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# **Charities, Sustainable Funding and Smart Growth**

## *Discussion Paper*

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## **Charities, Sustainable Funding and Smart Growth: Discussion Paper**

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# 1

## INTRODUCTION

Canada's charitable and nonprofit sector has grown more rapidly than the economy as a whole over the last twenty years, creating jobs and growth and expanding services and supports available to Canadians.<sup>1</sup> Charities and nonprofits are now an important source of social, cultural and recreational services. They also play a major role in advocating for the environment and other causes. Collectively, they are a significant employer and major contributor to the Canadian economy.

The expansion of the charitable and nonprofit sector has been fueled by two factors. First, demand for what charities and nonprofits provide has increased as the population has aged and changed. Second, the expansion of the sector has occurred in the context of an economy that has been performing well, generating the income and wealth that have enabled individuals, businesses and governments to support the sector. Revenues to support the rapid expansion of the charitable and nonprofit sector have come from the sale of goods and services produced by sector organizations and the sale of memberships in sector organizations, from governments, and from the generosity of individual Canadians and, to a lesser extent, Canadian businesses. All these sources of revenue are heavily influenced by the health of the overall economy.

But the world is changing. While demands for services from the charitable and nonprofit sector continue to expand with ongoing demographic and cultural change, Canada is facing a future characterized by slower economic growth in the long term (twenty years or more). Drummond and Capeluck<sup>2</sup>, the Conference Board<sup>3</sup>, the Parliamentary Budget Office<sup>4</sup> and others have remarked on the impact the convergence of slowing

<sup>1</sup> This is not just a Canadian phenomenon. It is also the case in most of the developed world. The State of Global Civil Society and Volunteering: Latest Findings from the Implementation of the UN Nonprofit Handbook, Lester Salamon, et al., Johns Hopkins Centre for Civil Society Studies, 2013.

<sup>2</sup> Long-term Fiscal and Economic Projections for Canada and the Provinces and Territories, 2014-2038, Don Drummond & Evan Capeluck, Centre for the Study of Living Standards, 2015.

<sup>3</sup> A Difficult Road Ahead: Canada's Economic and Fiscal Prospects. Kip Beckman, Daniel Fields & Matthew Stewart, Conference Board of Canada, 2014.

<sup>4</sup> Fiscal Sustainability Report 2014, Parliamentary Budget Office, 2014. Fiscal Sustainability Report 2015, Parliamentary Budget Office, 2015.



productivity growth, declining labour force participation rates, soft commodity prices, and an aging population will have on the Canadian economy and on government revenues. They point to an emerging structural deficit, most pronounced at the provincial level, which will have worrying consequences for the ability of governments to finance programs Canadians value.<sup>5</sup>

Even though it is mission-driven and provides many services for free or at non-market prices, the charitable and nonprofit sector is an integral and important part of Canada's evolving economy. The relationship between charities and nonprofits and the economy could be deemed symbiotic: the charitable and nonprofit sector generates major benefits to the economy in terms of jobs and growth, as well as value to consumers in terms of the services it provides, but at the same time it relies on a strong economy to generate the revenues it needs to meet demands. But the correlation is not as simple as that. As Drummond, Capeluck and Calver have implied, growth that is not equitable, inclusive and environmentally responsible increases the demand for the social and environmental services the charitable sector provides.<sup>6</sup>

This paper will argue that Canada faces a growing, long-term, structural social deficit, analogous in many ways to a structural fiscal deficit. This structural social deficit is the result of interactions between changes in the charitable and nonprofit sector (driven by demographic, cultural and social trends) and the evolution of the broader economy. The social deficit, like its economic counterpart, will require structural reforms to the way charities and nonprofits are financed and policies that promote sustainable smart growth in the economy as a whole.

Unlike a fiscal deficit, a social deficit will not reveal itself in red numbers on a balance sheet. Instead, it will appear as an accumulation of unmet needs, in growing waiting lists for social services, and in increasingly overburdened charities and

<sup>5</sup> "...a cyclical deficit will normally improve with economic growth... In contrast, fiscal imbalances that are structural are caused by fundamental changes in the economy, and growth will not necessarily improve the deficit... The classic example an ageing population, and expenditure on age-related health issues will grow irrespective of the state of the economy." Budget explainer: what is a structural deficit and why does Australia have one? Guay Lim, 2015.

<sup>6</sup> The Key Challenge for Canadian Public Policy: Generating Inclusive and Sustainable Economic Growth, Don Drummond, Evan Cape-luck & Matthew Calver, Centre for the Study of Living Standards, 2015.

nonprofitss, overworked staff and volunteers. In short, a social deficit will appear as an inability of charities to meet the social, cultural and environmental needs of Canadians and as a slow but perceptible erosion of Canadians' quality of life. This paper explores and attempts to quantify Canada's emerging social deficit.

Section 2 defines the scope of the charitable and nonprofit sector and looks at the recent history of the sector and its growing importance to the economy. It will argue that the health of the sector is important to the economy as a whole. In turn, charities and nonprofits have a vital interest in economic growth that is equitable, inclusive and environmentally responsible. Smart growth increases the income that funds the sector; the sector, in turn, is a positive and creative economic force, a component of smart growth and an inclusive creator of good jobs. This section poses two fundamental and related questions: will rapid growth in the need for the services provided by the charitable and nonprofit sector continue and, if so, can it be financed?

Section 3 looks at the performance of the sector over the last couple of decades and argues that the sector has grown rapidly for two reasons: it has met rapidly growing needs and it has benefited from the resources available from a robustly expanding economy.

Section 4 turns to the future and examines whether continued growth in the need for what the sector does combined with expectations of slower long-term economic growth will result in a structural social deficit that will threaten the quality of life of Canadians.

Section 5 contains conclusions and recommendations.

