

Nevertheless, some NGOs are trying to reach out to the public in fundraising campaigns but success seems to be limited to a circle of those who engage in the relatively higher cost professional fundraising. One of the detrimental effects of the one percent law may have been that it has hindered the development of the „traditional” way of raising funds, i.e. personalized and regular (cyclical) communications with the donors.

Country specific

The percentage mechanism was hoped to produce an increase in the low level of giving, and increase funding for large number of CSOs, as well as churches and causes of public interest. To some extent it achieved its purpose as people get more familiar with CSOs and started to think about which CSO “deserves” their support through the tax designations.

More traditional forms of fundraising such as street collections, charity events and direct dialogue are not overregulated. Simple technical barriers exist and present difficulties in

raising money from individuals (e.g. private banking cheques crucial for most widespread fundraising methods in the West are not in use, or more than 50% of a donation via sms goes towards taxes and fees).

Role of CSO:

The CSO is both the initiator of the relationship and the recipient of support. It is therefore regarded as worthy of support (unlike in the paternalistic relationship with a state donor).

Best practices, examples:

Even though individual giving represents a lower share in the income of the sector, the level of individual donations was 6-7 times higher over the last years than the income from 1%. It is important to recognize that while the 1% is a capped amount, donations from individuals are not – they can be increased through including a new cause, a new target group or new ways of asking.

Observations

Due to relatively strict data protection rules, obtaining data of potential donors is difficult (still hard to find relevant data on donors in large quantities) and therefore expensive.

There is a lack of expertise relating to the different forms of professional fundraising and there are no clear benchmarks on how to evaluate success.

The percentage scheme brings public funds into the picture, which ultimately weakens the involvement and commitment of the individual (even if the person makes the decision, s/he remains anonymous and will not feel the financial consequences of this decision).

It remains to be seen whether having more net income – with the introduction of the flat tax – results in an increased level of individual giving.

Income generation

Historic-cultural context

Generating earned income has always played an important role in the development of the Hungarian CSO sector. Over 40% of the income of Hungarian CSOs comes from own income including two major parts: income related to their mission (e.g., training on advocacy) – 26% and non-related business income (e.g., renting office space) – 15%.

CSOs can engage in economic activities directly or through establishing a company. However, foundations and associations cannot be established to primarily conduct economic activities. There was a special form, the public benefit company that was supposed to serve the purpose of service oriented nonprofit organizations, which could conduct economic activity more freely. However, it became a tool for local municipalities to contract out municipal services on a non-competitive basis (by setting up such companies). As a result the

model was changed in 2009 and now instead of having a privileged form that is “automatically” considered public benefit, any corporate legal form may obtain public benefit status, if it complies with the same requirements as common CSOs.

Such companies represent a simple and flexible form for providing services in a way they would in any market: reacting quickly on changing needs of the beneficiaries. However, they are usually excluded from calls for grant proposals even though their public benefit requirements are the same as for other CSOs. Overall, since the nonprofit company in this form is still new, there is not much experience with it yet.

Country specific

Hungarian CSOs are engaged in many types of economic and business activities but there are also earned income models they do not favor. Membership fees are one of the latter.

Membership fees are regarded as not important by most of the CSOs – not counting trade unions – and often they don’t even collect it. The notion of the membership fee being symbolic still prevails in most associations.

CSOs receiving property as a grant (mostly from governments and municipalities but now more and more from corporations as well) are in privileged situation as they can generate unrestricted income through rents.

Role of CSO:

In this function CSOs are proactive, initiators of relationships with customers and beneficiaries, and of course, service providers in a competitive market. Importantly, this is the only form of financial income where the feedback on CSO performance by the service user is immediately expressed in monetary terms as well.

Examples best practices

While much abuse has been reported over the years relating to government funding and the 1%, there were no major scandals relating to economic activities. This indicates that the Hungary found a good balance of incentives and controls in regulating this type of activity.

Mission related income represents 26% of the total revenue of the sector in Hungary. This unrestricted income allows CSOs to invest own resources into areas that are strategic for them as well as self development or into non-mainstream areas.

Observations:

Hungary has pool of mechanisms that could make the CSO sector more self-sustaining. A strategic approach to harmonize these methods, increased benefits and clear rules may improve performance significantly.

Income generating activities are on a large scale linked to areas, where state service delivery is not cost effective, e.g. employment and re-integration of disabled people trough production and services.

IV.2. Croatia

		Legal/Fiscal Framework	Historic/ cultural conditions	Country specific elements	Role of CSOs	Examples/Best Practices	Observations
Interaction with the state	Funding mechanisms	Supportive	Post-war period: CSOs delivering humanitarian aid; strong international presence, weak government	Tri-partite system of CSO strategy implementation: Government Office, National Foundation for Civil Society Development (CSD) and Council for CSD.	Recipients and partners	National Foundation: lottery proceeds, decentralized structure, multi-year funding, institutional support; Code on Good Practices for Funding CSOs.	Strength: clear strategy and autonomy. Weakness: small CSOs may remain without support.
	Social contracting	neutral-not supportive	CSO services subsidized by foreign donors, no history of CSO involvement in state service provision.	No systematic involvement, strategy currently being developed. Good examples exist especially locally.	Lobbyists for improved conditions.	Cross-sector participatory process to develop the strategy for involvement of CSOs.	CSO capacity exists, e.g. quality management systems promoted among CSOs. CSO involvement will be in line with EU expectations.
	Alternative financing		No significant model identified				
Interaction with the private sector	Private giving through institutionalized mechanism	Neutral - not supportive	Foreign re-granting organizations did not establish indigenous grant-making foundations despite large volume capacity building programs.	Weak foundation sector; National Foundation "took over" CSO support from re-granting organizations; foundation law outdated.	Recipients	CroNGO program introduced good practice in grant-giving that was taken up by the National Foundation (multi-year institutional funding)	Role of private donors was taken over by the state.
	Private-corporate giving	neutral	Corporate social responsibility still in early stages of development due to unfriendly business environment.	Growing support of CSOs by companies but mostly ad-hoc giving. Tax deductions not significant.	Beneficiaries, recipients only	Certain companies introduced responsible practices e.g. Croatia Telecom in a telephone fundraising campaign	No significant differences from other countries in the development of corporate philanthropy.
	Individual giving	neutral	Giving to church and charity is part of traditions; post-war solidarity enhanced community giving.	The majority of Croatians give but only small amounts. Use of new technologies is spreading.	Generally not active in fundraising	Some good examples for fundraising success exist, e.g. Guide Dog Association	Despite generally positive attitudes to giving, CSOs do not raise funds; they are not familiar with professional fundraising.

Earned income	Income generation	Supportive	Economic activities a rare practice. CSOs used to give services for free, now late to change this pattern.	Legal framework favorable for CSO economic activities, mission related income tax free; but interpretation issues. No public benefit status.	Initiator-service provider.	Some good examples for social enterprise, especially among environmental groups.	Transition and economic development could be helped by increased role of CSOs in social enterprise and social service delivery.
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Basic data on the Croatian nonprofit sector

In 2009, there were more than 37,000 registered civil society organizations, including associations, foundations, sports and religious organizations.⁵⁶

In the same year, the government funding amounted to almost 530 million Kn (over 71 million Euro), which is 15.5% less than in 2008. Out of this amount, 46.2% was distributed from the lottery proceeds. Most of the funds were given through the Ministry of Science, Education and Sport (31% of total funding). Sport is the most funded activity (31%) followed by projects in the fields of culture, people with disabilities and socially disadvantaged groups.

From 1999 to 2009, 27.543 projects of CSO were funded by the state, amounting to more than 320 million Euro of funding allocated to the sector. According to a research conducted among CSOs that received grants from the state budget in 2008 almost 70% of CSOs rely on funding from the central and regional/local government's budgets as the main source of funding.

CSI research results indicate that 33.2% of surveyed CSOs receive funds from the corporate sector, and the average share of corporate sector funds among CSO income amounts to 18.2%.

Government Financing

Historical-cultural context

The post civil war period entailed a strong position for CSOs within the society. They played a prominent role in delivering aid and assistance, and helped in post war conflict resolution in affected communities. As the whole state system was to a level newly created, the interaction with a newly formulating CSO sector was frequent, compared to early phases in other countries in CEE.

There were large scale international donor programs implemented here. Croatia belonged to the countries of the Western Balkans in which the imported know how had been already

⁵⁶ USAID, *The NGO Sustainability Index for Central and Eastern Europe and Eurasia: Croatia*, www.usaid.gov/locations/europe_eurasia/dem_gov/ngoindex 2009.

adapted in other countries of Eastern Europe. Development programs like USAID used experts from the region and implemented joint projects with Central European CSOs.

At the same time, Croatia had been historically closer to Western Europe than most other Western Balkan countries, which made it easier for them to adapt democratic institutions and adhere to European norms in practice even when the laws were not yet up to date (see law on foundations). It was also the first country in the Balkans that undertook a strategic effort to support the development of civil society, and such, it established exemplary models.

Country specific elements

Croatia is the first country in the Western Balkans to undertake initiatives to develop specially designated mechanisms for Government-CSO cooperation and a mechanism to support transparent funding of CSOs.⁵⁷ This process resulted in significant innovations, the most influential was without doubt the creation of a National Foundation for Civil Society Development that was the first and has a unique place even among similar funds in the CEE region. Compared e.g. to Hungary the fund supports a relatively small number of organizations, but for the same reasons the support provided makes the donations relevant in terms of the wished impacts. Another unique feature is the support of multi-year activities. (See best practices)

The National Fund has now been decentralized and it made agreements with four regional organizations to manage community grants programs. In addition, line ministries support CSOs with grants in their respective field of operation. Croatia also benefits from the EU funded Instrument for Pre-Accession Assistance (IPA), which has a civil society support component.

As a result of the learning process from several years of government funding experiences, in February 2007, Parliament adopted a Code for Good Practices in funding CSOs.⁵⁸ (See best practices) This was aimed, among others, to fend off criticism relating to conflicts of interests that the National Foundation was accused of in the early years.

The National Foundation is the „funding arm” of the broader institutional framework connecting civil society and the Croatian government. It fits into a tripartite system of Croatia’s “new model,”⁵⁹ which also includes the *Government Office for Associations* (created in 1998) and the more recently established *Council for the Development of Civil Society*, which is a specialized advisory body of the Croatian government. The Council is charged with monitoring, analyzing, and evaluating the financing granted from the state budget, and ensuring compliance with the Code.

⁵⁷Hadzi-Miceva-Evans (2010)

⁵⁸ *Code of Good Practice, Standards and Benchmarks for the Allocation of Funding for the Programmes and Projects of NGOs*. Official Gazette no.: 16/2007, February 2007.

⁵⁹For more information about the model see: Vidacak, Igor., “Developing Standards and Mechanisms for Public Financing of NGOs in Croatia”, *International Journal of Not-for-Profit Law (IJNL)* October 2010; and Hadzi-Miceva Katerina, “Legal and Institutional Mechanisms for Government-NGO Cooperation in Hungary, Estonia and Croatia,” in “Organizacje pozarządowe. Dialog obywatelski. Polityka państwa,” edited by Marek Rymysz, (Institute for Public Affairs, Poland), 2007.

CSO role

CSOs are seen as both recipients and partners in government funding.

Examples, best practices

Croatia undertook successful decentralization of a once centralized model of support for civil society. (All state funds to CSOs used to be distributed through the Government Office for Associations.)

The National Foundation for Civil Society Development is a good example for a state fund supporting civil society. Its concept follows the approach of an excellence model: based on strategic priorities it determined areas to be developed that have the largest potential to make positive influence even on the part of the sector that is not heavily subsidized through the fund (multiplying effect). It has set a strategic goal that it aims to accomplish and it views CSOs as key partners (rather than simply vehicles) in achieving it.

The main goal is to encourage Croatian citizens to take an active part in public life – not only at elections but also in taking care of each other and addressing social problems on a daily basis. It uses effective and appropriate funding mechanisms that are in line with development principles (such as rootedness and long-term processes). E.g. instead of directly giving very small grants to community based CSO programs (like the Hungarian fund), it agreed with regional intermediaries who can manage those programs more efficiently. Uniquely in the region, it also supports up to three years of institutional development of CSOs. This is not typical of governmental donors who usually support on an annual cycle.

Further, the Foundation is financed from the lottery proceeds, which provides a relatively secure and predictable financing year after year (in contrast with other countries where the Fund depends on annual budget appropriations.)

The Code on Good Practices for government funding of CSOs is also exemplary in that it sets out basic rules and procedures for public authorities at all levels of government in distribution of public grants. It achieves this through a very simple and easy-to-follow document that contains eight key principles with concrete guidance for their application.

Observations

The model has the strength of focusing on large and mid size market leader CSOs, who are able to deliver good programs; at the same time this represents a weakness as well in that rural CSOs and startups have difficulties to access it.⁶⁰ Another advantage is that while the overall strategies are set with the government, the fund has autonomous decision making and it has been able to develop good funding practices, responsive to the needs of CSOs making it a reliable partner for CSOs in the long term.

⁶⁰According to the CSI survey from 2005, the geographical distribution of CSOs indicates the markedly urban character of these organizations. Most CSOs are not rooted in local communities, where citizen's activism is mainly characterized by informal assistance to neighbours or family members.

Social contracting

Historical-cultural conditions

Unlike in Hungary, in Croatia CSO services were largely subsidized by foreign donors and they provided the services for free, therefore the tradition of social contracting has not developed as much over the past decades. The expectation of free social services by the state has been coupled by the expectation of free social services by the CSOs, so both the citizens and the state expect that they don't have to pay for the CSO delivered services. CSOs also believed in this, however, they are struggling to sustain their services and so have started to lobby to change the situation. As a result, there are already some good examples of local service provision by CSOs at the municipal level.

Country specific elements

In Croatia there is no systematic involvement of CSOs in the provision of social services and local governments often lack the interest to contract CSOs. At the same time, there is an emerging dialogue among the state and CSO sector on the opportunities. A working group was formed to develop a Proposal for Improvement of the System of Contracting Social Services of Public Interest with Civil Society Organizations.⁶¹

CSO role

Lacking as yet a mechanism for financing, CSOs are mainly advocating for improved conditions.

Examples, best practices

It is a good practice that the Office for Cooperation with NGOs is leading a cross-sector, participatory consultative process including competent ministries, local authorities, and CSOs in order to develop a strategy to improve the situation in CSO contracting.

Observations

There is relevant and high quality CSO service providing capacity in Croatia due to the investments into institutional capacity building by both foreign donors and the government. In line with the EU practices, as a result of cooperation among sectors, the system of social contracting is likely to develop soon. There are evidences that show readiness for such cooperation, e.g. the attempt of a group of CSOs to introduce broadly accepted quality management systems for CSO services.⁶²

Institutional private giving

Historical-cultural context

⁶¹USAID NGO Sustainability Index 2009

⁶²PQASSO by Charities Evaluation Services(CES) UK

Despite big foreign aid programs, there were no large private funds, with a few exceptions. For a long period the USAID funded CroNGO Program (a re-granting organization) was playing the role of a semi-private donor. Essentially, a few large scale state funds, like USAID and more recently the National Foundation played the role of classical private institutionalized funding – developing capacity of CSOs, financing their overheads, innovative projects, etc. USAID already had the experience with Central European countries, where such capacity contributed to the strengthening the sector at large. The National Foundation was then open to take over the good practices from such donors, e.g. institutional support and multi-year funding.

Country specific elements

Compared to Hungary, Croatia received much higher levels of foreign aid and massive development programs took place. Yet, unlike in Hungary, there were hardly any local re-granting organizations; and there are hardly any indigenous grant-making foundations.

This has had two main reasons: first, with the establishment of the National Civil Fund in 2003, foreign donors could have had the impression that the state has “taken over” the financing of their key grantees, so they were less worried about “exit strategies”.

Second, Croatia was the country in the Balkans where due to political infighting, an outdated foundation law is still in force. It contains e.g., that the foundation cannot be created for unlawful or immoral purposes, or “if there is no serious reason for the establishment of a foundation, particularly if the purpose of the foundation is obviously lacking seriousness.”⁶³ Obviously such provisions leave a wide space for interpretation; yet there have been no problems with registering foundations in Croatia. At the same time, there was no incentive, legal or fiscal for indigenous grant-making foundations to evolve.

CSO role

In their relationship with foreign private funds, CSOs played mainly a recipient role.

Examples, best practices

One of the most successful funding programs from the point of view of capacity building of CSOs was run by the CroNGO program. This included three year institutional funding coupled with technical assistance to develop a strategy for the development and sustainability of the organization; and in addition training and pilot-funding for fundraising and income generation projects. In the program, some large scale fundraising projects were implemented, which achieved a concrete target – an unusual result in the region.⁶⁴

Observation

⁶³Law on Foundations and Funds, *Offl. Gazette*No. 36/1995, 64/2001

⁶⁴E.g., the Croatian Guide Dog and Mobility Association raised 500,000 Euro in a campaign to build a dog training center, which was a great success beyond any expectation.

