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**DEFINING THE NONPROFIT SECTOR:  
THE UNITED KINGDOM**

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## **PREFACE**

This is one in a series of Working Papers produced by The Johns Hopkins Comparative Nonprofit Sector Project, a collaborative effort by scholars in a dozen countries to understand the scope, structure, and role of the nonprofit sector using a common framework and approach.

The Working Papers provide a vehicle for the initial dissemination of the work of the Project to an international audience of scholars, practitioners and policy analysts interested in the social and economic role played by nonprofit organizations in different countries, and in the comparative analysis of these important, but often neglected, institutions.

Working Papers are intermediary products, and they are released in the interest of timely distribution of Project results to stimulate scholarly discussion, and to inform policy debates. A full list of these papers is provided on the inside of the back cover.

The production of these Working Papers owes much to the devoted effort of Donna Schaub. I also want to express my deep gratitude to my colleagues on this project, especially Assistant Project Director Dr. Helmut Anheier, to the International Advisory Committee that is helping to guide our work, and to the many sponsors of the project listed at the end of this paper.

The views and opinions expressed in these papers are those of the authors and do not necessarily represent the views or opinions of The Johns Hopkins University, its Institute for Policy Studies, or any of its officers or supporters.

We are delighted to be able to make the early results of this project available in this form and welcome comments and inquiries either about this paper or the project as a whole.

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## DEFINING THE NONPROFIT SECTOR: THE UNITED KINGDOM<sup>1</sup>

### Introduction

There is little doubt that the voluntary sector - to use the most common term for the nonprofit sector in the United Kingdom - is important. What must be in considerable doubt, however, is quite *how* important, for the sector's boundaries are poorly defined, many of its activities go unremarked, and its full contributions to the UK economy and society are uncharted. This paper examines the issues surrounding the treatment and definition of the voluntary sector in the UK. We first provide a short account of the sector's historical development, and then set out the major organizational types to be found in the UK voluntary sector. We then examine some issues of political economy, particularly the links between the State, society and the voluntary sector. In the final substantive section we move to a definition, concentrating on the criteria to be met for an entity to be termed a "voluntary organization," and examine the boundaries around the sector and some of the issues which surround these.

### Historical Note

The history of the formal voluntary sector in the UK is one of gradual secularization and formalization of voluntary action, and of changing roles in relation to the State (see Owen, 1964, for the leading account of the sector's history in England up until 1960). It concerns equally important traditions of philanthropy and mutual aid - and collective action combining elements of both - and charts the development of charitable giving and its conduits. An important set of subthemes concern the changing balances in service provision between the four principle domestic economic sectors - the formal voluntary sector, government, households and informal community action, and private for-profit enterprises. In the UK as in most other countries, the voluntary sector's roles as substitute and complement have been determined by, and have themselves determined, the inter-sectoral balances of provision of key services. The history of the voluntary sector is also about a dynamic set of organizations which through their campaigning and innovation have performed a pivotal role as catalysts for change in the wider society. These developments have taken place against a backcloth of sometimes focussed, but more often seemingly piecemeal and *ad hoc* policy reform.

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The formalization of philanthropy began in earnest with the Elizabethan Statute of Charitable Uses in 1601. Passed in the wake of the religious upheaval of the Reformation, it marked the beginnings of the secularization of philanthropy (Ware, 1989a), but, in common with the Poor Law passed in the same year, it was also a response to the economic and social upheaval of the period, including the emergence of a class of landless and indigent people. As the movement from the land accelerated with industrialization in the eighteenth and nineteenth centuries, the pressures of industrial development, rapid population growth and blighted cities made increasing demands on both philanthropy and the State (Prochaska, 1988). The reluctance or inability of the State to intervene left the way open for the development of formal voluntary organizations at local and national level.

During the eighteenth and nineteenth centuries, philanthropic organizations were formed by members of the middle class, often combining exemplary and innovative service provision with a strong campaigning role, highlighting new needs and bringing old injustices to public attention. These agencies have stayed firmly within the voluntary sector to the present day, and have often evolved into what we refer to below as *professional non-profit organizations* and *voluntary service organizations*. These range from social welfare agencies like Dr. Barnardo's, which grew to develop national remits providing orphanages and services for children across the country (albeit unevenly), through church-based local activities with missions and visiting societies concerned to preserve family life in the face of severe poverty, particularly in towns and cities, to federal bodies working through local branches. The latter included women's organizations which provided "a compelling, and relatively unrestricted, avenue for expression and status" (Prochaska, 1988:24-25). Many of the prominent fields of activity of the sector over this period remain important today, including social care provision, public health at the workplace and domestically (including housing provision), schools and adult education, culture and the arts, and the environment (preserving common land and urban open spaces). These constitute just a few examples of the sector fulfilling its "historic role as pioneer" (Nathan, 1952).

Mutual aid organizations for working class people were also established at this time, particularly in the latter part of the 19th century. Rose's Act of 1793 gave formal recognition to the *friendly societies*, bodies of (typically) men who pooled their resources to create a contingency fund for sickness, burial and old age, meeting in the local inn or chapel. *Trade unions*, *consumer co-operatives*, *building societies* and *housing societies* were also part of this trend, recognized by the Royal Commission of 1871-4 as examples of "the working spirit of self-help . . . by which that portion of the population which is most within the risk of pauperism endeavours to escape from it" (Beveridge, 1948:85-6). The *benevolent societies* performed a similar role for the indigent higher classes.

The sector's profile was perhaps highest during the nineteenth century as a bulwark against poverty in areas as yet deemed inappropriate for State support, combining the direct provision of resources with its quintessential advocacy role. Re-emphasizing a division of responsibility between state and voluntary sector which can be traced back to fourteenth century legislation (Chesterman, 1979), the reform of the Poor Law in 1834 delineated the State's control of the "undeserving poor" through the deterrent of the workhouse, while the voluntary sector's role was principally to provide for

the "deserving poor." Over this period, the Charity Organisation Society (COS) or, to give it its more descriptive full title, the *Society for Organising Charity and Repressing Mendicity* (begging), attempted to act as umbrella and coordinator for the philanthropic wing of the sector, though with mixed success. The nineteenth century also witnessed the social surveys of major philanthropic reformers and the settlement movement mobilizing "citizens of public spirit to undertake civic tasks," who both lived and worked in the newly emerging ghettos of increasingly divided cities.

