Religious Charities and Government Funding

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Abstract

In this paper, we examine several aspects of the relationship between religious nonprofits and the government in the context of recent governmental programs such as the Faith-Based and Community Initiatives. The government has the responsibility of providing a public good to its citizens. It decides whether to award the funds to a religious nonprofit, secular nonprofit or produce the public good itself. Religious charities are willing to provide the public good at lower costs if they can use the funds as an opportunity to proselytize their doctrine. This is because they gain utility from preaching to more individuals which allows them to gain more adherents. This provides them with an advantage over non-religious providers and rival religious charities. The choice of which religious denomination(s) to award the funds to will determine the nature of the change in believers' preferences due to the proselytizing, which will in turn affect the religious 'balance of power' between denominations in the society. In a situation of equal grants to competing religious charities, this is shown to have the significant consequence of reducing the number of extremists in all denominations and increasing the proportion of moderates as a result. Furthermore, the model postulates that strict or conservative religious denominations may discriminate against secularists or non-religious individuals in the provision of the public good. This is due to the possibility that preaching to this group of the population may lead to the undesired effect of benefiting less strict or more liberal denominations. The model's results present important policy implications with regards to recent and future public policies towards faith-based organizations.

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1. Introduction:-

On 29th January, 2001, the White House Office of Faith-Based and Community Initiatives was established with the declared objective of creating a partnership with faith-based agencies in order to achieve common goals in the field of social service provision. This development raised severe controversy with regards to its legality under the laws of the Constitution. It also initiated an extensive debate from all interested parties on the effectiveness of faith-based social service providers in relation to other social service providers, and whether they possess unique advantages that warrant any special treatment from the government. But this debate will continue to exist and even intensify as the program progresses on. Religious denominations and their affiliated faith-based agencies will be in continuous competition against each other to obtain government funding in order to achieve their specific interests. Political parties now have a useful tool that they can refer to in times of elections when they are in need of legitimacy or endorsements. It seems therefore that such an initiative may not necessarily be a productive partnership or lead to the desired common goals that many would expect.

The purpose of this paper is to examine some aspects of the relationship between religious nonprofits and the government. The paper presents an economic model that describes this relationship in order to give us an insight into the different motives of these institutions and the outcomes that arise as a result of their interaction. We study this relationship by investigating the impact of government funding on religious charities and on religion in the society as a whole. We model a government that awards funds to religious charities[1] or denominations so that these funds are used for the production and

[1] In this model, the terms religious charities, faith-based agencies and denominations will be used interchangeably.

distribution of a public good. We provide a rationale for why the government chooses to award the funds to a *religious* charity in particular. A unique nature of religious charities allows them to have an advantage over secular nonprofits in the production of the public good. Based on this formulation, the government decides *which* religious denomination or denominations to award the funds to according to the specified government objective. We argue that religious charities will *intentionally* use part of these funds for proselytizing purposes[2]. As a result, the religious preferences of believers in the population are altered and this alteration leads to a change in the relative powers of the different denominations and the religious nature of the society as a whole. The fact that a particular denomination is given the rights to provide the public good means that the government is intentionally or unintentionally giving one sect an advantage over others. This is mainly because the 'award-winning' sect will use the funds to pursue its specific religious causes. Any law passed by the government to ensure the complete secular nature of the public good is bound to fail under instances of incomplete information. Also, requiring the religious charity to exclude any religious content in the provision of the public good may mean that the religious charity will have to act as a secular producer and this nullifies their efficiency advantage which was the reason they were given the award initially.

In instances where the government provides equal grants to all types of denominations, this is shown to still have far-reaching consequences on religion and believers. Furthermore, the model examines the instances where particular denominations

[2] Proselytizing can still occur even if denominations do not consciously pursue it. This is usually in the form of externality effects arising from the existing religious and cultural environment.

may decide to discriminate in the provision of the social service by restricting their services based on the religiosity or religious affiliation of the social service recipients.

The model derives results that have important policy implications for present and future programs by the government to fund religious and secular charities. The paper raises many significant issues that are overlooked by most parties involved in the debate. In the part 2 of the paper, we discuss the theoretical and empirical literature on nonprofits and faith-based agencies. We later explain the model in detail in part 3 and derive results in part 4 under different assumptions. We then conclude in part 5.

2. Literature Review: -

The literature on the economics of nonprofits and altruistic behavior has developed substantially over the years in the areas of economic theory and empirical research. According to Rose-Ackerman (1996), economists are increasingly becoming interested in exploring areas of related interest that were originally thought to be outside the realm of economic inquiry. Rose- Ackerman (1996) states that many theories have been developed to explain the motives behind charitable donations, ranging from donations driven by a sense of commitment as in Sen (1977) and Sugden (1984), to donations driven by the intention of signaling one's wealth to others as in Glazer and Konrad (1996). Andreoni (1990) also presented another explanation for altruistic behavior based on the desire to gain utility from the act of giving, referred to as the warm-glow effect.

Additional literature has focused on the economic behavior of nonprofit institutions in particular. Rose-Ackerman (1996) presents the theories developed that aim to explain the functions of nonprofits. One function of such organizations is to provide a

channel for private donations as many donors may trust nonprofits more than other types of institutions, such as for-profit agencies. Also, nonprofits may have emerged as a response to information problems that donors are facing as in the works of James and Rose-Ackerman (1986), Steinberg and Bradford H. Gray (1993) and Weisbrod (1989). Furthermore, "nonprofits may provide a more diverse collection of services than is possible in the public sector" (Rose-Ackerman, 1996).

The empirical economics literature has mainly sought to test the hypotheses proposed by many theorists. Much of the empirical work has focused on testing the hypothesis of crowding out of private contributions by public spending with results ranging from complete crowding out as in Roberts (1984), Sugden (1982) and Warr (1982) to partial crowding out as in Cornes and Sandler (1984, 1994), Steinberg (1987) and Andreoni (1989, 1990). With regards to the effectiveness of nonprofits, Rose-Ackerman states that initial studies such as Clarkson and Martin (1980) concluded that for-profits were more efficient than nonprofits due to the advantage that the profit motive presents. Others such as Hawes and Phillips (1986), Weisbrod (1988, 1994) and Aaranson et al (1994) concluded, using data from nursing homes, that the lack of the profit incentive served as an advantage for nonprofits over competing agencies. Also, Rose-Ackerman (1996) argues that some studies such as Kagan (1991) and Kisker et al (1991) conclude that for-profits provide services at a lower cost but also at a lower quality. As such, "when nonprofits provide higher quality services, they may also charge higher prices to compensate, [thus] reducing their advantage" (Rose-Ackerman, 1996).

