PUBLIC FINANCING MECHANISMS AND THEIR IMPLICATIONS FOR NGO SUSTAINABILITY

– Elizabeth Warner[5]

INTRODUCTION

Financial viability remains one of the most difficult challenges for NGOs in the regions covered by the NGO Sustainability Index (NGOSI). As foreign funding declines, NGOs are increasingly looking to domestic sources of support. This paper examines various aspects of domestic financing. It considers four common methods by which public funds have been disbursed to the NGO sector: state-sponsored vehicles dedicated to the support of civil society; contracting; taxpayer designation systems (so-called "one percent" laws); and subsidies.[6]

Governments have diverse motivations for financing NGO activities. Among other motivations, some governments recognize that NGOs are well-positioned to deliver social services, and funding enables them to "outsource" service delivery. Governments may also wish to finance NGOs to promote "public goods"—such as culture, art, or scientific research. In addition, a government might procure services for its own use—for example, a government might contract with an NGO to conduct a poll, write a draft law, or evaluate a government program. Less benevolently, some governments in the region remain suspicious of NGOs (particularly foreign-funded NGOs). In these countries, independent NGOs often have restricted access to public funding, or funding is used as a mechanism of control, financially tethering certain NGOs to the state.

A threshold issue is how to generate revenue to finance NGO activities, and countries in the region have developed a number of innovative funding sources. For example, in Hungary, the Cultural Fund is financed from a tax on artifacts and pornography; the Environmental Fund is financed from a tax on gas and fines paid by polluters; and the National Civil Fund is funded from the general treasury in an amount equivalent to the funds designated to NGOs by individual taxpayers under Hungary's famous "one percent" law.[7] The Czech Republic utilized 1 percent of privatization proceeds to endow foundations working on human rights, culture, environmental protection, and other fields. Additional sources of funding have included car registration fees (Macedonia) and lottery proceeds (Montenegro and Croatia).

Perhaps the ultimate "sin tax" can be found in Kazakhstan. The Bota Foundation, established in 2008, is technically a private foundation but is jointly governed according to an agreement among the Kazakh, Swiss, and United States governments. It is funded by $84 million in frozen funds that were allegedly to be paid as bribes by various Western oil companies for extraction rights. The foundation's resources will be used to provide stipends to poor families as well as grants to some NGOs under procedures currently being developed.

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[6] Other mechanisms also exist, including per capita payments, voucher systems, in-kind contributions, etc., but these forms of financing are beyond the scope of this paper.

[7] This law, discussed in detail below under "Taxpayer designation systems," permits individual taxpayers to direct that 1 percent of their income taxes be remitted from the government treasury to one or more designated public benefit NGOs.

FUNDING MECHANISMS

Once funding sources are identified, the next question relates to the funding mechanisms through which they are distributed.

1. State-sponsored funds or vehicles dedicated to the support of civil society – examples from three countries

Croatia

One of the best-known funds in the region is the Croatian National Foundation for Civil Society Development ("Foundation"),[8] established in 2003. In addition to grantmaking, the Foundation is charged with providing training, technical assistance, and capacity-building assistance to NGOs; it views programs that encourage sustainability to be a key component of its core mission. The Foundation also conducts extensive research on the state of civil society organizations, including their financial health, relationship with donors, and the legal environment in which they operate. It is governed by a nine-member board appointed by the government: five members are civil society representatives, three are from state ministries, and one is from local/regional government.

The Foundation was originally supported by a revenue stream derived from the national state lottery, and it has grown in stature over the years, receiving funding from Western aid organizations such as USAID, the British government's Department for International Development, the European Commission and the Charles Stuart Mott Foundation

Between 2004 and 2007, the Foundation provided $15 million in civic initiatives, projects, programs, and institutional support of civil society organizations. Much of this support was provided through grants, some of which were multi-year awards. The maximum grant amount is approximately $63,000. The Foundation also provides institutional support grants to NGOs working in areas such as human rights, the development of democratic institutions, sustainable development, and the rule of law.

As a result of some challenges it faced in the first year of its operation, the Foundation has implemented a number of measures to promote the transparency of its operations.[9] Its website posts announcements of tenders, application forms, results of the tender process, and other key information. The Foundation developed evaluation grids that guide both NGOs and evaluators in making funding decisions. It also has established clear conflict of interest rules to avoid allegations about NGOs supporting their own peers. In addition, bidders may appeal adverse decisions to the Foundation's Management Board, and the Management Board is obliged to respond to the appeal within fifteen days.