# 2

## THE NATURE AND EVOLUTION OF THE CHARITABLE & NONPROFIT SECTOR

The charitable and nonprofit sector is often described by what it is not, which is neither the public (government) sector nor the private (business) sector.<sup>7</sup> In this paper, however, the charitable and nonprofit sector is defined as including organizations that meet the following criteria, which are used by statistical agencies around the world, including Statistics Canada.<sup>8</sup>

1. They have some institutional reality and structure (e.g., legal status).
2. They do not exist primarily to generate profits and distribute them to owners or shareholders.
3. They are self-governing (i.e., able to control their own activities).
4. Membership is not required by law and is not a condition of citizenship.

Statistics Canada typically describes the charitable and nonprofit sector in two ways. The core sector, which excludes the institutions hospitals, universities and colleges. These institutions have much in common with other charities and nonprofits – they are, for example, not part of the market economy, depend to an extent on donations for their financial stability, and engage volunteers. But they are also different in important ways – for example, they are generally much larger than other charities and nonprofits and they get a much higher proportion of their revenues from government. The broad sector is defined as the core sector plus hospitals, universities and colleges.

Table 1 gives a more detailed breakdown of the core sector and the types of services it provides to Canadians. The sub-sectors are listed according to the size of their share of the sector. Also included is an indication of how quickly each sub-sector grew between 2000 and 2008.

<sup>7</sup> This is why it is sometimes called “the third sector”.

<sup>8</sup> For more information, see: The State of Global Civil Society and Volunteering: Latest Findings from the Implementation of the UN Non-profit Handbook, Lester Salamon, et al., Johns Hopkins Centre for Civil Society Studies, 2013 or Satellite Account of Non-profit Institutions and Volunteering 1997 to 2007, Statistics Canada, 2009.

**Table 1: Elements of the Core Nonprofit Sector, Their Size and Growth Rates<sup>9</sup>**

<b>Sector</b>	<b>Types of Organizations in Each Sector</b>	<b>Share of Core Nonprofit Sector GDP, 2008</b>	<b>Rate of Growth, 2000-2008</b>
Social Services	Youth services and welfare; family services; services for the handicapped; services for the elderly; personal social services; disaster prevention and control; temporary shelters; refugee assistance; income support and maintenance; material assistance (food banks, clothing)	21.4%	7.0%
Development and Housing	Community and neighbourhood organizations; economic development; social development; housing associations; job training; vocational counselling and rehabilitation	17.3%	6.5%
Culture and Recreation	Media and communication; visual arts; performing arts; humanistic societies; museums; zoos and aquariums; sports; recreation and social clubs; service clubs	10.7%	6.9%
Education and Research	Vocational/technical schools; adult/continuing education; medical research; science and technology research; social science and policy studies	10.1%	6.0%
Religion	Congregations and association of congregations	8.3%	3.1%
Business, Professional Associations and Unions	Business associations; professional associations; labour unions	8.3%	7.5%
Health	Mental health treatment; crisis intervention; public health and wellness education; health treatment; emergency medical services	7.3%	6.2%
Philanthropic Intermediaries and Volunteerism Promotion	Grant-making foundations, volunteerism promotion and support; fund raising organizations	2.1%	8.9%
Law, Advocacy and Politics	Advocacy and civil rights organizations; ethnic and civic associations; crime prevention and public policy; rehabilitation of offenders; victim support; consumer protection; political parties and organizations	1.8%	8.5%
Environment	Pollution abatement and control; natural resources conservation and protection; environmental beautification and open spaces; animal protection and welfare; wildlife preservation and protection; veterinary services	1.1%	6.9%
International	Exchange/friendship/cultural programs; development assistance associations; international disaster and relieve organizations; international human rights and peace organizations	0.8%	8.2%
Other	Organizations not elsewhere classified	10.8%	10.1%

<sup>9</sup>Author's calculations based on CANSIM table 388-0002.



From 1997 to 2008, Canada's economy performed well, growing at a rate of about 5.6% per year in current dollar terms.<sup>10</sup> The core charitable and nonprofit sector grew even more rapidly, more than doubling in size over the course of the period.<sup>11</sup> This reflects, the paper will argue, underlying economic and social trends that will continue to influence the growth in demand for the sector's services well into the future.

The importance of the core charity and nonprofit sector's economic contribution can be seen when comparing it with selected key industries in Canada. The sector accounts for about the same GDP as utilities or accommodation and food services and half again as much as agriculture, forestry and fishing, or mining and quarrying. It accounts for more employment than construction and finance, insurance and real estate.<sup>12</sup>

<sup>10</sup> Author's calculations based on CANSIM table 380-0063.

<sup>11</sup> Author's calculations based on CANSIM table 388-0001.

<sup>12</sup> CANSIM tables 388-0001 and 379-0031; National Survey of Nonprofit and Voluntary Organizations. Michael H. Hall, et al., Statistics Canada, 2003; CANSIM table 282-0008.

# 3

## WHY HAS THE CHARITABLE & NONPROFIT SECTOR GROWN SO RAPIDLY?

The charitable and nonprofit sector has been a social and economic success story for two reasons. First, and most important, it has responded to the needs of Canadians—needs that have not been met by government or the private sector. These needs, in turn, have been driven in large part by non-economic factors, such as demographics, social and cultural change and the deterioration of the environment. Increased demands on charities and nonprofits have also been driven by economic growth, which has not been equitable and inclusive. Second, the Canadian economy has been growing well, enabling a corresponding growth in funding for the sector’s missions from earned income, from government and from the generosity of Canadians (and, to a lesser extent, the generosity of Canadian businesses).

### 3.1 Charities and Nonprofits Have Met Expanding Need

The most important factor driving expanding need is demographic – the aging of the Canadian population and the related increase in demand for health care and services to seniors. The significance of this trend is profound for both charities and governments. The ratio of Canadians aged 15 to 64 to the number of Canadians 65 and older was relatively stable until about 1980, at which point the ratio of older Canadians to working age Canadians started to rise, increasing markedly from 1990 onwards.

