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Outsourcing - A Policy Option for Improving Social Service Delivery System

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A. BACKGROUND

Since declaring independence from the USSR in 1991, Georgia has undergone a complex transition from Soviet system towards a market economy. Like many other Soviet republics, the country has undergone a serious economic difficulties embittered by high inflation, budgetary deficits, collapse of industry, widespread corruption. The latter has caused a huge rise in migration, unemployment and social vulnerability.

One of the most costly and intractable legacies of the command economy in Georgia as in other transition economies is the heavy reliance on residential institutions for the care of children, the elderly, and people with disabilities, in general for socially vulnerable groups. The most visible reflection of this is thousands of residential institutions and individuals whose lives have been stunted or shortened because of long years in residential care.

A centralized, fragmented national bureaucracy with little accountability for the care provided within residential institutions was a defining result of existing social welfare policies in Georgia. Poor, neglected, or disabled children lived in institutions that stunted their physical, intellectual and emotional development. Children with disabilities are segregated from society. The elderly and disabled adults were cloistered in social care homes. Few, if any, of these individuals needed to be confined to institutions. This legacy has created profound barriers that must be overcome if reliance on residential institutions is to be reduced.

The legacy of the reliance on residential institutions profoundly shapes and constrains the development of the social welfare system that is emerging today. There are insufficient number of community-based alternatives to care for large and growing numbers of vulnerable individuals in the Country. Many barriers must be overcome before community-based social services can be a credible alternative to large residential institutions. These obstacles have been created by the legacy of the command economy, the deteriorated socioeconomic conditions resulting from the transition to a market economy, and the loss of much of the preexisting social safety net.

The data suggest that an estimated total number of 5,204 children live in 43 State funded institutions (including infant houses), 2,591 of which are children with disabilities. An additional 1,600 children are known to be in municipal institutions. The data on disability in Georgia is too limited and fragmented. The database of registered persons with disabilities maintained by the State United Social Insurance Fund of Georgia contains only medical information. However, the actual number of disabled persons in Georgia is likely to be higher than 213, 184. The World Health Organization estimates that 7-10 % of the world's population has disabilities, implying difficulties in daily activities and participation in society. Therefore, with a population of 4.4

million, Georgia could have around 400,000 persons with disabilities caused by physical, mental or chronic disorders.

All residential institutions in Georgia fall under the Ministry of Education and Science authority, with the exception of infant houses that have the status of LTD (commercial entity) and have been until recently supervised by the Ministry of Labor, Health and Social Affairs. De-institutionalization and establishment of alternative services for inclusion of children with disabilities are today key social sector priorities for both: Ministry of Education and Science of Georgia and Ministry of Labor, Health and Social Protection of Georgia.

The transition from reliance on residential institutions to community-based services has created opportunities as well as problems for the country. Rapidly deteriorating socioeconomic conditions and limited government resources have increased the use of residential institutions. At the same time, a slow but growing interest in community-based alternatives by international organizations has laid the groundwork for change.

As a result, de-institutionalization and establishment of alternative services for inclusion of children with disabilities have recently become a key social sector priorities for both for the Ministry of Education and Science of Georgia and Ministry of Labor, Health and Social Protection of Georgia. This is basically the result of *first*, change of Government in January 2004; *second*, advocacy campaign carried out by EU and other international agencies; and *third*, the United Nations Convention on the Rights of the Child, adopted by the U.N. General Assembly in 1989, which discourages the use of residential institutions for children.

In April 2005, within the limits of Economic Development and Poverty Reduction Programme of the European Union and pursuant to Article 4 of the UN Convention on the Rights of the Child, the Government of Georgia adopted Action Plan on Child Protection and Deinstitutionalization, Government Commission of Child Protection and Deinstitutionalization and Statute of the Commission.¹ The Government resolution established Government Commission of Child Protection and Deinstitutionalization, principal functions of which are ensuring efficient implementation of Government Action Plan and submission of respective proposals/recommendations to the Government. Members of the Commission include Minister of Science and Education of Georgia, Minister of Finance of Georgia and Minister of Labor, Health and Social Affairs of Georgia.

The Commission elaborated childcare standards, which were adopted by Minister of Labour, Health and Social Security and Minister of Education and Science of Georgia in 2007. The childcare standards shall enter into force on

January 1, 2008. Until the date of entry into force, the standards shall have recommendatory power. The Order recommends childcare institutions and other interested persons to ensure that their activities meet the standards enshrined in therein until the date of entry into force.²

Also, The Ministry of Education and Science of Georgia has been running a Programme for Prevention of Child Abandonment and De-institutionalization of Children under State Care or Deprived of Parental Care. The main goal of the Programme is to fulfill the right of the child to grow up with his/her family. To achieve this goal, the Programme aims at: prevention of inflow of children into childcare institutions and child abandonment; Reintegration of children currently in residential institutions into biological families; Foster arrangements for children in need of short or long-term care in foster families. Within the limits of the Programme, Ministry of Education and Science works on optimization of childcare institutions. The process implies in-depth analysis of institutions, elaboration of individual plan for optimization of each institution in accordance with needs of local children and community, alteration of profiles and structure of the institution to create a responsive alternative to existing childcare services.

Although the major ideological shift towards de-institutionalization of children has occurred, no clear policy has yet been elaborated by the Government. Further, the process has not yet touched other socially vulnerable groups, particularly people with physical disabilities, those with mental disabilities and elderly. The Government is sometimes moving too fast in the direction of closing down childcare institutions, before a continuum of services has been established and alternative community-based services are available. The process cannot be successfully completed without simultaneous emergence of alternative community-based services.

B. PROBLEM STATEMENT

The basic question posed is how can the Country make a smooth transition from relying on residential institutions to developing community-based services. Other industrial nations have experienced similar periods of economic and social upheaval and also relied on residential institutions to care for vulnerable and marginalized groups. Most of these nations no longer rely on residential care for children, people with disabilities, and the elderly. Instead they rely primarily on community-based social services provided in a framework of protection for the vulnerable.

International practice confirms that the basic barrier against the smooth transition from residential care to community-based care is underdevelopment of alternative services in the Country. The problem addressed in this paper is therefore how to improve the system of social service delivery in the country so that to ensure that a continuum of

alternative, community-based social services are available to socially vulnerable groups.

C. POLICY ALTERNATIVES

I. Evaluation of Alternative Policies

Social services delivery process analyzed in this paper fall into four broad policy options each of which can be seen along a spectrum of degrees of engagement of Government in social service delivery. Options I and II reside at one end of the spectrum representing a policy in which, social services are funded by Government and delivered by welfare not-for-profit organizations and private for-profit enterprises respectively. Option III resides at the other end of the spectrum resulting in a Government monopoly on the market of social services, *hence*, a maximum degree of Government engagement in the direct delivery process. Finally, the preferred option occupies an intermediary position along the spectrum in which Government engagement in social service delivery is complemented by engagement of welfare not-for-profit organizations. Accordingly, the following alternatives are evaluated in the analysis: *first*, outsourcing of social care services to welfare not-for-profit organizations; *second*, outsourcing of social care services to private for-profit enterprises; *third*, monopolistic Government provision of social services; and *fourth*, complimentary delivery of social services through outsourcing to welfare not-for-profit organizations and delivery by public sector.

1. Alternative I – Social Care Services Outsourcing to Welfare Not-for-Profit Organizations

The proposed alternative refers to a mode of social service delivery arranged exclusively via welfare not-for profit organizations. In this model, social service provider not-for-profit organizations are primary providers of social services. The Government delegates the function to not-for-profit organizations operating in the country. The services are centrally funded and controlled by the Government, while the delivery function is vested in welfare not-profit organizations in the Country. The state would here reserve regulatory and supervisory power and financing responsibility. The model stresses complete substitution of state provision by private not-profit provision.

1.1 Evaluation of Alternative I

Three principle rationales in support of alternative I are presented below: a) Private not-for-profit organizations have comparative advantage *vis-à-vis* private for-profit enterprises and Government agencies in delivering social care services; b) Outsourcing of social care services to private not-for-profit providers may help to reduce costs; c) Outsourcing of social care services to private not-for-profit providers may improve quality of social care services.

a) Comparative Advantage of Not-for-Profit Organizations vis-à-vis private for-profit enterprises and Government agencies

The argument that not-for-profit organizations have comparative advantage vis-à-vis private enterprises and Government agencies finds ample support in both international practice and literature.

Governments that delegate some functions to private organizations typically prefer not-for-profit organizations for delivery of social services while preferring for-profit enterprises for the management of infrastructure. The reason is that the former involve activities where performance is hard to measure and non-profits are perceived to be committed to high quality or serve better vulnerable groups due to their religious or ideological orientation as opposed to government agencies or private for-profit enterprises.³ Private not-for-profit organizations are believed to be motivated by a strong sense of mission, which may lead them to offer higher quality services, especially social services for vulnerable people.⁴ Moreover, Government systems and government workers are often seen as too slow, too inflexible, too focused on process, and too indifferent to results,⁵ as opposed to non-profits that are more in tune with the interests of beneficiaries.

Non-profits may be seen as superior both to private for-profit firms, and to public agencies at supplying social services. This relates first, to notions of altruism – the concern for the well-being of others, and second, to the notion of “development technology” related to their superior preference revelation abilities of people’s needs. Consequently, the comparative advantage of non-profits, that is what makes them better in terms of quality and price than private for-profit organizations, comes in part from employing altruists, since altruists may work for lower wages or work harder for the same wages; and in part from the idea that not-profits have a greater ability to reveal preferences, that is they are better at knowing the needs and priorities of beneficiaries and thus more efficient at increasing welfare through appropriate targeting. They are seen to be better able to understand and represent the needs of the people with whom they work given their closer working relationship with them. This in turn is based on an underlying idea of the value system from which non-profits operate. ⁶

Private Contract Failure theory stipulating that when the service users are vulnerable and unable to protect their own rights, there will be abuses by the for-profit service operators and these will persist, gives further support to the argument of superiority of not-for-profit organizations over private for-profit enterprises in social services market. There are increasing concerns that the profit-motive is inconsistent with the service motive underlying social welfare services. Under this theory, too the not-for-profit private sector with altruistic

service motives is the most effective safeguard against the abuse of the vulnerable.

Thus, it is asserted that the non-profit sector tends to be best at performing those tasks that generate little or no profit, demand compassion and commitment to individuals, require extensive trust on the part of customers or clients, need hands-on, personal attention, and involve the enforcement of moral codes and individual responsibility for behavior.⁷ The mission of “helping others” is a foil against “market” values of self-interest and profit-seeking encroaching on non-market areas of human activity and not-for-profit institutions represent key elements in the process of social capital formation.

Further, from a policy perspective, the challenge is to ensure that the evolving changes and pressures towards commercialization do not diminish the unique charitable role of non-profit organizations.⁸

According to the foregoing analysis, private not-for-profit organizations may be considered as having comparative advantage *vis-à-vis* both private for-profit enterprises and government agencies in the market of social services.

b) Cost Saving

Another argument supporting the alternative is that outsourcing of social care services to private not-for-profit providers may result in lower costs. Review of a large number of studies on the comparative efficiency of the public and private sector suggests that most - but by no means all - of them conclude that the private sector is able to operate at lower (*in some cases very much lower*) costs.⁹ This argument rests on the basic tenet of economic theory that the competitive markets without market failures will result in cheaper and higher quality goods and services as consumers shop around for the best deal and suppliers work to provide the best products at the lowest cost. Accordingly, contracting out of social services may result in significant cost savings, as the positive pressures of competition shall force organizations to find ways to work more efficiently.

This is thought to hold true for competition broadly, not only for competition by for-profit corporations. Thus, this includes also competition between not-for-profit organizations. In fact, for some observers, what matters most is the extent of competition rather than simply whether the public or private sector is the provider.¹⁰

Thus, from the cost saving perspective, the real issue is not so much public *vs.* private provision of social services - it is monopoly *vs.* competition. A key issue is the introduction of competition to increase efficiency, reduce costs, and improve quality and satisfaction of socially vulnerable groups.

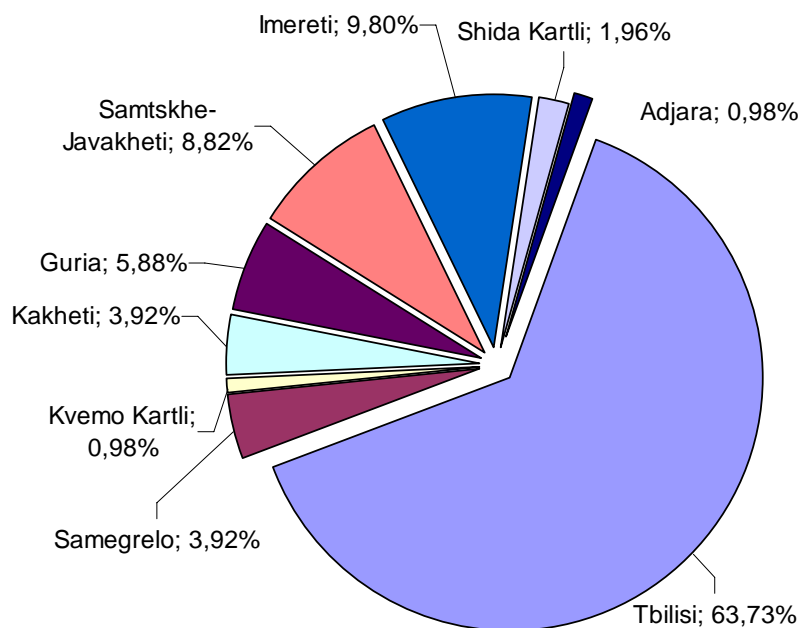
Accordingly, to judge about whether or not to outsource social services to welfare not-for-profit organization from cost-efficiency angle, we need to look first at whether there is a competitive marketplace of social services or, whether activity is already performed by the not-for-profit sector; if yes, in what areas; if no, whether a competitive marketplace can be created.

