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The giving economy  
*IoD Policy Paper*

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Graeme Leach

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**“The Lord loves a cheerful giver”  
II Corinthians 9:7**

**“It is more blessed to give than to receive”  
Acts 20:35**

**“The act of giving, like the quality of mercy, is twice blessed: it blesseth him that gives and him that takes”**

**The Wealth of Giving, IEA**

**“The greatest pleasure I know is to do a good deed by stealth and to have it found out by accident”**

**Charles Lamb**

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# Summary

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- *The Giving Economy* argues that the level of charitable giving in the UK is much too low, whilst at the same time arguing that IoD members display greater generosity than the population as a whole.
- In July 2002 the IoD undertook a member questionnaire<sup>1</sup> on *The Giving Economy* and attitudes towards personal philanthropy. Among the key findings of this research were:
  - One-in-five members give away at least 5% of their gross income each year.
  - One-in-three members give away at least 3% of their gross income each year.
  - 59% of respondents believe that, as a nation, we do not give enough to charitable causes.
- *The Giving Economy* shows that personal philanthropy is central to a correct view of the market economy. Market economics has never been about the unbridled pursuit of individual self-interest.
- The unbridled pursuit of individual self-interest was never the position of Adam Smith and will never be the position of the IoD.
- A market economy will function effectively when there is both selfless and self-interested behaviour – the invisible glue that holds the invisible hand together.
- Evidence is presented that a combination of affluent society consumption, declining religious influence and growth in the welfare state have eroded individual charity.
- Growth in the welfare state is shown to have undermined social capital, with negative consequences for long-term economic growth.

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<sup>1</sup> 401 questionnaires were received back from members – statistical issues of self-selection may apply.

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# 1 Introduction

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In 1999 the Institute of Directors published *The End of Altruism? (IoD Economic Comment Graeme Leach, June 1999)*. The conclusions of that report remain true today:

*“The level of charitable giving in the UK is pitifully low ... let us hope that an age of altruism can be created, an age of voluntary giving. People need to understand that the welfare state is not the first and the last provider, and that they cannot pass by on the other side”.*

*The Giving Economy* re-iterates this view, whilst at the same time arguing that IoD members display greater generosity than the population as a whole.

The Giving Campaign, launched in July 2001, is an independent national campaign supported by the voluntary sector and the Government. It has been established to increase the amount of money given to UK charities through an increased awareness of the need for greater philanthropy and the opportunities provided by tax-effective giving.

This report is intended to help and support the Giving Campaign<sup>2</sup>. Although it is an IoD report, the main focus of our research is the need for greater individual giving. The report does not examine corporate philanthropy.

A recent CAF<sup>3</sup> publication (*A Lot of Give – Trends in Charitable Giving for the 21<sup>st</sup> century*, C. Walker & C. Pharoah, CAF/NCVO<sup>4</sup>, 2002) stated that:

*“With the proportion of the public who give to charities declining the need to understand giving better has become urgent”.*

The IoD concurs with this view, but it provides only part of the motivation for this report.

*The Giving Economy* shows that personal philanthropy is central to a correct view of the market economy. Market economics has never been about the unbridled pursuit of individual self-interest. This truth has been lost and the IoD wants to see it re-discovered. This report shows that the moral case for a market economy is inextricably bound up with personal philanthropy.

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<sup>2</sup> The Social Market Foundation has suggested a ‘Take 2’ campaign to encourage individuals to donate 2% of their pre-tax income to charity – see below.

<sup>3</sup> Charities Aid Foundation.

<sup>4</sup> The National Council for Voluntary Organisations.

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## 2 Will the real Adam Smith stand up please?

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Ask any economics student<sup>5</sup> to summarise the key message of Adam Smith in his seminal work, *An Inquiry into the Nature and Causes of the Wealth of Nations* (first edition, 1776), and you will probably be told that the unconstrained pursuit of self-interest will best promote the general welfare of society.

Naturally, people tend to recoil somewhat at this pronouncement, and in so doing establish a prejudice from the outset towards the morality of market economies. Such views are profoundly mistaken.

The unbridled pursuit of individual self-interest was never the position of Adam Smith and will never be the position of the IoD.

