The Economics of Philanthropy and Fundraising

Volume I: Theory and Policy Toward Giving

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Introduction

James Andreoni

The Economics of Philanthropy and Fundraising

This two volume set contains 67 articles that span 52 years. Volume I, with articles published between 1962 and 2010, traces the development of the conceptual, theoretical, and policy questions about charitable giving that created our modern view of the economics of philanthropy. This volume will be especially interesting for learning about how economists found their way to consensus on some questions, and how they are still grappling with others. The first volume also includes a number of early papers, often published in hard-to-find books, but which give fascinating and important perspectives on how neoclassical economic theory was forced to open up to more modern notions of behavioral economics, long before the subdiscipline of economics had been more broadly recognized.

Volume II changes the focus. The research in this volume highlights the contributions that brought more depth and nuance to the question of what influences giving. Giving, as we learn in Volume I, is unlike almost any other economic transaction. Clearly there are those who supply dollars to the charity, and those who demand the goods and services the charity provides, but is this an exchange in the classical sense? Could it be that the “good” that the suppliers are offering is not the same as that which the demanders are receiving? If so, our usual reliance on price and income as providing sufficient information about the value of a transaction may be insufficient or, worse yet, misleading when we are discussing philanthropic behavior. In short, there are social aspects to being a both a giver (or non-giver) and a receiver of charity, and these features of the exchange, we now know, are of central importance to understanding the “market forces” at work among charities, fundraisers, and recipients.

The 34 papers in Volume II span from 1982 to 2013, however two-thirds of the articles were published after the year 2000, and one-third were published in the past five years. The topics featured in this volume are key representatives of an ever burgeoning literature on the social motivations for giving, the art of fundraising, the complex and sometimes unintended consequences of government policy, and fundraisers’ innovations.

Volume I: Theory and Policy Toward Giving

When the first articles on charitable giving began to appear in books and journals in the field of economics, it was not clear to all readers that this was a valid topic for economists to focus on. After all, economics is about the pursuit of self-interest, not about other-interest. As Adam Smith famously told us in *The Wealth of Nations* (1776), “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.”. The competitive market should move us toward efficiency. Charity, in its most basic form, is a voluntary transfer, and Smith tells us that the market should provide the incentives for us each to take care of each other by taking care of ourselves.

The first two papers in the volume make the case that, indeed, voluntary income redistributions are not only interesting for economists, but they can be welfare improving, even in the presence of a competitive market. Kenneth E. Boulding (Chapter 1), in a deeply thoughtful piece, raised many important questions and made dozens of insightful observations that were later developed and restated in modern economic language. He hints at notions of pure and impure altruism that we discuss in Parts III and IV of Volume I, and wonders about the welfare implications of various assumptions about social motivations for giving, as is debated in Part VI, Volume I. He goes on to talk about how empathy and face-to-face interactions are "almost always necessary to reinforce philanthropy," a point not widely appreciated until recent years (p.62). In his conclusion he begins to discuss foundation giving, a topic which our profession is only beginning to take seriously, as the growth of foundations has been staggering in recent years.

Although Boulding deserves credit for setting an agenda for ideas to come, there is still a lot of credit to share with those who fulfilled and expanded that agenda. The credit for putting philanthropy in the minds of public finance economists as an activity worth studying perhaps goes to the elegant and simple work by Harold M. Hochman and James D. Rodgers who wrote a paper entitled 'Pareto Optimal Redistribution' (Chapter 2). To a neoclassical economist, such a title would seem to be an oxymoron—redistributions of income cannot improve welfare unless we are willing to make take make interpersonal comparison of utility, as Harsanyi taught us. The beauty of the Hochman and Rodgers piece is that even if society cannot compare utilities across individuals, if individuals care about each other, and one is far more advantaged, then there may not only be scope for welfare increasing public redistribution, it is possible that a voluntary redistribution could also be Pareto Improving. That is, charity can be rational.

Gary S. Becker's (Chapter 3) pivotal contribution on social interactions is included in this section for its importance in removing economists' blinders to sundry social effects that are key to understanding altruism and philanthropy, and for the bold creativity of the paper. Kenneth J. Arrow's (Chapter 4) piece is added for its brilliance, but also to make this hidden gem more easily accessible. Arrow's paper is almost the antithesis of Becker's approach, and the contrast is a beautiful commentary of the value of each. Arrow makes a sensible assumption that, as moral animals, each individual may have their own "social welfare function" that expresses their notion of content with the distribution of income within society (p.267). The paper is rigorous, highly mathematical, and elegant. It also, Arrow discovered years later after seeing the results shown by others, contained the neutrality results that brought down this and many other approaches to giving.

