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Rethinking Welfare in the Age of Devolution

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RETHINKING WELFARE IN THE AGE OF DEVOLUTION

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In August 1996, President Clinton signed the "Personal Responsibility and Work Opportunity Reconciliation Act of 1996" (PRWORA), landmark welfare-reform legislation that curtails benefits and shifts the responsibility for distributing welfare benefits from the federal government to the states.[713] The new law reflects the public's dissatisfaction with the federal administration of welfare entitlements and, indeed, with the very idea of welfare entitlements.[714]

PRWORA embodies the concept of devolution: Temporary Assistance to Needy Families and child care block grants replace Aid to Families with Dependent Children (AFDC) entitlements and a host of other aid programs. Under the law, "[e]xcept as expressly provided under the statute, the Federal Government may not regulate the conduct of the States."[715] Thus, states now have the right to determine eligibility and benefits and the freedom to design programs that promote work, responsibility, self-sufficiency, and stronger families.

Among PRWORA's provisions are:

- a requirement that, with few exceptions, recipients must find work after two years of receiving assistance;
- a five-year ceiling on assistance to families;
- built-in waivers for states that receive approval for waivers before July 1, 1997;
- termination of welfare benefits for some legal immigrants; and
- reductions in food-stamp allotments while providing money for child care under a separate block grant.[716]

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[713] 42 U.S.C. ' 601 *et. seq.* (West Supp. 1997).

[714] *See, e.g.,* R. Kent Weaver et al., *The Polls -Trends: Welfare*, 59 PUB. OPINION Q. 606-08 (1995).

[715] OFF. OF FAM. ASSISTANCE, U.S. DEP'T OF HEALTH AND HUMAN SERVICES, PUB. NO. TANF-ACF-PA-97-1, TEMPORARY ASSISTANCE FOR NEEDY FAMILIES POLICY ANNOUNCEMENT 2 (1997).

[716] *See generally* U. S. DEP'T OF HEALTH AND HUMAN SERVICES, HHS FACT SHEET (1996).

In passing PRWORA, Congress reversed welfare policy that has its roots in the New Deal and in the Great Society and successor programs. Under PRWORA, states are free to craft and implement policies that substantially restrict benefits traditionally enjoyed by welfare recipients. Initially, the Clinton Administration approached the idea of welfare reform with a view toward continuing "a strong Federal role in safety net programs."[717] By signing PRWORA and thus reversing his position, the President made national welfare policy an extension of restrictive policies already being fashioned at the state level.[718]

A notable example is Wisconsin, which had implemented stringent welfare rules requiring private-sector or community-service work as a condition for participation in AFDC. As national caseload levels rose, Wisconsin was cutting its caseloads in half. As one commentator noted, "Wisconsin's decline in dependence is the most significant change in the 60-year history of AFDC."[719]

Wisconsin's success might be unique, in part owing to its early start and in part owing to a distinct political culture and a well-organized, mission-oriented public sector.[720] It is an open question whether Wisconsin's success can be duplicated elsewhere. Nevertheless, welfare reform in Wisconsin and in other states is a harbinger of future welfare policy.

While overall spending for big-ticket items such as food stamps will be cut, PRWORA includes a fairly generous baseline. Under this baseline, "[m]oney will be distributed to each state based on its federal funding for AFDC benefits and administration, emergency administration, and the Job Opportunities and Basic Skills (JOBS) program in either fiscal 1995, fiscal 1994 or the average of fiscal 1992-94, whichever is higher."[721] The government will reward those states that are the most successful in moving people from welfare to work and reducing out-of-wedlock births. Conversely, the government will penalize states that are unsuccessful by forcing them to replace federal dollars with state dollars.

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[717] ECONOMIC REPORT OF THE PRESIDENT, H.R. DOC. NO. 104-161, at 123 (1996).

[718] *See* U. S. DEP'T OF HEALTH AND HUMAN SERVICES, *supra* note 4, at 5 (stating that before the President signed the bill, the Department of Health and Human Services had approved 78 welfare-reform experiments in 43 states).

[719] Robert Rector, *Wisconsin Beats the Feds on Welfare Reform*, WALL ST. J., Mar. 6, 1997, at A14.