An essential component of the nonprofit sector is religious charities and faith-based agencies[3]. The vast majority of the theoretical literature on the economics of nonprofits has focused on the economic choices of private donors, the economic functions and decisions of nonprofit agencies and the impact of income and wealth redistribution policies by the public sector on the decisions of donors and nonprofits. There has not been any formal examination of the impact of government policies on the religious state of society, both on the individual and group level. In addition, the models have treated all types of nonprofits identically, while none has sought to examine *religious* nonprofits in particular. In this paper, we formally examine the relationship between religious nonprofits and the public sector with the primary aim of studying the impact of this relationship on religion in society. Also, we specifically investigate the religious nature of religious charities in order to study their uniqueness relative to other types of social service providers. Reinikka and Svensson (2003) develop a simple model to highlight the differences between religious nonprofits and for-profit service providers. In their model, managers of nonprofit agencies will seek to hire altruistic workers that are willing to work at lower wages and produce the service at a lower cost, thus allowing the agency to offer the service cheaper than it is offered by for-profit agencies. In our model, instead of *assuming* that managers intentionally seek to employ workers who are willing to accept lower wages, we endogenize workers' wages and derive the proposition that religious nonprofits are more efficient than secular or non-religious nonprofits in the production of social services. This essential result will then allow us to study the impact of government funding of religious or faith-based agencies on all parties involved.

[3] We do not differentiate between congregations and faith-based organizations as in Wuthnow et al (2004). All nonprofit agencies that have a distinctly religious identity fit into our model.

The majority of empirical work on religious nonprofits has been in the fields of sociology of religion and religious studies. These empirical studies have aimed to study the unique nature of religious charities and also do comparative analysis with secular or for-profit organizations. Smith and Sosin (2001) examine the general characteristics of faith-based agencies in a series of interviews with faith-based officials. They classified faith-related agencies in terms of source of funding, link to religious authority or congregation and the underlying religious culture that different agencies exist within. Their study provided an insight into the degree of linkage between faith-related agencies and the doctrine they subscribe to, and also policy implications with regards to possible funding of such agencies by the government (Smith and Sosin, 2001). Ebaugh et al (2003) also discuss other authors who have classified the different characteristics of faith-based agencies, such as Unruh (2001) and Jeavons (1998).

In their study of faith-based agencies in Texas, where the concept of the Faith-Based Initiative was first implemented, Ebaugh et al (2003) argue that faith-based agencies do not differ from secular agencies in the types of services that they provide to their recipients. However, Ebaugh et al (2003) concluded that faith-based agencies are unique in that in addition to providing the social service, they also convey a collection of religious services simultaneously. This led to their conclusion that, "'organizational culture' significantly differentiates religious from secular agencies, with the former supporting a culture thoroughly imbued with religious values in terms of staff interaction with clients" (Ebaugh et al, 2003). With regards to specific social programs, many studies have arrived at a variety of results concerning the effectiveness of faith-based agencies. Desmond and Maddux (1981) studied the success of religious programs aimed at drug

addicts in San Antonio and concluded that the programs had a positive impact relative to other programs. Other studies include Berrien, McRoberts and Winship (2000) where they studied the effect of clergy-police partnership on crime rates in Boston. (Wuthnow et al, 2004). In his book, "When Sacred and Secular Mix: Religious Nonprofit Organizations and Public Money" (1996), Stephen Monsma presented a comprehensive historical and empirical study of the relationship between nonprofits and the public sector. He examined the history of the relationship between these two sectors and studied this relationship in the context of different religious denominations. These studies and others provide useful insights as to the future of the Faith-Based Initiative and other programs that involve some form of economic alliance between the government and faith-based agencies.

Although extensive applied research has been done on religious nonprofits, little has been said about the impact that government funding of these nonprofits has on religion and believers in general. The literature has mainly dealt with the characteristics of faith-based agencies and their effectiveness in relation to other service providers. In this article, we will seek to explain the unique nature of faith-based agencies or religious charities and provide an economic rationale for their efficiency. Based on this, the paper seeks to fill an important gap in the literature by trying to explain how denominations and their affiliated faith-based charities compete with each other for adherents, for public funds and ultimately for religious hegemony. Ultimately, the paper predicts the impact on religion and believers of any relationship that might exist between these agencies and the government sector. Several empirical results that already exist in the literature will be shown to support our propositions.

3. <u>The Model</u>: -

The main components of our model consist of the government, the adherent population and the religious charities or nonprofits. The government consists of the decision makers that make choices with regards to public revenue and public expenditure. The religious charities or denominations are comprised of the religious authorities that direct and coordinate the institutions' plans and services, and the clergy that are essentially the religious workers performing their duties in accordance with the rules and regulations set by the religious authorities. The adherent population consists of the total number of believers in the society.

Government: - The government has funds that she intends to award to a nonprofit agency. We assume that the funds are obtained exogenously. The purpose of the funds is the production of a public good or service, Z. This public good is assumed to be different from the religious 'club' good, R_k, which is already produced by religious denominations. The government may opt to award the funds to a religious nonprofit or a secular nonprofit or may have to choose between two competing religious nonprofits. We assume that the government seeks to award the funds to the most efficient nonprofit agency. In particular, the government awards the funds to the nonprofit agency that can produce the public good with the least cost of production.

Denomination: - Denomination or charity k is a religious institution that cares for the welfare of a community of adherents. The religious authorities in charge of the denomination are assumed to have a benevolent nature and as such, seek to maximize the total welfare of their adherents. There are two denominations in the model, A and B. In addition to the task of providing its specific religious 'club' good to its adherents, a

denomination may also be given the responsibility of providing the public good, Z. This happens when the government awards the funds or public good contract to the denomination.

Religious Clergy: - They represent the staff working in the religious organization. In other words, they are the religious producers or workers. These workers are employed by the charity to produce the religious 'club' good, R_k. But in addition to producing the religious good, they will also be assigned the task of providing the public good, Z, in the event that the charity they work for is awarded the contract by the government. The objective of the religious clergy is to maximize their utility by preaching their doctrine to larger number of adherents. In other words, the amount of utility they derive is directly proportional to the amount of preaching they achieve.

Believers/Adherents: - An individual i is a believer who belongs to a particular denomination. There are N believers in the population. In an extension to the model, we consider a set of non-believers or pure secularists, n in addition to the N believers. The utility of a believer i in denomination k is given by:

$$U_{ik} = ß\{R_k - s(r_k - a_i)^2\} + (1 - ß)\{U_{ik}(Z_k, X_i)\} \qquad (1)$$

Where **i e {1,...,N}**; **k e {A,B}**.

