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I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System

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I Like To Pay Taxes:

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

By Yair Listokin & David M. Schizer¹

Draft of August 24, 2012

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Abstract

This paper is based on a simple proposition, which we believe but cannot prove: 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, draw on the more general economics and psychology literature on prosocial behavior, and also invoke philanthropy as a “real world” analogy; after all, charitable donors contribute money voluntarily (indeed, 2% of the U.S. GDP), largely because they believe in the way their contributions are used.

Our claim has a number of concrete policy applications. The government should publicize popular uses of tax dollars, and go to particular lengths to avoid the negative publicity associated with waste. The government also should make broader use of taxes, like lotteries for education and the social security tax, which are dedicated to specific (popular) spending programs. In addition to proposing greater reliance on user fees, we 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 feel more connected to a local or state government’s activities and less inclined to free ride within a homogeneous local community. We also suggest ways to adjust audit strategy and penalty structure to enhance prosocial motivations. Furthermore, we urge the government to seek voluntary contributions from taxpayers for programs they especially value. Finally, we explore the more controversial step of allowing taxpayers to allocate some of their tax bill to programs they value, and conclude that, at most, taxpayers should be permitted to do so only in a very limited way.

¹ We are grateful for comments received from Yishai Baer, Kimberly Clausing, Mihir Desai, Michael Doran, Elizabeth Emens, Bert Huang, Alex Raskolnikov, Elizabeth Scott, Ethan Yale, and at workshops at Columbia Law School, NYU Law School, Hebrew University, and the Interdisciplinary Center in Herzliya.

*"I like to pay taxes. With them I buy civilization."*² 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,³ just as legal obligations generally offer an inadequate explanation for most law-abiding activity.⁴ Another answer, then, is that some people pay taxes because – like Oliver Wendell Holmes – they like to do so. In other words, 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 find satisfaction in contributing 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 effective if taxpayers support the way their tax dollars are spent. We believe 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 U.S. GDP),⁵ largely because they believe in the way their contributions are used.

Our claim has a number of concrete policy applications. The government should publicize popular uses of tax dollars, and go to particular lengths to avoid the negative publicity associated with waste. The government also should make broader use of taxes, like lotteries for education and the social security tax, which are dedicated to specific (popular) spending programs. In addition to proposing greater reliance on user fees, we 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 feel more connected to a local or state government’s activities and less inclined to free ride within a homogeneous local community. We also suggest ways to adjust audit strategy and penalty structure to enhance prosocial motivations. Furthermore, we urge the government to seek voluntary contributions from taxpayers for programs they especially value. Finally, we explore the more controversial step of

² Felix Frankfurter, Mr. Justice Holmes and the Supreme Court 71 (1961) (quoting Holmes).

³ James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and Europe*, 27 J. ECON. PSYCH. 224 (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*]. Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 Mich. L. Rev. 71, 80-85 (2003).

⁴ TOM TYLER, *WHY PEOPLE OBEY THE LAW* (1990); EDGAR ALLEN LIND & TOM TYLER, *THE SOCIAL PSYCHOLOGY OF PROCEDURAL JUSTICE* (1988).

⁵ In 2011, charitable giving equaled 2.0% of GDP. See *Giving USA 2012: The Annual Report on Philanthropy for the Year 2011*, Executive Summary 21 (chart).

allowing taxpayers to allocate some of their tax bill to programs they value, and conclude that, at most, taxpayers should be permitted to do so only in a very limited way.

Before we continue, we want to avoid three potential misunderstandings. First, many of our recommendations are “symbolic” in the sense that they would have at most a modest effect on the way the government actually spends public money. Instead, our proposals focus on providing taxpayers with information and on influencing their perceptions of the tax system. In effect, we are positing that taxpayers have imperfect information about how their tax dollars are spent and also, based on a large body of evidence, that they do not always behave rationally, such that framing can influence behavior. As a result, we believe that “symbolic” gestures can have real effects on the efficiency of taxation. A caveat is that we expect framing and symbolism to have more influence on individuals than on businesses because of the fiduciary duties managers owe to investors, and perhaps also because of the training and professional norms of managers. As a result, our argument is less relevant to corporations and, likewise, to investment funds and other sophisticated businesses taxed as pass through entities. More generally, we recognize that behavioral effects can vary and are hard to predict but, in our view, this does not make them any less important.

Second, we believe that deceiving taxpayers would be counterproductive. If the deception ever comes to light, it would undermine the very prosocial impulses we are trying to foster. Our recommendations aim to make the prosocial aspects of taxing and spending more salient without deceiving taxpayers.

Third, we do not believe that framing will generally make taxpayers “like” paying taxes (our title notwithstanding). Instead, the goal of the analysis is to make taxes less painful than they currently are, enhancing the efficiency of taxation regardless of the baseline level of ill will taxpayers bear for taxes.

Part I explains why the tax system is likely to be more effective if taxpayers support the way their tax dollars are spent. Parts II and III offer institutional applications of this idea. Part IV 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 effective 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 two reasons why we believe it still matters.

First, although taxes are legally mandatory, they are costly to enforce. 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.⁶ At the margin, it should take less effort and expense to ensure that they pay. Of course, in some contexts enforcement is already so effective – withholding on wages, for instance – that our argument is less relevant.⁷ Yet in other settings – use taxes, nanny taxes, and cash businesses, for instance – enforcement is so costly and impractical that those who pay these levies may feel as if they are choosing to do so.

Second, 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. For example, taxpayers who like the public goods funded by their tax dollars may be less likely to invest in a tax shelter. They may even work more than economists suspect because they do not view the marginal tax burden caused by the additional labor as a burden without any benefit. 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

⁶ Dan Kahan emphasizes that tax compliance is enhanced when taxpayers view their taxpaying as part of a reciprocal arrangement. *See generally* Kahan, *supra* note 3. Many of our suggestions below are likely to enhance the feelings of reciprocity associated with paying taxes.

⁷ For many taxpayers, opportunities for evasive behavior are curtailed by withholding and reporting systems. *See* Henrik Jacobsen Kleven, Martin Knudsen, Claus Thustrup Kreiner, Soren Lonstrup Pedersen, and Emmanuel Saez, *Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark*, 79 *ECONOMETRICA* 651-692 (2011) (demonstrating that tax compliance is very high for Danish taxpayers subject to withholding and information reporting systems).

be spent. They find a significant difference: the average compliance rate falls from .337 for a popular use to .081 for an unpopular one.⁸ 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.”⁹ 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.”¹⁰ 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.”¹¹

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 and 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).¹²

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.¹³ 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

⁸ 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]”).