Moving into the twentieth century, many aspects of formal voluntary action were increasingly being coordinated by umbrella groups such as the local and national councils for voluntary service.<sup>2</sup> The need for effective coordination was made all the more crucial by the upheavals of the First World War and the subsequent economic depression. All the while, State action was growing, though slowly and unevenly. The Second World War saw a strong partnership of State and voluntary effort, as manifested in the contributions of women's groups, the Red Cross and Citizens' Advice Bureaux, for example. It was not until the foundations of the Welfare State were laid through the social legislation of the 1940s that the public sector came to dominate the funding and provision of education, health, social welfare and income maintenance services. This redefinition of the role of the State and its responsibilities naturally had implications for the voluntary sector. The pioneers of State socialism saw the voluntary sector moving away from, to use the terminology of the Webbs (1912), the "parallel bars" role in social provision of the Poor Law and COS period, with more emphasis now to be placed on the "extension ladder" role, complementing and supplementing the new universalism. Although stability and acquiescence were common reactions among some of the health, social service and education organizations which were not absorbed into the mainstream State system (Wolfenden, 1978:20), many parts of the sector were invigorated rather than marginalized by the reforms - for example, in the mental health field, MIND (the National Association for Mental Health) and the Mental Health Foundation were both established in the late 1940s. Into the 1950s and 1960s, the vibrancy of the sector was beyond doubt, as established organizations pioneered new technologies, particularly in health and social care, while many new organizations were formed, including innovative self-help groups, international aid and awareness agencies, and myriad sporting and leisure bodies.

During the 1960s and 1970s, then, voluntary organizations continued to be at the forefront of social change. As the broadened boundaries of the State became more apparent, so too did its limitations. Realization of these limitations, combined with a desire to combat newly emerging problems, such as urban decay and racial tension, and enhanced expectations from the general public prompted public sector bodies, at national and local level, to fund community-based groups and consumer and service user organizations to a much greater extent than before. Lobbying groups in the voluntary sector such as the Child Poverty Action Group and Shelter called for the extension of the rights and entitlements of those adjudged to be in need. Government agencies were also increasingly being characterized as inefficient and unresponsive in their provision of services. It was in this context that a

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<sup>2</sup> These replaced the COS as the center of gravity for much of the sector. The COS itself moved on from its role as an intermediary to becoming a social service specialist, and was later renamed the Family Welfare Association.

new Conservative government came to power in 1979, under Margaret Thatcher's premiership, with a commitment to reduce or limit the role of the State in practically all fields of activity, and with an especial emphasis on rolling back the boundaries of State social provision.

## Major Types of Organization

There is no single or simple route in the UK to the identification of "types" of voluntary or non-profit organization; as with definitions, the most useful categorizations will depend on the reasons for using them (Johnson, 1981). In this section, however, we start by considering some categorizations which provide an overview of some important characteristics of the sector, and we then describe the legal and tax environments in which the sector operates.

### Functions and types of voluntary organization

A useful descriptive prelude to the consideration of legal and tax structures and frameworks, and a way to highlight the niche occupied by these organizations in UK society, is to categorize them by primary *function*, even though most voluntary bodies would characterize themselves as *multi-functional*. Such typologies are neither substitutes for a definition of the sector, nor of a classification of the "industries" or fields of activity within it. Brenton (1985) suggests the following set of functions for voluntary sector social service organizations, but it could equally well be applied in other industries (Murray, 1969; Wolfenden, 1978; Johnson, 1981; Handy, 1988; Nathan, 1990).

1. The *service-providing function* "typifies those voluntary agencies which supply a direct service to people, in kind or in the form of information, advice and support" (Brenton, 1985:11). In the social services field, agencies such as Dr. Barnardo's, as providers of child care, have this as their primary function, as do voluntary hospitals and schools. Law centers and independent advice centers are legal service providers.
2. The *mutual aid function* is "about self-help and exchange around a common need or interest" (Brenton, 1985:12), and is the main feature of organizations like Cruse (for widows), Alcoholics Anonymous, and a whole range of local community-based organizations in education, health and recreation.
3. A third function identified by Brenton is the *pressure-group function*, "the marshalling of information around some specific cause or group interest and the application of this to some public arena through direct action, campaigning, lobbying and advocacy to achieve a desired change" (Brenton, 1985:12). The Child Poverty Action group, Liberty, and Oxfam are three well-known campaigning or pressure groups. Organizations whose primary activities are mutual aid or lobbying are less obviously producing a tangible good or service than direct service providers, since social participation is a key dimension of the value added to society by their existence.

4. Finally, we have what Brenton terms the *resource* and *coordinating functions*, which typically involve blending service provision to other voluntary sector bodies, often in particular industries, acting as "a central catalyst or repository of expertise, information, research, etc., on a specialist subject," with "represent[ing] a membership of other voluntary bodies and seek[ing] to liaise between them and coordinat[ing] their activities, their public relations or their connections with government" (Brenton, 1985:12). Included here are sector-wide national and local intermediaries (Wolfenden, 1978) such as the National Council for Voluntary Organisations, the Charities Aid Foundation, the Volunteer Centre and Local Development Agencies, together with industry-specific bodies such as the National Youth Agency and the National Federation of Housing Associations.

Another way to categorize the voluntary sector is to identify different structural types, depending on the method of resourcing and nature of organization (Home Office, 1990:3; Chanan, 1991:14). One type would be the intermediary bodies referred to above. Following Chanan (1991) another three varieties can be distinguished. *Professional non-profit organizations* are providers of professional services - employing paid staff at national and local level - where the national organizations directly run the local offices and raise funds for local work. *Voluntary service organizations* have professionally-organized national headquarters, but autonomous local groups which raise their own funds and use volunteers. *Independent local community groups*, finally, are "self-standing bodies with no head office to provide support" (Home Office, 1990:3); their overwhelmingly important resources are their volunteer members' unpaid labor. In common with the (local) mutual aid and pressure group functional varieties in Brenton's taxonomy, the essence of the "output" of many of the latter groups will not be some identifiable service. Such bodies are difficult to classify in terms of an "industry" or market since conventional distinctions between demand and supply, user and volunteer, or process and output often conflict with their underlying ideologies and operating principles.