The Foundation is committed to decentralizing in an effort to provide more closely tailored financing to local activists and organizations. To that end, in 2007 the Foundation delegated grantmaking responsibilities to four regional foundations established by local governments with whom it signed cooperative agreements. The first regional tenders were announced in October 2007. The implementation of this initiative is based on two fundamental principles: regional action and partnership with local/regional community foundations, as set forth in the Foundation's Strategic Action Plan for

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[8] The Foundation's website is at http://zaklada.civilnodrustvo.hr/frontpage.

[9] Because selection criteria were not clear, NGOs accused the government and their own peers of bias after the first round of grants was published. The Foundation did not at the time have conflict of interest rules and had a hard time fending off these allegations. Conflict of interest issues have proven an even greater challenge to overcome in the case of Hungary's National Civil Fund, where to date there are no satisfactory regulations to prevent NGO representatives in a decision-making position from providing preferential support to their own and affiliated NGOs.

2008–11. Also in 2007, the Foundation entered into partnerships with five regional civil society networks to provide training, information, and consultation to local associations (both registered and unregistered).

Over the years, the National Foundation has had a significant impact on NGO financial sustainability in Croatia. Five structural elements have contributed to this outcome:

- *Procedures and criteria*. The Foundation operates pursuant to clearly defined, transparent procedures and criteria.
- *Decision maker*. Funding decisions are made by a cross-sectoral board, with civil society representatives holding five of nine seats.
- *Funding levels.* The Foundation has disbursed a relatively large amount of funding ($15 million from 2004–07) through a relatively large number of beneficiaries (878 grants from 2004–07).
- *Use of funds.* The Foundation will explicitly fund programmatic and institutional support for a range of organizations including those engaged in activities such as human rights, the rule of law, and the development of democratic institutions.
- *Duration of support.* Awards can be made on a multi-year basis, and grantmaking is expected to continue in future years (albeit through different intermediaries).

Other countries in CEE have also established funds, including Estonia, Czech Republic, Poland, and Hungary. Albania established a new fund last year that is expected to commence operations sometime in 2009. Dedicated funds are not, however, limited to CEE. In the NIS, several countries have established funds, and the following sections examine two of the most recent examples.

Azerbaijan

In December 2007, Azerbaijan established a new Council on State Support to NGOs ("Council"). The Council consists of eleven members, eight of whom are NGO representatives nominated by NGOs and then approved by the president. There are also three government representatives on the Council. The Council is supported in its work by an NGO Experts' Board that consists of local and international experts.

Most of the government-sponsored dedicated funds for support of civil society are run by a board or council whose members are selected by the government, albeit with input from the NGO sector and other stakeholders. But the National Civil Fund in Hungary is run by a series of local boards, all of whose members are publicly elected. Prospective board members campaign for votes like members of parliament and other elected public officials.

The Council established competitive rules for soliciting grant applications and awarding funds, and the first call for applications was launched in early 2008.[10]

In August 2008, the Council awarded grants worth more than $1.2 million to local NGOs working in areas including human rights protection, capacity building, public health, social services delivery, and refugees' rights. Three hundred and sixty-one projects were submitted, and 191 were selected for grants. The grant maximum was approximately $25,000. Awards could be used to cover program costs, including expenditures that support institutional capacity (such as staff training, participation in conferences, etc.).
Over 2 million AZN (equivalent to $2.45 million) have been budgeted for NGO financing in 2009, and as of March 2009, approximately 561 proposals have been submitted and are currently going through the selection process.

[10] Some NGOs expressed concerns about the complexity of the application forms, and the Council is currently considering simplification of the process.

During the development of the Council, there was concern that the government might use the availability of new domestic funding as a partial excuse to prohibit foreign funding. Importantly, this did not come to fruition. Reflecting this significant outcome, the presidential decree establishing the Council explicitly states, "Carrying out state support to non-governmental organizations by the Council does not limit the possibilities of rendering assistance to non-governmental organizations by the state authorities and international organizations."

Noteworthy elements of the Azeri model include:

- *Procedures and criteria.* The Council established and published procedures for making awards—though some argued that the procedures were overly complex and amendments are now under consideration.
- *Decision maker.* The decision maker is a cross-sectoral Council that includes eight NGO representatives nominated by NGOs but approved by the president;
- *Funding levels*. 191 grants were approved in the first round, and the maximum grant size was approximately $25,000.
- *Use of funds.* Awards were made to a broad range of NGOs including groups engaged in human rights and other advocacy issues.
- *Duration of support*. Short-term awards were made in the pilot phase, but grantmaking is expected to continue in 2009 and beyond.

The Council's operations are still at an early stage, and it is still working through the first round of grants. While the Council has established transparent procedures, and its initial steps look promising, it is still too early to determine how it will impact NGO sustainability in the longer term.

