

Charitable Giving

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Introduction

In 2005 charitable giving in the United States totaled over \$260 billion, or around 1.9% of personal income, making it a significant fraction of the economy. Individual giving accounted for 77% of this total, while foundations accounted for 12%, bequests for 7%, and corporations for 5% (Giving USA, 2006). Almost 70% of US households report giving to charity. While the US typically has one of the largest and most extensively studied charitable sectors, other countries around the world also have significant charitable giving (Andreoni, 2001, 2006).

There are three sets of actors in markets for charitable giving, and understanding each and their relations to each other is essential to an understanding of charity. First is the donors who supply the dollars and volunteer hours to charities. Second is the charitable organizations, that is, the demand side of the market. They organize donors with fundraising strategies, and produced the charitable goods and services with the dollars and time donated. The third player is the government. Governments are involved in charities in a number of ways. In many countries, including the US, individual tax payers may be able to deduct charitable donations from their taxable income. Governments also give directly to charities in the form of grants.

The following highlights the most important and fundamental aspects of research on charitable giving.

What motivates giving?

Why would a self-interested agent give away a considerable fraction of their income away, often for the benefit of complete strangers? Obviously, acting unselfishly must be in their self interest. One model of this is that the public benefits of the charity enter directly into a giver's utility function, that is, charity is a privately provided public good. This approach is advanced by Warr (1982) and Roberts (1984). They show theoretically that if giving is a pure public good, then we would predict government grants to charities will perfectly crowd out private donations, meaning government spending is largely ineffective. Bergstrom, Blume, and Varian (1986) develop this model further to provide a series of elegant derivations, including the (unrealistic) prediction that redistributions of income will be "undone" if everyone gives to a public good. Andreoni (1988) pushes this model to its natural limits and shows that in large economies we would predict a vanishingly small fraction of people will give to a public good, which is clearly contradicted by the statistics presented above.

For this reason, economists have felt more comfortable assuming that, in addition to caring about the total supply of charity, people also experience some direct private utility from the act of giving. While there are numerous models and justifications for such an assumption, they have often been gathered under the general (and slightly pejorative) term of warm-glow of giving (Andreoni, 1989, 1990). In large economies, in fact, it is easy to show that this motive must dominate at the margin (Ribar and Wilhelm, 2002). The intuition is clear. If large numbers of others are collectively providing a substantial amount of charity, the incentive to free ride must be so overwhelming that the only remaining justification for giving is that there is some direct benefit to the act of giving.

The consequence of assuming a warm-glow motive is that we can treat individual donations as having the properties of a private good. When income is higher or when the price of giving is lower, we predict individuals will give more.

What is the Impact of the Tax Deduction for Charitable Giving?

Studies of the charitable deduction are aimed at understanding just how individual giving is responsive to changes in income and price. If t is the marginal tax rate faced by a giver, and if (in the US) the person itemizes deductions, then the charitable deduction makes the effective price of a dollar of donations $1 - t$. The policy questions are how responsive is giving to the price, and is the policy successful in promoting additional giving.

Let g be the giving of the household. If the policy is effective, then the new giving received by the charity should exceed the lost revenue of the government, that is, total spending on giving will rise with the deduction. This means $d(1-t)g/dt > 0$, which holds if $\varepsilon = [dg/d(1-t)]/[(1-t)/g] < -1$. This means that the policy is effective if giving is price-elastic, $\varepsilon < -1$. Since the first studies on giving (Feldstein and Clotfelter, 1976), researchers have debated whether this “gold standard” has been met.

Dozens of studies of this question have been undertaken. Most studies employ cross-sectional data, either from surveys about giving or from tax returns. Each of these data sources has advantages and weaknesses, and each presents special challenges for identification and estimation (see Triest, 1998, for a careful discussion). These studies are summarized by Clotfelter (1985), Steinberg (1990), and Andreoni (2006). Prior to 1995, a consensus had formed that the income elasticity was below one, typically in the range of 0.4 to 0.8, and that the price elasticity was below -1, generally in the range -1.1 to -1.3, thus meeting the gold standard. Only a few studies found giving was price-inelastic.

This consensus was upset by an important study of Randolph (1995). There are two important features of his analysis. First, he uses a panel tax returns rather than a cross section. Second, the period of his sample, 1979-1989, spans two tax reforms. These reforms provide independent variation in price that can be helpful in identifying elasticities. Moreover, his instrumental variables analysis allows him to separate short-run and long-run elasticities. Contrary to the prior literature, he estimates a long run

price elasticity of only -0.51, meaning that the policy no longer satisfies the gold standard. Short run elasticities, by contrast, are high at -1.55. This means that givers are sophisticated at substituting giving from years of low marginal tax rates to years with high marginal tax rates. His analysis suggests that cross-sectional studies conflate short and long run elasticities and thus mislead policy analysts.