[720] *See* Lawrence M. Mead, *An Administrative Approach to Welfare Reform, in* WELFARE REFORM: AN ANALYSIS OF THE ISSUES 22-23 (Isabel V. Sawhill, ed., 1995) <http://www.urban.org/welfare /overview.htm#Chap05>.

[721] Jeffrey L. Katz, *Welfare Overhaul Law,* 54 CONG. Q. WKLY. REP. 2696, 2697 (1996).

Despite anticipated savings of $55 billion over the next five years, PRWORA hardly enjoys universal support. In signing PRWORA, the President invoked a negative reaction from defenders of a more traditional approach to welfare policy. One critic has condemned PRWORA on the ground that it "does not promote work effectively, and . . . will hurt millions of poor children by the time it is fully implemented."[722]

Indeed, cutbacks in benefits might affect negatively the health and well-being of some, including poor children. States suffering an economic slump may find themselves strapped for welfare funds. There is also a strong sentiment to reconsider those provisions of the bill that affect legal immigrants. In addition, some critics anticipate a patch-quilt effect where different states offer aid of varying quality.[723]

Not all concern about PRWORA comes from defenders of traditional welfare policy. Other critics point out that reversing the disincentives, lost opportunities, and the social decline spurred by thirty years of heavy government spending requires more than rudimentary caseload reduction.[724] They suggest that a walk through any inner city reveals the utter failure of American social policy. They believe that soaring illegitimacy rates and the emergence of a broad underclass of poor women and children will not be turned around by a policy that pushes welfare recipients into entry-level jobs. Dependency does not end with devolution. Furthermore, some critics complain that devolution merely replaces one enormous, inefficient bureaucracy with at least fifty smaller, but similarly inefficient bureaucracies:

> [T]he history of block grants is not a pretty one. Tales of mismanagement, waste, and abuse in past or existing block grant programs are legion. Most audits have shown little or no increase in administrative efficiency. Although supporters of block granting welfare have suggested that administrative savings could be as high as 20 percent of program costs, past block grant programs have seldom achieved savings of more than 5 percent. And the tensions between state and federal government were often merely shifted to a battle between local and state governments.[725]

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[722] Peter Edelman, *The Worst Thing Bill Clinton Has Done,* THE ATLANTIC MONTHLY, Mar. 1997, at 43, 43.

[723] *See* Christopher Georges & Dana Milbank, *Sweeping Overhaul of Welfare Would Put Onus on the States,* WALL ST. J., July 31, 1996, at 1.

[724] *See generally* MARVIN OLASKY, THE TRAGEDY OF AMERICAN COMPASSION (1992); WILLIAM D. EGGERS & JOHN O'LEARY, REVOLUTION AT THE ROOTS: MAKING OUR GOVERNMENT SMALLER, BETTER, AND CLOSER TO HOME (1995).

[725] Cato Institute, *Cato Handbook for the 105th Congress: Welfare Reform* (February 28, 1997) <http://www.cato.org/pubs/handbook/hb105-25.html>.

RETHINKING WELFARE

There is reason to believe that the apparent triumph of devolution over tradition in national welfare policy might prove illusory. Economic theory suggests that the existing debate, which gives government the job of bringing about an "equitable" distribution of income, centers on a particularly narrow and counterproductive approach to the question of welfare policy.

Stripped of euphemisms about "social safety nets" and "individual responsibility," the existing debate is about whether the reformed welfare policy is "more equitable" or "more fair" than traditional welfare policy. As noted, defenders of traditional welfare policy talk about the unfairness of stripping children of benefits.[726] Defenders of reform talk about the unfairness of forcing some working mothers to support mothers who refuse to work.[727] This gives rise to a "win-lose" rhetoric of modern politics as it relates to welfare policy. The rhetoric can be changed from an emphasis on "redistribution," a win-lose proposition, to an emphasis on "allocation," a win-win proposition.

If the government forces A to give money to B unwillingly, B wins and A loses. If, on the other hand, the government creates a legal system under which A can exchange his money for B's car, A and B both win. In the first example, the government is redistributing income. In the second, it is creating a framework were A and B can bring about a superior allocation of resources. A more fruitful approach to welfare reform would create a similar framework for allocating resources from taxpayers to welfare recipients.

To see how this framework might be constructed, consider how the existing welfare system, broadly defined, works. Government requires or induces taxpayers to contribute to the provision of welfare services. These services are provided mainly by government but also (albeit to a much smaller extent) by private charities.

