

Mapping Out Economics of Non Profit Sector in Turkish Context

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Abstract

At the course of 1970s, non-profit sector – that became a significant entity in nation's economic activity particularly in delivery of public/welfare services- started to attract attentions of economists whom have been trying to understand the emergence of these organizations relying on economic notions. To date, plethora of arguments has been put forward by them inspiring from demand and supply side analysis as well as institutional approaches. Donor motivations, customer attitudes and preferences of entrepreneurs can be stated as the backbone of these aforementioned theoretical explanations. In this paper, firstly, non-profit organizations will be defined and elucidated in economic senses, besides NP sector will be examined concerning microeconomic approaches that articulate the emergence of it. This analysis will be exercised relying on three reference points consisted of demand and supply-side theories in addition to the institutional differences approach. Secondly, Turkish NP sector will be mapped out regarding to three fundamental sections: a) historical background, b) legal framework and taxation, c) their role in provision of public services.

Keywords: *Public Economics, Provision of Public Services, Non-Profit Sector, NPOs, Turkey*

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Introduction

Since the beginning of 1980s, thanks to profound boom of neo-liberal policies, idea of welfare state as well as provisions of public/welfare services by governments have been questioned and re-examined. In recent years, many researchers -even ardent supporters of welfare state models- have finally acknowledged the fact that welfare provision of governments account for remarkable part of government expenditures which threaten the fiscal structure of countries in an alarming way (Anderson 2002, Barr 1998). Eventually, policy-makers in US and EU countries tended to support new mechanisms which have potential capabilities to take over some of the responsibilities of governments in terms of public services provision. These new mechanisms can be enumerated as local authorities, non-profit (NP hereafter) sector and free market system through privatization.

Apart from local government bodies and private companies, NP sector have gained great importance due to their non-governmental structure encompassing less bureaucracy as well as lack of profit motive which makes customers feel secure about the quality of good and/or service provided. The numerical increase in NP entities had an impact on academic environment and accordingly loads of papers have been published in the last three decades. In this paper, firstly, non-profit organizations (NPOs hereafter) will be defined as well as NP sector will be examined concerning economics-oriented theories that articulate the emergence of it. This analysis will be exercised relying on three reference points consisted of demand and supply-side theories in addition to the institutional differences approach. Secondly, Turkish NP sector will be mapped out under three sections: a) historical background, b) legal framework and taxation, c) their role in provision of public services.

What Makes An Organization Non-profit?

Studies indicate that non-profit organizations (NPOs) have been significant actors in nation's economic activity particularly in delivery of public/ welfare services due to not only their increase quantitatively but also their influence over to the societies for decades (Rose-Ackerman 1996, Glaeser and Shleifer 2001). Since the emergence of non-profit sector, NPOs have been operating across the wide range of public services comprising health care, education, research, the media and the arts (Hansmann, 1980). Whilst the visibility of these organizations extended among the citizens and governments, the scientific inquiry and research have boosted so as to define and analyse this particular sector and the entities residing in it.

At the beginning of 1970s, in the literature of non-profit economy, first and foremost question among the researchers was that 'what sort of features or motivations should an organization have in order to be counted under the rubric of non-profit sector', in other words 'what makes an organization non-profit'. Hansmann (1980) argued that 'the critical characteristic of a non profit firm is that it is barred from distributing any profits it earns to persons who exercise control over the firm.' It must be stressed here that "nondistribution constraint" (hereafter NDC) doesn't imply that NPOs are blocked to earn profits; on the contrary many of them actually have positive balances in their accounts, the crucial aspect of NPOs is the prohibition on the distribution of their net earnings or residuals.

Although, Hansmann's definition of NPOs is fairly satisfactory for the first step, it raises the question of ownership in some circumstances and remains obscure in his masterpiece. For instance in the case of termination of organization, what will happen to its assets? NDC entails that if a NPO terminates because of any reason, its assets can't be shared and possessed by the people who are exercising control over the organization. Therefore from a very logical way, the assets of a terminated organization can be passed on to another NPO which has similar aims and objectives (Bennett et al. 2003). Even this devolvement process seems to be legal and logical with respect to the notion of no-residual claims, decision-making process for choosing the appropriate NPO preserves its obscurity and is still open to the academic discussion.

