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ECONOMICS OF PHILANTHROPIC TAX INCENTIVES

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1 Introduction

Most OECD governments offer tax-favorable treatment to charitable donations. In the United States, charitable donations are deducted from taxable income; France offers a non-refundable tax credit with a 66% subsidy rate, while the UK Gift Aid scheme offers a mix of a ‘match-style’ incentives and deductions. We document the different schemes systematically in Section 2 subsequently. One aim in tax-favoring giving is to encourage donations and support charities. Two important questions for policy-makers are: 1. Are tax incentives, which come at a cost of tax revenue foregone, the best tool for increasing charity incomes, compared to an alternative of funding grants directly to charities? 2. Is subsidizing charitable donations better than the government providing services directly? Addressing these questions requires an understanding of the effect of tax incentives on charity incomes (tax efficiency) and the wider impact of tax incentives for the level and composition of public goods and services (social efficiency). These issues are the focus of this chapter, and our discussion brings together several themes from other chapters in this volume (see also Andreoni, 2006a; Fack and Landais, 2016; Andreoni and Payne, 2013).

We first discuss the tax efficiency of tax incentives for charitable donations (Section 3). By tax efficiency we mean whether the government can increase charities’ incomes by ‘spending’ tax revenue on tax incentives rather than on grants (see Steinberg, this volume). We include a discussion of insights from behavioral science (see Cutler, Adena, and Ugazio et al., this volume) for improving tax efficiency.

We next discuss the social efficiency of tax incentives (Section 4). This moves the discussion away from the ‘income pie’ to the ‘output pie’ (see Lohse and Scharf, this volume; Saez, 2004; Diamond, 2006). We touch briefly on a couple of aspects that have not featured prominently in economic discussions of tax incentives for donations, including the benefits of civil society and wider support for taxes and public spending.

We end with a brief discussion of large gifts in Section 5. The past decades have seen an increasing concentration of giving in the United States, which means that discussion about tax subsidies for giving increasingly leads to a discussion about tax subsidies for large gifts. Consideration of large gifts brings with it slightly different issues to that of donations by regular donors.

Three current challenges make discussion of these issues very topical. First, there is a documented stagnation of giving and a decline in the number of givers in countries such as the United States (Osili et al., 2019) and United Kingdom (Charities Aid Foundation, 2012). The share of Americans who do not give has been rising in recent years, with an accelerated trend following the 2008 financial crisis. Meer et al. (2016) report that in 1960, under 5 per cent of itemizing households reported no contributions. In 2016, the share had quadrupled to about 20 per cent. Second, there is an increasing concentration of giving in the hands of a few (relatively rich) donors, whose donations may be distributed differently than those of the general population (Duquette, 2020; Duquette and Mayo, this volume). Finally, the current COVID pandemic may reduce (and/or redirect) donations at the same time as sharply increasing social need. The wealth of many of the world's billionaires has also increased by an estimated 20 per cent during the pandemic, leading many to ask how the super-wealthy – whether through taxes or philanthropy or both – can be part of the solution to the many social and economic problems that COVID has created.

2 Giving and the tax treatment of donations out of income

2.1 Giving

Table 9.1 shows that donating to charity is a widespread activity in most OECD countries: more than half of the population gives in one-third of the 38 countries listed. These numbers suggest high levels of engagement in philanthropy across the population, but a recent study by Rooney et al. (2020) finds that a static lens (i.e., looking at a snapshot of who gives in a single year) may be misleading because many donors give infrequently and not in every year. In their analysis of giving data from the Panel Survey of Income Dynamics, Rooney et al. find that half the U.S. population (more than half of those who donate) are ‘switchers’ who move in and out of donating over time. This means that more people have ever given than the static lens suggests but that there is a smaller number of regular donors who give every year. Regular donors typically donate larger amounts conditional on their other characteristics and, indeed, whether someone is a regular or switcher donor has greater predictive power for how much they give than observable characteristics. Greater understanding of what characterizes these different groups of donors (regular donors versus switchers) would be helpful for charities and policy-makers.

Turning to amounts donated, the United States tops the rankings – by some margin – for the amount donated as a share of GDP (at 1.44 per cent). Outside the United States, the value of donations (for the countries for which the information is available) is below 1 per cent GDP. New Zealand, Canada, the United Kingdom, and the Netherlands make up the “top five.” As discussed further in the following, the trend in the United States has been towards greater concentration of giving. The share of the population that gives is in decline, and the share of total giving accounted for by big givers has been increasing (Duquette, 2020). There is evidence of similar trends in the United Kingdom (Charities Aid Foundation, 2012).

In every country, giving as a share of GDP – and the level of public goods and services funded out of private donations – is dwarfed by government spending. However, donations play a crucial role in the provision of public goods and services in many ways. They are critical to some services – for example, the UK lifeboat service, which carries out sea rescues, is funded entirely in this way; private donations also represent around one-quarter of total funding for international aid in the United Kingdom/United States. The COVID pandemic has also revealed the crucial importance of, for example, privately funded food banks in meeting a dramatic and sudden increase in need.

