Legal Mechanisms to Encourage Development Partnerships

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Summary of Paper

- "Development Partnership" is a term that describes the newly evolving relationships among governments, businesses, and local NGOs to assist social and economic development. As a legal mater this is an imprecise term, which needs better definition. There is need to focus on partnerships involving the state, as well as business and NGOs.

- In order for development partnerships to be successful, it is necessary that there be a supportive legal and fiscal enabling environment to nurture their growth.

- This includes not only the general framework laws, which permit NGOs to come into existence and operate free from undue government interference, but also a variety of other legal and fiscal mechanisms, including, for example:

    - tax benefits for both NGOs and donors;
    - adequate procurement legislation;
    - specialized local government grantmaking authority; and
    - privatization mechanisms that apply to social and cultural services.

- Given increasing interest in power devolution by governments, it is important to foster a supportive environment for this new development paradigm. States should adopt legislation that will support the growth of development partnerships.

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Introduction. It was only five or six years ago, when ICNL was founded, that persons in various parts of the world perceived that it would be good to have an institution devoted to creating a better legal and fiscal enabling environment for development NGOs, CBOs, and other not-for-profit organizations of civil society. Before that time, there was only slight awareness that the laws governing NGOs in emerging democracies and transition economies should be changed to promote their greater freedom of action and to enhance their capacity to fulfill a much-needed role in social and economic development. Law was not seen as an important vehicle for social change.

My, how times have changed! In those few short years ICNL has grown from a two-person, all-volunteer "mom and pop shop," with a few local projects funded by private donors, to a sustainable institution with twelve lawyers, offices on four continents, and projects all over the world. Seminars on legal and fiscal issues affecting NGOs have been held in Asia, Africa, Europe, Australia, North America, and Latin America. Various publications have been produced by ICNL and others and are available in hard copy or through the Internet, on ICNL's website (www.icnl.org). All of these ecent useful publications (by ICNL and others) cannot be mentioned here, but the most significant include the following: The World Bank *Handbook on Good Practices for Laws Relating to Nongovernmental Organizations* (available in English, Spanish, Arabic, Russian, Chinese, French, and Albanian, with excerpts available in Bulgarian and Latvian), the *International Guide to Nonprofit Law* (by Lester Salamon, John Wiley & Sons), and an Inter-American Development Bank (IDB) and United Nations Development Programme (UNDP) publication entitled *Marco Regulador de las Organizaciones de la Sociedad Civil en Sudamerica*.

In the past five or six years, the focus of ICNL's work has moved from the fundamental issues of registration and tax benefits for NGOs to a broader perspective that we call the enabling environment for "development partnerships." It is impressive to see the ways in which attention is now focused on "partnerships" around the world – many organizations are working on "partnership" issues, looking at them from various perspectives. We must begin this paper, however, by noting that the term "partnership" in current use is really quite imprecise as a legal matter, given that it is used to encompass a variety of different legal relationships. These include the following:

- The Hitachi Foundation and the Prince of Wales Business Leaders Forum have focused on ways to encourage businesses to engage NGOs in development efforts – to encourage "corporate citizenship" by contracting with NGOs or by making grants to them.

- A reliance by local governments on "contracting out" social services has been noted as a world-wide phenomenon by Lester Salamon and Helmut Anheier.
- New mechanisms for grant-making to NGOs are being developed by governments and intergovernmental organizations in various countries around the world.
- Development banks have begun to provide assistance for the privatization of social and cultural services into NGOs in a number of countries.

Given the terminological imprecision, it is clear that a wide range of arrangements and transactional relationships exists under the rubric of "partnerships."

But not all of these arrangements involve legislative or regulatory mechanisms. Much valuable "partnership" activity has been accomplished by private contract between business entities and NGOs. For example, the case studies discussed in *Partnerships for African Development* and the valuable materials produced by the Prince of Wales Business Leaders Forum (particularly the new book by Ros Tennyson on *Managing Partnerships)* show how the use of private contracts can and should encourage development partnerships. Lawyers working on such issues would do well to consider these materials because they will give them a greater understanding of how to write partnership contracts.

Discussion of the private law mechanisms for achieving sound partnerships is, however, beyond the scope of this paper. The focus here is on the more neglected issue of partnerships that can be facilitated by legislation or regulation rather than private contract -- in other words, contracts or other relationships that involve the state along with NGOs and business. Not all of these are tri-sector partnerships, but, as the paper indicates, the need for financial resources will frequently mean that business must be involved in state-NGO partnership relationships. The legislation needed to facilitate such partnerships varies greatly, as the list at the end of this paper makes clear.