In addition to the Hansmann's formulation of NPOs in economic terms, many national and global institutions have constituted their own definitions. In the System of National Accounts (SNA) which is a department under United Nations (UN), defines NP sector with respect to its sources of income. To this definition, NPOs are the organizations which receive their income by and large from the contributions of their members and supporters in lieu of sale of their goods and services (United Nations, 1993:95). In the US, definition of NPOs under federal tax law is quite broad, however these sorts of institutions are being counted under the rubric of tax-exempt organizations referring to the 501 (c) of the International Revenue Code (Salamon, 1997). Unlike US, boundaries of NP sector are poorly defined and its role in the economy and society underestimated in United Kingdom. In England and Wales, practically, Charity Commission has the legal right and power to decide whether that particular organization is charitable or not (Kendall and Knapp, 1997). That is to say, in UK, being a NP or not in legal terms is highly contingent upon the Charity Commission's practices.

Since the discussions started around the non-profit sector, not only researchers in economics but many political scientists and sociologists such as Laster Salamon and

Halmut Anheier have contemplated on this subject rigorously. The Comparative Non-Profit Sector Project in John Hopkins University which has been led by the mentioned researchers has accumulated a momentous literature which predominantly consists of empirical works to be carried out different countries around the world. According to this cross-national analysis, it's quite hard to point out a monolithic definition of non-profit sector which varies incredibly among countries (Salamon and Anheier, 1997).

Salamon and Anheier (1997) summed up all these various kinds of definitions in to four pillars including legal, economic/financial, functional and structural-operational. Whereas legal definition refers to the country's own law, economic/financial one is developed with respect to the NPOs' sources of income. Financial illustration of NP sector linked to the purposes of organization such as public interest/purpose. Last category, structural-operational definition doesn't take into account either the purposes of the organizations or its sources of income, but their structures. According to this way of description, an organization can be named as NP if it has five structural features comprising organized, private, non-profit distributing, self-governing and voluntary.

As it can be interpreted easily, forming a unique definition for NPOs existing all around the world is hardly difficult. To Salamon and Anheier (1997), there are two essential reasons that preclude researchers to create unique definition for non-profit or third sector. One of them is that plethora of organizations are summed up in this sector such as soup kitchens, environmental groups and symphony orchestras. Secondly, the other major sectors-public and for-profit- wield tremendous power influencing modern societies, consequently non-profit sector can't be grasped or seen as a concrete and separate sector.

Economic Theories on Non Profit Sector

Demand Side Theories

Literature around the non-profit sector has been enriched by the publications on motivations and driving forces behind the rapid and recent emergence of NPOs. Rose- Ackerman (1996) pointed out three possibilities that seem to be significant for elucidating the motives behind the demand-side dimension of this emergence. First one of her arguments is donors' willingness to donate only to non-profit organizations in lieu of for-profit ones due to their fear about for-profit firms' profit-maximization attitudes. Secondly, asymmetric information in some sectors (mostly in health care) leads customers to prefer non-profit institutions because they believe that NPOs

have less incentive to deceive them owing to lack of profit motivation. Third and the last assumption is that NPOs have a capacity to deliver a more diverse collection of services when they are contrasted with their public sector competitors.

The second assumption of Rose-Ackerman can be discussed in much broader way with respect to the current literature. Arrow (1963) put forward that due to asymmetric information between patients and health care providers, non-profit hospitals might be preferred by customers in place of their for-profit counterparts. In addition to the health care sector, Krashinsky and Nelson (1973) figured out that parents are inclined to select non-profit day care centres because of the fact that lack of proper judgement over to the services provided by them lead parents to the sector spreading more trustworthy signals. Although NPOs are expected not to exploit asymmetric information, some NPOs' management may prefer to take advantage of customers' insufficient information mostly in rival products (not for the non-rival ones) in order to subsidize other activities and/or consumers (Ben-Ner, 2003).

Even though asymmetric information's role in the literature of non-profit sector was discussed among the researchers during 1970s; this concept was animated by Hansmann (1980) under the theory of "contract failure". The main argument in the essence of contract failure theory –which is linked to the first assumption proposed by Rose-Ackerman- implies that non-profit organizations are more reliable than for-profit firms due to lack of profit maximization motive that is good for customers when asymmetric information exists in the market of that particular good or service. In the literature of microeconomics, this type of good/service is called "experience good" that can be identified as contracts for exchange of it are incomplete and sellers are tended to shade its quality (Huck and Tyran, 2007). Huck and Tyran (2007) argue that consumers may buy the experience good when they trust sellers not to lessen the quality of good and abstain if they think the seller does this. In the market of experience goods, contract failure theory suggests that NPOs are more advantageous than their counterparts due to lower profit incentives to make sure consumers not to be deceived.

