



Why do people give their money away and how can we stop them acting so irrationally?

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I spent a good proportion of my time fundraising when I was Director of the LSE. The professional fundraisers and I were quite successful, roughly doubling the previous run-rate. A serious error of judgment brought that run to an end. So perhaps I would do well to steer clear of the topic of philanthropy. But my experience raising money for a university did give me some insights into why people give money away, and why they do not, which may be relevant to the work of Pro Bono Economics (PBE).

PBE, of which I am a Patron, aims to help charities with problems where the skills of economists may be relevant. An empty set, do I hear someone cry? We think not. There are many areas in which careful analysis can help charities and NGOs. Improving their understanding of the impact of their work is one, and presenting that impact persuasively to prospective donors is certainly another. Around 30 projects have been carried out over the last year, in areas as diverse as voluntary service overseas, youth homelessness and eating disorders. Volunteers have helped to enhance fundraising for Barnardo's and Tomorrow's People.

As my mildly provocative title implies, philanthropy is not obviously good territory for economists. Steven Levitt and John List, who have extensively researched the motives for giving, point out – with tongues somewhere near their cheeks – that (1) “Homo economicus is unswervingly rational, completely selfish, and can effortlessly solve even the most difficult optimization problems”. Faced with the awkward phenomenon of someone giving away her hard-earned money for no obvious return, economists can easily be stumped. I recall talking to my wife a few years back about a sinuous argument presented by a Chicagoan economist, designed to explain the baffling phenomenon of people tipping in restaurants in remote cities to which they are highly unlikely to return. She looked blankly: “it’s just human nature”, she observed. Not to freshwater economists it isn’t, no sir.

But perhaps they can have something useful to contribute. And it is an increasingly important and topical area. Discussing income inequality and what to do about extravagant pay for bankers on Radio 4 recently, Michael Portillo said that when the Thatcher government reduced marginal income tax rates and public spending they hoped it would stimulate a big increase in individual giving, but that has not happened. The quid pro quo she expected did not materialise. While the British are quite generous by European standards, donating around 0.8% of GDP to charity, about four times the proportion in France or Germany, we still give less than half as much, in relative terms, as do the Americans.

That seems to be particularly true at the top end of the income scale. The Economist reports that “In the past year some 69 of America’s billionaires have promised to give away at least half of their fortunes by signing the Giving Pledge championed by Bill Gates and Warren Buffett”. (2) There is a roughly parallel effort under way in the City, promoted by people like Paul Myners, to encourage people to commit to give 10% of their estate to charity, but it is on a far smaller scale so far. There were only 174 charitable donations of over £1million in the UK in 2010.

We are nowhere near the situation in the US where, as we discovered a couple of weeks ago, Mitt Romney’s charitable donations were, at 16% of his income, somewhat larger than his tax payments of 13%. That seems generous, but recall that the Cheneys gave away 78% of their income in 2005. (How much the Rumsfeldts gave away is, to me at least, an unknown unknown). Over the last few years Romney has donated about 10% to the Mormon church – his tithe- but has also given to the Heritage Foundation, Harvard Business School, and to Citizens for Lower Taxation. If that latter donation is successful he may be able to keep his tax bill lower than his donations for the foreseeable future.

This, and Portillo’s argument, suggests one significant influence on individual giving. In their cross-country analysis of giving, the Charities Aid Foundation note that “giving tends to represent a lower proportion of GDP in countries with higher levels of personal taxation, particularly social insurance”. (3) Indeed the CAF are worried that “if social insurance payments were to rise in future because of the needs of an ageing population, this could represent a threat to voluntary income”.

For charities dependent on voluntary income, one can understand the concern. But one can look at this relationship from another perspective. Writing in 1914, J.A.Hobson, the eminent Marxist historian of the British Empire, argued that “every act of charity, applied to heal suffering arising from defective arrangements of society, serves to weaken the personal springs of social reform...it substitutes the idea and desire of individual reform for those of social reform, and so weakens the capacity for collective self-help in society”(4). Mrs Thatcher could not have put the relationship better herself, though of course she saw the causation working in the opposite direction.

