

Charity and redistributive taxation in a unionized economy[☆]

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Abstract

European economies are characterized by unionized labor markets and governmental redistribution of income. This paper studies a model where those two features are combined with the possibility for individuals to make charitable contributions to the poor. The model exhibits equilibrium unemployment that increases with the degree of altruism. It is shown that a more progressive income tax can both reduce the unemployment rate and improve the public budget. These results are driven by charity increasing wage pressure and the altruistic rich failing to internalize the effect of their donations on the wage setting behavior of the unions.

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1. Introduction

In rich Europe, poverty rates of 10% and more are common.¹ Among the main determinants of the poverty risk in European countries, becoming unemployed is a major one, both because it reduces a person's disposable income today and because it reduces a person's probability to be in employment tomorrow. The unemployed are characterized by a poverty rate of about 50 percent and, conversely, a substantial fraction of the poor population has a personal background of long-term unemployment.

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¹ Poverty line defined at 60 percent of median disposable income adjusted for family size. See e.g. Hauser and Nolan (1999) and Sainsbury and Morissens (2002) for evidence on several countries.

Income support for the poor typically comes in form of publicly provided transfers like unemployment benefits, social assistance, and minimum pensions. While the generosity of the welfare state is crucial for the living conditions of the poor, the government is not the only source of aid. Private giving, often channeled by a multitude of non-profit organizations, also contributes to improve the living conditions of the poor. By way of an example, the Catholic and Evangelical Churches have welfare agencies that offer a number of health and social services explicitly directed at the needy; their provision is partly financed by private giving and often involves volunteering. Thanks to their flexibility and discretion, philanthropic organizations can successfully complement governmental action in order to raise the poor's well-being. Hence, even in welfare states, the economic perspectives of those who become unemployed and face a considerable poverty risk depend not only on the safety net financed by the government but also on the support from privately-sponsored charities.²

The current paper explores the implications of private support of the unemployed poor in a simple model economy characterized by unionized labor markets and a progressive tax-transfer system, i.e. institutional features that are typical for European economies. Private giving is endogenous and generated by an operative altruistic motive. Altruism is modelled as in [Arrow's \(1981\)](#) celebrated essay, where it is derived from reasonable axioms on individual preferences over income distributions. In the current model, individuals can use their post-fisc income to make charitable contributions to support the poor. The trade unions are endowed with wage setting power, and correctly anticipate how market incomes are redistributed by both the government and voluntary contributions to the poor.

The model exhibits equilibrium unemployment that increases with the degree of altruism. Its main result has that a more progressive income tax reduces the unemployment rate. Furthermore, it is always possible to design a progressive tax reform such that the public budget is improved.

In the setting considered in this paper, the results mentioned above are robust and have a natural explanation. They are driven by the fact that individuals fail to internalize the effect of their donations on the wage setting behavior of the unions. Charitable contributions improve the standard of living of the poor and thus reduce the utility loss caused by losing a job. Therefore, donations turn out to increase wage pressure by the unions, and equilibrium unemployment is higher.³ Since the marginal utility of own consumption is lower for the rich, the rich are those who donate. A more progressive income tax, by hitting the top incomes, reduces the average propensity to give to charities. Thereby, it reduces wage pressure and leads to a higher employment level.

Although it is rather straightforward, this link between income taxation and unemployment has not been explored so far,⁴ possibly because charity is not perceived as an important determinant of the expected utility of the unemployed in European countries. However, even if that perception were correct, the model developed in this paper would still be relevant for two

² According to the AAFRC Trust for Philanthropy, in the United States total yearly donations to human services amount to about 20 billions USD. This sum is close to the yearly expenditure for governmental food stamp programs. While the relative weight of charity in Europe is not as large, it is increasing; see [Salamon et al. \(1999\)](#) and [Andreoni \(2006\)](#) for cross-country comparisons and [Anheier and Seibel \(2001\)](#) for a case study on Germany.

³ Therefore, it is the expectation of altruistic behavior toward the poor that makes the unions demand higher wages and finally increases the number of those who are poor. As such, the link put forward by the current model is a variant of [Buchanan's \(1975\)](#) Samaritan's dilemma.

⁴ See e.g. the very comprehensive volume by [Agell and Sorensen \(2006\)](#) on tax policies and labor markets.

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