

12-2008

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The Impact of Accepting Government Funds on a Faith-Based Organization:
A Case Study of the Northwest Leadership Foundation

Brian J. Eggers
December, 2008

Senior thesis submitted in partial fulfillment
of the requirements for a
Bachelor of Science degree in Economics
at the University of Puget Sound

Introduction:

Faith-based and community organizations have a long tradition of helping Americans in need and together represent an integral part of our nation's social service network. Yet, all too often, the Federal government has put in place complicated rules and regulations preventing Faith-based and community organizations from competing for funds on an equal footing with other organizations. President Bush believes that besides being inherently unfair, such an approach can waste tax-payer dollars and cut off the poor from successful programs. Federal funds should be awarded to the most effective organizations—whether public or private, large or small, faith-based or secular—and all must be allowed to compete on a level playing field¹(The White House, 2008).

Faith-Based Organizations (FBO's), 501(c)(3) nonprofits, were able to fully participate in the Federal grant process when President George W. Bush signed the executive order 13198 of the creation for the Faith-Based and Community Initiative on January 29th, 2001. This executive order, George W. Bush's first as President, derives from work done by the three Presidents before him, beginning with Ronald Reagan. Ronald Reagan shifted many social programs from the Federal government to the state and local government, referred to as the New Federalism era, which was then built upon by George H.W. Bush's "Thousand Points of Light" initiative. George H.W. Bush encouraged charitable giving and acknowledged all types of volunteer efforts in local communities. Subsequently, Bill Clinton's Charitable Choice Initiatives prohibited states from discriminating against religious organizations to carry out social service programs such as drug rehabilitation, job training, and welfare reform (Davenport, 2008). FBO's today, as a result of the Faith-Based and Community Initiative, now provide an array of

¹ Quote from the opening statement from the brochure of the White House Faith-Based and Community Initiative's website. The brochure contains information on the initiative in action, the focus of the initiative, its accessibility, White House conferences, and written documents (The White House, 2008).

government-funded services. There are eleven Federal agencies with faith-based offices, all supporting the role FBO's play in social service work (The White House, 2008).

One of the main focal points of the Faith-Based and Community Initiative is "Identifying and eliminating barriers that impede the full participation of Faith-based and community organizations in the Federal grant process" (The White House, 2008). This paper will look specifically at one FBO's budget that uses government funds, the Northwest Leadership Foundation (NLF), and examine how the NLF's budget reacted to the availability of more government funds.

The NLF began in 1989 as a faith-based intermediary nonprofit organization in Tacoma, WA. Its mission is "to encourage, strengthen and develop leadership for the spiritual and social renewal of the city" (Northwest, 2008). The NLF encompasses fourteen different initiatives that serve parts of the community often overlooked by the government and private sector (Northwest, 2008). Before the Faith-Based and Community Initiative, the NLF relied on donations and small fees to operate, whereas now the organization gets fifty percent of its budget from the government. Since the NLF accepted its first grant, government funds have created numerous changes throughout the organization (Hillis, 2008). These changes have impacted many aspects of the organization; however, this paper will evaluate the impact of the changes on the budget.

This paper will provide a study, through the examination of the NLF's budget reactions, of the relationship between the government and FBO. First, the paper will review the literature regarding the relationship between FBO's and the government, looking at the benefits and costs of accepting government funds. The theory section will then address accepting government funds, crowding out, and allocation decisions of

designated and undesignated funds. Following the theory section will be a discussion comparing two budgets of the NLF, the 2002-2003 fiscal year and the 2007-2008 fiscal year, which will provide information on the NLF before and after government funds were a significant part of the budget. The discussion will include information on the overall growth of the NLF, how donations were impacted by the government funds, and how funds were allocated to reach a certain quantity of production. Moreover, opinions from the leadership of the NLF will provide vital detail in determining the impact.

The impact of the government funds on the NLF's allocation decisions will be examined through three lenses: supplementary, complementary, and adversarial. By examining the complex relationship that government funds bring to the table, one of the three lenses will gain focus.

Literature Review:

Dennis R. Young (2006) presents insight into the complex relationship between nonprofits and government through three different lenses: supplementary, complementary, and adversarial. Young begins by looking at the supplementary lens by which he suggests there is public good demand left unfulfilled by the government which the nonprofit sector supplies (Young, 2006, 39). The government, restricted by equity issues, the democratic voting system, and the way it follows the majority of the population's desires, decides the level of the public goods that it will provide for the citizens. But, when dealing with a very diverse nation without homogeneous preferences, the people outside of the majority, whose needs weren't represented, will be left unfulfilled or will receive too much of the public goods. This situation opens the door for

the nonprofit sector to generate the additional output. This lens of the nonprofit-government relationship depicts the nonprofits as an addition to what the government is already providing (Young, 2006, 41-42).

The complementary lens is a partnership between nonprofits and government where the government supplies the funds and the nonprofits deliver the services. In some cases, it may be more efficient for the government to fund nonprofits to carry out services rather than carry them out internally. Nonprofits might have cheaper labor costs and take advantage of economies of scale which would provide more reason for the government to partner with them. In addition, Young describes that the government would spend too much of its resources to try and meet the needs of a heterogeneous population. To gather all the information needed in order to serve the population would be too much for the government to handle. Thereupon, the government should contract out to the nonprofits that are in the community they serve. The nonprofits would be able to overcome the information problem and provide the services needed for the community. This argument for a complementary function outlines a partnership between nonprofits and government. In regard to this paper, this lens is very important because Bush's Faith-Based and Community Initiative was designed to partner with FBO's (Young, 2006, 43-45).

In the third lens of the nonprofit and government relationship Young suggests nonprofits and government as adversaries, specifically dealing with policymaking and advocacy activity. This lens represents nonprofits and government as adversaries on policy issues because the government reflects the concerns of the majority, whereas the nonprofits reflect the interests of the minorities. This leaves minority views not well reflected in government policies. But, minority groups can mobilize through interest

groups, or nonprofits, and with concentration on certain issues can have some of their concerns addressed regarding public policy. Also, as nonprofits represent the interest of minority groups, the government may decide to represent and defend the majority interest by attempting to restrict nonprofit advocacy. The government must ensure the nonprofit's trustworthiness by making sure certain principles are met. These principles might not be in the best interest of the nonprofits and would cause some unrest.² By understanding what is conflicting in the more general arena of nonprofits, as Young describes, a more in depth judgment can be made about FBO's in this paper (Young, 2006, 46-48).