Another way of putting Hobson’s argument is that large-scale philanthropic activity may change the balance of funding from the public to the private sector. If private funding of essential services becomes the norm, that may be damaging, because the funding stream is uncertain and may be volatile. Also the prioritisation of need may be influenced by individuals, and be less objective. There is a deal of evidence to suggest that individuals are far more ready to give to charities meeting local needs than they are to charities supporting needy people nationwide, or overseas. Since donations may be more readily available in relatively affluent areas, needy cases supported in those areas may be relatively less deserving than cases not supported in poorer areas.

Similar arguments have been advanced as criticism of the Coalition Government’s Big Society programme. If local service delivery is delegated to community groups, that may come to benefit more affluent areas, where those groups may be better resourced from private sources, and also be more skilled and experienced.

In the case of Higher Education one can observe a related phenomenon. As voluntary income becomes relatively more significant, those universities with a longer stronger tradition of success, and larger numbers of prosperous alumni, especially Oxbridge, will find their positions further

reinforced. To them that hath shall more be given. Voluntary giving to universities is now heavily skewed towards a small number of institutions. The LSE, usually next in the fundraising league after Oxford and Cambridge, raises over 7% of its income in that way. Most of the newer, post 1992 universities struggle to raise even 1%.

Perhaps it is these arguments which cause economists themselves to be such reluctant donors. A field study carried out at Cornell University in New York showed that economists were more than twice as likely as academics overall to say that they gave nothing at all to charity (5). The authors wonder whether economists behave in more self-interested ways because they are exposed to the 'homo economicus' model, or are simply more self-interested to begin with. They conclude that economists are not naturally mean, but that "exposure to the self-interested model does in fact encourage self-interested behaviour".

This suggests that the most important impact of the work of Pro Bono Economics may not be to enable economists to help charities, but to make it possible for charities to turn economists into normal human beings. Andy Haldane tells me he has evidence that this is indeed happening.

It is only fair to acknowledge, however, that economists have made a useful contribution to our understanding of why people give, even if they indulge only rarely themselves. Adam Smith noted the presence of a "moral hector" – the chief executive of the FSA is well-named – "who, looking over the shoulder of each moral man, scrutinizes every move he makes". More recently, economists have challenged the theory of "perfect altruism" which lies behind the idea that the state crowds out voluntary contributions. The perfect altruism model suggests that "an individual donor is indifferent between giving a dollar to a charity and the charity's receiving it from someone else" (6). That does not seem to fit the facts well. Donors prefer to contribute themselves, and do not get as much satisfaction from giving a taxed pound as from a cheque of their own.

A variation, which derives from public goods experiments, has been called the "strong reciprocity" theory (7). Researchers have observed that investment games, where individuals can benefit from co-operative behaviour, or so-called ultimatum games, show that behaviour is influenced by feelings of fairness and reciprocity as well as calculations of short-term gain. In an ultimatum game one player is given a sum of money and asked to contribute part of it to an anonymous person whom he will never meet again. If the offer is accepted, both sides keep the money; if it is rejected, neither does. One might think that the offeror would offer as little as possible, and the recipient would accept whatever was offered. But people do not act that way. Both sides are influenced by what they perceive to be fair and make more generous offers or, on the receiving side, refuse mean ones (made by economists, presumably), even if that means they get nothing at all.

James Andreoni and others (8) take a more subjective approach, with a rival theory, often dubbed the "warm glow" hypothesis: the warm glow is the sense of satisfaction and purpose experienced when we commit support to a worthy cause. Put simply, the reason we give money is that it makes us feel good – regardless of the benefit it gives to the recipients.