Let's examine what Smith actually said<sup>6</sup>:

*“Every individual is continually exerting himself to find out the most advantageous employment of whatever capital he can command. It is his own advantage, and not that of society, which he has in view ... he is in this ... led by an invisible hand to promote an end which has no part of his intention”.*

Stapleford (*Me, myself & why* in *Bulls, Bears & Golden Calves: Applying Christian Ethics in Economics*, J.E. Stapleford, 2002) argues that this text clearly shows that Smith never offered unqualified blessing of the unconstrained pursuit of self-interest:

*“Smith's qualified recognition that social benefits may accrue from the self-interested investment of capital, is a far cry from the typical claim that unconstrained pursuit of self-interest in all areas of economic activity always promotes the general welfare”.*

Smith clearly recognised the failings of human nature and how individually or corporately people could engage in economic activities detrimental to society. In 1759, Smith wrote his *Theory of Moral Sentiments*, in which he expressed his doubts about the natural virtue - or lack of it - of humanity:

*“Man, when about to appear before a being of infinite perfection can feel but little confidence in his own merit”.*

However, Smith also sees the potential positive impact of a selfless attitude and personal philanthropy to the effective running of a market economy. He recognised that in addition to the impact of competition, economic excesses may also be constrained by a desire to seek the approval of others.

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<sup>5</sup> This view is not surprising since the majority of economics degree and A-level students have not read Smith's seminal work.

<sup>6</sup> This is the only occurrence of the phrase 'invisible hand' in the entire book.

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In Part 1 of *The Theory of Moral Sentiments* he states:

***“How selfish so ever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it”.***

As discussed below, this social capital effect has powerful economic consequences. The economic historian Jeffrey Young has stated:

***“The frugal self-interested man of Wealth of Nations is also the prudent man of Theory of Moral Sentiments, and self-interest in both is to be understood as ‘proper regard for self – that degree of self love which elicits the approval of the impartial spectator because it does no harm to others”.***

It may come as a surprise to some, that Adam Smith argued that there needed to be internal and external constraints on the pursuit of self-interest. Both are integral to the smooth operation of a market economy:

- Self interest operating within the confines of effective competition – competition is seen as the major curb on the excesses of self-interest.
- A degree of selfless behaviour – the approval of others, the so-called sympathetic motivation.
- A degree of government activity – the term *laissez faire*, denoting a complete absence of government in economic affairs, never appears in Smith’s *Inquiry into the Nature and Causes of the Wealth of Nations*. Smith also found the existing pattern of wealth and income shares less than optimal, owing to mercantilist regulation, certain taxes and the remnants of feudalism in the agricultural sector<sup>7</sup>.

Summarising this final point, Stapleford states that,

***“Smith’s position on jurisprudence and justice reflects an other-regardness that goes unrecognised by many”.***

Some scholars have seen a contradiction between the altruism of the ‘sympathetic’ motivation, advanced in *Moral Sentiments*, and the self-interest advanced in the *Wealth of Nations*. This charge is wrong.

Smith saw both motivations as fundamental. Smith clearly wanted to unleash market forces, but he was also assuming that responsible people would constrain themselves in the pursuit of self-interest.

Economics is clearly about value but Smith shows it’s about values as well. Because economic activity takes place within a community, it’s impossible not to talk about values.

A market economy will function effectively when there is both selfless and self-interested behaviour – the invisible glue that holds the invisible hand together.

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<sup>7</sup> Before any statist gets too excited, this is hardly a clarion call for the welfare state. Moreover, Smith also states that ***“I have never known much good done by those who affected to trade for the public good”.***

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This message is difficult to get across but needs to be driven home.

There remains a wide gulf between this view of the economy and contemporary 'third way' advocates such as Anthony Giddens. For Giddens (*The Third Way: The Renewal of Social Democracy*, A. Giddens, 1998):

***“Devotion to the free-market on the one hand, and to the traditional family and nation on the other, is self-contradictory ... nothing is more dissolving of tradition than the permanent revolution of the market. The dynamism of market societies undermines traditional structures and fractures local communities”.***

This report challenges such a view, arguing that Adam Smith's 'sympathetic' motivation provides an explanation for altruism that can enhance social capital within a market economy. We would argue that Giddens is wrong. There is no contradiction between market economics and strong families. In fact, the one reinforces the other.

How best to maximise social capital – the moral dimension - via the state or through personal philanthropy, is a major focus of this report.

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## 3 IoD Giving Economy Survey

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In July 2002 the IoD undertook a member questionnaire<sup>8</sup> on *The Giving Economy* and attitudes towards personal philanthropy. The responses were fascinating for their insight into members' attitudes.

Anyone who believes that the IoD membership is characterised by unbridled self-interest – so-called 'fat cats' – is given short shrift by this survey. IoD members are revealed as being generous with both their time and money.

The survey results show:

- One-in-five members give away at least 5% of their gross income each year.
- One-in-three members give away at least 3% of their gross income each year.
- 59% of respondents believe that as a nation, we should give more to charitable causes.
- 53% of respondents aspire to give more time to charitable causes in the future.
- 37% of respondents aspire to give more money to charitable causes in the future.
- 72% of respondents were actively involved in charitable organisations (this response indicates self-selection issues may apply to the questionnaire)
- 60% of respondents believe that the level of tax relief for charitable giving is 'about right'. 35% of respondents believe the level of tax relief is 'insufficient'.

