COMMENT ON BOETTKE AND PRYCHITKO

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By challenging the condition of Pareto Optimality as the benchmark against which the voluntary sector is compared, Boettke and Prychitko make an important correction in the literature on the philanthropic process. In addition, their analysis of the relationship between the state and the voluntary sector sends a chilling warning. State funding of nonprofit organizations may ultimately erode the voluntary sector's ability to serve as a check on government power. Further, I agree with the authors that Austrian economics has much to contribute to our understanding of the philanthropic process, and it is on this point that I wish to devote the substance of my commentary.

Specifically, I want to challenge the starkness with which Boettke and Prychitko draw the distinction between profit-seeking firms and nonprofit organizations. By emphasizing the theme of calculation within the Austrian intellectual tradition, the authors focus too little on the Austrian themes of non-price discovery and local knowledge. By developing these themes—themes that both Boettke and Prychitko emphasize elsewhere—I argue that we would go further in advancing our understanding of philanthropic processes.[1]

Boettke and Prychitko direct our attention to the Austrian school's understanding of economic calculation in order to "contribute to the development of an alternative theory of nonprofits." Nonprofit organizations, the authors argue, are incapable of engaging in economic calculation. Following Mises' argument regarding the impossibility of rational calculation in the context of a centrally planned economy, Boettke and Prychitko carefully draw the distinction between calculation and measurement:

> [Calculation] is not merely measurement as in some input/output flow chart. After all, Soviet planners could measure how much land, labor, fertilizer, tractors, and so on it took to produce a ton of wheat on the collective farms. But they couldn't calculate the added value of that effort to determine whether they had used those resources efficiently and productively. Lacking market-generated prices, they had no way of solving, with Mises, "the task of allocating [scarce resources] to those employments in which they can render the best service" (1966, p. 207). They couldn't

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> determine whether or not their production plans were worth the cost, i.e., whether they generated a positive *net improvement* in wealth…[Central planners] lack the knowledge to plan the economy successfully because they lack the ability to calculate.

Economic calculation affords entrepreneurs the ability to check their expectations against the realized monetary net return for their efforts, and as such provides an essential and meaningful set of signals for how the entrepreneur might revise plans and set a course for future action.

It is not necessary for the entrepreneur to retain the profits earned from an enterprise in order to engage in economic calculation, the authors argue. Not-for-profit organizations, because they charge for their services, are capable of calculating the residual above and beyond the costs of providing those services. Nonprofit organizations, on the other hand, are in an entirely different situation. Because they do not charge for their services, they have no way of engaging in economic calculation. Certainly a nonprofit can make judicious use of monetary prices when counting up its costs, but there is no way to determine through economic calculation whether society is, on net, better off for their efforts.

At this point in the paper, it sounds as though the authors are suggesting that nonprofit organizations are akin to state enterprises in a soviet economy, likely to generate pronounced inefficiencies. But surprisingly, Boettke and Prychitko spare nonprofits from this condemnation. The authors liken decision-making in the nonprofit sector to decision-making within the family, or a decision that preserves a historical landmark, or a piece of great, though non-vendible art. When making decisions in contexts such as these, we know that our "specific goals and efforts are worthwhile," and for this reason, the nonprofit sector is not systematically prone to failure in efficiency terms.

But this raises the question: *How* do we know this? How do we assess the worthiness of contributing resources to non-vendible objects and services? According to Mises, we know their worthiness directly:

> Those things that do not enter into the items of accountancy and calculation are either ends or goods of the first order. No calculation is required to acknowledge them fully and make due allowance to them. All that acting man needs in order to make his choice is to contrast them with the total amount of costs their acquisition or preservation requires. (Mises 1966: 215, cited in Boettke & Prychitko).