Data available to us suggests that no competitive marketplace of social services exists in the country, for there is not a sufficient number of not-for-profit competitors delivering social services and directly competing with each other. This is evidenced by findings of the countrywide *Study of Development of Welfare Organizations in Georgia* conducted in March-April 2007. The study depicted the *status quo* marketplace of social services delivered by non-profits. The findings of the study show that a total of 101 socially oriented not-for-profit organizations operate on the entire territory of Georgia. Out of this number only 73 organizations (75%) are service providers. There are also mixed type of organizations which can also be viewed as service providers. These organizations do not work exclusively for delivery of social services, but implement other activities also. The number of mixed-type organizations equals to 20. Therefore, a total of 93 organizations deliver social services in the country.

To determine whether there is a competition between these welfare non-profits, we shall look at *first*, geographic markets of social services; and *second*, service markets. Although service market and geographic market are interrelated, these two shall be discussed separately for the sake of clarity.

Geographic distribution of service provider non-profits supports the hypothesis of this paper that no real competition exists between welfare non-profits, for very few of them serve identical geographic markets. Rather, geographic markets these organizations serve are so much distinct from each other that it can be said that there is no substantial competition between them. This hypothesis is directly evidenced by the findings of the *Study of Development of Welfare Organizations in Georgia*, showing that geographically, welfare non-profits are distributed harshly unequally. Specifically, the overwhelming portion of organizations is concentrated in the capital city. In regions, service deliverer non-profits are most frequently found in Imereti (10 organizations), while most rarely found in Kvemo Kartli and Adjara (Diagram 1).

Diagram 1: Geographic Distribution of Welfare Organizations



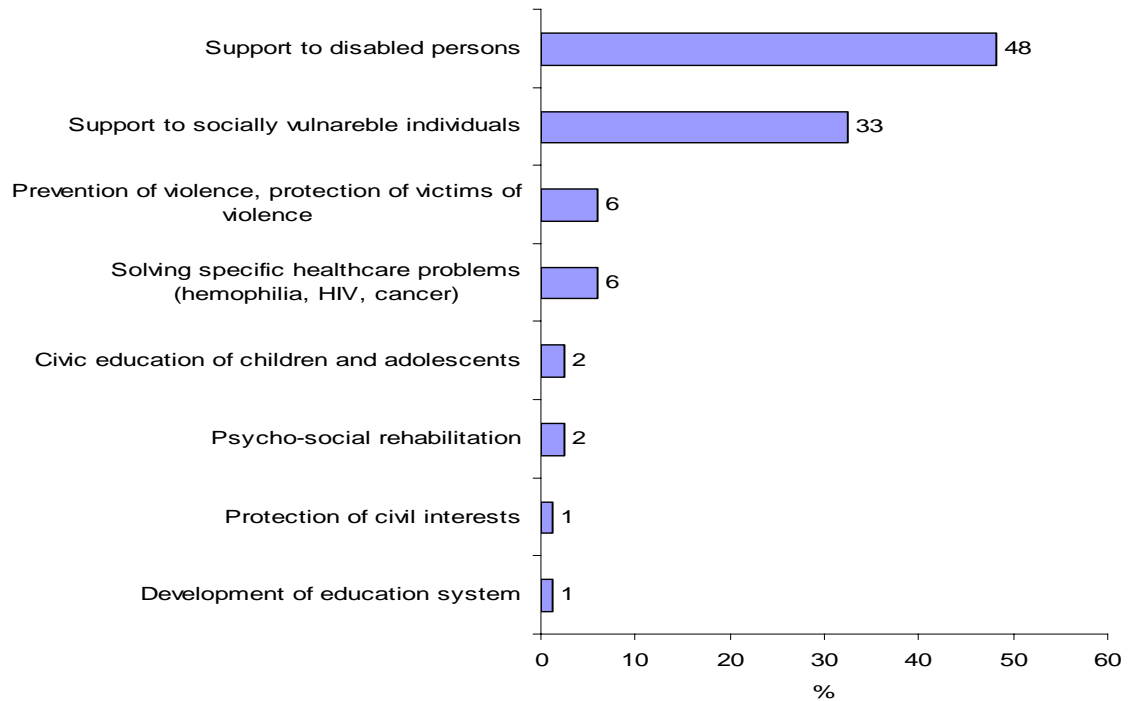
Secondly, we shall look at whether services produced by welfare non-profits should be included in the same service market. This would be so if they are actually used by consumers in a readily interchangeable manner, that is, if services in question are sufficiently acceptable substitutes to each other to act as a constraint on price. We could observe no such interchangeability of services delivered by welfare organizations, so that to conclude that services belong to the same service market.

Contrariwise, based on findings of the study, we are inclined to think that services delivered by welfare non-profit organizations belong to distinct service markets, for they are not reasonably interchangeable by consumers/consumer for the same purposes. Specifically, findings of the study show that organizations are entrenched in the following distinct service niches:

2 broad categories were identified among the service providers and mixed type organizations by the activity fields: organizations supporting the disabled persons and organizations supporting socially vulnerable persons. Besides, a smaller sub-group focusing on specific healthcare problems such as hemophilia, HIV prevention, cancer prevention was identified. In addition to organizations listed above, several mixed type organizations were identified that mainly focus on welfare activities. They work on civic

education of children and adolescents, protect civil interests, support development of education system. In various projects they have carried out social care type of activities. (Diagram 2)

Diagram 2: Main fields of activities of welfare non-profits



There is a further sub-distinction between types of services delivered by organizations belonging to the 2 broad category identified above - organizations supporting the disabled persons and organizations supporting socially vulnerable persons. 7 different types of assistance were identified in total.

Activities of an overwhelming portion of organizations supporting the disabled persons are focused on the promotion of integration of beneficiaries in the society. More than a third of organizations work on the education and development of skills of beneficiaries. Organizations providing long-term care services are smallest in number. Two organizations (5%) are village-type organizations providing long-term care to its own beneficiaries (Diagrams 3, 4).

Diagram 3: Types of Support Provided by Disabled People's Organizations

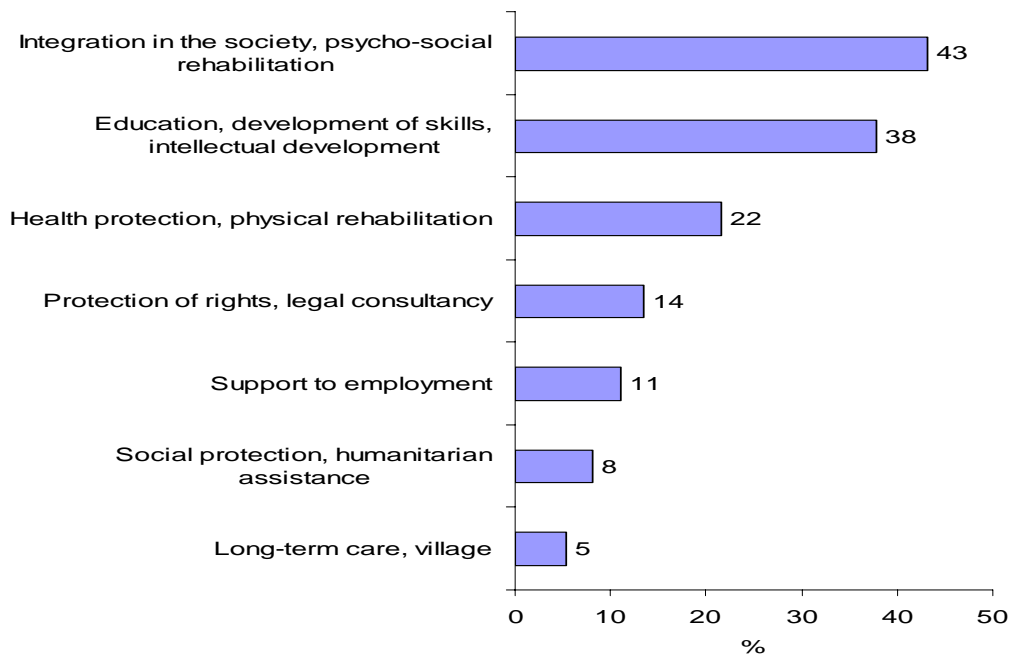
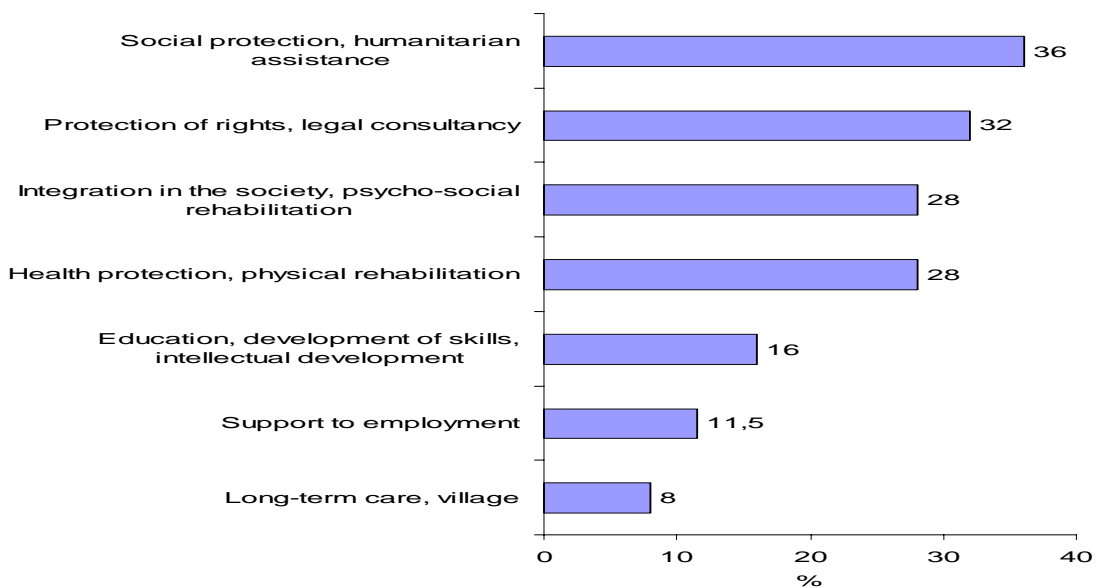


Diagram 4: Types of Support Provided by Organizations for Socially Vulnerable Groups

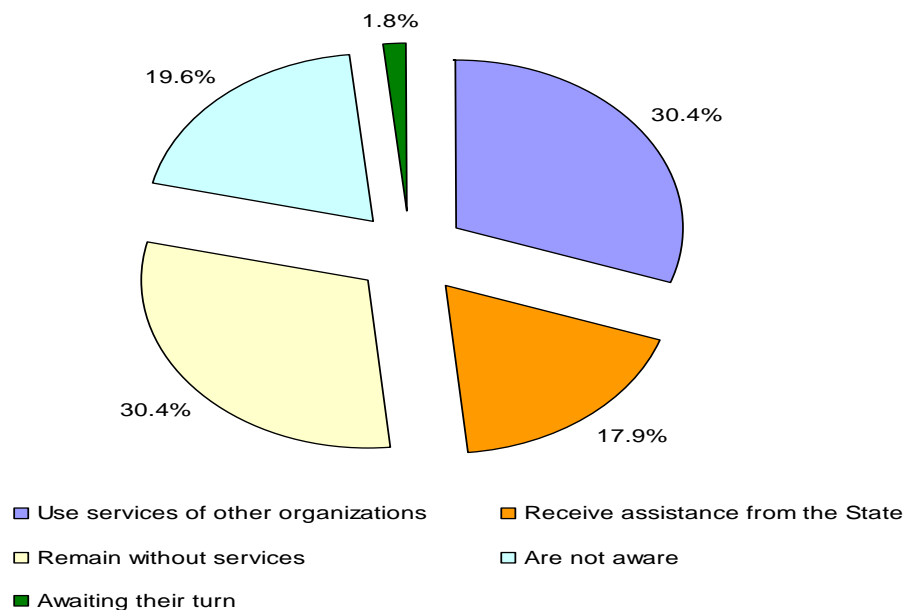


Based on this data, we conclude that very few regions can in fact boast competition in the social services field. The overall conclusion would be that welfare organizations operate in rather distinct geographic and service markets. Thus, non-profit service providers are entrenched in different

specialized areas of service delivery, leading to the carving up of the service market rather than competition for a share of it. Particular agencies gravitate towards particular geographic or specialized service niches and other providers withdraw from those niches to specialize in others.

Nonetheless, one final remark should be made here. The national survey of welfare organizations revealed a somewhat puzzling perception of welfare organizations which may be seen as an indirect indicator to the reasonable interchangeability and substitutability of services produced. A third of organizations (30.4%) that have refused to serve potential beneficiaries believe that these beneficiaries use the services of other similar organizations. Another third (30.4%) believe that they remain without any services whatsoever, 17.9% believe that they receive assistance from the state, and 19.6% are not aware about what happens to the beneficiaries after the refusal. Only 1.8% of the interviewed have noted that beneficiaries are awaiting their turn. This concerns cases when an organization offers beneficiaries extremely specific services that cannot be replaced by the services of other organization. (Diagram 5)

Diagram 5. Actions of potential beneficiaries following a refusal by an organization to provide services



c) Quality Improvement and Innovation

Another argument often cited in support of alternative I is that outsourcing of social services may lead to quality improvement. It is asserted that one consequence of social service delivery through private not-for-profit

providers would be a more diverse social services offer more accurately reflecting the heterogeneous preferences and needs of beneficiaries.

However, it should be underlined that here too competition provides the logical foundation of expectation of quality improvement. Therefore, arguments developed in the foregoing section equally apply to the present one. Since (as shown above) there is no substantial competition between service provider organizations, the probability of quality improvement through outsourcing is low, unless a competitive marketplace is created.

Alternatively, to put aside the lack of competition, the argument of quality improvement is based on a further premise that competition for beneficiaries among social service providers will be based on quality of services, which in turn assumes beneficiaries' involvement in decision-making and their capability of evaluating alternative social services offers.

Thus, competition between social service providers will not necessarily improve quality of services. Most beneficiaries shall probably lack information and/or knowledge needed to make rational decisions. Circumventing the information asymmetry is a hard task for individuals. As a result, many individuals might not grasp the main aspects that are involved in choosing a provider of social services. This shall further undermine the expectation of quality improvement.

d) Conclusion

Based on the foregoing arguments we conclude that alternative I is only profitable in terms of benefits if competitive market of social services is developed. Development of social services market is in fact a necessary prerequisite for implementation of the alternative. If Alternative I is to yield all of the benefits asserted herein, it is critical: *first*, to stimulate creation of competitive marketplace of social services; *second*, to strengthen the capacity of existing providers of social services and stimulate creation of providers in uncovered areas of social services; *third*, to ensure effective mechanisms of quality control; and *fourth*, to erode market failures (information asymmetries, distributional concerns). Consequently, we conclude that social services market is not developed enough to enable the complete substitution of Government provided services with services delivered by non-profits. We mean that at this stage the stress of the model on complete substitution of state provision by private not-profit provision does not appear to be achievable.