Another type of market failures revealing the role of NPOs in provision of welfare/public services can be addressed as public goods theory. Weisbrod (1977) stated that NPOs can be claimed as private suppliers of public goods which are being served by governments according to the demands/tastes of median voters. That is to say, to Weisbrod (1997), NPOs can play a gap-filling role in terms of providing services to the people who have greater tastes than median voters and accordingly are unsatisfied by the provisions of government. Number of these unsatisfied

consumers is being influenced by the diversity in societies leading to heterogeneity in the tastes which makes decision-making in the provision of collective goods reasonably knotty (James, 1987). Therefore, the role of satisfying these consumers falls to the NPOs that have more flexible structures than public equivalents. The point that must be taken into consideration related to Weisbrod's arguments is lack of illuminating arguments which clarify the emergence and existence of commercial NPOs that are vastly motivated by private goods not the public ones.

Supply Side Theories

It's quite obvious that explanation of the existence of NP sector in the market economies can't be reduced merely to demand-side approaches. In the following paragraphs, supply-side explanations of NPOs will be examined under three headings consisting of entrepreneurship theory, subsidies and consumer control theory.

In their paper, after Glaeser and Shleifer (2001) pointed out that many NPOs are established by entrepreneurs, they developed a model to draw the attentions to this particular question 'why an entrepreneur wishes to start a not-for-profit rather than a for-profit firm'? This model demonstrated that if goods with non-contractible quality are not valued by consumers, the market of those goods would be dominated by for-profit firms; otherwise non-profit firms will dominate the market where consumer is very sensitive to value the quality of the goods (Glaeser and Shleifer, 2003).

Although, in many researches, altruistic motivations are admitted as the influential factor to set up an NPO, Glaeser and Shleifer's entrepreneur model reveal the fact that in markets where ex post expropriation is a threat for both customers and donors like child care, hospitals and schools; even self-interested entrepreneurs seek to set up a NPO since they believe that soft incentives in non-profit sector assure customers to be protected from ex post expropriation consequently lead them to opt NPOs as their suppliers. While in some papers softer incentives are assessed as the reason for inefficiencies in non-profit sector, in the mentioned paper Glaeser and Shleifer (2001) count them as the comparative advantage of NPOs on which their existence/survival is highly dependent.

Glaeser and Shleifer (2001) indicated that non-profit economy requires non-profit entrepreneurs whom might be influenced either by altruistic motivations or self-interest. According to the Austrian school this non-profit entrepreneur can be defined as 'actor who discovers an opportunity and initiates a new venture, which is embedded in the nonmarket economy' (Frank, 2002). In addition to the Glaeser and Shleifer's arguments on softer incentives in the markets where ex post expropriation

is a threat for customers, Bilodeau and Slivinski (1998) stated that if an entrepreneur has an intrinsic motivation for contributing to public good provision and would also receive voluntary donations from outside, than his/her interest entails founding NPO.

Another aspect of supply-side explanations is subsidies that are given to NPOs in a variety of sectors in which both public and for-profit sectors operate. Fama and Jensen (1983) asserted that proliferation of NPOs is extremely correlated with the received subsidies. It can't be just a coincidence that number of NPOs is increasing rapidly in the sectors where different forms of tax-exemption status have been introduced. In his empirical study using cross-section data (state by state), Hansmann (1985) examined four industries in which for-profit firms and NPOs compete to each other. In that econometric model with the market share of non-profit firms as dependent variable, one of the significant variables in the model is income tax exemptions which were theoretically expected.

As one of the pillars under supply-side theories, consumer control theory suggests that motive behind establishing non-profit firm is sometimes linked to assure patron control over the enterprise like social or country clubs. In these organizations, club members as a group have an incentive to avoid exploitations when owner of a club enjoys monopolistic price in the market with lack of sufficient number of competing firms (Hansmann, 1997). In those particular markets, customers endeavour to exercise control over to the organization in which they can secure their demands and preferences with a non-monopolistic price. In a much comprehensive approach, Ben-Ner (1986) declares that not only special form of NPOs but also most of them are founded with the aim of providing consumers direct control over the firm which they're dealing with.