Economics of philanthropic tax incentives

Table 9.1 Summary of tax incentives

	<i>% who give</i>	<i>Giving as % GDP</i>	<i>Gini</i>	<i>GovExp as share of GDP</i>	<i>Tax relief</i>	<i>Cap on value of donations attracting relief</i>	<i>Floor to tax relief</i>
Argentina	18%		0.414	0.263	Deduction	5% annual earnings	
Australia	68%	0.23%	0.344	0.270	Deduction	A deduction cannot add to/create a tax loss	AUD 2
Austria	53%	0.14%	0.297	0.456	Deduction	10% total income	
Belgium	39%		0.274	0.414	Credit	Donation amount may not exceed 10% of global net income nor EUR 375,350 per spouse	EUR 40 per institution
Bulgaria	16%		0.404	0.324	Deduction	65% taxable income (after the deduction)	
Canada	63%	0.77%	0.333	0.173	Credit	Up to 75% of net income can be claimed	
Chile	44%		0.444	0.222	Credit	Credits received for donations to charity and education, culture, and sport are limited at 20% of the amount of the donation subject to beneficial tax treatment or UTM 320 (approx. USD 20,558)	
Colombia	22%		0.504	0.302	Credit	Credit received is limited to 25% of the income tax liability	
Czech Republic	22%	0.04%	0.249	0.329	Deduction	15% of taxable income	2% of the tax base or CZK 1,000
Estonia	20%		0.304	0.024	Deduction	EUR 1 200 and 50% of the taxable income	
Finland	42%	0.13%	0.274	0.399	Deduction	EUR 500,000	EUR 850
France	27%	0.11%	0.316	0.483	Credit	20% taxable income	
Germany	49%	0.17%	0.319	0.279	Deduction	20% total amount of income	
Greece	7%		0.344	0.488	Credit	Donation amount may not exceed 5% of taxable income	EUR 100
Hungary	20%		0.306	0.439	Allocation		
India	24%	0.37%	0.357	0.166	Deduction	10% of gross total income	

(Continued)

Table 9.1 (Continued)

	<i>% who give</i>	<i>Giving as % GDP</i>	<i>Gini</i>	<i>GovExp as share of GDP</i>	<i>Tax relief</i>	<i>Cap on value of donations attracting relief</i>	<i>Floor to tax relief</i>
Indonesia	69%		0.378	0.149	Deduction	5% from current net income	
Ireland	69%	0.22%	0.328	0.251	Matching		
Israel	51%		0.39	0.365	Credit	The credit cannot exceed 30% of taxable income or NIS 9,000,000	
Italy	38%	0.30%	0.359	0.423	Deduction credit allocation	10% of the taxable income	
Japan	23%	0.12%	0.329	0.169	Deduction credit	40% of total income	JPY 2 000
Latvia	25%		0.356	0.429	Deduction	EUR 600 and 50% of the annual taxable income	
Lithuania	12%		0.373	0.095	Allocation		
Luxembourg	51%		0.349	0.392	Deduction	EUR 1,000,000 or 20% of net income	EUR 120
Mexico	20%	0.03%	0.454	0.210	Deduction	For donations to private institution: 7% of last year's cumulative income. For donations to governmental institutions: 4% of last year's cumulative income	
Netherlands	71%	0.30%	0.285	0.390	Deduction	10% of the total income	1% of total income and over EUR 60.
New Zealand	65%	0.79%		0.308	Credit	Total amount of the donation may not exceed 100% of taxable income	NZD 5
Norway		0.11%	0.27	0.396	Deduction matching	NOK 50,000	NOK 500
Portugal	20%		0.338	0.414	Credit allocation	The credit cannot exceed 15% of tax liability (no limit for donations to public institutions)	
Romania	20%		0.36	0.313	Other		
Singapore	48%	0.39%		0.149	Deduction matching	No limits	
Slovak Republic	28%		0.252	0.402	Allocation		

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Slovenia	36%		0.242	0.403	Deduction allocation	0.5% of taxable revenue	
South Africa	18%		0.63	0.345	Deduction	10% of taxable income	
Sweden	55%	0.16%	0.288	0.314	Credit	The credit cannot exceed SEK 1,500	SEK 2,000 total donations and at least SEK 200 per individual donation
Switzerland	56%	0.09%	0.327	0.174	Deduction	20% of taxable income	CHF 100
United Kingdom	71%	0.54%	0.348	0.373	Matching		
United States	61%	1.44%	0.411	0.227	Deduction	60% or 30% of adjusted gross income depending on the beneficiary	

Notes to table: *% who give* refers to the % population who report having given to charity in the last month, taken from the World Giving Index, averaged over 2010–18, collected by Gallup as part of its World Poll initiative published by Charities Aid Foundation. *Giving as % GDP* refers to money donated to not-for-profits by individuals as a share of GDP, compiled by Charities Aid Foundation. All other information provided by the OECD.

2.2 Tax treatment of donations out of income

Most OECD countries offer favorable tax treatment for private donations. Information collected by the OECD on the type of tax relief offered by different countries is summarized in Table 9.1.¹

- **Tax deductions**, by far the most common form of relief, reduce the taxable amount of income before calculating the tax liability that is due. They are more generous to taxpayers who face a higher marginal tax rate.
- **Tax credits** are an amount subtracted directly from the tax liability once the liability has been computed. The value of the credits is equal for all taxpayers.
- In a **matching scheme**, the government effectively tops up donations so that the entity receiving the donation can claim the tax relief. The UK system of Gift Aid allows charities to claim the tax that was paid on donations that are made net of taxable income (at the basic rate of tax). Higher-rate tax payers can claim back the difference between their marginal rate and the basic rate.
- **Allocation schemes** are not formally a type of tax relief for giving, but they are a device through which taxpayers are able to allocate a fixed amount or a share of their income tax to a beneficiary directly through their tax return (e.g., in Lithuania, taxpayers can allocate up to 2 per cent of their income tax to their chosen NGO). They are more commonly

found in countries which have a lower share of givers and a limited tradition of philanthropy. See Bilodeau (1994) for an analysis of this type of funding system.