2. Alternative II - Social Care Services Outsourcing to Private for-Profit Enterprises

The Alternative II results in a model of social service delivery where social services are delivered by private for-profit enterprises. The model stresses substitution of state provision by private for-profit provision.

2.1 Evaluation of Alternative II

The arguments supporting Alternative II are almost identical to those supporting alternative I, for as noted above the basic benefits of outsourcing stem from competition on the marketplace. Specifically, it may be argued that similarly to private non-profit delivery, private for-profit delivery has a potential of reducing costs, improving quality of services and diversifying and innovating social services. It has been emphasized above that an indispensable prerequisite for achieving all of the listed benefits - cost saving, quality improvement and innovation - is existence of a marketplace of social services with sufficient number of competitors.

Thus, a key issue is the existence of substantial competition on the market resulting in increase in efficiency, costs reduction, improvement of quality and satisfaction of socially vulnerable groups. Therefore, what matters most is the extent of competition rather than whether for-profit or non-profit sector is the provider.¹¹ As emphasized above the real issue is not non-profit *vs.* for-profit or public provision of social services - it is monopoly *vs.* competition.

If this is true, to judge about whether or not outsourcing of social services to for-profit organizations is achievable, we need to look first at whether there is a marketplace of social services with sufficient number of for-profit competitors; or, whether one can be created.

In this connection, we note that no for-profit providers of social services operate on the market currently. Social services are delivered by either private not-for-profit organizations or public institutions. Private for-profit companies have not occupied the niche. Our presumption is that the barrier to market entry in the form of low profit potential in social services area is at this stage simply too high to allow generation of supply of social services by for-profit companies. Consequently, we consider that creation of a market with sufficient number of for-profit competitors is not achievable at this stage.

This would alone permit the elimination of the option. In any event, we shall set forth an additional argument against the alternative. It should be born in mind that profit motive does not mix very well with the delivery of social care services and may lead to decisions on the part of the private-for-profit deliverers that are not in the best interest of the vulnerable groups. Where there exist non-contractible elements of service provision, private firms have

incentive to undertake non-verifiable cost-reducing actions, which compromise the quality of provision.¹² Indeed, given the nature of social care services, requiring hands-on, personal attention, enforcement of moral codes and individual responsibility for behavior, Governments that have outsourced social services have typically preferred not-for-profit providers, while relying on for-profits in outsourcing tasks that are straightforward, tangible, easy to specify and easy to monitor.

2.2. Conclusion

In line with the above reasoning, we conclude that alternative II is only profitable in terms of benefits if competitive market of social services with sufficient number of private for profit competitors is developed. *Identically to alternative I*, development of social services market with sufficient number of for profit competitors is in fact an indispensable prerequisite for implementation of alternative II. We mean that if Alternative II is to yield all of the expected benefits, it is critical: *first*, to create a competitive marketplace of social services with sufficient number of for profit competitors; *second*, to erode market failures, particularly, information asymmetries and distributional concerns (failure in the form of information asymmetries is particularly acute in the context of alternative II given the reasoning above emphasizing incompatibility of profit motive with the delivery of social care services); *third*, to introduce effective mechanisms of quality control. Based on the arguments presented above that a) currently, there is an absolute absence of private for-profit providers on the market of social services relative to private not-for-profit providers; *second*, the probability of development of marketplace with sufficient number of private for-profit providers is at this stage too low relative to probability of development of not-for-profit providers; *third*, social service delivery does not fall within the area of comparative advantage of private for-profit providers, while the delivery function definitely belongs to the area of comparative advantage of private not-for-profit providers, we conclude at this stage of analysis that Alternative I should be given preference over alternative II.

3. Alternative III - Purely Government Provision

In Alternative III, the government makes all operating decisions and government employees typically provide social services. Social services are outsourced neither to private not-for-profit organizations, nor to private for-profit enterprises.

3.1 Evaluation of Alternative III - Purely Government Provision

The two principal rationales supporting Alternative III - purely government provision of social services - are examined below: 1) Government provision of social services may help enforce universal standards, which may be valued; 2)

Government provision of social services erodes failures associated with private provision.

a) Enforcement of Common/Universal Standards

One of the arguments cited in favor of Government provision of social services is Government's ability to enforce universal standards. Thus, if universal standards are considered to be a value, then government provision of social services should be preferred over private provision. The more that one cares about enforcing "universalism" in the provision of services, the stronger the argument for monopolistic government provision, for one of the strengths of the Government is the ability to enforce universal or common standards in social services provision. In short, if universalism in the provision of services is considered important, then government provided services should be preferred because of the greater control that government can exercise to assure universal standards are met.¹³

However, we note here that existence of universal standards do not mix very well with social care services examined in this paper. Contrariwise, by the very nature of social care services, they demand compassion and commitment to individuals, require extensive trust on the part of customers or clients, need hands-on, personal attention, involve the enforcement of moral codes and individual responsibility for behavior and demand individualized attitudes more reflecting the heterogeneous preferences and needs of socially vulnerable individuals. Therefore, we do not consider that existence of universal standards should be taken as a value in the context of this paper.

b) Failures Associated with Private Provision

One of the rationales often cited supporting monopolistic Government provision of social services is the inability of Governments to deal with failures that may occur on the market. Problems with market failure usually cause governments to be cautious in their outsourcing efforts. Indeed, it is illogical to outsource social services where it is not sufficiently clear that there exists a market of social services which shall function effectively, that is without failures (asymmetry of information, distributional concerns and agency problems).

Obviously, if the government has the capacity to monitor and does in fact monitor its own performance better than it would monitor the performance of a private not-for-profit or for-profit provider, then government provided services may indeed be of higher quality, particularly in cases where there are strong asymmetries of information between provider and consumer. The government, by internalizing both provider and consumer decisions in one entity - setting standards as well as delivering services - would better avoid the exploitation of the asymmetry that might occur in the private for-profit or

non-profit market. In this context, we note that there is no official data which we could reasonably rely upon to evidence the fact that Government would more effectively monitor government provided services than services provided by private contractors. Contrarily, the general management capacity of the Government in this respect we think is low enough with respect to private contractors and equally with respect to internal structure.

c) Conclusion

Based on the above reasoning, we conclude that no benefits are associated with alternative III - monopolistic Government provision of social services, for, *first*, enforcement of universal standards cannot be perceived as a benefit in the context of specific nature of social services, requiring hands-on, personal attention and demanding individualized attitudes more reflecting the heterogeneous preferences and needs of socially vulnerable individuals; and *second*, it is dubious that Government can better monitor its own performance than performance of private for profit or not-for-profit contractors. For these reasons we consider that alternative III should be eliminated.

D. PREFERRED ALTERNATIVE - MIXED PROVISION

I. Rationales for Preferred Alternative

As outlined above neither of the alternatives proposed in the preceding section can be successfully implemented, unless steps are taken in the direction of creating favorable environment for implementation of the respective model. None of the alternatives suggest a ready to use "best choice". We eliminated alternative 2 due to absolute absence of for-profit providers on the market of social services and based on presumption that the barrier to market entry in the form of low profit potential in social services area is at this stage simply too high to allow generation of supply of social services by for-profit companies. While, monopolistic provision of social services by Government was eliminated on the basis of unacceptability of universalism in social services area and further, on the basis of the fact that it can not be safely assumed that Government provision will be more effective than public provision.

Based on the analysis of benefits that alternatives presented can potentially reap, we come to the conclusion that alternative I should be chosen, albeit with various modifications and with elements borrowed from alternative III. Specifically, it certainly is impossible to completely outsource social care services to private not-for-profit providers, since the market is not developed enough (See above). Thus, Government should maintain the service delivery capacity to meet the demand that can not be met by private non-profit

providers. Mixed delivery in this view stems from either lack of private non-profit supply or inadequacy of tasks to be performed to non-profit providers. In this model, the complimentary functions of the government and welfare non-profits are stressed as opposed to complete substitution of non-profit provision by state provision.

II. Description of Preferred Alternative

Thus, a preferred alternative proposed in this analysis is a mixture of alternatives I and III – a collaborative model or mixed provision by public and non-profit agencies, which stresses complimentary functions of Government and welfare not-for-profit organizations based on their comparative advantages. Welfare not-for-profit organizations are not considered as a *substitute or alternative* but a *complement* to the state in the provision of social services. This model shall result in a thorough re-think and refinement of the role of the Government in social service provision. Particularly, as private not-for-profit service providers shall take greater responsibility for the direct delivery of social services, Government can focus more on its role as facilitator, “enabler” and regulator. Government’s role in the proposed model is to set priorities, encourage competition on the market of social services, retain a degree of capacity of social service delivery while outsourcing social care services for which not-for-profit providers exist, generate financial resources, ensure quality of social services through quality-control standards. The role of the welfare not-for-profit organizations would be to personalize the provision of services, operate on a smaller scale than the government, adjust care to needs of socially vulnerable groups, generate financial resources from channels other than Government.

The weaknesses of not-for-profit sector are thus the strengths of the state, and vice versa. The government is able to generate financial resources, to set priorities, to improve the quality of services through quality-control standards. On the other hand, not-for-profit organizations can personalize the provision of services, operate on a smaller scale than the government, adjust care to people’s needs rather than to the requirements of government agencies, and permit a degree of competition among service providers. Consequently, neither the replacement of voluntary sector by government nor the replacement of government by voluntary sector makes as much sense as collaboration between the two. The collaborative model then draws on the respective strengths of governments and not-profits while avoiding their respective weaknesses. Service provision through the voluntary sector may have some limitations which is then felt by the Government.

Essentially, Alternative IV aims at achieving a synergy of public and private provision, *hence*, avoiding a strict dichotomy between public and private. This model attempts to more cautiously reflect the findings of little empirical analysis comparing the effectiveness of public versus private service delivery,

which show no clear evidence that private non-profit service delivery is *inherently and in all circumstances* more effective or less effective than public service delivery, while the public and private non-profit providers each have their own relative strengths and weaknesses.¹⁴

It has been shown above that the non-profit sector tends to be best at performing those tasks that generate little or no profit, demand compassion and commitment to individuals, require extensive trust on the part of customers or clients, need hands-on, personal attention, and involve the enforcement of moral codes and individual responsibility for behavior.¹⁵ Therefore, given the comparative advantage of not-for-profit organizations *vis-à-vis* private for-profit entities and public agencies, the Government should outsource social care services, which fall within the realm of comparative advantage of not-for-profit providers, while retaining service delivery capacity for those services that do not directly fall within the sphere of non-profit comparative advantage. For the purpose of reaping the benefits of competition as described above (cost reduction, quality improvement, innovation), the Government shall also encourage the formation, operation and strengthening of private not-for-profit sector.

Outsourcing will be more effective for those services for which many alternative providers exist.¹⁶ Alternatively, for those services for which many competing providers can be created. Thus, Government retains some capacity for direct service delivery while outsourcing certain social services to private not-for-profit providers.

E. NECESSARY PREREQUISITES FOR IMPLEMENTATION OF THE PREFERRED ALTERNATIVE

We think that if steps are taken in the direction of strengthening not-for-profit providers, the implementation of the preferred alternative outlined below shall reap the benefits expected: cost reduction, quality improvement and diversification of services delivered. Given the basic premise of the model described above - that there are sufficient number of social service provider not-for-profit organizations delivering high quality services to socially vulnerable groups - successful implementation of the model requires first and foremost: a) strengthening the capacity of existing non-profit providers of social services and b) stimulating creation of a marketplace with sufficient number of not-for-profit competitors. In the context of these objectives the next section shall outline needs of the service provider organizations which have the impact on the level of their development.

I. Needs of Social Service Provider Not-for-Profit Organizations

In March-April 2007 a countrywide study of development of welfare organizations in Georgia was conducted. The study aimed at assessing development level of socially oriented not-for-profit organizations operating on the territory of Georgia and depicting the *status quo* marketplace of social services delivered by welfare organizations. A total of 101 organizations were interviewed. We consider that the mentioned survey is the only recent and comprehensive document incorporating all relevant aspects of evaluation of welfare organizations' needs. Consequently, the findings of the survey shall serve as the basis for evaluation of basic needs of welfare organizations.

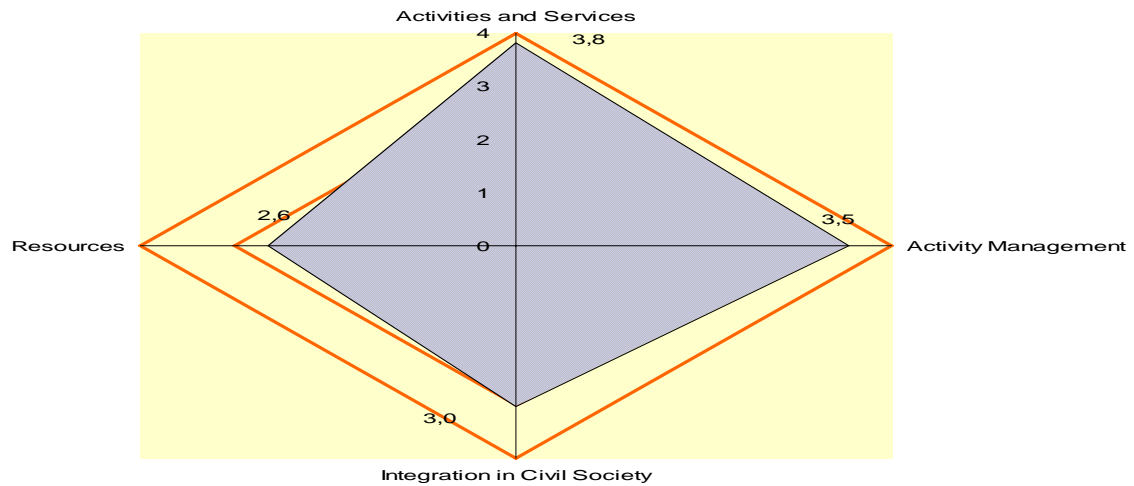
The overall conclusion of the study is that in order to better satisfy the needs of socially vulnerable individuals welfare organizations need on one hand to increase their own capacity in terms of human and financial resources and on the other hand effective mechanisms of procuring services from welfare organizations should be developed.