Young concludes by stating that all three of these lenses can exist simultaneously and are by no means mutually exclusive. Increasingly, one factor Young suggests impacts the relationship between nonprofits and the government is the political environment. Sometimes the missions of nonprofits are different than the administration's mission. This tension between the administration and nonprofits can change their relationship for better or worse depending on the circumstances. An example of this, pertaining to this paper, deals with the George W. Bush administration and its faith-based initiative. Young states that "While it promises to expand the complementary relationship of government with religiously based social service providers, it threatens to undermine longstanding government support of nonprofit social services, leading to greater reliance on the supplementary form of nonprofit social service provision" (Young, 2006, 48-49).

² Young describes three cases on attempted restrictions on nonprofit advocacy: the Istook amendment in the 1990's, the restrictions on foundations from the 1969 Tax Act, and the provision of the Federal Housing Finance Reform Act of 2005 (Young, 2006, 47-48).

Kevin P. Kearns (2003) argues that if a small faith-based organization accepts funds from the government, the government funds could have some harmful, unintended strings attached that would consequently affect the nature of the FBO. Even though the idea of getting funds from the government is attractive, Kearns warns that the funds can eventually change the FBO's core values and mission.

Kearns depicts a fictitious case of a small faith-based organization, funded primarily by donations, but because of rising expenses is considering applying for government funds. Kearns explains three consequences of accepting government funds. First, he argues the change of the FBO from an expressive to instrumental culture. Instead of the primary mission of expressing their faith, more resources may be directed towards a more concrete mission such as providing social services to the community. This change may look like becoming more outcome-oriented as opposed to process-oriented, negotiating and compromising core values, or moving towards a public organization instead of a private organization. Next, Kearns' second proposal is that the FBO could become more professional and lose its volunteer culture. This shift within the FBO may come in the form of becoming more technocracy instead of being a theocracy, from a unified organization to an organization with specialized concepts, from individual, unique practices to organizations modeled after ideal ones, or from delivering response services to planned services. The third change deals with the FBO's management relying on cash flows instead of their faith. This new environment for the FBO may automatically attach them to the regular cycle of cash flows that come with the funds from the government. Kearns says these flows could be more troublesome than any disruption that volunteer-driven programs would bring. These flows may bring more

uncertainty to funding as government contracts aren't typically guaranteed beyond one year, form an organization that has been a catalyst in change to one that might have pressure from the government to act a certain way, or cause the FBO to become more competitive and act more business-oriented to maintain the funds from the government (Kearns, 2003).

Amy E. Black, Douglas L. Koopman, and David K. Ryden (2004) describe their point of view, based off of interviews with key figures in Washington, of the effects that government funds could have on FBO's. They describe what the relationship may do positively and negatively to particular faith-based programs within African American church communities. For a positive impact, or complimentary relationship, the argument is made that African American churches, "as the most permanent institutional presence in urban neighborhoods," are able to have the ability to build community and serve as the avenue of the social structure that neither private firms nor the government could duplicate (Black, 2004, 281). This argument states that FBO's accepting government funds would benefit from a capacity-building perspective. The fact that FBO's can build their capacity from the government funds is the perspective that Black, Koopman, and Ryden highlight as the strongest case for the initiative, putting all other disputes and controversies aside.

The relationship that FBO's and the government form can also be adversarial. Black, Koopman, and Ryden express that this formal relationship may deteriorate the FBO's integrity and independence. The FBO's mission and values, which are keys to their success, will be overshadowed and overtaken by the state. Unfortunately, the traits that the government is trying to support and empower to serve "are most likely to be

muted, dampened, and eviscerated by the process of accepting government money and acceding to whatever demands or conditions government sets” (Black, 2004, 282). For example, throughout history African American churches “have provided a forum for voices of opposition and conscience, holding society and the state to account for their disregard for the needs of black communities” (Black, 2004, 282). By accepting government funds, they argue, the voice of the African American churches might be muted for future injustices or policy shortcomings. This will hinder the mission and direction of the church’s identity, resulting as a negative impact on the organization. Although this paper won’t be looking specifically at African American churches, Black, Koopman, and Ryden raise strong arguments both for and against the relationship between FBO’s and government that will aid in discerning the pros and cons of the NLF accepting government funds (Black, 2004, 281-282).

Meredith L. McNabb (2005) addresses the issues of how the FBO’s may be selected to receive the government funds and how the FBO’s will be monitored with the funds. McNabb describes that the money designated for FBO’s is limited and the government will have to make choices as to who will receive aid among the hundreds of thousands of organizations. This limit can cause competition among all of the organizations. Some of the criteria highlighted in the competition process include “bid competition, community-wide strategy, certification (from Medicaid, HUD, ect. As a proper recipient of funds), board of directors composition, and many other program-specific definitions of factors to be considered” (McNabb, 2005, 5). Next, McNabb discusses the supervision of grantees. “As much as we all prefer an existence independent from the government, as responsible citizen-taxpayers we also all want

oversight of how the government and its contractors spend tax money” (McNabb, 2005, 23). The supervision by the government will include examining the FBO’s finances and their government-funded activities. McNabb then points out that many FBO’s may be nervous about accepting government funds, stemming from the supervision aspects and the amount of control the government has over them once they take part in the funds (McNabb, 2005, 24-26). Although this paper won’t be comparing the NLF’s success to other FBO’s or questioning whether or not the NLF should accept government funds, the competition among organizations McNabb addresses is important as the NLF will have to make changes to compete and continue to secure funds for the future.

Economic Theory:

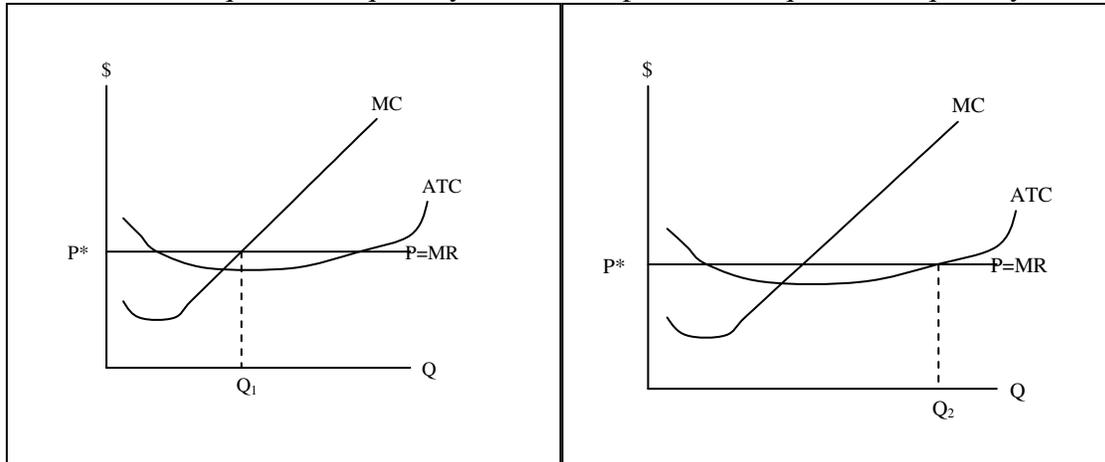
I. Accepting Government Funds

One of the unique aspects of faith-based nonprofit organizations, as well as all nonprofit organizations, is the nondistribution constraint. The nondistribution constraint means that the organization is prohibited from distributing “its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees” (Hansmann, 1980, 838). The organization is allowed, however, to put the profit into financing further production of their goods or services (Hansmann, 1980). Another unique aspect of nonprofit organizations is that they attract different kinds of managers than for-profit firms because of their different legal regulations. Studies have shown that managers in the nonprofit sector value being cheerful, forgiving, and helpful (Weisbrod, 1988, 32). “By contrast, those preferring the proprietary [for-profit] sector attached more importance to financial prosperity, ambition, neatness, obedience, and dependability . . .”

(Weisbrod, 1988, 32). These aspects of nonprofits allow them to invest their total revenue (TR) into their production of goods or services as opposed to maximizing profits for the firm. Modeled below are the equilibrium quantity outputs of a for-profit firm and a nonprofit firm.

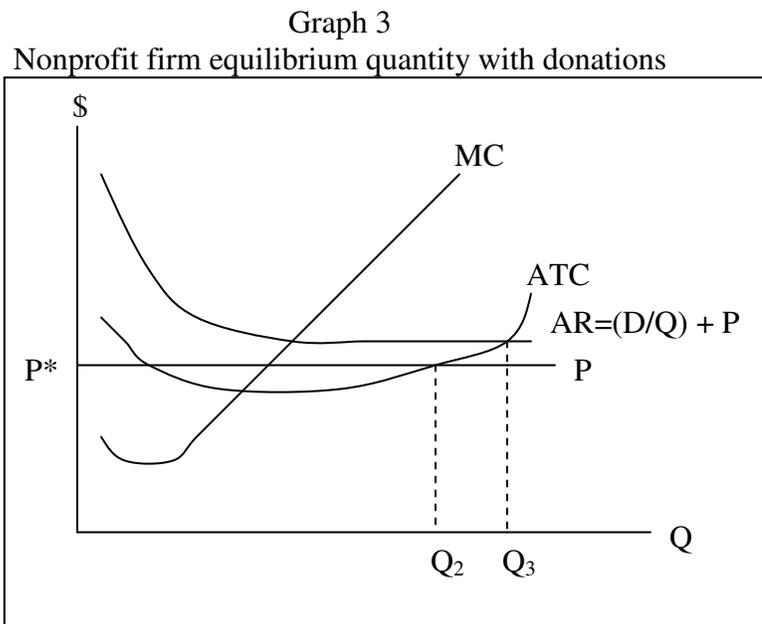
Graph 1
For-Profit firm equilibrium quantity

Graph 2
Nonprofit firm equilibrium quantity



The for-profit firm, graph 1, produces quantity where marginal revenue equals marginal cost ($MR=MC$) at Q_1 . This model has the firm operating at an economic profit where the price P^* is above the average total cost (ATC). On the other hand, a nonprofit firm, graph 2, with the exact same cost curves will produce quantity at Q_2 . Because of the unique aspects of the nonprofit firm, it's able to produce more quantity than the for-profit firm at the same price. The nondistribution constraint doesn't allow the nonprofit firm to distribute the profit, so the firm will just make sure they can cover the costs of production where $P^*=ATC$ and profit is zero. If profit equals total revenue minus total cost ($TR-TC$), then for nonprofits $TR=TC$. This equilibrium occurs at two different quantities on the nonprofit model, but because of the characteristics of the managers, who will choose to produce more quantity to benefit society, the nonprofit will produce at Q_2 .

The nondistribution constraint also provides nonprofit donors assurance that their money will go towards the organization and not into the pockets of the owners. As opposed to for-profit firms, the donors are able to trust the nonprofit organization that their donation will go towards the good or service being provided. Before the NLF accepted government funds as a result of the Faith-Based and Community Initiative, it relied heavily upon donations to operate. By being a nonprofit organization, the donors of the NLF were able to trust their money was being spent on the social and spiritual renewal of Tacoma. The NLF also received money from program fees. The model below, graph 3, shows the effect that donations have on a nonprofit organization's quantity produced.

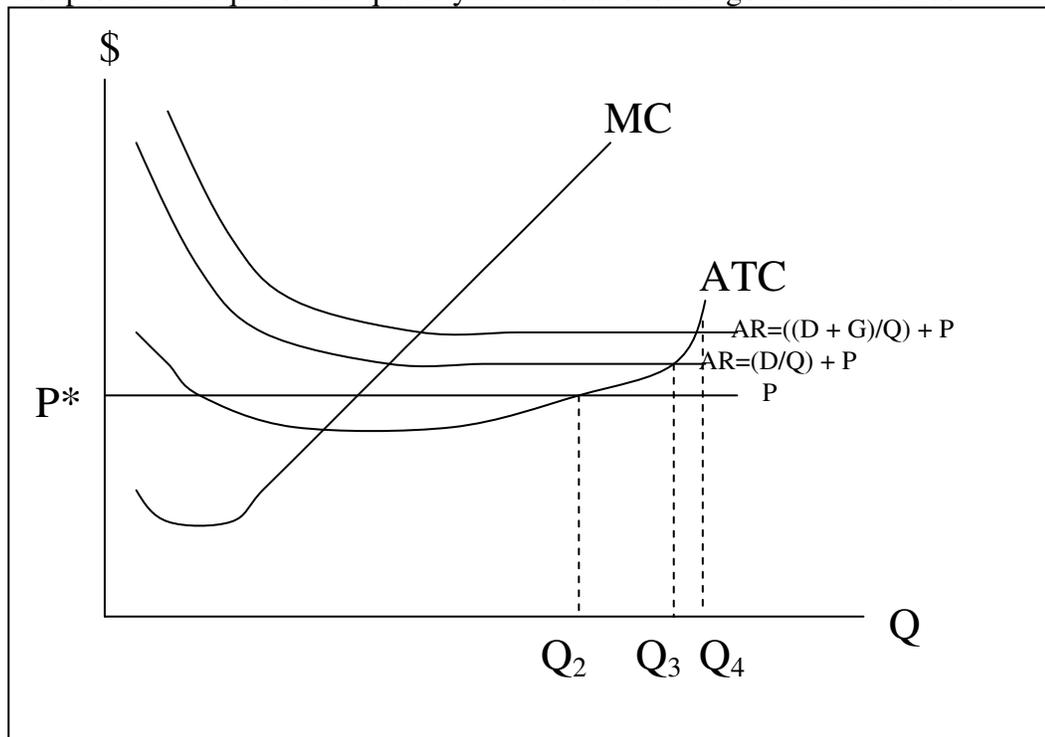


Donations are treated as fixed revenue as they are usually received as a lump sum of money. As mentioned before, the NLF will produce where $TR=TC$ and profits are zero because of the nondistribution constraint and the characteristics of the managers. Total revenue equals fixed revenue plus variable revenue ($TR=FR+VR$). Donations are