Uzbekistan

In 2008, Uzbekistan also established a new fund to support civil society.[11] Structural elements—or the lack thereof—mitigated the impact of this fund on the sustainability of independent civil society in Uzbekistan. Contrasting these elements with the attributes of the Croatian and Azeri models illuminate factors that help determine the extent to which such funds actually promote NGO sustainability in a given country.

Following the "color" revolutions and popular uprisings in Eurasia and Ukraine in 2003–05, Uzbekistan expelled most foreign NGOs from the country and effectively banned foreign funding, which led to termination of between two-thirds and three-fourths[12] of Uzbek NGOs. Today, the legal environment for NGOs in Uzbekistan remains very restrictive. For example, all NGOs must obtain an advance permit from the Ministry of Justice in order to carry out any "event," even if it is just a meeting of members. NGOs are also subject to burdensome monthly reporting requirements, even if they have no activity.

Against this backdrop, the Uzbek government passed a law "On State Guarantees of NGO Activities" in 2007, which among other things provides that the state can provide financial support for the activities of NGOs through grants, subsidies and contracts. The new law also purports to grant NGOs the freedom to conduct their activities, receive information from the government, and protect their property interests. However, nearly every provision is qualified by such phrases as "according to law" or "unless prohibited

[11] The Public Fund of Support for Non-Governmental Non-Commercial Organizations and Other Institutions of Civil Society of the Oliy Majlis of the Republic of Uzbekistan ("Public Fund").
[12] U.S. Department of State, Bureau of Democracy, Human Rights, and Labor, "2006 Country Reports on Human Rights Practices: Uzbekistan," March 6, 2007, http://www.state.gov/g/drl/rls/hrrpt/2006/78848.htm.

by law," thus effectively reducing the law to a declarative status that would not supersede any other restrictive or conflicting legislation.

During 2006–2007, an informal mechanism for distributing government grants had existed through the government-organized and controlled National Association of Nongovernmental Noncommercial Organizations (NANNOUZ). Approximately $350,000 was distributed through a series of tenders that were relatively open and transparent, resulting in ninety-four grants being issued to local NGOs working in such areas as social services, women's education and culture. However, overtly "political" organizations such as human rights advocates were not successful applicants.

In 2008 a Decree of the Uzbek Parliament established a formal legal entity—the Public Fund—to be managed by a parliamentary commission comprised of members of various ministries, parliamentary deputies and NGO members whose selection is based on unknown criteria. The list of members of the council is confidential (including the list of NGO members), but unofficial reports indicate that all the NGO representatives are members of NGOs established by—or otherwise closely connected to—the government. At present, there is no publicly known procedure to apply for Public Fund resources, nor is one expected to be implemented this year.

The Public Fund's purpose is to promote programs to enhance the material and technological potential of NGOs, providing them with legal, advisory, technical, and other support. The Public Fund's charter expresses a commitment to "the principles of transparency and openness." In 2008, the Uzbek government allocated an estimated $1.5 million for distribution to NGOs through this mechanism.

Despite the commitments in its charter, however, none of the parliamentary commission's records were made public, in stark contrast to the Croatian Foundation. No forms or procedures for applying for assistance were published, nor is there a public list of those organizations that received funding. According to this year's Sustainability Index report, all governmental funds for NGOs were distributed to GONGOs.[13]

Essentially, the Uzbek Public Fund includes the following components:

- Unknown procedures and criteria for funding;
- A politicized decision maker;
- Unknown recipients of funding;
- No evidence that independent NGOs were able to access any of the 2008 funding; and
- No evidence that the Public Fund will develop appropriate procedures in 2009 to enable independent NGOs to access resources available to the Public Fund.

Summary

Comparing the Croatian, Azeri, and Uzbek funds reveals that mechanisms similar in name have dramatically different implications on NGO sustainability based on their structural components. To assess whether a fund contributes to NGO sustainability in a particular country, the foregoing analysis suggests that the following factors should be considered:

- The extent to which there are reasonable and transparent funding procedures and criteria, including conflict of interest rules that limit the ability of governing board members to

[13] The term "GONGO" is an acronym for Government-Organized Nongovernmental Organizations. In essence, they are legal entities established under private law, but funded and controlled by the government to an extent that they are not considered independent.

participate in decisions benefitting organizations with which they are affiliated. These measures enable NGOs to determine eligibility for awards, access the system efficiently and structure their applications to maximize their chances of success;
- The extent to which a nonpolitical, independent entity implements the procedures and makes funding decisions, which increases the chances that funding will reach a range of organizations broader than those whose goals are closely aligned with government policies;
- Funding levels (both overall funding and the maximum size of grant);
- The number of awards and whether decentralization would afford greater outreach to smaller NGOs or greater responsiveness to local needs;
- The duration of the awards (one year or multi-year as is possible in Croatia);
- Permitted/prohibited use of funds (for example, allowing institutional support not linked to specific outcomes, which can have a profound effect on the ability of NGOs to remain operational and retain office space and staff during gaps between specific programs); and
- The likelihood of future grant rounds, providing for a longer term mechanism for sectoral sustainability.