According to the Parliamentary Budget Office, “population ageing will increase demand for government programs that mainly benefit older age groups, such as health care, elderly benefits, and public pension programs. The age-related increase in

spending will be greater than the decrease in spending on programs for younger age groups, such as education, children's benefits, and social assistance."<sup>13</sup> Age-related services provided by governments and by the charitable and nonprofit sector will be a central issue in the emergence of a structural social deficit in the next decade.

The growth of the charitable and nonprofit sector in Canada mirrors experience in other developed economies.<sup>14</sup> Lester Salamon has discussed a similar rapid expansion in the United States, noting that "nonprofit organizations are being affected by a number of trends that are boosting the demands for the kind of services these organizations provide" including:

- the aging of the population, increasing the demand for a range of elderly services;
- the expansion of labour force participation by women, increasing the demand for child care and related services;
- shift in family structure with an increase in single-parent families, often accompanied by significant economic hardship and social disruption;
- substance abuse, between 1977 and 2009 the number of Americans using substance abuse treatment services increased from 235,000 to 1.2 million; and,
- immigration, increasing the demand for cultural and resettlement assistance.

Salamon's conclusions are directly relevant for Canada: "taken together, these changes have expanded the demand for many of the services that nonprofit organizations have traditionally provided, such as home care for the elderly, family counselling, foster care, relocation assistance and substance abuse treatment and prevention."<sup>15</sup>

For both Canada and the United States, the expansion of the core charity and nonprofit sector has been demand-driven.

<sup>13</sup> Fiscal Sustainability Report 2014, Parliamentary Budget Office, 2014.

<sup>14</sup> The State of Global Civil Society and Volunteering: Latest Findings from the Implementation of the UN Non-profit Handbook, Lester Salamon, et al., Johns Hopkins Centre for Civil Society Studies, 2013.

<sup>15</sup> The Resilient Sector Revisited: The New Challenge to Non-profit America, Lester Salamon, Brookings Institution Press, 2015.

The sector has grown because the needs of people are increasing and increasingly pressing. The factors driving demand and growth are often not economic in nature, but rooted in demographic reality and cultural change. Moreover, there is ample evidence that, if anything, these demands are likely to grow in the future at an accelerating rate.

### **3.2 Revenue Growth Has Been Relatively Robust**

The charitable and nonprofit sector, while mission-driven, is part of the larger economy. The revenue on which the sector depends to meet demand is generated by economic activity, and good economic performance is a vital ingredient in the success of charities and nonprofits.

Charities and nonprofits fund themselves through:

- earned income, selling some goods and services and memberships;
- transfers from governments for core funding and to deliver government programs and priorities;
- donations from individual households and businesses; and, income on invested funds.

By far the most important source of funding for organizations in the core charitable and nonprofit sector is sales of goods and services, accounting for 41.6% of sector income in 1997, rising to 45.1% in 2008—a healthy 8.1% per year increase.<sup>16</sup> Robust increases in sales of goods and services have provided much of the impetus for the sector’s rapid expansion. Similarly, sales of memberships have contributed a significant and growing proportion of charitable and nonprofit sector revenues. Donations from households have generally kept pace with the expansion of gross domestic product during the period, but because the sector has grown more quickly than GDP, this has translated into a decline in donations as a proportion of the total sector revenues.

<sup>16</sup> Author’s calculations based on CANSIM table 388-0001.

The relative contributions of donations from businesses and contributions from the federal government showed the most rapid growth over the period (both from a relatively small base). The relative contribution of investment income is small and has been declining in relation to sector growth. Funding from provincial governments did not keep pace with either the growth of GDP or the growth of the sector. Provincial governments accounted for 18.2% of total funding in 1997 and 14.7% in 2008.<sup>17</sup>

### **3.3 The Performance of the Economy Has Supported Revenue Growth**

Sound economic performance over the last decade or so has been generally good for charities and nonprofits. The growth of the economy has helped finance rapid expansion of the sector, providing money to consumers to buy the sector's goods and services, to donate and to buy memberships. It has generated tax revenues for the federal government and the provinces, which finance transfers from governments to the sector. A change in the outlook for economic growth therefore has profound implications for the sector.

The Canadian economy has been fueled by relatively high commodity prices, relatively high labour force participation rates and moderate growth in productivity. During the years for which data is available on the charitable and nonprofit sector (1997 to 2008), Canada's economy grew at about 5.6% per year in current dollar terms. From 2008 to 2014, the growth rate of the economy declined to about 3.0% per year, heavily influenced by the "great recession" years of 2008 and 2009.<sup>18</sup>

Solid macro-economic performance over the past decade or so has obscured some important underlying issues. Drummond and his associates<sup>19</sup> argue, for example, that Canada's strong commodity prices and growth in participation in the labour force have hidden some fundamental weaknesses, including:

<sup>17</sup> Author's calculations based on CANSIM table 388-0001.

<sup>18</sup> Author's calculations based on CANSIM table 380-0063.

<sup>19</sup> The Key Challenge for Canadian Public Policy: Generating Inclusive and Sustainable Economic Growth, Don Drummond, Evan Cape-luck & Matthew Calver, Centre for the Study of Living Standards, 2015.



- dependence on high levels of commodity prices;
- poor productivity performance relative to competitors;
- growth that has been inequitable and non-inclusive; and
- growth that has been environmentally damaging.

If commodity prices remain weak, if productivity performance continues to lag, if labour force participation rates decline, Drummond and others<sup>20</sup> predict a reduction in long-term economic growth in Canada to about 3.6% per year in nominal terms over the next two decades, with significant impacts on government spending decisions and, by implication, on the funding of charities and nonprofits.

<sup>20</sup>Fiscal Sustainability Report 2015, Parliamentary Budget Office, 2015.