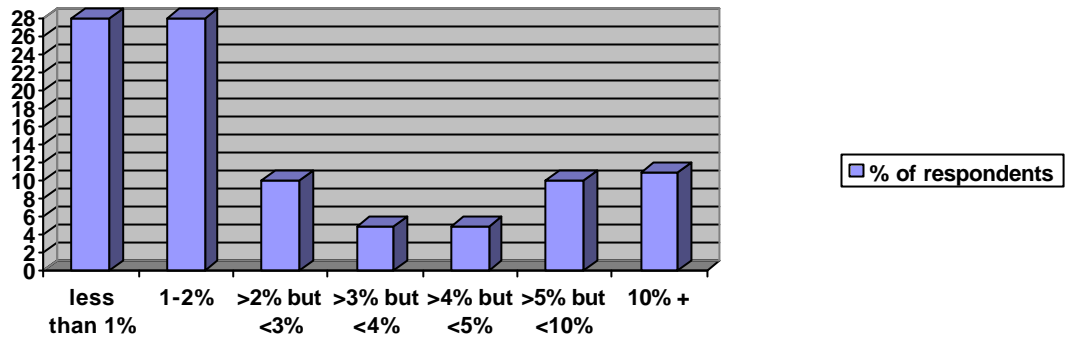
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<sup>8</sup> 401 questionnaires were received back from members – statistical issues of self-selection may apply.

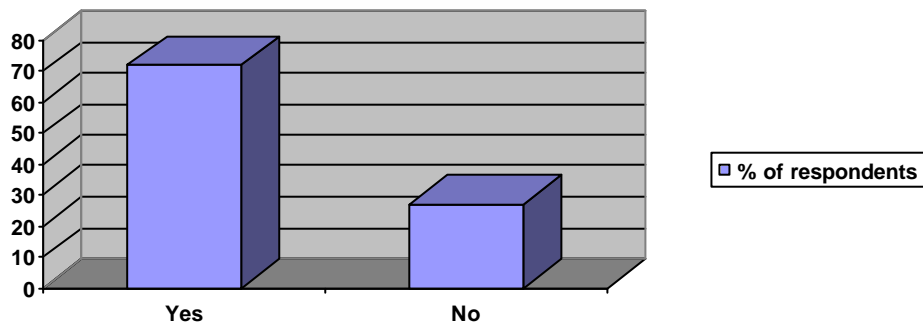
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Charts 3.1 to 3.4 below provide details of the survey results.

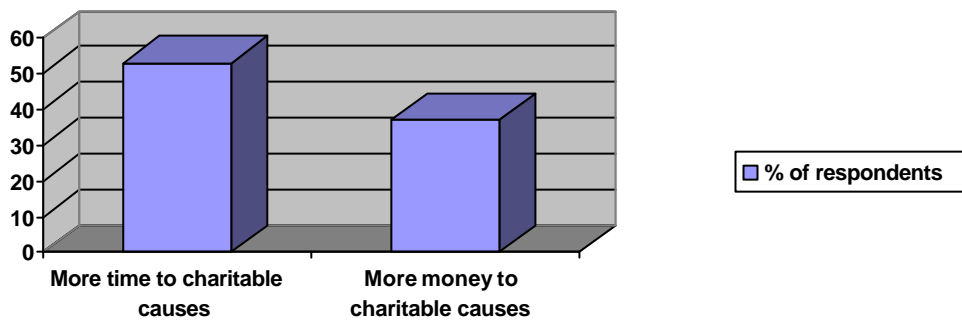
**Chart 3.1** As a proportion of your gross income, how much do you estimate you give to charitable causes each year?



**Chart 3.2** Are you personally, actively involved in any charitable organisation?

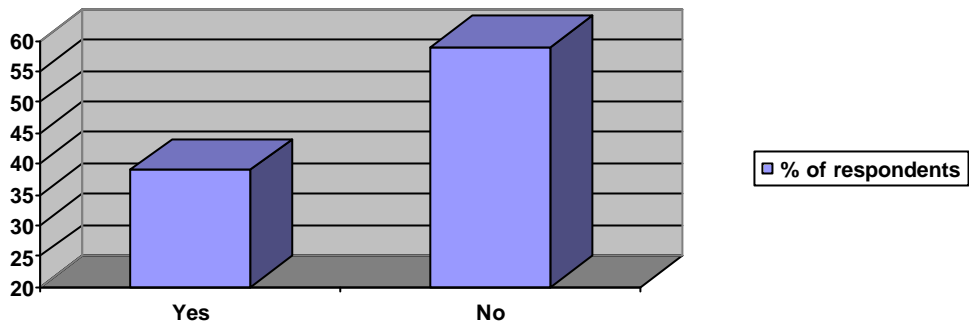


**Chart 3.3** In the future do you aspire to give ... to charitable causes?



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**Chart 3.4 As a nation, do you think we give enough to charitable causes?**



Supporting charitable causes involves both time and money. Chart 3.3 shows that more than half the respondents to the survey wished to give more time to charitable causes in the future.