As well as differences in the type of tax-favorable treatment offered, there is also variation in the scope of tax relief. Almost all countries set a maximum amount of donations which are eligible for tax relief – either in absolute terms or as a percentage of taxable income. In more limited cases, there is also a minimum threshold for tax relief to apply.

We use a simple ordinary least squares (OLS) regression to explore correlations between the share of the population who gives and alternative types of tax incentives, conditional on characteristics such as inequality, government spending, and per capita GDP. The results are reported in Table 9.2.

There is no difference in giving (the share of the population who gives) between countries offering a tax deduction compared to countries offering a tax credit. Countries offering a match have higher giving ($p = 0.076$) compared to a deduction, but this is a small sample. Countries with an allocation scheme have lower giving compared to a deduction ($p = 0.092$), indicating the role of allocation schemes in trying to foster a culture of giving. Of the other factors, per capita GDP has a positive effect on giving; doubling GDP is associated with a 10 percentage point increase in the share of the population that gives ($p = 0.070$). More inequality (a higher Gini coefficient) is associated with lower giving, though the estimated relationship is not statistically significant at conventional levels ($p = 0.195$). There is no systematic relationship between levels of government spending and giving. As indicated by the R^2 , these factors collectively account for 40 per cent of the overall variation in giving. Although tax incentives are important, there is a limit to the role that they play, and other deep-seated factors such as culture and values also matter. As a striking reminder of this, Adena, this volume, reports a sizeable difference in levels of giving between East and West Germany, which share common institutions.

In the next section, we discuss the effectiveness of tax incentives in encouraging donations, discussing both ‘tax-price elasticity’, that is, how much donations respond to changes in the tax-price of giving, and the effects of different features of tax incentives, drawing on standard economic theory and behavioral insights.

Table 9.2 Accounting for variation in giving

<i>OLS regression. Dependent variable = Giving (proportion of population)</i>			
	<i>Coeff</i>	<i>SE</i>	<i>p-value</i>
(Deduction)			
Match (0/1)	0.243	0.131	0.076
Credit (0/1)	-0.004	0.066	0.958
Allocation (0/1)	-0.144	0.082	0.092
Other (0/1)	-0.244	0.179	0.185
Gini	-0.555	0.418	0.195
Ln (GDP per capita)	0.107	0.057	0.070
Gov spending (share)	-0.216	0.277	0.442
Constant	-0.467	0.638	0.471

Note to table: $N = 35$. $R^2 = 0.40$. Deduction, Match, Credit, Allocation, Other are defined for any country that has this type of incentive (i.e., the categories are not mutually exclusive). Variables defined as in Table 9.1.

3 Tax efficiency

The effect of offering tax incentives is to lower the tax-price of giving. Suppose a donor wants to give money to a charity and cares about the dollar income amount ($\$d$) that the charity receives. Tax incentives lower the price (in terms of other consumption foregone) of giving this amount to $\$(1-r)d$, and this lower price is expected to increase donations. The tax-price elasticity of donations (i.e., how much donations respond to changes in the tax-price) has been a key policy parameter of interest in the empirical economics literature. It is important because it is a key factor in determining the tax efficiency of tax incentives in boosting charity incomes, compared to the alternative of the government giving grants. As discussed by Steinberg (this volume), the comparison of grants versus tax incentives also needs to take account of the degree of crowd-out from government grants to private donations (see also Saez, 2004; Diamond, 2006). Broadly speaking, if donations are responsive to changes in the tax-price, then tax incentives are more likely to be tax efficient. Absent crowd-out, then, if the tax-price elasticity is greater than one in absolute value, tax incentives are to be preferred to grants if the only objective is to maximize charity incomes.

Lohse and Scharf (this volume) provide a summary of the findings from the economics literature. Most studies focus on the United States, but there has been a range of estimates. In early studies, price elasticities of giving were found to be negative and greater than one in absolute value. More recently, estimates have been shown to be sensitive to the empirical strategy and in particular to the time horizon (short-term versus long-term) – most studies estimate a long-term price elasticity that is less than one in absolute value (although for an exception, see Auten et al., 2002). Summarizing the empirical literature, Andreoni (2006a) concluded that ‘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’. In addition to sensitivity to estimation methods, it has more recently been shown that there is heterogeneity in the tax-price elasticity across income classes. There is evidence, for example, that the tax-price elasticity is greater for richer taxpayers (see Adena, this volume). Hence, the estimated value will depend on the sample of donors being used for estimation.

In the next section, we discuss additional factors that might affect the tax-price elasticity, providing some reflections on what the tax-price elasticity is measuring. We draw on other chapters in this volume to discuss aspects of the tax treatment of donations (beyond the ‘tax-price’) that might affect how donors respond to tax incentives, including fixed costs, salience, match-versus-rebate, and minimum thresholds. The discussion offers some insights for policy-makers who are keen to maximize the effectiveness of tax incentives.

3.1 What does the tax-price elasticity measure?

The distinction between short- and long-term tax-price elasticities recognizes that tax-price changes may affect the timing of donations rather than the amount that is donated and that what is observed in response to a tax-price change may not be a change in underlying donations but a shift in the timing of donations to take advantage of preferential tax treatment.

Another obvious but often overlooked point is that the estimated tax-price elasticity (based on administrative data) captures the responsiveness of ‘taxable donations’, that is, donations declared for tax-favorable treatment, which may not be the same as total donations. At least part of an observed response to a tax-price reduction may be an increase in the share of donations that are declared, regardless of whether the total donations rise or fall. The decision to claim tax relief on donations is an important margin that is likely to be affected by the amount of tax relief

available. Using administrative data and exploiting a UK tax reform in 2010, Almunia et al. (2020) estimate an intensive-margin price elasticity of giving of -0.2 – but they also estimate the fixed cost of declaring donations is £47. There are two implications from this. One is that extensive-margin responses are important. The second is that part of what is captured in the extensive-margin responses may be the decision to declare.

