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Can Civil Society Finance a Private Welfare System? Completing the Move
from Public to Private Welfare

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Executive Summary

The outsourcing of welfare services in the U.S. in the past decade has allowed state and federal welfare agencies to reduce the overall cost of welfare services and improve the quality of services offered to welfare recipients. Although the outsourcing of welfare services is widely considered to be a great success, the welfare system can be further privatized, yielding even more potential benefits to society. The financing of welfare services is still almost exclusively the responsibility of the government. The current limited privatization of welfare could be expanded by allowing private entities to take responsibility not only for the delivery of welfare services, but also for their funding.

This study argues that public financing of welfare services is not a necessary condition. Private philanthropy could fully cover the costs of providing welfare services were individuals provided with the right tax incentives. Econometric studies using U.S. data show that charitable contributions are very sensitive to tax incentives. The estimates imply that if the government were to offer more tax-deductibility for charitable gifts, or subsidize private philanthropy through tax credits, charitable contributions would increase to the point of fully covering the costs needed to supply welfare services on a national scale. Note that the increase in charitable contributions required will not need to fully offset the loss in government revenues due to greater tax breaks. Private organizations can provide higher quality welfare services at a lower cost. This study reveals that one dollar of privately donated money is equivalent to \$3.70 of public tax dollar money.

If the U.S. government were to offer a 100% tax credit on charitable contributions, the national net budget for welfare services would be 135% higher than it is today under the actual schedule of 100% tax deductibility. More importantly, the government would decrease its funding by 32% and the private sector would increase its share of funding by 36%, allowing the welfare system to wear-off public money over time.

I. Introduction

The outsourcing of welfare services in the U.S. in the past decade has allowed state and federal welfare agencies to reduce the overall cost of welfare services and improve the quality of services offered to welfare recipients. The historically poor results of state welfare agencies, an increased interest in performance-based management techniques and the adoption of the welfare to work program spurred the utilization of private welfare providers in the US during the 1990s.

In 1996, the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) and its Temporary Assistance to Needy Families (TANF) block grant further expanded the scope of services that could be outsourced, when it dropped the requirement that eligibility for welfare services be determined only by public entities. According to the US General Accounting Office in a 2002 report, the “work first initiative” also known as TANF, has now been either partially or wholly outsourced in almost every one of the 50 states.

Although the outsourcing of welfare services is widely considered to be a great success, the welfare system can be further privatized, yielding even more potential benefits to society. The financing of welfare services is still almost exclusively the responsibility of the government. The current limited privatization of welfare could be expanded by allowing private entities¹ to take responsibility not only for the delivery of welfare services, but also for their funding.

This study argues that the public financing of welfare services is not a necessary condition. Private philanthropy could fully cover the costs of providing welfare services were individuals provided with the right tax incentives. Econometric studies using U.S. data show that charitable contributions are very sensitive to tax incentives. The estimates imply that if the government were to offer more tax-deductibility for charitable gifts, or subsidize private philanthropy through tax credits, charitable contributions would increase to the point of fully covering the costs needed to supply welfare services on a national scale. Note that the increase in charitable contributions required will not need to fully offset the loss in government revenues due to greater tax breaks. The reason is that one dollar of privately donated money can buy more welfare services than one tax dollar. Nonprofit organizations can provide higher quality welfare services at a lower cost.

The rest of this paper is organized as follows. In Section II, a brief evaluation of the U.S. past experience with outsourcing welfare services will be provided. It will be shown that the use of private welfare providers led to a decrease in the cost of welfare services and an increase in its quality. Results from econometrics studies in the US will be presented and it will be shown that the introduction of tax credit on charitable giving will not decrease the overall national budget for welfare. In Section III, the study simulates different schedules of tax credit and finds that the amount of funds available for welfare is positively correlated with the level of the tax credit. In Section IV, the results on U.S.

¹ Private entities include both for profit firms and nonprofit organizations.

data are checked against Israeli data, and similar results were found. This will imply that the privatization of the welfare system doesn't need to be limited to the U.S but could be expanded internationally.

II. Background

1. TANF

In 1996, the PRWORA legislation reshaped the welfare system of the US. The states were each given a federal block grant and were made responsible for chartering their local welfare programs. After the approval of the PRWORA legislation, individual states were allowed to design and implement its own TANF program. However, the state's autonomy was limited by federal guidelines. The new legislation required that each state place at least 25% of their welfare recipients in jobs or work-related activities by 1997, and 50% by 2002. If the state couldn't fill the federal requirements, their federal welfare funding could be lowered.