Institutional Differences

Not only consumers but also suppliers have preferences and priorities among institutional forms including private, public and NP sector in relation to the provision of public services. Weisbrod (1988) argues that as long as regulation of NPOs is easier than regulation of outputs, production process and distribution of it carried out by public institutions in production of collective goods, than NPOs become more attractive to provide that particular fragment of public service provision. Moreover, heterogenous demands among the collective goods –as was discussed in demand-side theories section- cause an institutional bifurcation between NP and public sector. That is to say, whilst public sector is more preferable in the markets where consumers have homogenous demand, heterogeneous demands

of society in particular sectors necessitates NP sector for meeting the needs of this sort of consumer choice (Weisbrod, 1988).

Until now, one of the components of the comparison between NPOs and governments is contingent upon the notion of cost-effectiveness of service provisions. This notion stresses the reality that means of income redistribution *per se* encompass both production and distribution costs. That is to say, if an institution is formed for redistribution, that institution would have administrative/bureaucratic costs in order to go on its operations. Arthur Okun (1975) clarifies this argument with “Leaky-Bucket” experiment: “However, the program (for income redistribution) has an unsolved technological problem: the money must be carried from the rich to poor in a leaky bucket. Some of it will simply disappear in transit, so the poor will not receive all the money that is taken from the rich”. Advocates of NPOs to supply welfare/public services are mostly triggered off this cost-effective structure of NPOs (Robinson 1997, Clark 1997). Estelle James (1990) proposed that thanks to less bureaucracy, lower staff salaries and reliance on volunteers, NPOs can offer more effective service delivery via reducing the cost of it. However, these arguments aren’t elucidating the obscurity on quality levels of cost-reduced products or services.

Up to this point in this section, institutional differentiation between NP and public sector has been discussed. From this moment onwards, in what senses and degree NP sector is distinguished from for-profit counterparts will be illuminated. Pauly (1987) put forward the argument that NPOs have three main institutional differences if they’re compared with for-profit firms: a) For acquiring initial capital, NPOs do need donations, b) Non-distribution of the residual earnings to the people inside c) Assets of them can’t be liquidated so as to promote firms’ owners. On the other hand, as Phelps (2003) figured out for-profit firms have fundamental advantages *vis a vis* NPOs especially in terms of raising capital rapidly, separation of ownership from control and limited liability to shareholders providing lower cost of capital.

Non Profit Sector in Turkey

Non-profit sector in Turkey encompasses a myriad of organizations which have different managerial structures, sources of revenues and relationship with public and private sectors. Yet, these various organizations in Turkey are being classified under the rubrics of foundations and associations in legal lexicon (TUSEV Report, 2006). This report indicates that whilst the number of active

associations is 71240, 4367 foundations exist in Turkish non-profit sector. While associations are being supervised and directed by Department of Associations under the Ministry of Interior, foundations are structured and controlled under General Directorate for Foundations.

In recent years –as in the other parts of the world- the pace of setting up NPOs has accelerated remarkably in Turkey. According to the current statistics (Department of Associations, 2009) whereas the number of associations raised almost 40%, there is a 50% increase in their members in the last decade (Figure 1 and Figure 2 respectively). This dramatic change can't be observed for foundations in Turkey due to the fact that their establishment procedures are more complicated than associations; therefore Turkish citizens' institutional choice shows a tendency over to the associations. However, new legislative changes in the current codes linked to the foundations are expected to be relatively influential for enhancing these institutions' status both quantitatively and qualitatively (Bikmen, 2006). Although foundations seem to be quantitatively insignificant in a comparison with the associations, they're quite influential in higher education and health sectors. To give an example, nearly 40 foundation-based universities are operating in the sector with the public competitors, and most of them have their own medical institutions (Department of Higher Education, 2010).

With respect to the Salamon and Anheier's taxonomy (1997), one can argue that NPOs in Turkey are generally recognized and identified both by government authorities and their own founders in relation to the category of legal definition. Turkish government's application for the termination cases might be seen as quite patriarchal: whilst the assets of terminated associations are conveyed to the Treasury, foundations' assets are devolved to the General Directorate for Foundations (Code No: 5072/3).