The organizations interviewed indicated that the major problem for them is fundraising. Organizations themselves view the problem as both: an inner-organizational and an external factor. In an inner-organizational context, they emphasize on underdeveloped fundraising system of organizations, while in external factor context they link the absence/lack of funding to the donors, state structures, and business organizations. Survey findings reinforce this statement. Specifically:

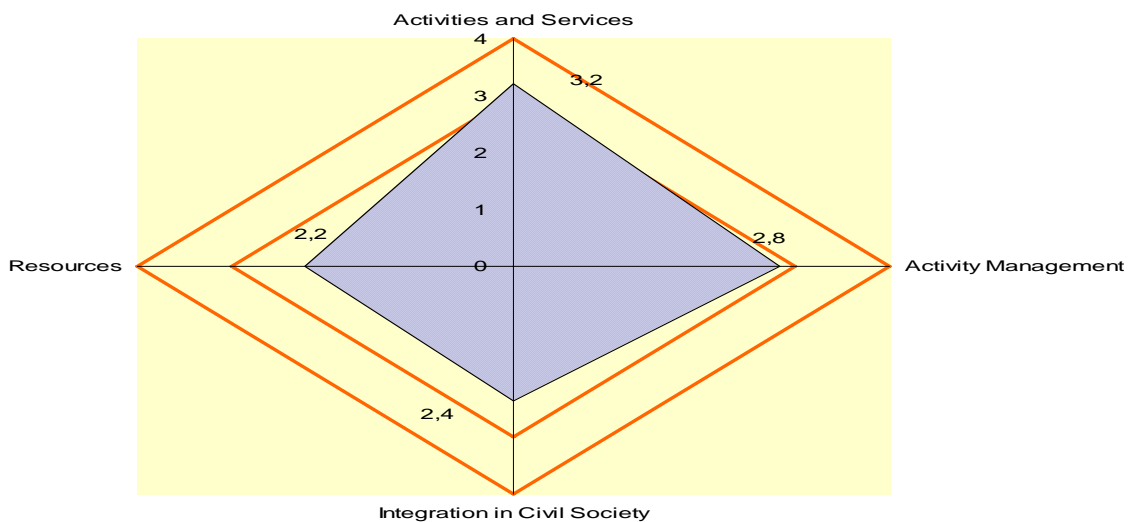
It is demonstrated below that the logistical and financial resources of an organization have a biggest impact on the overall index of organizational development. The graphs below show that if the comparative values of indices of Tbilisi-based organizations under the "Services/Activities", "Activity

Management” and “Integration in Civil Society” criteria among the I to IV levels are 2.3, 2.6, and 1.9 respectively, a comparative value of financial resources among the I and IV levels equals 3.2. Taking into consideration this data, we consider that it is safe to assume that financial resources have an immense significance from the perspective of strengthening organizational capacity of social service provider organizations, an objective outlined above.

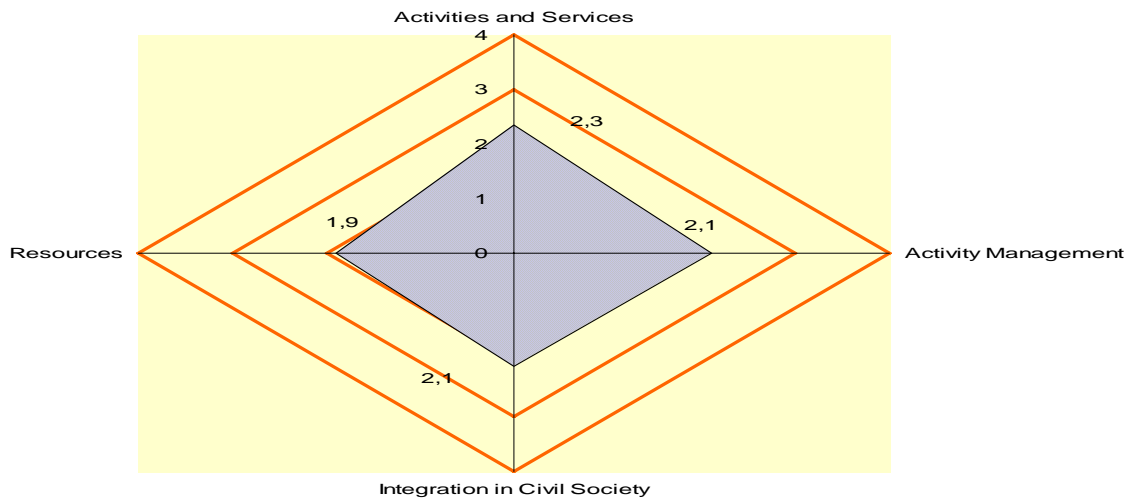
Graph. Indices of I Level Tbilisi-Based Organizations by the Criteria



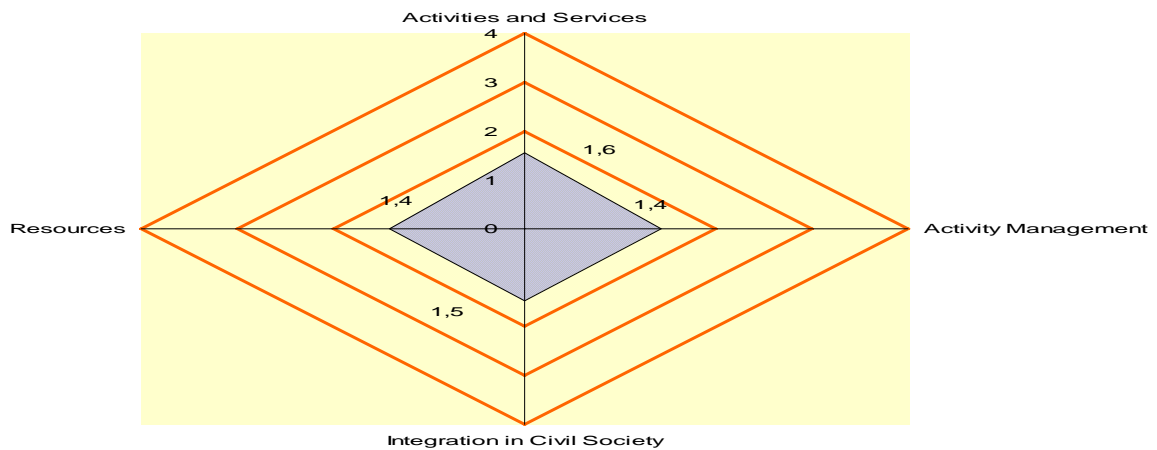
Graph. Indices of II Level Tbilisi-Based Organizations by the Criteria



Graph. Indices of III Level Tbilisi-Based Organizations by the Criteria

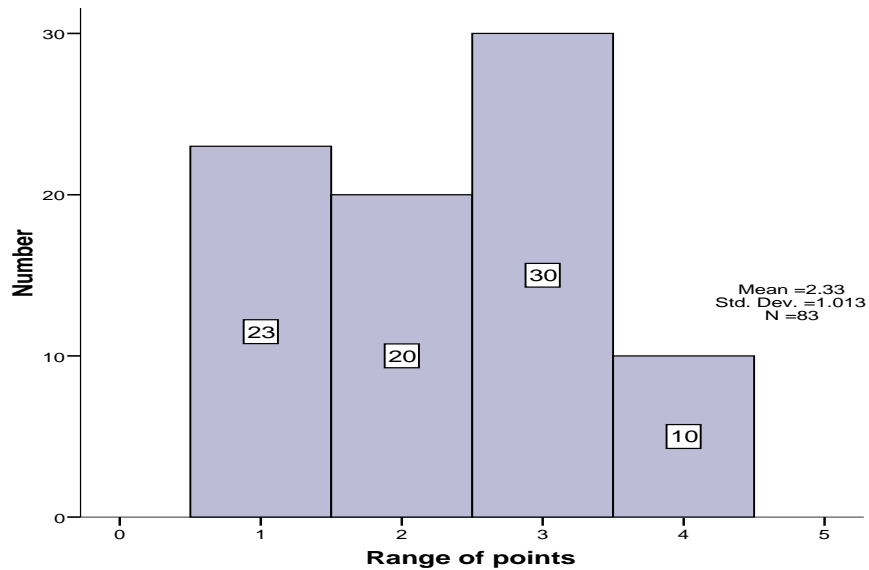


Graph. Indices of IV Level Tbilisi-Based Organizations by the Criteria



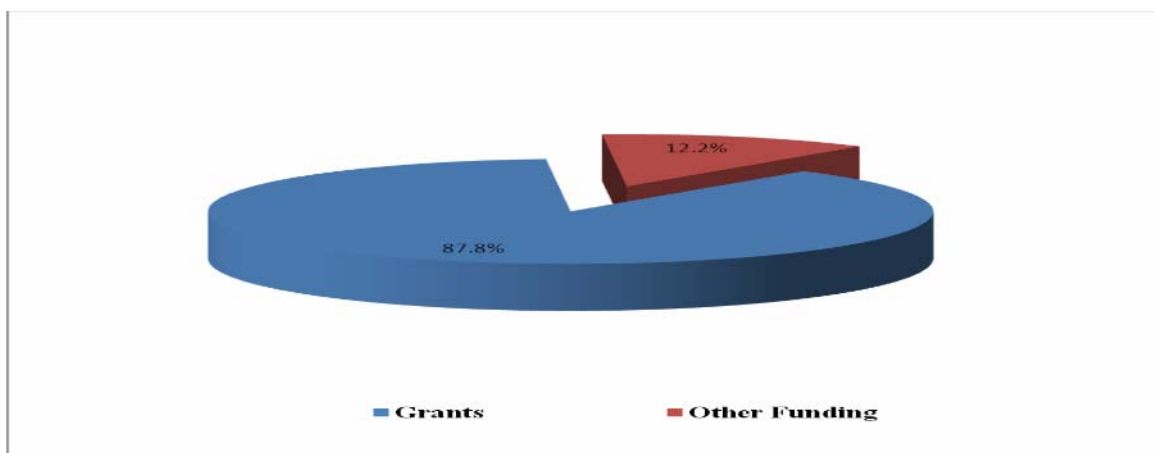
Following the assumption that financial resources have an immense impact on the level of development of social service provider organizations, we shall move to analysis of funding structure of organizations. Under financial resources sub-criteria organizations were evaluated by the following financial indicators: range of their income in the last three years, their income and expenditure, continuity and stability of funding, mechanisms of self maintaining during gaps between funding and diversity of funding sources. Overall, a development index of socially oriented welfare organizations under the "financial resources" sub-criteria was determined to be 2.33. (Diagram 6)

Diagram 6. Distribution of organizations by the “Financial Resources” sub-criterion



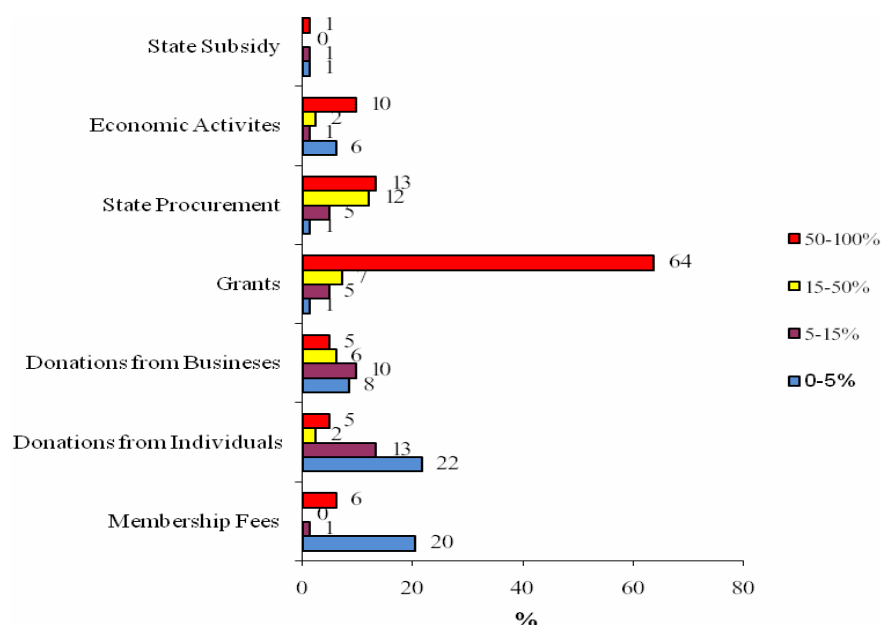
Socially oriented organizations operating in Georgia offer services to population, provision of which is viewed as Government's direct obligation. Despite this fact, which implies much, share of Government funds in total incomes of welfare organizations is low. The study indicates that welfare organizations operating in Georgia are immensely dependent on funds from foreign donors. (Diagram 7). A total share of foreign donors in the gross incomes of welfare organizations is 87,8%.

Diagram 7 - Funding Structure of Welfare Organizations



More specifically, the findings of the study indicate that grants stemming from international donor organizations constitute from 50% to 100% of incomes of 64% of organizations (Chart 1).