Other fixed costs, such as the cost of changing regular giving commitments ('hassle costs'), are likely to reduce the extent to which donors change out-of-pocket donations, particularly for small tax-price changes – for evidence, see Scharf and Smith (2015). Adena (this volume) reports that around two-thirds of private donations in Germany (including to big charities such as Greenpeace and the World Wildlife Fund) are paid in the form of membership fees. These are usually of a fixed, pre-specified value and are often automatically debited from members' bank accounts. They do not adjust when the tax-price changes.

Hassle costs may dampen the effect of *deduction-style* tax-price changes. One of the benefits of a *match-style* incentive is that more generous tax treatment of charities (i.e., higher match rates) are automatically passed on to charities as higher incomes even if donors do not change their out-of-pocket donations. In the case of a more generous tax deduction, on the other hand, donors must make changes to out-of-pocket donations for the income received by a charity to increase (Scharf and Smith, 2015).

Donation responses to changes in the tax-price necessarily reflect the behavior of those who are aware of the presence and level of tax incentives. The evidence suggests that awareness of charitable tax incentives is sometimes low. Insights from behavioral tax policy show that making sales taxes more salient increases consumer responsiveness (Chetty et al., 2009), and the same is likely to be true for donation tax incentives. The match element of Gift Aid is arguably very salient in the United Kingdom – charities need a declaration by the donor to reclaim the tax and will provide a prompt to 'tick the Gift Aid box' every time someone donates in a structured way. For evidence on the importance of awareness in the context of bequest giving, Sanders and Smith (2016) find large responses to a simple prompt to people who are writing their wills as to whether they have thought about making a charitable bequest. Using a regression discontinuity design, they estimate a sizeable tax-price elasticity effect around the bequests tax threshold. Discussions with will writers revealed that the presence of the tax threshold created an opportunity for conversations about making a charitable bequest and avoiding bequest tax. Some of these responses may capture some element of a social norm as well as salience, but clearly, awareness of tax incentives matters.

3.2 Design features of tax incentives

Table 9.1 shows that countries vary in the *form* in which tax relief is offered to donors – and this may matter for the tax-price elasticity in ways we discuss in the following. We review some insights from the economics literature on differences between the effects of *match-style* incentives and *deduction-style* incentives (see also Cutler, Adena, and Ugazio et al., this volume), and we discuss minimum thresholds for donations to benefit for tax relief and ask whether there are lessons from psychology and neuroscience that might be relevant for tax incentives.

3.2.1 Match versus rebate

Tax incentives can be offered as a *match* (for every \$1 donated out of pocket, the charity receives an additional \$*m* from the government in the form of a match) or as a *deduction* [such

that every \$1 donated out of pocket only costs the donor $\$(1 - r)$. If the donor cares about the income received by the charity, referred to by Hungerman and Ottoni-Wilhelm (forthcoming) as the impact of a donation, then both types of tax incentives lower the tax-price of impact in terms of other consumption foregone and should be equivalent in their effect on donations. However, estimated tax-price elasticities associated with changes in price driven by changes in the match rate are typically greater than the estimated tax-price elasticities associated with equivalent changes in price driven by changes in the rebate rate. This evidence comes from lab and field experiments with individual charities (Eckel and Grossman, 2003, 2017), from a hypothetical experiment varying the match/rebate elements of the UK Gift Aid scheme (Scharf and Smith, 2015), and from natural experiments studied by Hungerman and Ottoni-Wilhelm (forthcoming).

The literature discusses several explanations for the observed difference, including timing differences (matches are typically upfront, whereas deductions may benefit a donor with a delay) and pure framing effects (a deduction may be seen as selfish, whereas a match may be seen as co-operative). One explanation, already discussed, is that, if out-of-pocket donations do not adjust, for example, because of hassle costs, then the income received by the charity (impact) will vary mechanically with changes in the match rate and not at all with variations in the rebate rate (Scharf and Smith, 2015). More recently, Hungerman and Ottoni-Wilhelm (forthcoming) note that if the donor cares about the impact and also gets warm glow utility (Andreoni, 1989, 1990) from their own gift, a deduction affects the opportunity cost of both the impact and warm glow, while the match reduces the cost of impact but does not alter the cost of one's out-of-pocket donation. This adds to the explanations of why the two types of incentive might differ in their effect.

Matching done through the tax system, is different from matching used as a fundraising scheme. It is not uncommon for charities to use a large private gift as a fund to “match” the donations of other donors, until the fund is exhausted. In practice, large donors usually let the charities keep the full amount in the unlikely case that the fund is not exhausted. This means that a matched gift will not actually increase total donations and the matching fund is entirely infra-marginal. Consistent with this interpretation, Karlan and List (2007) find no effects of the rate of the match (1-for-1 versus 2-for-1). Rather, as shown by Huck and Rasul (2011), it is the fact that one donor has made a very large grant, not the match rate, that makes the difference to other donors, perhaps because it sends a signal of quality for that charity (Andreoni, 1990).

3.2.2 Thresholds

Several countries operate minimum thresholds for donations to qualify for tax relief. Recent field experiments provide insights into how these might increase donations compared to a system with no minimum threshold. Setting minimum thresholds can incentivize donors below the threshold to give at or above it. They can also set a social norm for acceptable donations – however, this can cause donations to go down as well as up, depending on the level of the threshold relative to individuals' donation amounts (Harbaugh, 1998, Andreoni and Petrie, 2004). Huck et al. (2015) show that non-convex matching with a lower price for higher gifts outperforms simple linear matching, but thresholds need to be high and ideally personalized such that they cause each donor to adjust their donations upwards (Adena and Huck, 2017). In a real-world setting, varying thresholds by income or by tax-rate in a progressive system would be one possible way forward.

