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"'I Like to Pay Taxes': Lessons of Philanthropy for Tax and Spending Policy."

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Vanderbilt Hall-208
Time: 4:00-5:50pm
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SCHEDULE FOR 2012 NYU TAX POLICY COLLOQUIUM

(All sessions meet on Tuesdays from 4:00-5:50p.m. in Vanderbilt Hall-208, NYU Law School)

1. January 17 – Michelle Hanlon, MIT, Sloan School of Management. "Taking the Long Way Home: Offshore Investments in U.S. Equity and Debt Markets and U.S. Tax Evasion." (with Edward L. Maydew and Jacob R. Thornock).

2. January 24 – Amy Monahan, University of Minnesota Law School. "Will Employers Undermine Health Care Reform by Dumping Sick Employees?" (with Daniel Schwarcz).

3. January 31 – Alex Raskolnikov, Columbia Law School. "Accepting the Limits of Tax Law and Economics."

4. February 7 – Victor Fleischer, University of Colorado Law School. "Tax and the Boundaries of the Firm."

5. February 14 – Heather Field, Hastings College of Law. "Binding Choices: Tax Elections & Federal/State Conformity."

6. February 28 – Daniel Shaviro, New York University School of Law. "The Financial Transactions Tax Versus (?) the Financial Activities."

7. March 6 – Edward Kleinbard, USC Gould School of Law. "The Sorry State of Capital Income Taxation."

8. March 20 – Susan C. Morse, Hastings College of the Law. "International Corporate Tax Reform and A Corporate Offshore Excise Tax."

9. March 27 – Stephen Shay, Harvard Law School. "Unpacking Territorial."

10. April 3 – Jon Bakija, Williams College Economics Department. "Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from U.S. Tax Return Data."

11. April 10 – Lane Kenworthy, University of Arizona Sociology Department. "Progress for the Poor, Chapters 6, 8 and 9."

12. **April 17 – Yair Listokin, Yale Law School. "'I Like to Pay Taxes': Lessons of Philanthropy for Tax and Spending Policy." (with David Schizer)**

13. April 24 – Alan J. Auerbach, Berkeley Economics Department and NYU. "The Mirrlees Review: A U.S. Perspective."

14. May 1 – Rosanne Altshuler, Rutgers Economics Department, and Harry Grubert, U.S. Treasury Department. "Fixing the System: An analysis of Alternative Proposals for the Reform of International Tax."

I Like To Pay Taxes:

Taxpayer Support for Government Spending and the Efficiency of the Tax System

By Yair Listokin & David M. Schizer[1]

Draft of March 29, 2012

Please do not quote this draft without permission

[1] We are grateful for comments received from Elizabeth Emens, Bert Huang, Alex Raskolnikov, Elizabeth Scott, and at a workshop at Columbia Law School.

"I like to pay taxes. With them I buy civilization." Oliver Wendell Holmes

Why do people pay taxes? The simplest answer is that they have a legal obligation to do so. But it has long been recognized that this legal obligation alone provides an inadequate explanation for taxpaying behavior,[2] just as legal obligations generally offer an inadequate explanation for most law-abiding activity.[3] Another answer, then, is that some people pay taxes because – like Oliver Wendell Holmes – they like to do so. They appreciate that the government provides a vast array of public goods, such as rule of law, roads, schools, and aid to the poor, and are happy to contribute to the public welfare.

This paper is based on a simple proposition, which we believe but cannot prove: that our tax system will be more efficient if taxpayers "like" paying taxes. In other words, if taxpayers support the way their tax dollars are spent, they are more likely to comply voluntarily and less likely to change their behavior to avoid tax. To show that our claim is plausible, we offer direct evidence from a literature involving experiments. We also draw on the more general economics and psychology literature on prosocial behavior – that is, the propensity to provide for public goods without any economic reason for doing so. In addition, we invoke philanthropy as a "real world" analogy, since charitable donors contribute money voluntarily (indeed, 2% of the GDP), largely because they believe in the way their contributions are used.

If we are right, the public finance literature has neglected an important connection between taxes and spending. Our claim also has a number of concrete policy applications. For instance, the government should actively publicize popular uses of tax dollars, while also making broader use of taxes, like lotteries for education and the social security tax, which are dedicated to specific (popular) spending programs. We also offer a new justification for subsidiarity – the idea that services should be provided by the lowest level of government competent to do so – on the theory that taxpayers will be more aware of, and feel more connected to, a local or state government's activities. In addition, all governments should go to particular lengths to root out waste, which otherwise will erode taxpayers' prosocial motivations to pay taxes. Furthermore, the government should seek voluntary contributions from taxpayers for programs they especially value. We may also want to take the more controversial step of letting taxpayers allocate some of their tax bill to programs they value, though only in a limited way.

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[2] James Alm & Benno Torgler, Culture Differences and Tax Morale in the United States and Europe, 27 J. ECON. PSYCH. 224, pg# (2006) [hereinafter Alm & Torgler, Cultural Differences]; James Alm & Benno Torgler, Estimating the Determinants of Tax Morale, in PROCEEDINGS OF THE 97TH ANNUAL CONFERENCE ON TAXATION, 2004, MINNEAPOLIS, MINN.: NAT'L TAX ASSOC. 269-274 (2005) [hereinafter Alm & Torgler, Estimating].

[3] Tom Tyler, Why People Obey The Law (Yale University Press, 1990); The Social Psychology of Procedural Justice (Plenum, 1988)

Part I explains why the tax system is more efficient if taxpayers support the way their tax dollars are spent. Part II observes that this insight generally is not taken into account in the public finance literature. Parts III and IV offer institutional applications of this idea. Part V is the conclusion.

I. Taxpayer Opinions About Spending and the Efficiency of Our Tax System

We begin by offering reasons why, in theory, our tax system should be more efficient if taxpayers support the way their money will be spent. We then show the plausibility of this claim with three sources of empirical evidence: experimental studies on taxpayer responses to the way their tax dollars are spent; the more general literature on prosocial behavior; and studies of philanthropy. We then use polling data to show that taxpayer support for government spending is weak, at least as measured in certain ways, so that there is significant room for improvement on this dimension.

A. Reducing Enforcement Costs and Tax-Motivated Behavior

We begin by asking why it matters whether taxpayers support the way the government spends their tax dollars. After all, taxes are mandatory. Taxpayers are legally obligated to pay them, even if they do not like the way the government uses the money. Even so, there are at least three reasons why we believe it still matters.

First, although taxes are legally mandatory, they are costly to enforce. Indeed, some taxes, such as use taxes and nanny taxes are so costly or impractical to enforce that those who pay these levies may feel as if they are choosing to do so.

Second, and more generally, a tax system will be more legitimate and also more efficient if more people choose to pay voluntarily – that is, if the tax system does not depend solely on muscular enforcement to extract taxes from an unwilling population. It is better if taxpayers are motivated not just by fear of legal sanctions, but also by support for the government and for the way the money is used. At the margin, it will take less effort and expense to ensure that they pay.

Third, if taxpayers support the way their tax dollars are spent, they may be less likely to modify their behavior in a range of inefficient ways that would reduce their tax bill. Although the existing literature on the subject focuses on compliance, we seek to broaden the lens. After all, a wide range of taxpayer choices affect tax liability, including how much labor to supply, how much to consume, how much to invest in legal tax avoidance strategies, and the like. If taxpayers support the way their tax dollars are spent, this positive feeling could influence these other choices as well as evasive behavior. For example, taxpayers who like the public goods funded by their tax dollars may not curtail labor supply in response to taxation as much as is generally assumed. As a dollar of tax spent on a desirable public good becomes more like a dollar of consumption, the tax becomes less distortive of decision-making.

B. Experimental Literature on Taxpayer Responses to Uses of Tax Revenue

Yet is there any empirical evidence to support this argument? Are people really more willing to pay taxes when they support how their tax dollars will be spent? Three experimental studies suggest that, in fact, they are.