⁹ *Id.* at 301.

¹⁰ *Id.* at 301.

¹¹ *Id.* at 301-302; see also Yankelovich, Skelly & White, Inc., *Taxpayer Attitudes Study: Final Report. Public Opinion Survey Prepared for the Public Affairs Division* (I.R.S., December, 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 and finding that attitudes about exchange relationship with government affect compliance).

¹² Tara Larson Brown, Catherine Eckel, Philip J. Grossman & Sherry Xin Li, *Giving to Government: Voluntary Taxation in the Lab*, 95 J. PUB. ECON. 1190 (2011).

¹³ Tara Larson Brown, Catherine Eckel, Philip J. Grossman & Sherry Xin Li, *Do Earmarks Increase Giving to Government?* (CEEBS, Working Paper No. 8, 2011).

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,” Brown, Eckel, Grossman and Li 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.”¹⁴

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.¹⁵ The terms “prosocial behavior” and “prosocial utility” are used to describe this unselfish instinct which leads people to care about the wellbeing of others.¹⁶

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.¹⁷ 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 the voluntary compliance rate at 84%.¹⁸ This compares favorably with compliance rates in many other countries.¹⁹

The tax morale literature offers several reasons why American comply so readily. A “social norm” of compliance raises tax compliance rates,²⁰ as do perceptions of fairness in tax

¹⁴ *Id.*

¹⁵ 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. Robert Boyd, Samuel Bowles, Colin Camerer, Ernst Fehr, Herbert Gintis, Joseph Henrich & Richard McElreath, *In Search of Homo Economicus: Behavioral Experiments in 15 Small-Scale Societies*, 91 AM. ECON. REV. 73-78 (2001).

¹⁶ Bruno S. Frey & Stephan Meier, *Social Comparisons and Pro-Social Behavior: Testing ‘Conditional Cooperation’ in a Field Experiment*, 94 AM. ECON. REV. 1717-3 (2004).

¹⁷ James Alm, G.H. McClelland & W.D. Schulze, *Why Do People Pay Taxes?* 48 J. PUB. ECON. 21 (1992); Lars P. Feld & Bruno S. Frey, *Trust Breeds Trust: How Taxpayers are Treated*, 3 ECON. OF GOVERNANCE 87 (2003).

¹⁸ <http://www.irs.gov/newsroom/article/0,,id=158619,00.html>.

¹⁹ 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). See also Joel Slemrod, *Trust in Public Finance*, (NBER Working Paper 9187, 2002).

²⁰ James Alm, Ana De Juan & Isabel Sanchez, *Economic and Noneconomic Factors in Tax Compliance*, 48 KYKLOS 3-18 (1995).

administration, the perceived equity of government spending, overall levels of trust in the government,²¹ as well as ethical commitments, altruism, and patriotism.²² Indeed, according to Professors 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.”²³

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.²⁴ 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., culture, religion, etc.) that encourages both.²⁵

2. *Size 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, Professor Olson famously argued that smaller groups will have an easier time overcoming the free rider problem than larger groups.²⁶ Many papers provide some degree of support for this hypothesis.²⁷

²¹ Ronald G. Cummings, Jorge Martinez-Vazquez, Michael McKee & Benno Torgler, *Effects of Culture on Tax Compliance: A Cross Check of Experimental and Survey Evidence*, (Ctr. for Research in Economics, Management and the Arts, Working Paper No. 2004-13); Alm & Torgler, *Cultural Differences*, *supra* note 3.

²² See generally Samuel Bowles & Sandra Polania-Reyes, *Economic Incentives and Social Preferences: Substitutes or Complements?* 50 J. ECON. LIT. (draft of Sept 2011).

²³ *Id.* at 243.

²⁴ Iris Bohnet & Stephan Meier, *Deciding to Distrust*, in PUBLIC POLICY DISCUSSION PAPER 05-4, FEDERAL RESERVE BANK OF BOSTON, at 10 (2005).

²⁵ 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. See Michael Wenzel, *Misperception of Social Norms About Tax Compliance: A Field Experiment* (Ctr. for Tax System Integrity, Working Paper No. 8, 2001), *cited in* Frey & Meier, *supra* note 16. Another, by contrast, shows that simple normative appeals to taxpayers asking for compliance have little causal effect on taxpaying behavior. See Marsha Blumenthal, Charles Christian & Joel Slemrod, *Taxpayer Response to an Increased Probability of Audit: Evidence From a Controlled Experiment in Minnesota*, 79 J. PUB. ECON. 455-483 (2001).

²⁶ Mancur Olson, Jr. *The Logic Of Collective Action: The Public Goods and the Theory of Groups* (1965). 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., ELINOR OSTROM, *GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION* (1990).

²⁷ See R. Mark Isaac & James M. Walker, *Communication and Free Riding Behavior: The Voluntary Contributions Mechanism*, 26 ECON. INQUIRY 585 (1988); R. Mark Isaac & James M. Walker, *Group Size Hypotheses of Public*

Experimental evidence also demonstrates that individuals are more likely to contribute to public goods when the beneficiaries are members of the same “group.”²⁸ Subjects who are randomly assigned to one group are more likely to cooperate with other group members than with individuals randomly assigned to another group.²⁹ Observational studies reinforce this laboratory evidence, showing that redistribution,³⁰ willingness to participate in social organizations,³¹ and public goods provision all decrease as ethnic diversity increases.

3. *Moral Engagement*

Prosocial behavior can also be encouraged or discouraged by institutional context, inspiring 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.³² 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.³³ 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.³⁴

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.

Goods Provision: An Experimental Examination, 103 Q. J. ECON. 179 (1988); R. Mark Isaac, James M. Walker, & Arlington Williams, *Group Size and the Voluntary Provision of Public Goods: Experimental Evidence Utilizing Very Large Groups*, 54 J. PUB. ECON. 1 (1991); James Andreoni & Rachel Croson, *Partners Versus Strangers: Random Rematching in Public Goods Experiments*, in HANDBOOK OF EXPERIMENTAL ECONOMIC RESULTS (2008).

