A Positive Model of Private Charity and Public Transfers

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This paper explores a model where private charity and public transfers are determined simultaneously. In political equilibrium, the government "overprovides" public transfers, transferring more to the poor than altruistic taxpayers prefer. At this equilibrium, private charity is zero. Evidence for this result is found by examining various types of data from the 1920s to the present. While private charity currently exceeds $50 billion, very little of it goes to the poor. I provide evidence that this phenomenon of zero private charity began, as the model predicts, in the 1930s, the beginning of federal intervention in the charity market.

I. Introduction

The growth in the size of government transfers is well known. At the same time, private charity reached an all-time high of $53.6 billion in 1981 (*New York Times,* April 9, 1982). While many authors have suggested that there is a negative relationship between public transfers and private charity, evidence for this crowding out has been sparse.

This paper derives a rigorous statement of the crowding-out relationship. Private charity is motivated by altruism. The political process then adjusts the distribution of income in order to maximize the political support received from both rich and poor. This simple model yields a number of strong predictions:

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1. Private charity to the poor is reduced dollar for dollar by public transfers.

2. In political equilibrium, there is overprovision: there is more redistribution than is preferred by altruists.

3. In political equilibrium, public transfers reduce private charity to zero.

As evidence I show that the growth in public transfers to the poor during the Great Depression reduced private charity and caused a fundamental transformation of private agencies away from the relief of poverty toward other activities. This remains true today, with only a fraction of that $53.6 billion going to the poor.

Section II of this paper models private charity and its response to government policy. The inefficiency of private charity with many altruists is the impetus for government intervention. Efficiency can be achieved either by a system of tax credits or by direct taxation to finance public transfers. I focus on public transfers and their effect on private charity. Section III is an equilibrium model of the political process incorporating altruism. Section IV presents evidence on private and public transfers that is consistent with the theory. A final section concludes the paper.

II. A Model of Private Charity

Define altruism as the case where the level of consumption of one individual enters the utility function of the other. For example, let A be altruistic and let C's consumption enter A's utility function. Assume for simplicity that C is not altruistic, so utility of A and C can be written as

$$U_A = U_A(x_A, x_C) \tag{1}$$

$$U_C = U_C(x_C), \tag{2}$$

where x is the only consumption good. A's endowment is x_A^0 and C is assumed for simplicity to have an endowment of zero. If the act of transfer is costless, then A will set the marginal rate of substitution (MRS) between own consumption and that of C equal to one, the slope of the budget line. This is shown in figure 1 at E^*.

Now consider a world of two altruists, A and B, where each altruist takes the transfer of the other as given, the Cournot-Nash solution.[1] The equilibrium transfers T_A^* and T_B^* are such that, given T_B^*, T_A^* maximizes A's utility and T_B^* maximizes B's utility given that A's transfer is T_A^*. At this noncooperative equilibrium, E_1, the MRS of each

[1] See Goldberg (1979) for an analysis of the Stackelberg case.

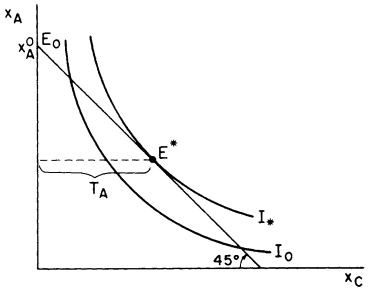

FIG. 1

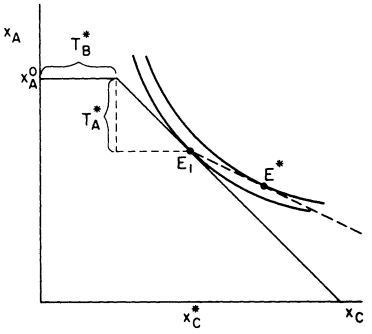

FIG. 2

altruist is again set equal to unity. This is shown in figure 2 from A's perspective. The noncooperative equilibrium is inefficient because there is a public good, C's consumption. If A and B agree to share equally the financing of increases in x_C beyond E_1, they can move outside their individual budget lines along a line of slope $-\frac{1}{2}$ from E_1. When A and B are identical they can move to a mutual optimum E^*, also shown in figure 2.