On one level, this makes sense. If Bill and Melinda Gates value finding a cure for AIDS and other infectious diseases enough to spend $1.2 billion on the effort, they will know directly whether such expenditures are worthwhile. Donors in this sense are like consumers—they are the ultimate arbiter of what their philanthropic ventures are worth to them. The Gates family may experience "buyer's remorse" if the pace of achievement proves too slow for their liking, but the decision itself was nothing less than rational. Further, as Boettke and Prychitko argue, the philanthropic process provides a way for donors like the Gates family to coordinate their plans with the medical research community, and, therefore, it is not systematically prone to failure in terms of efficiency.

But the decision to give to this or that cause represents only one level of the decision-making process in the nonprofit environment. How best to achieve the goals of a nonprofit organization is far more complex than donors directly assessing whether their contributions are worthwhile to them personally. The complexities of decision-making within the operations of a typical nonprofit are significant enough to throw open the door once again to the question of whether the voluntary sector is systematically prone to failure.

An active question within the economic development literature, for example, is whether microfinance organizations in the developing world ought to charge a fee for services such as business training, literacy courses, marketing courses, and the like, if for no other reason than to provide organization managers the meaningful feedback they need to know whether they are offering the right mix of services (see Chamlee-Wright, forthcoming).[2]

Even when we consider Boettke and Prychitko's own example of the "family as nonprofit," the decision-making process seems far more complex than the authors suggest. Boettke and Prychitko offer the following example to show how families, like so many other nonprofit organizations, are able to engage in rational decision-making despite their inability to engage in economic calculation: "Although [parents] cannot *calculate* the value added of their efforts, they can determine whether their specific goals and efforts are worthwhile." Presumably, parents are able to determine the worthiness of their decisions because they know directly what value they attach to their family's well-being.

But is it really that simple? In some cases it may be. The parents ask themselves, "Is correcting my child's overbite worth the $4,000 in orthodontic care? Yes. Is my child's desire to wear the latest tennis shoe fashion worth the $250 price tag? No." But most of the decision-making that takes place in this nonprofit we call the family is far more complex. We may know directly *that* we value our family's well being, but *how* exactly to achieve our goals is fraught with uncertainty. To instill a sense of confidence in our children, do we encourage them to try a variety of different activities or do we encourage the development of a single talent? Do we choose a home in the city, with all the cultural amenities it has to offer, or do we raise our children in the country where the pace of life is more relaxed? Do we pay for private piano lessons or take a family vacation instead? I agree with Boettke and Prychitko that in this context economic calculation is impossible. But the question of whether rational choice is possible in this non-calculative environment is not resolved simply by saying that we know the worthiness of our decisions directly. Much of the decision-making that takes place in the context of a nonprofit involves the weighing of two (or perhaps many more) alternative courses of action, each of which could be imagined to meet the goals of the organization but none presenting itself as clearly the best alternative a priori. Directors of nonprofits must test their expectations in a process of trial and error. Though discovery will not take the form of economic calculation, they will nonetheless discover.

The problem here is that Boettke and Prychitko draw too stark a distinction between organizations that calculate and those that do not:

> [T]here is either calculation or there isn't. There are no "proxies for calculation"—issues of trust, reputation, satisfaction, and so on might serve as effective guides to action, but they cannot serve as sources for calculation itself...Without a priced service, the agents of nonprofit organizations and their donors might engage in "pseudo-calculation," but let's understand that that really means no calculation.

This characterization suggests that economic calculation in the market context is something more than a mere "guide to action." I don't question whether monetary profits and losses are central to the learning process in the market, but the difference between economic calculation and other guides to action is one of degree, not of kind. Market prices and net monetary returns are not "marching orders." Profits tell the entrepreneur that she or he is doing *something* right, but profits do not necessarily signal whether some alternative plan might have generated even more profits. Losses certainly signal the entrepreneur that *something* is wrong, but just what the entrepreneur is supposed to do in response to these losses is a complex interpretive challenge (Ebeling 1986: 45). Indeed, profits and losses are essential guides to action, but they are *guides*, not logical directives. As all the possible courses of action and their corresponding outcomes are never laid out before market participants, entrepreneurial decision-making is a process of discovery, not logical deduction (O'Driscoll & Rizzo 1996: 103; see also Hayek 1948). Though monetary calculation is central to market discovery, nonmonetary discovery also takes place as entrepreneurs execute and revise their plans. This dimension of learning within the market seems to be lost in the current discussion.