The need for the state to improve their job placement services prompted them to outsource that task to private providers. Many states felt that their public servants lacked the skills or the motivation to place welfare recipients in work related activities. The state also felt the need to cut the overall budget of their national welfare system. First they had to keep their welfare bill under the level of their federal block grant, if they couldn't meet that limit, they will have to fund the overdraft by state resources. Increasing the state funding of welfare services will imply a heavier state tax burden and negative political consequences for the state politicians. Second, under the PRWORA, a state that doesn't use all its federal block grant for running its welfare system can reallocate the extra funds to finance other social activities. In turn the state funds that would have been spend on these social services are freed and the extra money can be used for service enhancement or tax cuts.

The need to increase job placement and the motivation of each local state to adopt cost saving measures spurred the adoption of outsourcing programs for welfare services. According to the 2002 General Accounting Office report², almost every state contracts out welfare services, amounting to more than \$1.5 billion for 2001, or 13% of total federal TANF. Private providers of welfare services are either nonprofit organization³ that received 73% of all contracts or for profit firms that won 27% of the outsourcing contracts. Among the functions of the TANF program that have been privatized are case management, employment services, support services like childcare and transportation and specialized services including mental health and substance abuse treatment. The task of determining eligibility for welfare services has also been outsourced in at least one location in 18 states.

2 General Accounting Office (GAO) (2002), "Welfare Reform, federal Oversight of State and Local Contracting can be strengthened." United States General Accounting Office, June 2002

3 These nonprofit organizations include national organizations, faith-based organizations and community-based organizations.

The TANF program is considered a huge success, and European States, especially Great Britain, Germany, the Netherlands and Israel are now looking to adopt similar programs in their own countries to alleviate the excessive burden of their welfare system⁴. In 2002, Brian Riedl and Robert E. Rector⁵ reported that since the adoption of the TANF program, the caseload of welfare recipients was cut by 65% from 14 million in 1994 to 5 million in 2002. More individual are now working and less families are living in poverty. In 2002, the US only counted 8.6 % of families living in poverty, an all time low, the number of children living in poverty is 2.3 million less than in 1996. These results are direct benefits from the TANF program and not the product of the 1990's economic growth, the caseload of welfare recipients never dropped from 1950 until 1996, although these years saw period of economic growth.

Few academic studies try to tie the success of the TANF to the use of outsourcing programs, however, there is a large consensus that contracting out social services has lowered the cost of welfare and at the same time improved the quality of services. According to the National Center for Public Analysis (NCPA)⁶, the privatization of welfare services in NYC through a private company "America Works of New York City, Inc" saved the State of New York more than \$18,000 per welfare recipient. America Works charges a flat fee of \$5,000 if it places a recipient in paid employment and out of welfare for at least seven month, it used to cost the State \$23,923 to achieve the same goal. In Washington DC, "Washington Works" a private company that offers training program was able to keep 87% of its clients off welfare for more than a year compared to a 55% national average. Private agencies perform better because their payments are directly linked to their performance and more importantly they are expected to compete against each other in the market in term of costs and quality of services.

2. Econometric Study US

The success of the TANF program and the widespread use of outsourcing by the state welfare administration to manage their welfare services has already shown that decentralization and the use of private providers in the field of welfare program is a winning combination. If the scope of privatization was expanded, further benefits for the society and welfare recipients could be ripped. A privately funded welfare program could reduce the overall cost of national welfare services and give better services to the underprivileged population.

To allow a full privatization of the welfare system, more charitable giving in society is to be encouraged. In 2003, Americans gave \$241 billion to charity; individuals made \$179.4 billion or 74.5% of all contributions. The rest came from corporation (5.6%), foundations

⁴ The UK adopted Working Families Tax Credit, modeled on the US "Earned Income Tax Credit" program; The Netherlands privatized part of their disability, employment and social insurance administration.