In a 1993 study, James Alm, Betty Jackson, and Michael McKee conducted a lab experiment testing whether compliance rates rise when taxpayers support how their money will be spent. They find a significant difference: the average compliance rate falls from .337 for a popular use to .081 for an unpopular one.[4] As one participant noted, "My payments would be lower if I disclosed less [i.e., if I cheated] but then the check to the Financial Aid Office [the popular use] would be smaller."[5] Compliance rates are also higher in their study when taxpayers are consulted (through a majority vote) about how their money will be used. "[C]ompliance suffers when individuals have no control over the use of their tax payments," they conclude, and "when their taxes pay for public goods that are unpopular."[6] As a result, "government can generate greater compliance by ensuring that individuals feel that they have a say in the manner in which their taxes are spent, that citizens are well-informed of the outcome of the vote, and that taxes are spent in ways consistent with the preferences of the citizens."[7]

In addition, two recent "real donation" experiments suggest that taxpayers will even give *voluntarily* to the government if they support the way their money will be used. First, Li, Eckel, Grossman & Brown test whether people are willing to contribute voluntarily to the government and, if so, whether they donate more or less than to a charity pursuing a similar mission. The study asks college students to make a series of choices (anonymously and voluntarily) in which they allocate $20 either to themselves or to a specified organization. They are given pairs of organizations – one a charity and the other a governmental organization – dedicated to the same mission, which is either wildlife preservation, disaster relief, cancer research, or education. On average, the subjects give 22 percent of their budgets to governments ($4.40 of $20); this is only slightly lower than the 27% they gave to charity ($5.30 of $20).[8]

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[4] James Alm, Betty R. Jackson & Michael McKee, *Fiscal Exchange, Collective Decision Institutions, and Tax Compliance*, 22 J. ECON. BEHAV. & ORGAN. 285, 298 (1993) ("The average compliance rate in IFC [when a popular use, student financial aid, is imposed] is 0.228, and falls enormously to only 0.081 when the choice is both imposed and unpopular in INC [an unpopular use, the University President's office]").
[5] *Id.* at 301.
[6] *Id.* at 301.
[7] *Id.* at 301-302; *see also* Yankelovich, Skelly & White, *Taxpayer Attitudes Survey* (1984); Quint C. Thurman, Craig St. John & Lisa Riggs, *Neutralization and Tax Evasion: How Effective Would a Moral Appeal Be in Improving Compliance to Tax Law"*, 6 LAW & POL'Y 309 (1984) (finding significant relationship between index measuring objections to government spending and self-reported compliance); (finding that attitudes about exchange relationship with government affect compliance).
[8] Sherry Xin Li, Catherine Eckel, Philip J. Grossman & Tara Larson Brown, *Giving to Government: Voluntary Taxation in the Lab*, 95 J. Pub. Econ. 1190 (2011).

In a second study, they show that subjects are more likely to give and also more generous if allowed to choose a specific use for their donation.[9] Subjects are asked to make a series of choices about how to allocate $20. Sometimes they are invited to donate to a general government fund ("Gifts to the United States"), and sometimes to governmental agencies that serve specific causes (National Cancer Institute Gift Fund or Corporation for National and Community Service Disaster Relief Fund). They are also invited to donate to a general charity (the United Way) or to a charity that serves a specific cause (American Cancer Society or American Red Cross Disaster Relief Fund). When giving to the government, subjects are more than twice as likely to give if a cause is specified (64% versus 30% of subjects) and their gifts are nearly three-times as large on average ($4.78 out of $20 versus $1.68 out of $20). Giving to charities is also more common and more generous if a cause is specified, although the differential is smaller (74% versus 54% and $5.82 versus $3.69). "This suggests that people value control over the use of their contributions," Li, Eckel, Grossman & Brown conclude. "When such control is lacking (e.g., the federal general fund or the United Way), people give significantly less and are more likely to give zero."

C. The Literature on Prosocial Behavior

These studies fit within a broader literature showing that people derive utility from supporting public goods – a point that, if true, lends credibility to our claim. Indeed, economists and psychologists have shown that, in a wide variety of settings, people free ride less than economic theory would suggest.[10] The terms "prosocial behavior" and "prosocial utility" are used to describe this unselfish instinct which leads people to care about the wellbeing of others.[11]

1. *Tax Morale*

Some of this scholarship has been about tax enforcement: the "tax morale" literature shows that U.S. taxpayers comply with the tax law at a higher rate than deterrence models would predict.[12] Evidence suggests that most Americans pay what they owe even though most would benefit economically from cheating on their taxes – since the expected savings would exceed expected penalties, given imperfect enforcement. Indeed, in the United States, the IRS estimates

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[9] Sherry Xin Li, Catherine Eckel, Philip J. Grossman & Tara Larson Brown, *Do Earmarks Increase Giving to Government?* (11/13/11).

[10] For example, in a common laboratory experiment (the "dictator game"), people are given a sum of money and asked to divide it between themselves and another player. They bear no economic consequence for keeping all of the money for themselves. Across many different societies, people share some of the money with other players rather than keeping it all for themselves as predicted by theories of rational self interest (Cite to Henrich et al in American Economic Review)

[11] Meier at 3.

[12] J. Alm, G.H. McClelland, W.D. Schulze, *Why Do People Pay Taxes?* 48 J. PUB. ECON. 21 (1992); L.P. Feld & B.S. Frey, *Trust Breeds Trust: How Taxpayers are Treated*, 3 ECON. OF GOVERNANCE 87 (2003).

the voluntary compliance rate at 84%.[13] This compares favorably with compliance rates in many other countries.[14]

Why do Americans comply so readily? The tax morale literature identifies several factors that encourage this prosocial taxpaying. A "social norm" of compliance raises tax compliance rates (Alm, Sanchez, and De Juan 1995), as do perceptions of fairness in tax administration, the perceived equity of government spending, overall levels of trust in the government (Cummings et al 2004, Alm and Torgler 2004), as well as ethical commitments, altruism, and patriotism.[15] Indeed, according to Alm and Torgler, who are leading figures in the tax morale literature, one reason why taxpayers comply is that "[i]f taxpayers perceive that their preferences are adequately represented and they are supplied with public goods, their identification with the state increases, and thus the willingness to pay taxes rises."[16] In other words, governments can improve tax compliance – inducing taxpayers to pay voluntarily – by including citizens in their decisions, and by delivering high quality results.

Admittedly, we should not overstate the precision of this literature. It suffers from a reverse causation problem. While people who mistrust government may be less inclined to pay taxes, people who are uninclined to pay taxes might also rationalize this impulse by invoking their mistrust of government.[17] There are also omitted variable bias problems. Although we know that Americans trust their government more than Greeks and also are more likely to pay taxes, we cannot assume that one phenomenon is causing the other; instead, there may be yet another factor (e.g., religion, education, etc.) that encourages both.[18]

2. *Size, Marginal Return, and In-Group Effects*

Other areas of the study of pro-social behavior – not specifically focused on tax – have made more progress in establishing causal links between institutional features and pro-social behavior. In his seminal treatment of the free rider problem and public goods provision, Olson

[13] http://www.irs.gov/newsroom/article/0,,id=158619,00.html.

[14] See, e.g., James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe*, 27 J. ECON. PSYCH. 234 (2006) (finding that tax morale in the United States is higher than in fifteen European countries).

[15] *See generally* Samuel Bowles & Sandra Polania-Reyes, *Economic Incentives and Social Preferences: Substitutes or Compliments?* J ECON LIT. (draft of Sept 2011)

[16] *Id.* at 243.

[17] Meier 2006 at 10

[18] Field experiments can be designed to avoid these flaws, but the results do not always seem perfectly consistent. For instance, one experiment shows that taxpayers who are told that compliance rates are higher than they might have expected will claim fewer deductions (Wenzel 2001, cited in Meier at 11). Another, by contrast, shows that simple normative appeals to taxpayers asking for compliance have little causal effect on taxpaying behavior (Blumenthal and Slemrod, NTJ 2001, cited in Meier at 10).