fixed revenue and variable revenue equals price times quantity ($TR=D+P(Q)$). This reduces to average revenue equals donations over quantity plus price which equals average total cost ($AR=(D/Q) + P=ATC$). Now with the donations, the NLF is able to increase their output to Q_3 . Therefore, by accepting donations, the NLF is able to produce more output than if they didn't accept donations.

The same argument is applied to why the NLF started accepting government funds; to be able to produce more output which will lead to more lives impacted and more renewal of the city. Government funds are received as a lump sum of money like donations and therefore, will be treated like donations as part of the NLF's fixed revenue as seen in graph 4.

Graph 4
Nonprofit firm equilibrium quantity with donations and government funds



With government funds, the NLF's total revenue equals donations plus government funds plus the price times quantity ($TR=D + G + P(Q)$). Then, like all nonprofits where $TR=TC$, the equation reduces as the average revenue equals donations plus government funds over quantity plus price which equals average total cost ($AR=((D + G)/Q) + P=ATC$). The increase in fixed revenue allows the NLF to produce quantity at Q_4 , given that donations and variable input remain the same.

II. Crowding Out

With the NLF accepting government funds, some donors may decide to give their money elsewhere, knowing that the NLF is being financed by the government, or some may continue to give. The following model aims to capture the preferences of donors, in the same fashion as James Konow (2006), assuming positive and diminishing marginal utility. It explains what choices donors can make when government funds are introduced.

If complete crowding out of donations were the result of accepting government funds, where all donors decide to discontinue donating, the donor's preferences would reflect pure altruism. Konow examines the relationship between two individuals using a donor and a recipient where the donor is in the position to share something with the recipient, which is money in this case. X represents the amount of money the donor chooses to keep, x represents the amount of money donated to the recipient, and e represents the recipient's money apart from any money from the donor. The utility function $U = u(X) + f(e + x)$ models a purely altruistic donor's utility function. In this model, the donor only cares about the recipient's final sum of money, not how much the

donor gave to the recipient. The donor gets utility from knowing the recipient has money and is indifferent to where that money comes from.

Next, Konow models charitable giving where donors experience a warm glow effect which was first proposed by Jim Andreoni (Konow, 2006, 6). The warm glow effect “implies that utility is a function of the gift itself, rather than of the utility or total allocation of the beneficiary” (Konow, 2006, 6). The function $U = u(X) + g(x)$ models this donor’s utility function where other donations have no impact on the donor’s contribution. Konow then formulates a utility function, $U = u(X) + f(e + x) + g(x)$, that combines both the donor’s concern for the final sum of the recipient’s money and the warm glow effect. This function reflects impure altruist’s preferences which are consistent with incomplete crowding out (Konow, 2006, 6).

Charitable giving to FBO’s will take Konow’s impure altruist function and add to it a tithing variable. Many people of faith tithe in many different forms. An example of this may look like donations made towards FBO’s. Tithing may be viewed as a requirement regardless of outside circumstances. Thus, tithing will continue even if a donor knew that outside sources were also providing resources. The function $U = u(X) + f(e + x) + g(x) + t(x)$ models the donor of a FBO who cares about the total amount of money the recipient gets, the pleasure from giving (warm glow effect), and knowing they are participating in their faith. The donors of the FBO would continue to give even if more funds, such as government funds, were contributed.

III. Allocation Decisions

As a result of accepting government funds, the donations the NLF receives may be completely crowded out, remain completely unchanged, or somewhere in between depending on the preferences of donors. Each situation will leave the NLF's revenue with some combination between government funds and donations.

Many government funds are designated for specific use whereas most donations are undesignated. Designated funds must be spent or allocated the way the provider intends them to be. For instance, if government funds were provided to the NLF to hire more mentors for a youth at risk program for a particular initiative, the NLF must spend those funds on hiring mentors for a youth at risk program in that initiative. If the government funds were to completely crowd out the NLF's undesignated donations, the government would most likely be the one making the decision on how the money is spent, resulting in the NLF losing much of its voice in how it operates. By contrast, with undesignated funds, organizations are able to spend the money as they view best. If the NLF has undesignated funds, the money could be used to hire more staff in one initiative or it could be used to purchase a car-pool van for a different initiative. Donations that remain unchanged, or not crowded out, would allow the NLF to make decisions to reach its optimal allocations among the different programs by internally reallocating funds around different initiatives to maximize its return on the budget.

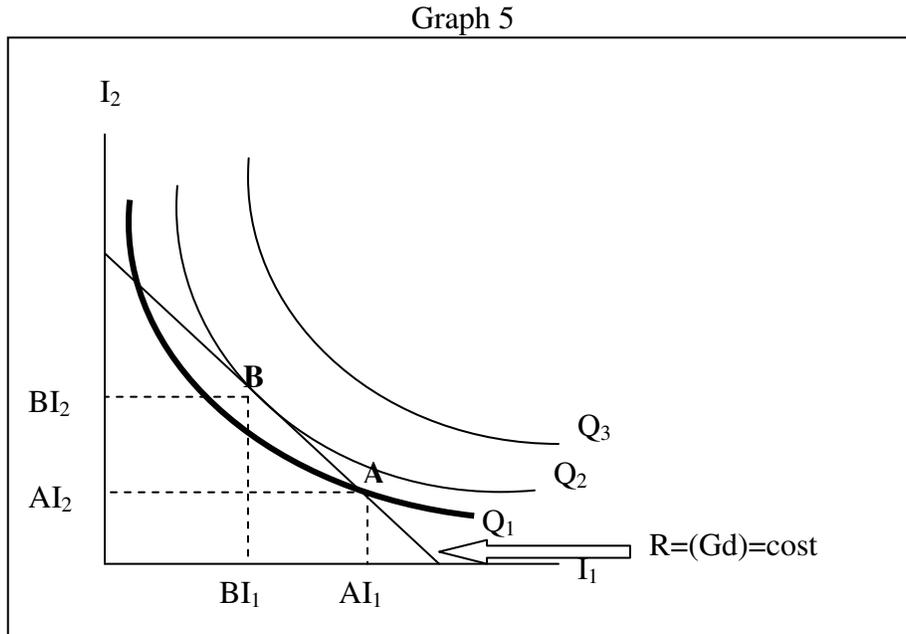
The rest of this section will discuss the decisions the NLF has, or doesn't have, to maximize the return on its budget based on its donations. In this model, it is assumed that all the government funds are designated and all donations are undesignated; these being the only two forms of revenue. The NLF does generate revenue through fees, but

