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Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals

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Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals

DAVID M. SCHIZER*

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Introduction

The charitable deduction has enjoyed relatively little support in the legal academy. Many commentators have asked what it adds to the tax system and, as critics such as Stanley Surrey and Paul McDaniel have observed, the deduction obviously does not itself collect tax revenue.[1] Defenders respond that the deduction helps to measure income and to keep taxpayers from inefficiently substituting leisure for

[1] Stanley S. Surrey & Paul R. McDaniel, Tax Expenditures 205 & n.32 (1985); Paul R. McDaniel, Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction, 27 Tax L. Rev. 377, 390 (1972).

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work, but these points are, of course, contested.[2] Instead of revisiting debates about what the deduction adds to the tax system, this Article focuses on the broader question of what it adds to the pursuit of public goals. The deduction—and any other government subsidy that matches charitable contributions through the tax system (here called "subsidized charity")—enlists private individuals to pursue public goals in a somewhat unique manner. While in other settings the government delegates implementation but still specifies the goal to be pursued,[3] charitable donors are allowed to select the goal as well.[4] Is it desirable to pursue public goals in this way?[5]

This is very much a live controversy since President Barack Obama recently proposed to scale back the deduction for charitable contributions (as well as other itemized deductions) as a way to raise revenue.[6]

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[2] William Andrews argues that money the taxpayer gives away, and thus does not consume, should not be considered her income. William D. Andrews, Personal Deductions in an Ideal Income Tax, 86 Harv. L. Rev. 309, 314-15, 346 (1972). In response, Mark Kelman argues that giving money away is something a taxpayer chooses to do, so this money should be considered her income. Mark Kelman, Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World, 31 Stan. L. Rev. 831, 833-34 (1979); see also Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants? 28 Tax L. Rev. 37, 59-60 (1972) (noting that charitable deduction is needed to create parity in tax treatment of those who donate money and those who donate time); Peter Diamond, Optimal Tax Treatment of Private Contributions for Public Goods with and Without Warm Glow Preferences, 90 J. Pub. Econ. 897, 901 (2006) (arguing that charitable deduction allows marginal rates to be higher by keeping taxpayers from substituting leisure for work).

[3] Examples include government contracting (for example, to build a new weapons system), regulation (for example, to reduce pollutants), or targeted tax benefits (for example, to promote education).

[4] Donors can choose from a very broad range of public goals. "The exempt purposes set forth in section 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term charitable is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency." IRS, Exempt Purposes—Internal Revenue Code Section 501(c)(3), Jan. 5, 2009, http://www.irs.gov/charities/charitable/article/0,,id=175418,00.html.

[5] The literature focuses on public goods such as clean air, which are undersupplied because they can be enjoyed even by those who do not pay for them. But this Article uses the broader phrase "public goals" because other market failures require government intervention as well—to redistribute wealth, operate natural monopolies, and address imbalances in information, among others.

[6] President Obama has proposed limiting the deduction so that donors can reduce their taxes by at most twenty-eight cents for every dollar that they contribute, even if their marginal tax rate is higher than 28%. Office of Management and Budget, Budget of the United States Government, Fiscal Year 2010, Jumpstarting the Economy and Investing for the Future 29 (2009) ("The Administration's Budget includes a proposal to limit the tax rate at which high-income taxpayers can take itemized deductions to 28 percent. . .").

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In response, this Article analyzes three justifications for the deduction, each responding to a different information or incentive problem that is inherent in the pursuit of public goals. First, the subsidy can counter free riding by encouraging donors to be more generous. This goal is familiar,[7] but novel applications are explored here. A second objective is to measure and respond to popular preferences about public goals. Subsidized charity can encourage experimentation and competition and can empower minority perspectives that are underrepresented in the political process. Yet subsidized charity also disproportionately represents the views of wealthy donors. While this Article draws on prior work in delineating these competing considerations,[8] the analysis here offers new insights and institutional design responses. The third goal is to recruit private donors to monitor the quality of nonprofits, so that the government can piggyback on these quality-control efforts. This goal is new to the literature, as are the institutional design alternatives offered to enhance it.

Since there are three competing rationales for the subsidy, its institutional design can vary depending upon which has priority—a tension that, to my knowledge, is new to the literature. To encourage generosity, the subsidy should focus on wealthy donors, giving them broad discretion about which causes to support and targeting marginal contributions. Recruiting these wealthy donors as monitors is largely compatible with this program. Yet by focusing on wealthy donors, the subsidy may fail to reflect broad popular preferences. In response, one option is to compensate with other policy instruments, such as government programs, to address the preferences of low-income nondonors. While I find this approach appealing, others reasonably could want subsidized charity itself to be more representative. Toward that end, we could go to extra lengths to persuade low-income

[7] See Mark Gergen, The Case for a Charitable Contributions Deduction, 74 Va. L. Rev. 1393, 1398-406 (1988) (justifying charitable deduction in part as response to free riding); Evelyn Brody, Charities in Tax Reform: Threats to Subsidies Overt and Covert, 66 Tenn. L. Rev. 687, 747 (1999). There is also a burgeoning economics literature on why individuals give to charity, and whether a charitable subsidy will increase or decrease private giving. See generally James Andreoni, Philanthropy, in Handbook of the Economics of Giving, Altruism and Reciprocity 1201, 1230-48 (Serge-Christophe Kolm & Jean Mercier Ythier eds., 2006) (surveying literature), available at http://www.sciencedirect.com/science/handbooks/15740714 (follow "Chapter 18 Philanthropy" hyperlink; then follow "PDF (664 K)" hyperlink); Gerald F. Auten, Charles T. Clotfelter & Richard L. Schmalbeck, Taxes and Philanthropy Among the Wealthy, in Does Atlas Shrug? 392, 414-17 (Joel B. Slemrod ed., 2000).

[8] See Saul Levmore, Taxes as Ballots, 65 U. Chi. L. Rev. 387 (1998) (defending charitable deduction as a way to circumvent public choice problems that arise when the government allocates funding); Burton A. Weisbrod, Toward a Theory of the Voluntary Nonprofit Sector in a Three Sector Economy, in The Economics of Nonprofit Institutions 21, 30-31 (Susan Rose-Ackerman ed., 1986) (defending charitable deduction as empowering minorities to pursue public goals that majoritarian political processes would not endorse).

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taxpayers to contribute more (for example, through extra-generous matches) or, for that matter, to induce wealthy donors to contribute less (for example, through caps on giving) or to support causes that reflect broad popular consensus (for example, through limits on which causes are subsidized). Yet the cost of making the subsidy more representative in this way is that it will be less effective at advancing the other goals of encouraging generosity and recruiting monitors.

Part II offers a justification for subsidizing charity, rooted in problems of information and incentives. Part III considers the goal of encouraging generosity and institutional design alternatives for doing so. Part IV explores the goal of representing preferences, as well as associated tradeoffs and institutional design alternatives. Part V analyzes the goal of recruiting private monitors, as well as the tradeoffs and institutional design options it involves. Part VI is the conclusion.[9]

II. The Externalities of Giving and the Challenges of Information and Incentives

It is well understood that contributions to charity generate positive externalities that justify a commitment of public resources. Yet it does not necessarily follow that subsidized charity is the best means to deliver these public resources, instead of alternatives such as tax-supported government programs. If a cause is worthwhile, why shouldn't the government simply pursue it directly? Why use subsidized charity? This Part previews three reasons, each of which addresses problems of information and incentives that burden competing policy alternatives.

A. *Externalities of Charitable Giving*

Gifts of all sorts—not just charitable gifts—generate positive externalities.[10] For instance, if a grandmother gives her grandson $1000, the grandson will enjoy spending this money, and the grandmother derives separate satisfaction from this gift. Feelings of altruism induce the grandmother to be happy whenever her grandson is happy. This is true whether or not the grandmother is the cause of this happiness; indeed, if her grandson finds the cash in the street, an altruistic grand-

[9] Given the breadth of this topic, a number of issues are not considered. There is no discussion of in kind giving or split-interest giving, and only passing reference (mostly in footnotes) to the gift and estate taxes, special issues associated with foundations, the tax exemption of nonprofits, and the question of what qualifies as a public goal (and thus the boundary between nonprofits and for-profit firms).

[10] See Louis Kaplow, Tax Policy and Gifts, 88 Am. Econ. Rev. (Papers & Proc.) 283, 284 (1998); Louis Kaplow, A Note on Subsidizing Gifts, 58 J. Pub. Econ. 469, 469-70 (1995) (discussing double utility associated with gifts).

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mother still feels joy in her grandson's good fortune. In addition, the grandmother may feel additional satisfaction from knowing that she is the one who made this gift, a sensation separate from altruism that economists call "warm glow."[11]

In deciding whether to make a gift, the grandmother undercounts the utility it generates. The problem, as Louis Kaplow has shown, is that she does not fully account for her grandson's utility.[12] His happiness should be double counted since it makes two people happy (both the grandmother and grandson), but instead his happiness is counted only once (just through the grandmother's feelings about his happiness). Thus, gifts generate positive externalities, since the donor does not fully account for the donee's utility when making a gift.

A charitable gift is like any other gift in this respect, as Kaplow has emphasized.[13] In addition, charitable gifts present other welfare benefits. First, they are likely to support public goods, so this means that the cause being funded is broadly valued. Not only do the donor and the donee derive utility, but also free riders who are pleased to know that a cause they value is being supported, even if they do not support it themselves. Second, charitable gifts often involve redistribution, which enhances welfare since donees tend to be less wealthy than donors and thus have greater need for the money. Third, donors derive satisfaction in contributing labor, as well as money, and sometimes find community and recognition through the nonprofits they support.[14]

On the other side of the ledger, charitable giving can lead to welfare losses as well. Donor motivations are complex and in some cases the satisfaction from giving is limited. Peter Diamond and James Andreoni offer the example of someone who gives to an aggressive panhandler in order to end the unpleasantness of the solicitation.[15] Yet I suspect this motivation is unusual in other settings, if only because there are painless ways to refuse a solicitation. It is perfectly easy to explain that one has other commitments, leaving no capacity for another gift even to a worthy cause. Indeed, sometimes people derive perverse satisfaction from refusing a solicitation, using the opportu-

[11] E.g., Louis Kaplow, The Theory of Taxation and Public Finance 261 (2007).

[12] Id. at 253.

[13] Id. at 270-74.

[14] For example, religious institutions continue to be hubs of communal life for many people. Especially among wealthy people, boards and social activities of museums, educational institutions, and hospitals offer a social network and a sense of community.

[15] Diamond, note 2, at 909; Andreoni, note 7, at 1225.

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nity to articulate reservations about the cause.[16] Even so, Diamond and Andreoni's critique reminds us of the need to consider context.[17]

Donees and free riders may experience welfare losses as well. Although receiving a gift generally makes donees better off, they may feel some resentment, and also may become less motivated to work.[18] Again context is important, though, since some gifts may actually enhance the donee's ability to work, such as charitable support for education or health care. The reactions of free riders also can prove complex. While they may be pleased that a cause they value is attracting support, as noted above, they may also envy the recognition the donor receives for the gift.[19]

The net of these various effects determines which social investments give rise to the greatest positive externalities, and thus justify a commitment of the most resources. As a normative baseline, welfarists generally want each public goal to be supported to the extent that it is valued, in the aggregate, by individual members of society. This "Lindahl solution," as it is called, simulates what the market would supply in the absence of market failure.[20] Although this Article generally uses the Lindahl result as the baseline, other baselines obviously are plausible as well, such as a Rawlsian approach that favors the preferences of the least well off.[21]

B. *Why Rely on Subsidized Charity Instead of Alternatives?*

The Lindahl solution (and any other baseline) can be pursued through various institutional arrangements, including government regulation, government programs (whether at the federal, state, or local level), government grants to for-profit firms and nonprofits, targeted tax credits for specific public goals, and the like. Why, then, should we rely on subsidized charity?

To answer this question, we should determine which approach is more efficient and more equitable. Which is less likely to be resisted

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[16] It may be more difficult to say "no" to friends, but if there is an implicit quid pro quo—we give to a friend's charity, and in return they give to ours—then we are really making an indirect contribution to our own preferred cause.

[17] Diamond and Andreoni go further, suggesting almost as a matter of principle that it is never appropriate to factor a donor's "warm glow" in the social welfare function. See Diamond, note 2, at 915-17; Andreoni, note 7, at 1224-27. But this goes too far. Obviously, many donors derive great joy from their donation, and this satisfaction should not be dismissed as irrelevant.