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## 4 The rise of modern philanthropy

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People tend to forget that the rise of philanthropy, in the form of voluntary associations, is very much a feature of the modern world<sup>9</sup>. In his *Leviathan* (1651), Thomas Hobbes had attacked voluntary associations and the voluntary principle. Since nothing should exist apart from state control, he maintained, voluntary organisations were:

***“Worms in the entrails of Leviathan”.***

A number of social and economic changes came together to spur on philanthropy in the 19<sup>th</sup> century:

- **Industrial expansion** – The convergence of capitalism and the industrial revolution, together with population expansion, uprooted traditional communities and systems of support in Europe and North America.
- **The Second Great Awakening** – During the 1820s and 1830s - the Second Great Awakening – a spiritual renewal developed with an emphasis on good works. Guinness (*Doing Well and Doing Good: Money, Giving and Caring in a Free Society* Os Guinness, Trinity Forum, 2001) has argued that in early America, doing good was rarely done alone.
- **Political philanthropy** – The enormously successful precedent of the British abolition movement, led by leaders such as William Wilberforce and his ‘Clapham Sect’, encouraged the flowering of many voluntary associations. Wilberforce was described as, ***‘Prime Minister over a cabinet of philanthropists’***. The 19<sup>th</sup> century was characterised by many examples of benevolent capitalism where successful entrepreneurs saw it as part of their duty to help the less fortunate – either campaigning against ‘Dickensian’ conditions and/or giving back significant portions of their wealth to society.

In the US, the extraordinary number of voluntary associations has been famously documented by de Tocqueville’s study, ***Democracy in America*** (second edition, 1840). Alexis de Tocqueville was astounded to see Americans forming associations to deal with need, rather than waiting for government to act.

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<sup>9</sup> Elements of modern philanthropy extend back to the Old and New Testament, but much of this was either lost during the Dark Ages, or became unnecessary, due to the agrarian economy and the influence of extended family and close knit communities. The Medieval world was characterised more by a vow of poverty (monasteries) than by a vow of wealth which could then be used for the greater good.

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Philanthropy was seen in global terms also. In 1905, Dr John Mott, leader of the Student Volunteer Movement, called on Americans to give generously and send 1,000 volunteers to Japan, ***“or within 50 years we will be sending 200,000 of our boys with bayonets”***.

## ***Schools of thought***

The rise of modern philanthropy in the 19<sup>th</sup> century, was accompanied by deep-division between competing schools of philanthropy, over the best philosophy and most effective approach to take. Guinness (2001) identifies three schools of thought – which resonate to this day:

**Social Calvinism** – Characterised by extraordinary enterprise, deep compassion and discriminating moral requirements - such as work tests. This school of thought aimed at discerning between the ‘deserving’ and ‘undeserving’ poor.

**Social Universalism** – This wing of philanthropy blended theological liberalism with political socialism to produce a movement that grew into the dominant 20<sup>th</sup> century thinking. Characterised by strong universalist and utopian overtones, it relied confidently on the government and an aim to eliminate the causes of social problems, not just ameliorate them.

**Social Darwinism** – This school has thankfully faded from the debate - although it still persists in the minds of many individuals<sup>10</sup>. It was based on the ideas of natural selection and survival of the fittest<sup>11</sup>. Guinness points out that it was more a school of thought in reaction to poverty, because its implications for philanthropy were so hard-hearted, it was almost anti-compassion.

Today, those who give wealth might not have the Victorians’ sense of mission or obligation, but they are still attracted to causes that are empowering, innovative and effective. Wealth is but a means to an end, with the result that it is a short step from this recognition to an acceptance that we should use wealth to further good ends.

This doesn’t mean that one person has a moral claim on the property of another, but it does suggest a voluntary sense of duty - instead of a revolution in government there needs to be a revolution in the heart.

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<sup>10</sup> Many people make the mistake of believing that market economists such as Adam Smith, would also have advocated Social Darwinism and survival of the fittest. Smith did not argue from a specific religious orthodoxy, he was a deist, believing in a ‘supreme impartial spectator’, the author of nature. However, as shown in chapter 2 above, his position was much closer to that of the Social Calvinist school of thought.

<sup>11</sup> Since the 1960s some academics have advanced the view that altruism towards kin, and reciprocal altruism (co-operation) between unrelated individuals are both favoured by natural selection under certain conditions. Presumably this means that a Darwinian Giving Campaign would be focused not on the idea of moral duty, but on the idea of reciprocal altruism and ‘what will I get out of it?’