It is clear that the more sizeable, transparent and independent the dedicated fund, the more it can contribute to the sustainability of NGOs overall. However, these funds may not be the most suitable vehicles for ensuring sustainability of certain types of NGOs. In particular, some advocacy and human rights organizations may have policies that prohibit them from accepting public funding even through an intermediary mechanism. Furthermore, as noted above, the overall political and human rights situation of a country needs to be examined when assessing the impact of a dedicated fund on NGO sustainability.

2. Contracting

Recognizing that concepts and terminology differ throughout the region, this paper uses the term "contracting" to refer to the government's purchase of services, goods, or property, either to provide a state function or service or to provide a direct benefit to the government. At a functional level, a government might use contracting to acquire services that it might otherwise provide directly—for example, health care, education, and support to vulnerable populations (the elderly, orphans, war veterans, women with young children).[14] A government might also acquire goods, property, or services for its direct use or benefit. In the NGO context, examples might include a government contract to conduct a poll, to undertake research, or to conduct an evaluation of a governmental program.

Although the precise procedures and terminology vary, most of the countries covered by the NGOSI engage in some form of contracting with NGOs. Contracting therefore serves as a potentially important source of funding for the NGO sector. For example, Poland's laws encourage NGOs to compete for social service contracts in open tenders[15] organized by local government units and also to form partnerships with public administration bodies to deliver services on a cooperative basis. When deciding to offer a service, local governments are required to consider proposals from NGOs. In addition, local governments are required to put out a tender if an NGO submits an unsolicited bid to provide a service that is currently being provided solely by the government, resulting in situations where public administration bodies actually compete against NGOs for contracts. The rationale for this open competition is to avoid the risk that the third sector will only receive contracts for activities that are unwanted or ignored by other administration bodies. The effect is to give NGOs broad opportunities to

[14] A comprehensive discussion of NGO service delivery is presented in a separate essay. This paper therefore presents a more limited analysis of the impact of contracting mechanisms for service delivery on NGO sustainability.
[15] The term "tender" means a publicly announced process identifying the services to be contracted for and soliciting bids or proposals from potential contractors.

develop innovative ways of providing social services and to encourage governments to be responsive to NGO proposals.

At the same time, contracting has limitations as a source of third sector financing. Many of these limitations are similar to those addressed in the section on dedicated funds (e.g., the transparency of the process, the extent to which there is an independent decision maker, etc.). The following therefore focuses on illustrative issues specifically linked to contracting laws:

In many countries, income from procurement contracts is subject to taxation, especially in situations where NGOs compete alongside commercial companies for those contracts. In some cases, however, NGOs are exempt from a certain amount or certain categories of income received through economic activity. In addition, some countries explicitly exempt income earned by NGOs on procurement contracts. For example, in Kazakhstan, NGOs are exempt from income taxes on procurement contracts designated as "social contracts." In Kyrgyzstan, a new law adopted in 2008 states that social contracts will be awarded as grants, thus exempting them from income under existing tax law.

Barriers to entry. In some countries, it is impossible for NGOs to directly engage in procurement contracting. In Ukraine and Armenia, for example, public associations are precluded from engaging in any economic activities. This has been interpreted by tax authorities and other government officials to preclude these NGOs from entering into procurement contracts. In addition, until 2007, the Kazakh constitution prohibited state funding of public associations (the primary NGO form in Kazakhstan), which was broadly interpreted to prohibit any financial relations—including contracting—between the state and any NGO.

Restrictions on activities. In other countries, certain activities are off-limits. For example, in Bulgaria, NGOs are prohibited from providing health services. In other countries, barriers are more subtle. In Ukraine and Montenegro, NGOs must obtain a license or attain a certification by the state to provide certain services. While reasonable at first glance, NGOs have complained the licensing procedures are often opaque and expensive, creating a barrier to entry into certain fields. In many countries, NGOs may engage in economic activity only "to the extent necessary for" or "closely related to" their statutory goals (e.g., Belarus, Kyrgyzstan, Russia, Romania, Tajikistan). The meaning of these phrases is usually not articulated by government officials, but often discourages NGOs from entering into contracts for fear of being accused of engaging in illegal activity

Conversely, some countries have created set-asides for NGOs, precluding businesses and other entities from bidding on certain kinds of agreements (often cast as "social contracts"). For example, Kazakhstan forbids commercial organizations, trade unions, political parties and religious organizations from bidding for contracts designated as social contracts under the Budget Code. Similarly, Hungary sometimes favors bidders that have been designated as "public benefit organizations" when awarding social contracts. However, in many other countries, the primary goal of procurement contracting is not to provide support to NGOs. Rather, governments are seeking to provide the lowest cost for the service tendered, and they open the competition to commercial companies, NGOs and others (this is the case, for example, in Croatia, Montenegro, Russia, and Ukraine).