The point E^* is efficient since further increases in x_C reduce the utility of the altruists; reductions in x_C make C worse off. But points to the right of E^* along the line of slope $-\frac{1}{2}$ are also efficient.[2]

Assume that the noncooperative equilibrium in a world of many altruists is inefficient.[3] Efficiency can be achieved by a lump-sum tax combined with a subsidy or tax credit, s, that lowers the private price of transfers from unity to $1 - s$. As s increases, the price of charity falls and x_C increases, sweeping out the efficient points along the line of slope $-\frac{1}{2}$ out of E_1 when altruists are identical. Efficiency can also be achieved through taxation of the endowments x_i^0 to finance public transfers, T_G ($= \Sigma t_i x_i^0$), to C. Such a policy will reduce private transfers by each individual a dollar for each dollar each individual is taxed. In the aggregate then, the trade-off will also be dollar for dollar.

The result follows since government transfers financed by taxation leave budget lines and thus the equilibrium unchanged.[4] Before gov-

[2] More generally, efficient points are all points such that resources are exhausted and the sum of the marginal rates of substitution of altruists is less than or equal to one. For a proof of this result and a more detailed discussion of the Cournot-Nash model with many altruists, see Roberts (1983).

[3] I assume that private cooperative efforts to overcome free riding reduce inefficiency incompletely. Examples include pressure by employers during United Way drives and Israel bond drives where donors' names and contributions are revealed at fund-raising dinners.

[4] I wish to thank Gary Becker for insight into this proof.

ernment intervention, A chose x_A to maximize utility as in (1) subject to

$$x_C = T_A + T_B = x_A^0 - x_A + x_B^0 - x_B. \tag{3}$$

With taxes and transfers, A's constraint becomes

$$\begin{aligned} x_C = T_A + T_B + T_G &= x_A^0(1 - t) - x_A + x_B^0(1 - t) - x_B + tx_A^0 + tx_B^0 \\ &= x_A^0 - x_A + x_B^0 - x_B. \end{aligned} \tag{4}$$

Since (3) and (4) are the same, the same choice of x_A given $x_B^0 - x_B$ ($= T_B$) solves the maximization problem. This requires that T_A fall by tx_A^0. By the same argument, T_B will fall by tx_B^0. It can be shown that this result does not require identical altruists or tax rates.[5]

This dollar-for-dollar offset in the aggregate implies that x_C is unchanged when government transfers increase from zero. However, once the tax burden of an individual is equal to the original transfer T_i, increases in taxes increase x_C while private transfers are zero. Thus in the aggregate, if altruists are identical and taxed identically, transfers are zero at any point to the right of E_1.

This section has described a model of private charity and derived the reaction of private charity to policies that achieve efficiency. Now turn to the question of the level of redistribution chosen by the government.

III. A Positive Analysis of Government Redistribution in the Presence of Altruism

There are two extreme explanations for government redistribution. The first is that the alleviation of poverty is a public good; because of problems with free riding, as discussed, the private solution is inefficient.[6] An alternative explanation is captured crudely in the phrase "taxation is theft," where redistribution is seen as a struggle over the division of a pie with winners having more political power than losers.[7] These arguments can be combined by assuming that

[5] This result has been derived independently by Warr (1982). The result also holds when donations are tax deductible as long as individual tax burdens are held constant when deductibility is introduced. If only the aggregate tax burden is held constant, then the aggregate effect will be approximately dollar for dollar. Individual effects depend on whether income effects differ.

[6] Early articles on this theme include Hochman and Rodgers (1969) and a host of others.

[7] Peltzman (1980) uses a version of this argument to explain the size of government, a proxy for redistribution. Theoretical versions of this argument are found in Peltzman (1976) and Becker (1978). Becker (1983) more recently has allowed political power among pressure groups to be endogenous in determining general patterns of redistribution.

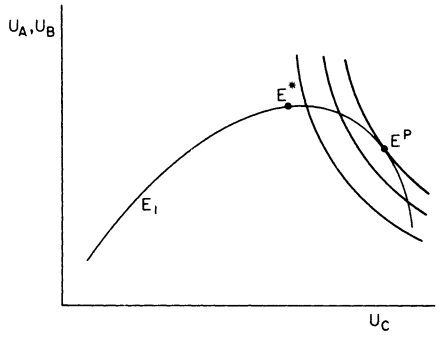

FIG. 3

redistribution is determined politically with the level of public transfers determined by the maximization of a function that has the utility levels of political constituents as arguments:

$$P = P(U_A, U_B, U_C). \tag{5}$$

Thus the political power of individuals is crucial, but efficiency considerations are important because individuals' utility, which enters the function, depends on the consumption of others.