[18] Kaplow, note 11, at 254.

[19] Tomer Blumkin & Efraim Sadka, A Case for Taxing Charitable Donations, 91 J. Pub. Econ. 1555, 1556, 1563 (2007).

[20] For a discussion of the Lindahl solution or benefit pricing, see Gergen, note 7, at 1400-01.

[21] See John Rawls, A Theory of Justice 75 (1971).

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by potential funders, so that they will not change their behavior in inefficient ways? Which generates lower administrative costs? Which allocates money more reliably to high-value public goals? Another important set of questions asks which approach is more consistent with our distributional goals and our notions of democratic legitimacy.

To make these judgments, we need to look for notable differences between subsidized charity and its alternatives. Yet as an initial matter, it is worth emphasizing that, at least in theory, the differences may be quite limited. In a hypothetical world of perfect information and incentives, at least, government programs and nonprofits should yield the same results (as, indeed, would the market). After all, the decision of how much of the economy to devote to public goals is made by the same people—whether individually as donors or consumers or collectively as taxpayers—and, in a world of perfect information and incentives, the decision ought to be the same in either setting. Likewise, these same people decide which goals to support, and in this idealized environment the institutional context should not affect this choice. Either their government representative will accurately assess collective sentiment and will faithfully translate it into the relevant programs, or individuals will band together on their own to pursue the same goals. Finally, the implementation of these public goals should be of equal quality—whether conducted by government or private employees—because, by assumption, each workforce is perfectly informed and motivated.

The goal of this thought experiment is not to prove that it is irrelevant whether we use subsidized charity or an alternative. On the contrary, in the spirit of Coase and Modigliani and Miller,[22] the goal is to show why this institutional design choice really does matter by showing how unrealistic the premises have to be in order for it not to matter. If we need to make heroic assumptions about information and incentives in order to render institutional design unimportant, then we know that information and incentives have to be a central preoccupation in determining whether to rely on subsidized charity.

C. *Information, Incentives, and the Case for Subsidized Charity*

Indeed, information and incentives lie at the heart of three challenges that arise in pursuing public goals, whether through subsidized

[22] See generally R.H. Coase, The Problem of Social Cost, 3 J. L. & Econ. 1 (1960) (arguing that legal rules would not matter in a world with no transaction costs because parties would bargain around the rules); Franco Modigliani & Merton H. Miller, The Cost of Capital, Corporation Finance and the Theory of Investment, 48 Am. Econ. Rev. 261 (1958) (arguing that capital structure would not matter in a world of perfect information and no transactions costs).

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charity or in other ways: securing funding, allocating this funding among competing public priorities, and monitoring quality. A subsidy for charitable contributions has unique advantages in addressing these challenges. Yet there are disadvantages too, as well as tensions among the three goals, such that institutional design is important in managing tradeoffs.

1. *Encouraging Generosity*

The first goal is to raise money. The familiar problem here—in both tax collection and charitable fundraising—is that potential funders sometimes free ride, withholding support even from programs they favor, hoping others will pick up the slack. Free riders depend on imperfect information, since their true ability to pay (in the case of taxes) and their true level of generosity (in the case of charity) can be concealed, at least in part. In response, a familiar rationale for subsidizing charitable contributions is to persuade donors to be more generous.

2. *Reflecting Preferences*

A second challenge that arises in pursuing public goals, whether through subsidized charity or in other ways, is that there is imperfect information about which causes should be supported.[23] We do not know enough about popular preferences or about which emerging approaches or technologies are the most promising means to fulfill these preferences. Those who claim to have this information, moreover, may be motivated to misstate the facts. Does someone who is touting a new approach to educating teenagers really believe that she will succeed, or is she merely seeking a donor- or government-supported sinecure?

An important institutional design goal, then, is to funnel the subsidy toward high-value projects. In response, subsidized charity can serve as a means for identifying and reflecting popular preferences, since the government invests money only when individual donors do so as well. In a sense, donors are voting with their dollars. Whether individual donors are making this decision (as in subsidized charity) or government processes are doing so (as is the case with most policy alternatives), flaws in the process will lead to an overinvestment in some public goals and an underinvestment in others (as measured against the social welfare function that is the baseline). "Allocation

[23] There is a familiar parallel problem with gifts among family and friends. Donees sometimes value gifts at less than their cost. See Joel Waldfogel, The Deadweight Loss of Christmas, 83 Am. Econ. Rev. 1328, 1328 (1993).

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error" is used here to describe the welfare cost of these misallocations. As an example, assume that an eccentric donor uses a nonprofit to build a museum on the history of ketchup—or, for that matter, an eccentric member of Congress secures an earmark to build one in his district. Allocating public money to this low-priority project, instead of a high priority such as feeding hungry children, creates a welfare cost. Minimizing this sort of allocation error is an important goal in designing a subsidy for charitable contributions.

3. *Monitoring Quality*

Third, imagine that a soup kitchen opens too late in the morning—missing the opportunity to serve breakfast—because its manager likes to sleep late. Unlike the ketchup museum, the problem here is not with the goal, but with the way it is pursued. As in any other setting, agents are tempted to shirk or to behave self-interestedly, and principals may not have enough information to know they are doing so. "Implementation error" is used here to describe the welfare costs from poor or costly administration. Minimizing this sort of error is a third objective in designing a subsidy for charitable contributions.

* * *

To what extent can a subsidy for charitable contributions deliver on these goals, and at what cost? I turn now to a discussion of each of these goals, the tradeoffs they present, and institutional design options for mitigating these tradeoffs.

III. ENCOURAGING GENEROSITY

The fact that charity is voluntary gives rise to a tradeoff: Donors enjoy giving to charity more than they enjoy paying taxes (because charity is not compulsory) but, unfortunately, they do not give enough (again, because charity not compulsory). A familiar reason to subsidize charitable contributions is to address this incentive problem by encouraging donors to be more generous.

A. *The Tradeoff in Relying on Volunteers for Funding*

1. *Donor Satisfaction from Giving*

A great advantage of relying on charitable contributions is that they are given voluntarily, and thus avoid some of the welfare costs of (compulsory) taxation. In generating utility for both the donor and the donee—so-called "double" utility—charitable contributions avoid the familiar problem of excess burden from taxation, which arises

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when taxpayers make wasteful changes in their behavior to avoid paying taxes. Indeed, the ability to deduct charitable deductions actually may reduce the excess burden from taxation, as Peter Diamond has claimed, by inducing taxpayers to work harder without having to pay taxes on the extra income they earn (that is, as long as they give it to charity).[24]

Creating this double utility is not a frictionless process, as donors must find charities that they enjoy supporting. Solving this information problem is the role of professional fundraisers, who help pair donors with programs they would enjoy funding that are also high priorities for nonprofits. In effect, fundraisers are "double utility engineers."[25] Obviously, there are administrative costs associated with this effort, both for nonprofits (for example, the time of managers and fundraisers as well as the cost of events, mailings, and the like) and for potential donors (for example, time and effort reviewing solicitations). Containing these costs is desirable, and it is worth knowing how they compare with the administrative costs of a tax increase.

There also may be a qualitative difference, beyond any quantitative one, between tax collection and charitable fundraising. The latter can have collateral educational and community building benefits. For example, when a zoo or museum hosts a benefit or sends a brochure informing the public about its activities, it is providing entertainment and information that is likely to be appealing to many people. Would anyone say the same of Form 1040 or a tax audit?[26]

2. *Free Riding and the Need for a Subsidy*

Nevertheless, charity has the disadvantage of raising only a limited amount. As noted above, even those who value a public goal may look to others to pay for it when the benefits of a goal are widely shared.[27] A familiar response to free riding is a government subsidy, which forces nondonors to give their support through taxes they pay.

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[24] Diamond, note 2, at 901.

[25] Cf. Ronald J. Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 Yale L.J. 239, 253-56 (1984) (lawyers as "transaction cost engineers").

[26] Perhaps the best analogy to a nonprofit's fundraising costs are the advertising expenses incurred in the for-profit sector, which might be either informative or wasteful depending upon the context. See William S. Vickrey, One Economist's View of Philanthropy, in Philanthropy and Public Policy 31, 55 (Frank G. Dickinson ed., 1962) ("The pursuit of the contributor's dollar has obvious external economies and diseconomies not greatly dissimilar to those encountered in any kind of selling activity."). Meanwhile, even a Form 1040 can have some value aside from its role in tax collection, for example, as financial disclosure to a taxpayer's creditor. I am indebted to Brian Galle for this point.

[27] The charitable sector cannot command enough resources to fund all of society's public goals; it represents only 6% of our economy compared with over 30% for the government. See Auten, Clotfelter & Schmalbeck, note 7, at 392.

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If some would-be donors are discouraged from giving because they do not want others to free ride on their generosity, then a subsidy reassures these donors about giving. This is especially true if the subsidy is structured as a match so that, in giving their own money, donors can direct tax revenue to their preferred cause as well.[28]

Of course, it would be counterproductive if donors have the opposite reaction, responding to a subsidy by reducing their giving. Since others are giving, they may feel that they are off the hook.[29] This reaction is likely for donations motivated by altruism (such that the donor wants the cause to be supported, but does not care if she is the one supporting it), but not for donations motivated by warm glow (such that the donor cares that she herself is the source). The precise effect obviously is an empirical question, and the vast literature on the subject shows that tax subsidies do increase the level of contributions, but by less than once was thought.[30] There is clearly room for improvement on this dimension.

While we want to increase the volume of charitable contributions—something a properly structured subsidy can do—we obviously also want to preserve the double utility benefit too. When contributions are subsidized, do donors still feel enthusiasm for contributing? The double utility benefit is not as robust for marginal contributions, since these are gifts that donors otherwise would not have made. Yet donors still derive some utility from these gifts or they would not make them (that is, as long as the subsidy is less than 100%). The donor

[28] In the public finance literature, solutions to free-riding problems tend to link the giving of each donor to the giving of the others. For example, Mark Bagnoli and Barton Lipman posit that the free-riding problem is solved if everyone's gift is conditioned on the fact that everyone else must give; if even one person does not give, then everyone else receives a refund. Mark Bagnoli & Barton L. Lipman, Provision of Public Goods: Fully Implementing the Core through Private Contributions, 56 Rev. Econ. Stud. 583, 584 (1989). In the same spirit, Todd Sandler and John Posnett theorize that donors are more likely to give if they believe that, in giving, they are likely to prompt others to give. Todd Sandler & John Posnett, The Private Provision of Public Goods: A Perspective on Neutrality, 19 Pub. Fin. Q. 22, 24 (1991).

[29] Using this logic, Peter Warr has proposed a "neutrality theorem," positing that subsidies to charity will not affect the level of giving since government support will perfectly crowd out private donations. Peter G. Warr, The Private Provision of a Public Good Is Independent of the Distribution of Income, 13 Econ. Letters 207, 208 (1983). This influential article spawned a host of theoretical papers developing and critiquing this result. For example, one problem with Warr's theory, pointed out in a widely cited piece by Bergstrom, Blume and Varian, is that a subsidy can still increase giving on a net basis by tapping nondonors. See Theodore Bergstrom, Lawrence Blume & Hal Varian, On the Private Provision of Public Goods, 29 J. Pub. Econ. 25, 27 (1986).

[30] Early studies showing a larger effect failed to filter out effects on timing and thus tended to overstate the impact on overall giving. Auten, Clotfelter & Schmalbeck, note 7, at 417 (reporting new study with implied income elasticities of 0.41 and 0.43).

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also may derive utility from being able to direct government money to her preferred cause as well.[31]

B. *Institutional Design: Constraints on Donor Choice*

How should the subsidy be structured if the goal is to encourage generosity? Three issues are considered in this Section and the next two: First, how free should donors be to choose the cause they want to support? What constraints, if any, should there be on this choice? Second, how should the subsidy be distributed among donors with different incomes? Should it focus especially on wealthy donors? Third, how should the subsidy be structured? How much should be given per dollar of charitable contribution? Should this level be constant across all contributions, or should it change as giving increases?

The best way to encourage generosity is to give donors the broadest possible latitude about which causes to support. People are more likely to support causes that move them, so if the goal is to increase the overall level of support (without regard to what is being supported), we ought to let donors choose.

There is, however, one important constraint: We need to be sure the contribution is genuinely charitable, and is not a disguised purchase of goods or services (which obviously would not generate the same positive externalities). This is not a new insight, and current law already polices this line through the private benefit doctrine, as well as the requirement that charities disclose the value of goods or services provided to donors, and the like.[32] This concern also helps explain why gifts to private individuals are not subsidized, even though they can also generate positive externalities, as noted above. It probably is too difficult to police whether a payment to a private individual is a gift or part of an exchange.

