

CHARITY AND NON-PROFIT INSTITUTIONS

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INTRODUCTION

Perhaps the most popularly discussed economic trend of the 20th century has been the boom in all kinds of observed transfer payments, or, as we shall call it, "charity." Yet economists have had little effect on these discussions. While pure economic theory covers the phenomenon of charity by considering the effects of utility interdependence under perfect market conditions (e.g. De Graaff, Arrow, and Daly-Giertz) we observe that transfer payments are not made through the institutions described in pure economic theory. Charity is almost always paid through non-profit institutions, either private or governmental. The central task of this paper is to identify the sources of efficiency of non-profit institutions as producers of charity.

Most economists who have written on charity think they know why the government provides much of observed charity. Charitable contributions often take the form of collective goods, where everyone else gains when one individual gives charity (as much as if they had given the charity themselves). With such goods, it is thought, there is a prima facie efficiency of government provision. But an alternative to government provision is government subsidy to private provision. A correct argument for government provision is that the value of the real resources devoted to excluding non-payers by private providers in an attempt at internalizing the benefits of the collective good may exceed the extra costs involved in government provision. But individuals who do not give private charity are not observed to be substantially excluded from enjoying the benefits of another's charitable contribution. Hence, there is no prima

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facie case for government provision of charity as a collective good.

Moreover, there is a difficulty in applying collective-goods analysis to charity in order to rationalize even a subsidy to privately provided charity. The problem is that private charity induces recipients to devote resources to enhancing their charity revenue. It works, for example, to set a positive price on contacting lung cancer by paying one's medical bills at a cancer research center. Thus, given that donors feel sorry for cancer victims and help pay for their care, people smoke too much, for they will not pay the full social cost of such behavior. But since charity here has the attributes of a collective good, everyone else suffers when a particular person gives charity to the cancer victim. For they do not like seeing someone suffer from cancer and the contribution increases the incidence of cancer. Hence, the charitable contribution is a collective bad as well as a collective good. I am better-off when you give another dollar of charity in that I free ride on the benefits you create for the recipient, but I am also worse-off in that I suffer from the losses your contribution inflicts by inducing more people to smoke. Presumably, you would not give up your dollar in the above scenario if you knew that the incidence of lung cancer would rise sufficiently to wipe out the net benefits to the recipients of your subsidy. So, in equilibrium, the external benefit exceeds the external cost of donation. But now suppose you can internalize some of the benefits of your donation, which appears to be quite prevalent based on studies of social pressure to give charity (Ireland-Johnson). Then you may rationally donate your dollar even though it does more social harm than good.

Hence, we cannot, with any confidence, rationalize government support -- let alone government provision -- of charity with standard, collective-goods analysis. (A rationalization of the observed U.S. subsidy to privately-supplied

charity based on a non-collective goods argument appears in Thompson (1974).) This leaves us with the part of our original question in which we seek to provide an efficiency explanation for the observation that a large and growing part of observed charity payments are made by the government sector. We begin our analysis with this question, holding our efficiency rationalization of private non-profit institutions until Part II of this study.

I. CHARITY AND THE GOVERNMENT

First we shall describe an equilibrium with charity in a private property system. To initially abstract away from collective goods problems, we first assume that there are only two individuals, G & R. To avoid notational complexities, we allow only a single, homogeneous, transferable commodity, whose quantity is indexed by the real number, x . For still more simplicity, we endow individual G, the "giver," with all of the goods; the "receiver," R, is endowed with none of the good. We thus write x_0^G and 0 as the respective endowments for individuals G & R. Also for simplicity, we allow each of our individuals to freely vary a real, continuous behavior variable of his own, given, respectively, by y^G and y^R . These can be thought of as variables representing a particular kind of non-transferable leisure activity which is performed prior to any social interaction between the individuals. Its significance will soon become clear. Preferences of our giver and receiver are described, respectively, by the differentiable, quasi-concave utility functions, $U^G(y^G, x^G, V^R(x^R; y^R))$ and $U^R(y^R, x^R) = F(y^R, V^R(x^R; y^R))$, where $(U_x^G, U_v^G, U_x^R, -V_y^R) \gg 0$. V is R's "utility," or valuation, function for x after he has consumed y . It is his relevant utility function at the time he receives his transfer. The assumptions on the derivatives imply that increases in y^R always reduce R's subsequent utility for a given x^R . High living in R's youth

takes its toll on his later capacity for enjoyment.