⁵ Brian Riedl and Robert Rector "Myths and Facts: Why Successful Welfare Reform Must Strengthen Work Requirements." The Heritage Foundation, Backgrounder No. 1568, July 2002

⁶ www.ncpa.org

(10.9%) and bequests (9%)⁷. Because individual giving is the main component of all charitable contributions it has to be the first target of any policy geared towards encouraging private philanthropy. Individual charitable giving is determined by two main factors, the price of giving and the income of the donor, should the government decrease general income tax rates, or increase the tax-deductibility of charitable gifts? Lowering general income tax rates encourages more charitable giving through an income effect. That is, more disposable income implies more charitable giving will be “consumed.” Increasing tax-deductibility also encourages more charitable giving, but through a price effect rather than directly through an income effect. The price effect refers to the increase in the charitable giving that arises as a result of it being less costly to donate.⁸

The price of charitable giving is defined as

$$Price=(1-taxrate*\%tax\ deductibility)$$

In the case where charitable gifts are 100% tax deductible, the price of giving one dollar will be 50 cents if the donor top marginal tax bracket is 50%. It would be 70 cents if the donor top marginal tax rate were 30%. The price of charitable giving decrease with higher tax rate and with higher rate of tax-deductibility.

In the first stage of implementing privatize welfare the use of the price elasticity, as an instrument to encourage private giving is favored over policies using the income effect. A review of the main literature using US data shows that donors are more sensitive to the price of giving than they are to changes in their disposable income. Price elasticity estimates in the US cluster around -1.30 and income elasticity estimates cluster around $.70$.⁹ This means that a decrease of 10% in the price of giving induces a 13% increase in the dollar amount of donations. In contrast, a 10% increase in disposable income is associated with only a 7% increase in charitable giving. The issue that about two third¹⁰ of the individual donations come from non-itemizers and therefore a change in price elasticity will not influence their level of giving is only relevant under the current legislation. If tax credit were introduced the price of charitable giving will also be lowered for non-itemizers¹¹. It's also worthy to note that itemizing households gave 40% more to charity than non-itemizing households in 2001, regardless of their income, and they tended to give more to religious charity¹². Finally, every tax credit given by the government for donations to private welfare organizations, translates immediately in less

⁷ Giving USA Foundation-AAFRC Trust for Philanthropy/Giving USA 2004

⁸ The price effect can be illustrated as follows. Suppose charitable donations are 35% tax deductible and the donor's marginal income tax bracket is 50%. The price of donating one dollar in this case is 82.5 cents. If the donation were 100% tax deductible, the price of the gift would be only 50 cents. As in the law of demand for economic goods in general, when the price of charitable giving decreases, more charitable giving will be “consumed”.

⁹ Barrett, Kevin “Panel-Data Estimates of Charitable Giving: A Synthesis of Techniques”, National Tax Journal, Vol 44, no. 3., September 1991

¹⁰ John S. Barry “How a Flat Tax Would Affect Charitable Contributions” Backgrounder #1093, Heritage Foundation, Dec 1996

¹¹ In that case, only non-tax payer individuals will not benefit from a change in the price of giving.

¹² Giving and Volunteering in the United States, Deducting Generosity, The Effect of Charitable Tax Incentives on Giving, Independent Sector 2001

public revenue and more private revenue for welfare programs. This simultaneous switch from one source of funding to the other is only possible when using price policy.

Since the work of Feldstein and Clotfelter in 1976, more than 60 papers have tried to estimate price and income elasticities on charitable giving. Feldstein (1980) argue that if charitable contributions are price elastic, private donations to nonprofit organizations will more than offset the lost of government revenue, when the price of giving is made lower by an higher “deductibility” rate. Until the 1990’s all empirical studies found that charitable giving is indeed price elastic, the magnitude of the price elasticity varied depending on the sample used in the estimation. Studies that used tax files, containing only records of filers that itemize their contribution, usually found smaller price elasticity than the studies using household data. Among the studies using tax model file, Feenberg (1976) found an elasticity of -1.23 , and Clotfelter and Steurle (1981) estimated the price elasticity to be -1.27 . Studies that used household data, like Boskin and Feldstein (1977) found that the value of the price elasticity was -2.54 , similar to the Dye (1977) estimate of -2.25 . The fact that studies using tax data containing only itemizers where higher income households are over represented points to the fact that price elasticity may be related to income. The relationship between the magnitude of the price effects and the donor’s income was first introduced in the work of Feldstein and Taylor (1976) who found that individuals with an income between \$4,000 and \$20,000 in 1962 had a price elasticities of -3.67 , almost three times the price elasticity of the individuals with an income above \$100,000. However, Clotfelter and Steurle (1981) found inverse results, the price elasticity of individuals with income less than \$10,000 in 1976 was only $-.95$, for individuals with an income above \$100,000 it reached -1.76 .