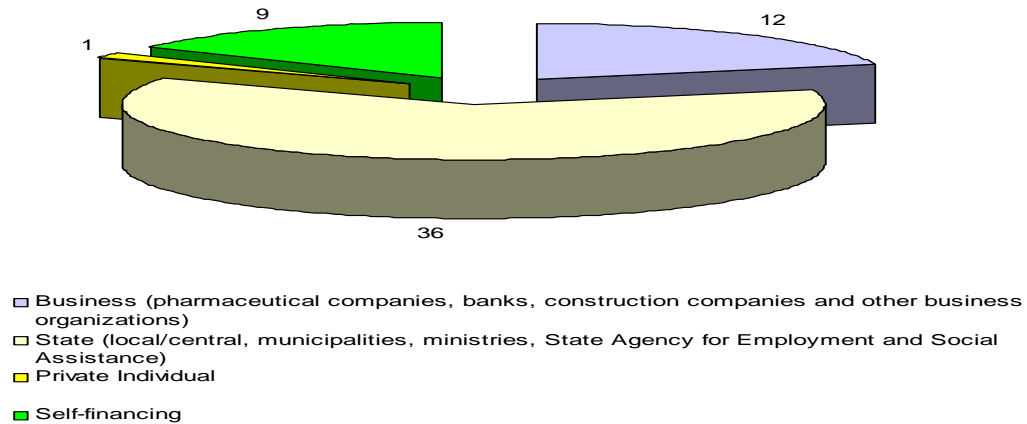
Chart 1. Share of funding sources of welfare organizations in the total budget in 2005-2006



Despite the fact that on a surface the funding sources of organizations seem to be diversified, funds necessary to pursue activities are secured only after receiving grants from the donor organizations. A small portion of organizations (7%) did not receive funding in 2005-2006 from any source, more than a third (36%) had only one funding source, and more than half (56.6%) had funding from two or more sources. Although it carries a symbolic character in terms of organizations' incomes, 23% of organizations have a membership fee system. Traditionally, a biggest portion of funding of organizations is attributed to grants. More than a third of organizations have had donations from private individuals, approximately fourth had donations from the business and the state order. Incomes from entrepreneurial activities and state subsidies are the rarest examples.

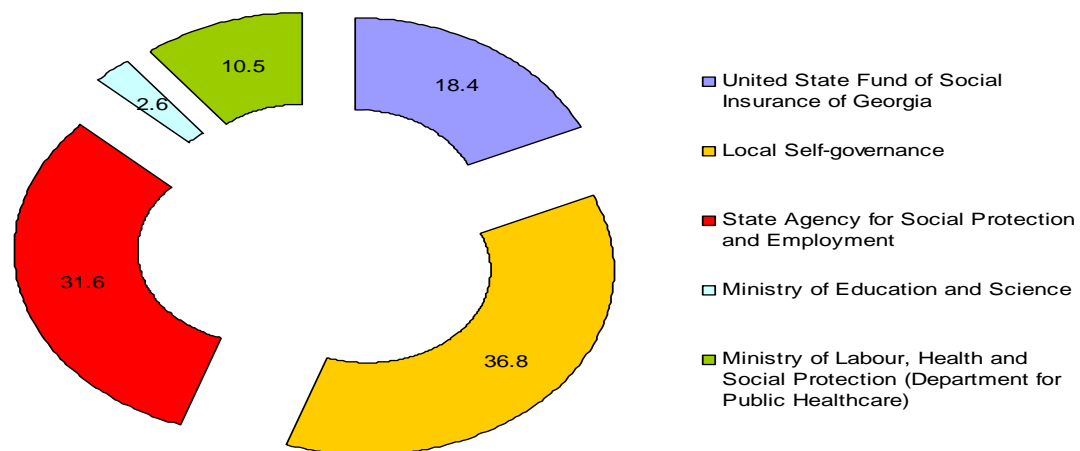
Nevertheless, it should be pointed out that among other sources of income (business, donations from private individuals, self-financing, state funding), share of state funding is the biggest (Diagram 8). 43.4% of organizations (36 organizations) have implemented projects with the state funding. Total number of projects that the welfare organizations implemented with the support of the state during last two years is 47. 14.5% of interviewed organizations (12 organizations) have implemented 20 projects with the financial support of business organizations. 10.8% of organizations (9 organizations) have implemented 17 projects through self-financing.

Diagram 8 - Other Financial Sources through which Welfare Organizations Implemented Projects in 2005-2006



The Survey further revealed state structures, with financial support of which welfare organizations have implemented projects (Diagram 9). As the diagram demonstrates state-funded projects were mainly implemented via two sources: local municipality budget and ministries (Ministry of Education and Science of Georgia and Ministry of Labor, Health and Social Protection of Georgia). Interviewed organizations have implemented projects with support of three structures under the Ministry of Labor, Health and Social Protection: Department for Public Healthcare, United State Fund of Social Insurance of Georgia and State Agency for Employment and Social Assistance of Georgia. However, it should be emphasized that with the support of local self-governances the organizations have mainly implemented *single measures*, e.g.: sound-tracking books for the blind, single monetary assistance for the elderly, prophylactic medical examination, New Year presents, provision of beneficiaries with bread, etc. Projects funded by the ministries are more long-term and are directed at a long-term care (1-2 years) for beneficiaries of organizations: day care center, social integration of children and people with disabilities, rehabilitation, in-house services, inclusive kindergarten, publication of learning methodological handbooks, etc. In total, in last two years the ministries have provided organizations with 1,108,428 GEL (Information Provided by Interviewed Organizations). In total, in last two years local self-governances have provided organizations with 125,603 GEL (Information Provided by Interviewed Organizations).

Diagram 9 - Distribution of Projects Implemented by Welfare Organizations with State funding by State Structures



Three conclusion that can safely be made on the basis of data presented above are: *Firstly*, financial resources of an organization have a biggest impact on the overall index of organizational development; *secondly*: the very existence of social service provider not-for-profit organizations is almost entirely dependent on the funding stemming from international donor organizations; and *thirdly*, despite the fact that social service provider organizations deliver services provision of which is a direct responsibility of Government, the share of state funding in total budget of organizations is miserable. This concern is becoming particularly acute, given that in 2006 a number of donors made first statements about phase-out from the country. In line with this reasoning, we conclude that the state should increase funding of social service provider organizations. In the light of this objective, the next section shall present the possible mechanisms which can be employed for effective financing of service provider organizations.

II. Proposed Solutions

1. Option I - Using Vouchers to Deliver Social Services

Voucher may be provided in the form of a subsidy, a coupon or electronic credit; an account that is debited for the purchase of certain types of assistance; or in other ways. Broadly speaking, vouchers provide a capped value and for a designated purpose and they offer recipients some flexibility for choosing a provider of goods and services. In the context of providing social services, a voucher is a restricted subsidy, often distributed in the form of a certificate or coupon, which gives recipients some choice in their provider

of services. Government agencies, most often on the state or local level, then reimburse the service provider.

There are a number of common reasons, policy goals and economic rationales that a voucher-based system may be established as social services financing mechanism. Three primary arguments that may support the employment of voucher-based system as a service delivery mechanism are presented below: a) Promoting informed client choice; b) Promoting competition among service providers; c) Focusing purchasing options.

a) Promoting informed client choice

Primary argument and reason for employing a voucher-based system is promoting client choice. Funding social services through vouchers has created the opportunity for beneficiaries to choose among a range of providers and allowed Government agencies an alternative to direct service provision. Vouchers enable clients to take part in selecting their own service provider reflecting their heterogeneous needs. By making benefits portable and engaging a variety of providers, voucher programs may facilitate clients' access to services that meet their individual preferences or needs.¹⁷ Portability of vouchers thus ties benefits to an individual client. In this way, voucher contrasts with grants or contracts, which generally dedicate a set amount of Government funding to a specific provider.¹⁸

However, expected advantage of voucher-based programs in the context of social services relies on the premise that clients make *informed* choice among providers. For the rationale behind the voucher-based system is to promote *informed* client choice, as opposed to promoting client choice *per se*.

Due to specific nature of social care services, beneficiaries need assistance in making the selection between social service providers. Client's need for assistance naturally depends on the characteristics of services. In the context of social services, the need of assistance to beneficiaries is increasingly important, for to select appropriate social care provider clients need to be aware of details of social services to be delivered. This is particularly so when services are provided to third party beneficiaries who cannot make personal selections themselves. For example, parents must make decisions about childcare arrangements, but they do not experience direct service themselves. They must rely on what they can learn about the type and quality of care and their own perceptions. Thus, there is a common agreement that a necessary precondition of using a voucher-based system as a service delivery mechanism is the capacity of consumers and their families to make an informed choice.¹⁹ If this imperative condition is not met, the voucher program may not be an appropriate social service delivery mechanism. Indeed, voucher-based systems are most used in social service areas (e.g. housing, nutrition, childcare) that are straightforward and easy to assess.

Contrarily, the use of vouchers decreases in areas requiring more complex analysis on the part of consumers, where more information is needed to determine the quality of services.

b) Promoting competition between service providers

Further argument in support of voucher-based system is that vouchers have a potential, not inherent though, of promoting competition as between competing providers of social services on the market. By increasing a number of providers for a publicly financed service, voucher programs can generate competition among them for clients and funding. Competition in turn may promote diversification of services and improvements in service quality as providers seek to be responsive to customer needs and distinguish themselves to attract voucher holders. The benefits of competition can extend to public as well as private providers by encouraging Government agencies to make improvements in their operations and services as they vie with private organizations for clients and funding.

However, there is concern that the use of vouchers might come at the expense of quality in social care. Although in theory vouchers should increase competition among providers and force them to be responsive to consumer demands in order to attract maximum number of customers, customer demands for quality depends on how much customers value quality over other factors in their decision, what they know about how to assess quality, time and resources they have to make this assessment, and their ability to make transitions among providers to satisfy their quality demand. Shortfalls on these components may prevent reliance on market responses alone to uphold quality, thus making vouchers an inadequate mechanism for promoting quality by themselves. Thus, for example, many childcare experts argue that offering parents their choice of any service provider may conflict with the goal of improving the quality of childcare. Parents may value features other than those valued by specialists, such as the provider's location, and are often willing to make trade-offs among these features. Low-income parents also face budgetary constraints and other pressures that may make them less likely than relatively higher-income parents to emphasize "quality" in their search for childcare. Even if quality is a priority, information on the quality of particular childcare options is difficult to obtain, and parents may not have the time to research, compare, and finally select providers.²⁰

c) Focusing purchasing options

Vouchers have advantage over direct cash benefits, for providing beneficiaries with cash benefits gives them the greatest flexibility in determining how to meet their own needs. However, it is never clear whether cash benefits are used for designated purpose. There are fears that giving cash assistance to socially vulnerable groups might not ensure that the cash aid is

spent “wisely”, that is for purposes determined by Government. This concern is not only about choosing alcohol over food, it is also about choosing clothes over food, or education over health care, or transportation over housing, and so forth and vice versa.²¹ Naturally, publicly funded programs have a strong interest in helping beneficiaries access a particular good or service that a Government deems appropriate to meet specific needs. Unlike benefits provided in cash, purchasing power of vouchers is restricted to certain goods and services. Benefits received for childcare services for example cannot be used to purchase other goods not related to this purpose.

d) Conclusion

As indicated above, voucher-based system has a potential, not inherent though of *first*, promoting client choice; *second*, increasing competition between providers concomitant of which is service diversification and quality improvement; *third*, focusing purchasing options.

However, all these benefits of voucher-based financing require a functioning, decentralized market of social services. The preexisting market is perceived nearly as a prerequisite of using voucher-based financing. Indeed, voucher-based systems are generally used as social services’ financing instrument where a true marketplace of social welfare services already exists, where the recipients of services have a capacity to switch from one service provider to another and where service providers have a capacity to deliver quality services. On the other hand, it is very difficult to assume that introduction of voucher-based system alone would result in development of array of social service provider not-for-profit organizations in the country. It is certainly possible that supply of services shall increase as a result of consumer demand generated from voucher-based system, however, we consider that the barrier to market entry in the form of low profit potential in social services area is at this stage simply too high to allow generation of supply. Indeed, fears that competitive market for social services will not develop is what has created a major obstacle for considering voucher-based system as a financing instrument in many jurisdictions.

Based on the foregoing reasons, we eliminate the possibility of employing the voucher-based system as an alternative of direct funding of social service provider not-for-profit organizations. We view this mechanism as a complement, rather than a substitution to direct financing of service provider organizations. This paper considers that this alternative would disregard the primary objective of the implementation strategy - strengthening institutional and operational capacity of social service provider not-for-profit organizations. It is also dubious whether voucher-based system, which is exclusively demand-oriented, has a capacity of realizing another objective of the strategy - stimulation of creation of social service provider organizations.

Since a critical step in implementing the policy is strengthening existing social service provider not-for-profit organizations and stimulation of creation of new organizations, we consider that a supply-oriented approach is imperative at this stage.

2. Option II - Percentage Mechanism

This alternative considers the introduction of a percentage mechanism as a financing instrument of social service provider not-for-profit organizations. The mechanism is increasingly used in several Central and Eastern European nations in the context of financing not-for-profit organizations generally without exclusive focus on social service provider organizations.

The central idea of percentage mechanism is that taxpayers may designate a certain percentage of their income tax paid to a specific non-profit and in some cases to other organizations.²² Percentage mechanism thus allows taxpayers to allocate a certain percentage of their previous year's paid income tax to beneficiaries entitled to receive such funds. Percentage type laws have been adopted in five countries in Central and Eastern Europe (Hungary, Slovakia, Lithuania and Poland, Romania). Naturally, the legal framework and mode of operation of the percentage laws differ in each country and the number and types of beneficiaries also vary but largely include not-for-profit organizations carrying out public benefit activities, including, but not limited to delivery of social services to socially vulnerable groups.