²⁸ 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. HENRI TAJFEL, *HUMAN GROUPS AND SOCIAL CATEGORIES: STUDIES IN SOCIAL PSYCHOLOGY* (1981).

²⁹ Lorenz Goette, David Huffman, and Stephan Meier, *The Impact of Group Membership on Cooperation and Norm Enforcement: Evidence Using Random Assignment to Real Social Groups*, AM. ECON. REV., May 2006 at 212-216.

³⁰ Erzo Luttmer, *Group Loyalty and the Taste for Redistribution*, 109 J. POL. ECON. 500–528 (2001).

³¹ Alberto Alesina & Eliana La Ferrara, *Participation in Heterogeneous Communities*, 115 Q. J. ECON. 847–904 (2000).

³² Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUD. 1 (2000) (fines for daycare in Haifa caused people to think the fine was a price).

³³ 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. Elisabeth Rosenthal, *Motivated by Tax, Irish Spurn Plastic Bags*, N.Y. TIMES, February 2, 2008. (fines for plastic bags in Ireland was a signal about moral / community norms); Patricia Funk, *Is There An Expressive Function of Law? An Empirical Analysis of Voting Laws with Symbolic Fines*, 9 AM. LAW ECON. REV. 135 (2007) (lifting fine on not voting lead to less voting).

³⁴ Bowles & Polonia Reyes, *supra* note 22.

Yet perhaps the most telling evidence that people give money if they support how it will be used is the charitable sector. Millions of people give time and money to charity every day. Charitable giving represents 2% of U.S. GDP and individuals across the income spectrum make charitable contributions.³⁵

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.³⁶

“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 is not a complete explanation for 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.³⁷ Yet the empirical evidence contradicts this prediction. Government funding does not “crowd out” charitable giving to the degree predicted by theories relying on altruism.³⁸ Second, if giving is motivated solely by altruism, a small number of wealthy individuals should be the exclusive givers of every type of charity.³⁹ 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 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.⁴⁰

³⁵ See Giving USA, *supra* note 5. The non-profit sector produced about 5.4% of GDP in 2010. See The Urban Institute, Non-Profits, available at <http://www.urban.org/nonprofits/index.cfm>.

³⁶ James Andreoni, *Charitable Giving*, in NEW PALGRAVE DICTIONARY OF ECONOMICS 748 (Lawrence E. Blume & Steven N. Durlauf eds., 2d ed. 2007).

³⁷ 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).

³⁸ 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 37, at 1223 (offering citations).

³⁹ James Andreoni, *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*, 100 ECON. J. 464, 465 (1990).

⁴⁰ 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

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.

Warm glow is a powerful motivation for charitable giving, and we believe there is an analogous motivation when people pay taxes to support initiatives they value. Admittedly this would not be the case if warm glow arises only from *voluntary* giving. Is the key to warm glow that you *choose* to be the source of the funds, or just that you *are* the source of the funds? Although the literature on philanthropy does not address this question, we believe it is plausible to think that variations of warm glow could arise with mandatory payments as well.

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 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.⁴¹ 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.

b. Financial Incentives

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. See <http://www.cbo.gov/ftpdocs/124xx/doc12480/10-18-charitableTestimony.pdf>, at 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).

⁴¹ David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221 (2009).

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%.⁴²

c. Recognition, Shaming

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.”⁴³

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

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 literature on pro-social behavior and philanthropy. This literature offers evidence that people contribute to the community not only because they *have* to do so, but also because they *want* to do so.

⁴² 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); Frey & Meier, *supra* note 16.

⁴³ 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. Peter Diamond, *Optimal Tax Treatment of Private Contributions for Public Goods With and Without Warm Glow Preferences*, 90 J. Pub. Econ. 897 (2006). If “warm glow” is really just avoiding the awkwardness of saying “no” to a solicitation, he says, we should not view it as a positive source of utility. See Stefano Della Vigna, John A. List & Ulrike Malmendier, *Testing for Altruism and Social Pressure in Charitable Giving*, Q. J. ECON. (forthcoming) (estimating that the cost of saying no to someone who knocks at one’s door to solicit for charity is between \$1.40 and \$3.80). 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.

If we are correct that people are more likely to pay their taxes 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.⁴⁴

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.⁴⁵ 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.⁴⁶ Likewise, Americans generally endorse “spending cuts” in the abstract as a way to reduce the federal deficit,⁴⁷ 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 were reduced to tears.⁴⁸

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.”⁴⁹

The silver lining here, of course, is that there is significant room for improvement. Americans clearly do support specific government programs. But they seem not to associate the

⁴⁴ *Americans Say Federal Gov't Wastes Over Half of Every Dollar*, GALLUP WEBSITE (Sept 19, 2011), <http://www.gallup.com/poll/149543/americans-say-federal-gov-wastes-half-every-dollar.aspx>.

⁴⁵ 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.”).

⁴⁶ 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”).

⁴⁷ *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.”)

⁴⁸ Binyamin Appelbaum & Robert Gebeloff, *Even Critics of Safety Net Increasingly Depend on It*, N.Y. TIMES, Feb. 12, 2012.

⁴⁹ Bartels, *supra* note 46, at 21.

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 spent and to encourage them to associate tax payments more directly with government initiatives they favor. The question, though, is how to do this.

II. **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 taxes? The overriding goal is to encourage taxpayers to associate taxes with programs they support and, correspondingly, to minimize the extent to which they associate taxes with government expenditures they oppose. As the old song goes, “accentuate the positive” and “eliminate the negative.”⁵⁰

This Part offers examples of how to pursue this goal. We begin with efforts to focus taxpayer attention on popular programs and to avoid waste, and then consider the value of formally linking taxes with specific programs, whether through dedicated taxes or user fees. We also argue that the degree of taxpayer warm glow can be influenced – not only by how we structure taxes – but also by the level of government that collects them, and by the way penalties and audits are structured.

Before proceeding, we should offer a caveat. While it is easy to say that we should emphasize popular programs and deemphasize unpopular ones, 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 look for ways to pair taxpayers with initiatives they personally value. In effect, this strategy is to segment taxpayers, so that individuals are supporting (or at least are focusing on) different initiatives. We return to this sort of choice-based approach – which, as we shall see, is more controversial – in Part III.