There are two main components of this utility, namely the religious utility and the secular utility. The religious utility is given by :

$ß\{R_k - s(r_k - a_i)^2\}$

R_k: religious 'club' good that is exogenously provided by denomination k.

ß : this represents the weight placed on religious consumption in the population. It is the same for all individuals. We can regard it as an indicator of the 'power' of

religious institutions or religion in the society, as evidenced by its effect on the utility function of all individuals. This power may represent the prominence of religious institutions and their impact on society in general. This parameter is not related to the individual-specific preference on 'religious investment'.

a_i : this represents the ideal position of individual i on 'religious investment'. A principle assumption of our model is that preferences can be represented by a unidimensional variable, in the form of 'religious investment'. All individuals in the population have an ideal preference regarding the 'amount of religious investment' they are willing to undertake in their religious life. This religious investment may refer to the preferred amount of money each individual is willing to contribute to religious institutions, or the amount of time the person prefers to contribute in assisting in the social and religious activities of the religious institution he/she belongs to[4]. This parameter describes the level of religion preferred by individuals in terms of measurable variables such as monetary contributions or voluntary assistance in church activities. *Thus, we can safely assume that these variables serve as proxies for the religiosity of individuals.* As such, we can construct a spectrum of religiosity based on ideal religious investment preferences, starting from 0 (minimum religiosity) to 1(maximum religiosity). In his survey of the literature on Economics of Religion, Iannaccone (1998) remarks that most measures of religious involvement such as voluntary contributions or participation in religious activities are positively related to the level of religiosity in the denomination. For example, he states, "[that] the members of liberal Protestant denominations contribute a relatively small proportion of their income to churches (around 1.5 percent),

[4] The 'value' of time may be in the form of the opportunity cost in terms of productive secular activities such as working, studying, e.t.c.

whereas the members of conservative Protestant denominations, such as the Southern Baptists and the Assemblies of God, contribute significantly more (between 2 percent and 4 percent), and Mormon contributions average 6 percent of income" (Iannaccone 1998).

Furthermore, Iannaccone (1998) states that religious involvement in terms of, "rates of church attendance, follow a similar pattern, with liberal Protestant denominations ranking lowest, conservative Protestants attending more, and sect members, such as Mormons and Jehovah's Witnesses, attending still more (Dean Hoge and Fennggang Yang 1994; Iannaccone 1992, 1994)" (Iannaccone 1998).

In a statistical survey on the determinants of religious participation, Iannaccone comments that, "members of conservative and sectarian denominations attend and give much more than members of liberal denominations even after controlling for socioeconomic differences". (Iannaccone 1998)

r_k : this corresponds to the level of religious investment chosen optimally by denomination k. We assume that denominations can move on the religious spectrum at no cost.

s : this is the cost incurred by individuals as a result of their obligation to conform to the teachings or rules of the denomination, given by r_k. It is the 'price' of sacrifice. This value is the same for all individuals in the society.

From the form of this utility, we can infer that the individual loses utility as a result of conformism to the denomination's rules, but also gets utility from giving his/her preferred investment level. As such, the total effect is given in the quadratic form, $\{-s(r_k - a_i)^2\}$.

The secular utility is given by:

$(1- ß)\{ U_{ik}(Z_k, X_i)\}$

$(1- ß)$: this refers to the weight that society places on secular consumption in the population.

Z_k : this is the public good or service that may be produced by the denomination if awarded the funds.

X_i : this is the private consumption of individual i after investing in religion.

The *initial* budget equation is given by: $Y = X_i + a_i$. The *actual* budget equation is $Y = X_i + r_k$.

The paper makes use of the framework of spatial location models. We follow, to some extent, the procedure of Barros and Garoupa (2002) in which they use a spatial location model to formulate a theory of church strictness. In particular, they use a modified Hotelling model. See Hotelling (1929). Also, denominations or charities[5] compete in a Nash environment.

Similar to Barros and Garoupa (2002), we study a situation where believers locate on the 'religious spectrum' and choose that denomination that maximizes their utility. This follows the Hotelling model of consumers grouping near different sellers, according to their preferences. Furthermore, we model the choices of individuals in similar fashion to Becker's theory of household production. See Becker (1967, 1974), and Stigler and Becker (1977). In our case, we have individuals' resources allocated between religious

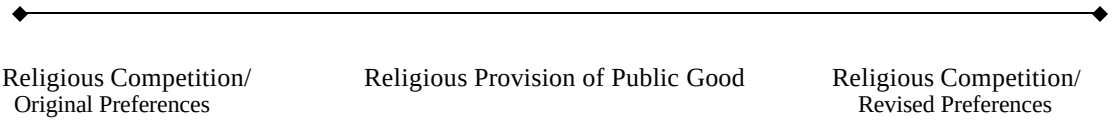
[5] In this paper, we will be using charity and denomination interchangeably.

consumption (in the form of religious investment) and secular consumption (consumption on private commodities)[6].

The games of strategic interaction in this model will utilize the tools of game theory and in particular, the concept of 'backward induction', to derive the sub-game perfect Nash equilibrium results.

Stages of the Game:-

The sequence of events in the model is as follows:-



Stage 1: Religious Competition/Original Preferences

Religious Human Capital

In this stage, the religious preferences of individuals in the population are formed and denomination compete optimally given this spectrum of preferences. To study this gradual formation of religious preferences, we employ an approach similar to the religious human capital method used by Smith and Sawkins (2003). This formation of preferences represents a long period of learning by the individual in his/her interactions in the society. It also represents an accumulation of parental investment decisions over time, in addition to the cumulative influence of the social and cultural environment. The outcome of this long process is given by, a_i. We assume that the individual has been primarily exposed to the influence of one denomination only. This can be due to the religion of the parents and the circle of close relatives and friends, or it can be due to the

[6] In this model, it is charities and the government that actually *choose* the equilibrium resource allocations. Charities or denominations choose a religious investment level according to some given objective and all adherents conform to this level. The government also decides a specific tax level that all citizens abide by.

cultural and political structure of the country where the individual lives. This limited exposure to the teachings of a particular denomination has shaped the individual's preferences over time. The exposure to teachings of other denominations is assumed to be negligible. We let this relationship be given by: $a_i = g [\delta_k , \delta_{-k} , E]$, which then becomes: $a_i = g [\delta_k , E]$ since $\delta_{-k} = 0$.