The common for all systems is that percentage mechanism is a form of redistribution of state resources by individuals. The process involves anonymous "donations" to eligible beneficiaries by a significant number of people, administered by the state but without its classical redistribution role. Meanwhile, non-profits are free to use the received support legally according to their needs and wishes.²³

Policy rationales that may support the introduction of the percentage mechanism in the Country are as follows: a) the percentage mechanism may generate additional financial revenue for social service provider not-for-profit organizations; b) the mechanism may raise public awareness of and public attitudes towards social service provider non-profits; c) Mechanism may contribute to development of philanthropic culture.

a) Generation of Additional Financial Resources

The principal argument cited in favor of percentage mechanism is that the mechanism has a potential to generate additional financial revenue for not-for-profit organizations. However, cautious approach here is imperative. The expectations in this regard should not be set too high. Relatively few surveys were conducted aimed at determining impact, including financial, of the

mechanism in countries where percentage laws operate. The limited available data indicates the following:

In Slovakia, in 2002, the first year of the 1% system's operation about 2.5 million Euros were designated to eligible organizations. This amount was distributed among 3,923 organizations. The smallest amount received by a beneficiary was about 0.68 Euros, the largest - about 88,000 Euros. On average, each organization received about 600 Euros.²⁴ In Hungary, in 2003, nearly 22,000 organizations were allocated about 23 million Euros through 1,358,000 taxpayers' designations. On average, each organization received about 1,000 Euros. The highest amount designated by one taxpayer was about 500,000 Euros, which was for a health care foundation. The average value of one designation was around 20 Euros.²⁵

The financial support percentage system generates should not and cannot certainly be perceived as an exclusive form of state support to eligible organizations. Governments in question do not see the percentage system as an exclusive form of state support, as its alternative or substitute. Neither does this paper. One percent designations are only perceived as *an additional*, as opposed to an *exclusive* source of income for organizations in question. Data from Hungary for example shows that income the percentage system can generate each year represents 0.7% of the sector's total annual revenue.²⁶ This amount, modest as it may seem, should not be underestimated however. As shown above, this is still a substantial amount and the relatively small share in total annual revenue of the sector does not lessen the significance of funds received by the organizations concerned. It is an important new source because the non-profits receiving funds can use them flexibly.²⁷

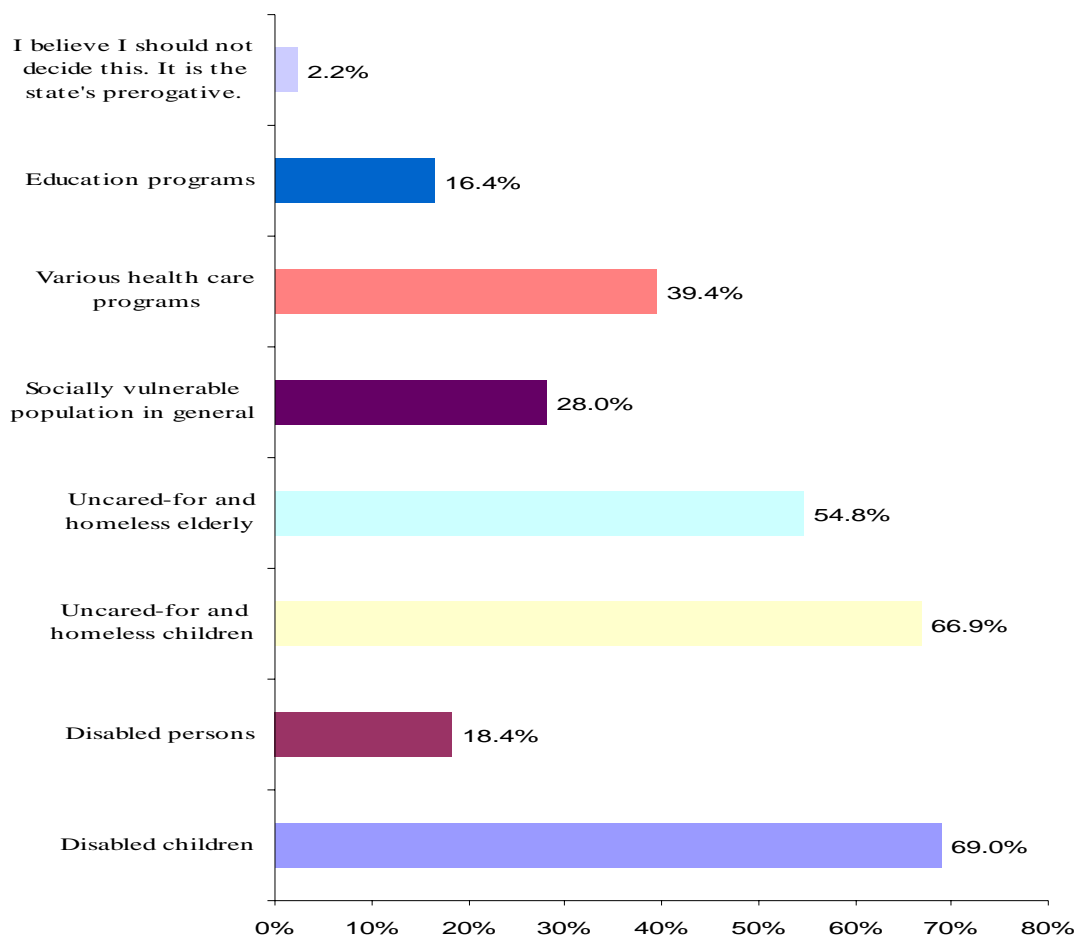
In addition, a significant indication is the Hungarian data, which shows that 1% designations to non-profits have grown steadily from a total of 3 billion forints in 1999 to 6.1 billion forints in 2003,²⁸ *accordingly, roughly doubled*. Further, the 1% provisions in Slovakia had been extended to allow corporate entities to allocate a portion of tax. This opportunity started in spring 2004. As a result, companies, when reporting on their income are able to allocate amounts of tax of up to 2%, the new percentage level. Thus, the size of the designated funds involved may well represent a much larger amount than in the case of individual taxpayers.

From the angle of generating financial resources for not-for-profit organizations, the effective operation of the percentage mechanism requires that there is sufficient number of taxpayers willing to use their designation option. In Hungary and Slovakia, despite high level of public awareness around one third of taxpayers actually make such designation.²⁹ It is not disputed that taxpayers' participation is a key driver of the effectiveness of the percentage mechanism from financial, as well as other perspectives; *hence*,

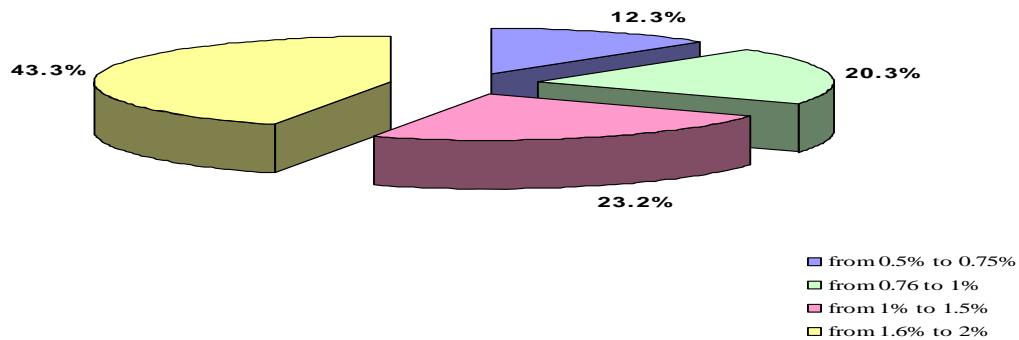
we need to look at whether such involvement will be sufficiently high to ensure its efficient operation.

It is increasingly difficult to make such prediction (whether sufficient number of taxpayers would use their designation option in the event such option is introduced in the Country). The only data available to us suggests that taxpayers do not preclude the possibility of their involvement in financing social programs. Specifically, Study of Georgian Population’s Awareness of and Attitude towards Social Policy, Actors and Social Welfare Groups³⁰ demonstrated that society does not preclude its own involvement in financing social programs. Although answers obtained during the process more reflect *population’s attitude* as opposed to a *degree of its real future financial involvement* (The same study depicted that 17% of the employed are unaware of taxes they pay to the budget), it can be assumed that the society has a degree of readiness for purposeful allocation of portion of its own taxes. Particularly, only 2.2% of the interviewed believe that they should not decide on allocation of certain portions from their personal taxes to fund specific sectors and that this is the state’s prerogative (Diagram 10).

Diagram 10. If possible, which social group would the respondents prefer to fund from their own taxes?

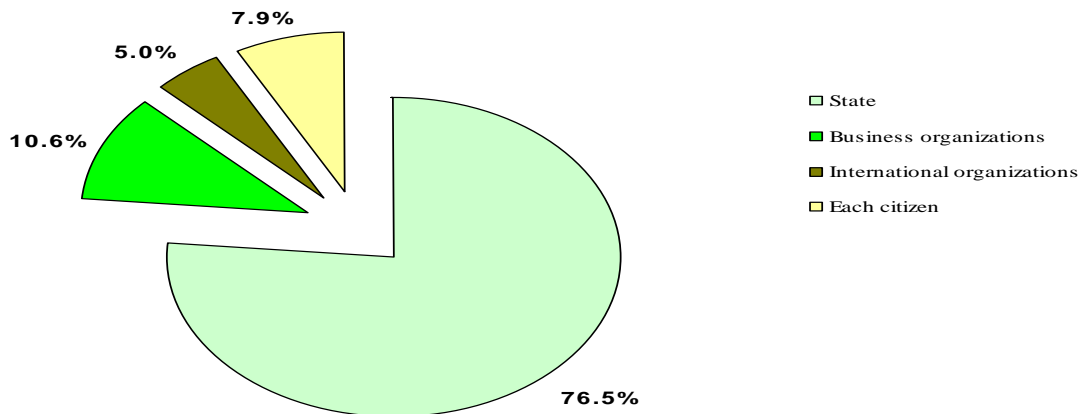


If it were up to each citizen to allocate a portion of his/her taxes for the benefit of a certain social welfare group, the society is ready to make a choice for the benefit of provided/listed groups. More specifically, respondents were asked to indicate an approximate portion of taxes they would consent to allocate for a selected group. 43.3% of respondents indicated they were ready to allocate 1.6%-2% of taxes for the benefit of a selected group (Diagram 11).



Nevertheless, the nature of the question posed to respondents should be accurately looked at. Respondents were asked as to the possibility of their involvement in *financing social programs per se*, as opposed to possibility of their involvement in *financing welfare not-for-profit organizations implementing social programs*. Since majority of respondents perceive that Government should implement social programs in question, as opposed to not-for-profit organizations, the above findings might not necessarily permit the conclusion that the same degree of readiness would be expressed if social programs were implemented by not-for-profit organizations. Specifically, 88% of the respondents believe that social programs should be funded and implemented *exclusively* by the state. Only 7.9% of the interviewed think that entire society and each citizen should be involved in funding and implementation of social programs in question (Diagram 12).

Diagram 12. Distribution of respondents' answers about funding sources of social programs



What is more directly related to the issue in question is the finding of the study that more than half of the people informed about the activities of welfare not-for-profit organizations *who trust* these organizations, if possible they would still allocate a portion of funds from their taxes to assist state institutions implementing social programs, as opposed to welfare non-profits. General group of respondents yielded similar results – majority (60.2%) would pay a certain portion of taxes for the benefit of state institutions (Chart 2).³¹

Chart 2. Distribution of interviewed respondents' answers to question – “If it was up to you how to allocate amounts paid by you for improving conditions of specific social group, what type of caring institutions would you fund?”

Type of organization	%
24-hour boarding-type caring institution in state subordination (for uncared-for/disabled children, grown-ups, elderly)	60.2
Daytime boarding-type caring institution in state subordination (for uncared-for/disabled children, grown-ups, elderly)	7.1
Private 24-hour boarding-type caring institution (for uncared-for/disabled children, grown-ups, elderly)	16.7
Private daytime boarding-type caring institution (for uncared-for/disabled children, grown-ups, elderly)	1.7
NGO's 24-hour boarding-type caring institution in state subordination (for uncared-for/disabled children, grown-ups, elderly)	12.9
NGO's daytime boarding-type caring institution (for uncared-for/disabled children, grown-ups, elderly)	1.4

To summarize, we have no real evidence to consider that the probability of involvement of sufficient number of taxpayers is high.³² Quite the opposite, we are more inclined to hypothesize that such probability is low enough to allow the elimination of the alternative from the perspective of generating financial revenue for not-for-profit organizations.

This conclusion is reinforced by another argument. As a general rule, easier the procedures, the more likely taxpayers will take time and effort to complete a designation. The more difficult it is to make the designation, the less likely that people will actually make it.³³ That this is so is confirmed by all evidence from Slovakia and Hungary. Now, if we look at tax administration system in Georgia, the probability of taxpayer involvement shall further decrease, for, as one author puts it: “a degree of difficulty of administering the model in Georgian reality is one of the strongest arguments against the model. Georgian tax administration is still in the formation process. Three years after the revolution were not enough for the establishment of a well-functioning and effective system. This system has many flaws ... Ensuring administration of one per cent model under this system is practically impossible. Imposing additional tax obligation on an employer is problematic as well (tax administration of transferring a portion of an income tax of employees to certain organizations) [emphasis added].”³⁴

For the foregoing reasons, we do not see the introduction of a percentage mechanism as a viable solution from the perspective of creating additional financial revenue for social service provider not-for-profit organizations.