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[31] The extent to which this is the case, if at all, obviously depends on the donor's utility function. Louis Kaplow suggests that warm glow donors would not derive any utility from the government's share of their contribution, since the whole idea of warm glow is that the donor values the fact that the contribution comes from her. Kaplow, note 11, at 261-63. Yet one can imagine donors who are happy to be "the source" of the contribution in the sense that it happened because of their choice, even though it did not come from their pocket. An analogy here is the pleasure that a trustee of a foundation takes in allocating funds to a cause, even if the trustee is not the donor of the foundation's assets. To my mind, this feeling of agency also should be considered warm glow.

[32] See IRC § 501(c)(3) (containing private inurement prohibition) and § 170(f)(8)(B) (requiring disclosure of any goods or services provided for contributions and a good faith estimate of the value of such goods or services).

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C. *Institutional Design: Distribution*

A further institutional design choice is whether to focus subsidy dollars on a particular subset of the population, or to spread them evenly. If the goal is to encourage generosity most effectively—or, to be more precise, to maximize the overall level of contributions induced by a given subsidy expenditure—then the focus should be on high-income donors.[33] Empirically, their charitable giving is the most tax-sensitive, and this is not surprising. It should cost less to induce a high-income donor to give a dollar in charity than a low-income donor, since the opportunity cost in welfare terms is higher for a low-income donor, given the diminishing marginal utility of consumption. For instance, it might require a subsidy of fifty cents to persuade the high-income donor to donate a dollar, compared with a subsidy of a full dollar for the low-income donor.[34] Subsidy dollars concentrated at the upper end, then, will induce more contributions.[35]

As a matter of distributional justice, an appealing aspect of encouraging charity from the wealthy is that it induces them to increase their support of public goals. Since charity tends to be redistributive, we are promoting voluntary redistribution, while also placing public burdens on those best able to bear them. Even so, it is difficult to analyze the distributional impact of the charitable subsidy in isolation. Obviously, the rate schedule has a pronounced distributional effect, and it can be set in combination with the charitable subsidy, however structured, to achieve the overall objective we seek. For instance, one possible critique of focusing the charitable subsidy on the wealthy is that they will disproportionately enjoy the consumption component of subsidized charity—that is, the pleasure of making subsidized gifts. But

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[33] In this spirit, the charitable deductions in the estate and gift taxes are relevant only to very wealthy people—since only they are subject to these taxes (assuming the incidence of the tax is on decedents as opposed to heirs). While a discussion of whether these taxes are justified is beyond this Article's scope, it is worth noting that an advantage of current law is that the focus of the deduction in the estate and gift taxes is on very wealthy people, and that this may be a relatively effective way to encourage generosity. It is worth noting, moreover, that donor utility from making bequests may vary with the reason for the bequest. So-called "precautionary savers" who saved more than they needed and leave these assets to a charity may derive relatively little utility from these inadvertent bequests.

[34] Jeff Strnad, The Charitable Deduction: A Politico-Economic Analysis, in The Economics of Nonprofit Institutions, note 8, at 265, 265 (noting that absolute value of price elasticity increases with income).

[35] There is an irony, then, in the fact that a deduction is currently used in our income tax, instead of a credit. With a deduction, the subsidy per dollar obviously increases with income (in allowing the taxpayer to avoid a higher marginal tax). It does not make sense to offer a more generous subsidy per dollar to wealthy people, since they probably could be persuaded to give with a lower subsidy per dollar, on average. Even so, the subsidy can still be structured as a deduction if the amount per dollar is appropriate for high-income taxpayers. If that is the case, then chances are it is too low for low-income taxpayers, such that the subsidy focuses on the wealthy, for the reasons noted above.

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this does not raise any distributional issue if they "pay for" this consumption benefit through the rate structure. Toward this end, the charitable subsidy can be financed through an increase in the top bracket, as Jeff Strnad has shown.[36]

A different distributional concern, though, is that subsidized charity can give wealthy donors disproportionate influence in deciding which public goals are pursued with tax dollars. As shown in Part IV, there are ways to diminish this influence, but at the cost of encouraging generosity less effectively.

D. *Institutional Design: Structure*

I turn now to the "structure" of the subsidy, a term used here to refer to the trigger for the government contribution, and how this trigger changes in different circumstances.

1. *Matching*

If the goal is to encourage generosity, the subsidy should be structured as a match, so that it is triggered by private contributions. In other words, the government should invest in a nonprofit only if private donors also are doing so. This is an obvious virtue of the charitable deduction under current law.

Yet there is a significant tax benefit for charity, wholly separate from the tax deduction, that does not have a matching component: the exemption of nonprofits from federal and state income tax. A nonprofit can enjoy these benefits without collecting a single dollar from a donor. These benefits do not reward charities for fundraising, but for running a surplus. To see the point, consider two charities, *A* and *B*. *A* has a $10 million budget, which comes entirely from private donations, and *A* spends every dollar it raises on its programs. Since *A* has no profit, it does not benefit from being tax exempt, even though it is heavily engaged in fundraising. In contrast, *B* does no fundraising at all. It raises $10 million per year from the fees it charges customers, but it does not spend this entire amount on its programs. Since *B* runs at a profit, it benefits from being tax exempt; yet this government support obviously is not targeted toward bringing in more donations since, in this extreme example, there are no private donations. Unlike the deduction for charitable contributions, then, the tax exemption for nonprofits is not tailored to encourage additional private contributions.[37] If our goal is to encourage generosity,

[36] Strnad, note 34, at 275-76.

[37] Exemption from property taxes is not, strictly speaking, a matching program, but it is close since someone must put up the money to buy the property. Yet if the charity finances

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we would be better off scaling back the tax exemption and redirecting these resources to increase the generosity of the tax deduction.[38]

2. *Marginal Contributions*

In designing the subsidy, we are more likely to maximize contributions by concentrating our resources on "near misses"—that is, on marginal contributions the donor is tempted to make, but will not make without a subsidy. To see the point, consider a donor who is deciding whether to make gifts of $100,000 to any of four different charities—*A*, *B*, *C*, and *D*. Let's say the donor derives $120,000 worth of satisfaction from a $100,000 gift to *A*; $90,001 of satisfaction from a $100,000 gift to *B*; $80,001 from such a gift to *C*; and $70,001 from such a gift to *D*. Without a subsidy, the donor will make a gift only to *A*, so that total private contributions are $100,000. Assume, then, that the government introduces a $30,000 subsidy. To maximize contributions, the subsidy should go to the near misses, *B* and *C*: $10,000 for *B* (so the donor has to give only $90,000) and $20,000 for *C* (so the donor has to give only $80,000). This way, total private contributions rise to $270,000. In contrast, dedicating $30,000 to *D* leads to a smaller increase in private giving—to only $170,000—since *A* and *D* are supported, but *B* and *C* are not. Finally, using the $30,000 subsidy on *A* is counterproductive—since the donor will make this contribution anyway—and causes private contributions to decline to $70,000.[39]

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the property by running an operating surplus, there is no matching element, and a property tax exemption becomes no different from an income tax exemption.

[38] Of course, there may be other justifications for a tax exemption—for example, as a way to channel resources to nonprofits so they can reduce their prices, or as a way to subsidize endowments, so they can substitute for the equity capital that a nonprofit cannot attract. Yet there obviously are alternative means of pursuing these goals, such as tax-exempt borrowing by nonprofits. In any event, a comprehensive evaluation of the tax exemption is beyond this Article's scope.

[39] The analysis above focuses on maximizing contributions and not on maximizing donor utility, which is more complicated and, in any event, is only part of the picture (since we also care about the utility of beneficiaries, and thus about the level of giving, allocation and implementation error, and the like). To an extent, donor utility is also enhanced by focusing on near misses, since donors would rather have these funded than their lower philanthropic priorities. Thus, donor utility is enhanced more by a subsidy for *B* and *C*—the near misses—than by a subsidy for *D*. To see the point, use the example above and assume that the donor has $400,000 that she can either give to charity or keep for personal consumption. If *B* and *C* are subsidized, the donor's utility is $420,002 ($120,000 from the gift to *A*, $90,001 from the gift to *B*, $80,001 from *C*, and $130,000 of utility from the money she keeps). In contrast, if the subsidy is devoted to *D*, then her utility is only $420,001 ($120,000 from *A*, $70,001 from *D*, and $230,000 from the money she keeps). In each case, this is better than the donor's utility without a subsidy, which is only $420,000 ($120,000 from giving to *A*, and another $300,000 from the money she keeps). Yet donor utility would increase even more with a subsidy that replaces gifts she would make anyway—such as the gift to *A*—so she can keep (and consume) more money for herself. Thus, if the gift

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The problem, though, is unobservable heterogeneity. Some people are more generous than others, so the level of contributions that is marginal is hardly uniform. If we had perfect information, we would know what each individual would do without a subsidy, and we would customize the subsidy for each individual so that it focuses on marginal contributions. But we do not know how generous people really are and if we start the subsidy at a lower contribution level for less generous taxpayers, then everyone has an incentive to understate their generosity so they can collect a larger subsidy. Obviously, the information costs here are quite substantial, raising the question whether we should even try to account for heterogeneity in institutional design. Do we want a standardized schedule that applies to everyone, or one that is tailored to individuals? Options for a standardized schedule are considered first, since they are easier to administer, and then a tailored approach is discussed as well.

3. *Slope of Subsidy: Declining, Constant, or Increasing?*

Whatever we do, an important guideline is that any individual donor is likely to find the first dollar she contributes to charity to be easier than the last, since there is diminishing marginal utility in her own consumption. To choose an extreme case, it obviously is easier for someone who earns $100,000 to increase charitable giving from zero to one dollar (and thus to forgo the last dollar of consumption) than to increase her giving from $99,999 to $100,000 (and thus to forgo the first dollar of her own consumption).[40]

If we want a standard schedule for everyone, it seems a reasonably safe bet that, for most donors, it is probably unnecessary to subsidize the first dollar of charity, and the system would induce more contributions by redirecting these resources to offer more generous matches of larger gifts, which are more likely to be at the margin. In this spirit, it

to *A* is subsidized, so that she contributes only $70,000, then her utility is $450,000 ($120,000 from the gift to *A*, and $330,000 from the money she keeps). Although this scenario offers higher utility to the donor, it obviously offers lower utility to potential beneficiaries.

[40] Although the analysis in the text does not consider charity to be part of a donor's consumption, there obviously is a consumption element to charity, which is inherent in the double utility concept. If we think donors have diminishing marginal utility in giving to charity, as is typically the case with any consumption item, then the argument in the text holds: Giving the first dollar generally is more appealing (and less in need of a subsidy) than giving the last. Of course, one complication here is that there may be added consumption value to giving a very large gift—including naming opportunities, being honored at charitable dinners, and the like—which are not available through smaller gifts. Yet these nontax inducements to make larger gifts are consistent with the idea of diminishing marginal utility in giving; they are thought to be necessary because otherwise donors would give less.

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is probably better for the government's match to increase as the donor contributes a larger percentage of income to charity—instead of having the match remain constant, or even decrease.[41]

Current law does this, to a rough extent, by requiring taxpayers to itemize in order to claim a charitable deduction; the first few dollars of itemized deduction offer no tax benefit, since taxpayers could have gotten the same result by claiming the standard deduction. But this is quite an imperfect way of pursuing this goal, if only because taxpayers who have enough mortgage interest or state and local income taxes to justify itemizing can deduct the first dollar contributed to charity.

In any event, an important feature of our system is thoroughly inconsistent with this principle: Taxpayers who contribute too high a percentage of their income cannot deduct these excess contributions (generally, contributions exceeding either 30% or 50% of their adjusted gross income, depending on the context).[42] If we want the tax system to induce more contributions, it is counterproductive to revoke the government match from taxpayers as their giving rises above this level. Since it is more daunting to give away 60% of your income than 10%, it is perverse to have a less generous match for the former.

Yet in contemplating a revision of this rule, we run up against a competing value—ensuring that each taxpayer is involved, at least to an extent, in funding public goals that are collectively determined. To be clear, the rule is not necessary to ensure that they are supporting public goals, since nonprofits also pursue public goals. Although I am inclined to give priority to incentivizing contributions, reasonable minds can disagree here, and the fault line likely will be whether we trust wealthy individuals (the only people who can realistically give away all their income) to support the right causes, a point that is discussed in detail in Part IV.