# 4

## A STRUCTURAL SOCIAL DEFICIT?

This section of the paper examines the interaction of demography and slower long-term economic growth for the core charitable and nonprofit sector, asking the questions:

- What is the impact of slower economic growth and accelerating demographic and culturally driven pressure?
- What does economic growth that is not inclusive, equitable and environmentally responsible mean for the sector?

The paper attempts to examine these questions using simple “what if” projections of revenue and need. For example:

- What if revenue does not continue to grow at historically consistent rates? What if revenue growth is affected by the reduced outlook for growth in the economy as a whole?
- What if the need for charitable and nonprofit services grows more rapidly than historical rates? What if the growth in need accelerates for demographic, social, environmental or other reasons?

Combining different sets of “what if” projections can give an indication of the scope of the challenges Canada will face in meeting the needs of the population.

The crux of this section is the argument that there is no reason revenue growth and need/demand should move in lockstep, each is determined by its own set of underlying factors. Revenue growth might fall short of or exceed historical rates for reasons largely to do with the economy and the spending decisions of governments. Similarly, need for services may

grow more quickly or more slowly than historically for demographic, cultural, social or environmental reasons.

If revenue grows less quickly than historically, revenue will fall short of need, creating a social deficit. If need grows more quickly than its historical rate of increase, a social deficit will also emerge. One of the objectives of this paper is to attach a notional value to this deficit to indicate the scope of the challenge we face.

#### **4.1 Scenario 1: Status Quo Projection**

This section establishes a base, or status quo, case by projecting forward historical rates of growth in both demand and revenue. In the status quo projection, demand for sector services is projected to grow somewhat faster than forecast GDP growth, just as it did in the period 1997 to 2008.

Assumed growth rates for demand for what charities and nonprofits do are necessarily arbitrary. There is no model available in Canada for projecting what Canadians will demand from the charitable and nonprofit sector over time. But this assumption seems reasonable in light of historically available data and evidence regarding underlying social and demographic trends in Canada. Among other pressures:

- The rapid aging of the Canadian population will continue with broad implications for social spending. For example, reflecting demographic pressure on health care, “Over 2.4 million Canadian seniors will need and receive paid and unpaid continuing care supports in 2026—a 71% increase over 2011. By 2046, this number will reach nearly 3.3 million.”<sup>21</sup>
- The characteristics of the Canadian population will continue to change. The combination of a declining birth rate and steady rates of immigration will

<sup>21</sup> Future Care for Canadian Seniors: A Status Quo Forecast, Greg Hermus, Carole Stonebridge & Klaus Edenhoffer, Conference Board of Canada, 2015.

increase the diversity of the Canadian population.

- Homelessness will likely grow. The number of people homeless in Canada in 2016 is estimated at about 30,000 on any given night up from roughly 10,000 in 2001.<sup>22</sup>
- The structure of the family will continue to evolve. The number of single parent families is continuing to increase. “Lone-parent families increased 8.0% over the same period [2006 to 2011]. Growth was higher for male lone-parent families (+16.2%) than for female lone-parent families (+6.0%).”<sup>23</sup>
- Hunger and food security are on the rise. The number of people accessing food banks in Canada increased by 25% from 2008 to 2014 to 841,191 visits.<sup>24</sup>

Based on trends observed in the period 1997 to 2008 and on an assessment that the need for the services provided by charities and nonprofits persists (and is, in fact, intensifying), the rate of growth in demand facing the core charitable and nonprofit sector is assumed to be 5.7% per year over the projection period adjusting for forecast rates of nominal GDP growth.

The second step is to project revenue growth. To establish a status quo growth case, the paper takes the observed rates of growth in revenue from 1997 to 2008 and projects these forward. These rates of growth were, by definition, just sufficient to finance sector growth from 1997 to 2008 and they are constrained to just finance continued sector growth of 5.7% per year over the projection period; that is, the status quo case is, by definition, one that does not produce a social deficit from 2014 to 2026.

This does not mean there will be no unmet needs from 2014 to 2026 (or were no unmet needs from 1997 to 2008). Evidence of homelessness, poverty, social disruption, and environmental damage clearly suggests otherwise. But this paper attempts to

<sup>22</sup> The State of Homelessness In Canada: 2014, Stephen Gaetz, Tanya Gulliver & Tim Richter, Homeless Hub Press, 2014.

<sup>23</sup> Portrait of Families and Living Arrangements in Canada, Families, households and marital status, 2011 Census of Population, Statistics Canada, 2012.

<sup>24</sup> Hunger Count, Food Banks Canada, 2015.

measure change, not to take a snapshot. It attempts to assess the extent to which the charitable and nonprofit sector's ability to meet needs improves or deteriorates relative to the status quo under different assumptions and to put a number to the scope of these changes.<sup>25</sup>

To establish a base case, this section projects revenue forward for each of the sector's sources of funds based on rates of growth observed from 1997 to 2008, adjusted for forecast lower GDP growth in the period 2014 to 2026. Need is projected to continue to grow somewhat faster than nominal GDP as in the period 1997 to 2008. Each source of revenue is projected to continue to grow in relation to GDP in the same way it did in 1997 to 2008. Need and revenue are constrained to move in lockstep, the social deficit in each future year will be zero.

**Scenario 1 shows a balance sheet for the status quo case.**

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	3.6%	9.6	14.7
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	8.9%	7.1	19.7
Transfer from provincial government	3.2%	13.7	20.0
<b>Total</b>		104.4	202.3
Demand for services from charitable and nonprofit organizations grows at 5.7% per year	<b>Demand 2026 (\$ billion)  202.3</b>	<b>Total Revenue 2026 (\$ billion)  202.3</b>	<b>Surplus/(Deficit) (\$ billions)  0</b>

Scenario 1 sees the core charities and nonprofit sector continuing to grow more rapidly than the economy as a whole. In fact, it nearly doubles in size over the period from 2014 to 2026, at

<sup>25</sup> Future Care for Canadian Seniors: A Status Quo Forecast, Greg Hermus, Carole Stonebridge & Klaus Edenhoffer, Conference Board of Canada, 2015. Based on 200,000 seniors with unmet needs today, the report estimates that unmet needs will grow to 458,000 by 2046.



which point it is a sector with just over \$202 billion in revenue. The sector would account for a slightly larger proportion of GDP in 2026 than 2014.