These early studies have somehow been later challenged, when Broman (1989) first introduced the use of panel data to model charitable giving as a dynamic activity. Current giving is not only function of the current price of giving and current income but also, last year charitable giving and next year price. Barrett (1991) founded that charitable giving today is a function of this year price of giving and next year price of giving. If donors expect a future increase in the price of giving, they will increase their current donations. He estimated the price elasticity to current price to be -1.09 and the price elasticity to next year price to be $.31$; an decrease of 10% in this year price will results in 11% increase in charitable giving a projected 10% decrease in next year price will results in 3% decrease in donations this year. Randolph (1995), using tax panel data, distinguishes between expected future price and current price, he found that the price elasticity to current price is -1.55 but the price elasticity to future expected price is only $-.51$. Andreoni and Sholtz (1995) made the argument that individual charitable contributions are interdependent of other individuals giving. Individuals determine their amount of giving depending on their neighbors, family, co-worker giving habit. According to their study, accounting for interdependence raises the price elasticity between 25 and 42%. They found that interdependent price elasticity were between -1.45 and -1.20 . Also Tiehen (2000) using cohort panel from the Independent Sector Surveys on Giving and Volunteering, found that price elasticities are in fact closer to the earliest estimates and are less than -1 .

Although the estimates of the price elasticity vary in magnitude it is always negative, meaning that a decrease in price will always translate in an increase of charitable giving.

III. Discussion

As shown above, most econometric studies on US data determined that tax incentives are able to encourage charitable contributions. Even if such tax incentives reduce the tax revenue of the government, the increase in charitable giving may more than offset this lost. In that case, the total budget available for the financing of the welfare system will actually be higher when private donations replace public taxes.

1. Simulations on US Data

The simulations results reported in Table 1 assume that all charitable contributions, regardless of the donor's income tax bracket, are subject to a price elasticity of -1.3 .

The simulations take into account that donors are faced with different price of giving, depending on their marginal tax rate. First the price of giving was calculated for all marginal tax brackets. For example, the price of giving one dollar for an individual who pays a marginal tax rate of 10% is 90 cents, under the current schedule of 100% tax deductibility. For an individual in the top marginal tax rate of 35%, the price of giving one dollar is only 65 cents. The same calculations were then made under different tax credit schedule. The magnitude of the variation in the price of giving among different tax credit schedule is also function of the donor's marginal tax rate. Following the above example, if tax credit of 50% were allowed the donor in the 10% marginal tax rate will enjoy a price reduction of 5%, the donor in the 35% bracket will enjoy a price decrease of 26%. The increase in charitable giving following a decrease in the price of giving is also a function of the donor's tax rate. In the above example, the donor in the 10% tax break will increase his contributions by 7%; the donor in the 35% tax break will increase his gift by 35%.

For the sake of clarity, the results presented in Table 1 are a weighted average over all tax filers. The Internal Revenue Service (IRS) reports the amount of contributions made by individuals by income brackets. For example, the charitable contributions from individuals whose income ranged from \$15,000 to \$20,000 represented 1.27% of all charitable contributions reported to the IRS in 2001. The weight assigned to that income group will be 1.27. Table A.2 of the appendix reports the distribution of charitable contributions by income as reported by the IRS. The weighted average can be understood as an average value representative of the civil society at large.

The first row of Table 1 shows the initial condition of the simulations. The "civil society" is assumed to contribute to charity \$1, the tax deductibility is set at its current level of 100% for all charitable donations. In that case the tax revenue on charitable contributions is null.

In Row (2), the government is now giving 25% tax credit (the equivalent of 125% tax deductibility). This new policy lowers the price of giving and therefore charitable contributions are increasing. The new donation by the civil society is now \$1.09, 9% higher than in the initial scenario. This tax credit program costs the government 6 cents in lost tax revenue. Overall the net budget available for welfare is now \$1.09 minus \$.06, or \$1.03.

In the final row, the government is now giving 100% tax credit (the equivalent of 200% tax deductibility). The amount of charitable contributions is now \$1.36. The government lost tax income is \$.32, leaving \$1.04 a net amount of funds for welfare of \$1.04 or 4% higher than in the initial scenario.

The results of the simulations presented in Table 1, show clearly that the increase in charitable contributions more than offset the lost tax revenue of the government. More importantly the private sector is, under the 100% tax credit scenario, in charge of allocating 36% more of the welfare funding than it was in the initial condition scenario. If government funding and private funding of welfare programs were perfect substitute, the gains to the society will be small, but if one dollar of private funding can buy more welfare services than one dollar of tax money, the gains to society will be in fact much higher.