There is another way in which current law has it backwards: Instead of offering a more generous match as the level of contributions rise, a deduction (as opposed to a credit) becomes less valuable as giving increases, as long as the rate structure is progressive. The reason is that, if the taxpayer gives away enough of her income, she shifts to a lower tax bracket, reducing the value of additional contributions be-

[41] Saul Levmore also suggests a subsidy that increases as taxpayers give more than a minimum percentage of their income. But his rationale is different. Levmore's goal is not to increase the volume of contributions, but to be more equitable. People who give a larger percentage of their income, he argues, are doing more than their share—they are giving more than they would have had to give if the funds were raised through taxes, instead of through charity—so they should be rewarded for doing so. Levmore, note 8, at 416 ("If . . . any earner contributes more than his progressively required share, then it might be fair to give a greater reward.").

[42] See IRC § 170(b)(1).

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yond that point (since the tax that the deduction helps her avoid is lower).[43] The practical impact of this point should not be overstated, though, since the donors who give very large gifts tend to have incomes so deep in the top bracket that, to them, the rate structure feels flat.[44]

A further problem with using a deduction (as opposed to a credit) is that the government's match is tied inextricably to the tax rate. The connection is that the government's matching contribution (in the form of tax forgiven) depends on the tax rate. This obviously means the charitable deduction is more valuable to high-income taxpayers than to low-income taxpayers (who are subject to a lower tax rate), which reinforces the concern that the deduction disproportionately benefits wealthy taxpayers.[45] A further problem is that the tax rate is not, and cannot be, set to induce the maximum level of contributions. Rather, in setting tax rates, policymakers are focused on different elasticities: the willingness of taxpayers to work and save, not their willingness to give to charity. It seems unlikely that these various elasticities are so closely related that a tax rate tailored for work and savings will also yield an optimal result for charitable giving. Our system would be more effective at encouraging generosity, then, if we stop using a deduction, and instead use a tax credit calibrated to giving elasticity, so that the credit's value generally increases with the percentage of income that the taxpayer is contributing.

Yet although it makes sense for the subsidy to increase in this way, this general principle does not provide the answer to specific questions. Where exactly should the subsidy begin? At what point should it increase? By how much? The problem with a uniform schedule, obviously, is that a point that is marginal for some will be too low for some and too high for others. As a result, a uniform schedule inevitably will commit some of the subsidy to inframarginal contributions of

[43] For example, assume that there are four tax rates: 0% on income up to $50,000, 20% on income from $50,000 to $200,000, 25% on income from $200,000 to $300,000, and 33% on all income above $300,000. For a taxpayer earning $400,000, the government offers a one-for-two match on the first $100,000 of contributions: The taxpayer avoids a 33% tax, so $66,666 of the first $100,000 comes from the taxpayer, while $33,333 comes from the government. But if the taxpayer gives away $200,000, then the government's match on the second $100,000 gift is only one-for-three. Because the tax rate has declined to 25%, $75,000 comes from the taxpayer, while $25,000 comes from the government. Since it is more difficult for the taxpayer to give the larger gift, it is unhelpful for the government's match to decline in this way.

[44] Indeed, given the limit on deducting more than 30% or 50% of adjusted gross income, described above, they typically cannot give enough away to get their incomes into a lower bracket.

[45] See Subsection IV.B.3 for a discussion of this distributional concern.

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very generous donors, and also may be too high to induce marginal contributions from less generous donors.[46]

Although a uniform schedule cannot create perfect incentives, it still can be improved. The challenge is a bit like the one for setting tax rates, which also must account for an unobservable characteristic, earning ability, which, like generosity, varies among taxpayers and which they have an incentive to conceal. We should prefer a subsidy schedule that, all else being equal, creates the right incentives often enough to induce the maximum additional contributions.

In that spirit, since the average U.S. household with an income above $100,000 gives 3% of their income to charity, the government may not need to match smaller gifts (for example, less than 1.5% of household income).[47] Instead, the government could use the savings from such a floor to sweeten the match for larger gifts (for example, in excess of 1.5%) in a revenue neutral way.[48] Or we could have a multi-tiered scale, such as a four-tiered credit in which (1) gifts totaling 1% or less of income receive no credit; (2) gifts totaling between 1% and 3% get a 10% credit; (3) gifts between 3% and 10% get a 30% credit; and (4) gifts over 10% get a 40% credit. There is a tradeoff here, in which more nuanced incentives can be created at the cost of more complexity.

Such a system is complicated not only in requiring multiple tiers, but also in requiring other refinements. For instance, a system with tiers would encourage taxpayers to concentrate into a single year gifts that they otherwise would have given over multiple years. If no credit is given for gifts under 1.5% of adjusted gross income, then a donor

[46] The literature generally assumes that it is unfortunate to subsidize inframarginal contributions. Indeed, the theoretical literature on the neutrality theorem and the empirical literature on whether a subsidy generates additional contributions have as their (at times unstated) premise the idea that this outcome is to be avoided. See note 29 (discussing and citing literature for neutrality theorem). Yet it is worth observing that, as long as the cause is a socially useful one, such that positive externalities are generated, the money is not wasted. The main reason not to crowd out private contributions, then, is if they are raised at lower social cost than taxes. I tend to think they are, but the answer to this empirical question obviously depends on the context. I am grateful to Louis Kaplow for this observation.

[47] See President's Advisory Panel on Tax Reform 75-76 (Nov. 1, 2005), available at http://www.taxreformpanel.gov/final-report/ (proposing 1% floor).

[48] For example, if a taxpayer has income of $1 million, every dollar of contribution in excess of 1.5% of a taxpayer's adjusted gross income ($15,000 for this taxpayer) could generate a credit of, say, 40 cents on her tax. If this taxpayer gave $15,000, then, she would not receive any tax credit. But if she gave $100,000, she would receive a $34,000 credit (that is, 40% of $85,000, which is the excess of $100,000 over the noncreditable $15,000). This should create a stronger incentive to give than, say, a 34 cent credit for every dollar given to charity (including the first dollar). The same analysis applies to taxpayers who earn $50,000, such that we want to encourage them to give more than $750 (which is 1.5% of their income).

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who otherwise gives 1.5% per year would likely give 4.5% in one year, and then nothing in the next two. To avoid creating this sort of perverse incentive, this regime would require a mechanism for averaging contributions and income across years (for example, a trailing three-year average).

4. *Individually Customized Schedule*

Even with these necessary refinements, a uniform schedule is still easier to administer than one that is individually tailored. But would a customized schedule be more effective at inducing marginal contributions? To tailor the structure to an individual, we need information about her generosity. The best information we have is what she has given in the past. For instance, the system can look to a donor's average giving over the past five years, setting a floor so that no subsidy is awarded for any giving below some fraction of this average giving (for example, one-third). Likewise, an extra benefit can be offered for contributions above this prior giving level.

For example, assume that *Donor A* and *Donor B* have the same earnings—$100,000 per year—but *A* is more generous than *B*. *A* has given an average of 6% of income per year over the past five years, while *B* has given 3%. Under this approach, then, *A* would receive no subsidy for contributions below 2%, whereas the floor for less-generous *B* would be only 1%. Likewise, the extra generous subsidy for *A* would apply to giving above 6%, and for *B* it would apply for giving above 3%. The incentives here may be better than a one-size-fits-all subsidy with a floor of, say, 4%, which would subsidize inframarginal contributions from *A*, and at the same time would be out of range for *B*.

Yet this individualized approach is more complicated, and it also may induce donors to backload their giving. For example, instead of giving 3% per year for six years, *B* could give nothing for five years, and then could make a gift of the same present value in the sixth year. In this way, *B* would deduct the entire amount, since her average giving over the preceding five years (and thus her threshold) would be zero. Put another way, every dollar the donor gives in the current year would have two effects: It would attract a subsidy in the current year, but reduce the amount of the subsidy in future years. This structure also may yield perverse effects during times of inflation, since increased nominal giving would not necessarily represent increased actual giving. Likewise, in a cyclical economy, donors who have given generously during a boom, unfortunately, would have less incentive to maintain their giving during a subsequent downturn, since their prior generosity would serve to reduce their current subsidy. More nuanced

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rules may temper these problems but probably would not eliminate them, and this reality undercuts the benefit of an individualized schedule. Indeed, a similar approach is used with the research and development credit, and has prompted similar concerns.[49]

5. *Elasticity versus Externalities*

Finally, it is worth emphasizing a potential tension between encouraging generosity, on one hand, and focusing on projects that generate the most positive externalities, on the other. For instance, assume that *Donor A* has an inelastic preference to support a project that generates a high level of positive externalities, and *Donor B* has an elastic commitment to support a lower-value project. Should the subsidy focus on *A*'s project (because of its higher value) or on *B*'s (because of *B*'s more elastic giving)? Of course, if we had perfect information, we could address both goals at the same time—for instance, by beginning the subsidy of *B* at a lower contribution level (to address *B*'s elastic giving) while capping the subsidy dedicated to *B*'s project (to account for its lower social value). Yet in a world of imperfect information, this subtle solution is difficult to pursue. Even so, in designing a subsidy for charitable contributions, we need to consider not only the need to encourage generosity, but also the need to allocate funds to high-value projects. I turn now to a discussion of the latter goal.

IV. Reflecting Preferences

Another information problem in the pursuit of public goals is the difficulty of knowing which programs would do the most good if supported. How should scarce public resources be divided among competing priorities? Do the parties making these choices have the right incentives? In subsidizing charitable contributions, we delegate significant influence over this decision to individual donors, who allocate not just their own contribution but the matching government subsidy as well.

This is a significant delegation of authority—not at all typical in other government programs—and it presents two tradeoffs, one relating to the quality of decisionmaking and the other to its legitimacy. First, decentralized decisionmaking can prompt experimentation and competition, but suffers from a lack of coordination and scale (the "coordination tradeoff"). Second, subsidized charity allows some public money to be allocated outside the political process, thereby em-

[49] See Robert Eisner, Steven H. Albert & Martin A. Sullivan, The New Incremental Tax Credit for R&D: Incentive or Disincentive?, 37 Nat'l Tax J. 171 (1984).

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powering minorities to pursue their preferences but, at the same time, concentrating disproportionate influence among wealthy donors (the "representation tradeoff").

Institutional design can temper these tradeoffs, and various options are highlighted here. To a degree, though, policy judgments also will turn on instincts about whether government or nonprofits are more deserving of our trust (or, perhaps, less deserving of our distrust).

A. *The Coordination Tradeoff*

Through charitable contributions, individual donors make independent decisions about which public goals to support. In this decentralized process, the information and incentive advantages of flexibility and competition come hand in hand with the disadvantages of insufficient coordination. In a sense, the tradeoffs here resemble those of relying on state or local government instead of the federal government—except that here, of course, no government is making any substantive decisions, so that charity is even more flexible and local than state and local governments.

1. *Flexibility*

The decentralized charitable process offers familiar advantages of competition, flexibility, and experimentation.[50] Let's say, for example, that we are committed to providing food to the homeless. To secure government assistance for this objective—even at the more flexible state or local level—we need to persuade a potentially large set of key government decisionmakers. We might need to approach key legislators, who could then help persuade a majority of their colleagues, either through the force of argument, vote trading, party loyalty, or other institutional mechanisms. We also need support in the executive branch. In any political process, the preferences of the median voter loom large, as Burton Weisbrod has emphasized.[51] Bureaucratic constraints are also significant, since any program will have to comply with a host of civil service rules, standard procedures, and the like. Sometimes bureaucratic incentives are complicated, focusing as much on turf protection or work minimization as on the public interest.

In contrast, pursuing this goal through a nonprofit can be very different. If we have resources and time of our own to contribute, we can simply buy food and hand it out. We do not need anyone's ap-

[50] See, e.g., Vickrey, note 26, at 36 (noting that charities enjoy "greater freedom of action" than government).

[51] Weisbrod, note 8, at 23.

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proval. Of course, we have to comply with all applicable laws Our effort will be more substantial if we can recruit others to our cause and, in doing so, we encounter some administrative complexity.[52] But we still need to persuade only the group of people who are helping us.

As this example suggests, the decentralization of this allocation process can allow nonprofits to be more nimble than the government. In response to a crisis, they can be formed quickly and then shut down once the need passes—all without clearing bureaucratic hurdles that are common in government.