The nexus between the taxpayer and the welfare recipient consists of a transfer and an expenditure. The taxpayer transfers funds to government, and the government (federal or state) spends the funds to assist the poor. In part because the federal tax code (and some state tax codes) permit

[726] *See* Edelman, *supra* note 10, at 58.

[727] Rep. John Kasich, Address at the Beacon Hill Institute and the David R. Macdonald Foundation Conference, Compassionate Welfare Reform: Empowering Charities and Private Citizens (Dec. 12, 1996) (last modified Apr. 30, 1997) <http://bhi.sclas.suffolk.edu/Transcripts CWR/Kasich.html>.

itemizing taxpayers to deduct charitable contributions, some taxpayers also transfer a certain amount of money to private charities, which assist the poor.

Despite this tax incentive, the system creates a strong bias in favor of government (as opposed to private-charity) spending on the poor. The existing tax deduction permits itemizing federal taxpayers to reduce their taxable income by $1 for every dollar they give to charity. The Beacon Hill Institute estimates that individual federal taxpayers incur an average marginal tax rate of 21%.[728] Thus, the "tax price" of giving $1 to private charities is 79".

Taxpayers can purchase a dollar's worth of private-charity spending on the poor by making a charitable contribution of $1, while sacrificing only 79" worth of personal consumption. This represents a lower price than taxpayers would have to pay if there were no deduction or if they did not itemize. Nevertheless, it is still a sufficiently high price that only a small fraction of all spending on the poor flows through private charities.

In 1994, total government spending on means-tested welfare programs (excluding education) totaled about $329.2 billion.[729] At the same time, total contributions to private charities that provide "human services" totaled only about $11.7 billion.[730] Tax return data suggest that, of this amount, only about 68%, or $8 billion, was reported as itemized federal income tax deductions.[731]

The relatively minor role played by private charity in this broadly-defined welfare system is partly the outcome of existing tax law. Despite the deduction for charitable contributions, the existing tax law keeps the "tax price" of giving high. Devolution will leave the tax price of giving at its current level of 79".

A better option for welfare reform consists of lowering the tax price of charitable giving and thereby inducing taxpayers to expand the role of private charities that provide welfare-like benefits or "social services." The most convenient and effective method of bringing about this result is a federal tax credit.

[728] *See* JAMES P. ANGELINI ET AL., GIVING CREDIT WHERE CREDIT IS DUE: A NEW APPROACH TO WELFARE FUNDING 96-98 (1995) [hereinafter *BHI Study*].
[729] Means-tested government programs provide benefits to individuals only if recipients do not exceed minimum income or property ownership guidelines. *See* U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 371, tbl.577 (1996).
[730] *Id.* at 388, tbl.611.
[731] *Id*. at 341, tbl.526 and at 388, tbl.611.

A charitable tax credit would permit the taxpayer, whether an itemizer or not, to reduce his tax liability by $1 (or by some, usually large, fraction of $1) for every dollar contributed to a qualified charity. Thus a 100% tax credit would permit a taxpayer to pay $1 less in taxes for every dollar contributed to charities that assist the poor, thus reducing the tax price of giving, in the current example, from 79" to zero.

A tax credit fashioned along the principle of "budget neutrality" would simply change the way in which welfare dollars were spent.[732] For every additional dollar contributed to a qualified private charity, there would be $1 less in government welfare spending and $1 more in private-charity welfare spending. So structured, a tax credit would shift the discussion away from redistribution to allocation. Introduction of the tax credit would presume neither an increase nor a decrease in taxpayer "effort" to assist the poor. The sole intent would be to bring about a superior allocation of welfare dollars, from government to private charities, and, in the process, superior results for taxpayers *and* welfare recipients.