Notice that the giver cares about the receiver, but the opposite is not the case. This reflects a presumption that philanthropy does not become a significant argument in one's utility function until he surpasses a certain level of wealth. While the presumption is not immediately confirmed in the empirical literature on charity (c.f. Schwartz), we believe, based upon a discussion with Professor Tullock, that these studies, which use gross income from income tax returns for their wealth proxies, are severely biased away from our presumption.

To describe an equilibrium, the giver chooses (y^{G*}, x^{G*}) , which maximizes $U^G(y^G, x^G, V^R(x^R; y^R))$ subject to a given value of y^R and

$$(1) \quad x^G + x^R = x_0^G.$$

This produces a differentiable function from y^R to x^{G*} , which we write $f(y^R)$.

By assumption, $f' < 0$; the more the receiver dissipates by consuming y , the more charity he will receive. The receiver chooses y^R so as to maximize $U^R(y^R, x^R)$, where $x^R = x_0^G - f(y^R)$. Assuming that these maxima exist, the first order conditions are: For the giver,

$$(2) \quad U_y^G = 0, \quad \text{and}$$

$$(3) \quad U_x^G = U_{v x}^{G,R}.$$

And for the receiver,

$$(4) \quad U_x^R f'(y^R) = U_y^R.$$

Equations (1)-(4) determine the four-tuple which characterizes our mini-general equilibrium, $(y^{G*}, y^{R*}, x^{G*}, x^{R*})$. Note from (4) that since $U_x^R > 0$ and $f' < 0$, in equilibrium, $U_y^R < 0$. That is, in equilibrium, the receiver's y -activity level is extended to the point that he has a negative marginal utility for it. This is so because the receiver will generate a positive transfer from the giver if he lowers his utility level by increasing y . By making himself worse-off, he earns a payment from the giver. Is this efficient? Does the giver want

the receiver to be worse-off, so he can have the opportunity to help? No, not in the above environment; our giver is too benevolent for that. The Pareto nonoptimality of this private charity equilibrium is easily seen by deriving the conditions for Pareto optimality in the above environment. This is done by maximizing U^R for a given U^G , say $U^G = U^1$. To do this, we maximize the Lagrangian,

$$U^R(y^R, x_0^G - x^G) + \lambda(U^1 - U^G(y^G, x^G, V^R(x_0^G - x^G; y^R))),$$

with respect to y^G , x^G , and y^R . The first order conditions are:

$$(5) \quad U_y^G = 0$$

$$(6) \quad U_x^R = -\lambda[U_x^G - U_{Vx}^G V_x^R], \quad \text{and}$$

$$(7) \quad U_y^R = \lambda U_{Vy}^G V_y^R.$$

We are assuming, of course, that the optimum exists so that λ is finite. Since $U_x^R > 0$ and since equation (3) says that $U_x^G - U_{Vx}^G V_x^R = 0$ in the private solution, equation (6) tells us that the private equilibrium is not a Pareto optimum.

Further inspection of (3) and (6) indicate that the inefficiency of a competitive equilibrium reflects a failure of the giver to take into account the full external effect that his giving has on the utility of the receiver. But one should not conclude that a private charity is undersupplied or that a simple subsidy to private charity is in order. For (7) is also violated in a private equilibrium.