Relatedly, nonprofits are freer to engage in experimentation, and to compete with each other. Even if there is a conventional wisdom about how to pursue a public goal, it is relatively straightforward for dissenters to form a new organization with a novel approach. If they can attract volunteers to provide time and resources, they are off and running. In the government, the process obviously would be quite different, requiring the requisite approvals within a hierarchy. Not surprisingly, then, a number of important social movements—from civil rights and women's rights to environmentalism—were pursued first through nonprofits (for example, the NAACP, the ACLU Women's Rights Project, the NRDC) before they ultimately became the subject of government action.[53]

Like state and local governments (but more so), nonprofits can rely heavily on local preferences and information. This point is really another manifestation of the lack of hierarchy within the nonprofit world. A new program does not have to be cleared in Washington, the state capital, or city hall.[54] If a community has a unique need, members of the community can organize to address it, without having to make a case to people above them in a hierarchy who may have less intimate knowledge of facts on the ground.

2. *Lack of Filters or Coordination*

Yet although a decentralized process can unleash creativity, it can unleash less desirable qualities as well. Without hierarchies, nonprofits do not necessarily have the same filters that governments have to

[52] For example, we probably will want to form a nonprofit corporation and provide tax-related documentation to donors who make contributions.

[53] This is not to say that nonprofits are all flexible and free of hierarchy. To some extent, there is an inverse correlation between flexibility and size. For instance, a large nonprofit hospital is likely to have hierarchies, and its institutional structure probably bears more resemblance to a public hospital (that is, an arm of the state) than to a small start-up charity. I am grateful to Reynold Levy for this observation.

[54] Of course, some government action may be needed to secure income or property tax exemptions, but those processes typically are quite different than the process of authorizing and appropriating funds for a new government program.

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screen out bad ideas. For example, a government manager who wants to build a "public" playground immediately opposite her home presumably needs to justify this decision to senior officials within the hierarchy, whereas there may be fewer constraints on a nonprofit manager or donor to behave self-interestedly. Likewise, in government a foolish use of public resources—such as the ketchup museum discussed above—would require the approval of various levels of bureaucracy, who (hopefully) would reject the idea. In contrast, a wealthy donor could simply create her own nonprofit and contribute money, thereby directing tax money to the project (that is, through the charitable deduction) without anyone else's approval.

Even when donors and managers behave generously and sensibly, lack of coordination can undercut the quality of their allocation decisions. As Saul Levmore has emphasized, many donors are forced to make decisions about what to support without full knowledge of what other donors are doing.[55] After September 11, for example, donors gave so generously to help victims and their families that these charities were overfunded.[56] If donors had known how much others were giving, they probably would have directed some donations elsewhere. Yet this problem should not be overstated. Whereas donors may not know how much the charity will receive this year, they can easily find out about last year. This provides the necessary guidance as long as giving patterns are relatively stable and, except in extraordinary cases like September 11, they tend to be.

Finally, a decentralized allocation process is also ill-suited to policymaking that requires coordination. Obviously, some public goals involve network effects or economies of scale, so that the quality of the program is enhanced by standardization and size. Regulating natural monopolies has this quality, as does the military, in the sense that a chain of command is necessary, and would be harder to attain if we relied on a series of independent militia units that were nonprofits.

B. Representation Tradeoff

A charitable subsidy's reliance on individual instead of collective decisionmaking has implications not only for the quality of decisionmaking, but also for its legitimacy.

[55] Levmore, note 8, at 411 n.71.

[56] See, e.g., C. Eugene Steuerle, Preparing for the Next Emergency: Some Lessons for Charities from September 11 2 (Urban Inst., 2003), available at http://www.urban.org/UploadedPDF/310852_preparing_for_next_emergency.pdf ("[M]any of the direct victims' needs could be met with only a fraction of the [September 11th] funds.").

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1. *Minority Preferences*

In a society in which tastes in public goods are heterogeneous, minority preferences may be underrepresented in the political process. As Weisbrod has emphasized, nonprofits allow these political outliers to organize and pursue goals that the general political process may not favor.[57] Ensuring that the funding for public goals is not a "winner take all" competition—such that minority preferences also are reflected—enhances the legitimacy of both the process for allocating funding and the outcome.

Minority preferences are registered not by political compromise or a mechanism that binds the decisions of elected officials, but by circumventing elected officials entirely. Donors vote directly with their contributions, Saul Levmore has observed, using "taxes as ballots."[58] Levmore argues that this mechanism is more likely to reflect popular preferences than governments burdened by public choice problems.[59]

Obviously, one's reaction to this idea is likely to depend, to a significant degree, on one's view of government. If we believe that elected officials have unique legitimacy as decisionmakers and that public goals need to be pursued communally, then we are likely to worry that donors, in allocating public resources, are usurping an authority more properly exercised by government. In contrast, if we are skeptical about the government's inclination and ability to reflect popular will, as opposed to the agendas of interest groups and professional politicians, then we are more likely to favor a robust role for donors as a useful and legitimate complement to the government's efforts. Like Levmore, I am inclined to take the latter view, but reasonable minds can disagree on this point.

2. *Separation of Church and State*

In any event, even those who believe that government decisions are uniquely legitimate are likely to feel differently about funding religious organizations. If public money is to go to religious groups, there are clear advantages in leaving the allocation of funds to individuals. Obviously, it is unconstitutional in the United States for government officials to make decisions about which religion to support, and it makes good sense, for a range of reasons beyond the scope of this Article, to reserve this sphere of life to organizations that are purely voluntary, and that can compete freely with each other for members without invoking the force of law.

[57] Weisbrod, note 8, at 31.
[58] Levmore, note 8, at 404-05.
[59] Id. at 406.

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3. *Disproportionate Representation of Wealthy Donors*

Although letting donors allocate public money has process-related advantages, as discussed above, there are two problems with doing so. The first is that donors may not adequately represent the preferences of society as a whole, so that there is allocation error when the wrong projects are pursued. Yet this concern should not be overstated. Obviously, there is no issue when donors pursue projects that nondonors also support. There also is no problem when donors neglect projects that nondonors would support, since the government is free to pick up the slack. Allocation error arises, then, only if donors overinvest in projects that do not command broad support. In some cases, this result is not at all problematic, for instance, if the lack of support in the general population is due to imperfect information. This may be the case, for example, with scientific research that has broad social value, but is better understood in the nonprofit world than in the population as a whole. But obviously in other cases, the lack of broad support derives from differences in taste, such that the commitment of public resources is harder to justify. This no doubt happens in the nonprofit sector, but it is worth remembering that it also happens in government (for example, through the influence of well-organized interest groups), and it is an empirical question about where the problem is more pervasive.

Even if the right projects are funded, there is a further problem that wealthy people have a louder voice in the process.[60] Wealthy donors have more money to give, and thus can disproportionately influence the allocation of public money (that is, the tax subsidy). To my mind, this is the most powerful critique of the charitable deduction.

To put it in context, though, it is worth remembering that wealthy people already exercise disproportionate influence over the market economy, as well as over other government decisions, given the importance of campaign contributions to elected officials.[61] Whether government funds are allocated actively by government officials or passively by government matches, wealthy people are likely to exert disproportionate influence either way. Indeed, if we are interested in reducing the influence exerted by wealthy people, we should start with their role in government decisionmaking, since that context does not offer voluntary redistribution and other welfare benefits to low-income people that are inherent in subsidized charity.

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[60] See Levmore, note 8, at 405-06 (noting concern that "charitable deduction institutes something of a poll tax" and that "wealthier taxpayers can afford more votes").

[61] See, e.g., Ctr. for Responsive Politics, Banking on Becoming President, http://www.opensecrets.org/pres08/index.php (last visited Jan. 19, 2009) (noting that in the 2008 Presidential election the two major candidates raised $1.11 billion and spent $1.04 billion).

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In any event, although it is reasonable to have reservations about allowing wealthy people to allocate public funds in this way, this is a price we must pay in order to secure the advantages of subsidized charity, which are substantial. Giving donors control over what they support is a necessary precondition for securing voluntary redistribution and a socially cheap source of funding for other public goals, and also for creating a set of flexible institutions that compete and experiment. As with any tradeoff, though, the question is not a binary one. Through nuances of institutional design, we can offer donors some types of control, while withholding others.

C. *Institutional Design: Constraints on Donor Choice*

If the subsidy's goal is to reflect preferences, it should be designed somewhat differently than if the objective is to encourage generosity or to recruit private monitors. Once again, three issues are discussed: the degree of control donors should have over the causes they support, the distribution of the subsidy across income classes, and the structure of the subsidy.

Whereas current law leaves individual donors with substantial control over what causes they (and government matching funds) will support, this individual control has costs as well as benefits, as noted above. This Section explores four different ways to constrain individual control. The first three do not involve any active decisionmaking by government officials, but make the requirements for claiming the subsidy more specific and rigorous: They relate to the characteristics of charities that are supported ("structuring limits"), the subject matter ("substantive limits"), and the freedom of wealthy people to participate ("eligibility limits"). The fourth involves the government in reviewing specific proposals. After discussing this range of options, this Section briefly considers two salient questions in the academic literature: whether a system of matching grants should replace the deduction, and whether a subsidy should be available to for-profit charity.

1. *Structuring Limits*

Without limiting the types of causes that donors can support or the freedom of wealthy people to make subsidized contributions, the government can specify criteria that individual organizations must meet (having nothing to do with which cause they support). This sort of structuring requirement already exists under current law: For example, the organization must be organized as a nonprofit—an issue to

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which I return below[62]—and contributions must be for the public good, not for the private benefit of donors, as noted above.

The virtue of structuring requirements is that, if they are crafted wisely, they can enhance the quality of individual decisionmaking without significantly limiting individual control over subject matter; as a result, they should not diminish a donor's utility in giving (so that a tradeoff with the goal of encouraging generosity is avoided) and these structuring requirements also should not impede the process of experimentation and competition. Yet for the same reason—because they do not reclaim substantive decisonmaking from individual donors to any significant degree—structuring requirements do not respond as directly to legitimacy concerns about wealthy donors exerting disproportionate control, although they can offer some help on that dimension as well.

In this spirit, current law could be changed to make greater use of participation requirements, so that an individual donor could claim a deduction only if a minimum number of other donors also contributed to the cause (even in very small amounts).[63] Participation requirements mitigate the coordination tradeoff by introducing a useful filter, making it more difficult for an idiosyncratic or self-interested donor to pursue an unwise idea with public money. We could solve the ketchup museum problem, for example, by requiring that a donor could claim a tax deduction for a project only if a minimum number of other donors were also willing to contribute. Thus, participation requirements can also mitigate the representation tradeoff as well, ensuring that wealthy donors are acting for others as well as for themselves.

At the same time, participation requirements do not limit in any way the subject matter that the donor is pursuing, so that donors should still derive full utility from giving. Indeed, they may feel all the better knowing that others share their goal. Donors should remain (largely) free to experiment, as long as they can attract the requisite number of people to join in the effort. It is worth observing, though, that poorly crafted participation requirements could be subject to abuse, for instance, when small donors are in effect bribed to contribute to a cause that a large donor wishes to support.

A second structuring innovation involves information. In general, public charities already fill out Form 990, and these are now available

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[62] See Subsection IV.C.6.

[63] Current law already incorporates this distinction to a degree in distinguishing public charities from foundations. Compare IRC § 170(b)(1)(A)(viii) (allowing a deduction up to 50% of an individual's adjusted gross income (AGI) for contributions to broadly supported charities, as defined in § 509(a)(2)), with IRC § 170(b)(1)(B) (allowing a deduction of 30% of AGI for contributions to most private foundations).

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online.[64] In addition, the government could require more information, and could compile it in ways that enhance individual decision-making. For example, Levmore worries that charitable donors do not know enough about what other donors are doing when making their own allocation decisions, as noted above.[65] In response, the government could publish an annual "charity budget," cataloging how charitable funds are allocated among different causes. What percentage has been devoted to education, the environment, poverty relief, and religious organizations? The government could propose classifications and ask charities to code themselves on Form 990. As with participation requirements, this structuring requirement does not seek to favor one type of cause over another, but to help individuals make better informed decisions.

In addition, this information would be valuable to the government, since government budgets should adjust to offset under- and over-funding within the charitable sector. For example, if the opera is already well taken care of, the National Endowment for the Arts should reallocate funding elsewhere.