The role of private donors was taken over by the state in funding key national level CSOs and in responding to civil society development needs (institutional support, pilot projects). At the same time, due to the existence of available central sources, there was not enough pressure towards wealthy individuals and strong corporations to establish private philanthropic foundations.

Corporate giving

Cultural-historical context

Research by the European Network on Research on Philanthropy (NROP) revealed that “the type of welfare state emerging in Croatia does not contribute to the development of a socially accountable corporate sector since the corporate sector is obliged to pay high taxes and contributions for social and public purposes, yet it is not seen as an important stakeholder for society at large”.⁶⁵

According to recent survey results on the extent of social responsibility of larger companies, over 50% consider their corporate social responsibility as insignificant (20.8%) or limited (33.6%). In general, firms see this type of spending as another way of spending money on marketing or sponsorship, rather than as their social responsibility.⁶⁶ At the same time, the media pays close attention to charitable giving, and stories in the media have reportedly inspired individuals and donors to give more.

According to the ENROP report, small and medium companies are becoming active in their communities, although they still provide most of their support to sport and cultural events. Therefore, on the whole, the current extent of corporate philanthropy still is seen as rather limited.

Country-specific elements

Overall, corporate philanthropy represents a new and growing tendency in terms of the total revenue of the sector. Civicus Index research results from 2005 indicate that 33.2% of surveyed CSOs receive funds from the corporate sector, and the average share of corporate sector funds among CSO income amounts to 18.2%.⁶⁷ This could be seen as a moderate level of philanthropic support; however, from CSO reports it seems that it is still not seen as a reliable, predictable income source, probably due to the prevalence of ad-hoc giving (a lack of strategic programs to support CSOs). As an example, only a few companies have established grant-making foundations.

As significant foreign investment was made in various industries whereby the foreign company’s charitable policies were adopted, the funding is growing but has a less institutionalized character. Domestic companies also engage more and more to in funding charitable programs, and young entrepreneurs showed interest to support CSOs in their

⁶⁵European Research Network on Philanthropy, Croatia <http://www.ernop.eu/country/24/croatia.html#Data>

⁶⁶Id.

⁶⁷Civicus Civil Society Index Report on Croatia, 2005
http://www.civicus.org/new/media/Croatia_country_report_English.pdf

communities.⁶⁸ Tax deductions available to businesses for donations are not significant (up to 2% of tax base deductible).

CSO role

Overall, the corporate sector considers CSOs solely as beneficiaries of their support, while the associations consider the corporate sector as donors only. Such a narrow view of civil society-business relations results in a limited number of partnerships between CSOs and the corporate sector.⁶⁹

Examples, best practices

Encouraged by the success of a number of humanitarian organizations soliciting donations over the telephone, Croatian Telecom has waived its right to profit from certain humanitarian organizations, so that the money raised can be fully distributed for humanitarian purposes. In cooperation with the Government, Croatian Telecom established a committee for allocating phone numbers to humanitarian organizations.⁷⁰ Construction companies, banks, often with an international background also play an important role promoting the culture of giving; and SMEs also started increasing their involvement mostly on the local level.

Observations

In terms of the development of corporate philanthropy, Croatia shows no significant difference from other CEE countries.

Individual giving

Historical-cultural context

Although regular giving by individuals to CSOs does not have a tradition in the country, a culture of giving for charity and other public purposes is an important part of a civic culture. In addition, post-war solidarity facilitated community level giving – even when there was an abundance of humanitarian aid, people continued sharing their food and products (although not necessarily across ethnic lines).

Most Croatians give only small amounts to charity. The CSI survey reveals that for 76.6% of respondents, the financial value of donations during 2004 did not exceed 500 Kuna (83\$). With the average net income per annum in 2004 being 4.143 Kuna (690\$) this amounts to 1.2% of a person's annual income. Another research (from 2006) showed that 77.8% of citizens donated up to 500 kunas and only 4.7% donated more.⁷¹

Country specific elements

⁶⁸ERNOP

⁶⁹ERNOP

⁷⁰CSI report

⁷¹Survey by Frank Sakic (2006), in ENROP report

According to the CSI survey 66.8% of citizens have donated cash or goods, such as garments and food, for humanitarian purposes in 2004. Since then, charitable giving has increased, partly thanks to the introduction of new technologies of giving by phone or recurring payments (see Examples, also under Corporate Philanthropy). A slightly higher number of women than men give to charitable purposes, and individuals with higher levels of education are more inclined to donate.

CSO role

CSOs are generally not very active in fundraising from the public; when they are, they are initiators and recipients.

Examples, best practices

While charitable giving is not widespread, there are good examples of fundraising organizations that use a professional approach and take advantage of modern technologies. The example of the 'PUŽ' Association is mentioned in the Civicus report, which is partially financed by permanent transfer orders from banks, which citizens can commission without additional charges, allowing for a transfer of small but regular monthly income for the associations activities.

Observations

Survey results indicate that, in general, the public is in favor of a culture of giving. Still, individual giving does not represent a strong part of CSO support. This can have a number of reasons, but in our view it is mostly due to the fact that CSOs have managed to raise resources from the state (at the central or local level), and also from corporations; therefore very few feel the need to raise funds from the public at large. CSOs are not familiar with professional fundraising techniques and lacking the motivation to "go for it", they have simply not asked people. This theory is supported by the fact that whenever a CSO decided to engage in fundraising activities they were most of the time successful.

Income generation

Historical-cultural context

In Croatia, self-financing activities by CSOs remain a rare practice. CSO economic activities did not develop properly for several reasons, including that donor programs often did not allow CSOs to charge for the products and services they developed with the donor's support. Therefore it has become almost impossible to start charging fees for the same services once the donors ceased supporting them, and CSOs have missed an important opportunity to become more sustainable. On the other hand, it was often not felt proper also by the CSO to charge for its services, due to the idea of solidarity and assistance to the needy. In addition, there has been a lack of capacity and entrepreneurial spirit on the part of the CSOs to under-

take commercial projects. Finally, there is no clear interpretation of the legal framework which, in principle, allows CSOs to engage in commercial activities.⁷²

Country specific elements

The Croatian legal framework is favorable toward the economic activities of CSOs, as such activities are explicitly permitted by law and they are not taxed, if they are conducted within the framework of the CSO. CSOs are exempt from paying corporate income tax on income generated through commercial activities unless such exemption has led to the acquisition of “unjustified privilege on the market.” Should the competent tax authority reach such a finding, which has not happened in practice thus far, a tax is levied on the CSOs income resulting in the same obligations as those incurred by for-profit entities (20%). CSOs will also need to pay the same taxes as for-profit entities if they establish a company to run the economic activities. There is no clarity about whether only such economic activities are allowed which are referred to in the statute of the CSO. Also, it is unclear on what basis the “unjustified privilege on the market” would be judged, but it is understood that the provision is construed to fend off possible abuse of the tax exemption.

CSOs have lobbied for the introduction of a public benefit status, which would increase the transparency and accountability of the qualifying CSOs, and would therefore reduce the possibility of abuse regarding tax exempt economic activities. This might enable the legislators to abolish the ambiguous provision relating to “unjustified market privileges” as long as only public benefit organizations would be fully tax exempt in their mission-related economic activities.

CSO role

Initiator, service provider. One reason why CSOs are not so active in this field may be that they don't feel comfortable in the role of “salesmen”.

Examples, best practices

Engaging in economic activities is a growing tendency in the social services sector, and some training and consultancy organizations incorporated it into their business models, but it is still not widespread on the national level. There are however, some good examples e.g. those in the portfolio of NESsT (Nonprofit Enterprise and Self-sustainability Team), including rental of coastal premises of the CSO and promoting the sales of cloth diapers.⁷³

Observations

The country has had to go through a difficult period in an extremely short time: from a post-war country into an accession country that has to reform most areas of recently created systems and mechanisms to comply with EU expectation. This could present itself also as an

⁷²NESsTCroatia guide <http://www.nesst.org/documents/2006CroatiaLegalGuideEN.pdf>

⁷³<http://www.nesst.org/NVFCentralEurope.asp#LSCroatia>

opportunity to involve CSOs more into economic development through encouraging social enterprises and CSO service delivery.

Introduction of the public benefit status may be helpful in clarifying legal uncertainties regarding the tax treatment of CSO economic activities.

IV.3. Germany

		Legal/Fiscal Framework	Historic/ cultural conditions	Country specific elements	Role of CSOs	Examples/Best Practices	Observations
Interaction with the state	Funding mechanisms	Supportive	Sizeable third sector with strong government support . CSOs respected by society. Added value of CSOs acknowledged by the state. After reunification Eastern CSO sector developed quickly.	High level of government support represents over 60% of sector income; at the same time political and professional independence of CSOs maintained.	Recipients and partners	Ability to maintain organizational autonomy despite government support.	Government invested in capacity development of CSOs. CSO independence does not mean there is no control of use of public funds.
	Social contracting	Exemplary	Subsidiarity as central principle means nonprofit providers are preferred over public ones. CSO sector has two main parts: quasi-governmental service providers and more grass-roots civic associations.	CSOs organized in 6 federations that represent interests vis-à-vis government. Services financed by social security payments and subsidies.	Service providers, partners, and recipients of subsidies.	Normative funding financed by social security system complemented with subsidies to cover full costs of CSOs.	Elements of the model very specific to Germany but principles are important. Such model needs well prepared CSOs with professional capacities.
	Alternative financing		No significant model identified				
Interaction with the private sector	Private giving through institutionalized mechanism	Exemplary	Foundation reform movement in 1990ies; since them real boom in private foundations due to new generation of donors.	Very favorable tax deduction scheme introduced in 2007 that led to over 1,000 new foundations being established every year. Many types of foundations, including political.	Recipients of foundation grants.	Tax deduction scheme provides real incentives. Political foundations a way to separate politically oriented CSOs from others.	Legitimate wealth generation and well defined public benefit purposes are important for the transparency of the system.
	Private-corporate giving	Supportive	Corporate social responsibility a long-lasting debate in Germany. Pressure from consumer groups for better practices.	Many forms of corporate philanthropy but only recently started strategic programs. 2007 tax reform also affected companies in a positive way but impact not visible due to crisis.	Recipients of support.	Large corporate foundations' important role in funding research and innovation.	Enabling environment for both large and small companies, supporting role of SME in local development.

Earned income	Individual giving	Supportive	Germany in the middle of European country rankings for level of giving compared to GDP (0.22%). Church tax indicates a larger interest in supporting good causes but expectation is for the state to finance welfare expenses from taxes.	Decreasing trend of donations. Cross border donations also tax deductible if there is a "potential benefit" for the German people. Few large fundraising CSOs collect major part of giving income of the sector.	Recipients and intermediaries delivering assistance.	Simplified and harmonized tax rules for deductions on donations adopted in 2007.	Countries with higher personal taxation show lower level of giving in relation to GDP.
	Income generation	Supportive	Economic activities a tradition in German third sector; including cooperatives, housing and banking associations. Membership fees an important source of income as well.	CSOs can undertake tax exempt mission related economic activities if they receive the public benefit status. This is well-defined and regulated in detail.	Initiator-service provider.	Tax regulation of economic activities related to a clearly defined public benefit status.	This model enables CSOs to generate substantial income from economic activities while preventing abuse.

Basic data on German nonprofit sector

There are two main types of nonprofit organizations in the German third sector:

- registered associations: their number is over 550,000⁷⁴; and
- foundations: their number is over 16,000⁷⁵.

In addition, there are over 5,000 cooperatives that also play an important role.⁷⁶

Financial data on the German CSO sector

The non-profit sector is a substantial economic force in Germany, as far as both expenditures and employment are concerned. It employed 3,6% of the active population; and including volunteers, an equivalent of 6,6%. Its expenditures represented 4% of the GDP. In fact, if the German civil society was a country, its GDP would be 2.2 trillion \$ for Germany (approxi-

⁷⁴ 554,401 in 2008; source: Vereinsstatistik 2008 - Statistics of Associations 2008, produced by the V&M Service GmbH with the collaboration of the Research Institute for Sociology at the University of Cologne, 2008, accessed on <http://www.vita.it/guide/view/50/91455>

⁷⁵ 16,406 in 2008; source: Stiftungen in Zahlen - Errichtungen und Bestandrechtsfaehiger Stiftungen des beurgerlichen Rechts in Deutschland im Jahr 2008, Association of German Foundations, published in 2009, accessed on <http://www.vita.it/guide/view/50/91455>

⁷⁶ According to data by the German Cooperative and Raiffeisen Confederation (DGRV), there were 5,291 cooperatives in Germany in 2007, with approximately 17.6 million members spread across them.

mately 1.7 trillion €), far above the 1.3 trillion \$ average (approx. 1 trillion €) of the all 35 countries analyzed in the *Global Civil Society – An Overview Report*.⁷⁷

The Global Civil Society Report also highlights that the sources of civil society organization revenue without considering volunteers are the following: 64.3% from the government; 3.4% from philanthropy; and 32.3% from income generated by economic activities. According to the same Report, the respective percentage including the value of volunteer work (as philanthropic support) will change to the following: 42.5% from the government; 36.2% from philanthropy; 21.3% from economic activities.

Government funding mechanisms

Historic-cultural context

Germany has a sizable third sector that is marked by strong government support. The nonprofit sector plays a prominent role in the everyday lives of German people by being the main provider of the basic social services, based on the so-called “principle of subsidiarity”. (See social contracting.) Due their significant role in both service provision and everyday community life, CSO are well respected by society as well as the state.

Since the Second World War, Germany was restrained from undertaking a military role abroad but at the same time due to its export-oriented economy it could not be isolated and had to develop its export markets. Therefore it also undertook a prominent role in international development, another area where CSOs are highly involved. The German Ministry of Foreign Affairs provides an opinion on CSOs that recognizes their added value and that is characteristic of the attitudes of the state towards the CSOs in general:

“Non-governmental organizations are a manifestation of civil-society involvement (...). The NGOs strength lies, among other things, in the high degree of motivation and specialist know-how of their staff and partners as well as in the fact that they are in close contact with under-privileged sections of the population – a key prerequisite for people to help themselves and take the initiative.

One thing that all NGOs share is that they have no state authority and conversely that the state has no direct influence over them. Nevertheless, or perhaps precisely for this reason, the work of NGOs is very well accepted the world over, among the population and the media. This gives many NGOs better access to people than state bodies. In many places they can create a special relationship of trust. This has often proved to have created a very solid foundation for staying in contact and in dialogue at critical junctures, especially in politically sensi-

⁷⁷ Lester M. Salamon, S. WojciechSokolowski, Regina List, *Global Civil Society - An Overview*, The Johns Hopkins Comparative Nonprofit Sector Project, 2003.

tive situations, even in countries in which cooperation with the government is difficult or impossible for political reasons.”⁷⁸

The development of the German nonprofit sector has also been influenced by the reunification of West and East Germany that took place in 1990 and the subsequent evolution of a nonprofit sector in East Germany. The Global Civil Society Report says in this regard: “In contrast to the experience of other transition countries in Central Europe, however, the emerging East German nonprofit sector largely adopted existing West German patterns and is by now virtually indistinguishable from its West German counterpart in size, structure, and composition.”⁷⁹

Country specific elements

What is intriguing in the relationship between government and CSOs in Germany is the dual presence of financial support and a relative high degree of political independence (autonomy). In general, the government takes it as an obligation to support nonprofit organizations that fulfill an important social role and help realize government policies (e.g. in social services provision, environmental protection or international development). Yet at the same time there is an inherent understanding that CSOs have their own autonomy and that it is not proper for the state to dictate the direction of their development.

This progressive attitude is rooted in the long-standing principles that have influenced legislation and that also govern the everyday lives of German people. Besides the subsidiarity principle as most relevant for the nonprofit sector and described below, these include also the principle of *self-administration* (self-governance) and *community economic self-organization* (Gemeinwirtschaft).⁸⁰ The former dates back to the 19th century and the absolutist state that realized that it has to provide space for its citizenry to organize themselves if it wants to hold the federal power. Since then, there is the duality of a strong centralized federal state that has the final say in the “big politics” and the bottom-up organizing of citizens to govern their everyday lives. Communal economics gave rise to the cooperative movement and mutual associations in the banking and housing industries, another important pillar in the diverse third sector in Germany illustrating autonomous self-organized entities.

In the light of the above, the government provides budgetary support to a range of CSO activities at all levels, primarily at the state and local level. There are a few policy areas, such as the youth, environment or international development, where federal support is also available. In these cases it is common to have project grants but also long-term strategic

⁷⁸Website of the Ministry of Foreign Affairs http://www.bmz.de/en/what_we_do/approaches/bilateral_development_cooperation/players/ngos/index.html

⁷⁹Germany: Unification and Change. In: Global Civil Society, p. 99
http://www.ccss.jhu.edu/pdfs/CNP/CNP_GCS1_Germany.PDF

⁸⁰Id. p. 105

partnership agreements between the competent Ministry (or federal agency) and the CSOs. At the local level, grants and direct budget support are typical ways to support CSOs.⁸¹

It has to be noted that with the growing economic restraints, originating not only in the recent economic crisis but also in the deeper crisis of the big-spending welfare state, the wide range and volume of CSO support has been shrinking. The tendency is inevitable, but the German government has been inventive in ensuring alternative ways of support for the CSOs that it considers crucial also in fighting the consequences of the economic crisis, namely to encourage private philanthropy (see Private institutional funding).