Subsectoral impact. Even if the foregoing barriers can be overcome and a valid project tendered, contracting has a disparate impact on different parts of the NGO sector. By definition, the primary purpose is to provide a state function/service or to provide a direct benefit to the government. Therefore—and most obviously—contracting favors NGOs working in fields aligned with governmental priorities and disfavors groups that challenge state policies or work in areas not prioritized by the government.

Bias toward well-capitalized organizations. Even within the subset of organizations working in prioritized areas, financial requirements have a disparate, negative impact on small organizations. Many procurements require the contractor to cover all or a significant portion of costs up front and then seek reimbursement for expenses paid. In Russia, for example, the Budget Code explicitly withholds 70 percent of payment for services until after the work is complete.[16] Some tenders also require security deposits or bank guarantees that most NGOs cannot afford.[17] Since NGOs in the region have limited access to credit, these rules often bias procurement contracts toward larger, well-capitalized service delivery NGOs (or GONGOs). Indeed, in Kazakhstan, the majority of social contracts awarded between 2004–07 went to organizations established by or closely connected to the government.

Duration of award. In addition, some procurements are funded on an annual cycle. In practice, this means that contracts are often not awarded until the middle of the year and must be completed before the end of the year (e.g., Kazakhstan and Romania). Funding restrictions of this type limit the ability of an NGO—particularly smaller NGOs with limited ability to reassign staff to other funded programs while awaiting funds—to build capacity and retain qualified staff.

Use of funds. Even if these challenges can be overcome, further sustainability challenges arise. In some countries, funds can only be used to carry out program-specific activities, and rules restrict or prohibit the use of funding for other legitimate expenses. In Kazakhstan, for example, funds awarded through a social contract may not be used to cover expenses relating to operating an office or acquiring equipment. Moreover, NGOs often have little role in the design of tenders, requiring them to produce largely pre-determined deliverables, leaving little room for innovation—a critical component of long-term organizational sustainability.

In summary, contracting has limitations, but it remains an important source of revenue for many NGOs, particularly those engaged in service delivery aligned with governmental interests. For example, in 2007, government contracting with NGOs in Hungary amounted to $196 million.[18] Government contracts with NGOs in Kazakhstan grew from just $400,000 in 2003 to $10 million in 2008 supporting organizations providing vocational training, drug addiction prevention programs, orphanages, and so forth. A newly launched social contracting program in Kyrgyzstan began with the distribution of $125,000 in 2008, albeit under rather secretive conditions, and will distribute some $500,000 next year under newly adopted regulations which provide a greater measure of transparency.

3. Taxpayer designation systems

One of the more innovative financing mechanisms in the CEE region are the so-called "designation" schemes, whereby individual taxpayers may direct that a certain percentage of their income taxes be remitted from the government treasury to one or more designated public benefit NGOs (in some countries, from a list developed and maintained by the government). Although a popular name for this mechanism is "percentage philanthropy," this type of funding mechanism diverts money that has already been paid to the government by the taxpayer and does not cause the taxpayer to incur any additional cost (nor, for that matter, does the taxpayer obtain any sort of refund or other benefit if he or she chooses *not*

[16] In others, final payment is conditioned on approval of the final project report, which is at the discretion of the government (Kazakhstan).
[17] To address this situation, some countries such as Kazakhstan have enacted special provisions to exempt NGOs from security deposits, but this is the exception rather than the rule throughout the region.
[18] Although this amounted to only 4.3 percent of total nonprofit sector income in that year, it is still a large sum of money. Furthermore, in Hungary, many NGOs receive financing for social services through so-called "normative" financing, which is distributed on a per-capita basis according to the number of recipients of the services; this amounted to an additional $377.4 million. Together, these two forms of financing accounted for about 12.5 percent of total nonprofit sector income.

to designate). Therefore, it is more properly considered a public financing mechanism than a form of philanthropy.