δ_k : the influence of denomination k on individual i. This is due to direct effects such as preaching, learning, advertising, training, etc. The direct effects of a denomination on an individual's religious preferences are due to the personal effort of the individual in the form of time invested in religious consumption, monetary contributions that provide religious utility and voluntary participation in religious activities. We construct the direct effect as a production process given by:

$\delta_k = \delta_k (L_k , S_k)$ where,

L_k : time devoted by individual i to denomination k.

S_k : all other human capital contributing to religious investment or education.

$$d\delta_k / dL_k > 0 ; d\delta_k / dS_k > 0 ; d^2\delta_k / dL_k dS_k > 0$$

These mean that as more time and human capital investment are devoted to denomination k's teachings, the individual becomes more committed to its teachings over time. We should note that δ_k increases if we are considering the 'conservative'[7] denomination since with more time and education, the believer becomes more

[7] The conservative denomination comprises of the adherents that prefer high levels of religious investment while the liberal denomination comprises of those that prefer low levels of religious investment. This distinction is made to allow us to examine the policy implications of our model.

conservative. In contrast, if we are considering the liberal denomination, δ_k decreases with more time and education. But this increase or decrease must be constrained because, for instance, it is not plausible to have a believer turn to an atheist ($a_i = 0$) if exposed to a substantial level of liberal teachings. Changes in religious preferences are usually small and slow[8]. A different but useful formulation would be to assume that all individuals start with $\delta_k=0$ and increase depending on the teachings they are primarily influenced by. That is, a person exposed to liberal teachings would have δ_k increase but still be to the left of the spectrum's midpoint.

δ_{-k} : the influence of denomination -k on individual i.

E : all other factors that influence an individual's religious preferences. These are the indirect effects such as learning through parents, friends and the community.

To consider the indirect effect, we can safely assume that all the individuals that influence the religious preferences of i go through the same process that i goes through. More formally, we can state it as follows:

$E = g'[\ \delta_k , \delta_{-k} , E']$ and so on and so forth.

$d\delta_k / dE > 0$: indirect effect such as parents, strengthens the commitment and learning outcome of δ_k , given that E is influenced primarily by δ_k.

$d\delta_{-k} / dE < 0$: indirect effect such as parents, weakens the influence of δ_{-k} , given that E is influenced primarily by δ_k.

[8] To make the concept more understandable, one can imagine that all individuals start at the midpoint of the spectrum and move left or right depending on the teachings they are influenced by.

This means that if the surrounding community around i is committed to the doctrine of k, then i will also be influenced primarily by k's doctrine. The doctrine of past generations passes on to future generations through parental and social investment in an individual's religious capital. This is similar to Smith and Sawkin's (2003) concept of social interactions that argues that religious involvement by individuals is proportional to their interactions with the surrounding religious community.

Therefore, we assume that a_i is formed initially by the influence of a single denomination, k, through direct and indirect means. This is given by:

$$a_i = g [\delta_k , E]$$

The denominations A and B take the religious preferences of individuals as given and compete against each other in a Nash environment. We regard the denominations as benevolent players whose objective is to maximize the expected welfare of *their* adherents by choosing an optimal position on the 'religious investment' spectrum. Individuals automatically join the denomination that is closest to their ideal position on the spectrum. We assume that all members of the population voluntarily join a denomination.

Stage 2: Religious Provision of Public Good

In this stage, the government decides which nonprofit agency to award the funds or grants to. We suppose that the objective of the government is to award the funds to the nonprofit agency that produces the public good with the lowest production cost. Much work on religious nonprofits emphasizes the quality of service that they provide in comparison to other types of nonprofits and to for-profit service providers. The argument made is that religious nonprofits produce better quality services due to their long

experience in service delivery and unique methodology and as such, should be encouraged by the public sector through funding. In our paper, the government funding is provided for efficiency reasons and not for quality concerns. The main results of the model hold even if we assume the quality-driven objective for the government.[9] Thus, the government seeks the most efficient producer of the public good. In this stage, if a religious denomination or charity is awarded the funds, that denomination will fulfill the task of producing the public good, Z_k. We will later examine a case where more than one charity may be awarded funds, as this is the case with the current Faith-Based Initiative. Also, the denomination(s) awarded the funds should be a more efficient producer of the public good than the government itself.

The funds are provided for a specific purpose, namely, the production of a public good. The government, through some objective, has decided that it is in its own interest to delegate the responsibility of providing the public good to the religious charity. This public good may be for educational purposes, such as building a school or a library. It may also be for health purposes, such as building a hospital, clinic or a drug rehabilitation center. We should note that the rules governing grants under the Faith-Based Initiative state that charities are prohibited from using the government funds for religious worship, teaching or proselytization, but should only be used for the provision of non-religious programs. As such, charities should aim to separate their religious activities from the non-religious services that are provided using the awarded government funds (Guidance to Faith-Based and Community Organizations on Partnering with the Federal Government., White House Faith-Based and Community Initiatives,

[9] In addition to being a reasonably sound objective for the government, the efficiency objective also has the advantage of being more convenient for empirical purposes.

http://www.whitehouse.gov/government/fbci/). However, our central argument in this paper is that, coupled with the task of providing the public good, the denomination and clergy are incidentally given an *opportunity to proselytize* the particular doctrine or religion that the denomination subscribes to. In the course of producing and providing this public good, the charity may seek to include religion via several means. A careful examination of the methods by which religious charities convey religious messages or doctrine as part of their social service delivery process is done by Unruh (2004). One method, that she calls religious self-descriptions, is through printed media such as program descriptions, brochures, pamphlets, etc. Another method is through religious objects present in the surrounding environment. This may include wall pictures, architecture of the buildings, artifacts, etc. The religious music played may also have a spiritual effect on the recipients of social services (Unruh 2004). In addition to these subtle and indirect ways, more direct methods can be employed such as prayers for the recipients, reading out loud religious text or quotations and participation in group worship (Unruh 2004). Also, the staff can also have an effect, through their dress codes, manner of conduct and their informal conversations with the consumers or recipients of this public good. Any imposed separation of religion and social services is arguably an impossible task to achieve. This is mainly due to the fact that religious charities are by definition, religious institutions with a religious identity that is essential to their operation and performance. Any forced disjointing of the religious element inherent in them and the social services they provide will only succeed up to a limit beyond which it cannot go further. Religion in both its implicit and explicit form of expression will continue to leave a noticeable mark on the activities and social service philosophy of faith-based agencies.

Furthermore, government monitoring of services provided by religious charities is both costly and difficult to implement.