THE ECONOMIC BASIS FOR TAXPAYER "EFFORT"

Treating welfare reform as an allocative rather than a redistributive problem has its basis in recent economic writings that treat "altruism" as a form of self interest. A brief review of the literature leading up to these writings is useful.[733]

The idea of modeling altruistic behavior does not come easily to the discipline of economics. For over 200 years, economics has been grounded in Adam Smith's characterization of the individual as an employer of capital who "neither intends to promote the public interest, nor knows how much he is promoting it . . . [but] intends only his own gain . . . ."[734]

The strength of Smith's characterization arises from its implications in the ability of a society to achieve an efficient allocation of resources. Smith saw the self-interested individual as being "led by an invisible hand to promote an end which was no part of his intention" - this end being an assurance that production will be directed in such a way as to assure that it will be "of the greatest value" to society as a whole.[735] That people were

[732] Budget neutrality occurs when government reduces its spending to compensate for the tax revenue lost because of the charitable contribution. Under budget neutrality, neither a deficit nor a surplus is changed by the increased contribution.
[733] The authors have excerpted extensively from BHI Study, *supra* note 16, in this section.
[734] ADAM SMITH, *The Wealth of Nations*, *in* THE ESSENTIAL ADAM SMITH 149, 265 (Robert L. Heilbroner & Laurence J. Malone, eds., 1986).
[735] *Id.*

self-interested was not an obstacle but a catalyst to achieving economic efficiency: "[b]y pursuing his own interest . . . [the individual] frequently promotes that of the society more effectually than when he really intends to promote it."[736]

Thus we have what later became the "fundamental postulate" of economic behavior: consumers attempt to make themselves as well off as possible, that is, they try to maximize their own satisfaction or "utility."[737] Producers, in competition with each other, attempt to maximize profit. Through this process, society achieves economic efficiency or "optimality." Profits flow to the most efficient firms, and individuals who contribute the most to production earn the highest incomes. Society exhausts the benefits from specialization and trade such that it becomes impossible to increase the utility of any individual through a further reallocation of resources without making some other individual worse off.[738]

Given so utopian an outcome, it is little wonder that economists have sometimes viewed altruistic behavior as having almost the opposite effect for which it is intended. Nevertheless, many people act altruistically. Thus, any economic model that ignores the existence of such behavior is, in important respects, incomplete. Insofar as altruism is a "public good," economic agents, operating on their own without prodding from government, might not provide enough of it.

The textbook example of a public good is national defense. Because national defense is freely available to everyone, taxpayers are likely to act as "free riders," enjoying its benefits without voluntarily contributing toward its provision. One argument for taxes is that, without them, people would not voluntarily contribute to the provision of goods like national defense which is in their interest for government to provide. The same can be said for altruism.

An additional problem with the free-market model has to do with "equity." According to this argument, and as noted above, the free market may fail to generate an "equitable" distribution of income. Economists have attempted to solve the equity problem by developing the idea of a "social-welfare function," which explicitly assigns weights to the utility (satisfaction) levels achieved by different persons. According to this idea,

[736] *Id.*

[737] Economists use the term utility to measure the level of satisfaction that comes from consuming goods and services. It is a subjective measure that is based on an individual's tastes and preferences.

[738] This state of affairs, called "Pareto optimality," is ideal in the sense that it cannot be attained without exhausting every possibility for mutually beneficial change.

society maximizes welfare by achieving an efficient allocation of resources *and* by bringing about the "correct" distribution of income.[739]

This approach suffers, however, from at least three important problems: (1) it assumes, unrealistically, that some person or entity (majority, philosopher king, dictator) knows scientifically how to weigh one person's utility relative to the utility of another; (2) it invites governments to engage in redistributive schemes in the name of maximizing social welfare (the win-lose problem cited above); and (3) it reduces the rewards for hard work and saving. The economics literature is replete with articles on the "impossibility" of a social-welfare function and on the philosophical objections to the very idea of a social welfare that transcends the individual.[740] An alternative approach is one that recognizes the individual as the relevant economic entity and as one that derives utility from giving. Under this approach, the individual's utility depends on both what he consumes and on the well-being, somehow measured, of other individuals. Here, the problem is not to maximize social welfare but to maximize the utility of the individual, given that one individual's utility depends on another.