A. Prosocial Benefits from Publicizing Popular Government Activities

Positive publicity for government spending can promote warm glow among taxpayers. By analogy, charitable organizations frequently trumpet their accomplishments to inspire warm glow, describing their activities in magazines, mailings, emails and tweets. They market their

⁵⁰ *Johnny Mercer, Accentuate the Positive* (Accentuate the Positive, 1944).

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 two related respects if it enhances warm glow.⁵¹

First, the government can help taxpayers derive satisfaction from paying taxes by showing they receive value for their money.⁵² For example, the government can run an 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.⁵³ Likewise, the IRS could require all tax preparation software to include a similar feature and could even require it to be filed with 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.⁵⁴ Indeed, positive publicity about the government’s work may enhance tax morale and improve compliance. As filing deadlines approach, the IRS already issues press releases describing enforcement measures.⁵⁵ 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

⁵¹ 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.

⁵² Amir Saeed & Attaullah Shah, *Enhancing Tax Morale with Marketing Tactics: A Review of Literature*, 5 AFR. J. BUS. MGMT. 13559, 13563 (2011); Richard M. Bird, Jorge Martinez-Vazquez J & Benno Torgler, *Societal Institutions and Tax Effort in Developing Countries*, in THE CHALLENGES OF TAX REFORM IN THE GLOBAL ECONOMY 283-338 (James Alm, Jorge Martinez-Vazquez and Mark Rider eds., 2006) (urging gov’t to “show value for money” just as private firms do).

⁵³ <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.”).

⁵⁴ See Part I.B.3.

⁵⁵ See Joshua Blank & Daniel Levin, *When Is Tax Enforcement Publicized?*, 30 VA. TAX REV. 1 (2010).

that a popular film star paid the highest tax bill in the nation.⁵⁶ Indeed, a number of studies show that stories about pro-social behavior of peers engender compliance more effectively than threats of sanctions.⁵⁷

Yet we do not mean to paper over the difficulties in implementing this strategy or to overstate its effectiveness. One challenge is cost – or, to be more precise, perceived cost. If taxpayers believe the government is overspending on publicity, it will not have the intended effect. Publicity efforts should thus be taken up slowly and carefully.

A further challenge – and, indeed, a recurring theme in this Article – is the need to be mindful of the diversity of taxpayer opinion, and to target messages accordingly. This is not especially different from the efforts of advertisers to segment the market. For example, the messages for urban and rural areas or for “red” and “blue” states might be different, just as political campaigns emphasize different themes in different media markets.

Another complication is that government officials who oppose a particular initiative will use publicity to portray it in a negative light, and this negative publicity could undermine taxpayer warm glow. Regardless of its effect on warm glow, this sort of opposition is an essential feature of our democratic system and must be permitted. But it is worth emphasizing that negative publicity will not necessarily undermine warm glow and sometimes can enhance it. On one hand, if the negative publicity is unpersuasive to taxpayers, it may prove harmless. On the other hand, if it is extremely persuasive – so that the program is terminated – the net effect of this publicity might be to *enhance* warm glow, for instance, by increasing the percentage of public money devoted to popular programs, and by reinforcing the conviction of taxpayers that the government is responsive to their concerns.

B. Avoiding Government Waste

Just as the government should remind taxpayers that their tax dollars support programs they value, the government should also make 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).⁵⁸ The costs of this waste are borne

⁵⁶ Saeed & Shah, *supra* note 52 (Indian government publicized that popular film star paid highest tax bill in country).

⁵⁷ 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).

⁵⁸ The corporate social responsibility literature rejects this premise. See Markus Kitzeueller & Jay Shimshack, *Economic Perspectives on Corporate Social Responsibility*, 50 J. ECON. LIT. 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 the case for private providers, then it will be all the more true for government, which has an explicitly public regarding role.

– 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.⁵⁹ 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 feel warm glow in paying taxes, knowing they are supporting important public goods. Yet government waste is likely to dim this warm glow. This perspective is familiar to charities, which are often ranked on how efficiently they turn contributions into public goods. Therefore, money spent on reducing waste – whether in nonprofits or in government – 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.⁶⁰

In making this point, we recognize that waste is not a self-defining term, and that what some consider waste might be a worthwhile initiative to others. Yet some expenditures will offend even those who sympathize with the goal being pursued. For instance, even the most ardent proponent of military spending will not want the military to pay \$500 for a wrench. Likewise, even those who recognize the importance of managing the government’s buildings will doubt the need to spend \$800,000 on a lavish Las Vegas conference for General Services Administration employees.⁶¹

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. In addition, in requiring particular taxes to fund only specified

⁵⁹ 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.

⁶⁰ Saeed & Shah, *supra* note 52.

⁶¹ Tom Cohen & Dana Bash, *GSA Official Takes the Fifth on Spending Scandal*, CNN, Apr. 17, 2012, at <http://www.cnn.com/2012/04/16/politics/gsa-hearing/index.html>.

programs, we lose the flexibility to redirect tax dollars as conditions change. All else being equal, the government obviously should want this flexibility.

Yet in our view, all else is not equal, so that explicitly linking a tax with a popular government program adds value that must be factored into the analysis. 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,

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.⁶²

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.⁶³ Likewise, surveys suggest that taxpayers are more willing to pay environmental taxes if the proceeds are used to fund environmental programs.⁶⁴

Linking a tax to a popular spending program 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

⁶² MICHAEL J. GRAETZ, ONE HUNDRED MILLION UNNECESSARY RETURNS 126 (2008) (quoting FDR).

⁶³ 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).

⁶⁴ 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).

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, such as social security, health care, and education.⁶⁵

D. User Fees

Many government-provided public goods can be funded through either general revenues or more targeted user fees. For example, roads are generally financed with gasoline taxes, but sometimes they are funded with tolls. Public goods that can be funded via fees or tolls are called “excludible,” because the government can exclude those who do not pay the toll from benefiting from the public good. Even more than taxes with dedicated uses, user fees and licenses link government revenue and taxpayer benefits.

Should the government fund excludible public goods via general revenues or fees and tolls? The conventional analysis points out that tolls and user fees lead to inadequate provision of public goods. If there is no marginal cost associated with using the good (*e.g.*, a car on an empty road imposes a near zero marginal cost), then charging a user fee leads to suboptimal use of the public good. Likewise, to the extent we want not only to fund public goods but also to redistribute wealth through our tax system, it is harder to do through user fees (unless, for instance, the size of the fee is adjusted for income).