The first partials of (5) are assumed to be positive. This type of function is found in Becker (1978), and a related idea is in Peltzman (1976). The level of the function is an index of political support; competition among political agents ensures that it gets maximized. Maximizing (5) requires that the distribution of income be efficient.[8] Which efficient point of the infinite number available maximizes (5)?

Figure 3 shows the utility possibility frontier and a set of iso-support curves—the set of utility realizations that keeps political support constant. Political equilibrium is found at the tangency between the utility frontier and an iso-support curve. With A and B assumed to be identical, one picture is sufficient. Altruism gives the frontier a hill shape. At low levels of U_C increases in x_C make A, B, and C happier.

The noncooperative point, E_1, is found on the upward-sloping portion of the frontier. Increases in x_C past E_1 continue to increase U_A, U_B, and U_C until E^*, the altruists' preferred point, is reached. The efficient points include E^* and those to the right. Increases in x_C beyond E^* benefit C at the expense of A and B.

If C has no political power, then the iso-support curves are horizon-

[8] This is not the same as saying that government passes only efficient laws. In a world of more complex policy options and costly redistribution, maximizing (5) could mean passing laws that had dead-weight loss associated with them.

tal and E^P and E^* are identical. But if C has any political power, that is, if (5) has positive first partials, then the iso-support curves are downward sloping and E^P must lie to the right of E^*. At E^*, the increase in political support from C when C receives an extra dollar outweighs the loss in support from A and B. The intuition is that at E^* small increases in x_C leave U_A and U_B unchanged since they are at a maximum but C is better off. Eventually this gain is offset by the losses to altruists and E^P is reached. This marginal political power of the poor at E^* results in E^P being to the right of E^*.[9]

IV. Implications for the Interaction between Public Transfers and Private Charity

This result has two strong implications. First, in equilibrium, at E^P, private transfers are zero. Private transfers are zero to the right of E_1. Since E^P must lie to the right of E^*, which is to the right of E_1, private transfers are zero at E^P. In the United States, spending on supplemental security income, food stamps, AFDC, and other government programs dwarfs private charity. Private charity in the United States is approximately zero. Measured charity by individuals was $44.5 billion in 1981. But most of these contributions are charity as defined by the Internal Revenue Service, not charity in the sense of helping the poor. They are mostly contributions to religion, education, health, and the arts.

Table 1 summarizes the findings of the 1982 study, *Giving, U.S.A.*, conducted by the American Association of Fund-raising Counsel. Private charity to the poor is in the social services category. Of the $53.6 billion donated to charity in 1981 by individuals, corporations, and foundations, only $5.32 billion was categorized as social services and only a fraction of that amount went to the poor. The social services category includes agencies such as the Salvation Army and religious organizations such as the United Jewish Appeal, Catholic Charities, and the Federation of Protestant Welfare Agencies. The religion category includes only sacramental spending that does not go to the poor.

But the social services category also includes the Boy and Girl Scouts and donations to the YMCA and YWCA. Almost one-third of the spending for social services in 1981 went to the United Way. United Way spending varies by community but typically includes spending on health and other items that only partially help the poor, such as day-care centers. So the social services figure, which was at

[9] Here I have used the concept of a support function to derive this result. More generally, it will hold for other models of the political process where preferences of different interest groups are given a nonzero weight in determining outcomes. The support function is just one way of capturing this property.

TABLE 1

CATEGORIES OF RECIPIENTS OF INDIVIDUAL, CORPORATE, AND FOUNDATION DONATIONS, 1955–81 (in Billions of 1981 $)