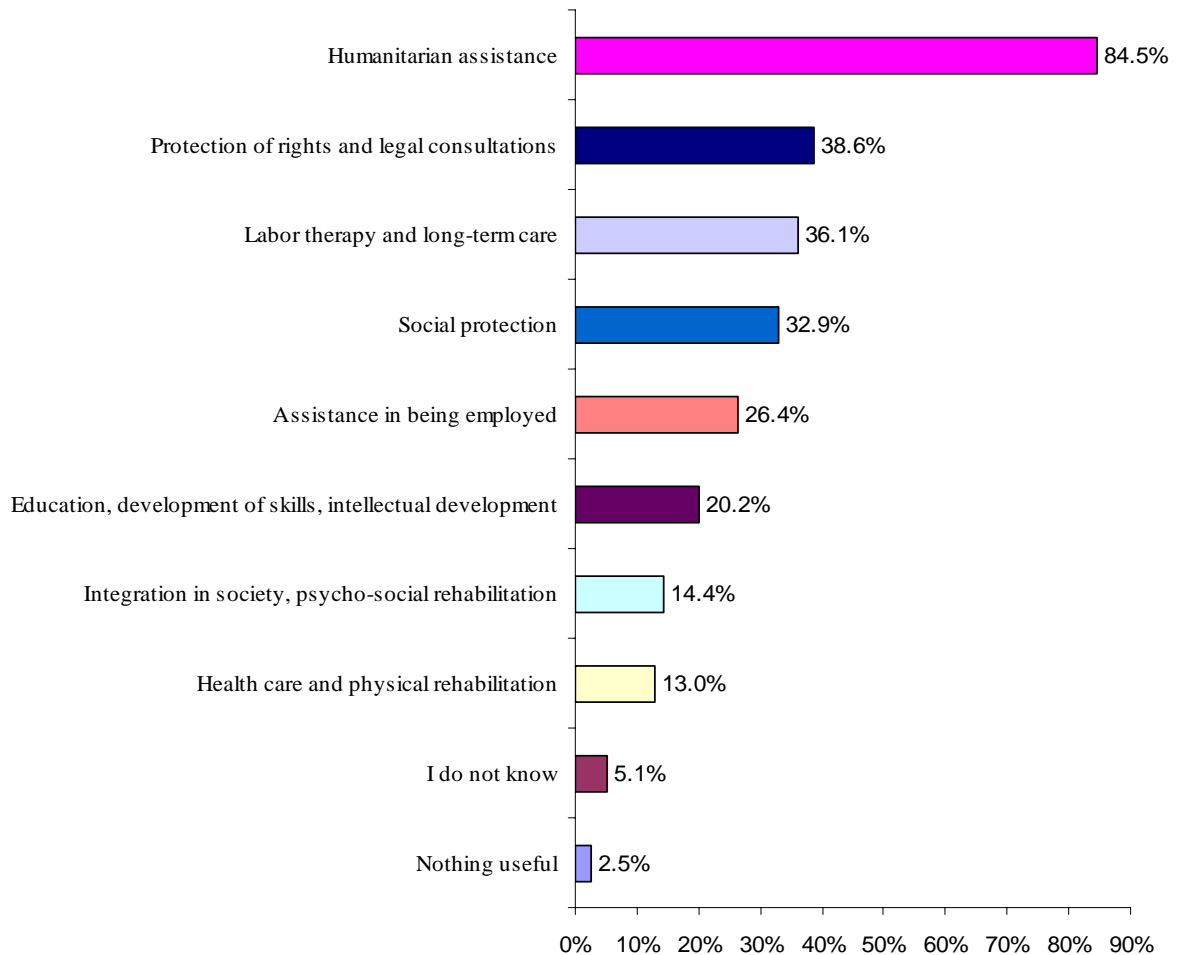
b) Public Awareness Raising about Social Service Provider Non-Profits

One of the arguments cited in favor of the alternative is the potential of the percentage mechanism to raise public awareness about not-for-profit organizations. This is referred to as a biggest possible benefit of the percentage laws.³⁵ Indeed, the mechanism has a potential to raise public awareness about social service provider not-for-profit organizations as shown by the impact assessment conducted in Hungary and Slovakia. The need of such awareness raising is also undisputed.

Data available to us suggests that awareness of the general population about activities of social service provider non-profits is low. More specifically, Study of Georgian Population’s Awareness of and Attitudes towards Social Policy, Actors and Social Welfare Groups³⁶ revealed that 51.2% of the interviewed possess information on non-profit organizations generally. Only one fifth of the interviewed (20.1%, 295 respondents) had information on non-profits working on social issues. 2.6% of the interviewed stated they possessed full information, 17.5% noted they were aware of them in general. Noteworthy, the perception of the interviewed individuals on non-profits working on social

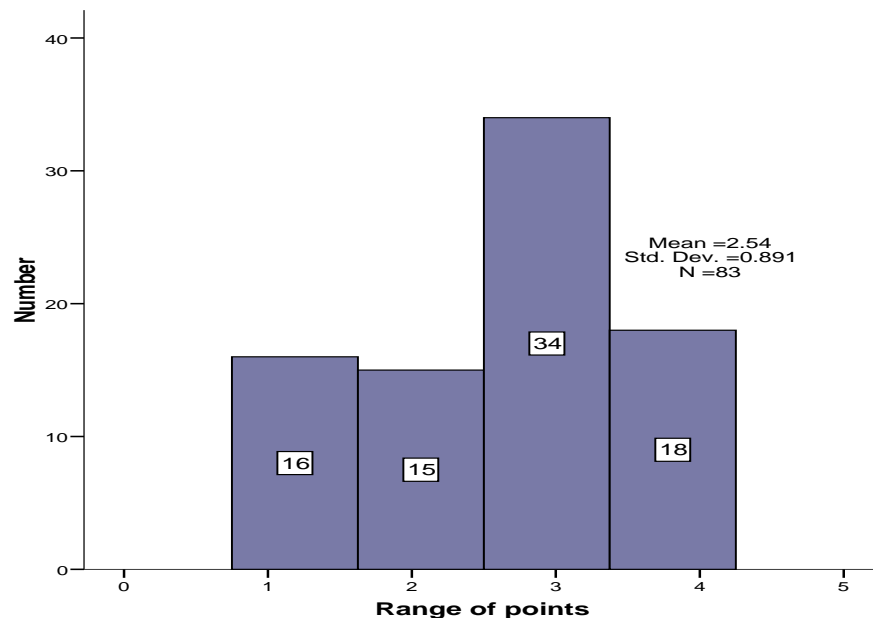
issues does not reflect reality, for majority (84.5%) thinks these organizations are delivering humanitarian assistance (Diagram 13).

Diagram 13. Distribution of respondents' answers to question - "What type of activities do welfare non-governmental organizations carry out?"



Further evidence in this respect is findings of the Survey of Development of Welfare Organizations in Georgia,³⁷ demonstrating that the index of development (arithmetic mean) of welfare organizations under the criteria "integration in Civil Society" measured by four sub-criteria (transparency, attracting volunteers, support of organization's activities by clients/society, protection of civil interests) is from 2.54 (Diagram 14).

Diagram 14. Distribution of organizations by the “Integration in Civil Society” criterion



Based on the foregoing evidence, we conclude that the need of awareness raising about welfare non-profits is undisputable: a small portion of population possesses information on welfare organizations.

Non-profits shall certainly be activated as a result of introduction of the percentage mechanism. They shall have to find new ways to promote themselves in their immediate and wider neighborhood. They shall simply have a financial incentive to prove their usefulness in a competitive environment. This shall inevitably lead to raised public awareness of activities performed by organizations in question. The question only is whether the benefits shall outweigh the costs of the campaigns that the organizations shall implement. If public awareness *per se* is viewed as a benefit (and indeed, in some contexts it may be viewed as a *per se* benefit), then the answer would be positive. Nevertheless, the position of this paper is that raised awareness about non-profits should in this context be viewed in conjunction with the concomitant benefit of financial revenue and other forms of support that may be generated. If this is true, then our prediction is as follows: if the eligible organizations' list does not only include welfare non-profits, but also other non-profits, which shall most probably be the case (otherwise, it will be increasingly difficult to justify the advantage granted to social service provider organizations *vis-à-vis* organizations which may similarly serve public purpose; we emphasize here that in all countries in which percentage mechanism is in effect, all forms of non-profits are included among beneficiaries. Access to the mechanism rests on a precondition that the activity benefits public, as opposed to the field in which the organization operates) the question arises whether these organizations shall manage to compete with larger, more stable (financially and otherwise) organizations,

particularly watchdogs. Based on common knowledge, we are inclined to think that harshly unequal distribution of benefits shall be inevitable to the disadvantage of social service provider non-profits.³⁸

In addition, we have looked at index of financial sustainability of welfare non-profit organizations. It is around 2.33.³⁹ The indicator is low enough. Consequently, we think that at this stage, introduction of the percentage mechanism shall have negative, rather than positive impact given that according to our prediction benefits shall not outweigh the costs incurred.

c) *Taxation Self-Determination*

Another policy rationale supporting introduction of the percentage mechanism is its attribute referred to as “taxation self-determination”, which is defined as the possibility for taxpaying citizens to make autonomous decisions on the use of a portion of their income tax. In the context of this rationale, the mechanism may be a tool for strengthening democratic values in transition societies.⁴⁰ We shall briefly examine the rationale. As suggested by one author “the percentage mechanism has a very good potential to increase citizen participation and taxpayer control over public funds. By giving them an opportunity to designate a percentage of their taxes, it makes people conscious of the fact that taxpayers may actually have a say in how their taxes are being used. This kind of “taxpayer consciousness” is still generally weak in CEE countries. It also has some limitations in this regard, especially related to the employers’ tax return and the ability of citizens to control the execution of their designations by the tax authority; nonetheless, this potential is significant and important for transition societies.”⁴¹

The general philosophical significance of the argument is not disputed. Neither the importance of development of individual taxpaying culture is undervalued. This is particularly so because under Georgian tax legislation, in line with general custom in Central and Eastern Europe, tax returns are filed by the employer for their employees. Individual taxpayers generally have no direct contact with tax authorities. Moreover, the study showed that 17% of the interviewed respondents were unaware of portion of taxes they paid to the budget.⁴² Nevertheless, we view this benefit as not directly related to the purposes of the paper. Therefore, this benefit alone, however immense philosophical value we may attach to it, would not urge us to introduce the mechanism in question, unless generated financial revenue and other forms of public support for social service provider non-for-profit organizations is secured, which we saw above shall most probably not be the case.

d) *Development of Philanthropic Behavior*

Fourthly and lastly, we examine the argument according to which percentage mechanism is a tool directed towards development of philanthropic behavior.

“...the designation arrangement is a hybrid construct that *can* be considered a peculiar form of philanthropy but whether and to what extent it helps true philanthropy to develop is not clear at all ... it is by far not enough in itself to address the lack of a philanthropic culture. [emphasis original]”⁴³ Thus, the mixed nature of the percentage mechanism makes it limited in its potential to develop a philanthropic culture as such. It may indeed develop a culture of designating a portion of taxes (quasi-philanthropy), but to what extent it can help classic philanthropy to develop is questionable. Contrariwise, percentage designation might well lead to replacement of traditional forms of philanthropy with the quasi-philanthropic behavior, such as designation of portion of tax. In Hungary, while the mechanism has increased the level of awareness about the importance of civil society among citizens, it has not resulted in increased financial contributions by individuals (specifically, the percentage of private contributions by individuals in Hungary has been declining). Contrarily, according to some accounts, this mechanism might well create a feeling in some individuals that they have done their share in society by “giving” a percentage of their taxes and there is no need to give more.⁴⁴

e) Conclusion

Based on the foregoing reasons, we do not perceive the introduction of a percentage mechanism as a viable alternative. For we hypothesize that *first*, the probability of generating financial revenue is low; *second*, legal awareness raising and development of philanthropic culture alone are not meet the objectives of the paper; *third*, political feasibility; *fourth*, administrative difficulties.

The effect of the mechanism on philanthropy cannot be easily assessed, as there are no comprehensive research results, which can show whether it achieves this objective.

are too long-term to permit and should be undertaken. The purpose of this paper is to suggest an optimal and instant response to the demand, rather than elucidate on long-term intangible perspectives.

3. Option II - Procurement

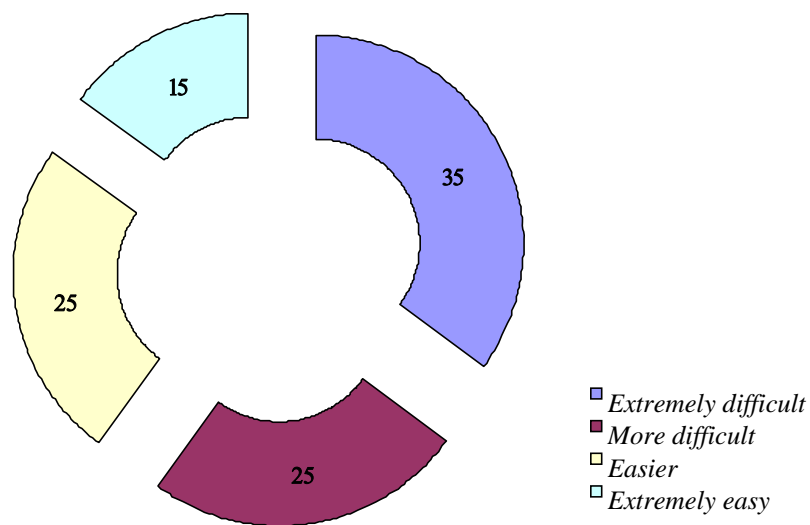
Alternative III considers the use of procurement as a tool to purchase social services from private not-for-profit service providers. This alternative expresses the *status quo* environment, for, currently, the purchase of social services falls within the domain of the Law of Georgia on Public Procurements. The Law ensures that state procurement is open to any person able to provide the needed social service, irrespective of whether it is a for-profit enterprise, not-for-profit organization or an individual. Thus, not-for-

profit providers possess a *de jure* and *de facto* eligibility to bid for public contracts.

Now, before we set forth our position on the viability of alternative II in the context of objectives of the paper, we shall first look at the attitudes of service provider not-for-profit organizations depicted by *The Study of Development of Welfare Organizations in Georgia*. We do not certainly perceive the findings as conclusive evidence of inefficiency of the mechanism. The findings have an indicatory value only.

The findings of the study suggest that 25.4% of interviewed organizations (approximately 25 organizations) had participated in state procurement procedure. Out of these, 60% of organizations (approximately 15 organizations) believe the process was associated with certain difficulties. Therefore, only approximately 10 organizations think the procedures are free from complexity (Diagram 15).

Diagram 15. Evaluation of state procurement procedures



Majority of organizations who have participated in state procurement believes the mechanism is not effective due to the following: difficulties associated with preparing tender-related documents; inefficient tendering procedures; low prices established by the state on services; type of tender agreements, which are classified as state orders; consequently, are subject to the same tax regime as economic activities. In addition, tender-related information is inaccessible to a part of non-profits, particularly in regions.

The findings however do not elucidate the fundamental causes of inefficiency of the mechanism. Although majority of organizations indicated certain factors which in their eyes were the cause of inefficiency of the mechanism, they experienced some difficulty in explaining why exactly the listed difficulties led to inefficiency. The two factors indicated by the organizations: inaccessibility of tender-related information to a part of non-profits; and difficulties associated with preparing tender-related documents may not be perceived as inherent in the mechanism. These difficulties may well be caused by lack of proper skills and knowledge of procedures on the part of bidders. If this proposition is true, then the problem can well be solved through measures directed at raising awareness of potential bidders in issues related to tendering procedures and through ensuring that the information is accessible to regionally-based organizations. However, these factors alone do not permit the conclusion that the mechanism is inherently inefficient.