In recent years, various economists have challenged the traditional view in economics that the distribution of income is a win-lose proposition. They have explored an alternative view according to which economic agents can be seen as deriving utility both from their own consumption and from the utility or consumption of others. Gary Becker, for example, has developed a model in which there are utility-maximizing donors and recipients and where the donor's utility depends on the recipient's utility.[741]

In this model, a transfer from the donor to the recipient makes both the recipient and the donor better off. The donor cares only about the effect of his transfer on the recipient's utility. What the recipient does with that dollar is his business. According to this logic, the donor gives freely if the utility he loses from reduced consumption is less than the utility he gains from the increase in the recipient's utility. In this fashion, giving is based on altruism as well as self interest. Robert Pollack has built a model in which the donor's utility depends on the recipient's consumption of certain goods, as opposed to the recipient's utility.[742] In this "paternalistic" model, the donor's utility rises if, but only if, the recipient consumes more of those goods that the donor wants the recipient to consume. Yet, in this

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[739] *See generally* AMARTYA K. SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE (1970).

[740] *See* DENNIS C. MUELLER, PUBLIC CHOICE II (1989).

[741] *See* GARY S. BECKER, A TREATISE ON THE FAMILY 172-201 (1981). *See also* notes 29-32 *infra.*

[742] *See* Robert A. Pollack, *Interdependent Preferences*, 66 AM. ECON. REV. 309 (1976).

model, as in Becker's, the donor might derive more utility from transferring a dollar to the recipient than by increasing his own consumption.

To be sure, motives for giving can range from pure altruism to pure self interest. Jeffrey Obler identifies three important motives of giving: (1) altruism, (2) reciprocity, and (3) direct benefits.[743] Altruism, selfless devotion to the welfare of others, may arise from sympathy over the situation of others, from a wish to do good for the sake of doing good, or from social norms according to which helping others is a requirement for good citizenship or from the "warm-glow" feeling that giving creates from feelings of commitment inculcated through received values.[744]

A second motive is reciprocity.[745] If A helps B today, in the future B may be able to return the favor when A needs assistance. This form of social insurance implies a sacrifice of current consumption in return for the implied promise that assistance will be there if A needs it in the future. Given risk-averse individuals, this smoothing of consumption over time may be utility maximizing.

As an example, consider a barn-raising where a group of individuals help build one barn per year. People donate their labor freely on the expectation that when it comes time to build their barn, there will be ample labor to help them. Mutual-aid societies act in this way. In the welfare system, if A helps B out of welfare by providing job training, then B will help A by lowering A's taxes and increasing A's disposable income and therefore A's personal consumption bundle.

A third motive is direct benefit. Here, the donor receives some type of benefit from his contribution. This is most easily seen in subscriber or membership organizations that provide services to their members. The Girl Scouts and Boys Club allow children access to the programs that they sponsor. The symphony allows one to purchase tickets to concerts. Volunteers may obtain direct benefit from these organizations, too. A volunteer at a hospital may receive benefits in the form of subsidized meals in the cafeteria and receive plaques in recognition of service. By volunteering to coach Little League, an insurance salesperson may network and create direct monetary income.

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[743] *See* Jeffrey Obler, *Private Giving in the Welfare State*, 11 BRIT. J. OF POL. SCI. 17 (1981).

[744] *See generally* James Andreoni, *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*, 100 THE ECON. J. 464 (1990).

[745] *See* Robert Sugden, *Reciprocity: The Supply of Public Goods Through Voluntary Contributions*, 94 THE ECON. J. 772, 773-75 (1984).

Although there are elements of self-interest in any such model, it is possible from these examples to reconcile the "allocative" branch of economic theory with the idea of altruism and of voluntary giving. The public-good nature of welfare may argue for a coercive system of taxes that has the effect of requiring taxpayers to maintain some minimum level of "giving." There is, however, no presumption, by virtue of this logic, that taxpayers should fund welfare or social-services programs maintained by government rather than by private charities.

The problem of welfare reform is not, in this light, one of fairness, but one of determining how to make a particular level of taxpayer effort as effective as possible in serving the altruistic goals (or not-so-altruistic goals) of the taxpayer. The challenge for government becomes one of maximizing the utility of the "donor" (who might also be a taxpayer). Consider a donor (taxpayer) A and a welfare recipient B. If A must sacrifice a dollar of his own consumption, what mechanism can cause the sacrifice of that dollar to rebound as effectively as possible to the benefit of A by, in turn, benefitting B?