(1965) famously argued that smaller groups will have an easier time overcoming the free rider problem than larger groups.[19] Many papers provide some degree of support for this hypothesis.[20]

Experimental evidence also demonstrates that individuals are more likely to contribute to public goods when the beneficiaries are members of the same "group." Even a seemingly trivial group identifier (preference for the artist Kandinsky over Klee or vice versa) inspires people to behave in a more prosocial manner (Tajfel 1981). Subjects who are randomly assigned to one group are more likely to cooperate prosocially with other group members than with individuals randomly assigned to another group (Goette Huffman and Meier 2006). Observational studies strongly support the laboratory evidence that group identification is an important determinant of prosocial behavior. Researchers have documented that redistribution (Luttmer 2001), willingness to participate in social organizations (Alesina and La Ferrara 2000), and public goods provision all decrease as ethnic diversity increases.

3. *Moral Engagement*

Prosocial behavior can also be encouraged or discouraged by institutional context. The setting can inspire either self-interest or so-called "moral engagement." This explains the famously counterintuitive finding that parents are more likely to pick up children late from daycare if they are fined for doing so. The fine inspires them to view overtime childcare as a service to be purchased, rather than as a boorish imposition on the community.[21] By contrast, if a fine is not seen as a price, but as a penalty for breaching community norms, people are less likely to incur it.[22] A long literature seeks to document when economic incentives, such as fines, serves as "substitutes" for prosocial incentives, as in the childcare example, versus when economic incentives "complement" prosocial incentives.[23]

D. The "Real World" Case Study of Philanthropy

So far, we have offered reasons why taxpayers are more likely to comply with the tax law, and less likely to change their behavior inefficiently to avoid paying, if they support the way their tax dollars are used. To show the plausibility of this claim, we have cited different aspects of the economics and psychology literature on prosocial behavior.

[19] In the extreme, people will free ride in small groups just as they do in large groups. So long as the public benefits of a public good contribution exceed the private benefits, then there should be free riding and underprovision. Smaller groups may be better at designing mechanisms to overcome this problem, however. See, e.g., Ostrom.

[20] See (Isaac and Walker QJE 1988 at 4, Isaac and Walker (1988) and by Isaac, Walker, and Williams (1991), Andreoni 1988, Partners and strangers,

[21] Gneezy & Rustichini 2007 ((fines for daycare in Haifa caused people to think the fine was a price).

[22] For example, fines for using plastic bags have been even more effective than self-interest would predict, since they are viewed as reinforcing a community's moral commitment. Rosenthal (2008) (fines for plastic bags in Ireland was a signal about moral / community norms); Funk (2007) (lifting fine on not voting lead to less voting).

[23] Bowles & Polonia Reyes, supra note xxx

Perhaps the most telling evidence that people give money if they support how it will be used, though, is the charitable sector. Even if we are skeptical about the imprecision and artificiality of experimental studies on prosocial behavior and the methodological limitations of the tax morale literature, we must recognize that millions of people give time and money to charity every day. The nonprofit sector represents 2% of GDP and individuals across the income spectrum make charitable contributions. It is therefore not surprising that economists and psychologists interested in prosocial behavior have developed a robust literature exploring the non-profit sector.

1. Why People Give: The Literature on Altruism and Warm Glow

In explaining why donors give to charity, the literature on philanthropy emphasizes, not surprisingly, that donors believe in the way their money is being used – a close analogy for our claim about the tax system. The focus of this literature is on two different prosocial motivations: altruism and warm glow. [24]

"Altruism" means that individuals derive utility from providing goods that can be enjoyed by others (public goods). While altruism's connection to philanthropy is obvious, there are two reasons why altruism alone does not explain charitable giving. First, if donors care only about the overall supply of a public good, they should reduce their giving, dollar for dollar, by the amount funded by the government.[25] Yet the empirical evidence contradicts this prediction. Government funding does not "crowd out" charitable giving to the degree predicted by theories relying on altruism.[26] Second, if giving is motivated solely by altruism, a small number of wealthy individuals should be the exclusive givers of every type of charity.[27] The reason is that altruistic donors would give when the benefit of spending a dollar on a public good outweighs the benefit to them of spending another dollar on a private good, and wealthy individuals derive

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[24] James Andreoni, Charitable Giving, in NEW PALGRAVE DICTIONARY OF ECONOMICS 748 (Lawrence E. Blume & Steven N. Durlauf eds., 2d ed. 2007).
[25] *See* James Andreoni, *Philanthropy*, in HANDBOOK OF GIVING, RECIPROCITY AND ALTRUISM, 1201, 1221 (Serge-Christophe. Kolm and J. Mercier Ythier eds., 2006) (summarizing crowding out hypothesis). See Peter G. Warr, *Pareto Optimal Redistribution and Private Charity*, 19 JOURNAL OF PUBLIC ECONOMICS 131 (1982) (developing theory of neutrality in which government contributions crowd out charity on a dollar-for-dollar basis).
[26] *See, e.g.*, Burton A. Abrams & Mark D. Schmitz, *The "Crowding Out" Effect of Government Transfers on Private Charitable Contributions*, 33 PUB. CHOICE 29 (1978) (offering empirical analysis showing that for every dollar of government support, there is a decline of 28 cents in private contributions); David C. Ribar & Mark O. Wilhelm, *Altruism & Joy-of-Giving Motivations in Charitable Behavior*,110 J. POL. ECON. 425, 444 (2002) (offering empirical support for fact that charity is motivated by joy of giving and not altruism, as there is very little evidence of crowd out; private giving declines by only 23 cents for every dollar of government spending and by only 8 cents for every dollar of spending by a charity with a similar mission, analyzing database from 1986 to 1992 involving database of 125 organizations that give foreign aid). There is experimental evidence too (*See* Andreoni, *supra* note 26, at 1223 for cites).

less benefit from another increment of private goods. Yet although wealthier individuals do give more in absolute dollars, they do not give more as a percentage of income.

To be more concrete, consider a moderate income individual who deplores the idea of others going hungry. If the government got into the hunger avoidance business, that individual should give less. Similarly, she should give a lower percentage of her income to combatting hunger than a wealthier individual with the same commitment to the cause. As long as enough wealthy individuals in the population support hunger avoidance, the moderate income individual should give nothing. Yet moderate income individuals give to charity at rates comparable to much wealthier citizens.[28]

Since altruism does not fully account for patterns of giving, economists invoke a second type of prosocial behavior known as warm glow, which means that individuals give to charity – not only because they value a particular public good – but also because they want to be the one *providing* it. Having someone else, like the government, provide the good is not the same as being its source.

2. Strategies to Encourage Charitable Giving

Our goal in this Article is not only to suggest that taxpayers are more likely to pay their taxes if they support the way their tax dollars are used, but also to help policymakers take advantage of this insight through better institutional design. In this spirit, it is worth surveying various ways in which nonprofits enhance warm glow and otherwise encourage giving.

a. Sympathy for the Cause

Not surprisingly, fundraisers seek to persuade potential donors of the value of their cause. They publicize their successes and seek to show that they are pursuing their mission efficiently. In asking for support, many charitable campaigns emphasize specific goals that their fundraising will achieve – addressing a particular crisis, financing a new building, and the like.

Relatedly, nonprofits invite donors to choose what they want to support, so that donors are paired with initiatives matching their preferences.[29] Some donors to a law school, for example, support financial aid, while others support faculty research, public interest programs, curricular initiatives, or building projects. Giving donors a choice also gives them a greater sense of ownership, so that they feel personally invested in the cause they are supporting.

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[27] James Andreoni, Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving, 100 ECON. J. 464, 465 (1990).

[28] *See* http://www.cbo.gov/ftpdocs/124xx/doc12480/10-18-charitableTestimony.pdf, at page 6 (demonstrating that households with adjusted gross income below $50,000 give slightly greater than two percent of adjusted gross income to charity, while households with $200,000-$500,000 give less than 2.5% of adjusted gross income to charity).