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## 5 Charitable trends

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CAF/NCVO (*A Lot of Give Trends in Charitable Giving for the 21<sup>st</sup> century*, CAF/NCVO, 2002) provides a comprehensive analysis of how much people give to charity and who the donors are. The key findings of their report are summarised below<sup>12</sup>:

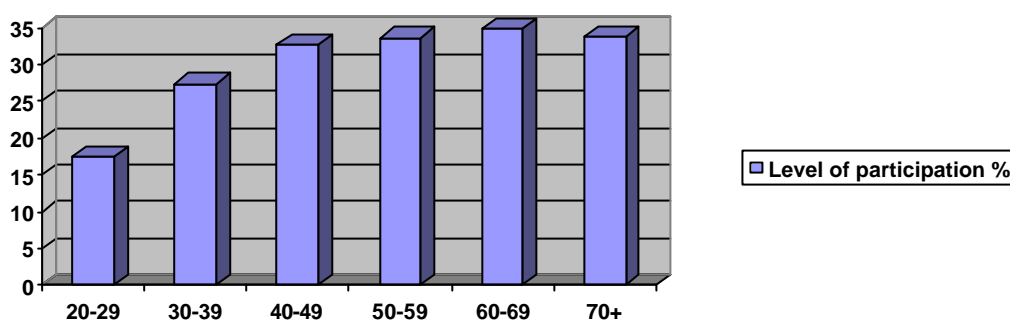
- The NCVO/NOP 2001 individual giving survey estimates total individual giving of approximately £5.7 billion. To this figure needs to be added an additional £400 million to take account of the under representation of bigger gifts through ‘tax effective’ or ‘planned’ giving through covenants or Gift Aid. Income Tax repaid to charities by the Inland Revenue amounts to a further £425 million. It is also estimated that a further £1.5 billion per annum is donated in the form of legacies. This means that total personal giving amounts to around 0.75% of GDP.
- NCVO surveys through the 1990s indicate a fall in the annual amount given by adults to charities, with a slight pick-up from 1998 onwards – possibly reflecting economic growth. Lack of full coverage in the NCVO survey – including larger gifts and legacies - makes it difficult to make definitive statements as to the overall trend. CAF report that there is evidence of these extra sources increasing.
- Analysis of the Family Expenditure Survey (FES) - by the Institute of Fiscal Studies - provides information on giving by families and households – as opposed to the individual based NCVO survey. Again, there are limitations with this source as well, but it does provide long-term statistics showing that in real terms, household gifts to charity virtually doubled between 1975 and 1998. Significantly, this analysis also shows a long-term decline in household participation in giving, particularly among younger households – the NCVO/NOP individual giving survey also displays a decline in participation in giving.
- Inland Revenue data – covering tax-effective giving – display continued growth over the past decade (Inland Revenue statistics, cited in CAF/NCVO 2002).
- Bringing the various data sources together, the CAF report that the evidence shows that throughout the 1990s fewer donors made larger and more numerous gifts, and that these donors may have been particularly attracted to tax-effective methods of giving.

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<sup>12</sup> This report also explains the various statistical sources and the complications involved in measuring giving.

- A small number of people are responsible for a large amount of the giving. One study has concluded that the 3% of people who give more than £50 per month contribute over half of total donations.
- Whatever the overall trend, the CAF evidence shows that, as a nation, we could give a lot more. Charitable giving amounts to just 1.3% of weekly household income. We spend 2% of household income on tobacco and 4% on alcohol.

**Chart 5.1 – Levels of Participation in Giving (by age)**



A recent study from the Social Market Foundation (*The Widow's Might: how charities depend on the poor*, Beth Egan, SMF, December 2001) provides additional information on the nature of charitable giving in the UK. A key finding of the SMF study<sup>13</sup> was that people on lower incomes consistently gave a higher percentage of their income (around 4%) to charity, than people on higher incomes (around 2%) – regressive giving or ‘Robin Hood in reverse’.

**Table 5.1**

Participation in giving and level of contributions (by age group of head of household)		
Age band	Level of weekly giving (£)	Level of participation in giving (%)
20-29	3.11	17.4
30-39	3.14	27.4
40-49	4.89	32.6
50-59	5.06	33.6
60-69	4.36	34.8
70+	5.06	33.8

(Source: FES/IFS, 1997-98 numbers, page 31, CAF (2002))

<sup>13</sup> Based on a quantitative survey of 1,076 UK charity donors by Prof. Adrian Sargeant (2000, unpublished data).