Year	Religion	Education	Social Services	Health & Hospitals	Arts & Humanities	Civic & Public	Others
1955	11.33	2.49	5.20	2.03	.68	.26	.67
1956	12.54	2.13	4.75	3.08	.48	.23	.48
1957	13.01	2.81	4.85	3.27	.52	.26	.82
1958	13.09	3.08	4.64	3.60	.51	.26	.50
1959	14.25	4.19	4.47	3.59	.62	.28	.57
1960	14.69	4.60	4.32	3.47	.58	.29	.86
1961	15.23	4.77	4.47	3.59	.59	.30	.90
1962	15.77	5.04	4.72	4.08	.63	.34	.90
1963	16.56	5.73	5.07	4.39	.67	.34	1.01
1964	17.33	6.01	4.96	4.25	.60	.46	1.75
1965	18.76	6.51	5.36	4.21	.65	.50	2.30
1966	19.78	6.58	5.35	5.80	1.05	.64	1.96
1967	20.16	6.68	5.15	7.68	1.03	.63	1.66
1968	21.46	7.65	5.51	7.88	1.06	.60	1.69
1969	21.96	7.87	6.30	8.02	1.36	.97	2.09
1970	21.78	7.59	6.74	7.96	1.46	.97	2.09
1971	22.43	8.00	6.56	8.20	2.06	1.34	2.74
1972	21.78	7.96	6.50	8.20	2.02	1.41	2.78
1973	21.51	8.38	6.26	8.49	2.56	1.25	3.91
1974	22.03	7.64	5.76	7.92	2.40	1.42	3.97
1975	21.81	6.67	5.30	7.47	2.90	1.50	4.48
1976	22.72	7.17	5.05	7.75	3.69	1.71	3.90
1977	25.42	7.13	5.28	7.36	3.41	1.76	3.72
1978	25.73	7.76	5.53	7.64	3.49	1.65	3.54
1979	25.24	7.51	5.45	7.46	3.38	1.50	3.68
1980	24.45	7.37	5.22	7.16	3.27	1.50	3.72
1981	24.85	7.49	5.32	7.36	3.35	1.54	3.71

SOURCE.—American Association of Fund-raising Counsel 1982.

virtually the same level in real terms in 1981 as it was in 1955, is an upper bound for measured transfers to the poor. This figure in 1981 was less than 10 percent of total private giving and an even smaller fraction of government spending on the poor, the exact fraction depending on how government programs are classified. Private transfers to the poor are simply not very large.

But the model says more than that private charity is zero. It predicts that private charity first became negligible when government first intervened in a significant way in the charity market. Significant government intervention began in the 1930s and has continued to grow over time.[10]

From the data to follow, a stylized picture of the 1930s emerges:

[10] There were public transfers before the 1930s, but the amounts were at the state and local levels, not the federal one.

TABLE 2

EXPENDITURES FOR RELIEF FROM PUBLIC AND PRIVATE FUNDS IN 120 URBAN AREAS, 1929–35 (in Thousands of 1929 $)

Year	Public Funds	Private Funds
1929	33,449	10,296
1930	56,158	10,944
1931	138,874	55,663
1932	315,061	71,619
1933	557,658*	36,939
1934	835,425*	18,804
1935	1,035,206†	14,536

SOURCE.—Geddes 1937.
* Excludes expenditures under the Civil Works Administration.
† Excludes expenditures under the Works Program.

private donations fell dramatically as public transfers rose. But they did not fall to zero. Instead, charitable donations underwent a fundamental transformation during the period. They became less concerned with poverty and more concerned with health and social counseling.[11]

Table 2 shows public and private transfers over time from 120 urban areas. From 1930 to 1932 both public and private transfers increased approximately sixfold. But while public transfers grew about 3½ times between 1932 and 1935, private transfers fell by a factor of 5 and approached the level of 1929. Unfortunately, the source for table 2 (Geddes 1937) stops in 1935. But other evidence suggests not only that the trend continued but that the uses of private charity changed dramatically over this period. The New York Association for Improving the Condition of the Poor (AICP) was founded in 1843. For 96 years it transferred resources to the poor, the unemployed, the sick, the elderly, and the husbandless mother. Between 1843 and 1939 it was one of the two most important private charities in the city, the other being the Charity Organization Society, an umbrella for a number of smaller charities. Between the 1920s and 1930s, the AICP's role and resources changed dramatically, as illustrated in table 3.

With the coming of the Depression, donations, total expenditures, and expenditures on material relief increased up until 1932.[12] This is the same pattern found in the national data. From 1932 to 1935, the experience of the AICP continues to parallel the national data—there

[11] Thus there is a serious problem with using aggregate donations to charity from 1929 onward. A dollar contributed to charity in 1929 bought a very different bundle of services than it did in 1939, e.g.