Role of CSOs

CSOs are essentially recipients of the funding but also seen as partner actors in the social and economic development of the communities.

Examples, best practices

The combination of state funding and respect of organizational autonomy is an important good practice that is hard to find in Central and Eastern Europe. Although the situation is not ideal even in Germany, it would be important to adopt the understanding that the state is funding these private entities because of what *they* do and not because of what the state intends to do. This can be done because as long as the *goals are the same* (e.g., assist the needy, develop the poor communities), it can be assumed that the local CSO will know the needs and possibilities better and it can devise better solutions. Over the past 60 years (since World War 2) this has been proved in the German practice.

Observations

Germany features a dominantly state financed CSO sector with good measures of success and value added. Due to the long-standing, historic principles that govern the relationship between the state and CSOs, it would be hard to “copy” this model in CEE. However, the Ukrainian government could start cultivating such principles in its funding mechanisms as they are of key importance for the development of a healthy civil society.

It is important to note that the lack of government’s political and professional influence does not mean that there is no control over the use of public funds; or in case of service provision, over the quality of service. There are rules of the Treasury by which the CSOs have to abide; and the funding has to be transparent from the side of the government as well.

CSOs have had to develop a certain level of institutional capacity to be able to take advantage of this system. The majority of the over half million associations does not receive government funding (at least not from the central level), but it is important to have a large enough pool of

⁸¹The JHU Global Civil Society Report also notes that only about one third of the CSOs reported that state funding is dominant in their income to the extent that they are dependent on the state. This signals, that while state funding is dominant in the total revenues of the sector (above 60%), it probably concentrates with the large service providing organizations and the majority of CSOs have their income from membership fees and sales of their products and services.

capable CSOs who can be eligible for the funding. The German government, and similarly the Hungarian and Croatian government realized that they need to invest also into the capacity development of CSOs.

Social contracting

Historical-cultural context

Historically the most important principle in German social contracting is that of “subsidiarity”. This principle is rooted in the agreement between the Catholic Church and the State and goes back to more than a century. It gives preference to community based private provision of the basic welfare services over those provided by the government. Essentially, the provider has to be as close to the need as possible; therefore the municipality will only start a service if there is no local CSO that would undertake it, and the state and federal governments will also intervene only if the lower level cannot take care of the service (this can happen e.g. in the case of a rare disease, when there are not enough clients in the territory of the local government to start a service).

As a result, in fields such as health and social services, extensive partnership arrangements emerged between the nonprofit sector and the state. However, this also resulted in the “duality” of the German nonprofit sector. One part of it, oriented at culture, community life, environment, youth is very much “civic”, its main income is from membership fees and service fees and it builds on community support engagement. The other part of it is providing social and health services financed by the state and forms an integral part of the welfare state; those CSOs are highly professional, institutionalized and receive direct budget subsidies and ongoing financing from the social security system (third party payments). They are indeed to some extent considered part of the public sector and perceived as less “civic”. While it cannot be said that the whole nonprofit sector in Germany depends on state funding, this is certainly true for this part of it.

Country specific

Germany has incorporated the principle of subsidiarity in its constitution. The principle of subsidiarity is defined in the following terms: „Subsidiarity means that the larger social unit (the state) should assist the smaller unit (the family) only if the smaller unit can no longer rely on its own resources. In terms of social policy, it basically translates into a system whereby private provision of services takes precedence over public efforts and local provision over non local”¹⁹.

In this connection, the Federal Social Assistance Act states in its article 93 that government agencies are forbidden to establish their own service providers if suitable associations are available, or can be extended or provided.²¹

According to the German Social Security Code, the public bodies are obliged to complement effectively by co-operating with the non-public bodies. Also, the local authorities have to respect the independence of these bodies concerning the setting of objectives, carrying out the

tasks and arrangement of their organizational structure. However, the local authorities have the right to examine the appropriate use of public means employed by the latter.²²

Accordingly, a majority of CSOs are working in the fields of service provision, mainly social services (38.8% of CSOs), health (30.6%) and education (11.7%).⁸²

Service providing CSOs are organized in a very specific way in Germany: they have convened into six major CSO federations which act as „CSO-unions”, representing the interests of their members. (Five of these are related to the major church denominations, while the sixth one brings together all the secular organizations.) These confederations negotiate with the government on an annual basis about the allocations to the service providing CSOs. Part of the funding is prescribed by law under strict criteria (e.g. the amount that is paid per capita for the service or the minimum quality standards of the service); but part of it is negotiable based on various factors, such as the annual inflation rate or the need for infrastructural investments (renovations, extensions of buildings etc). The government then transfers the total amounts of the direct subsidies to the federations and they forward the funding to their members.

CSO role

In this scheme, CSOs are most of all service providers who are partners to the state; also recipients of the subsidy funding.

Examples, best practices

That non-profit provision of welfare and social services is preferred over the public one is a good practice; however, it needs a well-prepared CSO sector that is able to undertake the responsibility for the services.

A good practice element is also that – unlike in Hungary – per capita third party payments are complemented by subsidies that help sustain and develop the CSO as an organization – otherwise the quality of its service provision would suffer. Therefore it shows a model for the „normative” system, in which CSOs are not discriminated but actually preferred.

Observations

Clearly this model is very specific to Germany. CSOs in this model are an integral part of the state welfare provision; this also generates some problems, e.g. that CSOs become almost like state providers and can over time lose their competitive edge (in contrast to the UK model, where there is no legally binding preference toward the CSO providers). The „unionization” of CSOs is also a unique model in Europe and is clearly due to the need for a strong lobby power vis-à-vis the state for the third sector, which receives the majority of its income from the government. Germany has a strong tradition of self-organizing and asserting the rights of

⁸² 1995 data; source: Annette Zimmer Ed., The Third Sector in Germany, MünsteranerDiskussionspapierezum Nonprofit-Sektor, Sonderband 3 –ArbeitsstelleAktiveBürgerschaft at the Institute for Political Science, WestphalianWilhelms-University of Münster, 2000), accessed on <http://www.vita.it/guide/view/50/91455>

private entities against the government, therefore it can be successful there. This may not be the case in some CEE countries, where the unions are usually co-opted by the reigning governments.

Private institutional funding

Historical-cultural context

Foundations have long tradition dating back to the 19th century.⁸³ Yet, until the 1990ies, the legal and fiscal environment for foundations did not receive much public attention. It was only in the 1990s when, due to the initiative of a few leading German private foundations such as the Bertelsmann Stiftung, a reform movement started to unfold and the foundation sector started to boom. This also had to do with a generational change: in the past two decades WW2 survivors have passed away and left considerable wealth to their children, who themselves have had accumulated enough assets not to need their parents legacies for making a living. Therefore this new generation of wealthy people has started to look for opportunities to devote at least some part of the assets to a good cause. Unlike their parents, they are not so concerned that their children will need all the wealth they accumulated during their lives, and are more willing to make an endowment in their lifetime. The tendency of increasing private wealth has continued until today. According to the Bertelsmann Stiftung, there are app. 200 billion EUR passing to next generations every year.⁸⁴

There are several types of foundations in Germany, both private benefit and public benefit foundations are typical. In addition, a new movement of community foundations has evolved (there are today app. 230 community foundations in Germany which were unknown before 1996).⁸⁵ Germany also has so-called political foundations⁸⁶, which are each affiliated with a political party along distinct ideological lines. They receive annual budget support from the related political parties to educate the voters about their political programs. These foundations are also involved abroad, working with affiliated parties, trade unions and CSOs.

Country specific

As mentioned above, over the past decade there has been a real boom in foundations in Germany. In 1996 there were 441 foundations established, while today there are 1,000 – 1,100, or more new private foundations registered per year⁸⁷, increasing the number of foundations to 16,406 in 2008. (Most of them were established in the cities of the former West Germany.)⁸⁸.

There are several reasons for this boom, one being the increase in private wealth and the new generation of high-net-worth individuals; a second being the role of leading German

⁸³ CIVICUS, http://www.civicus.org/media/CSI_Germany_Country_Report_English.pdf

⁸⁴ http://www.bertelsmann-stiftung.de/bst/de/media/xcms_bst_dms_27508_27509_2.pdf

⁸⁵ Id.

⁸⁶ Interestingly, in terms of their legal form, these are actually associations.

⁸⁷ http://www.bertelsmann-stiftung.de/bst/de/media/xcms_bst_dms_27508_27509_2.pdf

⁸⁸ <http://www.vita.it/guide/view/50/91455>

foundations in promoting a new model for foundations; and a third reason being the supportive tax deduction scheme that was introduced in the late nineties.

Concretely, an individual donor can deduct up to €1,000,000 for a donation to the endowment of a foundation with qualifying purposes. (This means essentially public benefit purposes as defined by the German tax law.) The deduction can be taken in the year of donation and/or divided over the following nine years. This has proven to be a serious incentive for many wealthy people who were seeking the most economically efficient “investment” of their assets.

The reason for the government to introduce such changes in the tax laws has been the realization of the inevitable fiscal difficulties faced by the welfare state, and that the tendency of budget restrictions will last for a long time. This meant that a gap was being created between the demand from society in welfare provision – including among others the gap in financing CSOs – and the possibilities of the state to meet the demand. Seeing the accumulated wealth among individuals (and to some extent, corporations), the government aimed to incentivize private philanthropy to address the needs that would remain unmet. Therefore, foundations and their active philanthropic engagement with society have gained political importance.

Role of CSO

CSOs are seen as recipients of foundation support; but also effective conduits of delivering the services to the needy with the funds of the foundations, i.e. partners and service providers on behalf of the foundation.

Best practices, examples

Motivating individuals to convert private wealth into a funding mechanism for public purposes is a good example. It is important to note that Germany resembles the CEE region in the public expectations towards welfare service provision, and that by financing the services, the state ultimately takes the responsibility for providing accessible and affordable social services, health and education for everyone – even if the services are actually delivered by private providers. The private foundation model in Germany is a strategic way to ensure that the services are delivered even when the state does not have the resources to provide them as broadly as earlier.

It is also a good practice that the law makes no difference if the person establishes its own new foundation or if the person donates to an existing one – as long as the funds go towards an endowment, i.e. they ensure the long-term financing of the given purpose. The ability of the person to distribute the deduction over ten years also contributes to the long-term thinking and shows that the legislator has thought with the perspective of the donor in mind.

Finally, the idea of separate political foundations is also an interesting one (it has already been adopted in Hungary too), as it is one way to “channel” the political interests into a legally controllable mechanism. If such category of foundations exists, the other foundations and

other CSOs can be required to refrain from party-related political activity, especially if they are receiving tax privileges (e.g., public benefit status).

Observations,

This is a win-win model for encouraging private philanthropy. However, it has two components that are specific to Germany (or rather, Western Europe): the origin of private wealth is legitimate and can be tracked down, which may be an issue in the case of CEE countries, including Ukraine; and second, the public benefit purposes that are eligible for the tax exemption are well defined in German legislation (tax laws and case law). In case of such a serious tax incentive, the government has to make sure that both the origins and the destinations of these funds will be legitimate and justifiably eligible for tax exemption.

Private corporate funding

Historical-cultural context

The issue of corporate social responsibility (CSR) and corporate citizenship had been a long-lasting debate in Germany, which was reinvigorated in the late 1990ies due to the new “wave” of CSR globally. Consumer pressure on companies to behave responsibly is certainly bigger than in the examined countries in CEE, and that plays an important role in the development of corporate responsibility as well as well as corporate giving.

Companies in Germany have different attitudes towards CSOs depending on their field of activity. E.g. CSOs active in culture and sports have always enjoyed sponsorship and other support from corporations; while consumer groups and environmental organizations have been more challenging towards them and thus, less supported (often they do not even accept funding from corporations). Local and regional companies often play an important role in the communities as employers as well as promoters of community development. Overall it can be said that the relationship between the corporate and CSO sector is a balanced one, where different players have different interests but they can negotiate around their interests in a constructive way.⁸⁹

More recently, companies find it more and more important to have a positive image in the media, and are organizing in various forms to promote social responsibility among their peers. In addition, they have started to become more involved in the promotion and support of the nonprofit sector as such, e.g. KPMG has been organizing a CSO transparency award for the past few years, while other companies are involved in supporting CSOs to become more professional in their management practices.⁹⁰

Country-specific

⁸⁹Based on Civicus Index Germany Country Report p. 37-38

http://www.civicus.org/media/CSI_Germany_Country_Report_English.pdf

⁹⁰Guidestar Europe Germanyreport, 2008

Companies are involved in philanthropic activities in many ways, from giving community grants or giving in-kind donations to company volunteering programs and secondment arrangements; as well as establishing corporate foundations.

Large corporate foundations (Bosch, Siemens, Bertelsmann and others) play an important societal role by financing research and development, social innovation and supporting difficult causes. Company giving in Germany is most often of a classical charitable character, i.e. it is not directly linked to business interests.

At the same time a cross-sector panel evaluating the role of corporate involvement in the Civicus project concluded that “companies are engaged in corporate citizenship, but their engagement is not comprehensive or reliable enough to make a lasting contribution towards solving social problems”.⁹¹

This conclusion is probably due to the relatively low overall level of funding represented by the corporate sector in the incomes of CSOs. According to the JHU data, only 3% of the sector income is derived from philanthropy, individual and corporate support combined.⁹² More recent data from 2007 show that in that year, 29.1% of the firms donated up to 5,000 €, whereas the 30.5% of the firms donated from 10,000 to 50,000 €. The small- and medium-sized enterprises mostly donate up to 50,000 € (86.3% of the small firms and the 65.7% of the medium firms fall in the first three donation categories); 42.1% of the bigger firms, instead, donates from 50,000 to over 100,000 € (2005 data).⁹³

However, in 2007 there has been a major tax reform, with the aim to encourage private involvement in addressing social problems. In this regard, cash, assets and any other economic goods except rights of usage and claims for specific performances can be deducted; and a tax deduction is possible up to 20% of yearly taxable income (or 0.4% of the sum of the turnover and salaries). Donations exceeding the deductible limit may be carried forward to subsequent fiscal years.

Since we have found no data from the past two years regarding corporate giving, it is not clear what the effect of these changes have been in corporate philanthropy. (However, considering also that it has been the period of the economic crisis, it would be hard to measure the effect of legislation separate from the general economic decline.)

Role of CSO:

CSOs are mostly recipients of corporate support.

Best practices:

⁹¹Civicus Index Germany Country Report p. 38

http://www.civicus.org/media/CSI_Germany_Country_Report_English.pdf

⁹²Germany: Unification and Change. In: Global Civil Society, p. 109

http://www.ccss.jhu.edu/pdfs/CNP/CNP_GCS1_Germany.PDF

⁹³ 2007 Report Citizenship in Germany and a Transatlantic Comparison with the USA - Results of a CCCD Survey by the Centrum für Corporate Citizenship Deutschland (Centre for Corporate Citizenship Germany, CCCD), <http://www.vita.it/guide/view/50/91460>

Transparent, exemplary operation in case of the largest, most visible corporate foundations that play an important role in promoting philanthropy and social and economic development in general.

The model whereby 0.4% of the turnover and salaries paid can be deducted from the tax dues as an alternative to deductions of the tax base is important, as it provides an opportunity for companies that do not report a profit in any given year to still enjoy a benefit related to their donation (since it can be carried over to the next years).

Observations

German companies in CEE countries do not have a socially responsible image, especially compared with UK and US companies. This can be a sign that the domestic context in which there is a high consumer pressure for socially responsible performance makes a big difference. It has to be noted that company giving abroad will not generally be subject to the same tax deduction as domestic giving, except if the donor can justify that the gift has been made to an entity pursuing public benefit and that the purposes supported abroad possibly have a positive impact for Germany. Thus, German companies are not encouraged to establish large giving programs benefiting the local environment (unless perhaps if they can argue that it enhances the general image of Germany in that country).

Another observation is that the general tax environment as well as tax incentives for giving benefit large and small companies in the same way. This is important, as small companies are key actors in supporting local development.

Individual giving

Historical-cultural context

Being a European welfare state, individual charitable giving is not as widespread in Germany as in Anglo-Saxon countries such as the UK or the US; however, the % of giving represents a higher level of GDP as in other continental European countries, e.g. France. Data from the Charities Aid Foundation (CAF) in 2006 show that the national giving level represents 0.22% of GDP in Germany, compared to 0.14% in France on the one hand, and on the other hand, 0.45% in the Netherlands, 0.73% in the UK and 1.67% in the US (largest % globally). It is interesting to note also that there was a significant difference between the two parts of Germany: giving in former East Germany represented only 0.12%, while giving in former Western Germany was at 0.26% of the GDP.⁹⁴

Another study revealed that about 35% of the physical taxpayers have declared a donation in their income tax returns between 2001-2003. This indicates a relatively high level of

⁹⁴ International comparisons of charitable giving, CAF Briefing Paper, November 2006
<http://www.cafonline.org/pdf/International%20%20Giving%20highlights.pdf>

engagement from the population compared to the fact that they contributed only a small percent of the income of the nonprofit sector.⁹⁵

In Germany there is also a church tax, which is a voluntary contribution with an opt-out system (in other words, taxpayers are assumed to pay it unless they refuse to do so). According to the CAF research, if this has been included, Germany would have been among the top countries in the levels of giving in proportion to GDP. This shows that there is a traditional basic commitment among German people to contribute to the “greater good”; however, the expectation is in general that the government should be for the welfare services from the taxes paid. Actually, the CAF study concludes that there is a correlation in the EU countries between the level of personal taxation, particularly social insurance, and the level of giving: countries with higher personal taxes show a lower level of giving in relation to GDP and vice versa (Germany obviously belonging to the first category).