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The cited explanation was that poor people were closer to 'need'. These conclusions clearly challenge the idea that charity is an agent of redistribution from rich to poor. Readers will also note that the IoD member survey - though not broken down by income - is at variance with these findings, but not inconsistent with the SMF's overall conclusion, due to different sampling populations.

### ***Long-term explanations – The Unholy Trinity***

The most obvious explanation of a decline in individual giving tends not to be cited very often – the competing demand for income to finance the huge array of consumer goods and services on offer. Individual demands are constant and ever upward, be it new houses, cars, holidays etc. There are almost limitless demands on our personal resources – creating a culture that says we never have enough. If the choice is between: charity and a new car, altruism and an American holiday, the forces favouring personal gratification are immense.

Thankfully, recent cultural history is also replete with examples of mass-market altruism, often driven by television. One could cite the Twin Towers attack, Kosovo, Live Aid, Children in Need and the death of Princess Diana.

In explaining long-term trends in charitable giving, Robert Payton of the Indiana University Centre for Philanthropic Studies, has pointed to a common denominator across western society:

***“ a rejection of religion and religious values by the educational elites and wealthy of society”.***

IFS/CAF<sup>14</sup> have reported that:

***“whether or not individuals consider religion to be important to them has a significant effect on whether or not they give to charity... those who give consider religion to be very important [conditional on their age, income, education and region] are 9 percentage points more likely to give than those who do not consider it important at all”.***

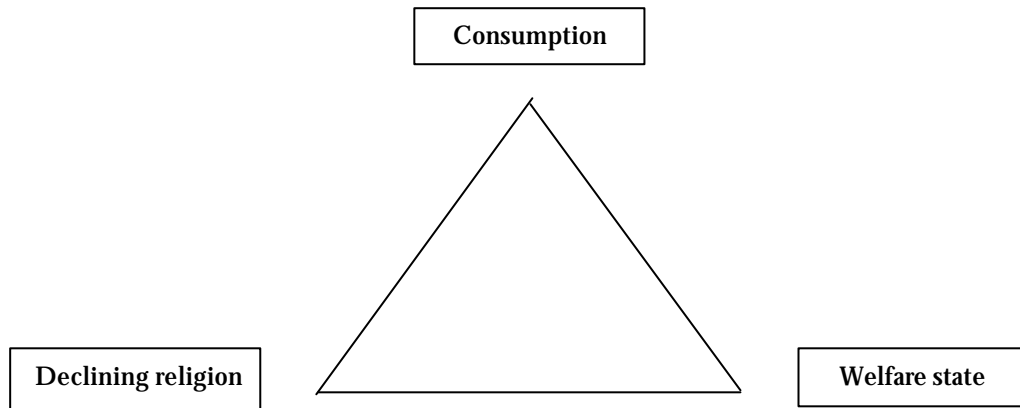
One can clearly see the Biblical concept of tithing 10% of your income as an important influence on this group. The role of religion is interesting because the most significant fall in church attendance has been amongst the 15-29 age cohort and this is the same group with the heaviest fall in the number donating to charity (***The End of Altruism?*** Graeme Leach, IoD Economic Comment, 1999).

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<sup>14</sup> IFS modelling suggests that for a 1% rise in income, charitable spending rises by more than 1%. Modelling also shows that altruism rises with educational attainment. Given the upward movement in both these variables over recent decades, it is clear that other forces have been exerting a downward impact on charitable giving.

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**Figure 5.1 - The Unholy Trinity – explanations of declining participation in philanthropy**



The IoD would argue that religious and consumption influences are very significant, but only part of the explanation and that another key influence has been the growth in the welfare state over the second half of the 20<sup>th</sup> century. It is interesting that Robert Putnam's study of social capital in the US (*Bowling Alone: the collapse and revival of American community*, R.D. Putnam, 2000) argues that a 'watershed' occurred around World War 2 where generations either side of that date had noticeably different attitudes towards voluntary organisations. Putnam reports that trends in American philanthropy are dismaying – in the 1990s Americans donated a smaller share of personal income than at any time since the 1940s. In 1998 Americans donated 1.6% of national income, compared with 2.3% in 1964. Despite this fall, the American GDP share is still twice that in the UK<sup>15</sup>.