Current studies point out the fact that Turkish people are more sensitive at donating and public giving because of their religious background which insistently recommends helping indigent humans (TUSEV Report, 2006); therefore their intentions to attend voluntarily organizations for assisting to needy citizens are worth mentioning. According to research taken by TUSEV, the revenue resources of foundations are mostly consisting of donations (57%) which are composed of individual and company donations. Whilst 75% of donations to the foundations are obtained from individual giving, companies' grants correspond to the 17% of them. In the mentioned report, researchers figured out that top three preferred motivations behind voluntary donations are helping needy, education and assisting handicapped.

History of NP Sector in Turkey

Most of the voluntary associations in Turkey were established in a strong connection with Ottoman foundation system which is called *wakfs* (foundations). These *wakfs* were extremely influential figures for affording the deficiencies of underprivileged persons as well as localized institutions which held nearly 15% of the whole budget in Ottoman era (Zaim, 1987). Cizakca (2006) argues that “Indeed, throughout Islamic history foundations organized and financed schools, universities, hospitals and public kitchens as well as innumerable other services that contribute to economic development”.

Aydin (2006) defines foundation as an institution of property which has eight basic properties:

1. Property
2. Meaningful and continuous institutional structure,
3. Private, and not part of the public system,
4. Self-managing, with the authority to make and implement decisions freely,
5. Not profit distributing,
6. Reliant on the principle of voluntary service,
7. Supportive of public goals,

8. Not dependent on the principle of membership (as is the case with associations). During the 18th century, nearly 20000 foundations were operating within the boundaries of Ottoman Empire (Yediyildiz, 1988), yet only 5859 of them were inherited by new Turkish Republic (Aydin, 2006). Besides, before the establishment of Republican regime, these *wakf* organizations had tax-exempt status on the revenue that they generate (Cizakca, 2006). Unlike in the Ottoman Era, there are merely 215 foundations that have tax-exempt status accounting for 4% of all foundations in current Turkey (Aydin, 2006). If one evaluates foundation system of Ottomans relying on current NP literature, she can come up with a conclusion that Ottoman policies towards *wakfs* particularly before the 19th century were quite liberal and supportive in terms of taxation and administrative procedures. This might be seen as an attitude developed by a “Great Empire” to be decentralised by the hands of trustworthy *wakfs* which act as complementary entities to provide public services in the places where central government confronted difficulties to access.

After 19th century, with government’s centralisation policies as a part of modernisation period, foundation system was declined and lost its importance in a

very dramatic way (Cizakca, 2006). The newly emerging Turkish Republic through which modernisation attempts were culminated was on its way to nation building process and approached wakfs as potential threats for that transition. Therefore, Prof. Leeman was asked for preparing a set of rules and procedures to be able to supervise foundations under the Foundation Law which came into force in 1935 (Aydin, 2006). Eventually, both centralisation and modernisation attempts commenced during 19th century resulted in destabilized civil society organisations which were forming the backbone of social welfare institutions in Ottomans. However, the culture of wakf in the Islamic tradition encourages Turkish people to set up philanthropic organisation such as foundations and associations for helping their fellow citizens who are in disadvantaged positions (Carkoglu, 2006).

Legal Framework and Taxation

As a part of EU accession process, couple of legal regulations were introduced to enhance standards of supervision of associations and foundations to European levels by Turkish government. The code 5253 called “Associations Law” was put into action in 2004 to manage all associations, their branches, federations, confederations, associations opened up by foreign citizens and other NPOs out of foundations. In this particular code, association is being defined as “an organization to be set up at least by 7 people for achieving a specific goal within legal territory and aside from any profit-distribution motivation.” Besides, this legislation entails every single association to have a constitution consisting of name and centre of the organization, aim& objectives, membership procedure and annual fee, rights and duties of board of directors, internal auditing and borrowing, lastly termination of the organization and distribution of its assets.