Now, we shall turn to the analysis of the third barrier against the effectiveness indicated by the interviewed organizations, particularly, tax treatment of contracts concluded between not-for-profit organizations and the state. As procurement results in commercial relations between the non-profits and the state, the result is that public contracts are subject to the same tax treatment as economic activities. It is worthwhile to point out here that not-for-profit organizations registered in Georgia are not prohibited from carrying out economic activities; however, in the event economic activities are implemented, non-profits become subject to the same tax treatment, as private for-profit enterprises. If this is true, then it is equally true that this mechanism fails to meet the objective of achieving financial sustainability of not-for-profit organizations, since the result is that the non-profits are deprived of the possibility to reinvest the profit in its entirety from economic activities to serve the ends of the organizations directly or indirectly. As a result of tax treatment, the mechanism leaves no levy to organizations that can be reinvested to serve social purpose.

We note here that it is merely illogical to view for-profit enterprises and not-for-profit organizations as similar structures due to the fact that they both deliver similar goods and services. Despite their more business-like activities, non-profits should not be perceived as for-profit enterprises in disguise. While non-profits may produce the same or similar goods or services as a for-profit enterprise, their "market" is quite different. Non-profits generally use their commercial opportunities in different ways than for-profits. Economic revenues are used to achieve organization's mission or to support mission-oriented activities. For example, non-profit organizations will set their prices to ensure access by geographically or socially disadvantaged groups. Even where it sets the same price as a for-profit enterprise, the profit is being used to cross-subsidize below market price provision of the same service to the needy.

Noteworthy, in countries, where procurement is used as a mechanism to purchase social services from private not-for-profit enterprises, that is, where non-profits and for-profits bid for public contracts on an equal footing, non-profits are exempted from taxes on economic activities. Thus, the two mechanisms operate in conjunction. The first ensures the equal standing of non-profits and for-profits as they bid for public contracts, the second ensures that the non-profits operate in a beneficial tax environment and are enabled to reinvest the funds to achieve mission-related objectives to a maximum extent possible.

One solution may be to introduce the tax benefit on economic activities implemented by not-for-profit organizations; however, it should be born in mind that "this issue has never been on a political agenda either before or after the revolution. Chief argument of the authorities both before and after the revolution (political feasibility of this issue was studied in the fall of 2004) is that tax benefits on economic activities can freely be abused for tax evasion purposes."⁴⁵ Therefore, at this stage we do not find it reasonable to examine the tax benefit models on economic activities and draft relevant legal regulations.

Further, we emphasize that although most legal systems acknowledge the contribution of nonprofit organizations to the public good and recognize this contribution by providing a range of tax benefits related to their activities,⁴⁶ these benefits do not constitute an exclusive form of state support provided to non-profits. We mean that even if tax benefit on economic activities are introduced in the country, which on its part would contribute to financial sustainability of non-profits, the procurement mechanism should not still be viewed as an exclusive form of state support. This is particularly true given the specific objective of the preferred alternative - developing a social services market with sufficient number of not-for-profit competitors. We consider that procurement mechanism should be viewed as *a complimentary*, rather than as *an exclusive* form of state support to social service provider non-profits. *This conclusion stems from our hypothesis that the mechanism as an exclusive form of non-profit financing shall fail to meet the objective of development of sufficient number of not-for-profit competitors on social services market.* It is however noteworthy that this paper acknowledges the complementary value of the mechanism. The position is that the mechanism should be employed in specific cases, e.g. where the aim is to outsource particular social care services that do not fall within comparative advantage of non-profits, thus, where it is more reasonable that private non-profit and for-profit providers bid on an equal footing for public contracts.

Option III - Government Grants

For the purposes of this alternative, Government grants are defined as financial support mechanisms provided by public authorities to service

provider not-for-profit organizations. This option foresees adoption of Law on State Grants and Subsidies as a financing instrument of social service provider non-profits. Employing grants as an instrument for financing of health care and social services is a common practice in western European countries.⁴⁷ Also, many countries in central and eastern Europe have designed government grants programs for development of not-for-profit organizations. Although they vary in scope and purpose, the underlying policy is one: strengthening non-profit sector.

One of the strengths of the model is that through this mechanism grant making agencies on central and local level shall have the flexibility to design grant programs to advance the implementation of the policy of improving service delivery system. For example, a need to support a particular area of social service might arise given a wider framework of social policy. However, a necessary prerequisite here then would be that Government agencies at all levels be required to systematically renew their grant programs so that they reflect and remain consistent with changing needs and priorities of social policy. We think that this alternative would best manage to attain the specific objectives defined by the paper: strengthening organizational and institutional capacity of non-profits and stimulating proliferation of social service provider organizations.

A further benefit of the instrument is that state grants will automatically place the monetary means issued by the state in beneficial tax regime, for under Georgian legislation grants received by non-entrepreneurial legal persons are exempt from the profit tax, reimbursements paid out of the grant funds by non-entrepreneurial legal persons are exempt from the social tax. The taxation regime to within which grants fall is one of the strongest benefits of the model. Beneficial taxation regime would enable organizations to conduct operations in usual tax environment and utilize the funds to achieve main objectives to a maximum extent.⁴⁸

This model is also, in comparison with other alternatives, much easier from administering perspective. Each state agency will be able to define the effective and efficient mechanism of administering grants/subsidies within the legal framework established under the law. Moreover, due to the fact that the model will entirely fit the specifics of non-profits, it will, unlike the mechanisms established under the law on procurements, not set requirements impossible for non-profits to meet.⁴⁹

The position of this paper is that relative to other financing alternatives, option III - introduction of state grants/subsidies is best suited for attaining the specific objectives of the preferred model of social service delivery – stimulating development of social service provider non-profits and strengthening social service provider non-profits, for, *first*, the mechanism, relative to other alternatives has a greater potential to stimulate development

of social service provider non-profits on social services market; *second*, relative to other alternatives the mechanism has a potential to attain financial sustainability of non-profits for it alone allows organizations in question to operate in beneficial tax regime, thus, to reinvest profits to attain main objectives and maximize extent; *third*, has a definite advantage relative to other options from the angle of political feasibility, flexibility and administration ease. For these reasons, the overall conclusion is that introduction of state grants/subsidies is at this stage the only available option capable of realizing the objectives sought.

Basic Principles Underlying the Model

It must be born in mind that the basic objective of using the mechanism of grants in the context of this paper is *first*, to strengthen social service provider not-for-profit organizations; and *second* stimulate creation of a market with sufficient number of social service provider not-for-profit competitors; These two objectives on their own part are instruments for improving social service delivery system in the Country. Consequently, the model should be designed to advance the implementation of these policy goals, whether at national or local level. In this section the paper shall outline the principles which we think should underlie the model.

1. Subsidiarity

We propose that the principle of subsidiarity be explicitly reflected in the drafted instrument. In this respect, we rely *inter alia* upon the experience of Germany, where social policies incorporate the "principle of subsidiarity," giving preference to non-profit over public provision of core welfare services. In terms of social policy, the principle basically translates into a system whereby private provision of services takes precedence over public efforts and local provision over non-local. "Therefore if the provision of social services is governed by the rule of subsidiarity, the "third sector" is to be given preference over the public sector for the delivery of social services. The Federal Social Assistance Act explicitly 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". This does not limit the independence of the welfare organizations in providing the service. Article 10 of the above mentioned act states that public bodies "should collaborate with the welfare associations, acknowledging in so doing their independence in the targeting and execution of their functions."⁵⁰

The same principle was recently incorporated by Poland in the Act on Public Benefit and Volunteer Act of Law with some modifications.⁵¹ The act stipulates in pertinent part that Public administration authorities *shall* provide support whenever public tasks are performed by non-governmental organisations engaging in statutory work in a specific area; Moreover, the Act

provides that the public administration authorities *shall entrust* the performance of public tasks to non-governmental organisations.

As observed above, a preferred alternative proposed in this analysis is a collaborative model or mixed provision by public and non-profit agencies, which stresses complimentary functions of Government and welfare not-for-profit organizations based on their comparative advantages. Welfare not-for-profit organizations are not considered as a *substitute or alternative* but rather a *complement* to the state in the provision of social services. Therefore, we think that a clear statement of the principle of subsidiarity conveying a complementary role of welfare not-for-profit organizations in the adopted instrument is important due to its power to act as an incentive for welfare organizations. It has been asserted above that stimulating creation of a competitive market is of critical importance for effective implementation of the model. If this is so, than our prediction is that clear statement of this principle would *first*, act as a safeguard against emergence of Quangos, that is quasi-non-governmental organizations acting merely as agents of the state; and *second*, make the role of the welfare non-profits in social services field unambiguous enough and would thus act as an incentive for operation of such organizations.

3. Qualification and Fiscal Requirements

Clear criteria should be elaborated to determine eligibility of organizations to provide social services to population. This paper proposes that a pre-qualification system be introduced in the adopted instrument. This means that a Ministry on a central level should maintain a database of qualified social service provider not-for-profit organizations who are eligible for funding through its state grant programs. The rationale of using a pre-qualification system in western European nations is that the system seems to result in significant savings of administration costs of deciding on technical and institutional eligibility of respective organizations on every single occasion.⁵²

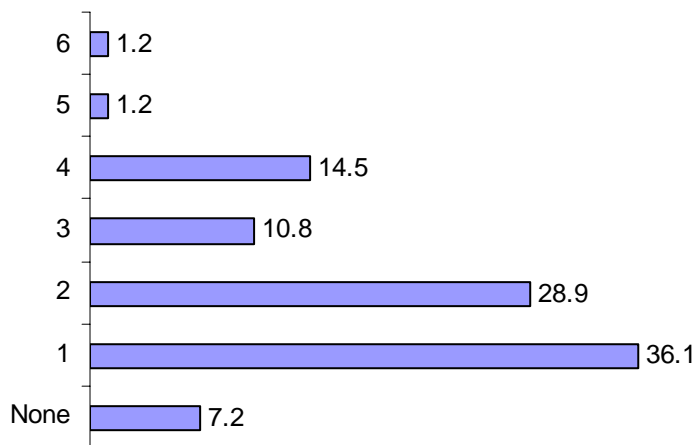
It is also of a critical significance that fiscal requirements for eligibility are determined explicitly. In this connection, the paper takes the position that not-for-profit organizations should commit other resources so as not to be fully dependent on Government funds. The latter is based on the understanding that *one of the advantages of employing not-for-profit welfare organizations as service deliverers is their ability to bring in additional private funding.*

The practice of requiring matching funds is common for many Governments. In fact, it is usual to require co-funding from eligible organizations for the activities for which they seek financing from the state.⁵³ For example, the minimal co-financing requirement in the Czech Republic equals 30%.⁵⁴ A further example is the Romanian Law on the Conditions of Non-Refundable

Financing from Public Funds Assigned for General Interest Non-profit Activities. Among the number of fiscal criteria for non-profits participating in Government grant programs is that maximum of public financing should consist of 90% of the total value of the project.⁵⁵ We think that a similar requirement should be incorporated in the drafted instrument.

This notwithstanding, we take into account the fact that welfare non-profits may not be in a position to raise additional funds, despite efforts. In some cases, this may adversely affect the objectives pursued, in particular mushrooming of service provider organizations. The findings of the Survey of Development of Welfare Organizations in Georgia show that a small portion of organizations (7%) did not receive funding in 2005-2006 from any source, *more than a third (36%) had only one funding source*, and more than half (56.6%) had funding from two or more sources.

Diagram 16. Number of funding sources in 2005-2006



Based on this data, we do not consider that the matching funds requirement should be made *absolute*, that is for each and every grant program. Contrariwise, whether the requirement is made a precondition for receiving Government financing should be determined on case by case bases. The discretion to decide upon the need and feasibility of requiring matching funds should be left to decision-makers. A common view in this respect is that it is not recommended for transitional countries to make the matching fund requirement an absolute for Government funding. "...Rather, it could be left to decision-makers of each agency and project tender to assess the need and feasibility of such requirement."⁵⁶

3. Competitive Mechanism

It has been stressed above that stimulating creation of a marketplace with sufficient number of not-for-profit competitors is a necessary prerequisite for reaping the benefits expected from the model, specifically, cost reduction, quality improvement and innovation of social services. Consequently, we

consider that competitive mechanism of grant allocation should form the basis of selection of service provider organizations. The allocation of subsidies on a competitive basis would provide for a fair selection process. This is a common practice in Central and Eastern European countries. For example, 80% of grants allocated by the Hungarian National Civil Fund are to be allocated through a competitive mechanism.⁵⁷ In Poland, too, competition forms the basis of allocation of subsidies from public funds.⁵⁸

It is also true that in some cases direct government allocations are provided to organizations specifically named in the budget. This means that annually the budget act grants subsidies to non-commercial organizations. We consider however that this mechanism does not reflect the objectives pursued in terms of stimulating creation of competitive market of services, for the mechanism raises concerns over the transparency of the processes and deprives the opportunity to other organizations seeking similar support. For this reason, we consider it critical that the allocation of grants should be implemented through a competitive process.

Based on this premise grant making agencies should be required to ensure that they receive as many applications as possible. This can best be achieved by requiring a wide circulation of the tender announcement among the potential target groups. This is particularly so given that when evaluating state procurement procedures, most of regionally based organizations cited inaccessibility of tender related documentation as one of the reasons of inefficiency of the procurement mechanism in effect.⁵⁹ Therefore, we consider that particular attention should be paid to ensuring accessibility of tender announcements to smaller, regionally based non-profits which usually do not have internet access.

The accessibility issue is paid a good deal of attention in similar laws in Central and Eastern Europe. Announcement dissemination processes include, but are not limited to: internet home pages, ministry's own database or electronic newsletter, electronic and print media, daily newspapers etc.⁶⁰ As a further example, Polish Law on Public Benefit Work provides that the announcements should be published according to the type of the task, in a nationwide or local newspaper and at a headquarters of public administration body at a place designed for announcements.⁶¹ Also, Romania Law provides as follows: "The contracting authority has an obligation to publicly announce its intention of assigning financing contracts. The publication announcement must be published in *Official Gazette* a central day newspaper on the web-site of regional or general interest contracting authority, respectively in at least two local daily newspapers and on the web site of the local contracting authority. In order to ensure a maximum transparency, the contracting authority will publish the participation announcement also through other national or international mass medias..."⁶²

Endnotes:

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⁶⁰ *Principles and Practices in Grant Tendering*, European Center of Not-for-Profit Law

⁶¹ Law on Public Benefit and Volunteer Work, Article 13

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