[29] David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221 (2009).

b. **Financial Incentives**

In addition, many campaigns involve "matching" grants, which promise that, for each dollar raised from a donor, an additional "matching" grant will come from another donor. Why should charitable campaigns be organized this way? It would be far simpler for each donor to contribute separately. In addition, if charitable giving is motivated by altruism alone, matching gifts would be counterproductive, since they would motivate potential donors to free ride. Yet this has not been the experience of fundraisers, presumably because matching inspires warm glow. When our donations are matched, we feel as if we are responsible for even more giving – not just what we personally give, but also the match triggered by our gift. Indeed, a field experiment by Karlan and List finds that the offer of a matching grant increases charitable giving by approximately 19%.[30]

c. **Recognition, Shaming and Community Norms**

Likewise, giving is encouraged through recognition. People are encouraged to give in order to have their names on a building or scholarship, to be included on a list of donors, or to serve on a board. The literature sometimes describes this sort of reputational motivation as a form of "extended self-interest."

Just as people may give to make a favorable impression on others, they may also give to *avoid making a bad* impression or, relatedly, to avoid the embarrassment or awkwardness of saying "no." Peter Diamond has argued that this sort of "defensive" motivation should not be viewed as contributing to welfare. If "warm glow" is really just avoiding the awkwardness of saying "no" to a solicitation,[31] he says, we should not view it as a positive source of utility. This seems wrong to us or, at least, it is a much more sweeping claim than he suggests. After all, many aspects of consumption have this quality. We might buy a beautiful car to avoid the embarrassment of driving a clunker, and to make sure that our consumption is comparable to that of our neighbors (i.e., "keeping up with the Jones'"). In assessing the welfare effects of such a purchase, we would not ordinarily distinguish between a consumer's sincere appreciation for the good itself, on one hand, and the reputational disutility she is avoiding, on the other.

E. Lack of Confidence in Government Spending: The Bleak Picture from Polling Data

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[30] *See* Dean Karlan & John List, *Does Price Matter in Charitable Giving? Evidence from a Large-Scale Natural Field Experiment*, 97 AM. ECON. REV. 1174 (2007); *see also* John A. List & Daniel Rondeau, *Matching and Challenge Gifts to Charity: Evidence from Laboratory and Natural Field Experiments*, 11 EXPERIMENTAL ECON. 253 (2008) (finding a large increase in donations when a fundraising campaign included matching donations); Bruno S. Frey & Stephan Meier, *Social Comparisons and Pro-Social Behavior: Testing 'Conditional Cooperation' in a Field Experiment*, 94 AM. ECON. REV. 1717 (2004).

[31] A recent paper estimates that the cost of saying no to someone who knocks at one's door to solicity for charity is between $1.40 and $3.80. See "Testing for Altruism and Social Pressure in Charitable Giving," Stefano DellaVigna, John A. List and Ulrike Malmendier, the Quarterly Journal of Economics (forthcoming).

So far, we have offered a theory about why taxpayer views on the way tax dollars are spent *could* affect the efficiency of the tax system. Although we cannot prove our theory definitively, we have sought to establish its plausibility by drawing on the economics and psychology literature on pro-social behavior. This literature offers evidence that people pay taxes and contribute in other ways to the community – even when it is not in their economic interest to do so – not only because they *have* to do so, but also because they *want* to do so. Indeed, the fundraising efforts of charities are a concrete precedent for this, representing 2% of the U.S. economy.

If we are correct that people are more likely to pay their taxes and less likely to change labor and savings decisions in order to minimize their tax liability if they believe in what the government is doing, there is reason to be concerned about the current state of American public opinion. Tax morale may be higher than in other countries, as noted above, but polls show that, unfortunately, taxpayer confidence in the way the U.S. government spends money is weak, and getting weaker. According to a 2011 Gallup poll, Americans believe the Federal government wastes 51 cents of every dollar it spends. This is the highest estimate on record, which is 11 cents more than in 1979 when the first poll on the subject was taken.[32]

It is also sobering that Americans do not seem to connect the taxes they pay with the services they receive from the government. For example, a majority of Americans believe they get less in government benefits and services than they are paying in taxes, even at a time when government spending dramatically exceeds tax revenue by almost 10% of the GDP.[33] Similarly, surveys about the Bush tax cuts showed that people who favored more spending on specific government programs were, ironically, *more likely* to support the tax cuts.[34] Likewise, Americans generally endorse "spending cuts" in the abstract as a way to reduce the federal deficit,[35] but they consistently oppose cuts in *specific* government programs. According to a 2012 *N.Y. Times* article about a conservative county in Minnesota:

> Support for spending cuts runs strong in Chisago . . . . But the reality of life here is that [residents of the county] continue to take as much help from the government as they can get. When pressed to choose between paying more and taking less, many people interviewed here hemmed and hawed and said they could not decide. Some

[32] Americans Say Federal Gov't Wastes Over Half of Every Dollar, Sept 19, 2011, Gallup Website.

[33] Alison Kopicki, *Most Americans Expect to Give More Than They Receive, Poll Finds*, N.Y. Times, Feb. 12, 2012 ("A majority of Americans say they expect to pay more in federal taxes over their lifetime than they will ever receive in benefits from the government, according to a recent New York Times poll. At the same time, the taxes Americans pay today are not keeping pace with the growing costs of government.").

[34] Larry M. Bartels, Homer Gets a Tax Cut: Inequality and Public Policy in the American Mind, 3 Perspectives on Politics 15, 23 (2005) ("those respondents who wanted to spend more money on a wide variety of specific government programs were also more likely to favor cutting the taxes necessary to fund those programs.").

[35] *Millionaire Tax Has Support, But More Favor Cuts*, Denver Post, Feb. 24, 2012. (According to an Associated Press-GFK poll, "by 56 percent to 31 percent, more embraced **cuts** in government services than higher taxes as the best medicine for the budget, according to the survey, which was conducted Feb. 16 to 20.")

> were reduced to tears. It is much easier to promise future restraint than to deny present needs. "How do you tell someone that you deserve to have heart surgery and you can't?" Mr. Gulbranson said. He paused. 'You have to help and have compassion as a people, because otherwise you have no society, but financially you can't destroy yourself. And that is what we're doing." He paused again, unable to resolve the dilemma. "I feel bad for my children."[36]

As Larry Bartels has observed, "Survey results . . . make it clear that most ordinary citizens are remarkably ignorant and uncertain about the workings of the tax system and the policy options under consideration, or actually adopted, in Washington."[37]

The silver lining here, of course, is that there is significant room for improvement. Americans clearly do support specific government programs. In other words, Americans like at least some of what the government is doing. But they seem not to associate the taxes they pay with the programs they like. One implication, of course, is for the government to focus its spending more on initiatives that are likely to attract popular support. Another implication, which is the focus of this Article, is that the government should make a more concerted effort to educate taxpayers about how their tax dollars are being spent and to encourage them to associate tax payments more directly with government initiatives that they favor. The question, though, is how to do this. Parts III and IV turn to this question. But first, Part II shows that our claim has not been adequately reflected in the public finance literature.

II. Incorporating Warm Glow and Other Prosocial Motivations In the Public Finance Literature

The last Part argued that taxpayers are more likely to comply with the tax law, and less likely to change labor and savings decisions in order to avoid paying taxes, if they support the way the government is spending their tax dollars. In making the claim that taxpayers might derive prosocial utility from paying taxes to fund public goods, we posit a novel connection between the cost of raising tax revenue, on one hand, and the way this tax revenue is spent, on the other.

In the optimal tax literature, the analysis of how to *raise* revenue generally is treated as analytically separate from the question of how to *spend* it.[38] A certain level of revenue is assumed to be needed, and the optimal tax literature considers how to raise it most efficiently and equitably. The idea that the efficiency of the tax system could depend in part on *what public*

[36] Binyamin Appelbaum & Robert Gebeloff, *Even Critics of Safety Net Increasingly Depend on It*, N. Y. Times, Feb. 12, 2012

[37] Bartels, *supra*, at 21.

[38] Joel Slemrod & Shlomo Yitzhaki, *Integrating Expenditure and Tax Decisions: The Marginal Cost of Funds and the Marginal Benefit of Projects*, 54 N. TAX J. 189, 189 (citing Musgrave and Musgrave "lament[ing] the disconnection between the expenditure and tax sides of public finance").

goods it is funding is generally not considered in this literature.[39] Likewise, the possibility that taxpayers might derive prosocial utility from in paying taxes – and that we might want to structure our system to encourage this utility – also does not feature in the optimal tax literature.