About one half of the revenue requirement in 2026 would be met by sales of goods and services. Membership sales are next in importance, followed by transfers from the federal government and provinces. If growth rates in transfers from government follow the trend observed in 1997 to 2008, transfers from the federal government will grow significantly (and perhaps unrealistically) more quickly than revenues from provincial governments and begin to overtake them in size in 2026.

#### **4.2 Scenario 2: Accelerated Growth in Need/Demand**

The base case reflects historical rates of growth in need. What if any or all of the underlying demographic, social and cultural pressures cited above were to grow more quickly from 2014 to 2026 than from 1997 to 2008? This would reflect the continuing impact of the underlying demographic, social and cultural issues that have driven the sector's recent expansion.

First, the aging of the Canadian population will become more rapid in the forecast period. This will create more demands on health care (and notco-incidentally on provincial financial balances), old age security and support for the aged in general. Second, the population will continue to become more diverse, with immigration projected to remain a significant proportion of economic growth, stable at a rate of 7.5 immigrants per year per 1,000 population. All of these factors are key drivers of demand for the services provided by the charitable and nonprofit sector.

Scenario 2 assumes that growth in demand increases by a relatively modest 0.5% per year over the base case — at a rate of 6.2% as opposed to 5.7%. All other assumptions remain the

same as Scenario 1. The following social balance sheet gives the result — a significant social deficit reflecting increased unmet needs.

### Scenario 2 Table: Growth in Need/Demand Accelerates

*Highlighted sections indicate change from the status quo scenario.*

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	3.6%	9.6	14.7
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	8.9%	7.1	19.7
Transfer from provincial government	3.2%	13.7	20.0
<b>Total</b>		104.4	202.3
Demand for services from charitable and nonprofit organizations grows at 6.2% per year	<b>Demand 2026 (\$ billion)</b> <b>214.1</b>	<b>Total Revenue 2026 (\$ billion)</b> <b>202.3</b>	<b>Surplus/(Deficit) (\$ billions)</b> <b>(11.8)</b>

Scenario 2 shows that if demand for the services that charities and nonprofits provide increases at even a slightly faster rate than in the past, the sector would have to raise an additional \$11.8 billion. The projected deficit would be about 20% less than total donations expected to be raised from households in 2026. If funding remains at status quo levels, Canadians are likely to have significant unmet needs.

### 4.3 Scenario 3: Slower Economic Growth

Work by Drummond, Capeluck and Calver, by the Parliamentary Budget Office and by the Conference Board of Canada, among others, projects a long-term rate of growth for the Canadian economy of 3.6% per year, based on estimates of the productivity of the Canadian labour force, commodity prices and demographic factors influencing labour-force participation rates. In addition,

Drummond points out that if growth continues to be inequitable and environmentally damaging, it will undermine, rather than contribute to, the pursuit of sustainable development.

The 3.6% nominal growth rate is embedded in the status quo case, which holds constant the relationship of nominal revenue growth for charities and nonprofits to nominal GDP growth. For example, if donations from households grew at the same rate as nominal GDP in the period 1997 to 2008 (5.6%), they are assumed to grow at a forecast rate of increase in current dollar GDP from 2014 to 2026 (3.6%). Similar assumptions are made for each of the other revenue sources.

But the impact of lower GDP growth is more profound than the status quo projection suggests, and this impact is likely to be transmitted through fiscal decisions of governments. The role of provincial governments is significant as this is the level of government that has historically been the most important source of government funding for charities and nonprofits. It is also the source of funding that has not increased in step with the expansion of the nonprofit sector, declining from 18.2% of sector revenues in 1997 to 14.7% in 2008.<sup>26</sup> This reflects pressure on provincial governments to balance their budgets. Pressure that has resulted in a slowdown in the growth of provincial support to charities and nonprofits, coupled with the down-loading of responsibilities for services onto the sector.

The most significant impact on charities and nonprofits from slower GDP growth will be felt through reduced transfers from provincial governments. The Conference Board of Canada,<sup>27</sup> Drummond and Capeluck,<sup>28</sup> and the Parliamentary Budget Office<sup>29</sup> all forecast large deficits as provinces struggle with two factors. The first is slower long-term growth in the economy as a whole, which affects the amount of tax revenue provinces are able to raise. The second is the rapid increase in demand

<sup>26</sup> Author's calculations based on CANSIM table 388-0001.

<sup>27</sup> Future Care for Canadian Seniors: A Status Quo Forecast, Greg Hermus, Carole Stonebridge & Klaus Edenhoffer, Conference Board of Canada, 2015.

<sup>28</sup> Long-term Fiscal and Economic Projections for Canada and the Provinces and Territories, 2014-2038, Don Drummond & Evan Capeluck, Centre for the Study of Living Standards, 2015.

<sup>29</sup> Fiscal Sustainability Report 2015, Parliamentary Budget Office, 2015.

for social services, primarily health care, driven by underlying changes in demographics in Canada which tend to increase health care spending. The Conference Board forecasts combined provincial and territorial deficits of well over \$60 billion by 2026 (and an even more striking \$300 billion by the year 2036).

The role of the federal government, while small relative to the provinces,<sup>30</sup> grew more quickly than the sector as a whole in the decade 1997 to 2008. While the outlook for provincial fiscal balances is difficult, both the Conference Board and the Parliamentary Budget Office forecast a picture of balance or surplus at the federal level. The rate of increase in federal contributions in the period 1997 to 2008 was exceptionally high (11%), increasing from a rather small base and observed on a relatively limited sample size. This rate of increase is unlikely to be sustainable.