3.2.3 Framing

The lessons from dictator and ultimatum games are that fairness, efficiency, equity, and reciprocity are important for people's decision to give (see Cutler, this volume). Sentiments such as 'giving back' and 'a sense of duty' feature prominently in the narratives of Giving Pledgers, billionaires who have pledged to give away at least half of their wealth. Giving Pledgers also frequently mention that their giving is shaped by values from religion or from their upbringing. To date, most experimental findings focus on how values affect the *level* of giving, but they may also affect how people respond to tax incentives – hence, the framing of tax incentives may matter for the response.

Studies have found that 'social information', in particular, information about other people's giving, affects donations. Shang and Croson (2009) study messages about other people's donations in the context of a donation phone-in, while Smith et al. (2015) find that donors respond to seeing information on how much other donors have given on a social fundraising platform. Behavioral tax policy has demonstrated that social norm messages from the government can increase tax compliance (Hallsworth et al., 2017). In the context of bequest giving, Sanders et al. (2016) show that social norm messages ('leaving a bequest is something that many people do') increases take-up among those writing a will for the first time compared to a simple awareness message ('have you thought about leaving a bequest'). Reciting the 'golden rule' and other moral suasion also increases giving (Dal Bó and Dal Bó, 2014). Such messages about donations could both increase awareness and also reinforce social norms about giving that could increase the effectiveness of tax incentives.

Recently, List et al. (2019) ran a field experiment on fundraising campaign in Alaska, where identical mailings about the "Pick-Click-Give" program were sent to thousands of households. While each mailing had the same information, their headline banner differed. Half appealed to their love of Alaska, and half appealed to the good feeling donors will have about themselves. They found significantly more giving among those who were invited to think about themselves when giving rather than the good the donation will do for the community.

4 Social efficiency

Tax efficiency is a relatively narrow concept focusing on the effect of tax incentives on the revenues of charities. Consideration of the social efficiency of tax incentives moves from a focus on the size of the 'income pie' to the size (and composition) of the 'output pie' and the social benefits derived from charitable income.

4.1 Maximizing the 'output pie'

One argument for using tax revenue to support charities emanates from the claim that non-profit provision is more (cost-)effective. The argument is supported by the observation that because private charities often work directly with the populations served, unlike bureaucrats and legislators, and so can generate greater socially beneficial impact for a given revenue cost compared to government provision. Offering tax incentives puts allocation decision in the hands of donors, rather than government grants and will result in an allocation of resources within the charitable sector that is more (cost-)effective if donors care about charity cost-effectiveness and have more information than the government about which charities are most cost effective.

Evidence on whether donors care about cost-effectiveness is mixed (Lohse and Scharf, this volume). Donors respond to information about the magnitude of overhead costs (Gneezy et al., 2014) and to simple ratings by watchdog organizations like Charity Navigator that combine

several metrics, including overhead (Gordon et al., 2009). However, such measures may not be good indicators of cost-effectiveness. In lab and field experiments, donors do not appear to respond to scientific measures of effectiveness, such as the ability of a charity to improve outcomes for recipients. Moreover, donors are not willing to pay to acquire information on effectiveness (Karlan and Wood, 2017; Burum et al., 2020). We show in the following that many Giving Pledgers are strongly motivated by the potential impact of their gifts and prefer to transfer results-based methods from business to non-profits. However, many (large and small) donors are motivated by a range of factors besides charity effectiveness, including personal interests, values, social pressure (Andreoni et al., 2017; DellaVigna et al., 2012, Andreoni and Serra-Garcia, 2021a, 2021b), and socially motivated fundraising that takes place in the context of workplaces or peer networks (Scharf and Smith, 2015).

The effective altruism movement, started in the late 2000s, promotes the twin ideas of directing giving to where it can do most good and determining what is the most good by using evidence and reasoning. However, there is debate about some of the practical implications of the effective altruism principle. First, there may be a limit to what impact has been measured, so donors can only choose from a limited range of organizations. More fundamentally, there may be a limit to what can be measured (at least on a comparable basis). A de-worming organization can measure how many people were treated, n , at an estimated value v per treatment: effectiveness is nv . An organization providing mental health services can count the number of people helped, but may find it harder to monetize the benefit. A suicide hotline may find it hard to know how many lives they have saved.

Second, when measures of effectiveness are available, they capture marginal benefits that are unlikely to extrapolate to a case for directing all donations to the (currently) most effective charity. Providing an additional mosquito net has been demonstrated to be a cheap and highly effective way to save a life by preventing malaria, but there is a limit on how many mosquito nets are needed.

Finally, many have argued that focusing on the interventions that work/don't work ignores the potential of systemic changes in power and institutions that might bring about even greater benefits in the longer term. Adherents of effective altruism would argue that donors should support systemic change if it does the most good, but it is hard to fulfill the second principle of using evidence-based reasoning: typically marginal interventions, carried out within existing institutional structures, are the easiest to evaluate in order to produce the required evidence base.

The principle of effective altruism makes sense for a donor who is considering which charity to give to out of a set of charities doing similar work where measures of effectiveness are available. However, it may be a 'social distortion' in the case of decisions across different charities, favoring charities for which effectiveness can easily be measured, potentially at the expense of charities engaged in less tangible, more risky, more experimental, more novel, or more long-term investments, that could ultimately be of greater value but whose rewards are, as yet, unclear.