#### Legal framework and tax treatment

The legal situation in the UK is complicated by the existence of three different legal frameworks. England and Wales are covered by English law. It is based on *common law*, the ancient law of the land deduced from custom and interpreted by judges, which has been exported to the USA, Ireland, Canada, Australia and some other countries. Scotland falls under the auspices of separately developed Scots law, which is based on *Roman law*, a close relative of civil law, in common with legal systems in mainland Europe. Northern Ireland is something of a "half-way house" between the two (Woodfield et al., 1987). In all the constituent countries of the UK, government legislation and European Community law are the other main sources of law. The treatment of the voluntary sector in the English and Scottish systems has been closely scrutinized of late, culminating in fresh legislation (see below), although this has not altered the definitional approach adopted by the law.

In none of the constituent countries of the UK is there such a neat and tidy concept as "nonprofit

status" as is apparently available to entities which are the nearest equivalent to voluntary organizations outside the UK. *Charitable status*, and the comprehensive and automatic constitutional and fiscal privileges granted to bodies which attain it, is available to independent organizations which have legally recognized public benefit objectives or "purposes" written into their constitutions, but probably less than a half of all UK voluntary sector organizations are thus recognized in law (Gerard, 1983). Moreover, there is no particular legal structure or form uniquely associated with either charities or non-charity voluntary organizations, and the same types of legal form are often adopted by both varieties (see below).

In practice, in England and Wales it falls to the Charity Commission to decide whether or not an organization is charitable in law. The Commission must be satisfied that the purposes or objects are *exclusively* charitable. Once recognized as a registered charity -as were over 170,000 organizations at the end of 1990 - these bodies "at once have the protection of the Crown, the Courts and the Commission for their purpose" (Guthrie, 1991). The Commission has had a number of supervisory, administrative and pro-judicial roles since its inception in its present form in 1853, although many of its powers were put in place or enhanced by the *Charities Act 1960*. Its duties now include the maintenance of a register, an administrative function performed on behalf of Parliament, and attempting to identify, control and remedy abuse in individual charities, in which it acts on behalf of the courts (Charity Commission, 1991). The Charity Commissioners thus act in a dual role, on behalf of the High Court on legal matters, and on behalf of Parliament (as any other government department) on administrative matters, always safeguarding charitable assets and the confidence of the public in charities and their trustees. The *Charities Act 1992* strengthens the Commission's powers by enhancing its ability to obtain information about the management of individual charities, and gives it greater powers to act quickly upon the detection of abuse. The Act also clarifies the responsibilities of trustees, the members of the unpaid governing boards of charities, introduces a new regime for accounting by charities, and includes measures to tighten control over professional fundraisers (Driscoll and Phelps, 1992).

Whether or not an organization is deemed charitable in law depends on a huge corpus of accumulated case or judge-made law, and past court decisions. Historically, the preamble to the 1601 Statute of Charitable Uses was an important catalogue or index of purposes that are charitable, but the single most influential indicator has been Pemsel's case of 1891, when Lord MacNaghten gave the judicial seal of approval to a classification of charitable purposes put forward by Samuel Romilly in 1805:

"Charity" in its legal sense comprises four principal divisions; trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads (*Income Tax Special Purposes Commissioners v. Pemsel [1891] AC 531*).

Organizations for the relief of poverty are the only ones capable of being charities if they benefit

a small group of people, since the relief of poverty is assumed *ex hypothesi* to be of public benefit; otherwise, an organization's purpose(s) must

be of actual benefit and it must benefit the public as a whole, or a sufficient section of the public. . . The extent of public benefit may vary between different types of charity. It is not possible to define precisely what amounts to actual benefit or what forms a sufficient section of the public: cases must largely be considered on their merits (Charity Commission, 1989:2-3).

In fact, in addition to the educational and religious establishments which have achieved charitable status under the second and third heads, a flexible and modern interpretation of the fourth head through an analogy to the preamble to the 1601 Act has allowed a huge variety of non-profit-distributing "public benefit" organizations to be legally admitted to the charitable sector. This includes health and social care agencies helping people or animals "in need," conservation and environmental bodies, organizations providing land and buildings "for public use," and organizations promoting racial harmony and equality of men with women in political and economic opportunity. Exclusive self-help groups, however, are denied charitable status.

Also charitable in law are around 100,000 bodies which are not subject to the full regulatory powers of the Commission (Cmd 694, 1989, section 3.15). These are the so-called *exempted* charities, over which other government agencies exercise a supervisory role, and include universities and polytechnics, the Church Commissioners and the institutions they administer, and bodies registered with the Registry of Friendly Societies (see below), a small proportion of which have achieved charitable status. Other charities have been *excepted* from the duty to register, submit accounts and obtain consent from the Charity Commission to land transactions. These include Scout and Guide groups, religious trusts and voluntary schools.

An important point to make, therefore, is that it is organizational substance rather than organizational form which dominates the legal position of charities: it is the pursuit of charitable purposes which earns charitable status, not the establishment of a particular organizational form or legal structure.

Although the framework of English charity law may at first sight seem somewhat rigid, it does in fact have a key strength in terms of its adaptability; its case law base means that "fossilization" can be avoided by the creative use of analogies: Lord Hailsham, the former Lord Chancellor, pointed out in 1980 that "the legal concept of charity [is] not static, but moving and changing." For this reason, the Government has decided not to change the existing approach in the new Charities Act: the present framework is currently overwhelmingly well regarded, and the concept of activity "being for charity," as underpinned by trust law, is almost instinctively and universally understood by the general public. Charity is a constitutional privilege, giving citizens the freedom to join together in the public interest as defined by law, not by politicians, and in so doing at once having the protection of the Crown, the Courts and the Charity Commission. Similarly, most informed observers would probably agree with the Government's own assessment that the present approach is preferable to the alternative of writing an

actual definition into statute law, which "would be fraught with difficulty, and put at risk the flexibility of the present law, which is both its greatest strength and its most valuable feature" (Cmd 694, section 2.11, 1989).