Another set of rules was introduced in 2008 named “Foundations Law” with code number 5737 to amend the previous legislation. This law acknowledges five types of foundations (wakfs) in Turkey: mazbut, mulhak, community, artisan and recent. The first three of them were inherited from Ottoman foundation system and integrated to the republican regime with Turkish Civic Code in 1935. The trustees and directors of mazbut foundation were died and therefore directly supervised by General Directorate of Foundations, whilst mulhak foundations are being managed by the descendants of original founders (Aydin, 2006). Community foundations were founded by non-Muslims to provide religious and cultural services to their members, besides artisan ones were established to serve predominantly to the interests of small-scale entrepreneurs. The last type of foundations is called “recent”

or “new” due to the fact that their establishment procedures were come into force after the emergence of Turkish Republic.

The central facet of these current regulations in NP sector can be stated as tax-exemption status of NPOs and donations either exercised by individuals or corporations. In accordance with formal set of laws, both associations and foundations are exempted from corporation tax, even as their financial enterprises are not. In a similar vein, they have privileged status in comparison with other private companies like non-payment of real estate taxes and a variety of legal fees. For the donations side, there is a tax relief mechanism in Turkey if an individual or a company make cash or in-kind donations to the following institutions (Sahin, 2007):

- Associations working for public interest and foundations having tax exemption status
- Institutions undertaking scientific research
- Associations and foundations that run Food Banks for helping to the needy
- Municipalities, town administrations, local government bodies

NPOs' Role in Provision of Public Services

Current government's policies to contract out some of the provisions to non-governmental bodies had a huge impact on NP sector preparing itself to undertake responsibilities. This policy change is basically coming from the fact that the share of social welfare expenditures have been increasing dramatically for the last 15 years. For instance, education expenditures in GNP have risen nearly 60% within the time period of 1996-2006 (General Directorate of Public Accounts, 2007). Consequently, government encouraged non-governmental actors like private and non-profit sector should take part in the welfare industries as long as they provide decent quality services in efficient ways.

Foundations and associations which are forming NP sector in Turkey have been providing basic social services such as education, health, daily nutrition and residential care mostly to the poor citizens for many years. Although, their percentage shares in the public services aren't significantly high for now, they behave as good substitutes in the areas where government accession is limited or service quality is low. In addition to their domestic efforts, charities like Kimse Yok Mu, Deniz Feneri and Kizilay have taken part in international work particularly in the places where a natural disaster occurred. These organizations

set up prefabricated houses, schools and hospitals in the disaster-torn regions in and outside the Turkey.

Current statistics reveal that the major divisions among the associations in Turkey are religious, recreational and philanthropic ones. These mentioned entities account for roughly 30% of whole associations in Turkey. Consequently, whilst the 12% of them in Turkey are operating in educational activities, 3% of them are in health care sector and 15% are providing social services (Department of Associations: 2010). Furthermore, to the records of Department of Associations, a significant proportion (35.9%) of associations is located in Marmara region in where most developed cities are situated and a very few (4.2%) percentage of them are in South-East region where less developed ones reside in it.

In Turkey, first and foremost requirement for opening up a university by entrepreneurs is not-for-profit motive (Turkish Constitution: Code No.130), hence there isn't any for-profit university in Turkish higher education sector. Whereas the first foundation university was launched in 1984, numbers of non-profit universities and their student attendance have dramatically increased by the beginning of 2010 as shown in Figure-3 and 4 (Statistics of The Council of Higher Education, 2010). The report released in 2007 by The Council of Higher Education underscores the significance of non-profit universities which started to shoulder the burden carried by public counterparts via providing high quality education to their students.

Conclusion

At the course of 1970s, NP sector started to attract the attentions of economists whom have been trying to understand the emergence of these organizations in economic paradigms since those days. Plethora of arguments has been put forward by them inspiring from demand and supply side notions as well as institutional approaches which were articulated in the first section of this paper. Donor motivations, customer attitudes and preferences of entrepreneurs can be stated as the backbones of these aforementioned theoretical explanations. In the second part, NPOs in Turkey were examined pertaining to historical background, legal framework and taxation, and eventually their role in provision of public services.

As indicated in the provision of public services section, NP sector is gaining importance thanks to the recent policies put into action by current government in Turkey. Moreover, NPOs will be significant actors especially in education and health sectors in which they have blatant advantage over to their private and public

counterparts as indicated in the first section of the paper. Therefore, future research in this area should be on the efficiency side of NPOs in comparison with their public equivalents to be able figure out and measure their capabilities in public services provision (Erkoc, unpublished dissertation).

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