There is no precise formula for translating these pressures into numbers, but the available evidence suggests that fiscal pressures are likely to lead to a decrease in the rate of growth of funding for the charitable and nonprofit sector over the projection period. For the purposes of developing Scenario 3, this paper assumes that provincial contributions, already observed to be increasing less quickly than GDP, will slow further, increasing at a rate of only 2.0% per year. Since the federal government enjoys a more robust fiscal position, federal contributions are assumed to increase at a rate of 3.6% per year, in step with growth in nominal GDP.

The table below shows that these assumptions produce a social deficit of about \$11.5 billion in 2026.

<sup>30</sup>However, the indirect role of the federal government in shaping financial options for charities cannot be underestimated. It is the level of government that determines the tax treatment of the donations under the Income Tax Act, for example, and constrains the extent to which charities can earn their own income. It is also the level of government responsible for overall economic policy affecting the growth of GDP and employment and therefore of the capacity of people to donate. Finally, it funds large social transfer programs such as unemployment insurance, old age security and pensions.

### Scenario 3 Table: Economic Growth Slows

Highlighted sections indicate change from the status quo scenario.

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	3.6%	9.6	14.7
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	3.6%	7.1	10.8
Transfer from provincial government	2.0%	13.7	17.4
<b>Total</b>		104.4	190.9
Demand for services from charitable and nonprofit organizations grows at 5.7% per year	<b>Demand 2026 (\$ billion)</b>	<b>Total Revenue 2026 (\$ billion)</b>	<b>Surplus/(Deficit) (\$ billions)</b>
	202.3	190.9	(11.5)

This scenario shows that the charities and nonprofit sector and provincial governments will face essentially the same problem. Needs, primarily driven by demographic, cultural and social change, will require more spending by nonprofits, governments or both. But revenues will be limited by lower long-term economic growth. How this will be addressed is the core challenge of long-term social sustainability.

### 4.4 Scenario 4: Government Policies Accelerate Long-Term Growth

Lower long-term economic growth is not inevitable. Governments can, and likely will, undertake policy measures to stimulate growth of the economy as a whole.<sup>31</sup> Scenario 4 looks at the impact of increasing the rate of growth of the economy by 0.5% to 4.1% on current dollars in the period to 2026. This impacts

<sup>31</sup> Drummond proposes a comprehensive list of policy measure that would promote growth. The Key Challenge for Canadian Public Policy: Generating Inclusive and Sustainable Economic Growth, Don Drummond, Evan Capeluck & Matthew Calver, Centre for the Study of Living Standards, 2015.



projections in three ways. First, federal government transfers are projected to increase in step with the economy at 4.1% per year. Second, the provinces are assumed to remain constrained in their spending but able to finance more in terms of transfers to charities and nonprofits; specifically, provincial governments are assumed to increase spending transfers by 2.5% per year. Third, donations from households, which closely track GDP, are assumed in this scenario to increase at a rate of 4.1% per year.

The following table summarizes the assumptions underlying the accelerated economic growth scenario and shows the resulting social deficit. Under these assumptions, economic growth reduces the social deficit by just over \$2.5 billion, but does not reduce it to zero. Economic growth is helpful, but it is not a cure.

#### Scenario 4 Table: Government Policies Accelerate Economic Growth

Highlighted sections indicate change from the status quo scenario

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	4.1%	9.6	15.6
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	4.1%	7.1	11.5
Transfer from provincial government	2.5%	13.7	18.4
<b>Total</b>		104.4	193.4
Demand for services from charitable and nonprofit organizations grows at 5.7% per year	<b>Demand 2026 (\$ billion)</b>  202.3	<b>Total Revenue 2026 (\$ billion)</b>  193.4	<b>Surplus/(Deficit) (\$ billions)</b>  (8.9)

## 4.5 Scenario 5: Incorporating the Negative Consequences of Growth

Growth can be helpful to charities and nonprofits, but the impacts of growth may not be straightforward. Drummond, Capeluck and Calver have noted that economic growth in Canada has been inequitable, non-inclusive and has damaged the environment. If growth were to continue in the same way, this would imply, among other things, an increase in the demand for social services and environmental action. Scenario 5 assumes this increase in demand due to the negative consequences of growth that is not smart is quite modest, 0.2% per year. In other respects, Scenario 5 is the same as Scenario 4.

### Scenario 5 Table: Consequences of Economic Growth that is Not Smart

Highlighted sections indicate change from the status quo scenario.

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	4.1%	9.6	15.6
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	4.1%	7.1	11.5
Transfer from provincial government	2.5%	13.7	18.4
<b>Total</b>		104.4	193.4
Demand for services from charitable and nonprofit organizations grows at 5.9% per year	<b>Demand 2026 (\$ billion)</b>	<b>Total Revenue 2026 (\$ billion)</b>	<b>Surplus/(Deficit) (\$ billions)</b>
	207.0	193.4	(13.5)

The results of Scenario 4 suggest that economic growth can be good for charities and nonprofits and reduce the social deficit projected for 2026. However, the results of Scenario 5 indicate that growth that is not “smart” (to use Drummond’s useful term)

is actually counterproductive. It increases demand for what charities and nonprofits do.

#### 4.6 Scenario 6: Donations from Households Decline

Donations from households (i.e., individuals) account for roughly a tenth of the revenues of organizations in the core nonprofit sector. Donations have generally tracked GDP, typically at the rate of about 0.5% of GDP.

Scenario 6 poses the question: what happens to the social deficit if the rate of increase in donations from households slows?

