

Why Charities Exist and The Price of Altruism



Disclaimer: For the avoidance of doubt, the Hobbit is a doctor with absolutely no training in Economics. As we all know, our local education system is such that one ends up in NUS Medicine with ZERO instruction in Economics from our secondary schools and junior colleges. So, the Hobbit apologises unreservedly if there are any inaccuracies and misrepresentation of economic principles in this article.

WHY CHARITIES EXIST?

In addition to the private and public sectors, there is a third one, commonly called the 'people' sector. Charities belong to this third category.

Put simply, charities exist to provide a service or fulfill a need that is not met because

- a) the person(s) requiring the need or service cannot afford to pay for it at a price the market is willing to produce; and/or
- b) the government is not willing or unable to subsidise the service to the point whereby the person(s) can pay for it. In some cases, the government subsidy can be zero.

In other words, there is often a gap between an individual's power to pay and the market price of what he needs. This gap gets larger and occurs more frequently with the poor, the sickly and the disabled. This gap can only be met in two ways: government subsidies and/or charity.

Another hypothetical reason why a charity should exist is that somehow the service provided by the charity is cheaper and better in quality than what the government can come up with either directly or indirectly through subsidising private sector providers. There is no reason to believe this is a plausible reason in Singapore's context, given the fantastic efficiency and cost-effectiveness of our public services.

One may almost argue that in developed countries with ample resources, such as Singapore, there is no need for charity. After all, should the government wish to do so, it can subsidise all the way, rendering charities redundant.

Let us take the case of the National Kidney Foundation (NKF). The actual subsidies given out by this charity for

its primary mission of helping dialysis patients amounted to only about S\$7M a year. In some good years, a large public hospital can have more surpluses than this amount. So for the government to fund everything that NKF does now is not an issue. Even if we double the amount to S\$14M a year, it is still within the capabilities of the government to continue funding the services fully.

But the ability of any government to fund something does not mean that it comes at no cost. In fact, James Buchanan, 1986 winner of the Nobel Prize for Economics argues that all collective decisions come at a cost. Termed 'interdependence costs'¹, it is further divided into two sub-categories: 'persuasion costs' and 'external costs'. Persuasion cost is that of convincing people to support a course of action and increases when more people are needed to arrive at the collective decision to support this course of action. External cost is imposed on people not benefiting from the collective decision should it be made. External costs are high if a relatively small number of people can make a collective decision that impacts a far larger group negatively.

Let us take the hypothetical situation that a decision has been made by the government to provide dialysis free of charge in Singapore. The actual number of beneficiaries (persons receiving dialysis and their families) from this decision is not large – maybe a few thousand people benefit at most. However, if this precedent is set, other demands may come in: free new and expensive chemotherapy, free organ transplants, free drug-eluting stents, and others. If these demands are all met, interdependence costs will eventually shoot up since: (a) the beneficiaries are relatively few, and (b) the costs have to be borne by almost all Singaporeans through higher taxes (that is, almost all Singaporeans have to be convinced to pay more taxes for people getting free transplants, dialysis, and so on and so on – that is, persuasion cost). Another way to look at this is that there will no end to what certain groups of people will want free, and once people are persuaded that a government can be coerced to provide free services, more lobby groups and coalitions will form to further such causes.

◀ Page 14 – *Why Charities Exist and The Price of Altruism*

To convince otherwise, that is, to deny free services to a large group of people, those who now believe free services are the norm, would entail huge persuasion costs. These scenarios have already occurred in many developed countries.

In summary, a government could well be caught in a Catch-22 situation: between high persuasion costs of convincing people of the need for higher taxes, and high persuasion costs of convincing people that free services are NOT the norm.

THE PRICE OF ALTRUISM

We get to the third and finally most important reason why charities exist: individuals want to donate for altruistic reasons (for the purpose of this discussion, we shall not examine why businesses engage in philanthropic and charitable causes). Altruism can be defined as a principle of action derived from unselfishness. This may sound counter-intuitive in a survival of the fittest, dog-eat-dog kind of world.

Gary Becker, winner of the 1992 Nobel Prize of Economics believes otherwise. He explains the basis of altruism: inherent in human nature and life is that we gain personal welfare by not only our own personal consumption (spending on ourselves and families), but by also deriving welfare from the consumption enjoyed by others who had received our altruism through transfers of income (that is, donations)².

Such gains in personal welfare that arise from altruism lead to further altruistic transfers of income. (We will not go into depth here how such gains come about.) It is this expectation and virtuous cycle of altruism that drives people to increase the welfare and income of others. As a result, charities grow from strength to strength in society.

Altruism is a beautiful concept from the perspective of political and persuasion cost. Because it is entirely voluntary and individualised, there is no collective decision to be made, and hence practically no persuasion cost is incurred, that is, through charities convincing people to donate out of altruism, needs of disadvantaged people are met without the need for collective decision-making, higher taxes or incurring of persuasion costs by governments. That is why successful charities with huge financial resources are usually feted by even rich governments and encouraged to take up more responsibilities: charities do work without governments incurring large interdependence costs.

Of course, there is a limit to altruism: one's income is limited. One cannot go on giving without it leading finally to a loss in the donor's quality of life, that is, one stops giving when marginal increase in personal welfare is less than loss in quality of life arising from income donated. And as charities take up more and more social

responsibilities, governments run the risk of being perceived by the public as shirking their responsibilities.

Nonetheless, charities exist because they represent a win-win situation:

- a) We want to donate to charities to maximise our personal welfare through altruism.
- b) Governments allow them to exist (or even promote their existence) as a means of decreasing interdependence costs (especially persuasion costs) that arise out of collective decision-making.

Now, what happened in the NKF saga? Why are people upset?

Most people came to the conclusion that their altruism did not go to the poorer or worse-off people but to person(s) who were richer or better off than themselves! Overnight, gains in personal welfare derived from helping the less fortunate through altruism became perceptions of loss in personal welfare. ("Alamak, I donated to make the rich richer!") We have now gone from win-win to potentially loss-loss.

The choices before the government had become stark as such – to either

- a) restore the belief that altruism is worthwhile as it brings gains in personal welfare of the donors; or
- b) make up for the gaps vacated by loss in altruism in the whole country with government funds, which would ultimately bring in higher taxes and persuasion costs.

As the NKF saga has shown, although donations are given freely, the price of altruism can be deduced from the fact that the absence of altruism is very costly.

So at the end of the day, there is still no free lunch. Needs of the poor and sick who cannot pay either has to be funded by taxes, altruism, or usually a combination of both. While there is a limit to how much governments can replace collective decision-making (and accumulation of persuasion costs) with altruism, donations still play an important role. The Hobbit believes that altruism is still the better way out most of the time. Parties and persons who are found to be somehow eroding people's trust in charities and inclination towards altruism through one-upmanship journalism really should be taken to task. On the other hand, charities will do well to now remember that while donations are given freely out of altruism, altruism is not cheap. ■

REFERENCES

- 1 James Buchanan and Gordon Tullock, *The Calculus of Consent*, University of Michigan Press, Ann Arbor, 1962. Full text available at <http://www.econlib.org/library/Buchanan/buchCv3Contents.html>
- 2 Gary Becker, *Altruism, Egoism and Genetic Fitness*, *Journal of Economic Literature* 14, No. 3 (September 1976)