Hungary was the first country in the region to adopt such a mechanism (in 1996), permitting taxpayers to designate 1 percent of their income taxes to be paid to civil society organizations, and an additional 1 percent to churches. Other countries followed with similar mechanisms: in Slovakia, 2 percent of income taxes may be designated (corporate as well as individual taxpayers may designate under this law); Slovenia 0.5 percent; Romania 2 percent; Poland 1 percent; and Lithuania 2 percent. Designation rules have not yet taken root in Eurasia.

The amounts of money distributed and numbers of recipients under tax designation schemes demonstrate their popularity. In Hungary, for example, the amount distributed more than doubled in real terms from 1997 to 2006 (from EUR 7.1 million to 29.7 million—a fourfold increase in nominal terms). Close to half of all eligible taxpayers participated and over one-third of eligible organizations received designations (from approximately 8,400 organizations in 1997 to 20,000 organizations in 2006). In Slovakia, where NGOs have to be registered beforehand to be entitled to receive designations, 97–99 percent of registered organizations are beneficiaries. The number of beneficiaries grew from 3,827 to 7,062 between 2002 and 2006, representing around 9 to 15 percent of the entire sector.

Key aspects of the tax designation schemes, compared with the other mechanisms considered in this paper, include the following:

1. *Ease of administration; low cost to the taxpayer/decision maker*. To participate, taxpayers fill out a short form; the government does the job of remitting the designated amounts to the NGO beneficiary. Taxpayer-designators do not have to spend any money out-of-pocket, as the designation is made from tax dollars already remitted.
2. *Broad array of NGOs that are potential recipients.* In Hungary and in Romania, the beneficiaries can be associations, foundations and other institutions seen as pursuing or promoting the public good.[19] In Slovakia, where beneficiaries have to be registered in advance, about 15 percent of the NGO sector is listed, but 97 percent of those listed are beneficiaries.[20] NGOs that might otherwise lack capacity to compete for financing through other mechanisms can still receive designations with potentially very little effort.[21]
3. *Broadly distributed support.* Empirical evidence from Hungary, which has had the longest experience with a designation scheme, indicates that over one-third of all eligible NGOs received some designations in 2006, which is almost certainly more than would have received direct financing from the government under grants or other programs with higher administrative costs. The ability to donate to more than one organization at the same time, as in Slovakia, increases the potential number of NGO recipients. The fact that the taxpayer makes the designations also increases the likelihood that some level of support reaches NGOs who may be critical of government policies or are otherwise not likely to be favored when a government agency is the decision maker.
4. *Broad array of potential designators.* In most designation systems, virtually any taxpayer with a certain minimum income may make a designation. In Slovakia, the law was amended in 2004 to permit designations by business entities as well as individuals. However, only those persons who

[19] The list of eligible beneficiaries also includes some public bodies (e.g. the Hungarian Academy of Sciences), government-funded institutions (e.g. the Hungarian State Opera House), and government-backed funds (e.g. the Hungarian Scientific Research Fund).
[20] Environmental and human rights organizations that are actively involved in politics are unable to apply. There have been some proposals to restrict the use of tax designations to organizations involved in social and health care, culture and sports.
[21] Further information on designation schemes can be found at www.onepercent.hu.

actually pay taxes may make a designation, thus eliminating from consideration large numbers of people such as pensioners, students and those whose income is not high enough after taking into account various tax benefit measures.

From a sustainability perspective, designation schemes have been most effective in fostering a closer relationship between NGOs and the public. In order to capture designations, NGOs have had to devote greater resources to serving the community, increase public awareness of their work, and build public support. Because a designation does not involve a financial sacrifice on the part of the designator, it has been easier, in cultures that do not have a strong tradition of private donations, for NGOs to reach out to people and explain what they do and why people should support them. In addition, the designation process made it easier for taxpayers to become aware of the existence of NGOs. These links between NGOs and the public encourage NGOs to build their capacity for fundraising in general, which is a key component of sustainability. At the same time, however, designations are anonymous, so NGOs have difficulty forging long-term links with their supporters and accordingly engaging in more targeted fundraising efforts.

In one sense, designation schemes are very popular (aggregate amounts designated continue to increase) and are highly effective in distributing support to a broad array of NGOs, generally more NGOs than would have been able to receive other forms of direct funding. However, evidence in Hungary and Slovakia also indicates that the amount designated per NGO has not increased significantly (about $1,500 per NGO in Hungary in 2007; slightly less in Slovakia). While the aggregate amounts designated have risen, the numbers of potential and actual beneficiaries have also risen, leaving the average designation about the same, and even decreasing over the past couple of years. Furthermore, the percentage of taxpayers making designations has not increased appreciably since the system was inaugurated and is now slightly below 50 percent, suggesting that the system “plateaus” after a few years. In Hungary in 2008, 52 percent of recipients received designations less than HUF100,000, or $476, and 95 percent received less than HUF 1 million, or $4,760. Only 5 percent of all NGOs receiving designations took in more than US$4,760 from the 1 percent mechanism, and there were only fourteen NGOs altogether which received more than HUF 50 million or $238,000.