Yet in our view, this analysis is incomplete. Charging user fees allows the government to reduce income taxes. In addition, user fees are viewed like any other price. They do not distort labor or leisure decisions because the user gets the full benefit of the spending. (This is true even without prosocial motivations). As a result, user fees reduce the inefficiency associated with

⁶⁵ See *e.g.*, <http://www.harrisinteractive.com/NewsRoom/HarrisPolls/tabid/447/mid/1508/articleId/693/ctl/ReadCustom%20Default/Default.aspx> (finding large majorities of the population opposed to cuts in health care, social security, and education spending).

income taxation. Governments should weigh this reduction in deadweight loss against the suboptimal use that user fees engender.

At the same time, a potential concern about user fees is that they might affect taxpayer attitudes toward the other taxes they pay. If taxpayers pay separate fees and tolls for all public services that are salient to them, they might develop a less favorable view of income taxes, since they might become less likely to associate these tax payments with public services that they personally experience and value. Such an effect would offset the efficiency benefits of lower taxation enabled by widespread use of user fees and tolls.

E. Subsidiarity

If taxpayers are more accepting of taxes funding public goods that are more immediate and salient, this insight has implications not only for the *type* of taxes we collect – for instance, dedicated taxes or user fees – but also for the *level of government* that should collect them. We believe that state and local taxes have three advantages over national government.

First, the public goods provided by lower levels of government are likely to be more salient, so that taxpayers are more likely to associate them with the taxes they pay. Second, and relatedly, taxpayers may feel as if they have more of a say in what their local government does, so that they feel more invested in the public goods being pursued with their tax dollars. Third, if taxpayers identify especially closely with their local communities, they might be less inclined to free ride at their expense; indeed, observational and experimental studies consistently demonstrate that smaller and more homogeneous groups have an easier time sustaining prosocial behavior than larger and more diffuse populations.⁶⁶

Each of these reasons – the salience of the public goods, the readier access to the decisionmaking process, and the homogeneity of the communities – suggest that taxes are more likely to be efficient if collected locally, instead of nationally. Our theory about the connection between taxes and spending, therefore, offers a new justification for subsidiary, *i.e.*, the principle that that public goods should be delivered and funded by the lowest feasible level of governance. There is some empirical support for this theory, for instance, in studies of Swiss cantons showing that more local autonomy is associated with significantly higher tax morale.⁶⁷

Obviously, there already are a host of other arguments for subsidiarity and federalism in the literature.⁶⁸ For example, subsidiarity allows greater oversight of public goods provision,⁶⁹

⁶⁶ See *supra* Part I.C.2.

⁶⁷ See Benno Torgler et al, "With or Against the People? The Impact of a Bottom-Up Approach on Tax Morale and the Shadow Economy" Working Paper (2012) available at http://www.yale.edu/leitner/resources/docs/paper_2_torgler_et%20al.pdf (finding that "decentralizing the political competencies to those who are close to the problems" raises tax morale).

⁶⁸ For a recent review and critique of the costs and benefits of federalism from a legal perspective, see Heather Gerken, *Federalism All the Way Down*, 124 HARV. L. REV. 4 (2010).

enables spending to be tailored to tastes,⁷⁰ encourages experimentation,⁷¹ and leads to healthy competition between jurisdictions for residents.⁷² These familiar theories focus more on the quality of local spending, as opposed to local tax collection. While we are breaking new ground in focusing on tax collection, the two obviously are connected. After all, if local spending is indeed more efficient, as Tiebout models contend, then taxpayers may well experience more warm glow in supporting it.

Needless to say, there are a number of countervailing considerations that favor higher levels of government, including economies of scale, the need to minimize free-riding by one jurisdiction on another, greater possibilities for redistribution of wealth, and the like. Our goal is not to offer a comprehensive analysis – all the more so because the analysis has to be context-specific – but to highlight an additional advantage of subsidiary that has not been emphasized in the literature: the relative advantage that lower levels of government have in generating warm glow in tax collection.

F. Fines, Rewards, and Audits

Our analysis has implications not only for which level of government should collect a tax, but also for how penalty and audit strategies should be crafted. We want taxpayers to view cheating as a breach of a moral and civic duty, and not as a wager where fines are the price of losing. So although we obviously need audits and sanctions to provide economic incentives for compliance, we do not want these incentives to “crowd out” prosocial motivations.⁷³ Therefore, we should strive to structure audits and penalties – and, more generally, to calibrate enforcement – in ways that minimize crowding out.

This obviously is a very broad topic, and our goal is not to offer a specific proposal or a comprehensive analysis. Indeed, we do not claim to know precisely what will work. A challenge is that taxpayer motivations for compliance are heterogeneous, as Alex Raskolnikov has emphasized.⁷⁴

Yet a clear lesson that emerges from the literature on prosocial behavior is that context matters. As a result, the government should experiment with various approaches to identify

⁶⁹ See, e.g., Paul Seabright, *Accountability and Decentralisation in Government: An Incomplete Contracts Model*, 40 EURO. ECON. REV. 61-89 (1996).

⁷⁰ See Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956); WALLACE OATES, *FISCAL FEDERALISM* (1972).

⁷¹ K.S. Strumpf, *Does Government Decentralization Increase Policy Innovation?* 4 J. PUB. ECON. THEORY 207–241 (2002).

⁷² Tiebout, *supra* note 70; Oates, *supra* note 70. But see John D. Wilson, *A Theory of Interregional Tax Competition*, 19 J. URB. ECON. 296-315 (1986); George Zodrow & Peter Mieszkowski, *Pigou, Tiebout, Property Taxation, and the Under-Provision of Local Public Goods*, 19 J. URB. ECON. 356-370 (1986) (identifying possibility of unproductive competition between jurisdictions).

⁷³ See Bowles & Polania-Reyes, *supra* note 22.