Others have provided a more upbeat – and very provocative - assessment of the state of giving in the US (*Am I my brother's keeper?* BBC Letter from America, 29<sup>th</sup> July 2002). Alastair Cooke recently stated that:

***“Recent research reveals an interesting and, I should say, little known social fact that the richest Americans give the highest percentage of their incomes to charity – which, of course, is as it should be. Down the scale, however, middle-class Republicans give next best, lower middle-class people next – and down at the bottom are leftists and liberals who, of course, believe on the principle that the welfare of the needy and the sick and old is an obligation of Big Daddy in Washington”.***

The past half-century has seen an erosion of the apparent willingness of individuals to join in collective endeavours without contractual formalities or government compulsion. As Francis Fukuyama has argued in *Trust: The Social Virtues and the Creation of Prosperity* (Free

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<sup>15</sup> There is a debate as to whether the correct denominator in such calculations should be income or net worth. Talk of the importance of net worth indicators obviously increased during the stock market boom in the late 1990s. One US organisation, the Newtithing Group, developed an economic model (Giving your all? *The Economist*, 29<sup>th</sup> May 1999) which showed that using such a measure, individual giving should have been \$417 billion in 1998, instead of the actual total of \$175 billion.

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Press, 1995), this has ironically been the result of a centralised state taking upon itself ever more of the roles for which such associations were once necessary. Fukuyama argues that the casualties of this expansion of government have been habits of initiative, trust, moral consensus and spontaneous sociability – ultimately the bedrock on which civil society and its virtues (such as charity) rest.

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## 6 Social capital and economic growth

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In the short term, charitable gifts can be seen as neutral transfers within an economy, although to the extent that they transfer money from individuals with a low marginal propensity to consume (MPC) to individuals with a higher MPC, they could boost economic activity. Clearly, charitable payments which are directed overseas, act as a leakage from the UK economy.

Seen in this perspective, charitable payments can impact on the level of economic activity in the short-term, but not the rate of economic growth in the long-term.

In contrast, the long-term economic impact of charitable activity could potentially impact not just on the level of economic activity, but on the rate of growth as well, via the accumulation of social capital – if the welfare state crowds-out individual charity.

### **Box 6.1 Can we measure social capital?**

Francis Fukuyama (*Social Capital and Civil Society*, F. Fukuyama, IMF Working Paper 00/74, April 2000) has defined social capital as an instantiated informal norm that promotes co-operation between individuals. In the economic sphere it reduces transaction costs and in the political sphere it promotes the kind of associational life necessary for the success of limited government and modern democracy. The norms that constitute social capital can extend from co-operation between friends all the way up to complex doctrines such as Christianity.

Social capital (SC) could be defined as the sum of the membership of all associational groups. However, there are clear deficiencies with such a measure because: (1) It is virtually impossible to know how many groups there are. (2) Key groups, such as family or extended family, fall outside the measure.

The above quantitative measure also ignores key qualitative influences – the Ku Klux Klan is an associational group but it undermines social capital. In the model relationship above, a qualitative coefficient would need to be inserted, but in reality, such a coefficient is impossible to measure.

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Central to the concept of social trust is the promotion of externalities – for example, associational groups such as the Rotary Club, which encourage honesty, will foster better business relationships when members deal with each other economically, in addition to the charity’s central objectives. Fukuyama describes this aspect as a ‘radius of trust’, a positive benefit (externality) that accrues to the group, independently of the collective action that the group formally seeks to achieve.

Fukuyama cites the example of *The Protestant Ethic and the Spirit of Capitalism*, where the coefficient for the radius of trust was greater than one, because of the positive spillover of honesty into the larger society. Precisely measuring social capital is impossible.

Some might argue that state welfare provision effectively substitutes for individual charitable activity and that as a result there is no need for concern<sup>16</sup>. The analysis below refutes this claim.

Fukuyama has shown that governments do not have many obvious levers for creating social capital, because it is frequently a by-product of tradition, religion or historical experience. In contrast, Fukuyama states that governments can have a serious negative impact on social capital when they start to undertake activities that are best left to the private sector or to civil society.

The relationship between social capital and the state can be illustrated by reference to the Bolshevik revolution in the former USSR. Following the revolution, the Communist Party destroyed horizontal associations in favour of vertical ties between party-state and individual. Fukuyama has argued that:

***“This has left post-Soviet society bereft of both trust and a durable civil society”.***

The transmission mechanism, by which an erosion in individual charity undermines long-term GDP growth, could work in a number of ways<sup>17</sup>:

- The crowding-out of individual charitable activity from the tax-financed growth in the welfare state. This effect could arise from individuals feeling they already pay substantial amounts of money to the less fortunate, through the tax system. A recent IPPR report on philanthropy noted that some high earners felt they already ‘gave’ through taxes. This view is not surprising given that, over the past decade, the top 10% of earners have seen their share of total Income Tax payments rise from just over 40% to more than 50%. Moreover, this effect may not have been confined to high earners. The majority of the population would appear to believe that the welfare function should reside with the state and not individuals – they actively seek the crowding-out of individual charitable activity.

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<sup>16</sup> The growth of the ‘contract culture’ with charities delivering certain services, is not necessarily a positive development, if the third sector organisation is ‘captured’ by the taxpayer or loses sight of its true mission.