The following social balance sheet shows the impact of assuming that donations grow at a rate of 3.0% per year compared to GDP growth of 3.6% per year. Other assumptions are the same as Scenario 1. The results indicate that a change in the growth of the donation rate of this magnitude would create a social deficit of slightly over \$1 billion compared to the status quo projection.

#### Scenario 6 Table: Donations from Households Decline

Highlighted sections indicate change from the status quo scenario.

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	3.0%	9.6	13.7
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	8.9%	7.1	19.7
Transfer from provincial government	3.2%	13.7	20.0
<b>Total</b>		104.4	201.3
Demand for services from charitable and nonprofit organizations grows at 5.7% per year	<b>Demand 2026 (\$ billion)</b>  202.3	<b>Total Revenue 2026 (\$ billion)</b>  201.3	<b>Surplus/(Deficit) (\$ billions)</b>  (1.0)

## 4.7 Scenario 7: Sales of Goods and Services and Memberships Constrained

Sales of goods and services and memberships are by far the most important source of revenue for the core nonprofit sector.<sup>32</sup> Revenue in both categories has become more important over the last decade, going from 57.8% of core sector revenue in 1997 to 62.2% in 2008.<sup>33</sup> Most of this growth was attributable to sales of goods and services.

Sales of goods and services are, however, a source of revenue that is highly constrained in Canada.

Current legislation limits public foundations and charitable organizations to operating businesses directly related to the charity's purpose. Private foundations may not operate businesses of any type... the Canada Revenue Agency's regulations are of little help for organizations that aim to achieve charitable ends by raising revenue through businesses unrelated to their charitable purpose.<sup>34</sup>

Scenario 7 assumes that regulatory and legal constraints slow the growth of revenue from the sales of goods and services and memberships. In contrast to the period 1997 to 2008, when these revenue sources grew noticeably faster than the charitable and nonprofit sector as a whole, growth is now assumed to just keep pace with the projected expansion of the sector, 5.7% per year.

The following social balance sheet summarizes the impact of different assumptions about the capacity of earned income to grow to meet the demand facing charities and nonprofits. Other assumptions are the same as in Scenario 1.

<sup>32</sup> "For example, arts and cultural groups, as well as recreational organizations, are dependent on administration and registration fees and other charges to generate income. Membership fees are certainly common across a wide range of nonprofit and voluntary organizations; others such as sport leagues or clubs charge fees for mission-related services that partially or wholly cover the cost of the service. Some nonprofit and voluntary groups have launched mission-related and/or ancillary businesses; various activities include the sale of program related products and services (i.e., employee Assistance Programs; museum shops)." Funding Matters: The Impact of Canada's New Funding Regime on Nonprofit and Voluntary Organizations, Katherine Scott, Canadian Council on Social Development, 2003.

<sup>33</sup> Author's calculations based on CANSIM table 388-0001.

<sup>34</sup> At the Crossroads: New Ideas for Charity Finance in Canada, Adam Aptowitzer & Benjamin Dachis, C.D. Howe Institute, 2012.

## Scenario 7 Table: Sales of Goods and Services and Memberships Constrained

Highlighted sections indicate change from the status quo scenario.

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	5.7%	49.8	96.5
Memberships	5.7%	18.6	36.1
Investments	2.2%	3.1	4.1
Transfer from households	3.6%	9.6	14.7
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	8.9%	7.1	19.7
Transfer from provincial government	3.2%	13.7	20.0
<b>Total</b>		104.4	196.8
Demand for services from charitable and nonprofit organizations grows at 5.7% per year	<b>Demand 2026 (\$ billion)</b>	<b>Total Revenue 2026 (\$ billion)</b>	<b>Surplus/(Deficit) (\$ billions)</b>
	202.3	196.8	(5.5)

Scenario 7 highlights the importance of sales of goods and services and memberships to charities and nonprofits. Small changes in rates of growth have a large impact on the forecast social deficit.

## 4.8 Scenario 8: Accelerated Demand Growth and Lower Economic Growth

Scenario 8 looks at the impact of a plausible combination of circumstances. What if the rate of increase in demand for what charities and nonprofits do accelerates at the same time as the economy and governments feel the impacts of lower long term economic growth?



## Scenario 8 Table: Accelerated Demand Growth and Lower Economic Growth

Highlighted sections indicate change from the status quo scenario.

Revenue From	Growth Rate 2014-2026	Total Revenue 2014 (\$ billions)	Total Revenue 2026 (\$ billions)
Sale of goods and services	6.1%	49.8	101.1
Memberships	5.9%	18.6	36.9
Investments	2.2%	3.1	4.1
Transfer from households	3.6%	9.6	14.7
Transfer from business	7.5%	2.5	5.9
Transfer from federal government	3.6%	7.1	10.8
Transfer from provincial government	2.0%	13.7	17.4
<b>Total</b>		104.4	190.9
Demand for services from charitable and nonprofit organizations grows at 6.2% per year	<b>Demand 2026 (\$ billion)</b>  <b>214.1</b>	<b>Total Revenue 2026 (\$ billion)</b>  <b>190.9</b>	<b>Surplus/(Deficit) (\$ billions)</b>  <b>(23.2)</b>

Under these assumptions, charities and nonprofits would require an additional \$23.2 billion over the status quo projection to meet the demands placed on them. This would mean close to doubling the amount forecast to be available from governments in 2026 or increasing revenue from sales of goods and services by about 25%.

### 4.9 Other Sources of Revenue

Charities and nonprofits earn income by investing their endowments and other revenues in the general economy in the form of equity and debt. Over the period 1997 to 2008, these investments contributed a relatively small but stable proportion of the revenue needs of charities and nonprofits. Investment earnings have roughly kept pace with the expansion of the sector and grown faster than GDP during this period. Over the longer term, returns from investments can generally be expected to track the performance of the broader economy.

Donations from municipalities and from the business community also comprise a relatively small proportion of revenue. Scenarios involving these sources have a relatively small impact on a projected social deficit.