In our view, prosocial motivations need to be included in these theoretical explorations of tax design. A tax that inspires warm glow or other prosocial motivations may alter behavior differently than other taxes (and, for that matter, other changes in price). If we do not take account of prosocial motivations, we may overstate the costs of taxation. Indeed, a tax and spending regime that facilitates prosocial motivations may be preferable, even if it seems deficient when analyzed from a standard public finance or optimal tax framework. In this spirit, many of the policy recommendations that follow demonstrate the difference between this "prosocial" perspective on taxes and the conventional analysis. When analyzed with standard public finance criteria, our recommendations add nothing and may even detract, since they increase transaction and administrative costs. But from the prosocial perspective, these recommendations may have prosocial benefits that outweigh their direct costs.

Even a small degree of prosocial utility can yield disproportionately large efficiency gains. Suppose taxpayers face a $1 dollar tax but get $.05 of prosocial utility from the public goods enabled by the tax (in addition to any private benefits the taxpayer derives). As a result, taxpayers perceive the $1 tax as having an effective cost of $.95. Because the deadweight loss of a tax is proportional to the square of the size of the tax, this 5% reduction in the effective size of the tax is associated with a nearly 10% reduction in the inefficiency associated with the tax.[40]

III. Applications: Accentuating the Positive and Eliminating the Negative

We have argued that taxpayers are more likely to pay their taxes – and less likely to change labor, savings, and other decisions for tax-motivated reasons – if they support the way their taxes will be used. If we are right, how should our tax system change? How can we encourage taxpayers to experience warm glow and other prosocial motivations in paying their taxes?

In general, the government should seek ways to remind taxpayers that their taxes are funding programs they value. As the old song goes, "accentuate the positive." Where possible, the government should pursue policies that are popular or, at least, to focus publicity on those policies.

The other side of this coin, of course, is that government policies are not always popular. While elected officials no doubt are well aware of the perils of pursuing unpopular policies, we

[39] The Li et al, papers, supra note 8 are exceptions to this rule.
[40] $.95^2=.9025$, which is nearly 10% lower than 1^2. If the warm glow value is much higher, say 50% of the value of the tax, then the decrease in inefficiency associated with the tax would be 75%.

emphasize a cost that may not be well understood: Taxpayers will especially resent taxes that fund programs they consider misguided or even immoral, and they may be particularly motivated to engage in legal tax avoidance or even illegal evasion to minimize their contribution to these programs.[41] Accordingly, we should "eliminate the negative." The government should try, to the extent possible, to avoid unpopular policies or, at least, to deemphasize them to taxpayers who disagree.

An obvious challenge is that our country is diverse, even polarized. Programs that appeal to some will be resented by others. In a sense, one person's warm glow is another's cold shower. In response, the government can also look for ways to pair taxpayers with initiatives they personally value, so that taxpayers will associate taxes with these programs, instead of with ones they dislike. In effect, this strategy is to segment taxpayers, so that individuals are supporting (or at least believe they are supporting) different initiatives. We consider this sort of choice-based approach – which, as we shall see, is more controversial – in Part IV.

A. Prosocial Benefits from Publicizing Popular Government Activities

Positive publicity for government spending can enhance our tax system's efficiency. With conventional goods, publicity is important in providing information for those who might be interested in using them. This rationale also applies to public goods.

Yet for public goods, publicity can also serve another purpose: By promoting warm glow and other prosocial motivations, publicity can add value even for taxpayers who will never even use the public good. By analogy, charitable organizations frequently trumpet their accomplishments to inspire warm glow, describing their activities in magazines, mailings, emails and tweets. They market their missions with phrases connecting donor support with concrete achievements such as, "for the price of your daily latte, you can feed a child."

Governments should (and do) engage in similar trumpeting – in signs about "your tax dollars at work," in press releases from politicians about benefits secured for constituents, and the like. Although political scientists generally dismiss these expenditures as inefficient "credit claiming" by politicians eager for reelection, the prosocial perspective suggests that this publicity has value in three related respects if it enhances warm glow.[42]

First, the government can help taxpayers derive satisfaction from paying taxes by showing they receive value for their money.[43] For example, the government can run an

[41] Cf. Alm, Jackson & McKee, supra (noting that subjects complied at a lower rate when they were told the tax would fund an unpopular goal than when they were not told how the money would be spent).
[42] If the publicity for public spending is overtly political, however, then this may taint the warm glow associated with public goods provision, as taxpayers feel that their tax dollars are being applied to enhance electoral prospects rather than for public goods. As a result, publicity for public good spending by the government may increase warm glow to the greatest degree when it is made in an apolitical context.
[43] Saeed & Shah (2011); citing Bird. (urging gov't to "show value for money" just as private firms do).

advertising campaign in which respected celebrities highlight popular government programs and urge viewers to take pride in paying taxes, perhaps modeled on Clint Eastwood's Super Bowl halftime commercial for General Motors. In addition, an image of the American flag can appear on tax forms and software, along with slogans like "Support our Troops" and marketing materials to remind taxpayers of programs they support. In this spirit, the Obama Administration has added a "Federal Taxpayer Receipt" to the White House Website; taxpayers enter the amount of taxes they paid, and the website specifies how much of their money was spent on "national defense, health care, job and family security, education and job training," and other spending program.[44] Likewise, the IRS could require all tax preparation software to include a similar feature and could even require it to be filed as a schedule in the return.

Second, by connecting tax payments with programs valued by taxpayers, the government should aspire to promote moral engagement, so that taxpayers are motivated by ethical commitments instead of bargaining when making decisions about taxes. Just as parents are less likely to be late picking up their children if this is a moral breach instead of a service they are purchasing, taxpayers may feel more committed to paying taxes if they consider them a contribution to society instead of a cost.[45]

Third, positive publicity about the government's work may also enhance tax morale and improve compliance. As filing deadlines approach, the IRS already issues press releases describing enforcement measures[46] They should also give examples of taxpayers who made voluntary contributions to the government beyond what they owe. In this spirit, the Indian government publicized the fact that a popular film star paid the highest tax bill in the nation.[47] Indeed, a number of studies show that stories about pro-social behavior of peers engender compliance more effectively than threats of sanctions.[48]

B. Fines, Rewards, and Audits

[44] http://www.whitehouse.gov/issues/taxes/tax-receipt ("In his State of the Union Address, President Obama promised that this year, for the first time ever, American taxpayers would be able to go online and see exactly how their federal tax dollars are spent. Just enter a few pieces of information about your taxes, and the taxpayer receipt will give you a breakdown of how your tax dollars are spent on priorities like education, veterans benefits, or health care.").
[45] *See* Part I.B.4.
[46] *See* Joshua Blank & Daniel Levin, *When Is Tax Enforcement Publicized?*, 30 VA. TAX REV. 1 (2010).
[47] Saeed & Shah. (Indian government publicized that popular film star paid highest tax bill in country).
[48] *See, e.g.*, Ian Ayres, Sophie Raseman & Alice Shih, *Evidence From Two Large Field Experiments That Peer Comparison Feedback Can Reduce Residential Energy Usage* (NBER, Working Paper No. 15386, 2009) *available at* http://www.nber.org/papers/w15386 (showing that positive encouragement through the use of social norms can have pronounced effects on energy usage).

In addition to positive publicity, the IRS should consider altering its audit and penalty system to account for prosocial behavior. A system of auditing and sanctioning taxpayers for noncompliance is necessary to provide economic incentives for compliance. At the same time, however, the creation of these incentives may "crowd out" prosocial motivations, though these impacts are extremely context-specific.[49] If taxpayers perceive that the government is coercing them to pay taxes, then their prosocial motivations to pay may decrease. As a result, increases in fines and audit probabilities for non-compliance may not have as large an impact as might be supposed based on economic incentives alone. Even so, we obviously would not eliminate audits and fines. Even if they crowd out some prosocial motivation, the economic incentives they provide are essential.