In *Scotland*, where there is no statutory body directly equivalent to the Charity Commission, a rather narrower legal interpretation has evolved, with charity usually interpreted as meaning the relief of poverty, although the Scottish courts have recognized that a wider interpretation may often be necessary in connection with trust deeds. The lack of a supervisory body other than the Inland Revenue, which prevents and detects tax abuse (see below), has been cause for concern for some time, and the *Law Reform (Miscellaneous Provisions) Scotland Act 1990* goes some way towards remedying the situation for the estimated 15,000 "Scottish charities." New measures implemented following the Act include the establishment of an index of these "recognized bodies" at the Scottish Inland Revenue open for public inspection, and the granting of supervisory and investigatory powers to the Lord Advocate, similar to those of the English Charity Commission (SCVO, 1991).

In *Northern Ireland*, the Department of Finance and Personnel has some supervisory powers, as a result of the *Charities Act (Northern Ireland) 1964*, over what are estimated to be at least 5,000 charitable sector organizations (Cmd 694, 1989, section 11.9), but those powers are less extensive than those of the Commission in England and Wales, and there are apparently no immediate plans for fresh legislation.

In contradistinction to the legal establishment and regulation of charities, *tax privileges* accruing to charities are uniform across the UK. The English "definition" now applies everywhere, and the Inland Revenue grants reliefs or "tax expenditures" providing that it is satisfied that the funds have been applied exclusively for charitable purposes (Income and Corporation Taxes Act, 1988). These tax privileges mostly relate to direct taxation, including exemption from income, corporation and capital gains taxes, mandatory relief of 80 per cent from the uniform business rate levied by local authorities, and various forms of tax deductibility both on planned giving (covenants) and, more recently, one-off giving. Nevertheless, the overlap between the English "definition" and fiscal privilege is somewhat more complicated than it may appear, since an organization established as a charity in law may have its tax privileges withdrawn if it misapplies its income.<sup>3</sup>

Non-charitable voluntary organizations throughout the UK are not afforded the same constitutional protection as charities, and accordingly are not subject to the Charity Commission's powers, although the proposals for tighter controls over professional fundraisers in the Charities Act 1992 do apply to what are confusingly called "charitable institutions," which includes both charities and non-charities which raise funds for "charitable, benevolent or philanthropic purposes" (Driscoll and Phelps, 1992). As far as tax treatment is concerned, non-charity voluntary agencies may qualify for certain fiscal privileges, although not as automatic and comprehensive as those available to charities:

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<sup>3</sup> Tax privileges were first offered to Oxford and Cambridge Universities and Eton and Winchester Schools in the late fifteenth century, and extended to all charities three centuries later.

"charitable status is not the only password to significant tax relief for institutions and donors engaging in philanthropy and the provision of social welfare" (Chesterman, 1979:253). For example, a body which is voluntary in the sense that "it is not a public body, but whose activities are carried on otherwise than for profit" (Local Government Act, 1972, section 137 (2D)) may get discretionary relief of up to 50 per cent on local taxation, the uniform business rate; non-profit-distributing scientific research associations are exempted from income and capital gains taxes; and hospitals, private schools and housing associations which, for some reason, have not gained charitable status are still exempted from income tax as long as the relevant income is applied for charitable purposes only (Income and Corporation Taxes Act, 1988).

### Legal structures

A number of legal structures are available to voluntary organizations, each with their own advantages and disadvantages, usually connected with the scale of the proposed activity and the amount and value of property which the body proposes to have.<sup>4</sup> The most common forms are the *trust*, the *unincorporated association*, and the *company limited by guarantee*. In the case of charities, as a direct consequence of underpinning English trust law principles, the governing boards are trustees, who must almost always remain unpaid, other than receiving legitimate expenses incurred in carrying out their duties, and must not personally materially benefit from the organization's activities, unless specifically authorized by the document originating or controlling the organization (which is rarely the case). This notion of unremunerated, "disinterested," even "altruistic," organizational management and control is possibly unique in Europe to the UK and the Republic of Ireland.

Neither the trust nor the unincorporated association have "legal personality;" therefore their property must be held by some individuals on the organization's behalf, often the trustees in the former case, and the members in the latter.<sup>5</sup> In the case of the trust, the organizations' founders are known as *settlers*, and the trustees who manage the property may be appointed or nominated in a way predetermined by the settlor(s). This structure is still in common usage amongst bodies formed today, particularly in the case of grant-making organizations, and was also important as a vehicle for the individual philanthropy that characterized the Tudor period, during which the 1601 statute was enacted. The unincorporated association structure, by contrast, is usually adopted when the participation of a membership is desired, with the governing board - usually referred to as the management committee -

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<sup>4</sup> This is a separate issue from whether or not they hold charitable status or are part of the voluntary sector.

<sup>5</sup> There are, however, two instances when these bodies can have a separate legal identity: Firstly, they may be incorporated under Royal Charter (see below). Secondly, trustees of a trust or association may be incorporated under the *Charitable Trustees Incorporation Act 1872*, a procedure amended to be made more user friendly by the Charities Act 1992 (Driscoll and Phelps, 1992). Also, even without incorporation, the position is necessarily different in relation to land, which can usually be vested in trustees.

democratically elected by the organization's membership, and trustees during their term of office.<sup>6</sup> This structure is significant amongst many new organizations operating with few financial resources (Chesterman, 1979:201).

The *company limited by guarantee* was first conceived in the *Companies Act 1862*, and differs from the two structures described above in being incorporated; that is, it has a separate personality recognized in law, and is therefore able to do most things that an individual can do, including purchasing, owning and selling property in its own right, suing and being sued in its own name, entering into contracts, being liable in tort, and being indicted and convicted for certain criminal offences. As with the unincorporated association, the governing boards of these organizations - which are usually referred to as Boards of Directors - are drawn from the organization's membership, and are trustees. Clearly, important incentives to adopt this structure include a desire to economize on transaction costs if an organization wishes to engage in contractual business agreements, and to gain the financial protection of limited liability with regard to business transactions. However, companies limited by guarantee are also regulated by UK company law and European company law directives, which might be regarded as restrictive in some circumstances. Writing in the late 1970s, one well informed observer suggested that these "are not numerous but constitute an important segment of the newer and larger active charities" (Chesterman, 1979:201), and it seems likely that these have been the fastest growing of the three forms during the 1980s, continuing the trend evident over the 1970s (Berman, 1983).