This can be seen as follows: Since $\lambda = \partial U^R / \partial U^1$ and we are at a Pareto optimum, $\lambda < 0$. So, since $V_y^R < 0$ and $U_V^G > 0$, (7) tells us that $U_y^R > 0$ in a Pareto optimum. But U_y^R was negative in the equilibrium. This indicates that y is overly extended in the private equilibrium as R overly consumes in his youth in order to reduce his later utility and induce larger transfers of wealth from G . This effect, by itself, is a source of increased charity so that there should be no presumption of a net undersupply of private charity in this model. And a subsidy to charity,

while working toward the advancement of (6), will induce more of the already overdone y^R , and therefore increase the degree to which the free market violates (7).

What has gone wrong? Haven't we asserted that pure economic theory has no difficulty covering the phenomenon of charity, in which case our equilibrium should be a Pareto optimum? The problem that has naturally made its way into our analysis is the classical -- no, biblical -- problem that the recipient of charity is encouraged to over-devote resources to activities which will make him more pathetic and therefore increase his charity income. This is why y^R is extended in equilibrium to a point at which $U_y^R < 0$. The problem, what Professor Buchanan calls "The Samaritan's Dilemma," is the result of the giver's inability to make his payment contingent on a certain level of y^R . ^{1/} So, presumably, y^R cannot be observed by G. This seems realistic enough and we shall maintain the assumption throughout our analysis. The fact that G (or some private agent working for G in an extended model) cannot observe y^R suggests that neither can some externally imposed government authority. So, even though y^R appears in the formal equilibrium model as a simple externality, we cannot treat it as such for policy purposes. The government cannot tax it if they cannot observe it. So the efficiency loss involved is not, when correctly understood, a standard, Pigouvian externality loss. I usually call such joint efficiency losses, joint losses due to information differences between contracting parties, "transaction costs," and will maintain that terminology here. Elsewhere, I have shown, and

^{1/} One might think that the giver need only be rigid and commit himself to a given amount of x^G independent of y^R . But this is not the case. To see this, merely note that maximizing $U^R(y^R, x^R)$ with respect to y^R , with x^R considered as a constant by R, yields $U_y^R = 0$, which violates efficiency condition in (3) since $\lambda < 0$, $v_y^R < 0$, and $U_v^G > 0$. Intuitively, R's human abstinence in his youth, and resulting health in his later years, benefits G so that he should not be led to ignore the effect. In a more conventional, but less realistic, model in which G benefits from U^R rather than v^R , this would not be the case.

will show in Part II in a more general charity model, that if real transaction costs cannot be reduced for a given set of transactions by government intervention, implying that government provision at lower real transaction costs is not possible, then a competitive private-goods equilibrium with transaction costs is Pareto optimal (Thompson, 1977 and 1968). However, an important, to me quite disturbing, characteristic of transaction costs is that, despite the impossibility of applying Pigouvian taxes, a wide variety of government interventions do exist which may serve to reduce transaction costs for a given set of transactions.

For the problem at hand, suppose we allow government intervention, where the government dictates a replacement of the private system of giver-selected charity with a system in which the recipient is allowed to choose his own level of charity, subject to a certain minimum amount of utility, \underline{U} , which the giver must maintain. The reason the government is required to make this change should not be immediately apparent. Nevertheless, the change in the incentive system changes the optimization problem to one in which the receiver chooses x_G as well as y^R so as to maximize the following Lagrangian expression:

$$U^R(y^R, x_0^G - x^G) + \mu(\underline{U} - U^G(y^G, x^G, V^R(x_0^G - x^G; y^R))).$$

This is the same maximand used above to compute a Pareto optimum (except that U' has been replaced by \underline{U}). But while y^G was a variable in computing the Pareto optimum, it is here chosen by G and taken as given by R in computing his individual optimum. Nevertheless, equations (6) and (7) apply here so that the misallocation which appeared in the private property equilibrium due to over-extending y^R and underproviding charity for a given y^R no longer hold. What remains is to examine the effect of this new system on y^G . Of course, G may still choose it so that $U_y^G = 0$. But what incentive does he have to do so if

he is guaranteed \underline{U} ? The answer is that G is only guaranteed a potential of \underline{U} . He must maximize U^G for given values of x^G and y^R in order to actually attain \underline{U} . Thus, G, taking the optimal choice of R as given, looking at constant values of x^G and y^R , will obviously maximize U^G by setting $U_y^G = 0$. So our problem is finished.