A New Approach

Several Congressional bills would offer a tax credit for charitable contributions. Among the most prominent is one proposed by Senator Dan Coats of Indiana and Representative John Kasich of Ohio.[746] The Coats-Kasich bill would provide a federal tax credit of up to $1,000 for married couples for contributions to private charities that assist the poor.[747]

The attraction of the bill lies in the belief shared by most Americans that private charities are more effective than government bureaucracies in helping the poor.[748] In making the case for their bill, Coats and Kasich argue:

> It is important for us not only to spread authority and resources within the levels of government, as was done with the recently enacted welfare reform legislation. We also need to spread them beyond government - to private and religious institutions that have the spiritual and moral resources absent from welfare bureaucracies. That is the essence of this proposal.[749]

[746] Project For American Renewal Act, S. 1904, 104th Cong. (1996).
[747] Sen. Dan Coats, *Project for American Renewal: The Charity Tax Credit Act* (visited Aug. 2, 1997) <http://www.senate.gov/~coats/7-b.html>.
[748] Joseph P. Shapiro & Andrea R. Wright, *The Faith Factor: Can Churches Cure America's Social Ills?*, U.S. NEWS & WORLD REP. Sept. 9, 1996, at 53.
[749] Dan Coats & John Kasich, *A New Idea For Welfare Reform*, THE WASH. TIMES, Dec. 12, 1996, at 19.

A study published by the Beacon Hill Institute (BHI) reviews some of the accounting, statistical and economic issues that the tax-credit approach poses.[750] In its study, BHI proposes that individual taxpayers, both itemizers and nonitemizers, should be allowed to elect a 100% federal welfare tax credit for contributions to eligible charities for up to 25% of their federal tax liability.[751] This would have the effect of "privatizing" means-tested federal welfare spending.

ARGUMENTS FOR A TAX CREDIT

The core argument for the tax-credit approach arises from the distinction between "giving" and spending. When a taxpayer transfers a dollar from his consumption to someone else's, the utility thus sacrificed is the same whether that dollar is finally spent by a welfare recipient or, in part, by some social-services "provider." And the sacrifice is the same irrespective of the conditions that are attached to the expenditure of that dollar by the social-services provider and irrespective of whether the provider is government or a private charity.

The question, then, is by what mechanism is it possible to have an outcome in which the utility gained by the donor and (in the donor's judgment) by the recipient is as great as possible. Here the marketplace provides a lesson. The principal mechanism on which the marketplace relies to bring about an "optimal" allocation of resources is competition.

Defenders of tradition over devolution might invoke the free-rider argument against welfare cutbacks: such cutbacks, so this argument would go, ignore the "public good" nature of welfare, whereby taxpayers are better off if coerced to provide for welfare expenditures from which taxpayers themselves benefit.[752] However, the traditional welfare system gives rise to a free-rider problem of its own: the reluctance of taxpayers to contribute time and energy to monitor the effectiveness with which their welfare dollars are spent. The inclination is to let someone else worry about how their money is spent.

A. *The Role of Competition*

The tax credit overcomes this free-rider problem. When the taxpayer has a range of charities from which to choose in allocating his tax dollars, he has an incentive to inform himself about how that dollar is spent. This puts private charities in competition with each other for both the donations

[750] BHI Study, *supra* note 16.
[751] *Id.* at 68.
[752] *See* Harold M. Hochman & James D. Rodgers, *Pareto Optimal Redistribution*, 59 AM. ECON. REV. 543 (1969).

of taxpayers and the services of welfare recipients. Charities that are effective in attracting welfare recipients and in assisting those recipients in ways that provide utility to donors would attract taxpayer dollars and succeed. Those that are not would fail to attract taxpayer dollars and fail.

The injection of competition into the delivery of welfare services would create a marketplace in which charities could try out various methods of assisting the poor. Building on their success in helping the poor, some charities could employ "tough love" monitoring programs, while religious organizations could add a spiritual dimension.

