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Striking the Balance: How Taxes Shape Charitable Giving & How Charitable Giving Shapes Taxes

by
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Charitable giving is a vital pillar of public good funding, from supporting education to addressing climate change. Yet, charitable giving plays also a vital role in supporting those who are least well off. At the same time, governments play a key role through taxation and public spending. This dual system raises a compelling question: How can tax policies best be used to ensure fairness and efficiency? A groundbreaking study by Thomas Aronsson, Olof Johansson-Stenman, and Ronald Wendner (JPE Micro, 2024) offers fresh insights into this issue.

The Challenge of Encouraging Generosity

In 2021, charitable giving in the United States accounted for over 2% of GDP, a significant contribution to public welfare. But donations alone aren't enough – governments also invest heavily in public goods. To optimize this balance, the researchers explored tax policies that consider human motivations, such as the personal satisfaction of giving (often called the "warm glow") and the social status linked to charitable acts.

Their study integrates these behaviors into an advanced taxation model, providing practical guidelines for policymakers.

Key Insights

Should the Government Contribute directly to Public Goods or rely on Subsidized Voluntary Contributions?

- If giving involves no transaction costs (like fundraising expenses): Governments should subsidize donations to the point where private contributions fully replace

public funding. This approach takes into account the added satisfaction people derive from giving.

- When transaction costs are included, however, governments need to directly fund public goods alongside subsidizing donations to avoid inefficiencies.

Flat Subsidies vs. Progressive Subsidies

- A government that values all aspects of personal well-being (a "welfarist" approach) should apply a flat-rate subsidy to all donors, regardless of income.
- A government that does not attach social value to warm glow (a "non-welfarist" approach) should adopt progressive subsidies, offering larger incentives to high-income donors. This strategy leverages the redistributive power of the tax system.

Status and Social Dynamics

Charitable giving often serves as a status symbol. While this can inspire generosity, it may also create social tensions, such as envy. The study finds that policies should account for these dynamics, adjusting subsidies to balance the benefits of conspicuous giving against its potential downsides.

Redistributing Through Giving

Subsidizing high-income donors can be especially effective, as their contributions often provide greater societal benefits.

Implications for Policy

This study underscores the importance of tailoring tax policies to human behavior. Encouraging charitable giving isn't just about incentivizing generosity; it's also about addressing transaction costs, promoting fairness, and managing social dynamics like status-seeking. Governments should consider a dual approach: pairing subsidies with direct public investments, particularly where transaction costs make private contributions less efficient. Additionally, targeting high-income earners with progressive subsidies can enhance both public good funding and income redistribution.

Conclusion

At its heart, tax policy for charitable giving can be used to support redistributive income taxation. By understanding why people give—and designing policies that support those motivations—governments can design better redistributive tax systems, accounting for taxing or subsidizing charitable giving, that benefit everyone.

This blog is based on the following research article, which was published in November 2024:

Thomas Aronsson, Olof Johansson-Stenman and Ronald Wendner

Charity, Status, and Optimal Taxation: Welfarist and Non-Welfarist Approaches

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