Sections II, III, IV, and IV show the progression of ideas about what motivates others to give. The natural first assumption is the one given by all the authors in Part I: people care about the community of others around them. Stated differently, if many people care about the welfare of someone else, the consumption of that other person then takes on the qualities of a pure public good. Using Becker's notion of social income in such cases, Peter G. Warr (Chapter 5) wrote a provocative paper showing that in this case, an involuntary tax that redistributes money from a donor to her recipient would have the effect of simply replacing that donation with taxes and restoring the pre-tax distribution of income and utility. That is, government redistributive policy crowds out private redistribution methods. Even if the government redistributes money between two givers to a single public good (that is, a single recipient), then the forces of equilibrium will *undo* the redistribution. Russell D. Roberts (Chapter 6) takes this conclusion further to argue that government can, with little cost, greatly reduce government transfers and instead rely on private philanthropy to take up the cause.

These neutrality results were deepened and extended in the papers in Part III. Theodore Bergstrom, Lawrence Blume, and Hal Varian (Chapter 7), in a celebrated paper, showed just which assumptions were necessary to get complete crowding out and neutral redistributions of income. These were further explored by the other authors in this part, with James Andreoni (Chapter 8) taking the arguments of Bergstrom, Blume, and Varian to their natural limits, that is, to large economies. He shows that to accept the policy implications promoted by Roberts earlier, one would also have to adopt many other extreme and obviously untrue predictions of the model. This argument by *reductio ad absurdum* meant that something in the model was missing, and some of the motives discussed so eloquently by Boulding were likely at play. This is the topic of Parts IV and V.

Robert Sugden (Chapter 11), Richard Cornes and Todd Sandler (Chapter 12), and Andreoni (Chapter 13) all saw a world in which the human psyche gained some utility from the *act* of giving as a more descriptive, if reduced form, characterization of a general phenomenon. The point of these papers, and the others in this section, is to show that these personal motives are not only helpful in understanding the broad patterns in the data, but they are the key to understanding giving altogether. As David C. Ribar and Mark O. Wilhelm (Chapter 16) show, as the economy grows large, the component of utility that captures a concern for the recipient of the charitable transfer (pure altruism) is largely swamped by the other components that bring the joy-of-giving (impure altruism). This impure altruism is often referred to as the warm-glow of giving.

Part V presents papers from the lab that attempt to identify a "warm-glow" in preferences. By necessity, these tests are indirect, since we must infer motives from behavior and cannot observe motives directly. The closest we can get to observing motives directly is through fMRI scans, and Ulrich Mayr, William T. Harbaugh, and Dharol Tankersley (Chapter 22) discuss evidence from brain scans that may be the most convincing evidence of utility from the act of giving yet. Regardless of whether giving to an Oregon food bank for the poor is voluntarily or involuntarily, the pleasure center of the brain shows greater activation than when people simply keep or are forced to keep all of the money for themselves. But when the donation is purely voluntary, the pleasure appears to be the greatest.

If people enjoy giving, then why not promote it to improve welfare? Part VI presents a debate on that point between Louis Kaplow (Chapter 24) and Peter Diamond (Chapter 25). Both papers are included to allow the readers to draw their own conclusions. My view is that Diamond has the stronger argument. The reason can be summed up in a simple analogy: Imagine that every week you and your friend go to lunch and each week you buy each other lunch rather than paying for your own. Over the long run, actual consumption remains the same but, under an assumption of joy-of-giving, both should be happier. But this then creates a possibility for a "utility pump." By passing a gift back and forth, two people can create infinite happiness. As policy makers our welfare criteria should not allow for this form of "welfare inflation" to color our ultimate concern with the real and not social consumption of the citizenry. Warm-glow, while it influences choices, should not, in my view, count when calculating social welfare.

Part VII presents an abbreviated arc of the vast amount of research on the effects of tax policy on giving. The important and path breaking work of Charles Clotfelter is featured as the first entry in this section, as it set the bar for this literature as well as established a methodology that is followed to this day by many researchers hoping to understand how individual donors respond to changes in the price of giving resulting from the tax deduction for charitable donations. Part VIII rounds out this volume with two important papers showing that crowding out measures are biased toward zero or possibly negative crowding out, and demonstrate the viability of unbiased and economically significant measures of crowding out of private donations by government grants to charity.

Volume II: Fundraising and the Sociality of Giving

By and large, the papers in Volume I have all assumed that charities are inactive receptacles for donations. Nothing could be further from the truth. Charities exert great efforts and costs to organize fundraising. This volume begins by broadening the earlier investigation in light of the fact that charities are active, perhaps strategic, decision makers. The theoretical challenge is first to understand how fundraising works from a theoretical point of view. The papers in Part I of this volume offer a number of ideas, including helping avoid inefficient equilibria, lowering transaction costs, and signaling private information. The empirical paper by James Andreoni and A. Abigail Payne (Chapter 5) suggest another reason—charities would rather put effort into programs than into fundraising and thus cut back on fundraising when they get relief from a government grant. The final and most recent paper in this section, by Alvaro J. Name-Correa and Huseyin Yildirim (Chapter 7), collects many of the ideas in the prior theory papers in one place and is an impressive contribution to this literature.