because that revenue is so small in their overall budget, this model ignores its contribution in the NLF's overall budget. Furthermore, it is also assumed that the NLF knows how to best serve the community it serves. The NLF operates in the community it serves and has been doing it for almost two decades. As opposed to the government, which is an outside source, the NLF will know how to best use its resources to maximize its output. The allocation decisions of the NLF will be addressed first with complete crowding out, then donations remaining unchanged, and finally with incomplete crowding out.

III.A. Complete Crowding Out

The NLF's budget decisions are examined with the government funds completely crowding out the NLF's donations. In this case the entire budget consists of designated funds. These funds must be spent how the government originally allocated them. Even if the money isn't entirely used up, the money cannot be transferred to cover other costs. Each initiative of the NLF is allocated the amount of funds it will receive, determined by the government. According to the assumption that the government doesn't know how to maximize the NLF's output, the allocations each initiative receives will be inefficient. The allocation might not be enough or the government might over allocate. This case is modeled by the production model where the NLF is making choices on how to allocate each dollar, the inputs, between two different initiatives to minimize its costs. Although there are fourteen initiatives within the NLF, this model will examine two initiatives (I_1 and I_2). The revenue of the NLF is represented by the isocost function $R=(D_u, G_d)=Cost$, where the revenue is a combination of undesignated donations and designated

government funds. This also equals the cost to produce a certain amount of quantity. The first case has the isocost function $R=(Gd)=\text{cost}$ due to the complete crowding out displayed in graph 5.



The NLF is restricted by its cost represented by the isocost line $R=(Gd)=\text{cost}$ which represents all combinations of allocating funds between the two initiatives. The isoquant curves, Q_1 , Q_2 , and Q_3 , represent all of the combinations of allocations that produce that same amount of output respectively. All combinations along curve Q_1 produce the same quantity of Q_1 , and the same applies to curves Q_2 and Q_3 . All of the isoquant curves reflect the preferences of the NLF, which again knows how to best use its resources. The quantity produced by the NLF is a social benefit, due to the positive externalities of the social service programs. The more quantity that is produced, the more benefit there will be to society. The optimal production point and most efficient

allocation in the model occurs at the point of tangency between the isocost line and isoquant curve.

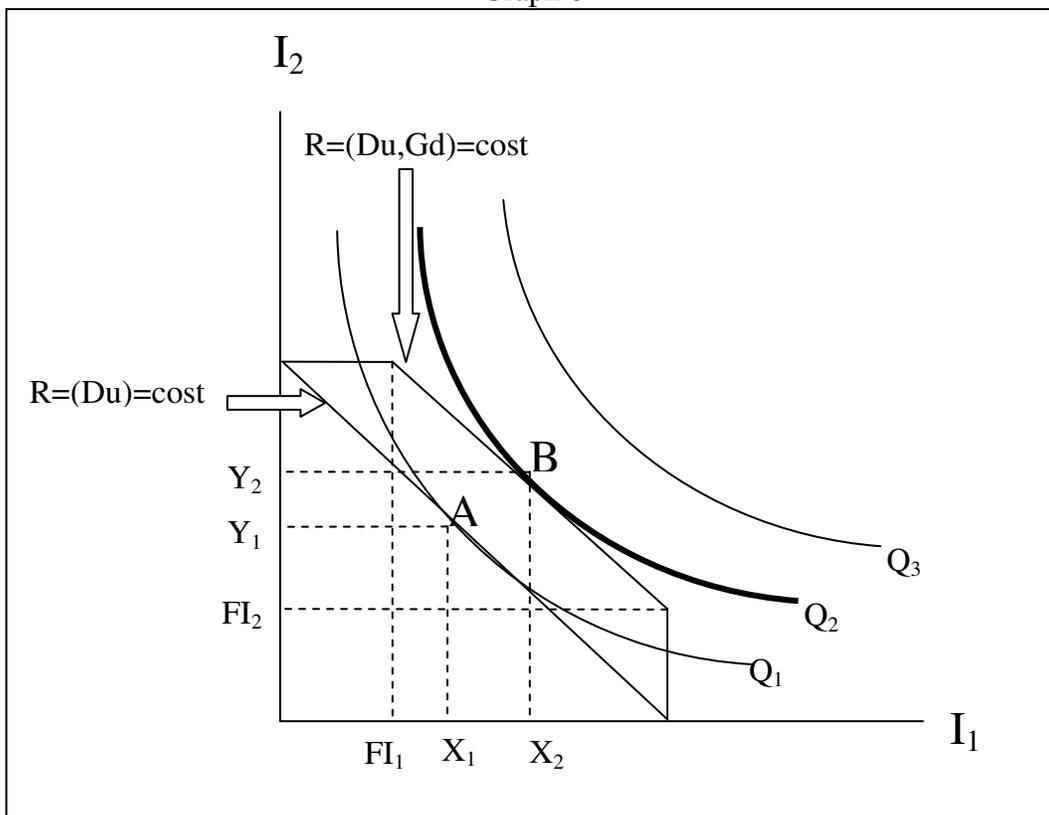
In this production model, the NLF doesn't have a choice on how to allocate funds between the initiatives as the government determines the allocations. This decision by the government is represented by the point A. At point A, where AI_1 is allocated toward I_1 and AI_2 is allocated towards I_2 , the entire budget is being spent as it is on the isocost line, but its benefit to society is not maximized. There exists another point, point B (BI_1, BI_2), where benefits to society are maximized and the isocost line and isoquant curve are tangent. Point B is producing quantity at level Q_2 , whereas point A is only producing quantity at level Q_1 . Point B is using the same resources as point A but is producing a higher quantity of output at Q_2 because it's a more efficient allocation of funds between the two initiatives. Point B reflects the NLF's preferences which are maximizing the benefit to society. Point B is unable to be achieved in this case because the funds are designated and can't be shifted around between I_1 and I_2 .