This brings us to what Reich (2017) calls the 'discovery case' for tax incentives. Tax incentives may help to support a plurality of organizations supplying public goods and services, and this plurality may be more likely to foster innovation, recognize real needs more quickly, and respond to changing circumstances. Precisely because individual donors do not all give to the (currently) most cost-effective charities but give to many different charities, donations can help to create and sustain a vibrant charity sector. There may be a short-term cost in not giving to the (currently) most cost-effective charity, but there may be longer-term benefits of sustaining a diverse charitable sector that are even greater.

Going further, there may be additional benefits to supporting a plurality of charitable organizations in terms of fostering a healthy civil society that exists between the public and the government. As well as the instrumental value from delivering public services, charitable organizations engage in advocacy on issues such as health, the environment, and human rights. They may be part of a vibrant civil society that is important for a healthy democracy – influencing policy and providing marginalized groups (including non-voters) with a voice. In some countries, they may also play a ‘checks and balances’ role and hold governments accountable. Tax-favoring donations, by introducing a degree of separation between the source of funding and the allocation decision, are likely to be a more effective way to promote civil society than government grants in a way that is free from direct political influence. This in itself may be a valuable output from a system of tax subsidies.

4.2 Composition of public services

Tax incentives for donations are likely to lead to a different allocation of funding across charitable causes (religious giving, social services, health, education, culture, etc.) compared to government grants/provision. According to standard political economy models, government provision will target the preferences of the ‘median voter’. By contrast, donors may allocate funding across charities according to their personal preferences (which will be reflected in different levels of warm glow from giving to different causes). More specifically, however, and this is a common criticism of tax incentives for giving, the allocation associated with tax subsidies will be weighted towards the preferences of richer donors both because they give more and also because they enjoy a greater subsidy under deduction-style incentives.

Evidence shows that the distribution of donations by the rich differs from that of the rest of the population. Reich (2017) reports that, among donors with incomes less than £100k, 67 per cent of donations went to religious causes, 10 per cent to basic needs, 4 per cent to health, 3 per cent to education, and 3 per cent to arts, whereas, among donors with incomes greater than £1 million, 17 per cent went to religious causes, 5 per cent to basic needs, 25 per cent to health, 25 per cent to education, and 15 per cent to arts. The important questions are whether directing funding in line with donor preferences, not median voter preferences, is socially efficient and whether it is equitable.

Inherent in the mechanism for allocating government money via tax subsidies is a tension between personal motivations for giving to different causes (which drive donor decisions) and the associated social benefits of donations, which, we assume, the government wants to maximize. Of course, many donors care about maximizing social benefits in the short or long term; arguably, richer donors are more likely to act on this, not least because they can pay for the information and advice needed to make cost-effective donation decisions (Andreoni, 1998). But many donor choices are motivated by personal (reputational) benefits or personal preferences that have nothing to do with social welfare – there are many examples of the latter in the narratives of those billionaires taking the Giving Pledge. In this case, the allocation by donors will not be socially optimal. In itself, this does not invalidate the case for tax incentives, but it would point to a system that targets tax subsidies at charities which generate greater perceived social benefits, possibly varying tax incentives by cause. Whether a government could do this objectively, without being swayed by political considerations, is, however, a separate issue.

The second consideration is equity. Giving weight to the strength of people’s preferences in directing funding in public service provision is arguably a potential advantage of tax subsidies over grants – it allows people to express their willingness to pay for different goods and services in markets where there is no price. However, tax deductions give greater weight to the

preferences of richer voters, and this is seen by many as inequitable. Again, this does not invalidate the case for tax incentives, but if this is a concern, then the value of tax subsidies should be equalized across donors through a system of tax credits. Here, there is a possible tension between designing a system of tax incentives that is tax efficient (which would imply giving more generous tax incentives to richer donors, who are more tax-price sensitive) and designing a system of tax incentives that is seen as 'fair' (which would imply equal-value tax subsidies for all donors).

A final argument in relation to the provision of public goods and services is that tax subsidies for giving may help to increase voter support for government provision, particularly in diverse societies. Allowing donors to direct the allocation of (some) government funding provides a mechanism for publicly funded services to reflect a wider range of preferences beyond those of the median voter. In a diverse society, government-provided services (meeting the preferences of the median voter) may be a long way from the preferences of different groups in society, and this may reduce voters' willingness to pay taxes (Alesina et al., 1999). Levels of public spending, support for redistribution, and the legitimacy of the tax system are lower in more diverse societies (Li, 2010). More ethnic and religious diversity in a community also predicts lower donations (Andreoni et al., 2016). Giving people a voice in the composition of public services provides an opportunity to overcome this by better reflecting diverse preferences, and this may increase support for tax and public spending more generally (De Neve et al., 2014). Tax incentives in the form of allocation mechanisms provide a voice in the tax system explicitly. Other types of tax incentives (deductions, credits, matches) could be framed in this way.

4.3 Happiness

As well as potential benefits to charity recipients, it is well recognized that act of spending or the decision to spend money on others generates good feelings, often called a warm glow (Andreoni, 1989, 1990). To what extent should tax incentives take account of personal benefits to individual donors? This is perhaps a philosophical question as much it is an economic one (Andreoni, 2006a).

According to the Haig-Simons ideal, warm glow from giving is outside the definition of social welfare; that is, the government should not count warm glow as part of social welfare even if donors care about warm glow when choosing donations. The argument is that the money a donor gives away rather than consumes is no longer the donor's income and should be taxed at the rate of the ultimate recipients' income, which in the case of poverty relief is likely zero, as argued by Diamond (2006). At the other end, Kaplow (1995) fully supports counting all warm glow in welfare, so even gifts to friends should be tax deductible for the giver. Steinberg, this volume, explores the implications of this argument, suggesting that there is a case for tax incentives to facilitate mutually beneficial donations that would otherwise not occur.