Part II provides a sampling of the ever increasing set of lab and field experiments exploring the various aspects of fundraising. Topics include, among others, the effect of seed money, matching gifts, donor recognition, leadership gifts, and charity auctions.

Part III presents a “second generation” of papers on crowding out that includes fundraising decisions of charities as part of the analysis. A key result in this section is the 1000-points-of-light problem illustrated by Stephen Coate (Chapter 17). In order to set efficient transfer policy, the government needs to commit to limits on helping people. This stems from issues of moral hazard. Charities, however, undercut the government’s ability to commit. For instance, if the government imposes limits on transfers, it can provide sufficient social insurance while also establishing incentives for human capital accumulation. A charity that will step in when the government’s limit is reached will undermine the efforts of the government to set an optimal (second best) transfer policy. As such, the government transfer will be inefficiently small and the charitable sector will be inefficiently large.

The next part returns to Boulding’s observation that the good or goods being generated in chartable exchange are hard to observe, measure, or quantify. There is nothing specific to the transaction that tells a person that their gift is the right size or is purchased often enough. How do people decide when they are “doing their share”? A likely possibility, according to sociologists, is that people look to what others around them are doing, that is, they engage in social comparison. The papers in Part IV represent a “second generation” of papers on motivations for giving that include the inherently social aspects of philanthropy. The authors shown here illustrate that people who are similar in important characteristics, such as age and education, can influence each other by their examples. They show that if people observe another person giving, those people will change what they do in order to influence the "social image" others hold about them, or perhaps the "self-image" they hold of themselves. If the person asking for a donation is a personal acquaintance, people are more likely to give, and people who know they may succumb to social pressure to give may opt to avoid that pressure from the start.

The volume ends with a taste of new papers that are drawn together only by the fact that they show that some intentions to do good can end up doing harm, and vice versa. For instance, people who are asked to pay more to their church will subsequently choose to go to church less often—paying to the church, it appears, is a substitute for actually attending. Another paper reexamines an old question about blood donations. Standard economics would lead to the prediction that paying more for something cannot result in less of it being supplied. Supplying blood may be different. Donating blood takes time and effort, so giving blood can be a signal to others about a commitment to this worthy cause. If people are paid cash to donate blood, this undermines the signal. Next, if a producer promises to give 1 percent of sales to charity, can it get away with charging a price that is more than 1 percent above the price it charged without the tie to charity? The answer, often, appears to be yes. So, by purchasing the charity-linked item, the consumer is worse off than had they bought a cheaper unlinked product and given the remaining money to charity. Finally, suppose people are allowed to choose the price of a product with the understanding that whatever the price, the proceeds go to charity. Again, basic economic theory suggests that the fact that revenue goes to charity should increase the demand and the willingness to pay, yet the pay-what-you-want policy results in fewer purchases than when the price is fixed and low. Social- and self-image concerns appear to be creating unanticipated consequences for policies designed to help charities and consumers.

A Third Generation of Research on Giving?

Volume I of this set presents a first generation of studies. These papers bring focus to both the theoretical and policy question that define the literature. Volume II showcases a second generation of studies that admit more realistic qualities of both givers and fundraisers. Seeing all parties as active players, we learn that individuals' responses to policy changes are often driven by fundraisers who are guiding donors' hands.

Is there a third generation of studies? My view is that the literature is now poised for some of the most difficult and fundamental questions yet. The questions are difficult because they will be hard to answer objectively and with data. The questions are fundamental because they cut across our instincts as researchers of philanthropy to assume that more giving is always better for society.

Susan Rose-Ackerman (Chapter 6, Volume II) wrote a prescient piece asking whether charities that compete for the same pool of donors are engaged in excessive fundraising. The idea is simple: do fundraising resources spent by one charity only move money away from competitor charities without increasing the number of donors or the amount given overall? If all our research on philanthropy and fundraising is only feeding an arms race between ever more charities spending ever more resources to simply reallocate the same charitable dollars, then we are not enriching society, but impoverishing it.

The third generations of questions for research on philanthropy needs to take a direct look at philanthropy itself. Is our research truly resulting in a better world? Is the charitable sector producing more surplus than it costs to generate it? Are there new innovations that could expand the base of givers and encourage more people to share in the burden of providing for society's needs? How can economic researchers be faithful to our charge: to help society produce, in the most equitable manner, *the greatest good for the greatest number*?