<sup>17</sup> There could also be an impact on transaction costs, with stronger social bonds boosting trust and co-operation and reducing contractual costs and bureaucracy - thereby boosting economic efficiency.

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- Higher marginal rates of taxation – to finance the welfare state - could also have worked to undermine long-term economic growth (*We're going the wrong way – tax and spend fiscal policy* IoD Policy Paper, Graeme Leach, September 2002) via the negative impact on incentives to work. In contrast, if individuals perceived individual charitable payments as being analogous to a lump-sum tax, the disincentive effects could be reduced.
  - Crowding-out via the displacement effect. Welfare provision has been displaced from the local level and centralised through the state. This may have resulted in a charitable version of Gresham's Law - with bad charity driving out good. The most obvious illustration of this is the inability of the state, all too often, to distinguish between deserving and undeserving need.
  - Kith & kin economics – Box 6.2 shows that where family, extended family and community links are strong, the optimal size of the welfare state approaches zero. If growth in the welfare state has undermined these social bonds, economic efficiency will have been reduced as a result. This raises a serious dilemma. If the encroachment of the state has forced traditional systems of support to retreat, they may now be so weakened, that even if the state were to withdraw, there would be no guarantee that the so-called 'little-platoons' could take their place. In other words, social capital could now be so depleted that there could be a long-term policy vacuum in the absence of state welfare provision.

#### **Box 6.2 - Does the welfare state destroy the family?**

A recent paper in the Economic Journal (*Does the welfare state destroy the family?* R. Di Tella & R. MacCulloch, The Economic Journal, July 2002) makes a number of telling observations:

- The optimal size of the welfare state when families are strong is zero. The welfare maximising level of public transfers depends on family strength. If strong family ties exist naturally, the state's best response is to keep these ties and opt out of welfare provision. The authors point out that this may provide a microeconomic rationale for the birth of the welfare state. Traditionally, the birth of the welfare state has been explained mainly in political terms or as a result of Keynesian macroeconomic policy.
- Proposals for a less generous welfare state, without measures to strengthen families, might offer too little insurance.
- State provided unemployment benefits can – under certain conditions - crowd-out intra-family transfers more than one-for-one. The more than one-for-one crowding out occurs because the state changes the opportunity cost of belonging to a family.
- Political parties that emphasize the role of the family seem also to have preferences for low spending on welfare. In contrast political preferences for high welfare spending seem to go together with weaker concerns for strengthening family ties.
- Families are in a far better position than the state to know if unemployed members are actively engaged in search activities –thereby reducing moral hazard considerations.

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- When families are strong, increasing state benefits serves only to increase unemployment due to the moral hazard problem.

The paper is useful as a means of highlighting that there are more economically efficient alternatives to the current welfare state. It also highlights the problem that because of the erosion in the family over recent decades, the state's role will remain important for the foreseeable future.

Another damaging effect of crowding-out is the impact on what we term 'virtue-capital' – the social bonds within society which boost civility, mutual trust, co-operation and general standards of behaviour.

As an illustration of this effect, consider the following hypothetical example. Suppose there is an unemployed individual who currently receives income support from the state. At present there is little incentive for his neighbours to consider his welfare. The state pays him money and his neighbours pay taxes to the state. Welfare provision is removed from the individual. Nobody feels a direct obligation to help the unemployed person. Contrast this with a situation whereby welfare is provided through local non-governmental organisations. In this case, the neighbours may well be directly involved in trying to secure employment for the individual, helping with financial distress and generally creating far greater bonds of mutual trust and support – in simple terms the unemployed person would feel more 'loved'. Society would surely be better-off as a result of millions of points of light such as this. Social capital would be boosted because welfare would become less impersonal.

The obvious criticism of this approach is that whilst welfare provision might become less impersonal it may also become less than universal, because of the policy vacuum discussed above. In other words, issues of universal coverage outweigh issues of economic efficiency and the accumulation of social capital. Politicians are very unlikely to try and disturb this equilibrium.

In order to make the welfare system more personal there is a risk that it will become less than universal. One needs to create an environment in which charitable organisations progressively acquire functions from the Government and then are seen to achieve far better results – by providing a trampoline instead of a safety net.

Professor Marvin Olasky (*The Tragedy of American Compassion*, M. Olasky, 1992) has written:

***“A truly compassionate government is one that rallies those armies of compassion and provides an environment in which they can thrive”.***

We need to create a land of social entrepreneurs. A land where compassion is not measured by the amount of public spending. Public spending can redistribute income but it can rarely build social capital.

Olasky's conclusion on the United States, surely applies to the UK as well:

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***“We generate lots of capital in the US, but it's our wealth of social capital – the values citizens possess and the linkages we make through churches, clubs, fraternal organisations and other voluntary associations – that has made this country exceptional”.***