The result, of course, is that in moving to a receiver-determined system, a Pareto optimal solution is created. By surrendering his power to decide the amount of charity to the recipient, the giver has freed himself from his overly charitable response to the recipient's dissipation. And since the recipient is not responsive to such behavior on the part of the giver, no new inefficiency is created.

The above amounts to a simple paradigm indicating the allocative superiority of receiver-determined charity over giver-determined charity. But does it really suggest government intervention in the private charity market? Since the givers in a private charity market see their dilemma, why do they not privately grant to the receivers the power to determine their own redistributive incomes? The answer lies, we believe, in the relatively high cost of any private charity contract which ties receivers to a specific set of givers and assures the givers a fixed benefit level. Furthermore, when y^R is unobservable, private charity contracts, which are then contracts without consideration, are unenforceable. In any case, private philanthropists are not observed to be legally bound to give, or not give, anything. The only method of commitment open to a giver is to establish an institution which, owing to its particular organizational structure, would be insensitive to the narrow philanthropic interests of the giver. That is, decisions within his charity organization could be made by individuals who do not have the charitable preferences of the founder. But if the

decisions in his organization were made by less charitable individuals, including personal reformers, then the founder would find it very difficult to assure that his initial wishes were carried out. He would have little confidence that his contributions would go to R individuals in the desired proportions. The decision makers could simplify their jobs fairly easily by indiscriminant giving, or, in the case of the reformer, by giving to people projecting the "right" attitudes. In any case, a good part of those receiving the charity would be undeserving according to the preference function of the philanthropist. But not all of these costs suffered by the founding giver would be social costs, as rents would accrue to the undeserving who could most easily qualify for aid from the largely indifferent or overly moralistic administrators. So the founder's private costs of such an organization would exceed the social costs of the organization. Apparently, the private costs of these latter organizations are sufficiently high that they are rarely adopted in the real world. Observed private charities are normally run by benevolent representatives of wealthy philanthropists. This means that private charity markets are pretty much as our paradigm characterizes them. In any case, there is an opening for government intervention in the form of "subsidies" to the kinds of charity run by the less-charitable and the reformers. These "subsidies" -- which represent government support for a particular organization form over another in providing the same product -- amount to what we have called government "provision."

In summary, government intervention in the form of the provision of charity may lower the real social transaction costs of charity by avoiding Samaritan's dilemma problems which private givers are unwilling to avoid due to what they perceive to be wastes but which are mere transfers to the undeserving.

Empirical signs of the applicability of this theory are unmistakable. Private charities are observed to be run, by and large, by benevolent, altruistic

beings, compassionately aiding the genuinely needy while public welfare agencies are observed to be run, by and large, by personal reformers and ex-altruists who suspiciously, and often begrudgingly, dole out money as well as services -- often on the basis of a rigid, relatively cruel formula -- to a motley crew of true indigents, undeserving professional welfare dependents demanding their rights under the law, and simple liars. (Weinberger.) It is testimony to the power of economic analysis over intuition that the latter may be an efficient institution when the former is an available substitute.

But the government may, at least in principle, achieve this efficiency not by giving the choice of x^G to the receivers but by simple setting up an institution which somehow or another achieves charity levels and anti-dissipation incentives so as to satisfy (6) and (7). So a question may arise as to why we are representing the superiority of the system with government provision as one in which the receivers, at least as a group, are given the constrained power to determine their own charity income. To answer this, first note that a government in which decisions are essentially unanimous is not itself completely immune to the Samaritan's dilemma. While such a government is a collective which includes many recipients of public welfare -- deserving and otherwise -- and therefore internalizes much of the external costs responsible for the inefficiency in the private supply of charity, it also follows the narrow self interest of the benevolent voters. It therefore will grant overly large subsidies to charities catering to relatively pathetic cases. But the kind of "government" which we consider here is one which is closer to majority rule in that it generates a continual, democratic, political determination of what we have taken to be the endowed distributions of wealth. In achieving an equilibrium redistribution, in any time period, a subgroup of relatively poor, politically enfranchized, individuals will maximize the excess of their redistributive wealth gain over