Producing output at a point that doesn't reflect NLF's best interests, such as point A, may cause some adversarial relations between the government and the NLF. The NLF wants to minimize its costs and maximize the benefit to society. Complete crowding out, as Kearns (2003) argues, would be harmful and affect the nature of a FBO. The NLF could lose much of its voice and not be able to express its mission and beliefs. The NLF's actions, by producing where it believes maximizes the benefits to society, are restricted by the regulatory capture of the government. The NLF will no longer be acting in its interest, but rather the interests of the government, causing an adversarial relationship.

III.B. Donations Remain Unchanged

The NLF's budget decisions are evaluated in the case that the government funds didn't have any impact on the NLF's donations. The NLF's revenue now consists of both the designated government funds and the undesigned donations represented by the function $R=(Du,Gd)=cost$. The designated funds must be spent how they are intended and the undesigned funds may be spent however the NLF determines. Each initiative is allocated an amount from the government, as in the previous case, but because the NLF still has all of the undesigned donations, the NLF is able to free-up funds that are now covered by the government funds. These freed-up funds are now used at the NLF's discretion. This case is modeled in graph 6.

Graph 6



The isocost line $R=(Du)=\text{cost}$ represents all the donations that remained unchanged. Then, because all the donations remained, the new isocost line $R=(Du,Gd)=\text{cost}$ represents the new revenue with government funds. The government has allocated FI_1 towards initiative I_1 and FI_2 towards initiative I_2 . The NLF must spend at least FI_1 and FI_2 towards each initiative respectively in order to comply with the government contract. The NLF has moved from point A, which represents the efficient quantity produced with just donations, to point B, which represents the efficient quantity produced with donations and government funds. The change in the amount allocated towards I_1 is X_2-X_1 and the change in the amount allocated towards I_2 is Y_2-Y_1 . Both of these changes are less than the amount the government has allocated towards each initiative of FI_1 and FI_2 . The total increase in spending is the same as the total increase in the amount of the government funds $FI_1 + FI_2$, but the increase in the allocation amount for I_1 and I_2 is less than what the government funds has allocated towards I_1 and I_2 . Because the NLF was already spending more than FI_1 and FI_2 with their donations, the NLF is able to shift around the government funds and freed-up funds and internally reallocate them at its discretion. The NLF is still meeting the requirements of spending at least FI_1 and FI_2 for I_1 and I_2 while at the same time able to reallocate some of the funds to maintain its preferences.

The quantity of production and benefit to society reflect the preferences of the NLF at point B which represents the most efficient point to produce. This relationship between the NLF and government represents a complementary partnership; the NLF is able to operate and make decisions with its budget to reflect its best interests and the government is helping to produce a higher quantity benefiting society.

III.C. Incomplete Crowded Out

The final case takes place somewhere between donations being completely crowded out and remaining unchanged. The quantity output will be greater than what is produced when donations are completely gone, but less than when donations are unchanged. Unsurprisingly, the more donors continue to give, the closer the quantity produced will reflect the NLF's interests. The fewer donors there are, the more the quantity produced will reflect the government's interests. This case, as it falls between the adversarial and complementary relationships, reflects the supplementary relationship, where the interests of the NLF are in addition to those of the government.

Results/Data:

In order to evaluate the effects the Faith-Based and Community Initiative had on the NLF in respect to government funds, the master budgets of the NLF from the 2002-2003 fiscal year will be compared to the 2007-2008 fiscal year. The creation of the Faith-Based and Community Initiative was on January 29th, 2001, but its effects on the NLF weren't realized until years later. Although the 02-03 budget is later than the creation of the Faith-Based and Community Initiative, it will serve as the basis to compare the effects of the government funds. First, despite the NLF having a small portion of its budget supplied by government funds in the 02-03 budget, this paper is evaluating the effects as more and more government funds poured in. The proportion of government funds in the NLF's budget from the 02-03 budget to the 07-08 budget dramatically increased as the NLF accepted more funds. Second, the NLF was only able

to provide its master budget as far back as the 02-03 fiscal year, which is an interesting note in itself discussed later. Therefore, the 02-03 budget will successfully serve as a basis for how the NLF operated and allocated its funds when nearly all of its revenue was generated outside government funds.

The master budgets of the 02-03 and 07-08 fiscal years were obtained from the NLF. Both master budgets include sources of income, an account of all expenses, and the budgets by initiatives, which are displayed throughout tables 1-5.³ Equally important, in order to add respected perspectives to the results, interviews with Patricia Talton, the President of the NLF, and Dave Hillis, former President of the NLF who helped establish the NLF and now the President of the Leadership Foundations of America, will be intertwined alongside the data.

The following layout of the results will begin with a discussion of the overall growth of the NLF from the 02-03 fiscal year to the 07-08 fiscal year. This will focus mainly on the government funds that were accepted. Next, the donations the NLF received will be examined to determine the impact the government funds had on them. The donations will be broken down from their specific source to gain a more in-depth understanding of which sources were impacted the most by the government funds. Then, the allocation decisions the NLF made from the addition of the government funds to its revenue will be determined in detail to shine light upon the type of relationship between the NLF and government.

³ The budget numbers are not in real terms.

I. Overall Growth

Table 1

| Year | Total Income | Gov't Funds | % of Income |
|-------------------|---------------------|--------------------|--------------------|
| 02-03 fiscal year | \$1,411,249 | \$210,458 | 15% |
| 07-08 fiscal year | \$3,877,244 | \$1,951,105 | 50% |

*percentages are rounded

Source: (NLF Master Budget, 02-03 and 07-08)

During the five years from the 02-03 budget to the 07-08 budget, the NLF's income grew by \$2,465,995 as shown in table 1. This is over two and a half times the amount in 02-03. The government funds grew by \$1,740,647 which is just over nine times the amount of government funds in 02-03. It is clear that accepting government funds increased the capacity of the NLF and allowed it to operate on a bigger scale. The NLF experienced overall growth by accepting government funds and was able to produce more output than if government funds weren't sought after, which supports a complementary relationship. However, instead of just 15% of the budget coming from the government in the 02-03 budget, the 07-08 budget is 50% government funds.