Country specific elements

Based on the available research data, it can be seen that there is decreasing trend in the total amount of donations to nonprofit organizations since 2005. While one report estimates 4.4 billion € donated to nonprofit organizations in 2005⁹⁶, the data for 2008 shows only 2.8 billion € that have been donated to third sector entities in Germany, by approximately 27 million people over 14-years old. The average donation amounts to 102 €, and women are somewhat more generous than men (44% of women donates, against 40% of men). Moreover, differences between West and East Germany exist: 43% of the population makes a donation in West Germany against 37% in East Germany. Age groups that are more willing to donations are the seniors and the 50/64-years old people, with respectively 61% and 45% of donors.⁹⁷

Unfortunately there is no reliable data available to compare the levels and structure of giving before and after adopting the new tax legislation in 2007, which harmonized and increased the tax benefits available for physical persons donating to public benefit purposes. Under this law, as described in the section on Corporate Funding, up to 20% of the annual taxable income is deductible for a qualifying donation, while exceeding amounts can be carried forward to future tax years without limitation.

Furthermore, following the recent call by the European Commission that Germany brings its legislation in line with EC Treaty principles regarding the tax benefits, as of January 1, 2009 donations to nonprofit organizations residing in other countries can also be eligible for the tax deduction, if they pursue public benefit purposes and if the donor can justify that the donation has the potential to benefit the German people. (Actually, the EC has challenged this latter provision and it is now under consideration for amendments.)

⁹⁵ Borgloh, Sarah: What drives giving in welfare states? ZEW Discussion Paper #08-123

<http://econstor.eu/bitstream/10419/27606/1/dp08123.pdf>

⁹⁶ Household budget survey, 2005 <http://www.ernop.eu/country/3/germany.html#Data>

⁹⁷ Report 14 JahreDeutscherSpendenmonitor - Fakten und Trends imZeitverlauf by the TNS Infratest Holding GmbH & Co. KG (2008; data from October 2007 to October 2008) <http://www.vita.it/guide/view/50/91460>

It has to be said also that there are only a few hundred CSOs in Germany that are large professional fundraising organizations, and those collect the major part of fundraising (giving) revenues of the sector.⁹⁸ Most CSOs know rather how to apply for state funding and have the same kind of capacity problems in public fundraising as their peers in CEE. This is another reason why the shift to increase available funding from philanthropic foundations can be an effective step (as these foundations also run project grant competitions which resemble fundraising from the state).

Role of CSO:

CSOs are recipients and intermediaries in delivering the assistance to the needy.

Best practices, examples:

Even though it is too early to see the longer term impact, the 2007 tax laws represent good practice in that they provided a unified definition of the qualifying organizations (earlier there were different levels of benefit available for CSO pursuing different public benefit purposes); and that they provided a cross-cutting rule on the tax deductions (earlier there were different limits of deduction depending on the purpose as well as the taxpayer – physical or legal person). In other words, these provisions represent a simplification and an increase in the incentive for making philanthropic donations by individuals.

Observations

Germany is an example of a country where there is a historic commitment to give to the church and public purposes, but where the taxpayers expect the state to pay for the welfare services from the taxes. Yet, through tax incentives this pattern could be slightly shifted (although results show thus far primarily in the field of foundations philanthropy and not yet in direct giving).

Income generation

Historic-cultural context

Income generation and engaging in economic activities has never been alien to the German third sector. In fact, cooperatives, housing and other mutual associations form an important part of the third sector both at the local level and as national federations. (See the reference to the principle of *Gemeinwirtschaft* in the section on Government funding.) More generally, revenues from economic activities, including membership fees, provide for more than a third of CSO sector income.

Unlike in the countries of CEE, membership fees are an important income source for CSOs. According to the Household Budget survey, 6.7 billion Euros were spent on membership fees

⁹⁸ DZI, the main German fundraising certification body certified 236 organizations in 2008, which have together collected 1.4 billion Euros, out of an estimated 2,45 billion (in other estimates, 2,8 billion) Euros in that year.
<http://www.ernop.eu/country/3/germany.html#Data>

in 2005⁹⁹; 1,5 times the amount as on donations (and twice as much compared to later years). Also, it is generally accepted that CSOs are sustained based on their earned income and so customers are willing to pay for CSO services (these are usually services offered beyond the basic services that the state sponsors).

While economic activities are permitted and CSOs generally undertake them, they are also taxed unless they comply with a strict system of rules that is required by the tax-exempt status. The criteria for this status and for the accompanying income tax exemption have been developed over the years and while the 2007 reform gave it a simplified framework, it has retained the key elements of the system. In Germany it is the competent tax authority that determines the eligibility of the organization for the public benefit status. If this is granted, the organization is free to engage in economic activities furthering its public benefit purposes without paying income tax on the returns.

Country specific

Here we are including the provisions relating to the public benefit status and the related tax exemptions as an example that we believe is a good practice for regulating income tax exemptions for economic activities.¹⁰⁰

The Fiscal Code (*Abgabenordnung/AO*) defines three types of purposes as being tax-privileged:

- According to the organization pursues *public benefit purposes (gemeinnützige Zwecke)* if “its activities aim to support the general public materially, intellectually, or morally”. The beneficiaries must not be limited to a closed circle of people, such as members of one family or employees of one corporation. The law also lists a series of purposes that are regarded as supporting the general public if the above requirements are met. The list, which is exclusive since 2007, includes the following categories: science and research, education, arts and culture, religion, international understanding, development aid, preservation of the environment and cultural heritage, support of youth or the aged, public health, amateur sports (including chess), support of democracy, care of soldiers and reservists, and the support of civic engagement. There are also additional explanations provided in the regulations to help interpret these categories.
- An organization pursues *charitable or benevolent purposes (mildtätige Zwecke)* if it aims to support and help people in need either because of their economic situation or because of their physical, psychological, or mental situation.
- *Church-related purposes (kirchliche Zwecke)* include the support of public law religious communities, construction of houses of worship, spiritual development, and religious education.

⁹⁹ <http://www.ernop.eu/country/3/germany.html#Data>

¹⁰⁰ This section is taken from the USIG country report on Germany, with slight modifications only.
<http://www.usig.org/countryinfo/germany.asp#exemptions>

In addition, the AO requires that an organization receiving tax benefits must carry out its tax-privileged (public benefit, charitable, or church-related) purposes *exclusively, directly, and unselfishly*. The organization should pursue its activities by itself (directly) which can also be through “*Hilfspersonen*” (auxiliary persons), through which the organization is acting (employees, free-lancers, other legal persons), e.g., by contracting or assignment. Just to lease premises or personnel to tax privileged organizations would not be considered to be directly pursuing tax-privileged purposes. Tax-privileged entities must use its income before the end of the year following the year during which the income was received.

If compliant with the above purposes, the CSO may receive tax privileges regarding its economic activities. If the activity is necessary to pursue the organization’s statutory purpose and it does not compete with for-profit organizations more than necessary, profits are not taxed and VAT is reduced to 7% (so-called “*Zweckbetrieb*,” according to Article 65 AO). Commercial activities which are not necessary to pursue the statutory purposes of the NPO are taxed at ordinary rates if the annual gross income of non-statutory commercial activities exceeds €35,000 (Article 64, AO).

Role of CSO:

CSOs are producers and sellers of goods and services, as well as service providers for their members.

Examples best practices

The tax regulation related to the public benefit status is a good practice as it ensures for transparency and accountability, and yet it allows CSOs to engage freely in economic activities that help ensure their sustainability.

IV.4. United Kingdom

		Legal/Fiscal Framework	Historic/ cultural conditions	Country specific elements	Role of CSOs	Examples/Best Practices	Observations
Interaction with the state	Funding mechanisms	Supportive	Robust voluntary sector with charity regulation dating back to 1601. CSOs seen as trusted good-doers of publicly raised funding; core to society. Blair "Compact" meant increasing their role in delivering public services; increased support for and investment in building capacity of CSOs.	Compact provides strategic framework. Big Lottery Fund and other funds support CSOs. Decentralized government offices, authorities, and municipalities provide grants for local projects.	Recipients and partners	Good practice guidance given to funders. Regular monitoring of impact of funding.	Compact hard to replicate but its principles can be followed. Current government set to curb CSO funding but strategic approach remains to guide policy.
	Social contracting	Exemplary	Long traditions of fair and open process for contracting out public services. CSOs, private sector and local government institutions are treated as actors with equal chances in public bids.	Best value principle combines high quality with reasonable cost in the evaluation of service tenders. High quality service provision by CSOs, strong user focus.	Service providers, partners.	Best value as guiding principle in contracting. Full-cost recovery (funder paying for indirect costs of the service).	Local municipality encouraged to contract out so doesn't see CSOs as rivals - it has an interest in the good performance of CSOs.
	Alternative financing						
Interaction with the private sector	Private giving through institutionalized mechanism	Supportive	Under common law, trusts have been playing the role of foundations. Charitable trusts are strictly regulated, trustees have personal liability for the assets.	The UK trust/foundation sector spends as much as the government and 10 times more than the corporate sector to support charitable purposes.	Recipients of gifts by trusts.	Increased accountability in safeguarding assets with a public benefit purpose.	Strong, large and diverse trust/foundation sector was key in the development of a strong and independent voluntary sector.
	Private-corporate giving	Supportive	UK companies have been leading worldwide in good CSR practices. Good image is a real motivation in the UK market. Accountability is a key term for the private sector as much as for the public sector.	A wealth of CSR and philanthropy good practices are being practiced from small enterprises to multinationals.	Strategic partners, service providers and recipients of support.	Payroll giving; community investment tax benefit.	Shift away from corporate philanthropy towards a holistic view of socially and environmentally responsible business.

Earned income	Individual giving	Supportive	Highly developed philanthropic culture - donors give as part of the "routine" of everyday life. Despite crisis, charitable giving remained widespread.	Gift-aid: government matches donation by redirecting tax on the amount to the charity.	Recipients and vehicles to deliver donor's intentions.	Certain limited benefits to donors in exchange for donations are allowed.	New government prefers tax incentives to direct funding of CSOs.
	Income generation	Exemplary	"Primary purpose" trading income tax free; trading income for fundraising and other "non-primary purpose" trading only allowed within limits.	Social enterprise movement has been playing a big role in social development.	CSO acts as business but profit reinvested.	Tax breaks for primary purpose trading	Highly enabling environment for SMEs in general is key to the success of the social enterprises.

Basic data on the UK nonprofit sector

There are 180,918 charities in England and Wales.¹⁰¹ Government funding of CSOs was around £12.8 billion in 2007/08 and it accounts to over one third of all income to the sector. Around 40,000 organizations have a financial relationship with the public sector, but over 75% of CSOs do not have direct financial relationship with the state.¹⁰² Most of the funding from state sources is distributed to organizations working in social service fields.

As part of the state funding, an important source of income is the proceeds from lottery. 28% of lottery proceeds are distributed to good causes in the categories of: charities, health, education and environment (50%); sports (16.67%); arts (16.67%); and heritage (16.67%). So far £25bn has been distributed to over 350,000 projects.¹⁰³ The largest distributor of lottery proceeds is the Big Lottery Fund.

Funding mechanisms

Historic-cultural context

The UK is a common-law country with very different traditions and legal mechanisms than countries in the continental Europe. At the same time, it has many specific solutions, examples that can be well adopted in European and CEE countries as well. Yet, here we would like to set as the main example not one or another concrete tool or mechanism but the overall approach that the UK demonstrated in its effort to involve civil society (in the UK, the voluntary sector) in the provision of welfare services.

¹⁰¹ <http://www.charity-commission.gov.uk/showcharity/registerofcharities/registerhomepage.aspx> (data as of December 1, 2010) However, charities are not the only form of CSOs. They constitute about a half of around 865,000 CSOs in the UK. European Commission, "Recent Public and Self-Regulatory Initiatives Enhancing NPO Transparency and Accountability of Non-profit Organizations in the European Union", developed by ECNL, 2009, www.ecnl.org

¹⁰² NCVO, Funding Commission, *Paper 4- Public Sector Funding- Findings and Emerging Recommendations, 2010*, www.ncvo-vol.org.uk

¹⁰³ www.lotterygoodcauses.org.uk/lottery-grants/lottery-grant-faq/

The UK has a robust voluntary sector with charity regulation dating back to 1601. Charities seen as trusted good-doers of publicly raised funding; while all voluntary organizations seen as core to society. Unlike in Germany, in the UK private nonprofit entities did not develop to be an integral part of state service provision. However, they developed their own services from philanthropic resources and demonstrated impressive results with the communities they served. During the time of financial constraints and in line with the general policy of streamlining the welfare state, in the mid-nineties the labor government set out to develop a new overarching policy to capitalize on the potential of the voluntary sector.

The result was the so-called Compact, a principle document which defined the tasks, rights and obligations on both sides (government and voluntary sector), and which served as the basis for a long-term strategic effort to maximize the benefits not only for the government and CSOs, but most of all, for the population. The Compact meant an increasing role for both charities and the voluntary sector in delivering public services. It also meant increased support for and investment in building capacity of CSOs.

The Compact was followed by several related policy documents, guidance and regulatory measures, all based on solid data and impact assessments. Today, the new government has somewhat different ideas about the role of and relationship with CSOs; however, it builds on the results of the process thus far and considers the outcomes – both negative and positive – in setting new policies.

Country-specific elements

The Compact provides a strategic framework for CSO support. The cooperation is institutionalized through the recently reformed *Office for Civil Society in the Cabinet Office*, which is active in the field of support for the sector through cooperation and funding, social enterprise, charity law and regulation volunteering and giving and the sector's role in public services. Central government funding is often channelled through other bodies, such as the regional government and regional development agencies, non-departmental public bodies and local National Health Services trusts.¹⁰⁴ Lottery proceeds provide significant funding to CSOs working in selected fields of activities. The past decade has witnessed countless initiatives both from the government, funding agencies and CSOs to improve funding practices. It supports web-based portals which aim to facilitate the implementation of the granting schemes and ease the access to information about funding opportunities (e.g., governmentfunding.org.uk, Decision Support Tool¹⁰⁵ and fundingcentral.org.uk).¹⁰⁶

Role of CSOs

CSOs are recipients of funding but they are seen as long-term partners by the governmental funders.

¹⁰⁴ NCVO, *The State and the Voluntary Sector; Recent Trends in Government Funding and Public Service Delivery*, 2009, www.ncvo-vol.org.uk

¹⁰⁵ National Audit Office, *A Decision Support Tool for Public Bodies in England*, www.nao.org.uk/guidance_and_good_practice/toolkits/better_funding.aspx

¹⁰⁶ Hadzi-Miceva and Golubovic, 2011

Examples, best practices

The Compact is a unique mechanism for government- CSO partnership. While it cannot be expected to be replicated as such in other countries, we find it important to point to some of the key elements of the Compact process (including its implementation to date) as instructive for devising a strategy for cooperation with the CSO sector:

- There needs to be a vision for the relationship, that clearly describes the role of CSOs vis-à-vis the central and local authorities, and provides clear benefits for both sides.
- The government will need to invest into capacity building of CSOs in order to make them capable of playing an increased role in social development. Even though the CSO sector in the UK was many times more developed than in any other European country, the government still needed to propose capacity building programs across the country to help them fulfill their new functions.
- There needs to be funding strategy supporting the overall development strategy, which enables the vision (see example written under “General Findings”).
- There needs to be enough data and information available to make sound policy decisions – if such data is not available, the government needs to invest into producing them (during the past years, several UK government agencies engaged in measuring progress in the various aspects of implementation).
- There needs to an ongoing assessment of the process and openness to flexibly change

Observations

The Compact itself is hard to “copy” in other contexts, but its principles can be followed: partnership, joint processes, clear rights and responsibilities, commitments on both sides. The current government is set to curb social expenditure and CSO funding but the strategic approach remains to guide policy (under the name of Big Society¹⁰⁷).

Social contracting

Historical-cultural context

In the UK there is a long tradition of fair and open procedures for contracting out public services for purposes of government efficiency. In principle, CSOs, the private (for-profit) sector and local government institutions are treated as actors with equal chances in public bids. Due to the boost in privatization during Thatcher, for-profit providers dominated the public services market for quite a long time. However, in the past 15 years, since the Compact was adopted, CSOs have been gaining a more prominent role in welfare service delivery, espe-

¹⁰⁷ See <http://www.cabinetoffice.gov.uk/content/big-society-overview>

cially in the areas of housing, social services and education. This was assisted by capacity building programs of the Blair government aimed at voluntary organizations and charities, with the aim to become more professional to meet contracting requirements, and more sustainable to ensure long-term partnerships.