Other than through the limited company structure, voluntary sector organizations may be incorporated by Royal Charter, ecclesiastical decree or Act of Parliament, and some of these bodies, governed by "arcane and complex law" (Chesterman, 1979:203), sit uneasily on the government-voluntary sector boundary, although in the legal sense they are unambiguously in the charitable sector. The other two significant mainstream legal structures available to voluntary organizations are the *friendly society* and the *industrial and provident society*. These structures are far less common than the three principal forms cited, both for charities and for the wider voluntary sector; they are also adopted by some organizations which are excluded from the sector according to the structural/operational definition on the grounds that they are primarily businesses (see below). The friendly societies, as unincorporated mutual insurance associations, register with the Registry of Friendly Societies under the *Friendly Societies Act, 1974*, along with building societies, working men's clubs, some of the older forms of cooperative organizations, and a ragbag of others. This government registry has very limited powers compared to the Charity Commission, and also registers Industrial and Provident Societies under the *Industrial and Provident Societies Act, 1965*. These bodies can be thought of as "quasi-corporations," being hybrids of the friendly society and limited company form, and are thus registered for the purpose of carrying on any industry, business or trade, whether wholesale or retail, if either (1) the society is a bona fide cooperative society, or (2) in view of the fact that the business of the society is being, or is intended to be, conducted for the benefit of the community, there are special reasons why

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<sup>6</sup> A recent survey by the National Council of Voluntary Organisations found that three-quarters of management committee members do not realise that they are trustees, and certainly do not appreciate their liabilities.

the society should be registered under the 1965 Act, rather than as a company under the Companies Act (Sections 1 (1), (2) of the Industrial and Provident Societies Act, 1965).<sup>7</sup>

### **The State, Society and the Voluntary Sector**

Before the first Elizabethan era, in which the 1601 Statute was enacted, the role of the State in the social arena was relatively minor; the informal sector and the Church were the key players. Social welfare functions were

essentially . . . the province of the Church, with support from the customary obligations imposed on feudal lords and from the guilds. At a less formal level, personal almsgiving and the families of poor people endeavoured to fill the gaps (Chesterman, 1979:13).

It was only with the breakdown of feudalism and the reduction of the Church's power that the State and secular philanthropy came to the fore, particularly in the relief of poverty and provision of education, with the State beginning to facilitate voluntary endeavor through the development of the protective legal framework for charities which has remained a cornerstone of the sector's privileged position in law to this day.

Indeed, as we have already seen, from this period right up until the start of the twentieth century, the formal delivery of social services was dominated by the voluntary sector, with government provision, funded through local taxation, always the gap filler. However, government policies were shifting: the State encouragement of philanthropy that had characterized the first part of the seventeenth century gave way to hostility and negligence from the judiciary and legislature for the last part of that century and for much of the next, as the high priority given to landlords' private property rights made it more difficult for property to be devoted to charitable purposes. In this period, the ruling classes were, in general, more repressive towards the poor, who were regarded as less of a threat due to a number of social and economic developments. However, Government policy again became more sympathetic to the poor and to the voluntary sector by the mid nineteenth century, motivated both by genuine social concern and fear of social upheaval. Around this time, support for the sector came through legislation to establish a permanent Charity Commission to supervise the management of charitable trusts, the introduction of various technical legal privileges for them, and the initiation of certain tax expenditures, as charitable organizations were exempted from newly introduced forms of taxation, most noticeably income tax. Other than the expansion of legal and fiscal privilege for the sector, the highest profile example of cooperation between the State and the voluntary sector at this time was its understanding with the COS to operate in mutually exclusive spheres, with the COS ideologically supporting the Poor Law's

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<sup>7</sup> Housing bodies and some recreational and social clubs are by far the most important voluntary sector bodies to adopt this structure, which is also adopted by some (but not all) cooperatives, credit unions and a miscellany of economically less significant bodies which are primarily business, and thus excluded from the sector by our definition (see section 5).

distinction between the deserving and undeserving poor (Chesterman, 1979:45).

It was not until sometime during the early twentieth century that the State replaced voluntary organizations as the principal agents of formal social service provision. This was partly in response to the growing realization by a better informed government of the scope and scale of *voluntary failures* - what we would now recognize as insufficiency, particularism, paternalism and amateurism (Salamon, 1987) - in the face of rapidly growing social and individual needs. This reversal of "market share" was a gradual process which reached its culmination in the Labor Government's social legislation of the 1940s, achieving different rates of State penetration across the fields where voluntary agencies had previously dominated. The broadening of statutory social welfare responsibilities had begun with extensive grant funding of the sector by government, largely from 1914 onwards, but the endpoint resulting from the ensuing incremental encroachment was different for the four main areas of social provision.

As already noted, in the fields of health care, education and social insurance the public sector almost completely took over both funding and production. Most voluntary sector hospitals were unambiguously absorbed into the State sector. Many voluntary sector schools became "maintained," retaining distinct religious identities and some autonomy, but nevertheless usually regarded then (as now) as State schools. In the field of social insurance, the friendly societies were excluded from the new arrangements, although Beveridge, the architect of the new system, had wanted them to administer the new State funds. In each of these "industries" or fields of activity, a small but significant number of providers survived fully outside the mainstream government system, funded mainly through private fees. By contrast, despite the socialists' implicit emphases on voluntary failures, and the perceived need for ever greater penetration of all embracing State-run services, the voluntary sector continued to be a key player in most social care activities, particularly child care and care for elderly people (Knapp, 1989; Wistow et al., 1992). A mixed economy of both funding and provision emerged over the post-war period, with voluntary sector bodies being used as agents of the State in fulfilling its new duties at local and national level, and also continuing to operate in mainstream areas where legislation had not mandated statutory responsibility.

Unsurprisingly, just as commentators - in government, and outside it, including those in the voluntary sector itself - had highlighted the limitations of voluntary action when voluntary agencies were the principal providers, so the deficiencies of the public sector, the *government failures*, which included an apparent inability to achieve efficiency and equity objectives, became fully apparent once the Welfare State apparatus had established the government sector as the dominant means of formally financing and providing social welfare. Initially, the assumption of government sector funding and provision seemed to be largely unchallenged across the political spectrum, with the voluntary sector seen as a "statutory supplementer" (Kramer, 1981) in its service provision function. However, the voluntary sector's other functions, as discussed in the preceding section, were acknowledged, and hence the considerable government funding over the 1960s and 1970s of community development and self-help groups, which, by their very nature, could not be incorporated into the public sector, and the recognition of the key role of intermediary bodies in ensuring a healthy and vibrant voluntary sector (Wolfenden, 1978). The legislation passed at the start of this period (see above) further enhanced the State's

protective legal framework for charitable organizations, although, in ensuing years, there was much controversy about the whole charitable law framework. Critics from the Left regarded it as having developed in such a way as to become inappropriately removed from its original "unifying purpose" of helping the poor and deprived (for example, see Gladstone, 1982; Gerard, 1983), and of being anti-working class and perpetuating privilege. These commentators and others saw the Charity Commission's and the judiciary's interpretation of the core "public benefit" requirement either as inconsistent or too restrictive, particularly through "unfairly" subsidizing fee-paying schools and hospitals by allowing them charitable status, whilst stifling social change by denying it to those parts of the sector fulfilling key mutual aid and pressure group functions (Brenton, 1985; Gladstone, 1979; Whittaker, 1979).