There are several reasons warm glow considerations do not belong in social welfare calculations. First, unlike utility from consuming 'real' goods and services, warm glow from giving is a 'decision utility' and may be affected by the context and framing of giving decisions. Andreoni (1995), for instance, finds giving depends significantly on whether the positive action is to choose how much to give (the remainder is not given) or how much to not give (the remainder is given), with the former giving more, despite having identical payoff spaces. Should these be treated differently? Second, there is evidence that fundraising creates social pressure and that people will pay to avoid it (Andreoni et al., 2017; DellaVigna et al., 2012). Does the warm glow from alleviating the guilt that fundraising creates count towards social welfare? It is also clear that some sources of warm glow from giving, such as personal reputation or prestige, have no social benefit and may create social harm by making others feel worse off. Should the billionaire

donor who enjoys personal satisfaction from endowing a fancy new university building receive a large tax benefit solely as a result? Andreoni (2006a) makes the case that if there is no compelling social interest argument for the donation itself, then the fact the donation has been made should have no effect on the calculation of the socially optimal level of the public good itself. The social welfare calculation should no more consider the additional utility from donating than the lost utility from other consumption foregone.

As discussed by Sellen (this volume), individual donors will consider the warm glow from donating in deciding whether and how to give – and in making trade-offs between donating and other spending. He explains that experiments show that spending on other people can generate more happiness than spending on oneself, as revealed by self-reported measures of happiness and he argues for promoting awareness of what he calls these “positive externalities”, but are personal benefits. What do these self-reports tell us? Kahneman and Deaton (2010) used happiness data to ask the question directly: Does money buy happiness? In brief, their answer is that money can relieve unhappiness but only for incomes reaching about the median household income in the area the respondent resides. Beyond that, association of income to happiness flattens out.

5 Large gifts

In this section, we briefly discuss large gifts, exemplified by donors who have made good on their Giving Pledge (<https://givingpledge.org/>). Launched in June 2010 by Warren Buffet and Bill and Melinda Gates, the Giving Pledge is a public commitment by billionaires, initially from the United States but now from 25 countries worldwide, to donate at least half of their wealth during their lifetimes. The site itself has information on the pledges rather than donations and whether the pledges have been fulfilled, but many Pledgers have given away billions of dollars. In recent years, large gifts have become increasingly important. Analyzing U.S. tax data, Duquette (2020) shows that in 1960, 9.8 per cent of potential donors gave half of all donations; by 2012, half of total giving came from just 1.8 per cent of potential donors. The increasing concentration is due both to a decline in the share of the population who gives and also an increase in the value of the largest gifts. Hungerman (2020) reports that the increase in giving concentration is steeper than the estimated increases in income inequality reported in the literature. Any discussion of tax subsidies for giving is therefore increasingly a discussion about tax subsidies for large gifts made by the very wealthy.

Following the COVID pandemic, which has brutally exposed global inequalities, there has also been an increased focus on the fact that just a handful of the world’s billionaires, who have seen their combined wealth increase by 20 per cent, have the capacity to tackle many of the major social problems that governments and the charitable sector are facing. For billionaire donors, there is no ‘public goods problem’ of coordinating contributions from many donors. Rather, billionaire donors have the resources to fund the whole of provision of some public goods/services individually. The head of the World Food Program USA recently called directly on billionaires to come forward to help tackle global food poverty, arguing that they have enough money (many times over) to solve the problem. The money spent by the Bill and Melinda Gates Foundation equals that of many individual countries – in fact, it is the around the same level as Office of Development Assistance spending by the Netherlands, the world’s seventh-largest donor country. Large gifts can also be used to make big investments in risky medical research that could be transformative. The increasing concentration in giving, and the growing importance of billionaire donors with the capacity for very large gifts, raises

fundamental questions about the implications for the charitable sector and also about what the appropriate policy toward large gifts is.

Tonin and Vlassopoulos (2018) present an interesting analysis of the Giving Pledgers. They show that, compared to the sample of all billionaires (defined by the Hurun Global Rich List), those who are self-made billionaires compared to those who inherited their wealth and those who are richer are more likely to pledge. Age and gender do not have an effect. Although Pledgers are more likely to be self-made billionaires, their giving narratives often refer to the 'luck' that they have experienced over their lives and a sense of wanting to give back and give others similar chances. Education – and the opportunities that education provides – is a common theme.

The giving narratives of Pledgers provide insights into their self-reported motivations for giving. In many respects, the motivations of Pledgers are similar to those of other givers (see also Andreoni et al., 2021). Many Pledgers refer to values that come from religion or from their personal upbringing. Joy-of-giving motivations are also important. Pledgers describe giving as providing happiness and satisfaction in a way that further material spending does not ('the more I do for others, the happier I am'). Perhaps different from regular donors, however, they see the (opportunity) cost of giving as low and perhaps effectively zero ('my family and I will give up nothing we need or want by fulfilling this 99% pledge'). Many explicitly say that they have no need for further material items and also see passing (a lot of) wealth on to their children as actively causing harm ('I do not believe that those who provide their offspring with luxuriously upholstered lives serve them well but rather saddle them with a terrible burden').

For major donors, however, a sense of agency and impact is more important than for regular donors (Kessler et al., 2019). Many Pledgers talk about translating methods and insights from their successful business careers to solving social problems ('I don't just write checks – we try to make the organizations we fund better. The results have been rather outstanding'). Not surprisingly, with the amount of money that they have to give away, many Pledgers talk about investing in solutions to problems rather than treating the symptoms ('I am not looking for band aids; I am looking for solutions').