What motivates the creation of partnerships involving the state and NGOs and businesses? In recent years many governments have become increasingly interested in encouraging NGOs and CBOs to take over responsibilities in the social and economic development spheres that were once solely the province of government. They have done this for a variety of reasons – budget constraints are clearly a strong motivating factor, but so too are public policy considerations that favor dispersing service delivery modalities among interested groups of citizens. As the state moves to devolve power to local authorities and to limit its role significantly in certain critical areas of social services, it is clear that some services previously within the state’s portfolio will be curtailed or even will not continue to be provided after the coercive power to support them through taxation disappears.

If the state transfers responsibilities to NGOs and CBOs, and does not raise enough tax revenues to provide them with one hundred percent of their support, how will NGOs and CBOs find the financial wherewithal to carry out their much-needed work? Clearly some state aid can continue to be provided in various ways – for example, governments can contract with NGOs to provide services (Salamon, 1987). And international financial institutions, the regional development banks and the World Bank, can provide assistance to governments in developing countries to help them provide financial support in such instances. In addition, the state can privatize certain assets (e.g., community hospitals), which would give the NGOs and CBOs greater capital against which they might borrow funds to operate. NGOs can also increase their "commercial' activities, generating income through a variety of different means. (Weisbrod, 1997). Increasingly, NGOs and CBOs are looking also to private businesses and individuals voluntarily to provide some of the financial wherewithal to support the provision of development services. Various mechanisms are being explored, including, in addition to private contractual partnership mechanisms, specialized endowments for development capital and the creation of community foundations.

The terminology "development partnership" has arisen in this context to describe a wide variety of government-NGO-business relationships that serve the social and economic development needs of a local community, a region within a country, a country, or even a multi-country region. Although development partnerships focus on encouraging business interests and the state to become involved in providing both financial and human capital to support needed projects conducted by NGOs and CBOs, they do so within a development paradigm, not a philanthropy or charity paradigm. Development partnerships permit beneficiaries to become partners with the service (NGOs) and capital (state and business) providers. In this sense they promote not only service provision, but also democracy of programmatic decision-making in all aspects of the project cycle, from conception to implementation to evaluation.

The Legal Enabling Environment to Encourage Development Partnerships. Creating an enabling legal framework for good development partnerships requires that many different laws be analyzed and modified to better nurture NGOs. In the appendix to this paper there is a list of laws that may affect development partnerships, and they will not all be discussed here. But some of them are worth mentioning in more detail.

1. General Framework Legislation. It is clear that a major factor in the ability of NGOs and CBOs to be good partners with the state and the business community is their ability to operate in a legal environment that is supportive of their independent operations, free of state intrusion and interference in what are appropriately internal affairs of the organizations. They must therefore have good general framework laws that will permit their operations to go forward. These laws should allow NGOs and CBOs to come into existence relatively easily, without too much cost and according to clear standards for qualification. The

laws should not set up unduly onerous reporting requirements for NGOs and CBOs, and whatever reporting is required should be consistent with the benefits received by the organization. In addition, the laws should not permit undue state interference with the normal operations of the organizations, thus respecting their autonomy as independent bodies. Such legislation permits NGOs and CBOs to be strong, and it assists their ability to be good partners with government and business.

One recent development in Italy exemplifies the sort of legislation that should be considered. Law No. 460 of 1997 has added a new regulatory system for Italian social utility organizations ("ONLUS"). Under this system ONLUS will be overseen by a regulatory body patterned after the Charity Commission of England and Wales, but which is part of the Ministry of Finance. The new Italian body will oversee both the tax preferences accorded to NGOs and the general regulation of their activities. Similar commissions or boards (some of which are independent bodies with NGO representation) have been created or are being considered in such countries as Russia, El Salvador, Kenya, and Pakistan. Although such regulatory bodies may not be appropriate for all countries and circumstances, considerations about regulatory complexity argue in favor of structures with combined duties, such as that now provided in Italy. The World Bank *Handbook* should be consulted for a broader discussion of these issues.