Country specific elements

The leading principle in contracting out social services in the UK has been the so-called “Best Value” principle. This was an important principle that is nowadays used by most public service tenderers. Traditionally in procurement price used to be the leading factor of selection. However, it has to be recognized that in most public services, especially the abovementioned welfare services price alone cannot drive the competition; that could lead to a serious decrease in the quality of the service. Ensuring a certain quality is key in the case of social services, education and similar fields. The “Best Value” principle combines high service quality with reasonable cost in the evaluation of service tenders.¹⁰⁸

In the UK, there is some evidence that CSOs are providing generally higher quality services than other sectors, especially the government. The Audit Commission of the UK¹⁰⁹ has published a Report in 2007¹¹⁰ which contains some hard data regarding comparisons of nonprofit (voluntary), for-profit (private) and governmental (public) service providers in the area of social services. The Report found that “voluntary sector providers meet a greater proportion of the national minimum standards than in-house [i.e. public] or private sector providers”. Data is retrieved from the Commission for Social Care Inspection. It analyses seven different types of social care services for children, younger adults and older people (mostly residential/institutional care services) over the period 2003-2006. In six types of services, the voluntary sector providers have consistently outperformed the other two sectors over the four years in terms of the levels of meeting national standards. Only in the service area of residential special schools have the private sector providers achieved a slightly higher rate of compliance than the voluntary sector.¹¹¹

In addition, UK CSOs can bring additional resources for the municipalities. They are able to attract volunteers and also donations (to cover part of the costs or add additional value to the services provided). The above mentioned UK Report cites an example from Greater Nottingham, where a study found that for each 1 GBP the local council invested in the form of grant

¹⁰⁸ Although it has by now been replaced with a newer, more complex performance measurement method, the Best Value remains a key principle for contracting out. See <http://www.idea.gov.uk/idk/core/page.do?pagelid=5184420>

¹⁰⁹ The Audit Commission is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local services for the public.

¹¹⁰ *Hearts and minds: commissioning from the voluntary sector*. Audit Commission Public Services National Report, July 2007

¹¹¹ *Id.* pp 19-20. It should be noted that the Audit Commission also observes: “the data available do not permit a robust assessment of value for money. For example, they do not reveal the cost of achieving a higher proportion of minimum standards, nor whether reaching a higher proportion of minimum standards actually lead to a better quality service for end users” (Although the latter is an implicit assumption).

funding to local voluntary organizations, the voluntary sector was able to lever in approximately another 6 GBP through mobilizing volunteers and community resources. In Newcastle, every 1 GBP given in grant aid brought in another 14 GBP from local voluntary organizations.¹¹²

Role of CSOs

CSOs are seen as strategic partners in delivering social services, therefore the government has invested in their capacities to meet quality standards.

Examples, best practices

Apart from the best value principle, there are two good practices to be mentioned: full cost-recovery and user-focus. Both came as a result of strategic advocacy processes led by the CSO sector.

- *Full cost recovery* has been one of the Compact funding principles and means that government funders should finance not only direct costs of a service but also any indirect (overhead, administrative) costs associated with it that the CSOs occur as an organization. See more on this under *Chapter III, General findings: The importance of a strategic approach*.
- *User focus* is a principle that has been championed by UK CSOs as an alternative to government services in the 1980ies, when service quality was largely measured by infrastructure (especially in institutional care) and evaluations by the caring professions (experts). CSOs argued that the most important factor is whether the users are satisfied with the service they receive; and that they should be involved in planning, designing and evaluating the services. The term “user” itself reflected a departure from the traditional term “client” or “patient”, as it refers to the entitlement of the beneficiary to use the service rather than being subjected to it. As a result of a long advocacy process, by today user-focus is a mainstream principle in all government services and it lead to the redesign of the service models (including user-consultation, user-empowerment, user-led services and other similar methodologies in the development and management of services).

Observations

In the UK, the local municipality is encouraged through the performance evaluation of the government to contract out. Therefore incentives for contracting (and thus, effectiveness and efficiency) are built in to counter the natural institutional interests of keeping the services in-house. Unlike in most CEE countries, municipalities do not see CSOs as rivals - they have an interest in the good performance of CSOs. At the same time, CSOs have high quality profes-

¹¹²*Id. p 24.* The two above sections were taken from Nilda Bullain and Luben Panov: *Handbook on non-state social service delivery models*, ECNL and UNDP, 2011 (under publication).

sional and infrastructural capacity which is not entirely dependent on the funder. These two factors account for a relatively successful model of social contracting.

Private institutionalized giving

Historical-cultural context

Under common law, there is no separate legal form for a foundation. However, there are foundations in the UK, which can assume different legal forms; most often this will be a trust. A trust is an entity created to hold and manage assets for the benefit of others. The trust must pursue a charitable purpose and is governed by trustees. Trusts have a long history in England. In fact, the protection of private property dedicated for public purposes was the original goal of charity regulation in the 17th century.

Charitable trusts have been a key factor in the development of the voluntary sector as well as society as a whole. Many of them maintain hospitals, schools or museums. Others are essentially grant-giving foundations that give grants to voluntary organizations and charities to support public benefit causes. Others are so-called Community Investment Finance Institutions, which lend money to businesses, social enterprises and individuals who struggle to get finance from mainstream banks and loan companies. They help deprived communities by offering loans and support at an affordable rate to people who cannot access credit elsewhere. They can also be by Government.

A trust ordinarily is not a legal person. Under the Charities Act of 1993, however, the body of trustees can apply to the Charity Commission for a certificate of incorporation. An incorporated body of trustees is a legal person, but without the usual corporate limitation on liability; in other words, trustees are personally liable for the assets of the trust. Incorporation allows the trust to perform particular functions -- hold property, enter into contracts, and sue and be sued -- in its own name rather than in the names of trustees.

Charitable trusts are regulated by the Charity Commission. Due to the strict regulatory environment and the fact that trustees have personal liability, trusts are a well established sector and enjoy the support of the public.

Country specific elements

There are three main groups of charities that act as grant-makers in the UK:¹¹³

- Charitable trusts and foundations. Independent charitable trusts and foundations in the UK act in a variety of ways to support the voluntary and community sector. Grant-making is the predominant activity for most foundations. The majority of foundations

¹¹³ Grant-making by UK trusts and charities, ACF and CAF, January 2007 http://www.acf.org.uk/uploadedFiles/Publications_and_resources/Publications/0416B_TrustAndFoundationBriefingPaper.pdf

- in the UK do not engage in any operational activities, i.e. the provision of services or other direct support to beneficiaries.
- **Community foundations.** Community foundations are charitable trusts that support local community causes. Their role is to manage donor funds and build endowments as well as make grants to charities and community groups, linking local donors with local needs.
 - **Other charities.** Some large operating charities, or operating fundraising charities (that is those that do provide direct services), also carry out grant-making. This type of grant-making often supports a charity's own programmes and projects and/or provides specific funding for their field of interest (e.g., the British Heart Foundation and Oxfam).

The estimated total number of trusts and foundations in the UK is 8,800. The spending from trusts and grant-making charities is broadly comparable with central government spending (£2.5 billion) and nine times greater than the £0.3 billion of corporate cash donations.¹¹⁴

Role of CSOs

CSOs are usually recipients of grants from the trusts.

Examples, best practices

Increased accountability in safeguarding assets with a public benefit purpose is good practice. While the personal liability of the trustee is not feasible under continental law, it serves as an example for creating greater incentives for prudent directorship of the public benefit organization.

Observations

The UK has a very strong, large and independent grant-making sector. Trusts are extremely diverse – not only in the scale and number of grants made and the type of trust - but in their age, their style of grant-making and in the areas they support.¹¹⁵ This sector is a key reason why UK CSOs are able to develop institutionally and yet remain independent and thus become equal partners to the government.

Private corporate giving

Historical-cultural context

The concept of corporate social responsibility (CSR) goes back centuries in the UK, to the Victorian era and industrialization when the success of factory businesses across the country brought about masses of urbanized factory workers living in overcrowded slums. One of the earliest mentions of an “industrialist philanthropist” is the Quaker entrepreneur Cadbury,

¹¹⁴*Id.*

¹¹⁵http://www.acf.org.uk/trustsandfoundations/?id=74#Grant-making_by_Uk_Trusts_and_Charities_a_briefing

whose aim with a coffee and tea (and chocolate) factory was “a business with a conscience: Quakers believed in equality and social justice, and Cadbury hoped his products would prove an attractive alternative to alcohol, seen as the principle cause of poverty and deprivation among the working classes.”¹¹⁶

CSR got a new impetus in the early 1980ies when as a result of a combined effect of Thatcherian privatization, global recession and the end of the manufacturing industry, Britain was faced with the unrest of socially excluded masses. A new movement among British businesses led to the formation of Business in the Community, a leading CSR membership organization until today. In 1985, the Prince of Wales became its president, and the following year, Thatcher attended the launch of the Per Cent Club, encouraging companies to donate at least half a per cent of pre-tax profits in cash or kind to Business in the Community and other projects.

“It’s worth noting, however, that this outpouring of generosity by business was driven as much by self-interest as philanthropy. (...) most of the big companies backing Business in the Community were cutting far more jobs than they were creating, and needed to show their remaining employees, trade unions and the communities (...) that they were doing something to help the victims. At another level, the prosperity of business was linked to the prosperity of society: right at the outset, David Sieff, a board member of Marks & Spencer and Business in the Community, remarked that the wealth of the high streets depended on the health of the backstreets, a catchphrase that was to become caring capitalism’s slogan.”¹¹⁷

In the mid-1990ies, came the new global push for social responsibility in protecting the environment and the future of the planet (an early representative of this trend has been the Body Shop). This trend over the past 15 years led to a shift in thinking about CSR among British (and multinational) companies from the focus on “caring” and charitable giving (corporate philanthropy) to a focus on their core business: to ensure that their supply, production and distribution lines, employee policies and operating practices are all “ethical” (respecting the environment, diversity, sustainability etc.).

Country specific elements

A wealth of CSR and corporate philanthropy good practices are being practiced from small enterprises to multinationals. According to the data, corporate philanthropy has been on a decline in the past decade (in line with the shift in the focus of CSR mentioned above). Although total charitable giving by the 500 biggest companies has grown in real terms over the past few years, it has tumbled by more than half as a percentage of pre-tax profits, according to the Charities Aid Foundation – from 1.6 per cent in 2001/02 to just 0.7 per cent in 2005/06, the latest period for which figures are available. Indeed, the Per Cent Club closed in 2006.¹¹⁸

¹¹⁶ Tomkins, Richard: Shifts in corporate philanthropy, in: Financial Times, January 17, 2009.

<http://www.ft.com/cms/s/2/3a0856c6-e1d5-11dd-afa0-0000779fd2ac.html#ixzz1ITRCUAKO>

¹¹⁷ *Id.*

¹¹⁸ *Id.*

The majority of corporate community support comes from a small number of companies. The latest (7th) edition of *The Guide to UK Company Giving*, just published by the Directory of Social Change, reveals that of the 490 companies covered in the guide, a mere 50 accounted for over three-quarters of the total cash donations given in support of charitable causes. Of the £500 million donated in total in 2007/08, nearly 77% (£384 million) was accounted for by this small group.¹¹⁹

A specific feature to be mentioned is payroll giving. Although this is a benefit in the personal income tax, it should be mentioned under the title of corporate giving, as it needs the commitment from the company as an employer to make it available for its employees. Payroll giving means that for employees who sign up to the system the company will deduct and automatically transfer a specified amount of the employee's salary to a charity of their choice. This gift is fully tax deductible, i.e. there is a 20-40% saving on the donation for the donor.

Payroll giving is growing in the UK: it has increased from £37 million in 1999/2000, to over £106 million in 2009/2010. But there is still room for further growth: only 4% of UK employees participate in payroll giving schemes (for comparison, in the US, the employee participation rate is nearly 35%). Research shows that companies which offer payroll giving believe it improves the company image, enhances community involvement programs, and supports employee volunteering. 96% of companies feel that payroll giving is something a good employer should offer; and nearly all said they would like to increase participation levels in their organizations.¹²⁰

Role of CSOs

CSOs are actively seeking funding from companies. However, over the past 15 years they have been increasingly undertaking other roles as well: partnering with companies on CSR programs (e.g. "cause-related marketing"¹²¹), giving advice and training to companies on CSR (e.g. on workplace diversity or "greening the office"), and holding companies accountable for their practices (advocacy campaigns). One of the reasons companies have adopted ethical practices in the UK has been the ability of CSOs to mobilize public opinion against them if they failed to do so (e.g. organizing consumer boycotts).

Examples, best practices

Incentivizing payroll giving (as a specific form of giving) is a good practice because it creates a joint incentive between employers, employees and charities. It encourages employees to organize and advocate for the introduction of this form of giving at their workplaces, and encourages companies to introduce it to improve their image. Often companies will match the amounts given by their employees which in turn can lead to a tax deduction for the company.

¹¹⁹http://www.companygiving.org.uk/page.aspx?SP=CG_News

¹²⁰<http://www.payrollgiving.co.uk/index.php?getID=4&getTitle=Employer>

¹²¹This is when a company sells a product with the logo of a well-known CSO and transfers part of the proceeds to the CSO.

Observations

The historic and cultural conditions for the development of corporate philanthropy are unmatched in continental Europe, not to mention the CEE region. However, globalization and the increasingly unified European markets mean that the good CSR practices are spreading to this region as well. While corporate philanthropy and cash-based giving is on decline, there is plenty of room for CSOs to engage with companies and for the government to provide innovative incentives for philanthropy.

Individual giving

Historical-cultural context

The UK is one of the countries with the highest levels of philanthropic giving in Europe and worldwide. It ranks 8th on the World Giving Index, with only Ireland, Switzerland and the Netherlands ranking higher among European countries.¹²² This is important in understanding the strength that the UK voluntary sector derives from having a strong supporter base independent from government support.

The Gift-Aid is a specific form of tax benefit provided upon charitable donations. It does not necessarily mean a tax advantage for the donor, however, the charity can receive the tax benefit.¹²³ If the donor claims Gift-Aid, the Treasury will match the donation with the proportionate amount of tax to be paid on the donation by transferring it to the charity. In essence, for every 1£ donated, the charity will receive an additional 25 pence from the Treasury. (In some ways it is similar to the percentage mechanism; however, unlike with the percentage scheme, in this case the donor has to make a real gift to the charity.) The fact that giving remains high (between 54-58% of UK population give to charity every year), regardless of the fact that donors do not get a real tax benefit, illustrates the importance of the cultural rootedness of philanthropy.

Another element that is important to recognize is the strong charity regulation. Charities are registered and supervised by the Charity Commission, an independent regulatory body that is specialized in understanding, supporting and investigating charities. As a result of a long and consistent regulatory practice regarding charities, the public considers a charity as a reliable organization that is worth supporting. Therefore, the “charity” label became like a trademark that people can trust with their gifts.

¹²²The World Giving Index 2010, Charities Aid Foundation
<http://www.cafonline.org/pdf/WorldGivingIndex28092010Print.pdf>

¹²³Only higher rate taxpayers can claim a tax benefit, which will be the difference between the lower rate tax (20%) and the rate they are paying (40 or 50%). Therefore, they will be able to claim 20 or 30% of the donation in a tax deduction.

Country specific elements

The crisis years (2008-2009) saw a decreasing trend in donations but a slight increase was reported already in 2010. Key findings of the most recent report on UK giving include:¹²⁴

- **Charitable giving remains widespread.** In 2009/10, 56% of adults living in households in the UK donated to charitable causes. The typical amounts given per donor per month in 2009/10 were £12, measured by the median, and £31 measured by the mean. Our best estimate of the total amount given to charity in 2009/10 by all such individuals is £10.6 billion, clearly a major contribution to the work of the voluntary sector. In addition, donations from individual legacies are estimated to provide at least a further £2 billion (the latest estimate, based on 2007/08 figures).
- **High-level donors have the greatest impact on the total amounts given.** The share of total donations coming from high-level donors in the survey (those making donations of more than £100), has increased slightly, from 6% in 2005/06 to 8% in 2009/10. Furthermore, this does not take account of the very wealthy who give very large amounts (..). It is estimated (...) that very wealthy individuals gave 100 donations of £1 million or more (...), with a combined value of £1.0 billion.
- **If the recession hit giving, levels are recovering.** Over the last year the proportion of people giving increased slightly, after decreasing between 2007/08 and 2008/09 at the time of the recession. The typical (median) amount given also increased, from £10 in 2008/09 to £12 in 2009/10. The overall amount of £10.6 billion given to charity was an increase in real terms of £400 million compared to £10.2 billion in 2008/09 (once adjusted for inflation). However, the total amount given has not recovered to 2007/8 levels.
- **The patterns of who gives and how they give remained much the same as in previous years.** Women aged 45 – 64 continue to be the most likely group to give (68%) and young men aged 16 – 24 the least likely (31%). People in managerial and professional occupations are the most likely to give (69%) and they also give larger median amounts on average (£19). Giving by cash remains the most common method of donation, used by half of all donors (50%) in 2009/10. After increasing between 2005/06 and 2008/09, the proportion of donors using direct debit now remains fairly steady at 29%. Those giving larger amounts tend to use cheque/card and direct debit.
- **Use of the Gift Aid scheme appears to be leveling off.** Gift Aid was used by 40% of donors in 2009/10, a similar proportion to 2008/09. Before that there had been a gradual increase in Gift Aid usage. People who donate larger amounts are more likely to use Gift Aid; in 2009/10 Gift Aid was used by 73% of those giving higher-level donations (£100+) but only by 20% of those giving donations of £10 or less.