Another explanation, from Glazer and Conrad (9), is that donors give at least partly in order to signal their wealth status to others. Charities understand that, so you will find donors' boards in art galleries and, indeed, in the entrance of the LSE. The theory is supported by the observation that where a ladder of donor recognition is offered donors congregate at the bottom of the relevant

band. They give just enough to get over the threshold to be listed as a “benefactor” or “premier patron”, or whatever the terminology might be.

I can certainly recognise the “warm glow” and the “wealth signalling” phenomena from my own experience.

The most important consequential question is: how can charities use this analysis to identify promising potential donors and maximise their appeal to them? Because whatever we may think about the fundamental arguments about public spending and charitable giving I discussed earlier, an individual charity cannot afford to abandon private fundraising in today’s climate. Whether you are with the Marxists and their objective allies the Thatcherites or not, you must take the world as you find it. As things stand, the public spending environment is likely to remain challenging for some time to come.

There is also some research which bears on that question. It suggests that the approach taken may need to be differentiated in relation to the nationality of donors. Many British charities, certainly in the arts and higher education, raise large sums from US donors, who tend to be amongst the most generous. The culture of giving to both the arts and education is much better established “over there”. Research sponsored by Barclays (10) suggests that Americans typically:

- Have a low view of the State’s capacity to act
- Are optimistic about the ability of individuals to solve social problems
- Believe that everyone has the opportunity to succeed in life, and that success depends more on initiative and indeed to some extent on luck, than on inherited status
- Are less inclined to bequeath their entire estates to their families.

This hints at an approach which might be rather different from that which might appeal to UK donors (I am talking principally about large donors here). Research among UK large donors by Coutts (11) tells us that we “tend to overestimate the extent to which people act as rational agents”. (Any lessons for the Bank of England’s financial stability staff here?). Their interviews with 35 large donors point to the view that donations are what they call “taste-based” not “needs-based”, and are heavily influenced by individuals’ personal and professional backgrounds, and to a lesser extent by their perception of a charity’s competence.

This is cautionary for those who see charity as replacing state funding, rather than supplementing it.

The question of charity competence, and the related question of how far donors are influenced by learning about the organisation’s impact and cost-effectiveness, is complex. Deborah Small, a psychologist at Wharton Business School, says “what we find is that when people are thinking more deliberately ...they end up being less generous overall”(12). She and colleagues conducted an experiment which showed that when people were given more facts and statistics about the problem a charity was trying to address they in fact became less likely to donate. The same point is made in Daniel Oppenheimer’s book “The Science of Giving”(13). He found that simply giving people more information about a charity’s overhead – even if it is low -makes them less likely to donate to it. Encouraging people to analyse the consequences of their donation may be counterproductive. According to Small, when we enter the “deliberative mindset” we become less altruistic. This may explain the disappointing news I gave you about economists earlier. They think too much.

John List produces a supporting argument called the “drop in the bucket” effect. If you think hard about the full scale of the problem to whose solution you are contributing, whether it is famine in Africa, or indeed the financial plight of British universities, it is easy to reach the view that your own contribution is not going to make a huge difference. List argues that a world in which everyone thinks rationally about their charitable decisions might be good for the most efficient charities, but overall much less money will be donated.

So the lesson here seems to be that charities need to do their homework about the backgrounds of their donors. They need to find some kind of peg on which to build their proposition (of course for a university with an alumnus/a that should be ready-made). And they need to offer a relatively simple, inspiring, message, without getting into too much detail about the cost/benefit calculations. That does not, of course, mean that a charity should not seek to be as efficient as possible, and to use as big a proportion of its income as possible at the front end. But that is a management task, and not one which can easily be subcontracted to the donor.

I might also add here that when it comes to making a pitch to government, or to large foundations, rather different considerations apply. There a tight approach to cost-benefit analysis is these days de rigueur. It is an area where PBE has been very useful to some charities already. Governments are not susceptible to the “warm glow” hypothesis. And even if an individual minister is so afflicted, the Public Accounts Committee is not likely to be.