The essential idea is that religious charities have numerous methods of utilizing the government funds for religious purposes. The religious clergy in particular will aim to preach their religion to the consumers or recipients of the public good that are initially non-adherents of their denomination. This is because by doing this, they can preach to a larger audience than before and thus gain more utility as a result. In so doing, they alter the distribution of preferences on the religious spectrum and shift the average religiosity level of the population in the direction of their preferred level. We are assuming that all members of the population, adherents and non-adherents, are consuming this public good provided by denomination k[10]. The non-adherents are particularly targeted by denomination k's clergy.

This proselytizing is in the form of δ_{-k}. That is, the individual i is now affected not only by denomination k, but also by denomination –k. The individual, through the consumption of the public good and its *associated religious messages*, is now exposed to the teachings of another denomination, -k. The individual is thus exposed to the doctrine of more than one denomination.

Stage 3: Religious Competition Given Revised Preferences.

With the added influence of another denomination's teachings on the preferences of an individual, the individual will accordingly revise his/her religious preferences. The function that now determines the ideal religious preferences of i is given by:

$$a_i^{'} = g^{'} [\, \delta_k , \delta_{-k} , E \,]$$

[10] This is consistent with the result obtained by Wuthnow et al (2004) in which they show that Faith-Based organizations cater to a varied community of social service recipients.

For simplicity, we assume that this can be given by:

$a_i' = g[\ \delta_k\ ,\ E\ ] +/- \delta_{-k}$.

Whether it is (+) or (–) will depend on the denomination that is awarded the funds. We have,

$a_i' = a_i +/- \delta_{-k}$. (2)

Denominations will now compete in the same manner as in stage 1 but with revised religious preferences of individuals.

We now investigate the model in more detail to derive results under different assumptions.

4. <u>Results:-</u>

<u>Stage 1</u>: Given the original spectrum of religious preferences, the denominations maximize the welfare of their adherents and locate at the optimal positions. With two denominations, there are two corresponding equilibrium positions on the spectrum. Each denomination maximizes the following:

<u>Denomination k</u>: $\underset{\{r_k\}}{\text{Max}} \int_0^t \{ß\{R_k - s(r_k - a_i)^2\} + (1-ß)[\ U_{ik}(X_i)]\}g(a)da$

$$s.t\ Y = X_i + r_k$$

$g(a)$: distribution of ideal preferences.

More specifically, we can write denomination A's problem as follows:

<u>Denomination A</u>: $\underset{\{r_A\}}{\text{Max}} \int_0^t \{ß\{R_A - s(r_A - a_i)^2\} + (1-ß)[\ U_{iA}(Z_k, X_i)]\}g(a)da$

$$s.t\ Y = X_i + r_A$$

Substituting in the budget equation, we have,

Denomination A: $\underset{\{r_A\}}{\text{Max}} \int_0^t \{ß\{R_A - s(r_A - a_i)^2\} + (1- ß)[U_{iA}(Z_k, Y-r_A)]\}g(a)da$

Denomination B will have similar equations.

F.O.C for A: $\int_0^t \{-2sß(r_A - a_i) + (1- ß)\delta U_{iA}/\delta X_i.(-1)\}da = 0$

$$r_A^* = t/2 - (1- ß)/(2ßs).\delta U_{iA}/\delta X_i$$

Similarly, for B, we have:

$$r_B^* = 1/2 + t/2 - (1- ß)/(2ßs).\delta U_{jB}/\delta X_j$$

We assume $g(a)=1$.

These represent equidistant allocations on the religious spectrum if we ignore the marginal utilities of private consumption, which are not relevant for our analysis.

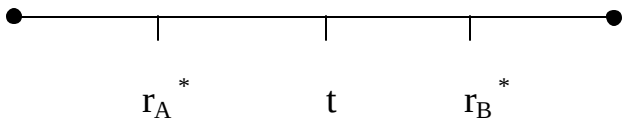


Figure 1.

For practical purposes, these positions may be labeled *liberal*(r_A^*)and *conservative*(r_B^*).

Stage 2: In this stage, the government chooses who to award the funds to. Let the funds be given by T.

Ideally, the funds should be used to cover mainly the costs of capital and labor. But the denominations may use part of the funds for proselytizing purposes.

Therefore, actual expenditure of the funds is given by:

T = Cost of Capital + Cost of Labor + Proselytizing Costs

T_A = Cost of Capital + $w_A L$ + A's Proselytizing Costs, A's expenditure of T.

T_B = Cost of Capital + $w_B L$ + B's Proselytizing Costs, B's expenditure of T.

T_G = Cost of Capital + $w_G L$, G's expenditure of T.

Where w is the wage rate paid to the public good workers or producers and L is the number of hours they are willing to work.

The government will award the funds to *a* denomination if and only if the government is less efficient in the production of the public good than the two religious charities.

Assuming that to be the case, the government then chooses to award the funds to the denomination that is more efficient or produces the public good at lower costs.

If the government *cannot observe* the proselytizing costs, then it bases its decision on the factor costs of both denominations. For example, the charity that has more volunteer workers will get the funds since its total labor costs will be lower than the labor costs of the other denomination. We argued that the government chooses to award the funds to k because it expects the public good to be produced at a lower cost. But instead of *assuming* that the cost of production is lower for the denomination, we construct a process that explains why this is the case. In other words, we endogenize the production costs of the public good.

The producers of the public good are the persons in charge of the religious denomination or charity and we denote them by **m**. *They are the religious workers*. Each clergy member has a utility function that describes their preferences in the religious arena. Specifically, this is given by,

$$U_m = U_m\{X_m, L_m, P\} \text{ where,}$$

$\mathbf{X_m}$: private consumption by m.

$\mathbf{L_m}$: total number of hours worked by m.

P: volume of proselytizing done by m.

The budget constraint of m is given by: $w_m L_m = X_m$. That is, total wages equal total consumption. We assume that the clergy do not consume the public good.

But the volume of proselytizing is given by: $P = L_m.g.\sigma$, where,

g: Proselytizing per person per hour.

s : total number of individuals being preached to.

Thus P=(Total number of hours spent on preaching)x(Preaching per person per hour)x(total number of individuals preached to).

Furthermore, the total number of individuals preached to is determined by two factors: r_k and Z_k. It depends on the number of adherents already in the denomination, and the number of non-adherents preached by the clergy as they consume the public good.

Without the funds, k is as follows:

$$P = L_m.g.\sigma(r_k)$$

With the funds,

$$P' = L_m.g.\sigma(r_k, Z_k)$$

The difference is: $P' - P = L_m.g.\sigma(r_k, Z_k) - L_m.g.\sigma(r_k) = L_m.g[\sigma(r_k, Z_k) - \sigma(r_k)]$

Clearly, we can observe that the difference is due to the presence of the public good.