2. Fiscal legislation. The tax laws of a country should provide for exemption from income and profits taxes for NGOs and CBOs. Although most such organizations do not make any profits (and thus such an exemption does not cost too much in terms of tax revenue foregone), it is useful for the law to provide this benefit in case there *are* profits. Whether or not such an exemption should apply to profits from business or economic activities is another matter, too complex to be addressed here. This is dealt with at length in Appendix 1 of the World Bank *Handbook*, and those materials should be consulted for a more in-depth treatment of the subject.

Fiscal legislation should also provide other tax benefits, such as exemptions customs duties, but these must be carefully tailored to meet local circumstances. Exemptions from customs duties and the import VAT are among the most contentious and difficult issues faced by both governments and NGOs. But ensuring that such benefits are available permits foreign donors (foundations, development banks, international NGOs) to establish good cross-border partnerships, because it means that legitimate aid provided in kind is not subject to import VAT and customs duties. Laws allowing customs and import VAT exemptions for NGOs have frequently tempted charlatans and crooks into the NGO sector with the prime motive of establishing an NGO to get exemptions on the import of certain goods. Nonetheless, many countries provide customs duty and import VAT exemptions specifically to public benefit organizations. If they permit such exemptions, they must also have a fair but thorough process for assuring that only genuine public benefit organizations qualify for the exemption

as well as a certification, licensing, or similar process to ensure that an organization's exemption will be honored at the border.

With respect to other taxes, various countries and various localities provide for specific tax exemptions for NGOs. A thorough analysis of the tax privileges provided by the City and Oblast of St. Petersburg, Russia, is set out in Olga Starovoitova's chapter in *Public Associations and Local Government* (Interlegal, 1997). Most countries permit a wide variety of such exemptions, but many do not.

It is also clear that in order for development partnerships to be successful, good fiscal incentives for the local business community should also be provided. If they exist, they will encourage donations to NGOs that carry out worthwhile activities, some of which are necessary because the state either cannot afford or does not wish to perform certain vital social services (e.g., primary health care and education). Although some countries limit the deductions for support of worthwhile activities to advertising expenditures, this is a short-sighted approach. It does not encourage detached and disinterested generosity, thus tending to limit the range of recipients of business contributions to the "sexier" projects (those of sports and arts organizations). It causes businesses to focus only on what they will get out of a contribution and not on the potential benefit to the community as a whole.

Fiscal benefits for donations, whether they are structured as tax deductions (against the income) or as tax credits (against the tax) or as tax rebates (designated by donors and given directly to NGOs by the state), should be permitted for gifts to a broad range of social and economic development causes. They should permit the donation of equipment or other property as well as money. For example, a local building supplies business should be encouraged to donate lumber for a new community center in an impoverished community near its warehouse. A provision that would permit in-kind donations along these lines to be deductible by public companies was adopted in the 1998 Finance Act in Pakistan.

The laws should also allow businesses to account for employee volunteer time as a contribution. The building supplies business in the foregoing paragraph should be encouraged to give its employees one day off from time to time to allow them to donate their time to worthy causes, perhaps getting them involved in painting the new community center or staffing a soup kitchen once it is operational. An example of ways in which such volunteer programs can be effective is described in *Global Corporate Citizenship,* which discusses a study done by the Keidanren in Japan in 1996, noting that the extent of employee volunteer programs has increased in recent years (Logan, Roy, and Regelbrugge, 1997).

The laws need to allow flexibility for businesses to explore new ways to become more involved in the communities that surround them. A "Philanthropy Survey"

conducted by the Kenya Community Development Foundation suggests that providing incentives for giving will in fact encourage businesses to participate in development. (KCDF, 1997) Many of the businesses surveyed indicated that while they are willing to assist in development, they would be far more likely to provide greater resources if tax incentives existed. More precise data exist for the new tax scheme adopted in Hungary in 1996, which resulted in a wave of citizen gifts to public benefit organizations (NIOK, 1997). Information on tax incentives for NGOs and the extent to which tax incentives encourage giving can be found in ICNL's longer paper on this subject (ICNL, 1998).