II. Donations: Incomplete Crowding Out

Table 2
02-03 Donations

| Donation Source | Amount of Donation | % of Income |
|------------------------|---------------------------|--------------------|
| Individuals | \$141,047 | 10% |
| Church | \$42,502 | 3% |
| Company | \$7,085 | 0.50% |
| Foundation | \$864,288 | 61% |
| Total | \$1,054,922 | 75% |

Source: (NLF Master Budget, 02-03)

Table 3
07-08 Donations

| Donation Source | Amount of Donation | % of Income |
|------------------------|---------------------------|--------------------|
| Individuals | \$424,968 | 11% |
| Church | \$62,812 | 2% |
| Company | \$42,500 | 2.00% |
| Foundation | \$882,000 | 23% |
| Total | \$1,412,280 | 36% |

Source: (NLF Master Budget, 07-08)

As seen in tables 2 and 3, the NLF received donations from four major categories: individuals, churches, companies, and foundations, where foundations are the NLF's strongest contributor. Overall, the total amount of donations increased by \$357,358 which is a 34% growth over the five years. Observably, the donations were not completely crowded out. Yet, it is unclear whether donations remained completely unchanged. From the data it appears that individuals, churches, and companies all remained about the same percentage of income over the five year period. The NLF was able to maintain a majority of donations from individuals, churches, and companies, which is consistent with the tithing and warm glow variables from the utility function modeling donors of FBO's in $U = u(X) + f(e + x) + g(x) + t(x)$. Maintaining these funds, however, was a tough fight according to Hillis. Many donors, specifically the ones who had been with the NLF for a long time, felt that the NLF got off track regarding its

mission. Hillis recounts numerous conversations with donors trying to educate them about the transition into the public and how they were still “unapologetically a Christian organization” (Hillis, 2008).

Foundations, however, seemed to have been impacted the most by the government funds as they went from 61% of the income to 23% of the income. Donations from foundations only increased by 2% over the five year period whereas donations from individuals more than tripled (increasing 301%), donations from churches grew by 48%, and donations from companies increased nearly six times (increasing 599%). Hillis recalls one foundation in particular that cut funding partly because of crowding out, but mainly due to that fact that the NLF didn’t feel Christian anymore. The foundation was uncomfortable continuing funding because they believed the NLF couldn’t continue their faith mission with government funds (Hillis, 2008). This consequence parallels what Black, Koopman, and Ryden (2004) described as the FBO losing integrity by accepting government funds.

Another explanation of why donations from foundations were impacted the most is that they were more aware of the government’s activities. Individuals, churches, and companies may not be aware of the amount of government funds the NLF received. On the other hand, because foundations are in the business of giving money away, they may be more aware of the other sources of money that organizations receive (Garrett, 2007). Whether donations from foundations were cut due to crowding out, a foundation being uncomfortable with government funds, or foundation’s awareness, losing funds from foundations was a negative effect from accepting government funds. This negative effect emphasizes an adversarial relationship.

III. Allocation Decisions of Resources

Table 4

| Year | # of Initiatives | Amount to Allocate | % of Total Income | % of Gov't Funds in Allocation |
|-------------------|-------------------------|---------------------------|--------------------------|---------------------------------------|
| 02-03 fiscal year | 15 | \$1,273,974 | 90% | 17% |
| 07-08 fiscal year | 14 | \$2,974,645 | 77% | 66% |

Source: (NLF Master Budget, 02-03 and 07-08)

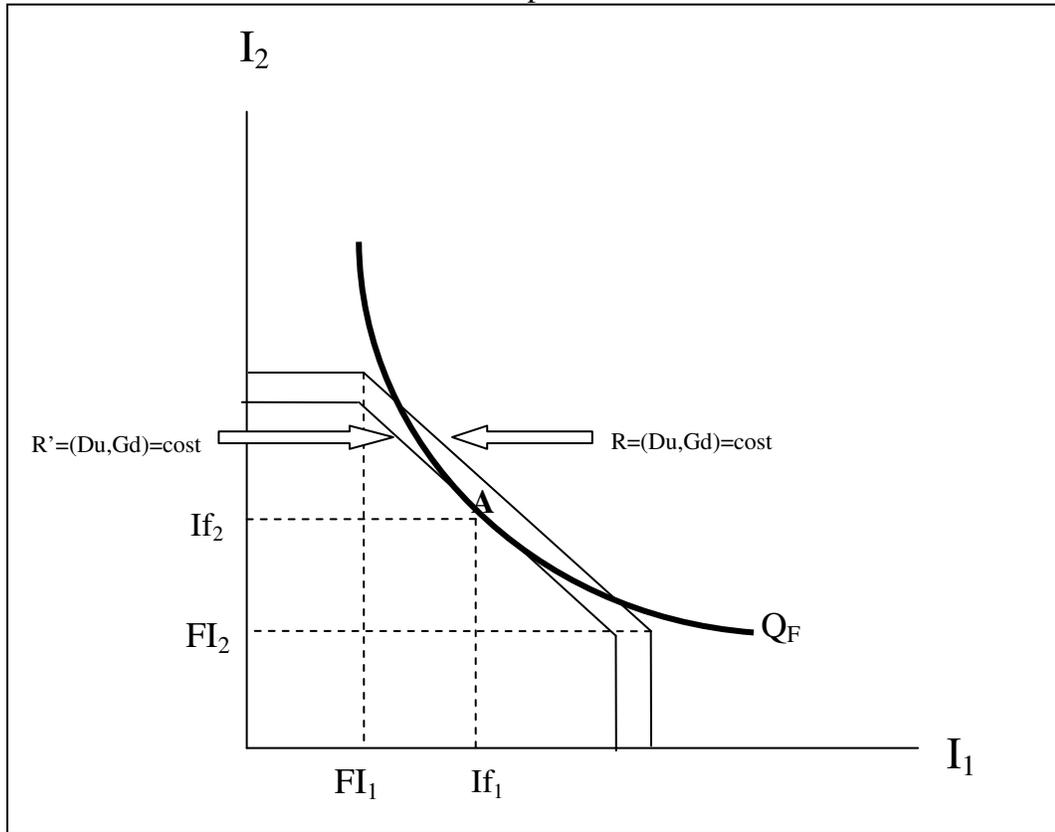
The NLF's budget increase from government funds yielded allocation money among the initiatives that consisted mainly of designated government funds. From table 4, the percentage of government funds allocated towards initiatives grew by 49%, from 17% in the 02-03 budget to 66% in the 07-08 budget. Also, donations from foundations, the NLF's largest donor source, experienced incomplete crowding out. In relation to the model in the previous section, the NLF and government relationship should be one of conflicting interests where the resources won't be allocated efficiently to execute the NLF's mission. The more designated government funds, the more the allocation decisions reflect the government's interests. The quantity produced won't fit the NLF's preferences.