The system also seems to favor NGOs with popular causes, such as child cancer, animal welfare or hospital foundations—organizations which also tend to receive significant state support through other mechanisms. Designation systems have yet to prove themselves as significant new funding opportunities for human rights NGOs or those representing difficult causes such as HIV/AIDS prevention and treatment or support for marginalized ethnic minorities.

Another drawback to this type of system is that some governments have perceived that designation laws are sufficient to support the third sector and have scaled back other programs or eliminated other tax benefits. For example, donations that could be deducted from otherwise taxable income have been eliminated in Slovakia and Lithuania. There were also fears that individuals would find designations a sufficient form of support for NGOs and might curtail other donations. However, recent evidence suggests that fears of widespread reductions in government or private support have been unfounded.

On balance, in countries with more developed tax administrations but less developed philanthropic cultures, the percentage mechanism may serve to help introduce more links between citizens and NGOs, and it may also assist in building public relations and fundraising capacities of NGOs, including smaller NGOs. However, due to the inherent limitations of tax designation systems, in the long term they can fail to keep up with sectoral growth, or even hold back development of a healthy private fundraising environment.

4. Subsidies

For purposes of this paper, a "subsidy" is general support from a government to an NGO. Unlike procurement contracts, subsidies are not typically tied to any particular deliverable or program purpose. Rather, funding can be used to cover general operating support of an organization. Often, the recipients and amounts are written directly into the national or municipal budget.

Among other countries in the region, Hungary, Romania, Bulgaria, and Russia provide subsidies to select organizations. Beneficiaries include organizations supporting youth, sports, pensioners, and people with disabilities. In some cases, these groups are successors to social support or trade organizations that in Soviet times were considered part of the government or were run by the Communist party and which successfully lobbied for continued support after transition.[22] In other cases subsidies are provided to organizations perceived to be the premier representative of a certain segment of the population—for example, associations representing veterans of the recent Balkan wars. Subsidies are also given to local chapters of recognized humanitarian organizations such as the Red Cross. Local government units that do not have the capacity to conduct open competitions for grants may provide noncompetitive subsidies instead.

Typically, subsidies are given by various Ministries and often the name of the recipient NGO and the amount provided are written directly into the budget. In recent years, as new organizations form with missions similar to those of organizations receiving subsidies, governments have been forced to evaluate whether they should provide subsidies to all such organizations or shift to a competitive grantmaking process. For example, in the early 1990s Hungary provided a subsidy to a women's association that had formerly been controlled by the Socialist party. As new, independent organizations dedicated to promoting women's rights began to form, the subsidy was increasingly seen as anachronistic and eventually was discontinued. On the other hand, an organization representing the physically disabled continues to receive a subsidy even though many other organizations with similar missions have since formed. One very interesting recent phenomenon in some new European Union member states has been the formation of organizations dedicated to international development. In Hungary, an association of international development NGOs known as "Hand" receives a subsidy from the Ministry of Foreign Affairs.

Since subsidies can often be used to cover operating expenses of an organization, including overhead and administrative expenses, they are important sources of financial sustainability for the organizations that receive such subsidies. At the same time, subsidies are typically provided to a small group of organizations through a noncompetitive process, so the impact of subsidies on overall sector sustainability is rather limited. Figures on actual subsidies, and the process for obtaining subsidies (if indeed one exists) are very difficult to come by, making it extremely difficult for NGOs to access the system or evaluate their prospects for obtaining financing in this manner.

CONCLUSIONS AND OBSERVATIONS

The funding mechanisms studied all have important implications for NGO sustainability in differing respects. Given these differences, one important conclusion to draw at the outset is that no single mechanism is preferred or should be thought comprehensive. Indeed, countries with more developed NGO sectors employ a variety of mechanisms to meet different policy objectives and NGO needs.

[22] Many of these organizations might have had roots as independent organizations before the Communist takeover, e.g., in Bulgaria, when virtually all CSOs came under the state-controlled system.

For example, contracting can work well for the procurement of certain kinds of services. Nearly every country has procurement laws already in place that can be adapted for social contracting by means of well-developed model legislation (e.g., along the UNCITRAL model[23]) or other means. By contrast, a grantmaking mechanism, as employed by the dedicated funds for civil society, can work well as a discovery mechanism to determine the programs that each NGO is most capable of providing and can enable the government to benefit from innovative proposals for addressing important social problems.