To date, social finance has played a very small role in financing charities and nonprofits, more experimental than practical. Although efforts have recently been launched to attract private investment capital to “social enterprises” and to entice foundations to act like philanthropic banks, such efforts remain on the frontiers of philanthropic practice.<sup>35</sup>

#### **4.10 Summary of Scenarios**

Charities and nonprofits have been remarkably successful in expanding to meet increasing need, growing as a proportion of the overall economy in the last couple of decades despite constant concern about financial sustainability. Staff and volunteers struggle every day to raise revenue and meet the needs of their clients. They suffer the frustration of seeing need and not having sufficient resources to meet that need.

Quantifying the unmet needs of today is beyond the scope of this paper. Rather, it has attempted to assess, in a systematic way, the extent of the financial challenges that will face charities and nonprofits over the coming decade, using reasonable assumptions about growth in demand and growth in Canada’s economy. The table below summarizes the results.

<sup>35</sup>New Frontiers of Philanthropy – A Guide to the New Tools and Actors Reshaping Global Philanthropy and Social Investing, Lester Salamon (Ed.), 2014.

## Projections of Social Deficits to 2026

Revenue From	Growth Rate 2014-2026	Social Deficit \$ billions 2026
Scenario 1	Baseline	-
Scenario 2	Demand growth accelerates to 6.2% per year	(11.8)
Scenario 3	Slower economic growth impacts government transfers	(11.5)
Scenario 4	Long-term economic growth accelerates	(8.9)
Scenario 5	Non-smart growth causes increased need for charities and nonprofits' services	(13.5)
Scenario 6	Donations from households slow	(1.0)
Scenario 7	Sales of goods and services and memberships are constrained	(5.5)
Scenario 8	Demand accelerates, slower economic growth impacts government transfers	(23.2)

Simple projections of revenue and need show that the financial sustainability of charities and nonprofits – given the existing mix of financial tools and government policies and regulations – will become increasingly precarious over time. The ability of charities and nonprofits to meet the demands placed on them is particularly affected by realistic assumptions about

- the rate of growth in demand for what charities and nonprofits do, generated by ongoing demographic and social changes; and
- changes in economic growth rates, translated through fiscal decisions made by governments.

# 5

## CONCLUSIONS

Canada's charities and nonprofits are at a financial crossroads.<sup>36</sup> Rapidly increasing demands and slower economic growth will stress Canada's ability to sustainably finance the sector's efforts to combat poverty, care for the aged, and provide arts and culture and recreation. This will challenge both the nonprofit sector and governments to broaden policy horizons, think more in the longterm, embrace a wider range of financial and other options and explore more creatively the close connections between the charitable and nonprofit sector and economic policy.

Even with status quo assumptions, the nonprofit sector will continue to grow as a proportion of the economy. It will roughly double in size over the projection period to account for more than \$200 billion in revenue and roughly 700,000 jobs in 2026. It is past time for governments (and nonprofits themselves) to recognize the sector's importance as an economic force and treat it as a legitimate target for macro and micro-economic policies designed to stimulate smart growth, productivity and employment.

Second, under all reasonable assumptions, there will be a growing gap between what is expected from charities and nonprofits and what they can do with reasonable projections of trends in revenue. Charities and nonprofits will face the challenge of financial sustainability beginning in year one of the forecast period and increasing exponentially.

In view of the likely continued expansion in the need for what

<sup>36</sup>At the Crossroads: New Ideas for Charity Finance in Canada, Adam Aptowitzer & Benjamin Dachis, C.D. Howe Institute, 2012.

charities and nonprofits do, this paper has projected a structural social deficit facing Canadians and the nonprofit sector ranging up to \$23 billion in 2026 – a number that implies either substantial unmet social, cultural and environmental demands in 2026 or a significant increase in revenue generation. And a significant increase in revenue implies broad structural reforms both in the way governments fund and regulate the sector and in the tools charities and nonprofits use to fund themselves.

The scenarios show that the challenge of financial sustainability is not just a problem for charities and nonprofits. It is an all-of-society problem arising from the impact of demographics and economics on the ability of governments and charities and nonprofits to meet the social objectives of Canadians. The question facing charities and nonprofits (and governments) is of the broadest nature: how can the nonprofit sector, government and the private sector, all of whom face a similar problem of ends and means, work to achieve the prosperous, equitable and environmentally responsible society that Canadians want? There is no magic bullet remedy for challenges of this scope. It will require broad structural reforms in the way governments think of, fund and regulate the charitable and nonprofit sector. This means a comprehensive review and modernization of the sector's relationship to both federal and provincial governments.

Third, the scenarios show the important and underappreciated reciprocal relationship between economic activity and the charitable and nonprofit sector. As noted above, a dynamic, growing charitable and nonprofit sector is good for Canada's economy. But charities and nonprofits, too, need to recognize their vital interest in economic performance. Economic growth is good for charities. It generates the revenues that allow donors and governments to support the sector. The projected structural social deficit is generated in part by lagging economic

performance and charities and nonprofits have a vital interest in policies and programs that address fundamental economic issues of productivity and growth.

Of course, charities and nonprofits have an interest not just in the amount of economic growth, but also its quality. As Drummond, Capeluck and Calver have noted, growth that is inequitable, non-inclusive and environmentally damaging is counterproductive (see scenario 5 for an illustration). The overlap between the smart growth agenda and the mission-driven charitable and nonprofit sector is significant and potentially highly productive for charities and nonprofits. It offers the potential both to highlight the contribution of charities and nonprofits to smart growth and for charities and nonprofits to benefit from many of the policy options proposed to promote smart growth. Charities and nonprofits should therefore be involved in and strongly supportive of smart growth initiatives. Economic issues, as well as social justice and environmental responsibility, deserve a place in the advocacy efforts of the charitable and nonprofit sector.

# 6

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