[12] Material relief is direct transfers of money and resources. Total expenditures include camps and homes run by the association for the poor, children, and the elderly.

TABLE 3

MATERIAL RELIEF, EXPENDITURES, AND DONATIONS, NEW YORK ASSOCIATION FOR IMPROVING THE CONDITION OF THE POOR, 1928–38 (in 1929 $)

Year	Material Relief	Total Expenditures	Donations*
1928	570,347	1,320,885	900,680
1929	538,167	1,397,047	827,286
1930	910,946	1,848,467	883,012
1931	1,377,964	2,518,749	1,092,823
1932	1,675,220	3,100,696	1,999,996
1933	1,415,593	2,748,344	1,712,399
1934	1,177,580	2,003,945	1,589,210
1935	1,096,386	1,931,303	1,306,765
1936	690,450	1,943,188	789,072
1937	544,153	1,848,110	855,906
1938	556,418	1,895,265	602,679

SOURCE.—Annual Reports of the Association, 1928–38.
* Excludes legacies. It is difficult to track legacies during the period.

is a decrease in donations and expenditures. But the most dramatic changes are from 1936 to 1938 when national data are missing. Donations fall to one-third of their 1932 level and two-thirds of their level in 1928. These results are consistent with the model.

An alternative explanation of these data is that as donors' incomes fell during the Depression, charity decreased and government had to take up the slack. Evidence against this explanation is found in the depression of 1890–94. In 1890–94 public transfers in the city of New York grew only 15 percent. At the same time, expenditure by the AICP grew by a factor of 4 over the 4-year period (Newcomer 1941, p. 654). So, despite a decrease in income, private charity rose substantially when increases in public transfers were relatively small. Even between 1929 and 1932 (see table 2), private expenditures grew sevenfold nationally. Donations to the AICP continued to grow until 1932 (table 3). Only when public spending continued to grow did private spending go to virtually zero.

Of equal importance with the large drop in donations from 1932 to 1938 is the dramatic change in the activities of the AICP away from antipoverty work. While donations did not go completely to zero, evidence suggests that transfers to the poor did. In 1939 the association merged with the Charity Organization Society forming the Community Service Society. This merger made the trend away from fighting poverty official. The theme is a common one in the annual reports of the AICP in the 1930s: "The AICP has made major revisions of budgets downward. Many families formerly cared for by the AICP have been turned over completely to public relief departments. Nearly one-third of the present number of families under care are

cooperative cases with public authorities, in which the cooperation consists in the AICP supplying social services not yet available in public departments" (Annual Report of the New York Association for Improving the Condition of the Poor, 1935–36, p. 10).

In 1939, *Survey Midmonthly,* a social work journal, reported the merger and explicitly recognized crowding out of private charity: "Both reports [by the two merging agencies] emphasize the freedom that has come to the private agencies with the public assumption of responsibility for relief. The AICP saw in this new found freedom a chance for the expansion of its health work, thus digging at the roots of one of the main causes of poverty and distress. The COS saw an opportunity for more intensive work in rehabilitation and family counsel" (*Survey Midmonthly,* May 1939, p. 152).

This shift from material relief to social counseling became more pronounced over time. Additional evidence suggests that this trend was a national one and that eventually private agencies came to ignore the poor, with counseling resources going to higher-income families. Dickinson (1970, p. 69) argues that religious organizations no longer dealt with the poorest families, letting these cases be handled by public agencies. Cloward and Epstein (1965) have documented this phenomenon across a wider set of organizations. They write, "Once publicly supported income maintenance programs came into existence, following the depression, private agencies began to refer economically deprived clients [to public agencies], thus conserving their resources for other services" (Cloward and Epstein 1965, pp. 623–24).

Initially, in the mid-thirties, public and private relief agencies were intended to supplement each other. However, "this division of labor—that is, private agency supplementation of public service—was . . . short-lived. As the pall of the depression lifted . . . a new conception of private casework began to emerge—one heavily dominated by psychological conceptions of family problems. It tended to eschew the importance of environmental approaches (housing, employment, medical, and other concrete environmental services). . . . The private agency began to limit its responsibility for poor people to conducting studies and to giving expert testimony about the current needs of welfare recipients" (Cloward and Epstein 1965, pp. 624–25).