Over the 1970s, an apparent consensus across the political parties seemed to be emerging both on the important roles of the voluntary sector in society, and on the need for effective partnership with the State to ensure healthy welfare pluralism. This view was vigorously endorsed by the Wolfenden Committee Report (1978), which emphasized the benefits to both sectors of pluralism and partnership, although the precise nature of the relationship was not clearly defined (Webb and Wistow, 1986), and some commentators drew attention to an imbalance of power, wherein the voluntary sector remained very much the junior, silent partner (see, for example, Kramer, 1981).

Moreover, Brenton (1985:139) detects "useful imprecisions and ambiguities" in the rhetoric of both the Governments and the Opposition parties at the time, for the definition and coverage of the terms "voluntary action" and "voluntary sector" were implicitly being adjusted to emphasize the type of organization, or function of the sector, which happened to suit each proposed or actual policy initiative. She argues that the policy statements in support of the sector made by the moderate Labor Government in the late 1970s, for example, verge on "wilful mystification" (Brenton, 1985:136) as it sought to rationalize freezing or reducing various forms of social expenditure with recession beginning to bite; indeed, she argues that its acceptance of pluralism in welfare service provision - particularly the encouragement of service provision from the middle class, traditional and "safe" wing of the voluntary sector - made it hard to distinguish from the left wing of the Conservative party.

From the radical left, too, the voluntary failures and the irreconcilability of the sector with socialist objectives that had been stressed in the 1940s and 1950s were also conveniently put to one side. In this case it was the sector's capacity to enable "bottom up" radical social reform as a vehicle for participatory, decentralized social action which was highlighted. The new image of the sector was now represented by

the proliferation of self-organized community nurseries, disabled mutual aid groups, allotment societies, black supplementary schools, women's aid centres, gay counselling services, tenants' cooperatives, public transport campaigns, community bookshops, cyclists' action groups [wherein] lies a very old political tradition (Worpole, 1981; quoted in Brenton, 1985).

This "politicized" version of the voluntary sector - with its emphasis on the more radical elements of its development, mutual aid and pressure group functions, as opposed to its more traditional service provision role - was to be the grassroots mechanism which some left-wing Labor local authorities, and most prominently of all, the Greater London Council, were to attempt to utilize in confronting the Conservative Government's centralization of power and loadshedding policies of the 1980s (Wolch, 1990).

Use of the voluntary sector as a strategic weapon in the political struggle between central and local government only partly explains local authority grant-making to the sector during the 1980s; the familiar rationales of cost-effectiveness, flexibility and innovativeness, choice and specialization, for example, also motivated this tier of government, including moderate Labor and Conservative, as well as radical administrations (see, for example, Judge and Smith, 1983; Knapp et al., 1990). Central government, too, continued to justify increased support for the sector - most prominently via funding channelled through quangos, measures to facilitate and stimulate individual and corporate giving, and legislation to encourage contracting-out - on these apolitical grounds, although political factors were clearly at work here also, with the sector arguably being used as a tool for centralizing power by bypassing local democratic control.

Many commentators cite the government's ideological desire for "privatization" as the key motivator of many of these policies, replacing public sector activity with nongovernmental activity wherever and whenever it could, and this was indeed a key policy objective of the Thatcher governments (McCarthy, 1989). Certainly, many policy statements made during the 1980s appeared to lump the informal and voluntary sectors together indiscriminately, and use the terms almost interchangeably with the word "volunteers," all during a time when State provision was being defined in residual terms for the first time since the early 1940s.

Into the 1990s, John Major's Government has continued to promote the sector both with specific measures, through, for example, the implementation of the Charities Act 1992 and the introduction of further measures to facilitate charitable giving, and more incidentally through the promotion of "quasi-markets" and the encouragement of contracting-out in fields where voluntary sector providers co-exist with other sectors (Le Grand, 1991; Wistow et al., 1992). The explicit aim of injecting more competition within and for government has allowed both for-profit and voluntary sector bodies to increase their shares in some industries. Most of these measures have been guardedly welcomed by the voluntary sector; Government calls for improved partnership between the sectors, and for better accountability and enhanced efficiency (Home Office, 1990) pose challenges, offer opportunities and threaten long-established relationships. However, there are very real fears that changes in the nature and mechanisms for government funding, in particular increased specificity through the replacement of grants with contracts, will threaten to undermine the autonomy of those organizations which receive these funds for their service provision function and constrain the fulfilment of their other functions (Gutch et al., 1990; Knapp and Kendall, 1991). There is also the concern that voluntary

agencies, particularly small, local ones<sup>8</sup>, may be further marginalized because central government fails to recognize their contributions and local authorities find it increasingly difficult to fund them from their declining resources.

### Defining the Voluntary Sector

The UK voluntary sector includes a variety of legal and organizational forms, and has developed in response to a variety of needs, buffeted and encouraged by government and other relevant factors. There is no single or simple legal route to the definition or delimitation of voluntary organizations, nor can we easily fall back on tax codes or company law to furnish us with alternative concepts within the sector. Simon's (1987) utilization of Section 501 of the (US) Internal Revenue Code to distinguish four concentric "circles" to describe what he calls "the nonprofit world," for example, cannot be repeated with anything like the same precision for the UK. In these circumstances, it has been common for UK researchers either to concentrate on registered charities (see, for example, Posnett, 1993) or to build up a definition from component criteria which organizations should satisfy before being labelled as "voluntary" (see, for example, Hatch, 1980; Johnson, 1981; Brenton, 1985). The utilization of a similar "first principles" approach is therefore not merely appealing in the UK, but virtually obligatory if progress is to be made towards the description and analysis of a meaningful construct.