their political costs, the latter being strictly determined by the extent of the redistribution. Because many in the benefiting group are undeserving (or many in the giving group are not charitable) the larger the redistribution, the greater the political cost of achieving it. Such a system implies a maximum net redistribution to the poor for given final utilities for -- and this for given redistributions from -- the relatively wealthy individuals. This is just the efficient, receiver-determined charity system described above except for non-charitable lump-sum transfers and the presence of variable resources devoted to the political system.

When explicitly accounting for the latter, the dead weight losses devoted to distribution fights within the kind of government considered here, the above conclusions remain in tact. Moreover, accounting for these losses enables us to explain the growing dominance of government in the welfare field. In examining democratic political systems which determine the endowments of private properties, it is often convenient, due to the non-existence of permanent equilibria, to perform the theoretical analysis in historical time. The following historical sketch contains our theoretical analysis.

At earlier, lower levels of aggregate wealth, the relatively wealthy were not so charitable. Being a political minority, they fought hard to keep their property and devoted significant resources to the political process in order to maintain their endowments and protect their savings. Proceeding to the present, aggregate wealth has increased, and the amount of charity which the relatively wealthy wish to give has greatly expanded. One way for them to achieve their desired expansion would be to keep up the political fight, earn a high income, and then give much of the spoils of their fight back to the poor in an expensive system of private charity. But a now-easier way for the relatively wealth to proceed, although some set-up cost is no doubt involved, is to yield more political power

to the poor and give less private charity than otherwise. The result is the same desired increase in charity with a lower present cost of their resources devoted to the political process. Samaritan's dilemma waste does not occur because the recipients would have to fight harder for their redistribution if it was present. So they prefer that the government choose -- instead of simple subsidies to the poor such as a negative income tax -- public assistance and welfare programs with rigid rules and professional social workers, inured to the sufferings of the poor, not themselves wealthy enough to allow their preferences toward the relatively unfortunate lead them into activities which significantly bend the rules for the relatively unfortunate, and bound to rules which transfer significant amounts of resources to undeserving types.

Summarizing our historical sketch: As aggregate wealth has increased, the relatively wealthy have found, because of the increase in their own demand for redistribution toward the less fortunate, that the benefits of reducing their normal expenditures on maintaining political power, while allowing more charitable-redistributional bills and broader political representation of the poor, have increased relative to the set-up costs of the change.

Holding this view of the world, we would expect a rapid expansion of public relative to private charity to occur with the expansion of total expenditures on charity. Along with this would be a greater liberalism (20th century sense) of the wealthy, a gradual political enfranchisement of the poor, and an observed increase in the use of political power by groups of welfare recipients. The occurrence of these events almost undeniable. (C.f., Pryor, Weinberger.) Moreover, Professor Demsetz has recently presented statistical evidence that the abnormal growth of government sector, which is largely due to the growth of the welfare sectors, has come pari passu with the political enfranchisement of the poor.

II. CHARITY AND NON-PROFIT ORGANIZATIONS

Professor Tullock has argued that private charity firms are different from other private suppliers in that the customers of a charity firm, the givers of charity, care what is done with their payments while the customers of non-charity firms do not. While firms providing financial services such as brokerage houses are an observed exception to this argument, another somewhat distinguishing characteristic of charity is that the customers find it relatively costly to find out what is really done with their payments. In contrast, it is relatively easy for a customer of a financial service company to detect a failure of the company to spend his money in the intended fashion. Combining these two characteristics, we offer the following uniquely determining feature of a private charity firm: A private charity firm is different from other private firms in that its customers substantially care what is done with their contributions and cannot easily determine what is, in fact, done with these contributions. We are therefore including private hospitals, schools, and research foundations in what we are calling private charity firms because they

all have contributors, or charity customers, who substantially care about what is done with their contributions but cannot easily determine what is, in fact, done.