We can now solve m's problem:

$$\text{Max } U_m = U_m\{X_m, L_m, P\}$$
$$\{L_m\}$$

Without the public good, we have:

$$\text{Max } U_m = U_m\{ w_m L_m, L_m, L_m.g.\sigma(r_k)\}$$
$$\{L_m\}$$

F.O.C. $(\delta U_m/\delta X_m)(w_m) + \delta U_m/\delta L_m + (\delta U_m/\delta P).g.\sigma(r_k) = 0.$

$$w_m^* = [- \delta U_m/\delta L_m - (\delta U_m/\delta P).g.\sigma(r_k)] / [(\delta U_m/\delta X_m)]$$

With the public good, we have:

$$\text{Max } U_m = U_m\{ w_m L_m, L_m, L_m.g.\sigma(r_k, Z_k)\}$$
$$\{L_m\}$$

F.O.C. $(\delta U_m/\delta X_m)(w_m) + \delta U_m/\delta L_m + (\delta U_m/\delta P).g.\sigma(r_k, Z_k) = 0.$

$$w_m^{\wedge} = [- \delta U_m/\delta L_m - (\delta U_m/\delta P).g.\sigma(r_k, Z_k)]/ [(\delta U_m/\delta X_m)]$$

But $\sigma(r_k, Z_k) > \sigma(r_k)$, because with the presence of the public good, we can safely assume that the clergy are now preaching to a larger audience than before, since it also includes all non-adherents.

Thus, $w_m^{\wedge} < w_m^*$.

Therefore, with the award to the denomination, the utility of the religious leaders or workers increases since they can now preach to a larger group of individuals than before. This increase in the size of the group receiving the clergy's preaching, will increase the clergy's willingness to 'give' more and 'take' less. *Religious workers are now willing to offer the public good at a lower supply price* $(w_m^{\wedge} < w_m^*)$ *than before.* This preference of religiously-oriented workers towards working in a religious work

environment is supported in the work by Ebaugh et al (2003) where their survey shows that employees of religious charities are attracted to their jobs primarily due to the religious nature of the job.

Proposition 1: *The supply price of the public good is inversely related to the amount of preaching that religious workers perform.*

Corollary: *Religious workers are willing to offer the public good at a lower production cost than non-religious workers. Religious charities are thus more efficient at the production of public goods than non-religious charities.*

This unique characteristic of religious workers gives religious charities an advantage over non-religious providers of public good. *Because they gain utility from providing to more consumers, they are willing to reduce their supply price in order to get that extra utility.* Ebaugh et al (2003) conclude with empirical evidence that faith-based agencies rely more on volunteer workers than secular agencies. In particular, "volunteers outnumber paid staff by more than 2:1 in faith-based agencies, while the ratio of volunteers to paid staff in secular agencies is a little less than one volunteer for every paid employee (.89:1)" Ebaugh et al (2003). As such, this supports our argument that the religious nature of working in a religious charity serves to lower the supply price or wages that workers demand to the extent that some may decide to work free of charge.

A non-religious provider will have this form of utility function:

$$U_m = U_m\{X_m, L_m\}$$

In this case, $w_m' = [-\delta U_m/\delta L_m]/ [(\delta U_m/\delta X_m)]$

We can see that, $w_m' > w_m^*$ and $w_m' > w_m\hat{}$.

A government thus awards the funds for a public good to a particular denomination because of the decrease in costs associated with the denomination's production.. But we should note that that the portion of the funds spent on proselytizing should not exceed the difference in costs between the government's provision and the denomination's provision of the public good. Even with lower costs, the denomination may use a large amount of funds such that very little amount of the public good is produced relative to if the government is producing it.

We assume for now that the government has awarded the funds to denomination A, because $w_A^{\wedge} < w_B^{\wedge}$. That is, A's religious producers have a lower supply price of the public good than B's producers. Since the government cannot observe the portion of funds spent on proselytizing, the denominations may have to alter their factor costs to increase their likelihood of obtaining the award. This means that the denominations may be asked to present a summary of their projected factor costs that the government uses to decide the final recipient of the funds.

Stage3: With A producing the public good, it would seek to influence the preferences of B's adherents. A produces both Z_A and δ_A(the proselytizing outcome).

New preferences are given by:

All of A's adherents maintain the same preferences because the proselytizing is directed only at B's adherents.

All B's adherents revise their preferences due to the influence of A's proselytizing. The new preferences are given by:

$$a_j^{'} = g^{'} [\ \delta_B , \delta_A , E\ ]$$

$$a_j^{'} = g[\ \delta_B , E\ ] - \delta_A .$$

$a_j' = a_j - \delta_A$.

The new preferences are reduced by δ_A because A is originally on the left part of the spectrum and seeks to lower the level of 'religious investment' or religiosity preferred by B's adherents. A wants B's adherents to become more *liberal.* We assume that the proselytizing affects all B's adherents equally.

The denominations now compete on this revised spectrum and locate optimally.

$$\underline{A}: \quad \underset{\{r_A\}}{\text{Max}} \int_{0}^{t'} \{ß\{R_A - s(r_A - a_i)^2\} + (1-ß)[U_{iA}(Z_A, Y-r_A)]\}g(a)da + \int_{t-\delta}^{t'} \{ß\{R_A - s[r_A - a_j)]^2\} + (1-ß)[U_{jA}(Z_A, Y-r_A)]\}g(a)da$$

$$\underline{B}: \quad \underset{\{r_B\}}{\text{Max}} \int_{t'}^{1-\delta} \{ß\{R_B - s(r_B - a_j)^2\} + (1-ß)[U_{jB}(Z_A, Y-r_B)]\}g(a)da + \int_{t'}^{t} \{ß\{R_B - s[r_B - a_j)]^2\} + (1-ß)[U_{jB}(Z_A, Y-r_B)]\}g(a)da$$

From F.O.C, we have:

$$r_A^{\wedge} = t/2 - \delta/2 - (1-ß)/(2ßs).\delta U_{iA}/\delta X$$

$$r_B^{\wedge} = 1/2 + t/2 - \delta/2 - (1-ß)/(2ßs).\delta U_{jB}/\delta X_j$$

We now have,

$t' = t - \delta_A/2$, where $t = ½$.