Instead, we should strive to use audits and penalties in a way that minimizes crowding out. Since the issue is context-specific, the IRS should experiment with various approaches, including the following three. First, it can be emphasized that audits are random, and do not reflect a lack of trust of the taxpayer. Second, taxpayers can be rewarded if their audit shows that they have paid in full. Third, a range of sanctions can be explored for noncompliance, including not just cash payments, but also mandatory courses in understanding the tax code, civics, and community service requirements. If one of these suggestions succeeds in changing the frame by which some taxpayers view our compliance system, the benefits can be large. It may lead to "crowding in", so that the incentive complements and reinforces prosocial motivations.

C. Taxes with Dedicated Uses

If the conventional wisdom is correct that public goods should be provided until their marginal cost (in direct terms and possibly from the distortions caused by taxation) equals their total marginal benefit (including direct benefit and redistribution), then it makes no sense for the government to specify how it will spend a particular tax. For example, why would it matter whether the proceeds of a government-sponsored lottery will support schools, as opposed to tax enforcement? The marginal costs of the lottery should not depend in any way on the marginal benefit associated with schools.

Under our analysis, though, explicitly linking a tax with a popular government program can be quite helpful. Obviously, specifying how a tax will be spent can build political support for it. For example, although the conventional wisdom is that a higher gas tax is politically unattainable in the United States, some commentators speculate that President Bush could have persuaded Congress to enact one immediately after September 11, 2001 to fund defense against further attacks. Similarly, although there is no economic reason why social security has to be funded through a separate tax – a point that President Roosevelt's advisors urged on him – there is a powerful political reason. As FDR explained,

[49] See Bowles & Polania-Reyes, supra note xxx.

> I guess you are right on the economics, but those taxes were never a problem of economics. They are politics all the way through. We put those payroll taxes there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program.[50]

Our point is that this sort of linkage is relevant not only to politics, but also to welfare. As noted above, if taxpayers support the way a tax will be spent, they might work less hard to avoid it, due to the prosocial utility associated with paying the tax. Indeed, studies show that taxpayers are more likely to buy state lotteries tickets when the proceeds are dedicated to education, instead of the state's general revenue.[51] Likewise, surveys suggest that taxpayers are more willing to pay environmental taxes if the proceeds are used to fund environmental programs.[52]

This strategy is especially helpful with taxes that are easy to avoid. For example, if state governments dedicate use taxes to a popular cause, such as feeding hungry children, they might see an increase in collections. Taxpayers will be especially motivated if they believe that paying this tax will increase the resources available to hungry children.

The government's commitment to use a tax to fund a particular cause must be credible in order to persuade taxpayers to raise their level of compliance. In theory, of course, all that matters is for taxpayers to *believe* that their tax dollars are being used to advance a popular public goal – even if, in fact, this is not the case. If the government announces that use taxes will fund meals for hungry children – when, in fact, they will be used for a different purpose – in the short run the government might inspire some taxpayers to pay taxes they would not otherwise have paid. But in the long run, when the real facts emerge, this effect will be reversed with a vengeance. Government credibility will be eroded, so that this sort of initiative will be harder to pursue in the future.

As noted above, a further challenge with this sort of strategy is the reality that, in a diverse society, taxpayers have heterogeneous preferences. Expressly linking a tax with a particular goal will encourage supporters of the goal to pay the tax, but it could have the opposite effect on opponents. For example, supporting religious instruction in public schools or longer incarceration for drug offenders is likely to inspire some taxpayers, while alienating others. In general, this strategy should be used only for public goals that attract broad support.

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[50] Michael J. Graetz, One Hundred Million Unnecessary Returns 126 (2008 (quoting FDR).

[51] Craig E. Landry & Michael K. Price, *Earmarking Lottery Proceeds for Public Goods: Empirical Evidence from U.S. Lotto Expenditures*, 95 Econ. Letters 451 (2007) (state lotteries dedicated to education sell more tickets per capita).

[52] Steffen Kallbekken & Marianne Aasen, *The Demand for Earmarking: Results From a Focus Group Study*, 69 Ecol. Econ. 2183 (2010) (people want proceeds of environmental taxes to be earmarked for environmental goals).

D. Subsidiarity

Observational and experimental studies consistently demonstrate is that smaller and more homogeneous groups have an easier time sustaining prosocial behavior than larger and more diffuse populations.[53] Institutional design of tax and spending programs should recognize this fact, and provide public goods and pay for them at the lowest feasible level of governance, recognizing the principle of subsidiarity.

There are already numerous existing arguments in favor of subsidiarity and federalism more generally. Subsidiarity allows greater oversight of public goods provision, enables spending to be tailored to tastes, encourages experimentation, and leads to healthy competition between jurisdictions for residents (Tiebout and Federalism Literautre).

We add a related argument: subsidiarity reduces the costs of taxation by enhancing prosocial motivations to pay tax. Less waste and tailored spending do not just improve the efficiency of public spending; they also enhance prosocial perspectives on the taxes needed to finance the spending. Subsidiarity also means that tax dollars are shared by smaller and more homogeneous groups, creating conditions that further promote prosocial responses to taxation.

This rationale for subsidiarity differs from the conventional Tiebout model. In the classic Tiebout formulation, lump sum taxes are collected costlessly and free riding becomes impossible. Raising funds for public goods is costless and local public goods therefore become like private goods. In the conventional Teibout view, subsidiarity promotes the efficiency of public spending. We argue that subsidiarirty not only improves the efficiency of public spending, but also reduces the costs of raising any level of funding. The enhanced efficiency of public spending and the small group context created by subsidiarity promote prosocial perspectives that change behavioral responses to taxation. In addition to promoting efficient public spending, subsidiarity therefore reduces tax-oriented distortions.

E. Avoiding Government Waste

Just as the government should remind taxpayers that their tax dollars support programs they value, the government should made particular efforts to avoid reminding them of government activities they dislike. For this reason, waste has unique implications for the government. After all, a dollar wasted by a for-profit firm producing a private good does not impact consumer utility. Consumers do not change their view of the product. They still buy it if the product's benefits outweigh its costs (and not otherwise).[54] The costs of this waste are borne

[53] See Supra Part I.C.
[54] The corporate social responsibility literature rejects this premise. See Markus Kitzmueller & Jay Shimshack. "*Economic Perspectives on Corporate Social Responsibility*." 50 Journal of Economic Literature 51–84 (2012). In effect, the CSR literature suggests that private goods such as sneakers or coffee also have some warm glow. If this is

– not by consumers – but by the for-profit firm's residual claimants, who should (and do) expend funds to avoid waste. Yet with government waste, taxpayers as a group are the residual claimants. A dollar of waste costs taxpayers one dollar. As a result, taxpayers (unlike consumers) should (and do) expend funds to limit waste, for instance, through ombudsman and the many inspectors general of government agencies.

At first glance, the expenditure rule for waste-reducing-activities by the government appears simple: a dollar spent on waste reduction should reduce waste by at least a dollar.[55] Spending on waste reduction beyond this level is inefficient, costing more than it yields.

But this rule ignores the possibility of prosocial utility from government spending. For instance, people may derive warm glow utility from paying taxes, knowing that their taxes support important public goods. Yet government waste is likely to dim this warm glow. If taxpayers believe their tax dollars are going to waste, instead of providing desirable public goods, their prosocial utility from making tax payments may be reduced or even eliminated. Money spent on reducing government waste, therefore, produces value from two sources. It reduces waste directly, and it prevents the reduction in prosocial utility. As a result, the government should devote even more resources than a private firm to avoiding waste.[56]

This perspective is familiar to charities, which are often ranked on how efficiently they turn contributions into public goods. Analogous rankings for private companies are both fewer and less salient (at least for consumers, if not for investors). With a private company, consumers decide whether to purchase goods and services based on benefit and price. Charities that provide public goods, by contrast, rely on warm glow for many of their contributions. For similar reasons, therefore, our emphasis on prosocial utility prescribes a different rule for spending to reduce waste than the conventional perspective.