The authors' stark distinction between calculating and non-calculating organizations also misrepresents the nature of the discovery process that takes place in the voluntary sector. As Boettke and Prychitko argue, in the absence of a priced output, nonprofits cannot engage in economic calculation. Yet, as I have argued, many of the most important choices facing nonprofits are complex enough that decision makers will not be able to discern directly the worthiness of any particular course of action. Does this mean that nonprofit organizations are akin to state-owned enterprises in a soviet-type economy, such that if efforts exerted in the nonprofit sector add (on net) value to society, it will only be by accident?

In that nonprofits cannot rely upon economic calculation, the answer seems to depend on whether directors of nonprofits have access to and can make use of alternative guides to action. Casual observation seems to suggest that many nonprofits have access to a rich source of local knowledge that serves as a meaningful guide to action. A mother looks for cues that her son's involvement in high school sports is contributing to or inhibiting the development of other life skills. The director of a domestic violence center tries to understand the particular reasons some clients return to their abusive spouse and others do not. She may adjust the center's programs in response, and watch to see whether the changes make a difference. Parents and directors of nonprofits may avail themselves of the latest scholarly literature that pertains to their situation, but ultimately it is access to this local (often tacit) knowledge that offers the chance of successful planning and plan revision.

Surely, the guidance such nonmonetary signals provide will not be as clear as the guidance offered by profit and loss calculations, but when we consider that even profit-seeking entrepreneurs need to cultivate nonmonetary guides to action in order to make sense of profit and loss signals, we see that the distance between nonprofit organizations and profit-seeking firms may not be as great as the calculating/non-calculating distinction suggests. A clear distinction *does* exist, however, between profit-seeking firms—which can make use of both economic calculation and relevant local knowledge—and state-owned enterprises, which are systematically incapable of doing either (see Lavoie 1995). With regard to nonprofits, the question seems to be whether they are capable of cultivating enough relevant local knowledge to serve as an effective guide to action. There is no guarantee that any one particular organization will be able to do this, but there is no systematic reason why we would expect sector-wide failure in this regard, either.

An organization's size, its scope of operations, and its proximity to the people it aims to serve are all potentially important factors in determining its access to relevant local knowledge. But ultimately it is the degree of connectedness, no matter how that might be achieved, that allows the decision maker in the organization to "dwell" in the mind of a person receiving their services. This potential for local knowledge to serve as a cognitive guide in the trial and error process requires further development on both the theoretical and empirical levels of research.

Though the Austrian understanding of economic calculation is indeed an important concept, if we are to understand better the philanthropic process, the Austrian concepts of nonmonetary discovery and the cultivation of local knowledge are equally relevant, if not more so. The inability to engage in economic calculation extends to all nonprofits and therefore does not offer a way to understand why some nonprofits are more successful in achieving their stated goals than others. Nonprofit organizations do differ, however, with regard to their ability to engage in discovery processes of trial and error, and they differ in their access to and ability to make use of relevant local knowledge. Understanding the ways in which nonprofits cultivate and make use of nonprice guides to action may go a long way in helping us to understand differences in performance among nonprofit organizations.

NOTES

1 See, for example, Prychitko's edited volume *Individuals, Institutions, Interpretations: Hermeneutics Applied to Economics*, and Boettke's contribution "Interpretive Reasoning and the Study of Social Life" in the same volume.

2 The nonprofit sector may also suffer from perverse incentives as managers

are not rewarded or punished according to the monetary return their decisions earn for the organization, and this can of course lead to significant principal/agents problems as Boettke and Prychitko point out. The current discussion, however, rests on issues of whether nonprofit managers have access to the *knowledge* they require to make rational decisions in the philanthropic process, an issue that remains even if we assume that the interests of the manager match up perfectly with the stated goals of the organization.

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