Auten, Sieg and Clotfelter (2002) challenged Randolph's results. They use a similar (although longer) panel of tax payers, but employ a different estimation technique. Their analysis capitalizes on restrictions placed on the covariance matrices of income and price by assumptions of the permanent income hypothesis. Their analysis again returns estimates to the consensus values, with a permanent price elasticity of -1.26. The sensitivity of the estimates to the estimation technique and the identification strategy has left the literature unsettled as to the true values of price and income elasticities.

Giving by the Very Wealthy

Most of the data available, for reasons of confidentiality, exclude the very wealthy. Yet, the richest 400 US tax filers in the year 2000 accounted for about 7% of all individual giving in that year. Auten, et. al (2000) provide a fascinating analysis of wealthy givers drawn from income tax filings at the Internal Revenue Service. Among the most interesting findings is that giving as a percent of income rises only modestly with income, up to about 4% for those earning over \$2.5 million. However, the variance in giving rises sharply. The inference is that wealthy givers are "saving up" for larger gifts. These larger gifts may allow them to exert some control over the charity, such as providing a seat on the board of directors, or may garner a monument, such as a naming a university building after the donor.

In discussing the wealthy, one must also address the effects of the estate tax on giving. Bakija, Gale, and Slemrod (2003) use 39 years worth of federal estate tax filings to study the sensitivity of estate giving to the estate tax. They rely on variation in estate tax rates across states for identification and find that charitable giving from estates is extremely sensitive to the tax. They measure the price elasticity of estate giving to be around -2.0, while the "wealth elasticity" is about 1.5. This indicates that recent changes in US estate tax laws that greatly reduce (and eventually eliminate) estate tax rates can have huge impacts on giving.

Do Government Grants Crowd Out Individual Giving?

There are many studies on crowding out, and most show that crowding is quite small, often near zero, and sometime even negative (Kingma, 1989, Okten and Weisbrod. 2000, Khanna, Posnett and Sandler, 1995, Manzoor and Straub, 2005, and Hungerman, 2005). Payne (1998), however, noted that the government officials who approve the grants are elected by the same people who make donations to charities. Hence, positive feelings toward a charity will be represented in the preferences of both givers and the government. This positive relation between public and private donations means that some of the prior estimates could be biased against finding crowding out.

Payne (1998) turns to two-stage least squares analysis to address this endogeneity. As an instrument for government grants she uses aggregate government transfers to individuals in the state, and finds that estimates of crowding out rise to around 50%, which is significantly above the 0% crowding that comes when she applies prior techniques to her data. This is a significant new finding.

All of this analysis, however, has not accounted for the fact that government grants may also have an impact on the fundraising of charities. Andreoni and Payne (2003) ask what happens to a charity's fund-raising expenses when it gets a government grant. Does it fall, and by how much? They look at 14-year panel charitable organizations and find there are significant reductions in fundraising efforts by charities after receiving government grants. This raises the possibility, therefore, that grants crowd out fundraising, which then indirectly reduces giving, and that this may be the actual channel through which "crowding out" occurs.

Incorporating Fundraising into Research on Charitable Giving.

One of the exciting new challenges for research on charitable giving is accounting for the strategic actions of charities in the analysis. This typically means understanding how charities choose fundraising strategies, and how givers respond. A theoretical literature has emerged to provide a framework for analyzing fundraising (see Andreoni, 2006 for a review). At the same time researchers have begun considering field and laboratory experiments on charitable giving. These studies look at the effectiveness of ideas proposed by the theoretical literature, and evaluate some of the standard practices of charities.

Rege and Telle (2004) and Andreoni and Petrie (2004) show in laboratory studies that the common practice of revealing the identities of givers, and reporting amounts given in categories (Harbaugh 1998), can have positive impacts on donations. Soetevent (2005) shows similar social effects in a field experiment.

List and Lucking-Reiley (2002) use a field experiment to establish that when charities require a minimum amount of contributions before a new initiative can be pursued, having a "seed grant" can be greatly effective (Andreoni, 1998), as can be guarantees of refunds in the event that the threshold of donations is not met (Bagnoli and Lipman, 1989).

Landry, et. al, (2006), explore the use of lotteries to raise money for charities (Morgan, 2000) in an actual door-to-door fundraising campaign. They find that lotteries increase giving, as expected. Perhaps surprisingly, however, they find that the physical attractiveness of the fundraiser has a significant affect on the amounts raised, and that this was at least as important as any economic incentives offered.

Conclusion

Charitable giving has been one of the perennial topics for economists. It presents challenges for the theorists to understand the motives and institutions for giving, for policy analysts to measure and identify the effects of price and income, and for experimenters to explore innovations in the market for giving. As governments become increasingly reliant on private organizations to provide public services, and as charities become increasingly sophisticated at raising money and delivering needed services, understanding the relationships among the suppliers and demanders of charity will become essential for calculating the social costs and benefits of charitable institutions.

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