2. *Substantive Limits*

In a more assertive intervention, the government could express a preference for some public goals over others. To a limited extent, substantive limits already exist under current law. First, the list of charitable purposes in § 501(c)(3) is broad, but not unlimited. Not everything qualifies as, "religious, charitable, scientific, . . . literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals."[66] For instance, enhancing national defense does not qualify, and rightly so, since national defense is not an appropriate subject for individual policymaking.[67] Second, the government already can disallow the charitable deduction for reasons of public policy. Thus, the deduction is not available for contributions to charities that finance terrorism or to colleges that ban interracial dating.[68] The government

[64] See Guide Star, Nonprofit Reports and Forms 990 for Donors, Grantmakers and Businesses, http://www.guidestar.org (last visited Jan. 19, 2009).

[65] See text accompanying note 55.

[66] IRC § 501(c)(3).

[67] There are of course nonprofits, such as the National Defense University Foundation, that support research about defense issues and the training of military leaders. In addition, someone wishing to support national defense by making payments to the federal government in addition to her tax payments can deduct these extra payments, but this is different from forming a nonprofit that would supplement the nation's defense capabilities.

[68] See Bob Jones Univ. v. United States, 461 U.S. 574 (1983) (disallowing charitable deduction to college that bans interracial dating); U.S. Dep't of the Treasury, Anti-Terror-

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is free to make greater use of this power by offering a broader list of disallowed causes.

As an even stricter substantive limit, the government could offer extra-generous tax benefits to causes that it deems a particularly high community priority. The government could offer different tiers of tax benefits, and periodically could prioritize among different types of causes. In one year, Congress could favor poverty relief and, in another, environmental protection; thus, donations to any charities with these missions could become eligible for especially generous tax benefits, while other charities would remain in the standard program.

Since different charities generate different externalities, the subsidy for different activities should vary, at least in principle.[69] A systematic effort in this regard could reduce the risk of allocation error and also could enhance legitimacy by constraining the discretion of wealthy donors. For example, we may think that private donors overspend on opera, museums, and other cultural institutions, while underspending on the homeless and the developing world; tax benefits could be scaled back for the former and ramped up for the latter.[70] Meanwhile, individuals still would be allowed to exercise discretion within the (narrowed) parameters, such that experimentation and competition would still continue, albeit to a lesser degree.

Yet there are reasons not to increase government control in this way. Obviously, there is a tension with the goal of maximizing generosity. Some would-be donors to disfavored categories may give as much overall as they otherwise would have, while simply redirecting their giving to favored categories. But others may simply reduce their overall level of giving.

A further cost of this approach is that the system becomes more complicated. If different types of nonprofits are supported in different degrees, charities would have to classify themselves. Assuming poverty relief was favored, would a law school qualify by offering financial aid for low-income students and clinical programs for indigent clients? Could a portion of the law school's overhead be allocated to these causes and, if so, what percentage? If not, would the result change if the law school created a separate nonprofit to house these programs, and charged it for the use of law school facilities? From the

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ist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities (2006), available at http://www.ustreas.gov/press/releases/reports/0929%20finalrevised.pdf.

[69] See Strnad, note 34, at 279 ("Generally, . . . different activities will have different price elasticities and income elasticities for contributions, different nonsubsidy levels of contributions and different optimal levels of contributions. This suggests that the optimal subsidy-rate structure for contributions may vary substantially across activities.").

[70] Cf. Gergen, note 7, at 1443-47, 1450 (arguing that charitable deduction should not apply to public television and that scope of deduction is too broad).

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donor's perspective, the preparation of a return can be complex enough, without cluttering it further with different tax benefits for different charities.

In addition, once the government declared itself in the business of differentiating among charities, the incentive of nonprofit managers to invest time and resources in lobbying the government would increase substantially.[71] Nepotism and corruption would rear their ugly heads, as the lobby for universities competed with the lobby for museums to hire a key Senator's daughter. Nonprofit managers also would be further detached from their primary mission of running nonprofits, as the burdens of lobbying were added to the burdens of capital campaigns. To my mind, the added government input is not worth these costs, although reasonable minds can disagree on the point.

3. *Eligibility Limits*

Another response to the disproportionate influence of wealthy donors is to limit what they can contribute. This approach, which conflicts with the goal of encouraging generosity, is discussed further below under distribution.[72]

4. *Project-by-Project Review*

In the three prior categories, the government ratchets up the rigor and detail of the eligibility requirements for making subsidized contributions, but does not pass on the wisdom of specific contributions. In theory, though, the government could claim the right to sign off on particular gifts. For example, Congress or a particular committee could be required to approve tax benefits above a particular size. After all, in deducting a billion dollar charitable contribution, a taxpayer reroutes a very substantial amount of tax revenue, and a case can be made for government input in this decision. More generally, the government could function like a private foundation, accepting applications in which donors ask the government to match their contributions.

This step lends greater coordination to charitable giving and diminishes the influence of wealthy donors, but at significant (and to my mind excessive) cost. To process the relevant information and make particularized judgments, the government would need a sizable infrastructure. Yet although the cost of government decisionmaking in-

[71] See Brody, note 7, at 752 n.262 (noting that one benefit of the current tax deduction is that "'the beneficiary organizations receive their governmental aid without having to petition for it'" (quoting Charles William Elliot)).

[72] See Section IV.D.

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creases dramatically, quality and legitimacy would not necessarily improve. In substituting their own judgments for those of private parties, government decisionmakers would forgo some of the benefits of experimentation and competition. This more active approach would not represent minority perspectives as readily, and also would spawn lobbying, and the nepotism and corruption that sometimes accompany it. It also might reduce the overall level of private giving in curtailing the choices open to private donors.

5. *Tax System Versus Expenditure System*

So far, this Section has considered various changes in the way the charitable subsidy is allocated. Another alternative, which has received attention in the literature, is to remove the function entirely from the tax system. Since Stanley Surrey, many tax academics have urged the tax system to focus only on raising tax revenue. In this spirit, Paul McDaniel suggests replacing the charitable deduction with a system of matching grants housed outside the tax system.[73]

Although at first blush this seems like a radical change, there is less at stake here than first meets the eye. Either alternative can be structured in a range of ways, and there is considerable overlap in what they can achieve. For example, either a tax-based system or a direct expenditure system can specify substantive priorities or limit the eligibility of wealthy taxpayers.

There are two main differences. First, the tax system is less able to conduct project-by-project review, since its employees lack expertise to evaluate the substance of donor proposals. If the government wants to pass on the merits of a proposal to support education, the Department of Education is better positioned than the Service to do so. Yet although the best reason to adopt McDaniel's proposal is for project-by-project review, there are significant reasons to oppose active government screening, as noted above.

Second, using an expenditure system might increase overall administrative costs. This is obviously the case if project-by-project review was adopted. But even if the government's role was more modest—so that current law is replicated, but moved out of the tax system—the cost savings in the tax system might be more than offset by the cost of creating a new bureaucracy.[74] For instance, there are synergies in ad-

[73] See McDaniel, note 1.

[74] One advantage for the tax system is that more taxpayers could claim the standard deduction instead of itemizing, such that their paperwork becomes much easier. I am indebted to George Yin for this point. But if the same taxpayers must file a separate application for a charitable match, it is not obvious that the overall administrative burden would decline, and it might well increase.

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ministering the subsidy through the tax system, since the information it collects (for example, a donor's level of income) is likely to be relevant.

6. *For-Profit Charity*

In discussing constraints on donor choice, it is worth considering one more intriguing proposal in the academic literature. Anup Malani and Eric Posner argue that the subsidy should not be limited to non-profits, but should be available to for-profits as well.[75] They argue that for-profits offer better incentives for charitable managers to be efficient, for instance, at minimizing costs.[76] This is probably true, although a for-profit manager might not have the same incentive to enhance the quality of charitable endeavors, as Malani and Posner acknowledge.[77]

Yet the main problem with Malani and Posner's proposal is that it puts pressure on the process for allocating the subsidy. Not-for-profit form is a useful, if imperfect, proxy for charitable purpose. As Henry Hansmann has argued, nonprofit managers signal their dedication to the cause by forgoing the opportunity to claim profits—the so-called "nondistribution constraint."[78] Malani and Posner are right that, in principle, for-profit managers also can be committed to philanthropy, but how can we tell? Under current law, the substantive scope of the charitable subsidy is quite broad—too broad to distinguish for-profits with genuinely charitable purposes from those who wish to pad their profits: The subsidy supports any efforts that are "religious, charitable, scientific, . . . literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals."[79] Yet any research and development efforts of for-profit firms might qualify as "scientific." Perhaps advertising expenses are "educational." Maybe the work of securities markets is also "educational," since prices have important informational value. Newspapers surely would make a similar claim, as would the publishing and maybe even the entertainment industry.

The answer here, obviously, is to tighten up the definition of which activities are eligible. In other words, for-profits also should be subsidized, as Malani and Posner suggest, but the subsidy cannot be an open-ended one, like the charitable subsidy under current law. In-

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[75] Anup Malani & Eric A. Posner, The Case for For-Profit Charities, 93 Va. L. Rev. 2017 (2007).

[76] Id. at 2028-29.

[77] Id. at 2033.

[78] Henry B. Hansmann, The Role of Nonprofit Enterprise, 89 Yale L.J. 835, 838 (1980).

[79] IRC § 501(c)(3).

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stead, if the government specifies a goal —like building a particular fighter plane or developing alternative fuels—a for-profit can be trusted to pursue this specified goal and, as Posner and Malani observe, they have incentives to contain costs. In this spirit, for-profit firms commonly receive government resources in other contexts. They are hired as government contractors and also enjoy targeted tax benefits such as accelerated depreciation,[80] alternative energy tax credits,[81] and the like.[82]

Yet making the regime for charitable subsidies comparably specific—a necessary step if for-profits are to be included—comes at a significant cost. As noted above, the vague definition of current law has value in taking the government out of the allocation process,[83] and in promoting experimentation and competition.[84] This way, causes not yet imagined can find a start with a small group of donors. This is a cost that Malani and Posner never discuss, but it strikes me as extremely important. As a result, it is better to subsidize for-profits in other ways (as, obviously, is quite common), while limiting the charitable subsidy—with its usefully vague scope—to nonprofits.

Even so, Malani and Posner are right that nonprofits have their own incentive problems, including the risk of inefficient implementation. Part V considers a range of ways to address this issue.

D. *Institutional Design: Distribution and Structure*

If the goal is to reflect preferences, instead of to enhance generosity, then directing the subsidy to wealthy donors becomes problematic, for the reasons noted above.[85] Their preferences may not be representative and, even if they are, there is a process-related concern with giving them a greater say in the allocation of public money.

One strategy for addressing this concern, as noted above,[86] is to limit the discretion of wealthy donors in a range of ways. The idea is

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[80] See IRC § 168.

[81] See IRC §§ 45, 48.

[82] Indeed, for-profits can even claim the charitable subsidy, for instance, by contributing to a charitable foundation that then works with them to pursue a charitable goal. Malani and Posner acknowledge this possibility, but suggest that the introduction of a charitable affiliate is wasteful, and that for-profits should be allowed to pursue charitable goals directly. Malani & Posner, note 75, at 2056-57. Yet the introduction of a separate entity is not as wasteful as they suggest, since it can help segregate the revenues and expenses of the philanthropic endeavor from those of for-profit activities in a legally meaningful way. Put another way, transfer pricing is already quite malleable, and without separate legal entities it becomes even harder to monitor.

[83] See text accompanying note 52.

[84] See text accompanying note 50.

[85] See Subsection IV.B.3.

[86] See Subsections IV.C.1-IV.C.3.

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to keep subsidizing their charitable contributions—and thus to keep encouraging their generosity—while at the same time using the political process, and the rest of the population's ability to be represented in it, to constrain what charitable donors can do with public money.

Instead of relying on wealthy donors for contributions but reducing their discretion, another option is to seek more contributions from low- and middle-income donors. In this spirit, these donors can receive a refundable credit or some other especially generous subsidy. At the limit, we could even use a checkoff, in which taxpayers can allocate money to a cause of their choice (by "checking off" a box on their tax return) without contributing any money of their own.[87] Yet if individuals do not have to invest any of their own funds, they may not give enough thought to the choice. Instead, they should be required to invest some amount of "earnest money," but less than what wealthy people must put up.[88]

Correspondingly, the subsidy claimed by wealthy donors can be capped. The limit could be either a dollar amount or, as under current law, a percentage of income. By relying on caps or multiple subsidy schedules in this way, we can reduce the percentage of the subsidy dedicated to the wealthiest taxpayers.[89] Yet the tradeoff, obviously, is that the subsidy will be less successful at encouraging generosity.