In relation to individuals, however, the main focus of my remarks tonight, the charity task would be made easier, however, if the overall propensity to give were greater. Total charitable giving in the UK is estimated at £11billion (14). The total has barely increased over the last five years. 58% of the population give something. But 40% of those donors give, annually, less than £10, and only 7% give over £100 a year. At the top end, the Coutts research I mentioned asked High Net Worth Individuals whether charity was a top priority for them. 41% of Americans, 30% of Irish and 24% of Swiss said yes, but only 18% of the British respondents.

So we have an attitudinal problem to deal with. It is one which may well become more politically salient, at a time when growing income inequality is attracting more attention. Rising inequality, combined with a low propensity on the part of the rich to give, is an unattractive combination. The last government made an attempt to stimulate giving to universities with a matched giving scheme. A similar idea is now emerging for arts organisations through the Arts Council. In higher education it was successful, up to a point. Universities were largely able to meet the terms of the scheme by raising qualifying private donations which allowed them to access the matching money. But American research has shown that such schemes are not as effective as one might think. While they do inspire more people to give, higher matching ratios do not lead to larger donations. Donors are not much influenced by the thought of the leverage they achieve with a matching sum from government. John List concludes that “People get utility or satisfaction out of giving to a good cause. And they do not care how much public good is provided”.

This suggests that some of the other ideas favoured by charities, especially more tax deductions, may not be quite as effective as they argue. And one has to consider the argument, advanced by Robert Reich, President Clinton’s Commerce Secretary, and others, that tax incentives for some forms of charitable giving can worsen social inequalities, by reducing the revenue the State has available for its own social projects. (15) This depends, of course, on what one assumes the State’s

marginal pound is spent on. Is it on Educational Maintenance Allowance, keeping a teenager in secondary education with all the benefits that should bring, or on another air to ground missile or a bonus for a senior civil servant?

Perhaps one of the Prime Minister's famous "nudges", rather than a costly tax deduction scheme, would be more effective.

Economics can, I suspect, take one only so far in this territory. You may think I have already gone well past that point. The macro picture is very complex, and any conclusions on the overall dynamics of philanthropy depend on many challengeable assumptions. Just like macroeconomics, really. But there is progress to be made on the micro front, by individual charities thinking hard about how best to present their causes and to appeal to donors. Some of the research I have cited is suggestive in that context at least.

The overall conclusion I draw, however, is that the fashionable emphasis on cost-benefit calculations may be, at best, a two-edged sword from a charity perspective. Much charitable giving by individuals is not rationally based, and we should embrace that conclusion. Donors want to be inspired, moved and enthused, shown individual illustrations of the particular good they can do, and never mind the size of the bucket. Most of us have quite enough rationality in our daily lives.

At the LSE I could, and often did deliver a persuasive analysis of the School's thin resource base in comparison with US competitors. I could point to the long-term decline in government funding and the overwhelming need to strengthen our sources of private funding. I had charts and graphs to prove every point. But in retrospect I can see that this intellectual approach triggered few large gifts. The personal stories told by students who could not otherwise attend the School at our scholars and donors events were far more compelling, as were individual academics who could enthuse a potential supporter about their own research project.

Giving behaviour is personal, and often quirky. It cannot supplant the role of the State in correcting systemic failures or providing robust safety nets for those whom the market, perhaps temporarily, leaves behind. Thatcherism's second shoe, as described wistfully by Michael Portillo, was never going to drop. But it can allow charities, of all kinds, to be more imaginative and entrepreneurial, taking risks with new ideas. That is something which government funding will rarely support, for understandable reasons. So the ideal outcome is not, I think, for the State to subcontract its social obligations to the third sector, but to encourage a mixed economy of funding, with private funding supplementing the core, and doing so in a way which encourages innovation and ambition.

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