In this section, we therefore discuss the relevance and interpretation of the structural/operational definition in the UK context. The structural/operational definition requires that, to be classified as belonging to the nonprofit or third sector, a body must possess the following characteristics: it must be a formal organization, self-governing, independent of government<sup>9</sup>, not profit-distributing, and voluntary.

#### Formal organization

All of the entities discussed above have formal character as organizations, ruling out of the study

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<sup>8</sup> This is particularly the case for community-based developmental, participatory and campaigning groups, for whom public support is presently minimal and precarious in any case.

<sup>9</sup> In the UK context, the use of the word 'private' is misleading here for three reasons, and is therefore avoided. First, since voluntary organizations with charitable status 'operate in the public domain, and charity trustees are publicly accountable ... no charity is 'private', and even the founder of a charity cannot direct the charity to act without its trusts: it has an existence of its own, which [the Charity Commission] stand to protect' (Guthrie, 1991). Second, in English trust law, the term private is in fact used to describe trusts which are *not* charitable, where the interest under the trust is purely private - for example, a conventional will leaving money in trust to a relative - rather than when referring to a charitable trust whose beneficiaries are, by definition, the public at large. In the former case, the trust can be enforced by a private individual, whereas with the latter, this must usually be done via the Attorney General through what is known as a 'relator' action. A third reason is that 'private' is a shorthand term for private for-profit organizations.

the huge set of informal activities of household and communities which are so important in some fields, particularly community development and social welfare. Public policy in the UK has recently paid more attention to this informal sector, for example in the *1990 National Health Service and Community Care Act*. Our research interest here, however, is in formal, structured entities, with a charter, constitution or set of rules (thus including charitable trusts and unincorporated associations), perhaps formally registered with a public body (including the tax authorities) or with a local or national voluntary sector intermediary, and possibly incorporated under company law as a company limited by guarantee.

### Independent of government and self-governing

The second and third requirements of the structural/operational definition are that a voluntary organization should be constitutionally or institutionally independent of government, and self-governing, that is with its own internal decision-making structures and not controlled by a for-profit or by government. Ben-Ner (1986) has argued that control by patrons (donors or clients) is the principal *raison d'être* for voluntary bodies, but some organizations are controlled by a "self-perpetuating board of directors." Hansmann (1980) calls these "entrepreneurial" as opposed to "mutual," which are controlled by patrons. These entrepreneurial bodies would stay within the structural/operational definition. One of the issues here is the *extent* of independence from government, and the essentially dynamic and changing nature of the relationship between government and the organization. For example, several charitable bodies exist which have been formed or incorporated by Acts of Parliament, and/or for whom many of the trustees are government appointees, and/or are fully funded by, or heavily reliant on, public money. Some of these agencies are consequently widely seen as government sector public bodies, including all but one of the universities, research and other "non-departmental public bodies" and quangos, maintained schools and the national museums, while others are regarded as voluntary, including many intermediary bodies, the Women's Royal Voluntary Service, Law Centres and Citizens' Advice Bureaux. In a legal sense, they are *all* completely separate from government, generally because of their charitable status.

Brenton (1985) and Wolch (1990) are among the many commentators who have expressed concern over the extent of State control over or "penetration of" the voluntary sector, via funding and otherwise. Wolch characterized the sector as evolving into the "Shadow State," a "para-state apparatus . . . administered outside of traditional democratic politics" (1990:4). The empirical question is where to draw the line between independence and dependence. Ideally, we might want to look at the extent to which each borderline organization controls its own constitution as a key indicator (6, 1991), or to examine carefully the processes by which resource allocation decisions are made in order to understand the dynamics of the relationship between organization and government.<sup>10</sup> We should recall that together with the perpetuation of existence, the protection of assets from government was the primary benefit of charitable status, and pre-dated tax privileges by many centuries.

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<sup>10</sup> This, however, is not possible in most large-scale research enquiries. Instead, organizations with charitable status - including those with government-appointed boards or chief executives and fully funded with state monies - are assumed to be part of the UK voluntary sector unless proven otherwise.

A very recent phenomenon in the UK, and one which may become increasingly important over the next few years, is the establishment of self-governing entities *within* the public sector. This builds on a general trend to increase the decision-making autonomy of many public bodies, and has been particularly noticeable with the proliferation of new "quasi-government agencies," particularly quangos and trading funds, designed to function at arm's length from government departments, thus avoiding direct political control. Although still responsible to Ministers they operate mostly in a more commercially orientated fashion than the bureaux which had previously discharged their functions (Parker and Hartley, 1991). However, such trends towards autonomy inside the government sector have only recently begun to directly affect the sector, as self-governing public bodies have been established to contest markets in key voluntary sector industries, including health, social services and education. For example, National Health Service (NHS) trusts have been in existence since April 1991, operating independently of public sector district health authorities without actually leaving the government sector. The *new* grant-maintained schools, which opt out of local authority control<sup>11</sup> are in a similar position, for they simply substitute central for local government as their paymaster. Curiously, however, the NHS trusts are not eligible for charitable status, but the grant-maintained schools are. Over time, these quasi-government entities may become quasi-*nongovernment* entities, and could soon therefore arrive in the voluntary sector as defined in this study.

### Not profit-distributing

The non-distribution constraint, to use Hansmann's (1980) terminology, is fundamental to most but not all definitions of the non-profit sector: it bars a voluntary organization "from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees" (Hansmann, 1980:838). There can be no shareholders as such: profits can be earned, but must be ploughed back into the organization for investment purposes, to enable cross-subsidization, or to affect transfers to 'noncontrolling persons' (Hansmann, 1987:27). The trustees of charitable bodies must remain disinterested and, under the legal restriction operating in the UK, this means unremunerated.<sup>12</sup> The non-distribution constraint rules out most cooperatives (including, for example, workers' cooperatives and agricultural cooperatives) and mutual benefit financial intermediaries, including some which have historically been regarded as part of the sector, such as building societies and some friendly societies, but whose commercial orientation is now so marked that they are sometimes hard to distinguish from users from private, for-profit bodies (see Kendall et al., 1992). Incidentally,

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<sup>11</sup> They are not to be confused with the original maintained voluntary schools, which opted *in* to agreements with their local education authorities in the late 1940s. To confuse matters further, however, these latter bodies can, like the schools run directly by local authorities, replace local government with central government funding and also become grant maintained.