Despite the percentage of government funds allocated towards initiatives, the relationship of the NLF and the government has been a partnership since the NLF started accepting government funds according to Talton and Hillis. The designated government funds in the NLF budget actually fit the NLF's preferences. The NLF's mission has remained unchanged throughout the years and the NLF has been able to keep all of its faith principles (Talton and Hillis, 2008). The NLF doesn't shy away from the government. As Talton describes, "Our mission is that we think we absolutely have to

hold hands with those of faith and those of good will for the social and spiritual renewal of the city. Both the religious context and secular context will transform the city together” (Talton, 2008). In addition, even though initiatives allocated money on the 02-03 and 07-08 budget have come and gone, not one initiative was established as a result of government funds (Talton and Hillis, 2008). As Young (2006) discussed with nonprofits, this relationship would be complementary; the NLF and government working together.

The allocation of funds of the NLF is a unique, favorable situation. Talton agrees the NLF is fortunate the initiatives aligned with the government funds, which isn't very typical for FBO's (Talton, 2008). However, there were allocation decisions with undesignated funds that provided the NLF with the opportunity to be in this position. In order for the NLF to be able to continue its mission and operate with a majority of its funds coming from the government, decisions were made about allocating its available resources. In the 02-03 budget, 90% of the budget was allocated towards the initiatives whereas in the 07-08 budget, only 77% of the budget was allocated towards the initiatives. This means that there was a 13% change in the amount of the budget which was allocated towards other aspects within the NLF. The aspects that were allocated resources, to help the NLF maintain its mission and operate efficiently with government funds, were becoming more professional, staying competitive, and complying with government regulations.

Graph 7



Graph 7 depicts the decision the NLF made to reallocate some of its revenue towards other aspects. The isocost line $R=(Du,Gd)=cost$ represents all of the revenue going towards the initiatives whereas the isocost line $R'=(Du,Gd)=cost$ represents the NLF's decision to reduce the amount of the revenue going towards the initiatives. The difference between R and R' signifies the funds that were directed towards becoming more professional, competitive, and complying. The required amount of spending by the government on each initiative is still fulfilled and the NLF is able to produce an efficient outcome at point $A(I_{f1}, I_{f2})$ which reflects its preferences.

Kearns (2003) proposed that a FBO will become more professional and lose its volunteer culture if it were to accept government funds, which he described as a negative impact. The NLF has become more professional as a result of undertaking government

funds, but on the contrary, has experienced a positive impact. Hillis describes one by-product of the transition of accepting government funds “required a higher level of sophistication from the NLF in terms of accounting systems, tracking progress, and an overall maturity level” (Hillis, 2008). Some examples of the higher level of sophistication are shown in table 5.

Table 5

| Year | % of Income Allocated towards meetings/training | % of Income Allocated towards management |
|-------------------|--|---|
| 02-03 fiscal year | 0.70% | 0.40% |
| 07-08 fiscal year | 3.10% | 10% |

Source: (NLF Master Budget, 02-03 and 07-08)

Both the percentage of income towards meetings/training and management increased from the 02-03 to 07-08 budget. The percentage of money allocated towards management experienced the greatest increase from 0.4% to 10%. Another example of the NLF becoming more professional, mentioned earlier, is the fact that the budgets before the Faith-Based and Community Initiative weren't available, but shortly thereafter were available. This suggests the NLF adapted more professional and organizational characteristics within their budget tracking. Some positive impacts of this transition include the fact that the NLF was able to demonstrate more clearly to individuals, churches, and companies that were contemplating to donate or not, the impact NLF has on the city. By having a better understanding of what the NLF does, through examples such as tracking progress of growth or expenses, donors will be more likely to donate to the cause (Hillis, 2008). Also, when applying for particular government funds that would benefit the NLF, being able to communicate clearly to the government the need for those funds, again through tracking progress of growth or expenses, increased the NLF's chance of securing the funds.

Becoming more professional also aided the NLF in staying competitive against other nonprofits competing for the same government funds. The NLF must not only apply for government funds, it must reapply for them as contracts usually expire within one to three years. In order to successfully secure the funds from the government, many resources were directed towards maintaining the government funds. Time, staff, and collecting data all go into the process of being competitive and getting the government funds (Talton, 2008). McNabb (2005) argued that this would be a consequence of government funds becoming available to FBO's and fortunately for the NLF, it was able to compete and secure beneficial government funds. With this object in mind, the NLF was able to go after government funds that fit its mission. By being competitive and professional, the likeliness of the NLF getting the government funds that align with its preferences was stronger than other nonprofits.

Equally important in obtaining government funds that adhere to the NLF's mission is the fact that the NLF complied with all of the government's regulations. McNabb (2005) stressed that many FBO's may be nervous about accepting government funds because of the regulations attached. The NLF, however, didn't shy away from the government and by directing resources towards meeting the government's policies, the NLF was able to put itself in a better position to secure more government funds (Hillis, 2008). Passing audits, using designated funds correctly, and tracking progress all allowed the NLF to continue to apply for government funds. The more the NLF met the demands of the government, the better the reason the government had to continue to support them. By being in a better position to secure government funds, the chances of the NLF landing government funds that fit its preferences increased.

Based on the impact the government funds had on the NLF in reference to the lack of support from foundations and the budget made up of a majority of government funds, the NLF and government should have conflicting interests where the quantity produced would neither be maximized to benefit society nor be reflecting the NLF's preferences. Rather, the NLF and government are a "hand and glove fit" (Hillis, 2008). The NLF was able to allocate resources towards becoming more professional, staying competitive, and complying with the purpose in mind to gain government funds that align with the NLF's mission. This blended the difference between designated and undesignated funds which reduced the cost of losing support from foundations while making the government funds more attractive.

Conclusion:

The impact of accepting government funds for the NLF was one that supported a complementary relationship, or partnership. This paper developed models to address why the NLF accepted government funds, what happened to donations when government funds were introduced, and the relationship between designated and undesignated funds. Then the NLF's 02-03 fiscal year budget and the 07-08 fiscal year budget were juxtaposed to evaluate the impact of government funds. The conclusions were made that the NLF experienced incomplete crowding out and operated with a budget that was made up with a majority of government funds. Based off of the interviews from the leadership of the NLF, which previous worked lacked, and the data, the NLF made choices to direct resources towards becoming more professional, staying competitive, and complying with government regulations. As a result, the NLF was able to get

government funds that aligned with the interests of NLF's mission. The designated government funds served the same purpose as the undesignated donations, blending the distinction between the two types of funds. All of these impacts have increased the NLF's capacity and landed the resources the NLF needs to execute its mission of the social and spiritual renewal of the city (Hillis, 2008).

Some weaknesses of this paper include the difficulty in specifically comparing the budgets in categories as the 07-08 budget was more detailed. Another concern would be that there weren't any opinions on the relationship captured from the government's perspective. A suggestion for future research would be the impact of the recent decline in the economy on donations for FBO's. Also, it would be interesting to research the impact of the economy on the government's supply of funds for nonprofits.

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