Role of CSOs

¹²⁴ UK Giving 2010. CAF and NCVO, December 2010
http://www.cafonline.org/pdf/UK%20Giving%202010_101210.pdf

CSOs in the UK are playing a strong role in raising funds for causes. However, “voluntary organizations not only benefit from donations, they also perform a role in highlighting social needs to suppliers and potential suppliers of social finance.”¹²⁵

Examples, best practices

The creation of the charity sector is an important example that can be adapted in continental Europe through a properly designed public benefit legislation. The charity sector is only about a third of the whole voluntary (CSO) sector, but it is the most institutionalized and professional part of it, which is working hard to gain and maintain the trust and monetary support of people. The Charity Commission not only controls, but rather supports the sector in becoming more professional and deserving of the public trust.¹²⁶

At the more technical level, a good practice that can be shared is that the UK determines a certain level of benefits that the charity can give to donors “in exchange” or rather, as an appreciation of the donation. This is a helpful way of regulation to make a clear difference between donations and sponsorships. The below table illustrates the value limits of benefits for donations in order for the donation to qualify as Gift Aid.

Benefit value limits for donations¹²⁷

<u>Amount of donation</u>	<u>Benefit value limit</u>
£0 -100	25% of the donation
£101 - £1,000	£25
£1,001 - £10,000	5% of the donation
Above £10,000	£2500 (maximum) ¹²⁸

Another good practice method is the *community investment tax relief*, which allows investors in the community development finance institutions (see above) to reclaim up to 25 per cent of their investment in tax relief over five years.

Observations

While the new government is cutting back on direct government funding for CSOs, it is increasing the available types and amounts of tax incentives for charitable giving. According to news on the latest Budget of the UK, George Osborne, the Chancellor of the Exchequer (Minister of Finance) has “unveiled a raft of measures aimed at helping voluntary sector organiza-

¹²⁵ The summary is taken from: UK Giving 2010, CAF and NCVO

¹²⁶ More recently, with budget restraints reaching also the Charity Commission, it is planning to focus more on its role as a regulator and less on the support functions it has been playing. However, by now there is a wider infrastructure available for the support of charities as well.

¹²⁷ http://www.hmrc.gov.uk/charities/gift_aid/basics.htm

¹²⁸ This is to be raised to £5,000 as of 2011.

tions in what he claimed were the "most radical and most generous reforms to charitable giving for more than 20 years".¹²⁹

Reforms will enable charities to claim Gift Aid on donations totaling up to £5,000 per charity without any paperwork, implementing an *online claim system* for the tax relief by 2013 and a 10 per cent tax break on inheritance tax for people whose wills include a 10 per cent legacy to charity. Osborne said he wanted to make "giving 10 per cent of your legacy to charity the new norm in our country". They will also retain community investment tax relief, which was recommended for removal.

Furthermore, in December 2010, the Cabinet published the so-called Giving Green Paper, which sets out „the Government’s initial ideas for building a stronger culture of giving time and money to start a national debate on our society’s attitude to giving.”¹³⁰

These policies demonstrate that while the Conservative government prefers different means than Labour to support charities (indirect rather than direct incentives), it places an equally high emphasis on their role in the well-being of society and the development of the country. The ideas relating to indirect incentives may be of interest to CEE governments that are cautious to commit direct funding to CSOs.

Earned income

Historical-cultural context

Charity law allows charities to exercise a trade in the course of actually carrying out a primary purpose of the charity. This is commonly known as “primary purpose trading”. Examples include, e.g., the provision of educational services by a charitable school or college in return for course fees; the holding of an art exhibition by a charitable art gallery or museum in return for admission fees; or the sale of tickets for a theatrical production staged by a theatre charity.¹³¹

However, if fundraising is the main or sole aim of trading activities (for example the selling of postcards by a child-welfare charity) this is called "non-primary purpose trading." Charity law does not permit charities to directly carry out non-primary purpose trading where a significant risk to their assets would be involved. There are special tax rules to help charities that wish to carry out small amounts of non-primary purpose trading, when all the profits from the trading are to be used by the charity. The maximum permitted non-primary purpose trading turnover for a given tax year is £5,000 for a charity whose total income is under £20,000; 25% of the

¹²⁹Ricketts, Andy: Gift Aid reform and tax relief figure prominently in Budget, In: Third Sector Online, 23 March 2011

<http://www.thirdsector.co.uk/news/Article/1061503/Gift-Aid-reform-tax-relief-figure-prominently-Budget/>

¹³⁰<http://www.cabinetoffice.gov.uk/resource-library/giving-green-paper>

¹³¹ USIG country note on England <http://www.usig.org/countryinfo/england.asp>

total income of a charity whose annual revenues are between £20,000 to £200,000; and £50,000 for a charity with an annual total income of over £200,000.¹³²

Commercial/economic activities other than the exceptions set out above cannot be conducted directly by the charity; however, any commercial/economic activities can be conducted through a for-profit subsidiary with the profits then transferred tax-free to the charity. Many charities now have trading subsidiaries for fundraising purposes.

Country specific elements

Social enterprises¹³³ are a specific form of businesses trading for social and environmental purposes that took hold in the UK. The pioneers of social enterprise can be traced as far back to the 1840s, for example in Rochdale, where a workers' co-operative was set up to provide high quality affordable food in response to factory conditions that were considered to be exploitative. A resurgence of social enterprise started in the late 1990s with the coming together of different traditions, including co-operatives, community enterprises, enterprising voluntary organizations and other forms of social business. Social enterprises are distinctive because their social and/or environmental purpose is absolutely central to what they do - their profits are reinvested to sustain and further their mission for positive change. Famous social enterprises from the UK include *The Big Issue*, a newspaper distributed by the homeless, or Jamie Oliver's restaurant *Fifteen*.

Government data (the Annual Survey of Small Businesses UK 2005-2007) estimates that there are approximately 62,000 social enterprises in the UK contributing at least £24bn to the economy. Social enterprises are estimated to employ 800,000 people. The State of Social Enterprise Survey, released November 2009 found that despite the recession, social enterprises are twice as confident of future growth as typical small to medium enterprises (SMEs), with 48% of social enterprises responding positively as opposed to just 24% of SMEs. Additionally, since the economic downturn began, 56% have increased their turnover from the previous year whilst less than 20% have seen it go down. This is a considerably better performance than SMEs in the UK, where only 28% increased their turnover and 43% saw it go down.

Social enterprises are active in a wide range of industries. According to a DTI survey in 2005, health and social care services is the largest category of trading activity for social enterprises as it was the principal trading income source for 33% of respondents, followed by education at 15%. Social enterprises are also extremely active in the energy, transport and recycling markets. However a social enterprise can be successful in any market - from an employee-owned bicycle shop to an IT consultancy firm hiring people with Asperger's syndrome.

Social enterprises can take different legal forms, the most often used is the company limited by guarantee (a nonprofit company form); as well as membership societies or the recently

¹³² *Id.*

¹³³ This section is written based on information on the webpage of the Social Enterprise Coalition UK. <http://www.socialenterprise.org.uk/pages/frequently-asked-questions.html>

introduced community interest company. Since tax considerations are important, many of them assume also a charitable status; however, this brings with it a layer of regulations that do not fit all types of social enterprises. In February 2010 the Social Enterprise Mark was launched as the brand for social enterprises. It requires a business to meet six defined criteria in order to qualify to receive the Mark.¹³⁴

Role of CSOs

CSOs in the UK are often entrepreneurial and engage in trading activities to achieve their charitable causes. In these cases they are essentially like for-profit businesses, showing great care for their multiple stakeholders (their customers, the community and the beneficiaries of their cause).

Examples, best practices

Encouraging social enterprises is a good practice in the UK. In terms of charity regulation, the tax free pursuit of “primary purpose trading” is a clear incentive that can lead to the emergence and spreading of socially oriented businesses that create employment, provide social and health care, promote education, develop communities and contribute to the social and economic progress in the country.

Observations

In the UK, there is a generally favorable legal environment for doing business, including starting and running a small or medium enterprise. It ranked 4th out of 183 countries of the world in the *Ease of Doing Business* survey of the World Bank in both 2010 and 2011.¹³⁵ This demonstrates that an enabling legal environment is needed not just in terms of CSO regulation but also (most of all) in terms of small enterprises in order to promote a culture of social entrepreneurship.

¹³⁴See more at <http://www.socialenterprisemark.org.uk>

¹³⁵<http://www.doingbusiness.org/data/exploreeconomies/united-kingdom/>

IV.5. Czech Republic

		Legal/Fiscal Framework	Historic/ cultural conditions	Country specific elements	Role of CSOs	Examples/Best Practices	Observations
Interaction with the state	Funding mechanisms	Neutral	Debate on the role of civil society and its relations to the state between Havel and Klaus - held back development of state support schemes.	Widely spread state budget support and local support to CSOs without an overarching policy or structure.	Recipients of state funding.	Use of EU facilities to support CSO development; contracting with independent grant-maker to manage grants.	No data on sector to support effective policy making. State builds on existing capacity for sector development.
	Social contracting	Neutral/Supportive	CSOs involved in social services provision since 1990ies. Special legal form created for public benefit service provision.	Contracting principle; competition for licensing of services; in-kind social benefits including recently introduced vouchers.	Service providers, dominant in certain fields (personalized care).	Voucher system can have great potential if successfully introduced in practice. Good practice, as increases service users' choice and voice.	CSOs part of the picture but without a system of support and development for long-term partnership in service provision.
	Alternative financing	Exemplary	Government endowment of private grant-making foundations using 1% of privatization income: a unique alternative financing case. See below.				
Interaction with the private sector	Private giving through institutionalized mechanism	Exemplary	In 1991 a law was adopted that dedicated 1% of the income of voucher privatization in the Czech Republic for the strengthening of the CSO sector (as a form of restitution for civil society).	Foundation Investment Fund distributed the assets from privatization to over 200 foundations in 1999-2001. Foundations are strictly regulated and have to report annually on their spending.	Foundations are long term strategic partners to the state.	This scheme resulted in a strong domestic foundation sector that can help ensure sustainability of CSOs when foreign donors leave.	CSO sector was supported by the public and by policy makers as a key part of the democratic transition.

Earned income	Private-corporate giving	Neutral/hindering	Due to lengthy process of the voucher privatization, company giving took on later than in other NMS.	Tax deduction available but minimal. Deductions available not only for donations not only to CSOs but for individuals as well.	Recipients of company donations.	Czech Donors Forum a good example of sharing good practices with company donors.	No special features or innovations in this field.
	Individual giving	Neutral/supportive	Giving was not typical in the 1990ies but started to increase after the 2002 floods. CSOs built on this occasion to raise their profiles.	Relatively high level of giving (not just to CSOs) and volunteering among the population. Fundraising permits required for public collections.	Recipients of charitable gifts.	CSOs used the flood rescue efforts in a creative and strategic way to raise funds.	Czechs active also in public life (petitions, demonstrations) so can be mobilized for supporting causes that matter to them also financially.
	Income generation	Supportive	Generally high levels of membership in associations. Asking for fees in CSO service provision is customary, they are not expected to provide everything for free.	Detailed regulation of the ability of various legal forms to engage in economic activities. Partial tax exemption for purpose-related business income.	CSOs: service providers; foundations: investors.	CSOs excel in certain types of services and are recognized through payments from government and service users as well.	High levels of membership and volunteering signal strong community links of CSOs and increase chances for sustainability.

Basic data on the Czech nonprofit sector

The Czech Republic's nonprofit sector consists of civic associations, foundations, endowment funds, public benefit institutions, church-related legal entities, and organizational units of civic associations, such as trade associations. At the end of September 2009, there were 105,758 nonprofit organizations operating in the Czech Republic. The most widespread types of nonprofit organizations are civic associations, which number 68,057.

The only information that is available to date on the overall income and its structure is the estimate made for the Johns Hopkins NPO project. According to Frič and Goulli (2001) public funding made up 39.4% of the Czech nonprofit sector's cash revenue, while fees provided 46.6% and private philanthropy 14.0%. If churches and religious organizations were included and the value of volunteer labor added, the estimates changed considerably: public funding then accounted for 31.8%, fees for 36.7% and philanthropy for 31.4%. However, these figures are more than a decade old.

The tradition of charity and voluntary association in “The Lands of the Czech Crown” is rich and old, dating back to the beginning of the Czech state in the 9th and 10th centuries. Its long evolution culminated in the latter half the 19th century - by the end of the 19th century the Czech Lands had the largest number of charitable and voluntary organizations in the Austro-Hungarian Empire - and in the twenty years of the first Czechoslovak Republic in the 1920’s and 1930’s. Its evolution was then disrupted by fifty years of totalitarian rule (1939-1989).

In spite of harsh repression, some independent citizen initiative as well as opposition to the communist regime did exist, but remained fragmented and weak. Both the early scattered opposition of the 1950’s and the mightier reform movement of the Prague Spring in the 1960’s were put down by force, and so after 1968 occupation of the country by the Soviet Union, cultural activists and civic leaders had to find new ways of independent existence and opposition to the regime. They found it in the parallel polis of independent cultural initiatives, samizdat publishing, underground church and underground university and in the defense of human and civil rights initiated and inspired by Charter 77.

Government Financing

Historical-cultural context

The communist regime had a huge impact on civil society in the Czech Republic, which persists to this day. This inheritance manifests itself, for instance, in the prominent role of the state, the paternalistic attitudes of the public, in the absence of a strong middle class, in the suspended traditions of giving and volunteering etc. A high level of mistrust in other people and in democratic institutions characterizes the Czech Republic, like the other post-communist countries, inhibiting the development of a strong civil society.¹³⁶

In the 1990s Czech conceptions of civil society were influenced by a polemical debate between two of the leading political personalities of the time, Václav Havel (the then president) and Václav Klaus (the then prime minister). The debate reflected the ambivalent relations between the state and CSO sector. A key question was that of the mandate and legitimacy of CSOs to protect public interest and to participate in public policy (in contrast to elected political representatives). Havel believed that CSOs play a central role in society and that they should be compensated for the losses suffered from the dictatorships in the same way as other segments of society (i.e. citizens, companies and the church). His initiative led to the adoption of the support of foundations (see below). Klaus, on the other hand thought that CSOs are no more than “hobby” organizations and the state should not interfere with their affairs, negatively (oppressing them) or positively (supporting them). As a result of this debate, the Czech Republic did not have an overall policy towards the development of the CSO sector and followed separate routes for CSO development than the other Visegrad countries. E.g. it intro-

¹³⁶ Vajdova, Teresa: An assessment of Czech civil society in 2004: after fifteen years of development. Civicus Civil Society Index Report for the Czech Republic http://www.civicus.org/media/CSI_CzechRep_Country_Report.pdf

duced a special scheme for creating domestic foundations but did not adopt a percentage law. Government funding as such has not been properly regulated until this day.

Country specific elements

Presently, CSOs receive public resources from the State budget and from budgets of all public administration offices (regional and communal), which amounted to a total of US\$ 264 million in 2007. 70% of this was provided by the Ministry of Education and Sports, and the Ministry of Labor and Social Affairs. Nearly half of this state support was received by CSOs seated in Prague. Furthermore, the Czech Republic provided support to civil society from specially dedicated funds (see below). In addition to the State funds, CSO also received funding from the 14 administrative regions and from more than 6,000 municipalities. The overall total of state support for CSOs amounted to US\$ 446,4 million in 2007.¹³⁷

The Czech Republic has uniquely introduced targeted funding to support civil society not only directly from the State budget but from specially dedicated funds from the EU and other foreign support schemes. One example is the EU Transition Facility, which was an instrument for new member states to help the transition period after becoming a member of the EU.¹³⁸ While other countries used this mainly to build capacity for the public administration, the Czech Republic dedicated a part of the funds to support the development of the CSO sector. Unlike other countries, which contracted the grant management to a state supervised or private agency, Czechs contracted with a leading grant-making foundation for this purpose (Civil Society Development Foundation, NROS).

NROS has also been managing the Czech NGO Fund (Block Grant for NGOs) that supports Czech CSOs under the Financial Mechanisms of European Economic Area and Norway, with over 10 million EUR¹³⁹. While the Norway mechanism supported CSOs also in other new EU member states, this was the first program in the region that provided institutional support for the development of CSOs and the CSO sector.

CSO role

CSOs are seen as both recipients and partners in government funding.

