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The Economics of Giving

In America, charitable giving is a thriving multibillion dollar enterprise, as illustrated in the accompanying chart. Most charitable contributions arise from the generosity of individual donors. In fact, the Giving USA Foundation estimates that individuals gave almost $188 billion to charities in 2004 (a 175 percent inflation-adjusted increase from 1964).[1]

Generosity is particularly evident after unexpected disasters. In September 2005, for example, the American Red Cross received about $807 million in gifts and pledges earmarked for Hurricane Katrina relief efforts—an increase of about $250 million over total Red Cross contributions during the 2003-04 fiscal year (www.redcross.org/news/ds/hurricanes/katrina_facts.html).

Economists analyze the motivations behind individual giving to better understand how contributions are influenced by demographic characteristics, tax policies, and fundraising behavior. A fundamental issue of this analysis is the nature of the benefits that individuals receive when they give to charity. A recent study summarizes two alternative views.[2]

First, donors may focus on the well-being of charity recipients. In this case, the benefits from giving have a public nature. If the well-being of recipients is tied to the charity's activities (the provision of disaster relief or the funding of cancer research), donors derive benefits from giving in the same way they derive benefits from public goods such as national defense. That is, a donor cannot exclude anyone else from enjoying the charity's accomplishments; also, a donor's enjoyment is not affected by the enjoyment or benefit derived by others.

Second, donors may focus on the enjoyment they receive from the act of giving itself—that is, the internal feeling they derive from "doing their share" or "giving back to society." Donors may also care about public recognition or about signaling wealth status. In these cases, the benefits from giving have a private nature. Individuals derive satisfaction from giving in the same way they derive benefits from consuming other private goods or services, such as clothing or food.

These two motives for giving (public and private) have entirely different implications on giving behavior. Donors who experience public benefits look at the overall amount of charitable contributions, and donors who experience private benefits look only at their own contributions. If a donor's benefits from giving are public, then a total contribution of $100 gives him the same sense that good is being done, even if his own contribution is $10 or $20. On the other hand, if a donor's benefits from giving are private, a contribution of $20 generates more satisfaction than a contribution of $10, even if the total contribution is $100 either way.

Economists predict that, according to the public benefits view, government subsidies to charities that are funded with increased taxes on donors will have no effect on the total contribution. This is because donors will reduce their private contributions by the same amount of the tax because they do not care whether they are giving on their own or indirectly through the tax. In other words, government grants to charities will completely crowd out private contributions. If donor benefits are entirely private, there should be no crowding out because donors do not care about the total amount of contributions, only about their own.

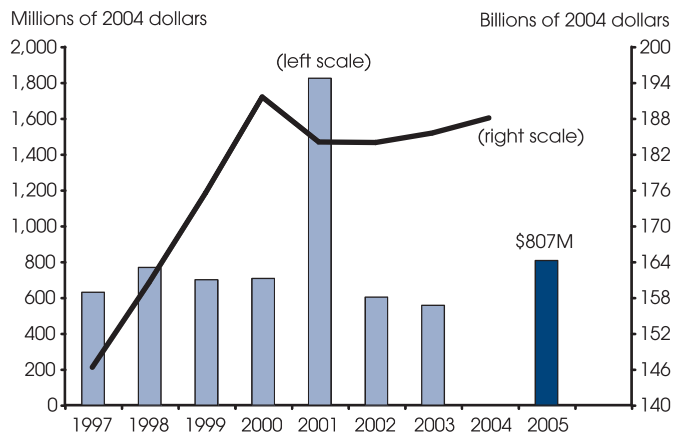
Empirical studies have found only limited crowding out, suggesting that most donors are not solely concerned with the charities' accomplishments, regardless of the source of contributions; instead, private motivations, such as the joy of giving or recognition, play an important role in their giving decisions.

—Rubén Hernández-Murillo

[1] Center on Philanthropy at Indiana University. "Giving USA 2005: The Annual Report on Philanthropy for the Year 2004," Fiftieth Edition.

[2] Vesterlund, Lise. "Why Do People Give?" in Richard Steinberg and Walter W. Powell, eds., *The Nonprofit Sector*, Second Edition. New Haven, CT: Yale University Press, forthcoming June 2006.

Charitable Contributions



Red Cross contributions (▭) are from IRS Forms 990 1997-2003, available from www.GuideStar.org.

■ Pledges to the Red Cross Earmarked for Katrina

— Total Contributions to All Charities from Individuals