$r_A^{\wedge} = r_A^{*} - \delta_A/2$

$r_B^{\wedge} = r_B^{*} - \delta_A/2$

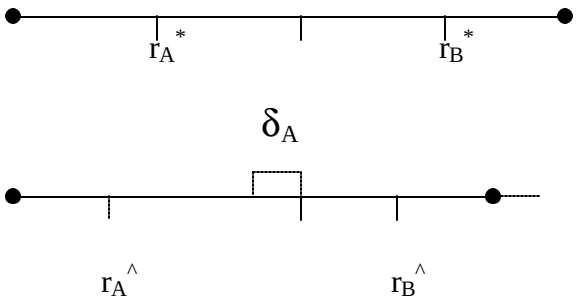


Figure 2.

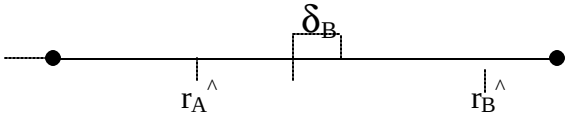


Figure 2A.

Proposition 2: *If the government awards funds to a charity with a low average religiosity level, the average religiosity of the population as a whole will reduce or move to the left on the spectrum.*

Proof*:* Consider: $t' = t - \delta_A/2$

Also, $r_A^{\wedge} < r_A^{*}$

$r_B^{\wedge} < r_B^{*}$

Implication: If the government awards the funds to the liberal denomination, the population as a whole will become more liberal or less conservative. Through similar arguments, if the funds are awarded to a conservative denomination, the level of religiosity in the population will increase as believers become more conservative. See figure 2A. As shown, this is due to the fact that denominations will utilize this

opportunity given to them to proselytize their own doctrine and alter the preferences of the adherents of other denominations. The exposure to the teachings of the liberal denomination influenced the religious preferences of the conservative believers, inducing them to become more liberal. Since they were previously only exposed to conservative teachings, they happened to belong to a conservative denomination. But with this new exposure to liberal teachings, they have an opportunity to revise their preferences. They are now affected by two contrasting religious positions, liberal and conservative. The funds gave the liberal denomination an advantage over the conservative denomination in the last stage of competition. *The conservative denomination was forced to reduce its optimal position on the religiosity spectrum as a strategic response to the proselytizing efforts of the liberal denomination. One should also notice that the funds reduce the number of extremists in the denomination that didn't receive funding. There are more moderates in that denomination.*

If the government awarded equal funds to both denominations, we will have the following situation:

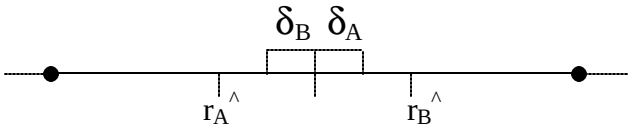


Figure 2B.

With this situation, the population is neither more liberal nor more conservative. This is because the proselytizing efforts of both charities offset each other, if we assume that $\delta_B = \delta_A$. The denominations' positions are closer to the center however. There are less people at the extremes of the spectrum.

Proposition 3: *If the government awards equal grants to the denominations, then the proselytizing efforts of the denominations have a zero net effect on the overall religiosity of the population (see figure 2B). The population is neither more liberal nor more conservative than before. However, there are fewer individuals at the extremes. Consequently, there are more individuals concentrated at the center of the spectrum. Both denominations have equal number of adherents.*

Corollary*: If the government awards equal grants to denominations, the result is a decrease in the number of extremists in both denominations as shown by the shrinking of the spectrum. There are more moderates as a result.*

Implication: This result gives us a possible motive for having government funding of religious charities. We have shown that with equal funds to opposing denominations, an important result is that there are fewer extremists on both sides and more moderates. By giving out funds, the government has given both denominations the opportunity to influence the other. As a result, this interaction between the players in both denominations encourages openness and toleration. Adherents are given the chance to learn more about the 'other' and this learning yields increased understanding and toleration by both sides. This may well be an important outcome that influences the decision a government takes regarding funding of religious charities.

Believers and Secularists

In this case, we add a new section of the population that we label, 'secularists' or non-believers. The unique feature about this portion of the population is that, in addition to being located at the extreme left of the religiosity spectrum, they do not belong to any organized community. That is, they are not members of an institution's congregation. They are independent individuals who located at the extreme left of the spectrum[11]. But with the public good being produced by a religious organization, they are now exposed to aggressive proselytizing by the denomination producing Z. The charity in question will seek to attract new members from the 'secular sect' in addition to its efforts at attracting new members from the rival denomination.

Stage 1: The spectrum is as follows:

Figure 3.

There are L non-believers or secularists in the population.

$a_l = g_l [E]$, the initial preferences of $l=1,\ldots, L$.

It is clear that the definition of a non-believer or secularist is an individual who did not receive any religious teachings from a religious institution. Also, the influence of friends, relatives and society was insufficient to induce this individual to be committed to any religious entity.

In this stage, the denominations have no influence over the secularist portion of the population. Thus, their location is an equidistant equilibrium as shown in figure 3.

[11] Barros and Garoupa (2002) label a similar group as the 'non-church'.

Stage 2: Let A be the award winner. With A producing the public good, it would seek to influence the preferences of B's adherents *and* the non-believers. A produces both Z_A and δ_A.

New preferences are given by:

All of A's adherents maintain the same preferences because the proselytizing is directed only at B's adherents and the non-believers..

All B's adherents revise their preferences due to the influence of A's proselytizing.

All the non-believers revise their preferences by increasing their religiosity or appreciation for religion. Some of the non-believers would actually commit to a particular doctrine and join a denomination while some would still decide to maintain their non-believer stance. Those that decide to join a denomination would choose to join the liberal denomination, A.

The new preferences are given by:

$$a_j' = g' [\ \delta_B , \delta_A , E\ ]$$

$$a_j' = g[\ \delta_B , E\ ] - \delta_A.$$

$$a_j' = a_j - \delta_A.$$

For the non-believers,

$$a_l' = g_l' [\delta_A , E]$$

$$a_l' = g [E] + \delta_A$$

$$a_l' = a_l + \delta_A.$$

The new preferences for the non-believers are increased by δ_A because A seeks to increase the level of 'religious investment' or religiosity preferred by the secularists. Denomination A wants B's adherents to become more *liberal* and the non-believers to become more religious.

Stage 3: The denominations now compete given this revised spectrum of religious preferences.