3. Procurement legislation. One issue that has arisen in ICNL's work concerns the way in which local governments interact with NGOs and CBOs in their contracting capacity. For example, a local government may decide to ask someone to operate a day care center that it previously operated on its own -- essentially contracting out to an NGO a "public" service. There are several good reasons why the government might choose to do this -- greater efficiency, more knowledgeable service providers, down-sizing, etc. The someone they ask may be either a business organization or an NGO or a CBO, but how they ask is important. The laws of the country, whether national level laws or local laws, should specify adequate procurement processes, so that bidding for the contract to operate the day care center will be done openly and competitively, with criteria specified in advance. In fact, in numerous countries procurement legislation permits governments to prefer nongovernmental contractors for certain services, and such provisions should be considered in all cases where the services to be provided might be benefited by a not-for-profit provider (e.g., care for sick children or elder care or provision of services to the handicapped or homeless).

An alternative to providing for special rules in the procurement legislation is to tailor the tender documents so that special rules apply to allow only an NGO to bid for a particular project. For example, in the privatization of the Institute of Finance and Economics of the Democratic Republic of Mongolia (discussed in more detail below), the tender documents specified that only an NGO could receive the privatized assets (Cassagrande and Irish, 1997).

It is also important to remember that playing a role as a partner should involve NGOs and CBOs not just in policy implementation but in the entire project cycle. For example, the decision to contract out the provision of day care services is one that should be made with adequate community and beneficiary involvement, including that of NGOs and CBOs that provide such services. Not only should these organizations be involved in policy development and implementation, they should also be brought in at the critical evaluation stage to ascertain whether the service is being well-provided by the new contractor. Thus, procurement processes should be open and transparent in all phases, and NGOs and CBOs should be viewed as valuable partners throughout the process.

One valuable example of such a partnership is discussed in the CIVICUS publication *Strategies for Resource Mobilization.* The discussion of Fundacion para la Juventad y Mujer Rural Funac 4-S in Costa Rica, notes the way in which the foundation helped the government to develop its policies about establishing employment opportunities in rural areas (CIVICUS, 1997). This was, of course, accomplished on an ad hoc basis. In other countries, such as the Philippines, Bolivia, and Colombia, legislation specifically mandates that NGOs must be involved in policy development as well as implementation. One of the current world-wide trends, devolution of power to local governments, encourages such NGO involvement in setting policy. New local government legislation in Bulgaria has, for example, encouraged partnerships for policy development (Bijeva, 1998). Similarly in Poland, the establishment of the "Program of Cooperation Between Local Government of Gydnia and NGOs" has resulted in a trend toward establishing other such programs in Poland (CIVICUS, 1997)

4. *Specialized local government grantmaking authority*. In order to provide support for the not-for-profit sector, it makes sense for local governments to provide for and participate in grantmaking mechanisms that exist outside the procurement processes for government contracts. Such mechanisms could be wholly funded by taxation, but it is presumably better to develop other sources of funds, thereby encouraging local individuals and businesses to play a role in providing funds for social and economic development and lessening the vulnerability of a government fund to changes in taxpayer sentiment. If local grantmaking is vested in a local foundation or trust fund, which is not part of the government, there is less likelihood of confusion between grants (awarded through a noncompetitive process by a foundation or fund) and contracts (awarded through a competitive procurement process by a government body).

Some private local grant-making mechanisms are currently called "community foundations," and that term generally is one that refers to an endowed local body that receives its funds entirely from contributions from private parties. In contrast, the term "community development fund" or CDF encompasses a range of funding mechanisms, as they are developing in transition economies and is thus broader than the "community foundation" concept, as it is known in North America and England. Significant support for CDFs can be found in Latin America – in certain countries in the region the Inter-American Development Bank has been instrumental in providing seed grants to allow CDFs to be established. The example of Comunidade Soldaria in Brazil is a good one. CS is currently undertaking projects in support of social development in Brazil, including a study of mechanisms for state support to NGOs in which ICNL has been involved.

There are several major distinctions between community foundations and CDFs:

- the community development funds or other support mechanisms addressed here combine both state resources and private

resources, pooling capital into one fund that is operated by an independent governing board;
- the board of a CDF is comprised of membership representing interested constituencies: elected officials (representing the taxpayers who are the source of the public money in the fund), business people (representing private contributors to the fund), and concerned individuals (representing individual donors and specialist NGOs that perform community service);
- the CDF is not necessarily endowed, but it may be endowed by a combination of government and private funds; and
- the focus of a CDF is on development, not charity or the arts.

These types of funds can be very useful for more innovative development projects, which are created by NGOs and CBOs and are not conceptualized within the service delivery mentality that one finds within contract processes. They allow for greater creativity than an activity that is completely government-funded, and they may finance projects that are shorter-term and less outcome-driven. Making room for CDFs under local law (particularly by permitting local governments to use their budgets to support CDFs) is itself an example of partnership, and it provides for greater flexibility and enhances development.