V. Recruiting Private Monitors

A further problem of information and incentives that arises in the pursuit of public goals—whether through government or through private actors—is the difficulty of monitoring quality. In response, another purpose of subsidized charity is to recruit private donors as monitors. Since they are contributing their own money, donors have the incentive to assess whether their gifts are having a positive impact. When the donor is capable of making a large contribution, moreover, she is likely to have influence with the nonprofit manager. By passively subsidizing such gifts, the government piggybacks on the positive externalities associated with this monitoring—a point that, to my knowledge, has not been made before in the academic literature on charitable subsidies.

[87] Levmore, note 8, at 389-404.

[88] I am indebted to Dan Shaviro for the "earnest money" formulation.

[89] Although transfer taxes generally are beyond the scope of this Article, it is worth remembering that the charitable deduction in that regime is enjoyed exclusively by very wealthy people, since only they are subject to the tax.

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A. *Information and Incentive Problems in Governing Nonprofits*

While the success of any enterprise needs to be monitored, nonprofits and government face special problems. They cannot use profitability as a measure of success. In addition, there can be a separation between those who benefit from nonprofit and government programs and those who pay for them.

The classic academic response, first emphasized by Henry Hansmann, is that nonprofit managers cannot receive a distribution of profits, and thus are shielded from the temptation to cut corners on quality.[90] Like nonprofits, the government also has a nondistribution constraint.[91] In both settings, the constraint is helpful, to be sure, but not wholly effective. For example, it is well understood that the nondistribution constraint cannot keep nonprofit managers from pampering themselves with inflated salaries, a short working day, and the like. Nor does it ensure that managers display good judgment or run a well-functioning organization.

To an extent, the beneficiaries of nonprofit and government programs monitor quality, but not always effectively. They need enough information about quality to be able to make a judgment. Individual beneficiaries may not have access to such information, or may not have the sophistication to evaluate it; they may be helped, to an extent, by organizations that evaluate the performance of nonprofits, but the quality of these efforts varies as well.[92] In addition, if the evaluation is negative, beneficiaries need an alternative so they can vote with their feet. These conditions do not always hold. For instance, exit may be difficult either because there are not any practically available alternatives (for example, only one religious school in the neighborhood) or because the nonprofit's endowment gives it an advantage that is hard to replicate (for example, leaving the church means losing the church building).

In addition to beneficiaries, senior managers in nonprofits and government can be of some help. They typically have a personal commitment to the cause, as evidenced by their willingness to work for below-market wages.[93] Although some may be looking for lighter

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[90] Hansmann, note 78, at 844.

[91] This point is obvious but, as far as I know, is not salient in the academic literature. The reason is that Hansmann's excellent work generally compares nonprofits with for-profits, not with government.

[92] Examples include Charity Navigator, http://www.charitynavigator.org/, and the Better Business Bureau/Wise Giving, http://www.bbb.org/us/charity/.

[93] Survey evidence shows that nonprofit and for-profit managers are comparable in their talent and work ethic, but nonprofit managers tend to be more community-oriented and collaborative. There is similar survey data about public interest lawyers who work for nonprofits. See Burton A. Weisbrod, The Nonprofit Economy 32 (1988).

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hours and better quality of life, the lean staffing at nonprofits and government tends to undercut this motivation, especially for senior people. Yet even idealists need to be monitored, if only to ensure that they are not making mistakes or unwise judgments. Also, idealists are not immune from self-interested behavior, especially if no one is watching.

The government also monitors nonprofits to a degree through the state attorney general and a range of other context-specific regimes. It is a familiar point that the state attorney general's oversight of the nonprofit sector generally is quite limited.[94] The extent of other regulation varies, sometimes dramatically, so that hospitals are subject to stringent regulation, while religious institutions are essentially unregulated.

B. *Tradeoffs in Donor Monitoring*

To fill in the gaps, donors can play a significant role in advising nonprofit managers and monitoring performance. Since monitoring in a governmental setting generally is quite different, donor monitoring is a distinctive feature of subsidized charity that previously has not been recognized in the academic literature. There are two tradeoffs associated with donor monitoring, one relating to the skill sets of donors and the other to their incentives.

1. *Skill-Set Tradeoff*

An important advantage of donor monitoring is that donors can be the source of rare expertise, helping to fill in gaps in the skill sets of nonprofit managers. The typical nonprofit manager has deep knowledge about the nonprofit's mission and an idealistic commitment to it. But some nonprofit managers do not have equally deep experience in crafting budgets, refining communications strategies, structuring departments, engaging in strategic planning, handling complicated subordinates, conducting periodic reviews, implementing governance systems, and the other nitty gritty that is second nature to successful entrepreneurs and for-profit managers. Of course, some nonprofit managers do have these skills, but for those who do not, there is an obvious source of advice to be tapped: These skills are common among significant donors.

This complementarity of skill sets creates the possibility for a highly synergistic partnership between nonprofit managers and donors—one

[94] See, e.g., George Triantis, Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises, 117 Harv. L. Rev. 1102, 1152-53 (2004).

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that can be replicated in every sector of the nonprofit world. To this partnership, donors contribute business acumen, advising the nonprofit manager on strategic questions, crisis management, and the day-to-day challenges of running an institution. Through these interactions, donors have ample opportunity to evaluate the performance of the nonprofit's programs and senior management.

Yet the tradeoff here is that donor expertise has limits, and it is important for donors to respect these limits. A highly successful investment banker has much to add to the operation of a hospital, but evaluating the quality of competing methods of treatment is probably not her strong suit. Although an accomplished movie producer can help a museum with branding and budgets, she may have less to say about which works of art are worth acquiring. Donors need to recognize that some issues are beyond their expertise and that some decisions need to be the responsibility of the nonprofit's professional staff (although the staff can be asked to explain their judgments). In my experience, donors usually have a clear understanding of these boundaries, but it is too optimistic to assume that donors always do. When donors seek to intervene beyond their expertise, nonprofit managers are in the delicate position of having to establish boundaries but, hopefully, without offending the donor and losing a potentially valuable source of funding.[95]

This is a long way of saying that wise and sophisticated donors can add considerable value, but that not all donors are wise and sophisticated. The challenge here is to empower donors whose input is constructive, while constraining the influence of those who are not.

2. *Incentives Tradeoff*

To monitor a nonprofit's success, a donor must have not only the skills, but also the incentive, to do so. An important precondition of the donor-manager partnership, described above, is the donor's willingness to invest time. Admittedly, some prefer to write a check and then have nothing else to do with a group (for instance, because they

[95] This analysis focuses on individual donors, as opposed to foundations. Foundation managers are sometimes professionals whose skill set overlaps significantly with the nonprofit manager's, such that they have more detailed knowledge than individual donors about the cause. Given their connection to a range of nonprofits, they are likely to have deep experience in advising and evaluating charitable programs. In some cases, though, professional foundation managers have somewhat less business experience than individual donors. Professional foundation managers also bring the potential for another incentive problem—the possibility that the foundation manager is not pursuing the agenda set by the donor who created the foundation. This agency cost problem obviously does not arise when donors make their own philanthropic decisions. These important issues require more extensive treatment than can be offered in this Article.

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are contributing as a favor to a friend). Yet especially among those who make large contributions, there is a strong incentive to ensure that money is well spent. After all, there are many potential outlets for a substantial gift, and donors want to be sure they choose the right one. They typically want access to the nonprofit's leaders before making the decision to provide financial support, and they usually want the relationship to continue after their initial contribution. This is all the more true, of course, if a feature of the nonprofit bears their name, such as a professorship or a concert hall. Then it becomes "their" opera or school, in a very personal sense.

This interest of donors in giving time, as well as resources, is exemplified by a new trend known as "venture philanthropy." The quintessential venture philanthropist is an investment manager whose "day job" involves critiquing business plans, evaluating senior management and, more generally, making judgments about where to commit capital in the for-profit sector. The idea behind "venture" philanthropy is to bring the same approach to the nonprofit world. Venture philanthropists do not want to hear only about how important a cause is; they want to hear what the nonprofit leader plans to do about it. They want detailed plans, progress reports, documented results – and, obviously, a seat at the table so they can be closely involved in the governance of the nonprofit.

In order for donors to play this monitoring role, it is not enough for the donor to be willing; the manager must be willing as well. The donor cannot have a meaningful role unless the manager shares information and, in some sense, authority as well. This cuts against the all-too-human impulse to protect one's turf, but managers should realize that they stand to benefit by tapping the donor's expertise. If this is not motivation enough, they have another strong (and obvious) reason as well: the need to raise money for their program.[96] In my experience, the best way to raise money is to make potential donors feel included. They appreciate time with nonprofit leaders—indeed, they will insist on it—and they want to be heard. If the relationship grows to the point where donors feel not only consulted, but in some sense responsible, then their financial commitment will be reinforced immeasurably.

Obviously, nonprofit managers do not have the time to provide this sort of access to every donor. The average donor who writes a small check will have little or no influence on the governance of the non-

[96] Significant donors will be especially influential in organizations that depend most heavily on donor financing, as opposed to fees charged to beneficiaries. But even if donations represent a relatively modest percentage of the overall operating budget, they still get a manager's attention; even a 5% cut in the budget involves layoffs, program cuts, and other unpleasant choices that nonprofit managers will prefer to avoid.

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profit—and, knowing this, they are unlikely to invest the time involved in seeking this role—just as small shareholders have only modest influence over a for-profit firm.[97] Managers still want their good will, since they have influence in the aggregate (again, just as small shareholders do), but managers are more likely to view this group as an audience for a communications strategy, rather than as a governing body.

The most meaningful monitoring is done by a small cohort of donors, who provide the most significant financial support. Again, there is a clear analogy to for-profit firms, where large shareholders are best positioned to monitor management, and the rest of the shareholders piggyback on their efforts. Whether they have formal responsibilities within the organization, such as a seat on the board of directors, is not critical. Being on the board gives them some formal legal authority, but the main source of their leverage—the real reason they can gain access, influence policy, and, in some cases, effect a change in the leadership—is their control of the purse strings. The influence comes not so much from terms or conditions that the donor has imposed on past gifts—although those, of course, can be important—but from the possibility that a donor will make another gift.[98]

In using this influence, donors often are motivated by idealistic impulses, as noted above—after all, their financial support evidences a personal commitment to the cause—but, in some cases, donor motivations will not be as pure. Self-dealing may be a concern. For example, a donor might make a gift to a nonprofit and then suggest that, in return, the nonprofit should purchase goods or services from her. Or the donor may want special treatment from a nonprofit, such as unique access to health care from a hospital or influence on admissions from an academic institution.

A subtler concern arises when a significant donor has a different substantive vision for the charity than other donors.[99] For example, assume that traditional donors to an advocacy group favor a litigation-based approach, but a significant new donor uses her influence to promote media-based strategies and community education. Or assume that traditional donors favor one substantive priority (for example, land conservation) while the new donor favors another (for example, global warming). If the new donor uses her influence to effect these

[97] See, e.g., Evelyn Brody, Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms, 40 N.Y.L. Sch. L. Rev. 457, 470-71, 474-75 (1996).

[98] Cf. Triantis, note 94, at 1147-53 (noting that donors have very limited formal power and that restrictions on gifts are hard to enforce).

[99] Triantis, note 94, at 1148.

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changes, other donors may feel that their views are not adequately represented.

To sum up, then, a cohort of top donors can perform an important monitoring function for nonprofits because these donors are likely to have both the access and sophistication to evaluate whether goals are being implemented effectively, and the influence to insist on changes, if any are necessary. There are tradeoffs here—including the concern that donors will overstep their advisory role or behave self-interestedly—and these are challenges for the nonprofit manager to finesse and, to an extent, for institutional design as well.

3. *An Advantage of Nonprofits Over Government*

Before turning to institutional design, it is worth emphasizing that monitoring in governmental settings generally is quite different. Legislators use hearings and studies to advise and monitor government agencies, but government budgets are so large, and the range of public goals is so vast, that legislators have only a passing knowledge of many programs they fund. Organized interest groups and their lobbyists may perform a monitoring role, but lobbyists are obviously much less likely than charitable donors to focus on the public interest. As a practical matter, individual voters are even less informed than legislators, and have only limited opportunities to vote "up or down" about a given initiative.

Government programs also do not have the same access to expert advice. Investment managers and entrepreneurs have rare skills, with a correspondingly high pay scale that is well beyond what the government pays employees. It is sometimes possible to attract people with this level of expertise to serve in cabinet posts and in other senior positions as political appointees. But given the size of the relevant government bureaucracy, these senior officials typically will be farther removed from programmatic details than their counterparts who advise nonprofits.