IV. Applications: Taxpayer Choice

While the government should publicize popular programs and avoid or at least deemphasize unpopular ones, to the extent possible, a significant challenge in doing so, as noted above, is the diversity of taxpayer opinion. Taxpayers are likely to disagree about the merits of a particular program, such that highlighting it is a mixed blessing. Charities do not face this problem to the same degree, since affiliating with a charity is voluntary. Those who oppose the mission of a charity are unlikely to support it. Indeed, the freedom to choose what to support is inherent in philanthropy. Yet such choices are an uneasy fit for government, which is inherently

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the case for private providers, then it will be all the more true for government, which has an explicitly public regarding role.

[55] This rule ignores the benefits derived from waste by government employees and contractors associated with waste. If these benefits should be included, then the government should spend less than a dollar to avoid a dollar of waste. Whatever the appropriate treatment of the benefits of "wasted" spending, the spending devoted to avoiding waste should be higher after considering the "warm glow" effect than it would be otherwise.

[56] Saed & Shah (2011); Torgler, Schneider & Kahn (2001).

a communitarian enterprise. Even so, can we find ways to offer taxpayers even a limited ability to choose what they will support? Pairing taxpayers with initiatives they support can promote prosocial utility within a diverse population. Some can support the troops, while others can support the schools, and so on. Borrowing from philanthropy, we may also want to recognize taxpayer support with matching gifts, naming rights, and the like. Yet a problem with these strategies is that, at least in some contexts, they are in tension with other important values. This Part discusses three different approaches that offer taxpayers at least some ability to choose what they will support.

A. Fundraising Through Affiliated Nonprofits

One option is for the government to use separate 501(c)(3) organizations to raise money for initiatives that enhance governmental programs. This already occurs, to a degree. For example, organizations such as the Army Relief Society, the Air Force Aid Society, the American Veterans Center, and the Disabled Veterans Charitable Trust raise millions of dollars to provide extra services to military personnel on active duty as well as veterans.[57] The military is just one of many contexts for this sort of initiative. Private fundraising for State Universities and local public schools are, of course, another. For example, donorchoose.org is a website in which public school teachers solicit funds for particular projects: Since 2001, 180,000 projects have been funded. Annual giving has increased from $1 million in 2001 to 27 million in 2010.[58]

Although in some cases these nonprofits have been incorporated as part of a government initiative, they generally are legally separate from the government. They have their own employees, boards of directors, programmatic activities, and fundraising initiatives. As a result, they can and should offer taxpayers the same ability to choose what they want to support as other charities, along with the same recognition (such as naming rights and award dinners), access to leaders of the charity, financial incentives such as matching grants (and the tax deductibility of charitable contributions), and the like. We believe this approach should be used more broadly as a way to inspire taxpayers to support programs they especially value.

In doing so, we should be particularly vigilant about the risk of corruption. A payment to an affiliated nonprofit might be a disguised method of buying influence from government officials. For example, veteran congressman Charles Rangel was censured in part because he

[57] http://www.afas.org/About/docs/2011_Fact_Sheet.pdf ("The Airforce Aid Society is the official charity of the United States Airforce," offering nearly $18 million to help over 40,000 in 2011 by providing worldwide emergency assistance, educational assistance, and base community programs); http://www.americanveteranscenter.org/ (describing activities of American Veterans Center); http://www.charitynavigator.org/index (supporting physical and psychological rehabilitation programs, shelters homeless veterans, etc.); http://www.aerhq.org/dnn563/ (helped more than 3 million soldiers and their families overcome financial emergencies during past 67 years).

[58] www.DonorsChoose.org/about/how_it_works.html#start; *see also* Lin et al, Earmarking, *supra*, at 3.

improperly solicited corporate donations for a college center bearing his name.[59] Although every charity must deal with the risk that a contribution is meant as a quid pro quo – for instance, when hospital donors seek special care – the risk for government-affiliated nonprofits is potentially greater, to the extent that donors expect special access to government officials.

B. *Taxpayers Choice for Supplemental Tax Payments*

Taxpayers can be invited not only to contribute to affiliated nonprofits, but also to make extra payments – beyond what they owe in taxes – directly to the government. In effect, taxpayers would make a charitable contribution to the government. This can be an outlet for taxpayers who are willing to pay higher taxes than are required by law. For example, Warren Buffett has publicly urged Congress to raise tax rates on the wealthiest Americans. It would be good for the country – and perhaps also fulfilling for him – if he decides to make an extra contribution beyond what is legally required.

There are a number of precedents for inviting extra financial support for the government, and some have been more successful than others. During World War II, over 85 million Americans purchased War bonds offering below-market interest.[60] All fifty states have "adopt-a-highway" programs, in which individuals or businesses volunteer to clean (or to for the upkeep) of a designated stretch of highway and are credited for doing so with a sign.[61] Massachusetts offers taxpayers the option of paying a higher state income tax rate, although only a fraction of taxpayers choose to do this.[62] Forty-one states offer the opportunity to make contributions to particular funds on their tax returns, and the states raised $38 million in 2008 through this initiative.[63] Likewise, the Federal Government has kept a general account since 1843 for "gifts to the United States."[64] In 1961 it began offering the option of making gifts specifically to reduce the national debt, attracting $3 million in 2009.[65]

To make this sort of initiative more successful, the government should model its efforts more explicitly on nonprofit fundraising in three ways. First, since taxpayers have

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[59] Chris Richardson, *Charles Rangel Censured on House Floor – What Does Censure Mean?,* Christian Science Monitor, Dec. 2, 2010, http://www.csmonitor.com/USA/Politics/2010/1202/Charles-Rangel-censured-on-House-floor-what-does-censure-mean.

[60] Rebecca Tuhus-Dubrow, *Voluntary Taxes*, Boston Globe, June 27, 2010.

[61] http://en.wikipedia.org/wiki/Adopt_a_Highway.

[62] http://www.mass.gov/dor/individuals/filing-and-payment-information/personal-income-tax-faqs/personal-income-tax-faqs (offering the option to pay 5.85% instead of 5.3%); Tuhus-Dubrow, *supra* (In 2008, 1,953 taxpayers opted for this rate, generating an extra $231,907) .

[63] Tuhus-Dubrow, *supra*. ; *see also* Sherry Xin Li, Catherine Eckel, Philip J. Grossman & Tara Larson Brown, *Giving to Government: Voluntary Taxation in the Lab,* 95 J. Pub. Econ. 1190 (2011) (210 such programs raised $32.8 million in 2002). New York State raised $1.9 million in 2011. http://www.tax.ny.gov/pdf/stats/stat_fy/2010_11_annual_statistical_report_of_ny_state_tax_collections.pdf.

[64] Sherry Xin Li, Catherine Eckel, Philip J. Grossman & Tara Larson Brown, *Giving to Government: Voluntary Taxation in the Lab,* 95 J. Pub. Econ. 1190 (2011). 394,000 in 2001.

[65] Tuhus-Dubrow, *supra*

heterogeneous preference, they are more likely to contribute voluntarily if they can choose what program they will support. To make the program administrable, the government can offer a menu of options such as "support for our troops," "education and job training," "crime prevention and law enforcement," "health care," "the national debt," and the like. By facilitating this sort of taxpayer choice, we would match individuals with programs they find appealing.

Second, the government can offer a matching program so that, by making an extra payment, taxpayers can become entitled to allocate the matching funds too. Indeed, such a match effectively is already in place. Extra payments to the federal government are treated as deductible charitable contributions under current law.[66] By making an extra contribution, then, taxpayers reduce the amount they otherwise are obligated to pay. This means that, in effect, they would divert an amount from their mandatory obligation (which the government allocates) to the amount they are giving voluntarily (which, under our proposal, they would be permitted allocate themselves).

Third, those who contribute should be recognized publicly for doing so (unless they request anonymity). For example, people who give at a minimum amount to a particular program can be included on a list of donors posted on a website. Tiers can be offered so that more generous donors are offered special recognition. If it is administratively feasible to do so, they should also be given details about how their money was used. For instance, just as donors to financial aid at a university are given information about the student they are supporting, taxpayers who chose to support our troops can be given the name of the soldier who is being funded by their contributions.