A private welfare system could offer the same level of services to as many welfare recipients at a lower cost. Collection cost and administrative costs are lower for private nonprofit organizations than for the government. Further, nonprofit organization can discriminate better between “genuine” welfare recipients and “under-serving” individuals that succeed in obtaining welfare services¹³; this will enable the private welfare system to cut the welfare bill without hurting the real underprivileged.

The delivery of welfare services is costly, the two main costs are “fundraising” costs, and administrative costs. Both, the cost of collection of revenue through taxes and the cost of administering monetary transfer to welfare recipients is very high in a government funded welfare system. These bureaucratic costs are higher for the public sector, than for nonprofit institutions. A reduction in the collection cost and administrative cost will reduce the overall budget needed for welfare, without lowering the level of welfare services.

A Cato study, reports that only 30 cents of every dollar raised by the government in 1996 went to help the needy, 70% went to pay for bureaucratic administrative costs.¹⁴ It’s interesting to note that the Council of Better Business Bureaus' Standards for nonprofit organization calls for “no more than half of the charity's total income to be spent on administrative and fund raising costs”¹⁵ The “Charity Navigator”¹⁶ organization reports

¹³ Edwin G. West and J. Stephens Ferris (1999) “Private Versus Collectivized Charity: Further Exploration of the Crowding Out Debate”, Working Paper, Carleton University

¹⁴ Michael Tanner, “Replacing Welfare” Cato Online Policy Report Vol XVIII, Number 6, Dec 1996.

¹⁵ Council of Better Business Bureau, Inc. “Tips on Charitable Giving”, 1996

¹⁶ Charity Navigator, www.charitynavigator.org

that the median administrative cost and fundraising expenses as a percent of the total functional expenses among all charities is respectively 10.2% and 6.5%. This means that for every dollar contributed to charity 83.3 cents goes directly to help the poor. In a government funded system, only 30 cents for each dollar reaches the welfare recipients. These results show that private nonprofit organizations can serve the underprivileged with the same level of benefits with only 36% of the amount of money that the government will need to raise through taxes.

In 2000, the US spent \$434 billion on federal and state welfare programs, an average expense of \$5,600 for each tax paying American household¹⁷. If the civil society had been in charge of welfare services, the US economy would have saved \$277 billion, and each taxpayer household would have kept an extra \$3,584 for private expenditures.

In Israel, more than \$10 billion was spent on welfare, if a private welfare system was to be implemented, every Israeli will be richer by \$926.

John Stuart Mill (1848) writes: "What the state may and should abandon to private charity, is the task of distinguishing between one case of real necessity and another. Private charity can give more to the more deserving. The state must act by general rules. It cannot undertake to discriminate between the deserving poor and the undeserving indigent. It owes no more than substance to the first, and give no less to the last."¹⁸

The government uses a bureaucratic identification of poverty; any family whose current income falls behind a family-size specific poverty threshold is entitled to welfare benefits. This arbitrary rule doesn't account for future potential earnings from work, human capital or property ownership.

Haveman and Bershadker (1998)¹⁹ measure poverty on individual "capabilities" defined as the "capabilities-to-generate-minimum-necessary-income"²⁰. The authors call this measure Self-Reliance Poverty Index; an individual who is self-reliant poor is able to be economically independent. Haveman and Bershadker estimated that between 1975 and 1995 in the U.S., one out of four "officially" poor individual was self-reliant and had the potential to generate an income over the official poverty line.

Private nonprofit organizations are more efficient in distinguishing between the "official" poor that qualifies arbitrarily for government assistance and the "genuine" poor that is in real need of welfare benefits. Nonprofit organizations don't function on rigid bureaucratic rules; they can rule on individual cases and discover whose applicant is genuinely entitled to welfare services.

In a private welfare system, the number of welfare cases could be reduced by a fourth without hurting the "deserving" poor, reducing the national budget for welfare by a

¹⁷ Rector, E. Robert, "The size and Scope of Means-Tested Welfare Spending", Heritage Foundation, Research Welfare, 2001.