As is the case for regular donors, preferences and personal passions are important in determining where large gifts are directed. One difference with large gifts is that each large gift has a bigger impact on the overall distribution. The evidence shows that richer donors – including the Pledgers – give to different charitable causes than do regular donors. Education, health, and the arts are the leading causes that are cited. This spread of causes contrasts with donors in the general population, who give a larger percentage of total donations to religious organizations than to any other subsector. The observed decline in the number of givers and an increasing concentration of giving is therefore likely to change the causes that benefit from donations, with a shift away from dominance by religious giving. Again, this is not an argument in itself to take away tax subsidies but to ensure that they are attached to charitable activities which are agreed to be genuinely in the social interest.

Should large gifts be treated differently by the tax system from regular donations? Currently many large gifts are likely to enjoy larger tax subsidies (per dollar), but only because they are likely to be made by higher-income donors who pay a higher marginal rate of tax, not because of the size of the gift per se. In many countries (see Table 9.1), larger donations may also be capped in terms of the relief they get if they exceed annual tax-free donation limits. There is a tax-efficiency argument for more generous tax treatment of large gifts are more sensitive to tax incentives. Studies that explore heterogeneity by income show that the tax-price elasticity is greater for high-income donors, which would justify a greater subsidy if the sole objective

were to maximize the size of the (income) pie for charities, albeit for higher income donors, not larger gifts per se.

Hungerman (2020) makes an explicit argument for giving greater subsidies to large gifts if giving is more concentrated. The intuition behind his argument that increasing large gifts will have fewer negative crowd-out effects in a system where giving is more concentrated and large gifts account for a greater share of total giving. The argument may be stronger still with evidence that large gifts from well-known billionaire donors crowd *in* other gifts by acting as a signal of quality (Vesterlund, 2006; Andreoni, 2006b; Karlan and List, 2020), although this argument applies to donations to a single charity rather than aggregate donation. In particular, it may be more about influencing the allocation of the pie rather than growing the pie.

Looking at the income pie only tells part of the story, and it is important to also look at what the donations are funding – and the social welfare that is generated. Many large gifts appear to be motivated to maximize the prestige (and other personal benefits) to the donors. This applies to the praise that is given for major philanthropists' giving (in aggregate); billionaire donors are now rightly being challenged for flaunting their philanthropy while doing everything they can to avoid paying tax on their business activities. However, even if they do pay all the tax that is due, many of the world's billionaires could still afford to give away huge sums of money. Much criticism by the effective altruism movement is of large donations made to cultural and higher education institutions, which seem to have little to do with wider social benefits. There is also criticism of donor advised funds, which allow donors to claim tax benefits up front – including benefits of avoided capital gains taxation – and pay money into a fund which may not be disbursed and may do no social good for many years (Andreoni, 2018).

Many of the narratives provided by those making the Giving Pledge focus on the desire to achieve impact. According to the analysis by Tonin and Vlassopoulos (2018), this is by far the most prevalent theme in their narratives. Reich's discovery case for subsidizing philanthropy (that is, promoting a plurality of organizations in order to build capacity for social innovation) likely applies more to large gifts than to smaller donations, since the latter will typically go to established organizations with fundraising capacity. Large donations can be used for risky investments with the potential for large pay-offs, such as investment in medical research. This type of funding may be particularly important in a sector where borrowing to invest may be difficult. Many large gifts also go to political/advocacy organizations, such as investing in ways intended to sustain a vibrant civic society. This evidence suggests that large gifts can generate sizeable social benefits, which would justify some subsidy. However, transparency and accountability are important where such large sums, including of public funding, are involved.

6 Discussion

Tax incentives are a key policy tool that governments have to affect the level and composition of donations to charities. There has long been a focus in economics on estimating tax-price elasticities, but responses to tax incentives will be affected not only by the tax-price but also by the design and framing of tax incentives. Relevant factors are likely to include salience, fixed costs, minimum thresholds, social norms, and social information. These are important design features for policy makers to consider.

The design and scope of tax incentives should aim to maximize social benefit while also giving a voice to citizens. The definition of social benefit goes beyond channeling giving to the (currently measurable) most cost-effective charities and encompasses a 'discovery case' for supporting a plurality of organizations offering the possibility of a wide range of benefits and longer-term innovation. By allowing citizens to have a say in the allocation of some government

funding via tax-subsidized donations, governments may also help to build support for tax/spending more generally. To date, there has been little discussion of these wider externalities, but understanding what it means to have a healthy charitable sector and a strong civil society – and the role of tax subsidies in that – is an important topic for discussion (see Lohse and Scharf, this volume).

Tax credits, rather than deductions, offer a way to give citizens equal voice. On social efficiency grounds, it is not clear that there is a case for offering greater tax subsidies (per dollar) for large gifts, not least since the opportunity cost of donating for the very wealthy is practically zero. The case for giving a subsidy is that large gifts have the potential to achieve big social benefits, particularly when used in ways that small donations cannot be to fund higher-risk/reward projects. If there is concern about the purpose of large gifts, the government can use tax subsidies to direct large gifts to causes where they will have maximal positive benefit, although there is a risk of excessive political interference. No matter the policy, however, ensuring transparency around large gifts and a degree of accountability is clearly important to include. The current trend towards increased use of donor advised funds works against this. A first step would be to focus as much attention on the donations that deliver on the Pledges as on the Pledges themselves.

Note

- 1 https://www.unige.ch/conference-philanthropy-taxation/files/4616/0646/4944/Full_report_oecd-taxation-and-philanthropy.pdf

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