⁷⁴ See Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice To Target Tax Enforcement*, 109 COLUM. L. REV. 689, 692-93 (2009).

context-specific institutional strategies that promote prosocial motivations. For example, if the government compensates taxpayers for the costs of a random audit, as Joseph Bankman has suggested,⁷⁵ the government would signal a desire to be fair, which, hopefully, would inspire taxpayers to reciprocate.⁷⁶ Likewise, we may want to reward taxpayers if their audit shows that they have paid in full, since rewards are sometimes more effective than penalties at triggering prosocial motivations.⁷⁷ In the same spirit, a range of sanctions can be explored for noncompliance, including not just cash payments, which are the most likely to crowd out prosocial motivations and may even signal that noncompliance is acceptable so long as the non-complier pays for the privilege,⁷⁸ but also community service requirements, mandatory civics courses, and the like. These steps are thought to “crowd out” less and may even “crowd in.”⁷⁹

To sum up, then, if a novel approach can change the frame by which taxpayers view our compliance system, the benefits would be large. It could lead to “crowding in”, so that the incentive complements and reinforces prosocial motivations.⁸⁰

III. Applications: Taxpayer Choice

While the government should publicize popular programs and dedicate particular taxes to fund them, as discussed above, a significant challenge in doing so 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. Indeed, the freedom to choose what to support is inherent in philanthropy. By analogy, can we give taxpayers some measure of freedom to choose what they want to support? After all, 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.

⁷⁵ See Joseph Bankman, *Tax Enforcement: Tax Shelters, The Cash Economy, and Compliance Costs*, 31 OHIO N.U. L. REV. 1, 9 (2005) (proposing compensating taxpayers for random audit costs); Joseph Bankman, *Who Should Bear Tax Compliance Costs?*, (Stanford Law Sch., John M. Olin Program in Law & Econ., Working Paper No. 279, 2004), available at <http://ssrn.com/abstract=519783> [hereinafter Bankman, *Who Should Bear Tax Compliance Costs?*] (proposing compensating taxpayers for random audit costs);

⁷⁶ See Bowles & Polonia-Reyes, *supra* note 22, at Section 5.

⁷⁷ Bowles & Polonia-Reyes, *supra* note 22, at Section 5.

⁷⁸ Bowles & Polonia-Reyes, *supra* note 22, at Section 6.

⁷⁹ Bowles & Polonia-Reyes, *supra* note 22, at Section 5.

⁸⁰ For example, Alex Raskolnikov has proposed to allow taxpayers to choose each year among penalty regimes that emphasize either deterrence or cooperation, so that they can sort based on their preferences. See Raskolnikov, *supra* note 74. We believe the effectiveness of this type of regime will depend in part on whether it is designed to promote or discourage prosocial motivations. If sorting creates crowding in, this would be another advantage of Raskolnikov’s proposal.

Yet such choices are more complicated for government than for charity, since government is inherently a communitarian enterprise. As a result, a problem with choice-based strategies is that they may be in tension with other important values. The degree of tension – and, of course, the extent of the benefit – depend on the specifics of how a choice-based strategy is structured.

This Part begins by outlining potential benefits and costs that can arise with choice-based approaches. We then discuss two examples that balance costs and benefits somewhat differently. First, taxpayers can be allowed to allocate only voluntary contributions that are in excess of what they are obligated to pay in taxes (which we call “allocating voluntary payments”), either by contributing to independent nonprofits affiliated with the government or to the government itself. Second, and more controversially, they can be permitted to allocate even a portion of taxes they are legally obligated to pay (which we call “allocating mandatory payments”).

A. Normative Tradeoffs

1. Potential Benefits

Obviously, the main reason to offer taxpayers this sort of discretion is to focus taxpayer attention on the segment of expenditures that they especially value, thereby increasing prosocial attitudes towards paying taxes and, hopefully, reducing enforcement costs, tax planning costs, and the like.

In theory, taxpayers could be invited to fund initiatives that are quite specific. To make the program more administrable, though, the government can offer only a menu of broadly-defined 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, thereby reminding them that taxes fund initiatives they value.

In addition, as in the nonprofit world, taxpayers can be recognized for supporting particular programs (unless they request anonymity). For example, they can be included on a list of donors posted on a website. 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.

In addition to encouraging prosocial motivations among taxpayers, a further potential advantage of a choice-based 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 opinion polls. 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.

2. *Potential Costs*

However, there obviously are administrative costs associated with implementing this idea. In addition, there are six other potential concerns, which might – or might not – arise, depending upon the details of what taxpayers are permitted to do.

First, while taxpayers may feel more enthusiasm for the payments they are permitted to allocate, there is a risk that they will feel correspondingly *less* enthusiasm for the rest of what they pay the government. If they associate this residual with programs they did not choose – and do not support – they will find it less fulfilling to make this residual 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.⁸¹ Of course, it may be that taxpayers will not feel this way. For example, they might feel *even better* about the residual because the choice-based payment has reminded them of programs they support.

Second, when money is allocated by individuals operating independently, this sort of decentralized process can have costs as well as benefits. On the positive side, charities are freer to experiment and innovate, as Burton Weisbrod has emphasized, because they do not depend on the support of the median voter; for this reason, the civil rights, women's rights, environmentalism, and gay rights were championed first by nonprofits before they were pursued by government.⁸² In addition, individuals are likely to be closer to grass roots organizations, and correspondingly less susceptible to the interest group influence than elected representatives, since they cannot be swayed by campaign contributions.⁸³ Yet on the other hand, 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. For example, taxpayers will make their individual choices without complete information about what others are choosing.⁸⁴ A particular goal is likely to be less appealing to

⁸¹ See Cagla Okten & Burton A. Weisbrod, *Determinants of Donations in Private Nonprofit Markets*, 75 J. PUB. ECON. 255 (2000).

⁸² Burton Weisbrod, *Toward a Theory of a Voluntary Nonprofit Sector in a Three Sector Economy* in THE ECONOMICS OF NONPROFIT INSTITUTIONS (Susan Rose Ackerman, ed.) (1986) (defending charitable deduction as empowering minorities to pursue public goals that majoritarian political processes would not endorse).

⁸³ For instance, a program in Hungary lets taxpayers allocate 1% of their tax liability to the nonprofit of their choice. Compared with the rest of the central budget, which is allocated by government officials, the 1% focuses more on education, health care, and social services, on small nonprofits, and on less populated regions of the country. See Agnes Vajda & Eva Kuti, *Citizens' Votes for Nonprofit Activities in Hungary*, at 18-20-, in <http://zunia.org/uploads/media/knowledge/hungary-forint-votes.pdf>.