Examples, best practices

The Czech government used EU funds to foster the development of civil society. To achieve this purpose, it contracted an independent domestic grant-giving foundation for the management of the funds. This was very beneficial for the effectiveness of the program, as NROS

¹³⁷ Pajas, Petr Jan: *Civil Society in the Czech Republic*, 2011. Data taken from: *Analysis of Financing CSOs from Public Resources in 2007* (Governmental Council of Non-Government Nonprofit Organizations, Prague, 2008). In: Yuwen, Li (Ed): *NGOs in China and Europe*, Ashgate, 2011. Page 266.

¹³⁸ The Transition Facility was created by the European Commission for the accession countries as a continuation of assistance in areas where administrative and institutional capacity is not sufficient yet compared to the current member states. It also focused on areas that could not be financed from the Structural Funds. The program was scheduled for the period 2004 - 2006, but the drawdown of funds for various projects running until 2009.

¹³⁹ See www.blokovygrant.cz

had experience of providing small grants to CSOs, which most government bureaucracies always struggle with. This was a good way to find a balance between the need to have a strict reporting and accounting framework for the EU and the Government, and the need to have smaller, flexible and needs-based projects for the CSOs. CSOs did not have to undertake unreasonably big administrative burdens, yet the reporting and accounting requirements of public budget spending were met by NROS.

Observations

Experts examining the Czech CSO sector have difficulties in making a sound analysis as there key data are missing, and the data available are unreliable, often contradicting or not representative.¹⁴⁰ This is a reflection on the lack of a coherent state policy towards the sector, as such data would be essential to devise an effective strategy for civil society development.

One feature that seems outstanding from the available information is that in the Czech model, the government often builds on already existing capacity of suppliers in the country for managing government funds. This is exemplified not only by the NROS example, but also e.g. by the establishment of the Czech Development Agency, that was inducted by the Ministry of Foreign Affairs to develop policy and manage programs in development cooperation of the Czech Republic. Instead of creating a new institution, it took up the activities of the already existing think-tank, the Czech Development Center. This approach also means that the Czech Government – unlike some of its neighbors in the region – considers the effectiveness of independent or semi-independent (“arms-length”) agencies in distributing state funding.

Social contracting

Historical-cultural context

CSOs have been participating in service provision since the political changes in the 1990ies. This was partly inspired by the post-independence economic reforms where privatization was a dominant feature not only in terms of state assets (as in most other countries), but also in terms of public services. The approach was reflected also in the legislation: the Czech Republic was the first in the region to create a special form for the provision of public services, namely the public benefit corporation (PBC). This is a non-membership, nonprofit legal person whose main function is to conduct social, educational and other "generally beneficial services" to the public on equal terms and conditions (which, on the other hand, endowed foundations cannot directly undertake). PBCs were originally created to enable the privatization of state entities providing public benefit services.

¹⁴⁰ http://www.e-cvns.cz/soubory/Hladka_paper.pdf Hladká is listing the two credible studies used by most researchers analysing the Czech sector, one from 1995, the second from 2001, revised in 2004. Specific cross-sectoral data are hard to collect even for institutions focusing on the analysis of the sector.

In practice, however, PBCs commonly have been used as an alternate legal form for those foundations created before 1998 that could not meet the criteria for establishing a foundation under the new Law on Foundations (see below). Other organizations, including theatres, hospitals, homes for the elderly, drug rehabilitation clinics, and other kinds of not-for-profit establishments providing community services, became PBCs after the enactment of the Law on PBCs.¹⁴¹ A more structured and fuller participation of CSOs in service provision was hampered by the competing policy views on the role of CSOs vis-a-vis the state (as noted above).

Country specific elements

The overall system of social service provision in the Czech Republic is based on the contracting principle. Social service providers compete to receive a license in order to be able to register and run the services. Licenses for concrete types of services are issued by regional authorities based on an assessment of whether the provider is capable of meeting all the conditions prescribed by the Law.¹⁴² Conditions include service quality standards and are regularly inspected. A fundamental measure of the quality of social services is the compliance with human rights when providing social services (a progressive approach compared to many other countries in the region). The principle of competitiveness is therefore included in the social contracting scheme, which in theory renders the provision of social services more effective. State licensed CSOs, private firms and even individuals may become service providers.

Besides annually revisited¹⁴³ priorities in social contracting, innovative projects beyond these priorities are also funded if the provider is able to show the added value of the innovation.

As a specific feature of the Czech social system, the Act No. 111/2006 on Assistance in Material Need also enables the provision for social allowances in kind. The provision in kind should be maintained either in the form of *vouchers (tokens)* which are intended for buying basic food, clothes or in the form of special credit cards scheme. The aim is a closer connection between the labor market and social assistance benefit system. At present, in some Czech municipalities and city districts there are pilot projects in progress with this scheme of social benefits provision.¹⁴⁴

¹⁴¹USIG Czech Republic Country Information <http://www.usig.org/countryinfo/czechrepublic.asp>

¹⁴²In March 2006 Parliament approved a set of three new acts related to social benefits with the date of implementation on 1st of January 2007: Act on Assistance in Material Need, Act on Living and Existence Minimum, Act on Social Services.

¹⁴³ The annual revisits are conducted more as an evaluation exercises to reflect on progress and introducing technical interventions rather than changing the course or strategy every year. Based on experience the priorities are rather stabile, leaving enough space for creating longer term strategies in line with state preferences by services providers.

¹⁴⁴Provazníková, Romana: An alternative provision of public services – the use of vouchers. University of Pardubice, Economic Faculty, 2007
http://dspace.upce.cz/bitstream/10195/35612/1/ProvaznikovaR_AnAlternativeProvision_SP_FES_2007.pdf

CSO role

Based on available information it can be drawn that NGOs are definitely accepted as social service providers. The decentralization of services is not only financial but relates to the transfer of responsibilities and possibilities for control. The process of decentralization is directed towards the local authorities, and then from local authorities to contracting services out to independent providers. Although territorial self-governments are still the majority providers of social services, CSOs play a dominant role in specific types of services such as social counseling or social prevention.¹⁴⁵

Examples, best practices

The voucher system which is included in the law but not applied widely yet, can be considered a good practice. In this system, the government distributes the vouchers to the service users, who will choose the provider (among those licensed), and the government will reimburse the cost of the services to the provider based on the actual usage. This system provides a choice to the service users, enables them to provide direct feedback on the services, and encourages competition among the providers. There are also counter-arguments, especially related to the fact that service users are often under-informed and may make the wrong choices (from a professional point of view). In the Czech Republic, it is early to see any serious effects of this tool as it has only been launched in very limited ways (It is planned in some districts of Prague with a more restrictive character, e.g., restricted use of social welfare for alcohol, etc.).

Observations

Overall, the Czech system with the contracting principle linked to a transparent and relevant accreditation system of the social services providers represents a progressive and user centered, decentralized approach, offering room for qualitative improvements.

CSOs are involved in the provision of social services but – in contrast with the UK or Germany - there is no general scheme that would assist them to become sustainable and reliable partners for the central and local government in ensuring the welfare services for the population. The voucher system may be beneficial for CSOs if they are able to prove that their services are in high demand by the beneficiaries.

Alternative Financing/Institutional private giving¹⁴⁶

In the Czech Republic, on the initiative of Vaclav Havel, the first Parliament of the new Republic adopted a provision in the law on privatization according to which 1% of the total

¹⁴⁵BCNL: Contracting of Social Services between the State and the NGOs in England, Germany, Poland, Hungary, the Czech Republic and the practices in Bulgaria. Sofia, 2004

¹⁴⁶The Czech Foundation sector is analyzed as an example under both of these categories as the form of financing the foundations was an innovative and unique method.

privatization income of the country shall go towards the support of the Czech nonprofit sector. This was justified by the fact that post-1989 all citizens, churches and private entities received some kind of restitution (compensation for assets that were nationalized by the socialist government) except CSOs, which were for the most part, newly formed.

It took almost a decade to agree on the exact form of the support, during which the privatization income was accumulated in a separate account. In 1998 the Parliament adopted a new law in which the system was laid out: foundations in the Czech Republic are required to have a certain level of endowment, cannot engage in economic activities and are subject to a set of strict transparency and accountability rules. These foundations were eligible to apply for the privatization funds, which provided them with endowments, which in turn allowed the foundations to support CSOs in their respective geographic and thematic fields on an ongoing basis.

With this solution the state played an important catalyzing role in the development of civil society through a one-time investment. Today there are around 300 indigenous grant-making foundations in the Czech Republic, making it the strongest foundation sector in CEE, and thus, relieving the burden of the government to finance small community organizations, startups, innovative pilot projects and other high-risk or economically not feasible philanthropic projects.

Country specific elements

The Foundation Investment Fund (NIF) was established in 1991 from the allocated 1% of shares from the second wave of coupon privatization as an asset of the fund. It has managed these assets that were dedicated to the nonprofit sector. NIF was designed to strengthen the nonprofit sector by ensuring the support of community projects, non-profit organizations. It has played an important role in the formation of a strong endowment base for the Czech CSO sector, and currently constitutes the majority of registered endowments of Czech foundations.

The tender for the breakdown of the contribution from the Foundation Investment Fund, took place in two stages. In Stage I (1999), a total of 500 million Czech crowns (CZK) were divided into 39 foundations in seven program areas. In Stage II (2001) a total of 64 foundations were distributed 849.3 million crowns, and share future revenues from the sale of shares in the NIF portfolio.

Foundations who benefitted from this arrangement are strictly regulated. They are required to distribute annual income (if any) and use the proceeds for the calendar year (real income) by the end of next year. There are certain rules as to how the income can be used (e.g., according to its purpose and through open grant competition). However, the Foundation should strive to preserve the real value of the endowed assets. They can use up to 20% of the income for its own administration or to increase/preserve the assets, while 80% has to be used for grant support. Investment policies are prescribed to the Foundations and they have to report annually on the incomes from investments and the use of the income for grants.

In exchange, Foundations enjoy certain benefits, e.g., tax free investment income and tax exemption for yields resulting from economic use of a property that is part of the protected endowment of a foundation.

Furthermore, foundations have pooled their assets and contracted with an investment company that worked out a specific portfolio that complies with the legal requirements and aims to achieve the highest yields within the limitations on risk-taking that the law and good practice require.

CSO role

Foundations that were recipients of the state funds were seen as long-term strategic partners of the government to provide sustainable support for communities and CSOs in the Czech Republic.

Examples, best practices

The concept of endowing private local grant-making foundations – with the appropriate regulatory environment - is itself a best practice. Due to the fact that the Foundation Investment Fund contributed largely to the stabilization of hundreds of local and national CSOs, by endowing them, the Czech donor sector is vivid and diverse supporting wide range of activities in the country. This presents a good model for the survival of CSOs without foreign funding while avoiding dependence on the government.

Observations

A unique example in Europe (and even globally), in which the state not only offers tax credits or annual support but practically contributes to the endowment of independent grant-making institutions. When this idea was raised in Hungary – with the aim to follow the Czech example -, Hungarian CSOs as well as the general public rejected it out of mistrust towards the potential recipient foundation (they were not convinced that such endowed foundations would spend the funds in their support). In the Czech Republic, CSOs and foundations were seen in a more positive light and the system was seen as part of the democratic transition process, so it did not meet a negative public opinion.

The comparatively high number of registered active CSOs within the country couldn't exist without the large number of donors –and the decentralized principle of funding –, which shows the practical relevance of the theory of a large one-time investment that pays off.

Since the institutionalized private donor community is rather big compared to the other NMSs, there is relevant experience with professional grant-making to share and learn from each other. Due to the diversity of funding models, these grant-makers also influence state and corporate grant-making practices.

Corporate giving

Cultural-historical context

Corporate charitable giving as well as various forms of corporate engagement with the society has strong historical roots in the Czech Republic. Due to the lengthy voucher privatization period the corporate engagement was developing slowly after the changes in 1989 but nowadays it is comparable or in some aspects more developed than in other NMSs. The large number of endowed foundations made an influence on changing attitudes of Czech firms for establishing more and more charitable mechanisms.

Country specific elements

According to taxation laws, subsidies, grants, and donations for NGOs are tax-deductible, and individuals and companies may deduct donations from their tax base. The current maximum allowed deduction (5% of taxable income for legal entities), however, is inadequate to motivate potential donors. In 2009, the situation worsened when the tax rate was lowered; with a smaller tax bill, individuals and companies were less motivated to offset their tax liabilities through charitable donations. The tax environment in the Czech Republic is further complicated by inconsistent interpretations of the tax law. For example, a lawyer, an economist, an accountant and a financial office may all interpret it differently.¹⁴⁷

The deductibility of a donation under Czech law is a function of the activity rather than the form of the recipient organization. In order to be deductible, a donation must be made for “financing science and learning, research and development, culture, schools, police, fire squads, support and protection of young people, protection of animals and their health, social and health care, ecology, humanitarian and charity purposes, religious purposes for registered churches and religious communities, and sports, as well as for supporting political parties in their activities”. Deductible donations can also be made to individuals under certain conditions (e.g. to support their education, to disabled people, to victims of a natural disaster etc.). In addition, a donor may receive a deduction for a donation to any legal entity that properly applied for and carried out a public collection under the Public Collections Law (i.e. fundraising).¹⁴⁸

CSO role

Recipient of funding from companies. Other roles (adviser, strategic partner etc.) are not typical as yet.

Examples, best practices

An interesting example of good practice is the Czech Donors Forum. This is a membership organization of donors that also exists in other countries. However, due to the strong foundation sector in the Czech Republic, the Czech Donors Forum has been building a vast

¹⁴⁷USAID Sustainability Index 2010

¹⁴⁸USIG Czech Republic country information.

array of practical knowledge, learning points and good practices in CSO grant-making that are very useful also for companies. Therefore, companies in the Czech Republic have a specialized resource and advocacy organization that they can rely on in order to be able to donate more efficiently, in a simple and cost-effective way.

Observations

Company giving and CSR in the Czech Republic is similar to that in other NMS, without any specific features or innovations.

Individual giving

Historical-cultural context

Most of the CSO sector has always had income from services and membership fees. In part due to this, also due to the greater availability of foundation grants, and finally because of the general attitude of the socialist past, individual giving has not been particularly strong in the Czech Republic. This was especially true in the first decade of the transition. However, there was an increasing movement among leading CSOs to mobilize public support, and the catastrophic floods of 2002 provided a sad but opportune occasion to turn the public sentiment on philanthropic giving. Fundraising initiatives to help flood victims produced outstanding results and provided a good basis for CSOs to carry on developing a broader pool of supporters for their “ordinary” work. The image of Czech CSOs was also strengthened during the flood rescue efforts as they acted quickly and professionally, often more effectively than the state agencies.

Country specific elements

According to the Civicus CSI Index, 47% of people have donated either money or a gift to a CSO in 2004. Over the previous 4 years there was a slight increase of 4% in charitable giving in the Czech Republic. The survey Civil Society 2004 reveals that the total value of material or financial donations last year did not exceed CZK 700 for two thirds of citizens making donations. The average gift per citizen in 2004 was CZK 1,161. With the average net income per annum in 2001 of CZK 83,000 this amounts to 1.4% of a person’s annual income.¹⁴⁹

The largest proportion of individual donors is found among people with university education (64% donated in the last year). Entrepreneurs, people with incomes over 15,000 CZK per month¹⁸, people from the higher status group and believers belong to groups who give to charity significantly more often than others. Czech citizens most frequently donate to causes related to children (49%), physically handicapped people (35%) and people stricken by a natural catastrophe (24%). These main target groups remain the same as in 2000.¹⁵⁰

¹⁴⁹ Vajdova, Teresa: An assessment of Czech civil society in 2004: after fifteen years of development. Civicus Civil Society Index

Report for the Czech Republic http://www.civicus.org/media/CSI_CzechRep_Country_Report.pdf p.30-31

¹⁵⁰ *Id.* p.30-31

The survey also showed that 32% of citizens of the Czech Republic did voluntary work during the last year. In light of the CSI's assessment criteria this is a minority, but when compared to Poland, the percentage of citizens volunteering at least once in the last year is approximately twice as high in the Czech Republic than in Poland. Based on CSI data, compared to Poles, Czechs are also more likely to donate to CSOs. These differences may have to do with the different role of the Church in the civil society: Church plays a major role in Poland while the Czech Republic is one of the most atheistic countries in the world with 59% of non-believers (Czech Statistical Office 2004). Church itself was not included among CSOs in the CSI project.¹⁵¹

As for the legal framework, CSOs aiming to conduct public fundraising activities need to register their campaign under the Act No. 117/2001 on Public Collections ("Public Collections Law"). Registration and permit for the collection is required not only from CSOs but anyone who wants to run such activity (e.g. a parent who wants to collect money for her sick child). Individuals may deduct donations to qualifying NGOs up to 10 percent of the person's taxable income. However, to qualify for the deduction, the individual must donate at least 2 percent of his/her taxable income or CZK 1,000.¹⁵²

CSO role

CSOs are recipients of donations. The culture of giving is still very much of a charitable (rather than philanthropic) nature in the Czech Republic.