¹⁸ Mill, J.S. (1969) Principles of Political Economy, p 969

¹⁹ Haveman, Robert and Andrew Bershadker (1998) "Self-Reliance as a Poverty Criterion: Trends in Earnings Capacity Poverty, 1975-1992," American Economic Review, 88, 342-347

²⁰ Haveman, Robert and Andrew Bershadker (1998b) "The 'Inability to be Self-Reliant' as an Indicator of Poverty: Trends for the U.S. 1975-1995", University of Wisconsin-Madison manuscript, August 7 1998

similar proportion. This will amount to \$108 billion saving for the U.S. economy and \$2.5 billion for the Israel economy

Because private charity can discriminate more, it can help the deserving poor more efficiently. As more individuals are lifted out of poverty, the amount of fund needed for welfare is diminished. The individuals that used to be poor are now working, paying taxes and contributing themselves to charitable causes. Although, this effect is difficult to estimate empirically, it is clear that it will lead to a further reduction in the national welfare budget.

In conclusion the private sector could offer the same level of welfare services to the underprivileged for almost a quarter of what it costs the government to administer these services. Private and public spending are not perfect substitutes, in fact, one dollar of private charity is at least equivalent to \$3.70 of public spending.

Column (4) in Table 1 shows the public money dollar equivalent of the overall budget available for welfare. When private donations were \$1, the public money equivalent was \$3.70, but when private donations reach \$1.36 the overall welfare budget is increase by more than 135% to \$5.03.

These results clearly show that charitable contributions could more than offset the lost tax income. The welfare budget will not be diminished and welfare recipients will not suffer from inadequate funding when private funding replaces public funding of welfare services.

The above discussion on the US case will now be expanded to Israel. It will show that privatizing welfare is also possible in the Israeli economy and that charitable contributions are able to replace tax money.

IV. Israel Study

Our study uses data from the annual survey of household expenditures conducted by the Israel Central Bureau of Statistics (ICBS) between the years 1998-2002. As reported in Table 2, this sample is very interesting for the purpose of this study because 91% of the respondents come from low-income households. Also 36% of the households receive welfare payments including allowances from the national insurance, general disability, unemployment benefits, income maintenance and other monthly assistance. Only 19% of the households reported positive charitable contributions for the survey years, this low percentage is a direct consequence of the over sampling of low-income individuals in the sample. Looking at the highest income range households shows that a much higher percentage of donors. The welfare recipients did also contribute at almost the same rate as the rest of the households, 17% of them reported a positive contribution. The fact that this sample contains an overwhelming majority of low-income households and welfare recipients allow us to check the sensitivity of these underprivileged populations to the price of giving.

In Israel only 35% of charitable gifts above \$82 is tax deductible and a lot of donations are made to nonprofit organizations that aren't able to get tax-exempt status for their donors from the Israelis authorities, meaning that charitable donations are 0% tax deductible. According to Professor Eliezer D. Jaffe, in 1998, only 11% of nonprofit organizations had tax exemption for their donors.

The estimation results, using a pool sample for the years 1998 to 2002, followed the traditional model of giving:

$$\ln Contribution = \beta_0 + \beta_1(\ln Price) + \beta_2(\ln Disposable Income) + \beta_3(Marital Status) + \beta_4(Age) + \beta_6(Number of Dependents) + e$$

The first model includes only households that reported a positive charitable contribution in the relevant year. The results of the estimation are presented in Table 3, Column 1. The results show that the price elasticity for the households that gave to charity in the relevant year is -3.64 . Very similar results are obtained when using the full sample²¹, the price elasticity is -3.77 , the full results of the model are presented in Column (2) Table 2.

Because only 18% of the households reported positive charitable contributions, a third model testing the sensitivity of the decision of giving was estimated.

$$(Give=0,1) = \beta_0 + \beta_1(\ln Price) + \beta_2(\ln Disposable Income) + \beta_3(Marital Status) + \beta_4(Age) + \beta_6(Number of Dependents) + e$$

This model, reported in column (3) shows that if the price decreases by 10%, 13% more households would decide to give charitable contributions. This result shows clearly that low-income households are very sensitive to the price of giving, and a minority of them can "offer" charitable gifts. A lowering of the price will not only increase the charitable contributions of the already donors but will also increase the number of individuals making charitable contributions.

In all the models presented in Table 3, older, married, and households with children tend to give more to charity than the rest of the households. These results are consistent with the existing literature.

The results obtained on Israeli data are consistent with the previous results obtained on U.S. data. A decrease of 10% in the price of giving induces a substantial increase in charitable giving between 36% -38%. An increase in disposable income of 10% is associated with a much weaker increase in charitable giving of only 1.3%. The result on the limited sample of an income elasticity of $-.0013$, is not statistically significant and not different from zero.