⁸⁴ Cf. Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387 (1998) (noting problem of individuals making allocation decisions simultaneously, without benefit of information about what others are doing).

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, at least if taxpayers are all making their selections at essentially the same time.⁸⁵ Likewise, we might unleash a blizzard of public lobbying as interest groups seek to persuade taxpayers to support their category of spending. Of course, this issue is less likely to arise if taxpayers are permitted to allocate only to a broadly defined category (e.g., “support our troops” or “education”), as opposed to more specific initiatives.

Third, by framing taxes as more like charitable contributions, we might increase the risk that support for the government would crowd out private charity. Studies show that such crowd out has been limited.⁸⁶ It is possible that this result could change if taxpayers begin playing a more active role in allocating their payments to the government, although the opposite is also possible; for instance, such a program could encourage taxpayers to develop *more* of a taste for charitable giving.⁸⁷

Fourth, allowing taxpayers a role in allocating payments to the government diminishes the role of our elected representatives. For example, would we also allow taxpayers to opt out of supporting programs they oppose, as conscientious objectors sometimes strive to do?⁸⁸ Depending on how the mechanism for taxpayer choice is structured, it could strike some taxpayers as illegitimate, and might even undercut their willingness to pay taxes.

Fifth, 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. Again, though, this risk is mitigated if she can choose only from a menu of very general items (e.g., “support our troops”).

Finally, if government resources are allocated by those who provide them, wealthy citizens are likely to allocate more. This gives them more personal influence on the overall

⁸⁵ 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.

⁸⁶ See *supra* note 37-39 & accompanying text.

⁸⁷ Hungary allows taxpayers to allocate 1% of their tax liability to charity. As Vajda and Kuti have observed, “There have been more concerns about a possible “crowding out” effect, that is, about a danger that private donations or government funding may fall as a result of the 1% provision. The statistical figures presented in the previous chapters seem to prove this did not happen, at least not at the level of the nonprofit sector as a whole.” See Agnes Vajda & Eva Kuti, *Citizens’ Votes for Nonprofit Activities in Hungary*, at 42-, in <http://zunia.org/uploads/media/knowledge/hungary-forint-votes.pdf>.

⁸⁸ For example, Archbishop Raymond Hunthausen of Seattle used to withhold half his tax dollars as a protest against nuclear weapons. See *Hunthausen Urges End of Nuclear Deterrence*, SPOKANE CHRON., Nov. 9, 1987, http://news.google.com/newspapers?nid=1345&dat=19871109&id=lw8TAAAIAIAJ&sjid=3_oDAAAIAIAJ&pg=2765,1541387.

allocation than low income taxpayers;⁸⁹ indeed, the 47% who do not pay any income tax will not be accorded this opportunity, at least if the program is for allocating taxes they otherwise have to pay.⁹⁰ 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 cap the amount that taxpayers can allocate. But the downside of this approach is that it means less money for the government (if it governs voluntary payments) or a less meaningful choice for high income taxpayers (if it governs mandatory payments) since the dollar amount is likely to represent a smaller percentage of their overall income. This alternative would be more consonant with egalitarian norms, but less effective at promoting prosocial utility among high income taxpayers.

To sum up, then, allowing taxpayers a role in allocating their payments to the government has both benefits and costs. The precise tradeoff depends on the details of how such an initiative is implemented, so we turn now to two different variations. The first involves extra payments made voluntarily, which are above and beyond what the taxpayer owes in taxes. The second involves the mandatory tax liability itself.

B. Allocating Voluntary Payments

By encouraging taxpayers to make extra contributions to support government initiatives – in addition to what they otherwise owe in taxes – we would attract additional resources for the government, develop information about what taxpayers like to support, and generate warm glow that might also apply to the mandatory tax payment itself, since taxpayers would be reminded of government programs they value and thus, hopefully, would feel correspondingly more willing to pay their (mandatory) taxes as well.

In seeking voluntary contributions, the government would in effect function as a charity. As a result, this strategy involves the same normative considerations inherent in charitable support, including the satisfaction donors feel in supporting initiatives they value, the benefits and costs of decentralized decisionmaking, the potential to crowd out contributions to other charities, and the disproportionate influence of wealthy donors.⁹¹

Perhaps the most important difference between letting taxpayers allocate *voluntary* payments and letting them allocate *mandatory* ones is that the former undercuts the role of elected representatives somewhat less than the latter. If payments are made voluntarily, the

⁸⁹ 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: Gerald E. Auten, Charles T. Clotfelter, and Richard L. Schmalbeck, *Taxes and Philanthropy among the Wealthy*, in DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH 392, 401 (Joel B. Slemrod ed., 2000).

⁹⁰ David Leonhardt, *Yes, 47% Owe No Taxes: Look Closer*, N.Y. TIMES, Apr. 13, 2010, at <http://www.nytimes.com/2010/04/14/business/economy/14leonhardt.htm>.

⁹¹ For a discussion of the tradeoffs inherent in subsidizing charitable contributions, see generally David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 Tax L. Rev. 221 (2009).

government would otherwise not have attracted these resources. As a result, elected representatives would not have had the opportunity to allocate this amount anyway (although, if the payment is tax deductible, they could have allocated a portion of it).⁹²

2. Fundraising Through Affiliated Nonprofits

As for the mechanics of how the government could raise this money, one option is for the government to use separate 501(c)(3) organizations. 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.⁹³ The military is just one of many contexts for this sort of initiative. Local businesses make voluntary contributions to “business improvement districts,” which provide extra services not offered by local governments. Private fundraising for State Universities and local public schools are, of course, another example. For instance, 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 2010.⁹⁴

Although 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

⁹² Charitable contributions to nonprofits and to the government generally are tax deductible under current law. See Section 170(c)(1). As a result, they reduce taxes by the product of the contribution and the taxpayer’s marginal tax rate, so that, for example, contributing a dollar reduces taxes by 35 cents if the marginal rate is 35%. In this respect, charitable contributions to the government are no different from other charitable contributions.

⁹³ 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).

⁹⁴ www.DonorsChoose.org/about/how_it_works.html#start; see also Brown, *supra* note 13, at 3.

improperly solicited corporate donations for a college center bearing his name.⁹⁵ 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.