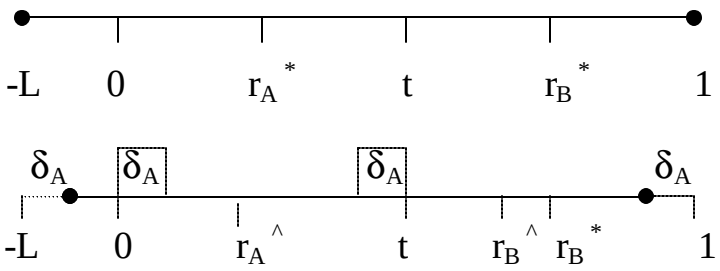


Figure 4.

$$\underline{A}: \quad \underset{\{r_A\}}{\text{Max}} \int_0^{t'} \{ß\{R_A - s(r_A - a_i)^2 + v_{iA}\} + (1-ß)[U_{iA}(Z_A, Y-r_A)]\}g(a)da$$
$$+\int_{t'}^{t-\delta} \{ß\{R_A - s[r_A - a_j)]^2 + v_{jA}\} + (1-ß)[U_{jA}(Z_A, Y-r_A)]\}g(a)da$$
$$+\int_{t-\delta}^{\delta} \{ß\{R_A - s[r_A - a_j)]^2 + v_{jA}\} + (1-ß)[U_{jA}(Z_A, Y-r_A)]\}g(a)da$$

where the last component is due to the entrance of non-believers into A.

$$\underline{B}: \quad \underset{\{r_B\}}{\text{Max}} \int_{t'}^{1-\delta} \{ß\{R_B - s(r_B - a_j)^2 + v_{jB}\} + (1-ß)[U_{jB}(Z_A, Y-r_B)]\}g(a)da$$
$$+ \int_{t}^{t'} \{ß\{R_B - s[r_B - a_j)]^2 + v_{jB}\} + (1-ß)[U_{jB}(Z_A, Y-r_B)]\}g(a)da$$

From F.O.C, we have:

$$r_A^{\wedge} = t/2 - \delta + \delta^2/t - (1-ß)/(2ßs).\delta U_{iA}/\delta X$$

$$r_B^{\wedge} = 1/2 + t/2 - \delta/2 - (1-ß)/(2ßs).\delta U_{jB}/\delta X_j$$

The locations are:

$$r_A^{\wedge} = r_A^{*} - \delta_A + \delta_A^2/t$$

$$r_B^{\wedge} = r_B^{*} - \delta_A/2$$

From the above equations, we have that the new position for A is more to the left than the previous scenario. This is to account for the additional adherents[12].

The spectrum facing the denominations is the same ranging from (0, 1-δ). However, A has more adherents at the leftmost part due to the entrance of non-believers. Therefore, *A has more adherents than B.*

By including a non-believer portion of the population, denomination A will have to proselytize two groups of individuals and in quite different ways. It will seek to lower the religiosity level of B's adherents to attract them into the liberal arena and at the same time trying to increase the appreciation for religion of the secularists to attract them into the religious arena. It is doing both of these tasks using the same public good Z.

[12] This is the case if: $-\delta_A + \delta_A^2/t < -\delta_A/2$. This holds for $\delta_A < t/2$.

One should note that denomination A can use the same teachings or methods for both targeted groups. In fact, all A is doing is teach its own doctrine or interpretation of doctrine through several means. By teaching the 'liberal doctrine', A is exposing B's adherents to a relatively more liberal interpretation of religious doctrine and at the same time exposing the non-believers to this same liberal interpretation which by nature of the religious spectrum, is not very different from their original preferences. The main difference is that the exposure is having varying effects on both targeted groups.

Proposition 4: *In a society that includes non-believers, the award of a government grant to the 'less strict' (liberal) denomination will induce it to attract the members of the 'stricter' (conservative) denomination and also non-believers. The liberal denomination will seek to lower the religiosity or strictness level of the rival denomination's adherents, and also increase the religiosity of the non-believers. As a result, there are more liberal than conservative believers in the population.*

***Proof**:* See figure 4.

As shown in figure 4, the non-believers who joined A meant that A has more adherents then B. Even with the strategic response by B, it could *not* account for the fact that A is also targeting non-believers who are located at the far left end of the spectrum where B has little or no power.

Let the grant be given to B. In this case, B would surely seek to influence A's adherents to induce them to be more conservative. However, can B induce non-believers to be conservative?

It is clear that if B attempts to increase the religiosity of the non-believers, this would mean that they move to the right and join A. By increassing their religiosity, B realizes that A would benefit and it would lose.

Proposition 4': *If B (conservative) is awarded the funds, any proselytizing that also targets non-believers could result in a relatively disadvantageous outcome for B. Targeting non-believers may benefit A (liberal) instead. As a result, B may decide not to target non-believers in its proselytizing campaign and only target A's adherents.*

Implication: This result implies that conservative denominations and charities may seek to *discriminate* against non-believers in the provision of the public good. If the proselytizing is a necessary by-product of the public good provision, then any service provided to non-believers will also mean that their religous preferences are altered so that they are more religious and eventually become liberal. This implies that the conservative charity is actually performing a favor for the liberal denomination at no cost to the liberal denomination. *Therefore, the solution would be to restrict the provision of the public good to individuals who are more likely to accept conservative teachings*.

Corollary: A will seek to target non-believers in the proselytizing process, while B will not. *Therefore, we expect a liberal denomination not to discriminate against any group in the population in the provision of the public good, while we expect a conservative denomination to discriminate against non-believers or any group to the left of the liberal denomination on the religiosity spectrum*.

5. Conclusion:-

In this paper, we have examined the relationship between religious charities and the government sector. In particular, we have sought to investigate the impact of government funding on relgious charities and on religion and believers in the society. In order to do this, we developed an economic rationale for the comparative advantage of religious charities over non-relgious providers of social service. We have shown that religious workers or clergy are willing to offer social services at lower costs than their non-religious counterparts and are thus more efficient. This comparative advantage is mainly due to the proselytizing opportunity that the government funds have offered to the charities. By catering to more social service consumers, the clergy can utilize this opportunity to preach their particualr doctrine to more people and thus gain more religious utility.

This unavoidable by-product of the government funds will give denominations an advantage over their rival denominations that didn't receive government funds and this will eventually change the religious balance of power in the society as a whole. But even with equal grants to all denominations, we have shown the the government funds will have the effect of reducing the number of extremists in all denominations and increase the number of moderates. Furtheromre, by including non-believers in the model, we argue that strict denominations may seek to actively discriminate against this group of the population in the provision of the social service.

These results provide imoprtant insights into the future of the Faith-Based and Community Initiatives. In its goal to encourage religious agencies in their social service missions, the government should be aware of the implications on religion and believers in

society. Religious authorities should also consider the effect that these programs may have on their denomination's position in society relative to other denominations. And finally, believers and adherents should be aware of the consequences of such programs on their religious preferences and affiliations.

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