Now if a private charity firm set itself up as an ordinary firm, where the owner-manager captured the excess of created marketable benefits over the corresponding costs of production, he would find some very suspicious customers. For they would have a very difficult time ever knowing whether or not the product which they desire to purchase is actually delivered. Rather than so substantially straining the customers' credulity, and receiving a correspondingly low revenue, the owner-manager may make a legal contract with the customers that he will never make more than a fixed "profit" -- i.e. a salary -- from the operation. Then the customers would, of course, have concrete, legal, assurance that the owner-manager was not pocketing most his contribution and making a token effort at supplying the desired service sufficient to avoid prosecution for outright fraud. The superior organizational form chosen by the owner-manager is called a private, non-profit organization. (A similar argument can be made for public non-profit organizations, but proper elaboration of this would take us beyond the scope of this paper.)

All of this seems to be a natural part of an efficient private property system. Moreover, we do observe in the real world that most private charitable organizations -- including private hospitals, schools, and research foundations -- do in fact take on a non-profit organizational form.

While -- as Professor Alchian has so well impressed upon us -- incentives of the managers of non-profit organizations are more attenuated in these systems than for managers in for-profit firms, apparently the reduced efficiency because of these incentives is often overshadowed by the increased efficiency in satisfying the customers that their contributions are being put to good use.

Nevertheless, as we pointed out in Part I, the private contributor realizes that he must appoint managers with preferences similar to his own or else suffer the large private costs of having his managers spend the contributions in ways which do not follow the contributor's preferences. This indicates that managers in non-profit firms do, in fact, follow fairly closely the preferences of the contributors. In fact, with Samaritan's Dilemma problems, they follow the contributor's preferences too closely and government intervention is in order to provide society with managers who are not so faithful to the contributors.

But our concern in this Part is only for the part of the world represented by private non-profit institutions. Our only problem at this point is understanding why economic theorists regard them to be such peculiar animals. Apparently, the answer is that there is no formal economic theory of the firm and industry for non-profit firms which stays within the assumptions of perfectly competitive factor markets and full rationality characteristic of the standard theory of production. So let us consider an industry composed of rational non-profit charity firms competing for a large number of customers such as those described above under conditions of perfect factor markets. Our goal here will be to simply compare and contrast the model with a standard model of perfect competition between profit maximizing firms selling to customers who know whether or not the product they are paying for has been delivered. We will close the analysis with a discussion of the policy implication of the model, tying the analysis into the discussion in Part I.

Measuring the output of a charity firm as the total number of dollars, or x , collected, the "total revenue function" of a charity firm can be represented by a 45° line coming from the origin. This is represented in Figure 1 as the TR curve. For every dollar collected, there is a dollar of revenue. The