B. *Evidence from the States*

The tax-credit option is not untested.[753] For example, Michigan allows a 50% tax credit for contributions to community foundations, homeless shelters and food kitchens.[754] Similarly, Colorado allows a 50% tax credit for contributions to charities within enterprise zones.[755] Idaho allows credits for contributions to children's homes.[756] Indiana has a neighborhood assistance program.[757] Kansas allows credits for those who support AFDC recipients.[758]

C. *Voluntarism*

Just as the tax-credit option would encourage taxpayers to pay stricter attention to how their "welfare" dollars were spent, it would encourage them to volunteer for the charities to which they contribute.[759] BHI has estimated that its proposed tax credit would roughly double the number of volunteers, from 3.76 to 6.95 million, for charitable organizations that provide social services.[760]

CEOs for Nonprofits in states offering tax credits believe that tax credits encourage voluntarism and increase the effectiveness of volunteers. In surveying these CEOs, BHI found that 90% believe that volunteers save organizations money and are therefore crucial for increasing efficiency; 84% believe that volunteers are necessary if they are to fulfill their mission of helping those in need; 77% believe that they

[753] *See* DAVID G. TUERCK AND WILLIAM F. O'BRIEN, JR., THE COMPASSION TAX CREDIT: A FAMILY ADVOCATE PILOT PROGRAM 75 (1996).
[754] *Id.*
[755] *Id.*
[756] *Id.*
[757] *Id.*
[758] *Id.*
[759] *See* Richard F. Dye, *Contribution of Volunteer Time: Some Evidence on Income Tax Effects*, 33 NAT'L TAX J. 89, 92 (1980).
[760] BHI Study, *supra* note 16, at 115.

can count on volunteers; and 73% believe that the time spent organizing and training volunteers is worth the effort.[761]

D. *Private-Sector Efficiency*

The economics literature suggests that for-profit private institutions deliver government services at lower cost than government.[762] Their access to volunteers allows private nonprofit organizations to deliver services at a lower cost than government as well. As noted, competition between private charities for donors and for recipients would encourage them to deliver services at the lowest possible cost.

E. *Donor Response*

Of several studies reviewed by BHI, all showed that a reduction in the "tax price" of giving induces taxpayers to give more.[763] Most studies found that the amount of additional giving exceeds the loss in tax revenue.[764] The median estimate showed that a 10% decrease in the price of giving causes a rise in giving by 13.5%.[765] In an examination of 62,422 individual federal tax returns for 1991, BHI estimated that the price elasticity of giving was -1.12, implying that a 1% decrease in the price of giving would increase giving by 1.12%.[766]

F. *Crowd Out*

The models of altruism explored above imply that people give more when the recipients are perceived to be more needy. The principle of 'diminishing marginal utility of income' implies that the utility gained by the recipient, and therefore to the donor, is greater when the recipient is worse off to begin with. Thus, government welfare programs that make recipients better off diminish people's willingness to give. These programs "crowd out" private giving.

If the crowd-out factor is, say, 10%, each additional dollar of government welfare spending reduces donations to charities providing social-services benefits by 10". Likewise, each dollar less of government welfare spending increases those donations by 10". The literature reports crowd-out estimates from .5% to 100%.[767]

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761 THE BEACON HILL INSTITUTE, NEWSLINK: IDEAS AND UPDATES ON PUBLIC POLICY 5 (1997).

762 *See, e.g.,* Thomas E. Borcherding et al., *Comparing the Efficiency of Private and Public Production: The Evidence from Five Countries,* ZEITSCHRIFT F&UUML;R NATIONAL&OUML;KONOMIE 127, 127-56 (1982).

763 BHI Study, *supra* note 16, at 50-56. These studies were included in CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 56-59 (1985).

764 BHI Study, *supra* note 16, at 91-96.

765 *Id.* at 51.

766 *Id.* at 91-96.

767 *See, e.g.,* JERALD SCHIFF, CHARITABLE GIVING AND GOVERNMENT POLICY 141-43 (1990); Richard Steinberg, *Does Government Spending Crowd Out*

A 100% tax credit framed on the principle of budget neutrality implies a dollar reduction in government welfare spending for every new dollar donated to private charity by a taxpayer. That means that there would be two factors causing taxpayers to give more: (1) the increased utility that recipients would receive as their dollars were more effectively applied to the assistance of the poor and (2) a "crowd in" of donations as government spending fell.