Of course, some government programs do have outside boards of advisors, such as state hospitals or universities, or grant-awarding agencies such as NIH. These sometimes offer expertise and monitoring benefits that are comparable to those found in the nonprofit setting, although much depends on context-specific factors such as the composition of the board and the degree of influence it can exert. In some cases it may be advisable to expand this model within the public sector, although this issue is beyond the scope of this Article. The main point here is that, unlike in government, the model has quite broad application in the nonprofit sector, and this is a strength of subsidized charity that has not attracted adequate attention.

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C. *Institutional Design: Control and Distribution*

How is institutional design affected if the priority is recruiting private monitors, instead of encouraging generosity or reflecting preferences? This Section and the next consider the familiar criteria of control, distribution, and structure.

To recruit monitors, we should let taxpayers support what they personally find most rewarding, so they are more likely to invest time as well as money. In this respect, there is overlap with what we do to encourage generosity and tension with a structure designed to reflect a broader range of preferences.

Even so, we might still want to constrain donor choice in two ways. The first is to create incentives to concentrate giving. If a donor gives to fewer causes, she has more time to monitor each one, and will devote more thought in choosing which to support. For example, if *A* and *B* each plan to give $2 million to charity, and there are two potential donee organizations, it is probably better for *A* to give $2 million to one and *B* to give $2 million to the other, instead of each making a gift of $1 million to each charity. Either way, each charity gets the same gift and, admittedly, *A* and *B* may feel somewhat less utility from their giving (that is, if they otherwise would have divided their giving), but the potential externalities from more careful monitoring favor concentrated giving.

A second constraint on choice has to do with the form of the gift, rather than the object: It may be better for donors to give spendable money instead of endowments on the theory that spendable gifts enhance the donor's leverage. By making decisions one year at a time, the donor makes an annual judgment about the quality of the nonprofit's efforts. With an endowment, in contrast, the donor has provided this cash flow in advance, and the effect is essentially irrevocable. Although conditions can be placed on how the endowment is used, it will be difficult for the donor to impose a condition relating to the quality of the effort, since the condition is hard to specify, let alone to enforce. As a practical matter, the nonprofit has to violate the condition quite blatantly in order to be legally vulnerable.

While there are thus reasons for the charitable subsidy to be more generous in the case of spendable money, there are also arguments that cut in the opposite direction. If the goal here is to piggyback on private monitors, then we might think that these donors send an especially strong signal—one that is particularly worthy of a government coinvestment—when they give an endowment gift. If they are willing to surrender control in this way, they must have particular confidence in the nonprofit's management. Of course, endowments are valuable

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on other dimensions too,[100] something that further complicates the question of whether to favor spendable money.

In any event, in deciding how much control taxpayers should have to choose which charity they support, there is a tension between recruiting monitors and reflecting preferences. A similar tension arises in deciding how to distribute the subsidy. A subsidy structured to recruit monitors will target high-income taxpayers, since only they can give generously enough to influence nonprofit managers. While such a subsidy also can encourage generosity, targeting wealthy donors is not optimal for reflecting preferences, as noted above. Once again, institutional design varies with the goal being pursued.

D. *Institutional Design: Structure*

To recruit private monitors, then, the subsidy should focus on high-income donors, while encouraging concentrated giving and, perhaps, spendable gifts as well. Yet whether or not we add these refinements, the essential precondition for recruiting private monitors is, more fundamentally, to structure the subsidy as a match. This way, government money is committed only if private individuals put up their own money. Since individual donors have incentive to spend their own money with care, the government can piggyback on these private judgments without conducting an independent investigation. Obviously, the tax deduction under current law has this essential quality, as do the other proposals explored in this Article.[101]

Since all of these proposals involve donor monitoring, each one presents the tradeoffs, discussed above, in relying on such monitoring. Before considering further what refinements of institutional design can mitigate these tradeoffs, it is worth emphasizing the vital role of nonprofit managers in this regard. They need to (graciously) deflect advice that is not valuable—and, indeed, to decline gifts that do not advance the nonprofit's mission—while handling self-interested donors with integrity and tact. Competition among nonprofits is helpful

[100] Endowments facilitate long-range planning, and help to bridge timing differences so that the donor can make a gift (for example, for tax reasons) before the nonprofit spends the money. It is well known, for instance, that nonprofit needs tend to become more acute during economic downturns, when donor capacity is likely to decline. See Triantis, note 94, at 1146.

[101] Although the focus of this Article is the income tax, it is worth noting that the analysis here may apply to the gift tax, but generally does not apply to the estate tax. Obviously, once the donor has passed away, she cannot serve as an advisor and monitor. At best, she can "pre-monitor" by making a careful investigation of the charity while she is alive. Donor monitoring might serve as a rationale, then, for the transfer tax system to favor inter vivos giving over bequests, a point that is underexplored in the literature on the subject. In any event, a detailed exploration of the estate and gift tax is beyond this Article's scope.

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here, since nonprofits whose donors offer constructive monitoring and input are likely to outperform their peers.

There also may be a role for the tax law, which can be refined to enhance monitoring in three ways: first, by flagging issues on which donor monitoring is particularly important; second, by rewarding especially active monitors; and third, by requiring disclosure about who the most significant donors are to each charity, so that other donors know who the relevant monitors are in evaluating a given charity.

1. *Flagging Issues*

First, the tax law can encourage donors to focus on issues that are of special concern. For instance, charities should not devote excessive resources to overhead or fundraising, since these expenses divert resources from the charity's core mission. The tax law can focus donor attention on this issue by denying the tax benefit, or a portion of it, when charities devote too large a percentage of their budgets to these noncore expenses. With this sort of rule, the tax law can motivate donors, who care about the tax benefit, to pressure charities to be more efficient.

This approach has its share of difficulties, though. It is hard to promulgate standards that are appropriate for all charities—on the proper level of overhead and fundraising, as well as on other issues. It is unlikely that "one size fits all" rules will be sensible in every context, especially as conditions change over time. Charities also will be motivated to recharacterize their activities in order to provide more generous tax benefits. Fundraising expense will be reclassified as "educational expense," and the like.

2. *Rewarding Effective Monitors*

An alternative strategy is to reward especially good monitors. This approach seems more promising than focusing on particular issues, although it too increases administrative costs. There are three different factors that the regime can consider to identify especially active monitors.

First, how sophisticated is the donor? As noted above, venture capitalists, entrepreneurs, investment bankers, and other professionals have valuable expertise they can lend to a nonprofit. In theory, the tax law can condition the size of the subsidy on the donor's education or professional experience, rewarding those who are in a position to provide sophisticated advice. Yet this is an imperfect way to measure what a donor has to offer. For example, someone who focuses on phi-

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lanthropy full-time may make a greater nonmonetary contribution than someone whose professional obligations are all-consuming.

A second factor, which is more objective, is to focus on the size of the gift as a way of measuring how much the donor will care about it, and how much influence the gift will have with the nonprofit. In measuring how much the donor has at stake, the system can measure the gift as a percentage both of the donor's income and of her overall giving (with the latter inquiry obviously encouraging concentrated giving). After all, a gift of $500,000 is less significant to someone giving away $10 million than to someone giving away $600,000. In focusing on size, the system also has to measure the percentage the gift represents of a nonprofit's budget. A gift of $25,000 is large enough to influence a charity with a $100,000 annual budget, but not a $100 million budget. In this spirit, a gift that represents more than a minimum percentage of the taxpayer's income, the taxpayer's giving, and also the annual charity's fundraising can earn the donor an extra "governance" subsidy.

Yet there obviously are complexities here, which may not be worth the effort. For example, a charity might have the incentive to split itself into multiple charities, so that each gift would seem like a more substantial percentage of its fundraising; in response, rules would be needed to aggregate these numbers. Likewise, donors would face some uncertainty about whether their gift is large enough, given uncertainties about a charity's fundraising in a given year, although this concern could be addressed by looking to the prior year instead of the current year.

A third factor for measuring whether a donor is providing advice and monitoring—and thus whether she should earn an extra governance-based tax benefit—is to ask whether she has a formal governance role, such as membership on the board of directors. A possible concern about this idea is that it is overinclusive, since it could lead to a proliferation of advisory boards that do not have a real role, existing solely to justify this tax benefit. To address this concern, the system would need a set of requirements that are hard to fudge. For example, the tax benefit can be conditioned on attending a minimum number of meetings, on having access to confidential information, and on having meaningful input on personnel issues, including the tenure of the nonprofit's senior managers. In addition, a limit would be needed on the number of advisors that a nonprofit (and related affiliates) can have.

A complicating dynamic here is that this rule would empower nonprofit managers to give donors something of value—a ticket to a more generous tax benefit. We might worry about making donors dependent on a nonprofit manager's good will, since this dependence may

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undercut a donor's ability to discipline the nonprofit, thereby defeating the purpose of the proposal. Given the important role that donors have in providing funding, though, it is hard to picture them losing much of this leverage.

Perhaps a more telling objection to this proposal (and others like it) is that it is unnecessary. The real source of influence that donors have is not formal authority, but the power of the purse. The larger the gift, the more influence the donor has. It is not clear that the government needs to provide an extra tax benefit to donors who have a formal governance role, since a similar effect arises—at lower administrative cost —in a basic matching program. As long as bigger gifts generally command bigger government matches (something that is already true under current law), the government can rely on the donors' own incentives to watch how their money is used.

3. *Disclosure About Most Significant Donors*

Given the influence that significant donors can exert in advising and disciplining nonprofits, we obviously want that influence to be used wisely. It stands to reason that some donors are better monitors than others. It may be valuable, then, to create a means to monitor the monitors. In this spirit, nonprofits can be required to offer more disclosure about their most significant donors (with special rules for trusts, such that the trustee and the donor to the trust are both identified). If the donors have strong reputations—if they are known to give good advice, not to seek preferential treatment, and the like—then the charity will draw strength from its association with these donors. Just like some investors are more inclined to invest in a firm once Warren Buffet has done so, some donors will piggyback on the charitable judgments of well-respected philanthropists. Likewise, if a donor has a problematic reputation, then other donors will be more wary of the charity, and will want to ask more questions about whether the donor is exerting undue influence.

VI. Conclusion

This Article considers why we should pursue public goals with subsidized charity, rather than using the many other policy instruments at our disposal, and offers three separate reasons, all rooted in problems of information and incentives: first, to encourage donors to be more generous; second, to measure and reflect popular preferences about which public goals to pursue; and third, to recruit private monitors.

This Article uncovers a series of tradeoffs inherent in subsidizing charitable contributions. Although funding that is given voluntarily

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comes at lower social cost, there is rarely enough. A decentralized process for funding public goals allows for competition and experimentation, but lacks coordination. It also empowers minorities, but gives disproportionate influence to wealthy donors. These wealthy donors have the influence and, in some cases, the expertise to be effective monitors, but who will monitor them if they overstep their expertise or behave self-interestedly?

These tradeoffs can be resolved any number of ways, and the precise institutional design we choose depends on our priorities. If our goal is to encourage generosity—and thus to increase the supply of voluntarily-provided (and, hence, low social cost) funding for public goals—we should focus the subsidy on wealthy donors, who are most tax sensitive. We should place only minimal limits on their ability to choose which causes to support, and we should focus the subsidy on contributions that are marginal. Recruiting these wealthy donors as monitors is largely compatible with this agenda. We should create incentives for them to concentrate their giving and invest time.

Yet this agenda obviously will be less successful at reflecting popular preferences, since the charitable priorities of wealthy people are not fully representative. How, then, can we ensure that every else's preferences are also satisfied? One possibility is to look to government programs, instead of subsidized charity, to ensure representativeness. In effect, we would look to subsidized charity to encourage generosity and to recruit private monitoring, while leaving it to other policy instruments to advance goals that wealthy donors are not interested in pursuing through philanthropy. This is the approach that I would follow, but others can reasonably take a different view.

If subsidized charity must itself be more representative, the agenda described above can be modified in ways small and large, depending on how willing we are to sacrifice success at encouraging generosity and recruiting private monitors. Participation requirements are a relatively modest adjustment. At the other end of the spectrum, we can mine the preferences of low-income taxpayers with a check-off system (or an extra- generous match), while capping the subsidized contributions of wealthy donors and constraining their ability to choose which causes to support. The balance we strike depends, ultimately, on the values we seek to pursue. Yet even then, thoughtful institutional design can help us negotiate these tradeoffs more effectively.

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