Although nonprofits also raise money by giving donors unique access to the nonprofit's leaders, this strategy obviously would not be appropriate for the government. Unfortunately, campaign contributors tend to receive this sort of access – a regrettable byproduct of our campaign finance laws – and we view this as a necessary evil to be minimized. The government should not sell access in return for voluntary tax payments. Relatedly, there will have to be rules against quid pro quos and self-dealing (e.g., "approve my merger and I will contribute to your agency" or "I will contribute money if you use it to buy goods and services from my business"),

C. *Taxpayer Choice for a Portion of Their Tax Liability*

In addition to letting taxpayers allocate voluntary contributions to the government, we also can let taxpayers allocate a portion of the taxes they are legally obligated to pay. This idea may sound outlandish at first blush, but it bears some resemblance to the "checkoff" system under current law in which taxpayers choose whether to contribute tax dollars to federal campaign funds. Even so, this is a more complicated – and, indeed, more controversial – step

[66] *See* Section 170(c)(1).

than allowing taxpayers to allocate voluntary contributions. After briefly outlining the competing considerations, we suggest an approach to striking the balance.

The main reason to do this, of course, is to increase the likelihood that taxpayers with heterogeneous preferences support the way their tax dollars are spent. For example, if we offer the sort of menu described above, taxpayers can dedicate a portion of their tax liability to government programs that they especially value. As with voluntary contributions, moreover, we can find ways to recognize taxpayers for supporting particular initiatives (e.g., listing names on a website).

A further potential advantage of this initiative is that it can generate useful information. Policymakers will learn what taxpayers support most enthusiastically. After all, the way people spend money is a meaningful indication of what they value – in ways, more meaningful than how they answer opinion polls. Taxpayers obviously will gravitate to different programs. If our political process is functioning properly, the budget should track, at least in a rough way, the distribution of preferences among taxpayers. If it does not, then that is information our legislators should have. It also should be disclosed, so the media and voters will have this information as well.

However, there obviously are administrative costs associated with implementing this idea. In addition, there are at least five potential problems that either are not presented or are not as serious when taxpayers allocate voluntary contributions.

First, while taxpayers may feel more enthusiasm for paying the portion of their tax dollars that they can direct, there is a risk that they will feel correspondingly *less* enthusiasm for the rest of their tax liability. If they associate this residual with programs they did not choose – and do not support – they will find it all the less fulfilling to make this payment. There is an analogy here to the challenge nonprofits face in raising money for overhead and other expenses that are necessary but not exciting to donors.[67] Of course, it may be that taxpayers will not feel this way. They may regard the rest of their tax bill as no worse than the payments they used to make in years when they had no ability to allocate any of their taxes.

Second, we may worry that taxpayers will allocate money based on inexpert judgments and imperfect information, so that the results will diverge, in unfortunate ways, from the choices Congress would (or at least should) make. Admittedly, individuals may have at least some advantages over members of Congress, for instance, in being less susceptible to interest group influence. But this sort of decentralized decisionmaking does have distinct disadvantages. For example, taxpayers will make their individual choices without complete information about what

[67] *See* Cagla Okten & Burton A. Weisbrod, *Determinants of Donations in Private Nonprofit Markets*, 75 J. PUB. ECON. 255 (2000).

others are choosing.[68] A particular goal is likely to be less appealing to taxpayers if they know that it already has adequate funding – but it is not easy to provide them with this information at the moment when they are making their choice, since taxpayers are all making their selections at essentially the same time.[69]

Third, allowing taxpayers too active a role in allocating tax dollars obviously undercuts the role of our elected representatives. This could strike some taxpayers as illegitimate, and might even diminish their willingness to pay taxes. It would be ironic if a strategy that is meant to *enhance* the willingness of taxpayers to pay their taxes ends up having the opposite effect, at least with some taxpayers.

Fourth, if taxpayers are allowed enough discretion to specify in some detail how their money is spent, there is a risk of self-dealing and interest group capture. For example, we would not want the owner of a defense contractor to specify that her taxes will be spent purchasing weapons systems from her company. Yet this risk is mitigated to a significant extent if she can choose only from a menu with very general items (e.g, "support our troops").

Finally, if taxpayers allocate a fixed percentage of their tax bill to a program of their choice, high income taxpayers will allocate more in absolute dollars. This gives them more personal influence on the overall allocation than low income taxpayers;[70] indeed, the 47% who do not pay any income tax will not be accorded this opportunity.[71] This issue is not unique to an individualized decisionmaking process of this sort, of course, since wealthy people tend to have more influence over elected representatives as well. But it is worth considering how we can mitigate this effect. One response is to allow taxpayers to allocate a fixed dollar amount, instead of a fixed percentage. But the downside of this approach is that it will be less meaningful to high income taxpayers, since the dollar amount is likely to represent such a small percentage of their overall tax bill. This alternative would thus be more consonant with egalitarian norms, but less effective at promoting prosocial utility among high income taxpayers.

In light of these problems, reasonable minds can disagree about whether it makes sense to offer taxpayers any ability to allocate their tax dollars. In our view, the farthest the government should go is to offer taxpayers choices that are quite constrained, so that the overall result is

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[68] *Cf.* Levmore, *supra* note **Error! Bookmark not defined.** (noting problem of individuals making allocation decisions simultaneously, without benefit of information about what others are doing).

[69] We worry less about this problem with voluntary contributions. Congress presumably can adjust the way it allocates tax revenue over time, if it learns that voluntary contributions are likely to cover a core need. Even if this is not feasible, moreover, the fact that voluntary contributions are incremental takes a bit of pressure off. Since these are resources the government would not otherwise have, they are pareto improving, even if they are not put to the highest and best use.

[70] There is, of course, an analogous problem with charitable giving as well. It is well known that wealthy donors give to different causes than low income donors – more to education, hospitals and the arts, less to religion: Auten et. al., *supra* note **Error! Bookmark not defined.**, at 401.

[71] David Leonhardt, Yes, 47% Owe No Taxes: Look Closer, Apr. 13, 2010, http://www.nytimes.com/2010/04/14/business/economy/14leonhardt.htm.

unlikely to diverge – or, alternatively, is hard-wired so that it *cannot* diverge – from allocations that Congress would otherwise have provided. In other words, the effect of these allocations would be more symbolic than substantive.

If we seek to constrain taxpayer choice in this way, there are three ways to do it. First, the policy categories which taxpayers are invited to select can be defined broadly. If taxpayers are invited to allocate money to "social welfare programs," that is a much larger category – which is harder to overfund – than if they are invited to allocate money to a narrower category such as "support for autistic children in Rhode Island."

Second, limiting the amount that taxpayers can allocate to a small percentage of their tax bill also reduces this risk. For example, if taxpayers can allocate only five percent of their tax bill in this way, and every category they are invited to support represents at least five percent of the federal budget, then there is no issue. Even if every taxpayer chooses the same category – which is extraordinarily unlikely – the most that can be allocated to the particular category is five percent of tax receipts.

Third, the government can leave itself some flexibility to modify the allocations made by taxpayers. The government might commit only to "use best efforts" to allocate taxpayer dollars to the programs they choose. Or alternatively, if taxpayers allocate more to a particular program than Congress believes is appropriate, the excess can be carried over to the following year. To avoid a second year of overfunding, the government can either inform taxpayers of how much has been carried forward from the prior year – information that presumably will discourage taxpayers in the second year from directing funds to this program – or the government can take the more extreme step of deleting the option from the menu in the second year. The more the government leaves itself room to override taxpayer choices, though, the less meaningful those choices will seem to taxpayers.

A downside of constraining taxpayer choice, then, is that taxpayers might not take the choice as seriously. While unsophisticated taxpayers may not fully understand the ways in which their choices are limited – since the fungibility of money is not obvious to everyone – sophisticated taxpayers will realize that their choices have only symbolic impact. It would be a mistake to hide this fact, since the government would lose credibility when this reality eventually comes to light. Yet even so, symbolism matters. After all, conscientious objectors periodically file (unsuccessful) law suits to keep their tax dollars from funding wars they oppose, and presumably they are motivated at least in part by symbolism. In addition, taxpayers may value the choice as a way to signal their preferences. This information could itself have influence, as noted above, so that taxpayers will feel more involved and invested in the process.

V. **Conclusion**

[To come]