<sup>12</sup> The non-distribution criterion does not, of course, prevent an organization ploughing profits back into the improvement of conditions of employment, inflated salaries, opulent offices and other generous fringe benefits, but the limited evidence for the UK voluntary sector suggests this is uncommon (see, for example, Reward, 1992).

many of these organizations would also fail to satisfy the voluntarism requirement (see below), whereas most voluntary hospitals and schools (usually charitable) and all housing associations (mostly not charitable) would meet it. In addition to applying any operating surplus to their missions, the latter's governing boards must remain unremunerated, although the organizations are "commercial" in the sense that most of their income comes through fees paid by clients. Several modern types of mutual and cooperative organization, such as credit unions and some housing cooperatives, may be ruled out by the strict enforcement of this criterion, but are nevertheless intimately linked with some parts of the sector's activities and thus extremely hard to separate from them.

### Voluntarism

The last criterion for an entity to be a voluntary organization is that it must benefit to a meaningful degree from philanthropy or voluntary citizen involvement. Even if 100 per cent of an organization's income came from government or from fees paid by clients, there might still be voluntarism in the form of gifts in kind or gifts of time from volunteers, either in the labor force or on the management committee. For the purposes of structural/ operational definition, it is not necessary to require that voluntarism be motivated solely by altruism: enlightened self-interest, reciprocity, moral duty and other motivations will do just as well. Participants, patrons and staff, are not coerced into an activity or into membership; they make independent and autonomous choices to be involved.

Voluntarism is, of course, not the preserve of the voluntary sector, but it is an essential defining characteristic of the voluntary sector in the UK, particularly as manifested by those bodies with unremunerated governing boards (their trustees), the voluntarism of which is perhaps the single most important defining characteristic of the sector (Prashar, 1991), and a key ingredient in nurturing trust and preserving the public's goodwill towards it (Nathan, 1990). Voluntarism, altruism or disinterestedness is at the heart of charity law; it is the dominant motivation for each of the four charitable purposes, and fundamental to all non-charity voluntary organizations, though no

"black letter rule expressed in terms of altruism has ever been formulated. There are simply cases which show that self-help and private profit prevent an organisation from qualifying as a charity because they deprive the organisation in question of an exclusively charitable nature" (Picarda, 1992:1).

It need hardly be said that, once again, we have a criterion which can be met, or violated, to varying degrees. Choosing the "right" degree is not straightforward. Where the voluntarism condition is clearly violated, while other criteria hold, and most of an organization's income comes from government, we have a quasi-non-governmental body. If most or all income comes from fees and charges, and no resources are donated, some classifications would still see this as a voluntary organization; we would prefer to see an alternative classification. Hence, we would not regard the newly emerging bodies sometimes known as *not-for-profit agencies* in the UK, which are especially active in the social care area, as part of the sector. For the present, at least, they appear to satisfy all criteria except voluntarism and perhaps, by extension, the non-distribution constraint, for members of management boards are paid

and may receive monetary payments linked to the health of the organization. If significant time or money donations were to be secured by these bodies at some point in the future, however, then they would fall within the structural/operational definition of the sector.

## Conclusion

The five criteria referred to above together generate the structural/operational definition of the nonprofit sector. They have been shown to possess direct equivalents in the UK. We have also seen that the *extent* to which some of these apply - for in reality, most are to be found on a continuum rather than being simply met or not met in their entirety - in fact constitutes a key element in the present debate as to the actual or appropriate niche of the sector in the UK economy.

The criteria-based, first principles, approach to the definition of the voluntary sector has precedents in UK research, although the lists of requirements may not always have been the same. For example, Hatch (1980) identified three conditions for an entity to be in the voluntary sector - formal, independent of government and not profit-distributing - and Brenton (1985) included these same three conditions, plus self-governing (private) and public benefit. Johnson's (1981) four factors were independence from government, self-governing (private), not profit-distributing and receiving some of its income from voluntary donations. Knapp et al., (1987) and 6 (1991) suggest longer lists which, not surprisingly given that all studies are looking at basically the same set of entities, overlap considerably with the structural/operational definition. Thus, both the approach and the detail of the definition of nonprofit organizations in this study have solid precedents in the UK.

A potential criterion which has not been adopted by the structural/operational but which, as we have seen, underpins the legal "definition" of *charity*, relates to the notion of "public benefit," and many commentators see this as an important characteristic of the voluntary sector. For example, Beveridge (1948) talked of "voluntary action for a public purpose - for social advance," and Robin Guthrie, the Chief Charity Commissioner, has argued that *charity* is "best defined as an action or gift of benefit to others" (1988:17). Indeed, Paton (1990) goes so far as to suggest that the very expression "voluntary sector," which he describes as "muddled, outdated, misleading and much else besides" should be rejected, and that we should instead start to think in terms of the "social economy" comprising "organisations oriented towards the provision of some kind of *common benefit or public good*" (1990:2; italics added). This property or orientation is usually linked implicitly to the voluntarism or non-distribution constraint through the "nonselfish or nonmaterialistic" behavior of those who are involved with the organization, most obviously through trustees and other volunteers. These organizations are seen as different because they are value-based, or because those who control them or work for them are characterized by levels of commitment, benevolence, altruism or beneficence and solidarity (Gerard, 1983) which are not to be found in other sectors (for criticisms of this approach, see 6, 1991). Lord Simonds in the *Inland Revenue Commissioners v Baddeley Case* (1955) referred to the public benefit purpose as "the most difficult of the many difficult problems in this branch of the law." As we have seen, the dividing line between primarily member-serving and primarily public benefit

organizations is an extremely controversial one.

In considering the definition and treatment of the UK voluntary sector, and providing an overview of the types of organization that populate it, what is clear above all else is the essentially *dynamic nature* of its juxtaposition to entities in other sectors and to "hybrids" on the borderline between sectors. Organizations can migrate from one sector to another over time, and also alter their function and type as a result of changing relationships with the other sectors. To understand these complex interactions, we require both an appreciation of the historical development of the sector, and of its changing relationship with the State -as legislator, regulator, funder and provider - as an essential prelude to locating the evolving role of these organizations in society.

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