Below are characteristics of the mechanisms studied that influence NGO sustainability.

Transparency: clear, published, objective rules for establishing eligibility, selection procedures and evaluation of applications. Transparency is a cornerstone concept for an effective financing program. In terms of dedicated funds, transparency is most evident in the operations of the Croatian National Foundation. Most procurement laws have some notions of transparency built-in, enabling NGOs to prepare responsible bids. Where transparency is lacking, as with the Uzbekistan Public Fund and most subsidy programs, independent NGOs may have little if any ability to access resources. In the case of the taxpayer designation systems, it is important that taxpayers understand how the system works so they can make designations, and for NGOs to know how to become eligible for designations so they can solicit support. It is also important that the tax administration system be seen as efficient and trustworthy in allocating designated funds properly. For subsidies, the decision making is often fairly opaque, with terms developed without transparent procedures or criteria.

Decision-making authority. The mechanisms studied vest financing authority in very different bodies. In the case of the dedicated funds in Croatia and Azerbaijan, these bodies include representatives from the NGO community, which—depending on the independence of the NGO members and the general political environment—may help balance the tendency of government representatives to make awards that directly further government interests. For example, awards for programs that monitor government activity might have a greater chance of being funded by a board that is independent of the governmental unit to be monitored. In the case of procurement contracting, the authority is very often given to line ministries and local government units, thus providing a decentralized scheme that can target support more effectively in specific sectors and local communities. In this regard, it is important also to note that the Croatian Foundation has delegated some of its grantmaking authority to four regional bodies. In the case of subsidies, decision makers can include parliament, the government as a body, or various government agencies or bodies individually. In the case of designation programs, a multitude of taxpayers make the decisions among designated public benefit organizations, which tends to spread financing to a much larger number of organizations who might otherwise lack the capacity to bid for awards under a more structured mechanism. In contrast, subsidies are often decided through political channels—whether the government or the parliament.

Recipients. We have seen that taxpayer designation systems reach a wide variety of recipients, including small NGOs. At the other end of the spectrum, procurement contracting laws often favor the largest, most sustainable organizations and are not the best tool for providing a lifeline to small and struggling NGOs. A dedicated fund mechanism lies somewhere in the middle, depending on how it is structured. It can provide smaller awards to a greater number of organizations if it wishes, and it can be more flexible in structuring its programs, so that, for example, in the same tender process it might issue a number of different awards of varying sizes. Subsidies, for those organizations which are in a privileged position to get them, may be the most secure source of funding for a time, but they tend to be awarded to only a few organizations on the basis of highly subjective criteria.

[23] UNCITRAL stands for United Nations Commission on International Trade Law, which among other things develops model legislation in compliance with World Trade Organization standards.

Size of awards. Larger awards are seen to contribute more to an NGO's ability to survive for a given term, all other things being equal. Of course, program awards are usually keyed to a specific timeline, and it is possible to spend a large amount of money over the same timeframe as a smaller amount, depending on the nature of the program. Taxpayer designation schemes, with their extremely broad reach, tend to provide funding to the greatest number of NGOs, but the other side of the coin is that awards tend to be quite small and usually not enough to sustain many organizations without additional support. But these designation schemes also are a great public awareness tool and encourage NGOs to be more responsive and sensitive to public needs and preferences when evaluating their own missions and programs. In that sense, designation schemes probably have a more profound effect on sustainability than would be the case if equivalent awards were made by a dedicated fund or government body, at least in the medium term.

Uses to which funding may be applied. As noted earlier, one of the severe difficulties with some funding mechanisms is that they often restrict the use of funding for operational or administrative expenses. (This is not limited to contracting laws; it can occur in grantmaking mechanisms as well.) These types of restrictions can constrain an NGO that might otherwise be willing and able to implement a given program, because the NGO might not have sufficient resources to fund non-programmatic costs. Restrictions of this type also can compel an NGO to suspend operations between funded programs, which can have a devastating effect on any organization if it cannot fund basic costs such as staff salaries, office space, and so forth. By contrast, some of the dedicated fund mechanisms provide not only programmatic and institutional support but also a variety of technical support programs designed specifically to assist NGOs in their efforts to become sustainable.

In sum, public financing of NGOs is playing an increasingly important role in the countries covered by the Sustainability Index. Nearly all the countries studied in the Index have employed at least one of the types of public financing mechanisms considered here, and more are currently under consideration in a number of countries. Careful consideration of the factors listed above can have a profound effect on the efficacy of a mechanism, for better or worse, in terms of helping NGOs to become more sustainable.