This evidence suggests an explanation for some of the puzzling findings in the research on the trade-off between public transfers and private charity. Using data from 1948–72, Abrams and Schmitz (1978) found that a dollar increase in government welfare expenditures reduced private charity by 28 cents. Schwartz (1966) reports that his estimates over 1929–60 resulted in a small but *positive* relationship between public and private charity. In both of these studies

itemized charitable deductions from income tax returns are used as the dependent variable. Since much of these data consist of religious contributions, it is not surprising that a dollar-for-dollar trade-off or even a negative one is not found.[13]

The evidence presented raises questions that the model is too general to answer. Public transfers in the 1920s, though small by today's standards, were not zero, nor were private transfers. We would like to know how the composition of private agencies was altered before the 1930s as public funds at the state and local level began to be used for different types of relief—aid to husbandless mothers, the blind, the aged, and the unemployed. I suspect that private agencies were crowded out of each of these in turn as they were eventually crowded out of all of them. Obtaining data to test this idea would be extremely difficult, however.

The model of altruism presented here, while simple, is not a very rich picture of compassion. Altruism goes far beyond a desire to raise the consumption level of the least fortunate. As government takes over this task our compassion turns to imperfect substitutes: counseling services, alleviating the diseases that afflict children, and helping the less fortunate of other nations.

Another empirical application of the model is to the recent cuts in social welfare spending proposed by the Reagan administration. The model predicts that private charity will not increase when government cuts welfare spending. Changes in public transfers are movements from one equilibrium point like E^P to another. Private transfers are zero at either point. This does not imply a lack of compassion on the part of Americans. The only time a trade-off between private charity and public transfers is observed is when government moves from E_1 to E^P, as occurred at the federal level in the 1930s or today if for some reason public transfers were reduced to zero. The model also predicts that the large cuts originally proposed by Reagan for 1984 and beyond will not be enacted since it is unlikely that there have been large changes in the tastes of altruists or political power, the determinants of public transfers in figure 3. The actual cuts have been relatively small.

Another implication of political equilibrium is overprovision. The attempt of the altruists to avoid E_1 and achieve E^* by putting redistribution into the political arena is partially frustrated by the marginal political power of the poor at E^*. This is a cost associated with living in a society with representative government. This is a price worth paying

[13] Schwartz says, "A predominant part of private donations, however, go to religious causes, while no government funds of the welfare category are so channeled. . . . Thus, similarity of titles gives a spurious feeling of similarity of purpose; the two series are, to a marked extent, not comparable" (1966, p. 34).

unless C's political power is unreasonably large, since altruists are better off than they were at E_1. However, individual altruists could easily be worse off if they were less altruistic than others or if their political power were less than that of other altruists and it was sufficiently inexpensive to use policies that discriminated against them.

On the other hand, altruists have incentives to disguise their preferences. An individual who is indifferent toward the poor would pretend to dislike welfare recipients to reduce his tax burden. Though I assume full information on the part of the political process with respect to preferences, this phenomenon may be important. It suggests that professed views and survey responses on the level of government transfers understate the altruism felt by taxpayers.

V. Conclusion

This paper integrates two explanations for the level of public transfers—the public good argument and the political power of recipients. One result that emerges is that the political process "overprovides" public transfers in the sense that more resources are transferred to the poor than altruists desire. This implies that private charity is zero.

Current data and evidence from the Depression yield support for the crowding-out result.[14] The huge growth in public transfers in the 1930s crowded out private antipoverty efforts and fundamentally changed the nature of private charity. Current data also support this conclusion.[15]

As usual, this paper uses a number of simplifying assumptions. Public charity is a perfect substitute for private charity since altruists and recipients only care about the consumption level of recipients. If altruists receive utility from the act of transferring as well, then private charity would still be positive in equilibrium. The analysis also concentrates on homogeneous altruists. A more intensive examination of a world of heterogeneous altruists may lead to further implications and help explain why some goods are publicly provided and others are not.

[14] Since private charity is also zero at E^*, zero private charity does not imply overprovision.

[15] The evidence for the model came from the United States. England has a much older tradition of public provision for the poor. Of England's experience, Poynter (1969, p. 3) has written, "it is apparent that in the century after 1660 payments under the Poor Law became almost everywhere the ordinary source of relief for indigence, with private charity a supplementary source of varying importance, called on for great efforts only in times of extraordinary distress." I thank Stan Engerman for bringing this source to my attention.

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