5. *Privatization mechanisms*. One of the most important contributions to development partnerships may be the privatization of social and other community-oriented assets held by national, subnational, or local governments. At the current time, with the strong political preference for down-sizing the government's role in many activities, countries around the world are privatizing state-owned businesses. At the same time, they are increasingly looking to ways to move state-run social and cultural enterprises into private hands. It has therefore become important to ensure that the law provides adequate legal structures to accomplish such privatizations. This sort of legislation will ordinarily need to be adopted at the national level. On the other hand, there are many informal methods of "privatization" of state held assets (below market leases, for example), and many of these take place at the local level (Simon, 1995).

Whatever privatization legislation is adopted must deal adequately with the problems of privatizing social assets. Often the legislation does not deal adequately with the valuation issue when a social asset is privatized (business privatizations may rely on the market to value assets, but that will not be appropriate for social assets being transferred to NGOs). In the privatization of the Institute of Finance and Economics in Mongolia, referred to earlier, the existing privatization legislation had to be amended to eliminate this feature for social sector privatizations. In addition, conditions had to be imposed in the tender documents to assure that the privatized asset would not be distributed for the private benefit of anyone nor could it be traded for another asset. (Cassagrande and Irish, 1997)

By way of example of such processes, let us look at the privatization of a health clinic, as is presently contemplated in the Republic of Georgia. When these assets are privatized, the recipient of the formerly state-owned assets should be set up as a NGO or CBO under local law. The former government employees who ran the clinic will presumably continue to be involved once the clinic is no longer run by the state. But they will then be employees of a new nongovernmental organization and thus they will be subject to the oversight of an independent governing board. This board should be comprised not only of government representatives but also of concerned community leaders and health professionals. It is a tricky business to ensure that good employees are kept on by the new NGO or CBO, while at the same time providing a competitive opportunity to acquire new staff who may conceivably be more knowledgeable. Thus, various issues about staff retention, board composition, independence of the new entity, etc., need to be carefully thought out when the privatization legislation or tender offers are being written. In addition, legislation may provide that for-profit entities may be involved in the management of the newly privatized assets, even though the body that will actually hold title to them will be an NGO. The World Bank is currently working in Hungary on a procedure that will contain similar elements in a pilot project for social sector privatization.

Ideally a privatization of a health clinic or some other socially useful state asset will be an opportunity for a real development partnership to emerge. Local businesses with a strong interest in seeing good health care in the community can be encouraged to become involved in financing the organization that holds the newly privatized assets. But they will only become involved if they think their voices will be adequately heard when it comes to management and governance. Thus, the privatization legislation should provide ample room for designing structures that will pull the whole community into a cooperative relationship.

Conclusion. This paper has summarized a few crucial legislative issues to be addressed so as to aid the creation of a good legal and fiscal enabling environment for development partnerships. Governments should not abdicate their important social responsibilities and thus should clearly continue to be providers of many social and economic development services. Yet development partnerships, which bring to the process of development not only government actors but also businesses, informed private citizens, and expert NGOs and CBOs, should be encouraged. All governments should promote a dialogue that will assist them in defining which types of social and economic development activities will best be accomplished using the partnership model. After these policy parameters have been set, legislation should be enacted to promote and support the existence of development partnerships.

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Appendix

Legislation Affecting Development Partnerships

National level legislation

- Law on local self-government
- Law on local administration
- Law on government procurement
- State budget law
- Privatization law (does it contain provisions affecting social and cultural activities of the government?)
- Laws governing formation of NGOs (particularly looking at the issue of permissible economic activities)
- Restrictions on investment activities of NGOs, including investment abroad
- Tax laws affecting NGOs
- "Sectoral" and licensing laws (laws governing provision of social services, education, health care, etc.)
- Borrowing mechanisms used for development (such as special bond issues)

Local level legislation

- Local laws on procurement (regional, county, municipality, etc.)
- "Sectoral" and licensing laws
- Municipal budgets
- Municipal fees, taxes, etc.
- Municipal grantmaking mechanisms, including those that are activity-based (e.g., special purpose foundations)
- Additional NGO benefits (preferential leases, etc.)
- Borrowing mechanisms used for development (such as special bond issues)
- Adequate fund raising legislation

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