G. *Social Pluralism*

There is nothing sacred about using a tax deduction as a method of inducing taxpayer support of private charities. In fact, the practice may be dubious because of the deduction's undemocratic bias. Under current tax rules, only filers who itemize, a distinct minority, can claim deductions, thus deterring charitable giving by nonitemizers. Because of this, charities favored by the rich, such as public television and museums, receive better treatment than charities favored by the poor, such as churches and mutual-aid societies. According to the late Nobel Prize-winning economist William S. Vickrey, "[o]ne may well question whether it is sound public policy to thus subsidize much more heavily the charities favored by the wealthy as distinct from those appealing primarily to the poorer contributors."[768]

Recognizing this inequity, Todd Izzo has proposed a 20% refundable tax credit for contributions which would not increase aggregate giving but would level the gift-giving playing field: The government would subsidize equally the decision of Taxpayer I to support his local church, the decision of Taxpayer II to fund the homeless shelter, the decision of Taxpayer III to donate to the Salvation Army, and the decision of Taxpayer IV to provide for public television.[769]

Donations?, *in* THE NONPROFIT SECTOR IN THE MIXED ECONOMY 99-126 (Avner Ben-Ner & Benedetto Gui, eds., 1993); Russell D. Roberts, *A Positive Model of Private Charity and Public Transfers*, 92 J. OF POL. ECON. 136 (1984).

[768] William S. Vickrey, *One Economist's View of Philanthropy*, *in* PHILANTHROPY AND PUBLIC POLICY 31, 54 (Frank G. Dickinson, ed., 1962).

[769] Todd Izzo, *A Full Spectrum of Light: Rethinking the Charitable Contribution Deduction*, 141 U. PA. L. REV. 2371, 2386-90 (1993). (Izzo uses four classes of taxpayers to illustrate the current disparity between the preferences of the low-income and high income taxpayers. Taxpayer I earns less than $5,500, incurs no tax liability, and donates to his church. Taxpayer II earns $20,000 and incurs tax liability, but does not itemize deductions and donates to the neighborhood shelter. Both bear the full cost of their contributions and receive no tax reduction. In contrast, Taxpayer III earns $32,000, incurs tax liability, and itemizes deductions while donating to the Salvation Army. Another itemizer, Taxpayer IV, earns $100,000, incurs tax liability, and donates to public television. Taxpayers III and IV receive a reduction in tax liability because they made contributions. "This allocation of decision making is inequitable. If individuals are to have the power to decide how public money is spent, then that power should be allocated without regard to an individual's income.")

According to Peter J. Wiedenbeck, additional justification for a tax credit lies in the following:

> [T]he deduction for charitable contributions must ultimately find its justification in nontax social policy considerations . . . . First, a tax incentive to encourage private support for the services traditionally provided by charitable organizations may be necessary in part because of constitutional restraints of government action . . . . [S]econd, the best available economic research indicates that the tax deduction is *efficient*. That is, deductibility increases gifts to charity by more than it decreases tax collections . . . . [T]hird, the charitable contribution encourages cultural and associational pluralism.[770] [emphasis added].

CONCLUSION

During the last four years, welfare reform has captured the imagination of both federal and state policy makers eager for a solution to more than six decades of failed policy. While PRWORA responds to taxpayer impatience over these policies, it will not rescue the poor from dependency. It suffers from a misplaced emphasis on the redistributive, win-lose elements of conventional welfare thinking.

The tax credit option represents a shift in the rhetoric, from a focus on redistribution to a focus on allocation. Considered in the context of traditional economic theory, expanded to incorporate the role of altruism, the tax credit option represents a win-win proposition for taxpayers and recipients.

A review of the existing literature and recent findings by the Beacon Hill Institute suggest the following reasons for adopting the tax-credit approach as an alternative to the traditional entitlement approach and the current trend to devolution:

The tax credit injects competition into the delivery of social services, replacing the existing government monopoly with a system in which many private charities would compete for taxpayer dollars and for recipients.

- Some states already have modest tax-credit programs in place.
- The tax credit encourages giving and voluntarism.

[770] Peter J. Wiedenbeck, *Charitable Contributions: A Policy Perspective*, 50 MO.L.REV. 85, 95-96 (1985).

- In part because it encourages voluntarism, the tax credit would permit private charities to provide services at less cost than government.
- The "crowd out" effect of government spending, along with the documented effectiveness of tax incentives in encouraging giving suggest that the tax-credit approach would encourage a transfer of dollars from government to private charities.
- Tax credits are superior to tax deductions on grounds of social pluralism.

The tax-credit option deserves consideration in the debate over welfare reform that is sure to take place in the years ahead. For reasons already well known to students of fiscal federalism, that debate did not come to an end with the last year's triumph of welfare reform.