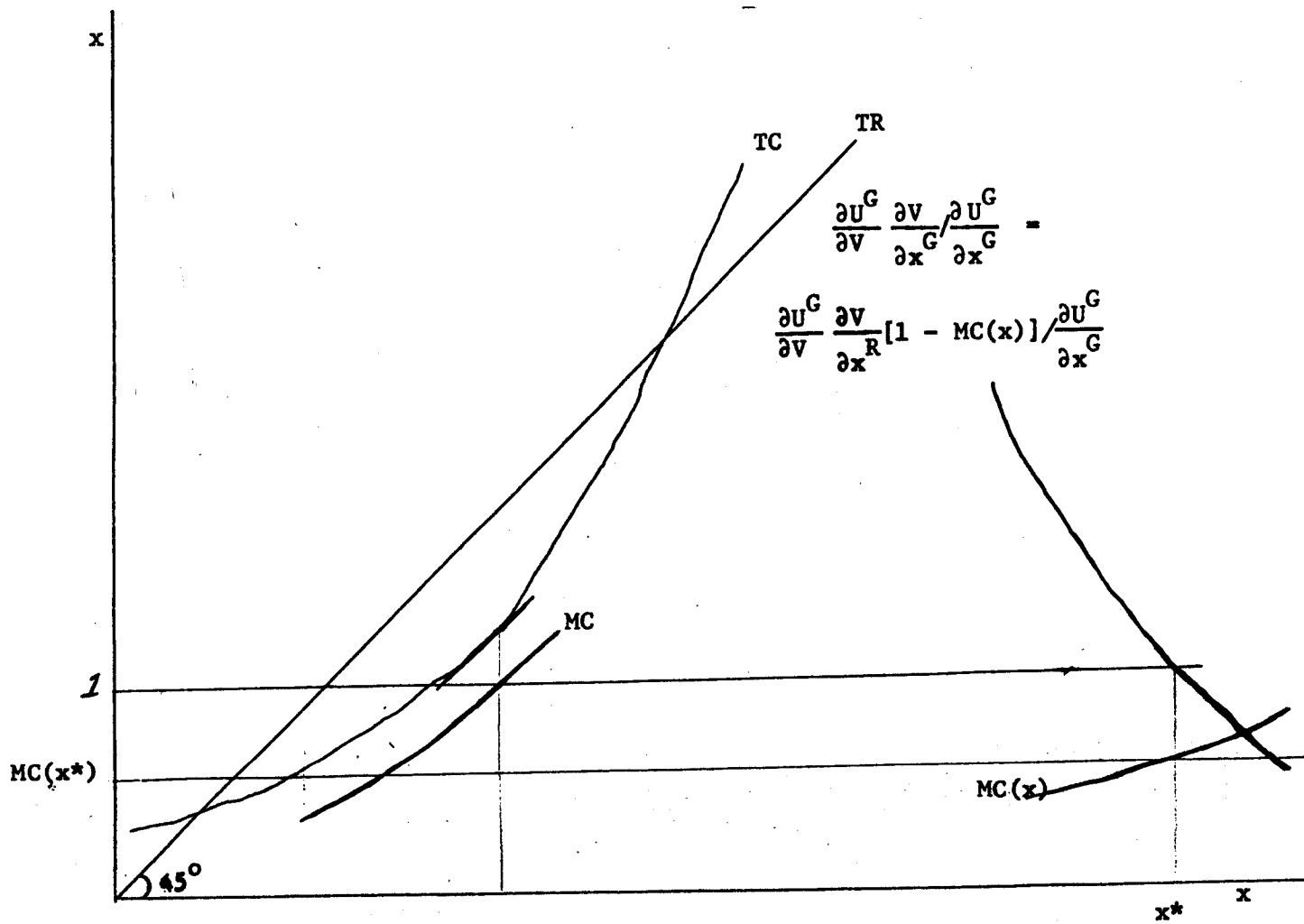


Figure 1: Competitive Equilibrium in the Charity Industry.

total transaction costs of the firm's collecting and giving are represented by the convex-from-below TC curve on Figure 1. TR - TC is, of course, maximized where marginal revenue equals marginal cost. But TR - TC is not profit. There is no profit, TR - TC is the firm's net charity payment. We could assume that the managers want to maximize their net charity payment, but this would be true only in a special case and not generally descriptive of the actual solution, which generally stays below this level of charity. In general, the managers are competitively paid factors of production and, as such, are indifferent to the firm's possible outputs. If the managers are indifferent and there are no controlling owners, how is the output determined? The answer is that the customers determine the output! A rational giver, in maximizing his net aid to the receivers for a given gross payment, equates his marginal net contributions to all charities. Thus if one charity firm had a lower net marginal transaction cost than the others, it would receive all of the charity business. And if one firm had a higher marginal cost, it would receive no contributions. So the marginal transaction cost of all charities must be equal in a competitive equilibrium. In equilibrium, the level of marginal transaction cost, MC(x), is that for which the supply and demand for charitable contributions are equal, i.e., as illustrated in Figure 1, for which,

$$\frac{\partial U^G}{\partial V} \frac{dV}{dx} \frac{\partial U^a}{\partial x} = \frac{\partial U^G}{\partial V} [1 - MC(x)] \frac{\partial U^G}{\partial x} = 1.$$

This is different than a standard, text-book competitive model in that the customers, not profit maximizing firms, are making all of the output decisions. And output price is not a variable; only cost is. And customers are attracted to and repelled away from firms according to their marginal production (i.e. transaction) costs rather than market prices.