Examples, best practices

CSOs have used the occasion of the natural catastrophe in a creative and strategic way to build interest in regular giving.

Observations

Czech people have a strong inclination to express their opinion and make their voice heard. This is also visible from the CSI index: close to 50% of Czechs have engaged in some kind of citizen advocacy activity in the past five years (some 12% of the Czech population has written at least one letter to a newspaper, around 14% have participated on a demonstration, and 43% have signed a petition). This would indicate that if asked effectively, they would be willing to donate as well. Philanthropic giving is another way of expressing their opinion on what should change in their country and their communities.

Income generation

Historical-cultural context

¹⁵¹*Id.* p. 30

¹⁵²USIG Czech Republic Country Information

Although there is no recent data available on the incomes of CSOs from economic activities, due to their role in service provision it can be assumed that the majority of income sources of the Czech CSOs is still income from statutory and non-statutory services.

The activity of citizens is high in Czech Republic (see below), for this reason the membership fees are likely to represent a relevant source of income at least for the major associations. This tendency has been improving except the trade union sector, where the decline is almost constant over the last 20 years¹⁵³.

The CSI survey showed that 47% of the Czech population is a member of at least one CSO, representing a significant increase from 2000 (29%). 23% of citizens are members of more than one organization, which means that almost half of the members of CSOs belong to more than one organization. The largest membership is found in sport organizations (16%) and trade unions (13%), followed by organizations of gardeners and growers (6%), voluntary fire brigades (6%), faith-based organizations (6%) and fishermen organizations (5%).¹⁵⁴

Country specific elements¹⁵⁵

An association may not be established for the primary purpose of carrying out economic activities. Foundations and funds are prohibited from engaging in economic activities directly or through other entities except for leasing real property in their endowment, and organizing lotteries, raffles, public collections, and cultural, social, sporting, and educational events.

Foundations (but not funds) are allowed to hold up to 20 percent of the shares of a joint stock company and invest up to 20 percent of their property remaining after subtracting the value of their endowment in stocks of shareholding companies traded on regulated stock markets. (Strict rules govern the use of the endowment on the capital market.)

PBCs may engage in so-called “complementary operations” (for example, economic activities) provided that these do not jeopardize the quality, scope, and availability of the organization’s public benefit services. PBCs may establish another juridical person but are not allowed to take part in the entrepreneurial activities of other juridical persons. Any profit earned from economic activities must be used for a PBC's development.

Income from profit-yielding economic activities that is related to the statutory purposes of a CSO is subject to a reduced tax. All related income is fully exempt from income tax up to CZK 300,000 (approximately USD 17,250). Total revenues (i.e., income minus related expenses) at the end of fiscal year over this amount are reduced before taxation by 30% or CZK 1,000,000 (approximately USD 57,500), whichever is less, provided that the proceeds are used for statutory public benefit activities within three years of accrual and other conditions are met.

¹⁵³ Martin Myant, Trade Unions in the Czech republic, 2010

¹⁵⁴ Vajdova, Teresa: An assessment of Czech civil society in 2004: after fifteen years of development. Civicus Civil Society Index Report for the Czech Republic
http://www.civicus.org/media/CSI_CzechRep_Country_Report.pdf p.30-31

¹⁵⁵ Information in this section is taken from the USIG Country Information on the Czech Republic.

CSO role

In relation to income generation, CSOs are mainly service providers. In addition, foundations are seen as investors in the capital markets.

Examples, best practices

In certain fields of social assistance, mainly in ones that offer rather personalized, local services, the Czech CSOs play a dominant role in services provision. Asking for a fee in exchange for the service is customary; CSOs are not expected to give the services for free.

Observations

The extent to which Czech CSOs have been able to generate resources from their constituencies (membership fees, volunteer contributions, service fees, other economic incomes) shows that there is at least a certain level of “rootedness” among CSOs. They have strong links with their communities that they can build on as they increase also the financial support from people. Notwithstanding the existing contradictions in the law, a generally well regulated, enabling legal environment has helped income generation activities.

V. Conclusions Based on Country Findings

Based on the analysis of various aspects of funding mechanisms in countries the research was covering the conclusions and recommendations listed in this and the next chapter may be divided into two main areas. The *Conclusions* refer to **general considerations, enabling environmental and policy conditions** for effective funding mechanisms (basing funding mechanisms on a clear strategy, ensuring larger transparency accountability and motivating systems through a version of defining public benefit status). The *Recommendations* (Chapter VI) refer to **concrete technical steps** and funding methods the legislators may consider introducing in Ukraine in the field of governmental funding, social contracting, private institutional giving, corporate giving, individual giving, and earned income. The recommendations are based on the general conclusions drawn from the country analyses and the identified best practices as could be applied in the Ukrainian context. As it is visible from best practice countries, only a harmonized approach of strategic level interventions and the palette of technical funding tools may bring the wished impact that is also cost effective.

Conclusions relating to the general funding environment

To ensure that the Ukrainian CSO sector can grow to serve the larger benefit of the citizens and become a reliable trusted partner for the government, it is crucial to develop a proper funding strategy for this sector. Key considerations in developing the funding strategy include:

a. Link between overall policy framework and funding mechanisms:

- The research has demonstrated that the success of a funding mechanism is strongly related to the existence of two key elements: (a) a clear understanding (in the form of a government policy) of the intended role for the CSO sector in social development, and (b) a strategic approach to funding which makes it possible for the CSO sector to fulfill this role.
- Therefore, there is a need of a “from the vision to the mechanism” approach to link funding mechanisms to be introduced with the vision and purpose of CSO development: the legislator needs to determine what functions it envisions for the CSOs; then to develop the appropriate tools to achieve the results.
- Developing a strategy for CSO development is typically the primary element that envisions a clear role for CSOs vis-à-vis the government. However, preparing the strategy itself means little in terms of the impact of governmental measures. Equally (if not more) important is the relevance of the strategy to the desired impacts; and the relevance of funding policies to the strategy.

b. Evidence based approach in developing and monitoring the funding mechanisms:

- There needs to be sufficient data and information available to make informed evidence based policy decisions in this field. This is important, as the CSO field is often neglected as a policy area and basic data are missing.
- There needs to be an ongoing and systematic effort to trace the practice and impact of the implementation of the strategy.

c. Success factors of the “funding mix” for the CSO sector:

- The CSO sector cannot be financed through one main mechanism. Funding streams have to reflect the diverse functions, organizations and needs of the sector. There can be a different funding strategy for larger service providing and for small community based CSOs. Both direct and indirect means of support can be effective.
- The funding streams have to come from long-term sustainable resources (public and private) so that CSOs can predict the levels of funding and can plan long-term. Some creativity may be needed to identify those – but based on the findings of the research it is possible.
- The funding mechanisms should be complementary rather than competing; e.g. re-granting or intermediary organizations should not be in a competition with the CSOs they are supposed to support.
- While certain income sources are less significant in terms of the total revenues of the sector, their absence or presence can dramatically change the conditions for CSO sustainability (the principle of “less is more”).

d. Importance of an enabling legal-fiscal environment:

- Developing funding mechanisms should take a long-term view (8-10 years) and consider a gradual development of the various mechanisms, building on each other (e.g., introduction of tax benefits after redefined public benefit status).
- A coherent approach in developing an enabling legal environment is needed, e.g. in introducing tax deductions and the public benefit status. The public benefit status can serve as a good basis for the indirect support of CSOs but only if it is well defined and entails tax benefits that serve as real incentives.
- It is essentially the culture and historic traditions that determine the behavior of taxpayers, CSOs and the state in any country. However, intelligent tax policy can capitalize on the opportunities presented by the ever changing environment and introduce incentives which can successfully change behaviors.
- Innovation and creativity can be helpful in legislation. Other countries can serve as models but every country can create its own most effective solution. However, in this case the risk of unintended impacts is much higher (see the case of the percentage laws in Hungary and other CEE countries).

e. Considerations in supporting CSO sector development

- Government needs to invest into the capacity development of the CSO sector. Even in the most developed countries, CSOs need support in delivering the expected increased contribution to the public good.
- Government should also ensure that there are resources that finance the ongoing development of the CSO sector – startups, innovations, service development etc. These are usually more effectively funded from private sources; where there is a lack of these, government can undertake this role or provide incentives to private actors to pursue it.
- Government should assume a difference between strategies supporting on the one hand CSOs that assist in state service provision – more long-term direct support and more regulation can be justified if they are more involved in providing government services; and on the other hand, other types of CSOs (community based, cultural, environmental etc.) – more indirect support, project based direct support and less regulation are typically needed in their case.

VI. Recommendations

The following proposals are recommendations based on the best practice examples that were identified in the country research, considering the general conclusions as well as their potential applicability in the Ukrainian context. They need to be considered within a strategic framework that is based on solid policy evidence.

Public benefit status

We see the introduction of a meaningful public benefit status as a central element of a CSO funding strategy, as it can serve as the basis of providing the various benefits that can be afforded to the CSOs through the funding mechanisms. The public benefit status ensures a higher level of accountability and transparency to the CSOs in exchange for being eligible for a higher level of direct and/or indirect benefits than “regular” CSOs. As such, it could be the basis for a number of benefits and privileges listed below, including e.g. eligibility for normative support, for tax deductible donations, for tax deductions on endowments etc.

Currently there is a “charity” status, related essentially to tax deductible donations. However, there are different limits (e.g., an additional 5% is deductible for donations for cultural heritage); the existing benefits seem not to be sufficient incentives to change behavior; and there is no unified understanding of this status (somewhat similar to the situation in Germany before 2007). A well-defined status with clear conditions and tangible benefits, available for a broad range of CSOs, could be the basis of a more developed CSO sector, with more state and private sector involvement but also with increased transparency and accountability.

Government funding

This Study proposes the establishment of a Fund for Civil Society Development (Civil Fund). The main aim of the Fund would be to build capacity in the sector in two ways:

- To strengthen CSOs that are capable of undertaking services contracted by the government; and
- To strengthen smaller CSOs and more broadly speaking civic groups and communities through a multiplier effect.

In order to achieve this, the Fund would not only give grants directly to CSOs but it could also be able to support through regional resource centers in all the main regions of Ukraine. The resource centers could provide professional methodological guidance to CSOs in the region, as well as operate a social innovation fund. (The innovation fund could also be centralized, however it may be better to have local decision-makers to support the local innovations.)

The board of the fund needs to be composed of credible and independent experts, who have expertise in both civil society development (at the policy level as well as practically), and grant-making to CSOs. The Board should be a mix of people from the nonprofit sector, from the government (or Parliament), and from independent institutions, e.g. media or academia. It has to have proper conflict of interest policies and procedures and should not be seen as trying to lobby for their own organizations. The Board should be able to set a strategic vision for the sector; seeing not just the needs of CSOs but also the needs of society and how CSOs can best address them. A credible independent expert governing board has been key to the success of the Croatian Foundation as well as the other successful Fund model in the region, Estonia.

The fund would manage a total of up to 9-10 million EUR/year, supporting up to 300 CSOs in a year (including multiple year commitments). It could be decentralized, like in the case of Croatia, whereby it could agree with existing regional development CSOs to manage the grants for that region. The central unit would give the large national level grants (e.g., 30,000 – 50,000 EUR), while the regional ones could also give small grants (e.g. 5,000 - 25,000 EUR). Therefore its overhead costs could vary between 8-12% (depending on the grant management scheme). The Fund could also choose to tender the regional centers every 3 years.

The Fund should provide institutional support to CSOs. It is very important to provide a clear definition for institutional costs, as there are many ways to interpret this type of expenses (also called core costs, running costs, administrative or overhead costs). The institutional support could also be provided in matching funds, preferably over a three years period and requiring the CSO to raise increasing levels of matching funds each year. There could be entry-level considerations, i.e. only those who already have a certain level of budget could apply – this would ensure that the Fund builds on existing capacity rather than encouraging to “create” CSOs just to apply for the funding.

The state can also decide to establish a sinking fund for the institutional support, aiming to strengthen a cadre of a few thousand CSOs over 10-12 years. This would be part of the overall Civil Fund, amounting to, say 30%, of its total budget. Then every 3 years, this part of the budget would be reduced by 20%, until at the end there would be only a minimal amount, circa 12% of the Civil Fund budget available for institutional support, to help newcomers. The Fund would need to communicate this strategy clearly from the beginning so that CSOs can take advantage of the opportunity in time.

Social contracting

This Study proposes to consider introducing the normative system in Ukraine, similar to the Hungarian arrangement. The reasons we propose the normative system over the contracting one are the following:

- it seems that both state and CSOs are not ready to enter into proper contracting relationships on a systematic basis; e.g. there may not be enough willingness with

local authorities to contract; or there may not be enough capable CSOs to apply for the bids.

- there is an ongoing reform of the financing of social services that shall introduce the unit-based calculations for each service, which can serve as the basis for per capita normative support.
- With the normative system, CSOs will become not competitors but complementary providers with the public administration system, as the funding will only be given if there is proven need for the service (based on the number of clients).

We are not proposing to introduce the German principle of subsidiarity in which CSO providers would be preferred across the board. It is important, however that (a) CSOs are not put into a disadvantaged position compared to local governments' own agencies, like in Hungary, and (b) that there are incentives for the local governments to engage with CSOs. These require innovative legal guarantees and solutions, the Polish example could be a good starting point.

The normative system could be introduced most of all in the area of social services, and over time, possibly also in health and education. For the social services, in case of certain types of services (institutional services and those requiring high intensity care) licensing of the organizations providing the service could take place. Although the state should determine the minimum quality of service requirements for the services it intends to finance, we would recommend to leave the decision as to which quality management system to use with each organization.

Alternative financing

We do not recommend to introduce the percentage mechanism at this stage in the Ukraine. We believe that with proper tax incentives for giving, a deeper and more lasting impact could be achieved in developing philanthropy and generating sustainable income sources for CSOs.

Private institutional giving

We suggest to consider the introduction of a system of incentives for private endowed foundations, similar to the German model. Although there are already private foundations in the Ukraine, those are seen as political undertakings. A clearly defined public benefit status would help in making the endowments free of political or private interests and would increase trust in the private foundations. Without doubt, there is private wealth in Ukraine and the challenge to the government is to make it work for the public good. In our view, the German system of tax deductible contributions to an endowed foundation (or making an endowment) would also work well in Ukraine, provided that the level of deduction is equally motivating

and deductible over time. It can also be considered to allow a shorter time period, e.g. 5 years only for smaller amounts (while 10 years can be allowed for a larger endowment).

Increasing the support of domestic private foundations toward Ukrainian CSOs would probably be the best strategy to address the gap that foreign donors are likely to leave when they withdraw from the country, i.e. the support of social innovation, pilot projects, protection of rights etc., especially at the national and regional level.

Corporate giving

For companies it can be suggested that in case of green-field investments, regeneration projects, privatization and similar transactions, 5% of the investment should be spent on public benefit purposes, supporting entities entitled under the public benefit law. This would create a real incentive for CSOs to opt for the PBO status, undertaking the increased accountability and transparency obligations. The level of support could also differ at the regional and national levels.

It is important to note that most mechanisms suggested in these recommendations focus on the support of the more capacitated CSOs, whether at the national, regional or local level. At the same time, the experience from other countries shows that it is the small enterprises that provide the most support to public causes locally – not only monetary but also in-kind and volunteer support. Therefore it would be important to provide special incentives for the small enterprises, which will be affected negatively by the new tax laws in Ukraine. One example can be to define an amount that is not too high but is already a good incentive that can be credited against the tax obligation, and which can be repeatedly used if the enterprise supports the CSO in the long term (perhaps up to 10% of the taxable income). It is also important that in-kind donations can be counted as support.

Finally, the German model of the deductibility of a certain percentage of the turnover as opposed to taxable income could also be considered in Ukraine, where it is quite common that companies do not report an end-of-year profit.

Individual giving

According to the CSI report, up to 65% of the population already gives to charity on a yearly basis.¹⁵⁶ While the culture of regular (e.g. monthly) support of CSOs is still some way ahead, intelligent tax policy could help speed up the process. With a well-defined system of public benefit organizations, incentives for individual giving can be reconsidered. It is likely that some increase in the current level of deductibility (5%) would be helpful, as the European average is closer to 10-12%; but most of all, it seems, that clear criteria and easy procedures

¹⁵⁶ Civicus Index Ukrainereport, 2006, p. 50 http://www.civicus.org/media/CSI_Ukraine_Country_Report.pdf

for claiming the deduction would almost be sufficient to assist CSOs in their fundraising efforts.

Earned income

In our understanding it is currently unclear whether CSOs may engage in economic activities on a tax free basis.¹⁵⁷ We suggest that public benefit organizations may conduct mission related economic activities exempt from income tax, and unrelated economic activities exempt up to 20% of the total income of the CSO (possibly, also including a limit in the amount).

In conclusion, we would like to emphasize once again that these are suggestions that are based only on the comparative analysis done in the course of the research. More research needs to be made to compile data and information that will further inform the decision-makers and allow for making informed decisions based on an understanding of the fiscal implications (e.g., the amounts involved in the tax benefits, the potential impact related to the Civil Fund etc.).

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