²¹ In order to estimate the full sample, we assumed that the households who reported zero charitable giving, had in fact given a shekel in charity. By convention, U.S studies assumed that non-contributing itemizers made gifts of \$10. This allowed the researcher to keep these "non-contributing" households in the sample, the log of their donations being zero.

The price and income elasticity estimates obtained from Israeli household data differ in magnitude from those obtained from U.S. data. However, the Israeli estimates are almost identical to the Feldstein and Taylor (1976) results who found that individuals with low income had a price elasticity of -3.67 , almost three times the price elasticity of the individuals with high income.

Using the Israeli estimate of price elasticity, Table 4, shows the results of simulating different schedules of tax deductibility for donors in the 10% marginal tax bracket.²² The lowest tax rate was chosen to take into consideration the make up of the sample. High-income households may have lower price elasticity, and therefore the simulations would have over-estimated the change in charitable giving for higher tax rates.

The calculations are done on the initial condition that an individual gives \$1 to charity, under the existing tax schedule of 35% deductibility. At that level of tax deductibility, the tax revenue of the government is 7 cents. The total amount of money available for welfare services is in that case \$1.07

Subsequently, the tax deductibility is increased and the individual's new level of charitable contribution is calculated. For example as reported in row (2) of Table 2, when the tax deductibility is increased to 100%, the price of giving is 7% lower than in the initial scenario, and the donor will now increase his donations to \$1.25.

The government could also decide to "subsidy" charitable contributions, through tax credit. The last row of Table 4 describes the scenario where a 100% tax credit on charitable contributions (i.e. 200% deductibility) is enacted. The initial donor will now give \$1.64 to charity. The cost of the tax credit to the government will be \$.33. More importantly, the private sector is now in charge of \$1.64 of charitable contributions and the government had to cut its services by \$.33. The value of \$1.64 of charitable contributions in public money is \$6.07. After subtracting the lost tax revenue of \$.33, the level of welfare funding will reach \$5.74, a 57% increase than in the initial conditions scenario.

V. Conclusion

This paper has shown that private charity can fully replace public funding of welfare services. In order to achieve this goal, the role of the government should be limited to offer tax credit for charitable contributions. Better tax incentive, will help wean off public spending and allow the civil society to become the main provider of welfare services, instead of the Government.²³

²² The same simulations for donors in the 30% and 20% tax bracket were also done. The results are the same sign, although the total gains are higher.

²³ This transition is already being experienced in England, Universities, museums, symphonies and Hospitals are mostly supported now by private funding.

It's worthy noting, that the results presented in this paper are under-estimates of the total gains to society that a private welfare system would be able to achieve. As private philanthropy replaces public funding, the welfare system will become more efficient and less costly. More importantly, welfare recipients will receive better services and will be more likely to be lift out of poverty. As the number of welfare recipient decrease, because of the success of the private organizations to fight against poverty, the overall welfare budget will be diminished and less charitable contributions will be needed. Also, as private charity increases and taxes are reduced the individuals will be left with more disposable income, leading to macroeconomic growth and job creations. In turn, economic growth reduces poverty and fewer individuals will need welfare services, further reducing the national welfare bill.

Table 1

U.S			
Price elasticity=-1.2			
Tax Deductibility Of Contribution	Contributions	Tax Revenue	Budget for Welfare in \$ Public Money Equivalent
	(2)	(3)	(4)
100%	1	0	3.70
125%	1.09	-.06	4.03
150%	1.18	-.13	4.36
200%	1.36	-.32	5.03

Table 2: Descriptive Statistics of Charitable Contributions by Income Range
(New Israeli Shekels)
2002

Income Range	Average Contributions	Average Positive Contributions	% Individuals that Contribute	N
All Sample	33.77 (203.94)	186.73 (448.85)	.18	29,661
Welfare Recipients	33.30 (118.24)	195.30 (320.70)	.17	10,714
Income <=28,410	36.17 (248.95)	182.98 (552.91)	.17	27,046
28,410<Income<= 42,630	67.20 (236.94)	194.82 (310.96)	.30	1,823
42,630<Income<=124,800	104.76 (586.62)	219.25 (446.90)	.35	756
Income>124,800	634.51 (2118.12)	272.75 (214.28)	.42	36