2. Supplemental Tax Payments Directly to the Government

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.⁹⁶ All fifty states have “adopt-a-highway” programs, in which individuals or businesses volunteer to clean or pay for the upkeep of a designated stretch of highway and are credited for doing so with a sign.⁹⁷ Massachusetts offers taxpayers the option of paying a higher state income tax rate, although only a fraction of taxpayers choose to do this.⁹⁸ 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.⁹⁹ Likewise, the Federal Government has kept a general account since 1843 for “gifts to the United States.”¹⁰⁰ In 1961 it began offering the option of making gifts specifically to reduce the national debt, attracting \$3 million in 2009.¹⁰¹

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 heterogeneous preference, they are more likely to contribute voluntarily if they can choose what program they will support.

⁹⁵ Chris Richardson, *Charles Rangel Censured on House Floor – What Does Censure Mean?*, CHRISTIAN SCIENCE MONITOR, Dec. 2, 2010, at <http://www.csmonitor.com/USA/Politics/2010/1202/Charles-Rangel-censured-on-House-floor-what-does-censure-mean>.

⁹⁶ Rebecca Tuhus-Dubrow, *Voluntary Taxes*, BOSTON GLOBE, June 27, 2010.

⁹⁷ http://en.wikipedia.org/wiki/Adopt_a_Highway.

⁹⁸ <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* note 96 (In 2008, 1,953 taxpayers opted for this rate, generating an extra \$231,907).

⁹⁹ Tuhus-Dubrow, *supra* note 96; *see also* Brown, *supra* note 12 (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.

¹⁰⁰ Brown, *supra* note 12. 394,000 in 2001.

¹⁰¹ Tuhus-Dubrow, *supra* note 96.

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.¹⁰²

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. Allocating Mandatory Tax Payments

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. In addition, Hungary implemented such a system in 1996, allowing taxpayers to allocate one percent of their tax bill to the nonprofit of their choice, which has proved to be quite popular among taxpayers.¹⁰³

By giving taxpayers some control over how their tax dollars are spent, we can help generate warm glow for the portion they allocate and, possibly, for the rest as well, since we would focus taxpayer attention on initiatives they value. On this dimension, allocating mandatory payments might be even more compelling than allocating voluntary ones. At the same time, we can generate information about what taxpayers value, as discussed above.

¹⁰² See Section 170(c)(1).

¹⁰³ See Agnes Vajda & Eva Kuti, *Citizens' Votes for Nonprofit Activities in Hungary*, at 13 (“To sum up, our findings seem to prove that the 1% provision has been generally welcomed by the overwhelming majority of the adult population.”), in <http://zunia.org/uploads/media/knowledge/hungary-forint-votes.pdf>.

In our view, however, allowing taxpayers to allocate mandatory payments is harder than allowing them to allocate voluntary ones. We are more wary of empowering individuals to allocate funds that otherwise would have been allocated by our elected representatives, and of giving wealthy individuals a disproportionate voice in the process, as discussed above.

In light of these potential costs, reasonable minds can disagree about whether it makes sense to offer taxpayers an ability to allocate their tax dollars and, if so, how much discretion to give them.¹⁰⁴ The farthest we would go is to offer taxpayers choices that are constrained, so that the overall result is unlikely to diverge much – or, alternatively, is hard-wired not to diverge *at all* – from allocations that Congress would otherwise have provided. In other words, the effect of these allocations would be more symbolic than substantive.

There are three ways to constrain taxpayer choice in this way. 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 one percent of their tax bill, the potential change in the budget process is capped at one percent. Indeed, there would be no change if taxpayers were invited to allocate 1% of their taxes to categories that each represented *more than* one percent of the budget. Of course, taxpayers will have less of a “real” say in the allocation of the budget, but there is still value in reminding them that their taxes fund programs they support, and in letting them signal their preferences to Congress.

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

¹⁰⁴ Any initiative of this sort also has to comply with the Appropriations Clause, which provides that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law.” U.S. CONST. art. I, sec. 9, cl. 7. We obviously intend for any initiative of this sort to be authorized by Congress. By enacting a statute that offers taxpayers the opportunity to participate in directing tax dollars, Congress would, in effect, be making a conditional appropriation (*i.e.*, in which the appropriation of money depends on the taxpayer’s choice). For example, if Congress offers a menu of options and allows taxpayers to allocate a small percentage of their tax dollars to one of the choices on the menu, as discussed above, such an approach seems indistinguishable to us from the choice that Congress currently offers taxpayers to allocate a portion of their tax dollars to campaign funds. We suspect that any variation involving narrowly constrained choices – the type of proposal that we support – is likely to satisfy the Appropriations Clause as a conditional appropriation. It may be that versions with unconstrained taxpayer choice are more likely to raise issues under the Appropriations clause, although, of course, charitable deductions – which have the effect of allocating public money to essentially any 501(c)(3) charity of a taxpayer’s choice – are obviously constitutional. In any event, a detailed analysis of the Appropriations Clause is beyond the scope of this Article. For a discussion of the Appropriations Clause, *see generally* Kate Stith, *Congress’ Power of the Purse*, 97 Yale L. J. 1343 (1988).

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. As we have emphasized, this choice should remind taxpayers of government programs they value, and this heightened awareness might positively influence their view even of the taxes that they are not permitted to allocate. In addition, taxpayers could 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.

IV. Conclusion

We have argued that taxpayers who support the way their tax dollars are spent are more likely to comply voluntarily and less likely to change their behavior to avoid tax. Although we cannot prove this proposition, we show its plausibility by offering direct evidence from a literature involving experiments, as well as the economics and psychology literature on prosocial behavior. Likewise, philanthropy is a “real world” analogy, since charitable donors contribute money voluntarily -- totaling 2% of the U.S. GDP – largely because they are committed to the charity’s goals.

Our claim has a number of institutional implications. The government should publicize popular uses of tax dollars, while making particular efforts to root out waste. The government should also rely more heavily on user fees, as well as on taxes, such as the social security tax and lotteries for education, which commit revenue to specific (popular) spending programs. We also develop 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 feel more closely tied to the activities of a lower level of government and more reluctant to free ride within a homogenous local community. In addition, audits and penalties should be modified to encourage prosocial behavior. The government also should solicit voluntary contributions from

taxpayers for initiatives they especially value, and may also want to allow taxpayers to allocate some of their tax bill, though only in a limited way.