Since the TR curve is always a 45° line, the familiar monopoly misallocation is not formally present in the charity industry. More directly, the customers atomistically choose their own contributions to the monopoly charity firm and thereby determine the output of charity to be that point at which their utility of consuming an extra dollar equals their utility from the charity receiver's consuming what is left of the dollar after the marginal charity transaction costs are taken out. This is the same calculation as characterizes the competitive solution. So monopolistic charities are, according to this model, no different in welfare terms than competitive charities.

The Pareto optimality of such an equilibrium, given transaction costs, is not immediately apparent. As in Part I, the social value of charity in equilibrium exceeds its private value because the givers only count their own utility for the receiver's gift; the receiver's utility is not an added component of the social value determining the equilibrium. But when we attempt to make everyone better off than they are in a competitive equilibrium by forcing more charity on the system, the only way to compensate the givers is to force the receivers to do less of the y^R activities which decrease the utility of the givers. But y^R is not observable by the givers or the government. So they cannot force such a decrease on the system. On the contrary, were charity to increase, there would be an increase in y^R activities! So the givers cannot be compensated for giving more charity, and the transaction-cost equilibrium is a Pareto optimum for given transaction costs. The only way to improve our private economy then is to reduce transaction costs, as was discussed in Part I.

SUMMARY

I. A source of efficiency of government in making charitable payments is its relatively superior ability to solve the Samaritan's dilemma. This occurs for at least one reason: Government provision allows a system where social workers are more able to redistribute to undeserving individuals and more able to operate independently of the benefactors that finance the system. Lower social transaction costs for a given amount of charitable redistribution thus results from some government provision of charity. This theory can be used to explain the observed government provision of charity and the observed qualitative differences between private and public charities. An additional reason for lower transaction costs via governmental provision exists when the government is run by simple -- rather than Wiksellian (e.g. 80%) -- majority rule. Under a simple majority rule government, redistributions continually occur within the political system. With such a government, we can view government-determined charity as receiver-determined charity, where no Samaritan's dilemma exists at all. Using this model of government, an explanation for the rapid increase in public relative to private charity is apparent: As the total demand for giving charity has increased, givers have simply reduced the resources that they devote to the political system in order to maintain their relatively high endowments, thus making it cheaper for the receivers to acquire charity payments through the public sector. The argument also serves to explain the secular trend towards broader political enfranchisement. This argument for the superiority of the government sector in solving the Samaritan's dilemma and for the growth in the political power of the charity recipients can -- by thinking of the world as a two-person interaction -- be formally supported by a model whose main theorem is that while a charity equilibrium in which givers determine

the amount of charity is Pareto nonoptimal, an equilibrium in which the receivers determine their charity incomes subject to a given utility level of the givers is Pareto optimal.

II. The concern of the customers of a firm over the distribution of their payments to the firm and the difficulty of discovering what is, in fact, done with their payments, is a distinguishing feature of charity firms relative to other firms. Correspondingly, a source of efficiency of private, non-profit organizations relative to for-profit organizations in making charitable payments is their relatively superior ability to convince the givers that their contributions will be delivered to their intended beneficiaries. The fact that almost all charity firms are non-profit firms and almost all non-profit firms are charity firms (with charity broadly defined) is evidence for the empirical power of this simple, efficiency-oriented theory of non-profit organizations. A Marshallian type of industry analysis reveals that a charity industry is like others in that its competitive equilibrium is a Pareto optimum, given the costs of private transactions (i.e. given the costs of the Samaritan's dilemma). But it is unlike other industries in that the customers rather than the managers determine outputs and that a monopoly equilibrium is equivalent, in welfare terms, to a competitive equilibrium.

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