Table 3

Determinants of Charitable Giving In Israel
Pool Sample 1998-2002

	Log of Charitable Contributions	Log of Charitable Contributions	Decision of Giving
	(1)	(2)	(3)
Price	-3.641 (.988)	-3.774 (.416)	-1.143 (.1635)
Disposable Inc	-.0013 (.0330)	.1286 (.0101)	.0619 (.0039)
Age	.0031 (.0010)	.0019 (.0003)	.0006 (.0001)
Married	.1658 (.0433)	.0832 (.0138)	.0321 (.0055)
Number Child	.0905 (.0092)	.0437 (.0037)	.0102 (.0014)
N	5,341	29,568	29,568
R-squared	.0346	.0375	.0346

Table 4

Israel			
Price elasticity=-3.77 50% Tax Bracket			
Tax Deductibility Of Contribution	Contributions	Tax Revenue	Budget for Welfare in \$ Public Money Equivalent
	(2)	(3)	(4)
35%	1	.07	3.77
100%	1.25	0	4.62
200%	1.64	-.16	5.91

Appendix
Table A.1

US. Econometric results

Feldstein (1975)	-1.24	Data from the Statistics of income, for taxpayers in the \$4,000-\$100,000 (1967\$) tax bracket
Feldstein and Clotfelder (1976)	-1.15	Household data from the Federal Reserve Board's Survey of the Financial Characteristics of Consumers for 1963-1964
Boskin and Feldstein (1977)	-2.54	Households with income less than \$30,000 in 1974, from the University of Michigan Survey Research Center for Households.
Reece (1979)	-1.19	1972-1973 Consumer Expenditure Survey, from the Bureau of Labor Statistics
Feenberg (1976)	-1.23	National Bureau of Economic Research TAXSIM model
Clotfelder and Steurle(1981)	-1.27	1975 Individual Tax Model file
	-.95	1975 Individual Tax Model file, for individuals under \$10,000 income
	-1.35	1975 Individual Tax Model file, for individuals with income between \$10,000 and \$20,000
	-1.66	1975 Individual Tax Model file, for individuals with income between \$20,000 and \$50,000
	-1.36	1975 Individual Tax Model file, for individuals with income between \$50,000 and \$100,000
	-1.78	1975 Individual Tax Model file, for individuals with income above \$100,000
Dye (1977)	-2.25	Households with income less than \$30,000 in 1974, from the University of Michigan Survey Research Center for Households, adding a wealth variable
Feldstein and Taylor (1976)	-3.67	1962 tax model file for Individuals with an income between \$4,000 and \$20,000
	-.97	1962 tax model file for Individuals with an income between \$20,000 and \$50,000
	-1.1	1962 tax model file for Individuals with an income between \$50,000 and \$100,000
	-1.29	1962 tax model file for Individuals with an income above \$100,000
Feldstein and Taylor (1976)	-1.74	1970 tax model file for Individuals with an income above \$100,000
Laura Tiehen	-.9 - -1.1	Household surveys covering the years 1987 to 1995, containing both itemizers and non-itemizers.
Auten, Sieg and Clotfelder (1999)	-.6 - -1.2	
Barrett (1991)	-.78	
Randolph (1995)	-.51 - -1.55	
Andreoni, Gale and Scholtz (1995)	-.35	1989 Independent Sector Survey

Appendix
Table A.2

Charitable Contributions by Adjusted Gross Income (2001)

Size of adjusted Gross income	Cash and non Cash Contributions (% Of Total Contributions)
Under \$5,000.....	0.16%
\$5,000 under \$10,000.....	0.36%
\$10,000 under \$15,000.....	0.80%
\$15,000 under \$20,000.....	1.27%
\$20,000 under \$25,000.....	1.95%
\$25,000 under \$30,000.....	2.10%
\$30,000 under \$35,000.....	2.12%
\$35,000 under \$40,000.....	2.60%
\$40,000 under \$45,000.....	2.73%
\$45,000 under \$50,000.....	2.96%
\$50,000 under \$55,000.....	3.36%
\$55,000 under \$60,000.....	3.12%
\$60,000 under \$75,000.....	9.32%
\$75,000 under \$100,000.....	13.01%
\$100,000 under \$200,000.....	19.27%
\$200,000 under \$500,000.....	11.02%
\$500,000 under \$1,000,000.....	4.71%
\$1,000,000 under \$1,500,000.....	2.79%
\$1,500,000 under \$2,000,000.....	1.47%
\$2,000,000 under \$5,000,000.....	3.81%
\$5,000,000 under \$10,000,000.....	2.34%
\$10,000,000 or more.....	8.74%

Source: IRS, Table 2.1, Individual Tax Statistics-Complete Report Publications, Tax Year 2001, Table 2.1

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