The Role of Charity in a Federal System

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* Assistant Professor, Boston College Law School. I am grateful for helpful comments from and conversations with Ellen Aprill, Rob Atkinson, Bill Bratton, Mihir Desai, Joe Dodge, Miriam Galston, Mark Gergen, Daniel Halperin, Adam Hirsch, Jill Horwitz, Aziz Huq, Doug Kahn, Louis Kaplow, Don Langevoort, Sarah Lawsky, Ben Leff, Saul Levmore, Ray Madoff, Dan Markel, Gregg Polsky, Diane Ring, David Schizer, Joshua Schwartz, Henry Smith, Linda Sugin, Bob Tuttle, and audiences at presentations at the American Association of Law Schools Scholarly Paper Competition Winners Panel, Boston College, Florida State, Georgetown, George Washington University, Harvard, and Loyola-L.A law schools. Rob Stevenson provided outstanding research assistance.

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Abstract

This Article critiques the prevailing justification for subsidies for the charitable sector, and suggests a new alternative. Existing rationales are based on an economic model that assumes a single government whose decisions are guided by a single median voter. I argue that this theory is unpersuasive when translated to federal systems, such as the United States, in which there may instead be thousands of competing local governments.

I then attempt to construct a theory of the charitable sector that takes account of interactions between charity, local government, and national government. In this revised account, charity is most important when federalism mechanisms break down. For example, frictions on exit produce too little jurisdictional competition, and excessively easy exit produces too much competition --- a race to the bottom. In both these cases, the quality of the resulting government services are predictably low, so that charity can be expected to out-perform rival governments. Even if not, the threat of the charitable alternative may supply competition that is otherwise missing from the market for government services.

These conclusions also have implications for the law of charitable organizations, as I detail.
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Introduction

Our contemporary theory of charity is simple, well-settled, and wrong. According to the dominant account, charity exists in order to provide goods and services that could not readily be produced in the for-profit sector. Typically, in this story, the market fails because the products are public goods --- their use by one person does not preclude their use by many others, so that no one person has any reason to pay for them herself. Subsidies, such as the deduction for contributions to charity offered by section 170 of the Tax Code, help to prop up the charitable production of these public goods. This same story of market failure is traditionally the basis of the economic rationale for government. Theorists distinguish charity from government by arguing that government meets only the needs of the majority, while charity can offer a diverse array of services for all segments of society. 

But, as I will argue here, this supposed advantage of charity assumes wrongly that we have only one government, one majority. To the contrary, our federal system is designed to offer precisely the pluralism, flexibility, and responsiveness that charity

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5 Gergen, *supra* note 1, at 1399.
theorists call for. Thus, in this Article I argue that we must reconsider charity from the ground up: in a world where both local governments and charities can provide public goods, and government has massive advantages in scale and fundraising, what role is there for charity? Is it that private associations provide a higher quality product than government? If so, is there some limit to that claim, or does it imply that we should “privatize” most government functions?

My goal here in fact is not to undermine support either for charity or local government, but instead to establish both sectors on firmer intellectual footing. Each sector—the charitable and the governmental—has distinctive strengths and weaknesses that better suit them for some tasks than others. The law of nonprofits should emphasize the sector’s strengths while leaving largely to government tasks for which charities are poorly suited.

But that is the end of the story. Let me begin at the beginning. The father of the modern, market-failure theory of the deduction is Henry Hansmann of Yale Law School, who set it out in a series of articles in the early 1980’s. Hansmann admitted that he had no particular explanation for why charity, rather than government, might be the best place to produce public goods. That piece of the theory was filled in by several other commentators. Some said that government could not itself capture the diversity, pluralism, and experimental energy of society as a whole. The economist Burton Weisbrod, arguing from a purely welfarist perspective, suggested instead that government

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8 Hansmann, Nonprofit Enterprise, supra note 2, at 896.
9 See infra text accompanying notes 38--43.
services could meet only the needs of the median voter, so that charity is necessary to satisfy demand for public goods in excess of the level that the median voter is willing to vote for.\textsuperscript{10} Weisbrod acknowledged that there could be more than one government, but dismissed the significance of that fact in a single sentence.\textsuperscript{11} And there have been only two brief mentions of federalism in the entire literature since.\textsuperscript{12}

As a result, existing discussions of why we ought to choose subsidies for charity over direct government provision of public goods are, to put it mildly, incomplete. Again, the central problem for charity is that state and local governments provide alternatives to monolithic central government decisions about the kind and quantity of public goods to provide, just as charity is said to do. To be sure, there are limits on the variety that local governments will offer, and limits, too, on citizens’ ability to move between those jurisdictions or reshape them to get the services they prefer. But the very possibility of such an array of options reduces considerably the need for charity to fill in. Moreover, subsidies for charity create a distortion, until now unrecognized in the legal or economic literature, in taxpayers’ choice of where to live. This distortion poses the danger that subsidies intended to increase overall social welfare may actually on net drag it below the level we would obtain through federalism alone.

At the same time, there is a rich literature extolling the virtues of privatization --- that is, of shifting even the production of public goods away from government to private firms and voluntary associations.\textsuperscript{13} For example, Saul Levmore and David Schizer have

\textsuperscript{11} Id. at 178.
\textsuperscript{13} See infra Part III.
argued that charity is typically more effective than government, mostly because of supposed advantages in information and skill in its stakeholders. Many other commentators have urged more generally that any private entity would be preferable to bureaucracy. These assessments, I argue, overlook the possibility that many of government’s putative flaws are equally true of charity. More importantly, they misunderstand the significance of the fact that government decisions are the product of deliberative processes open to all, while charity can be an instrument for the unreflective interests of a few. This single-minded approach can lead charities to neglect the impact of their decisions on others, and research on decision making suggests that any deliberations that do occur may be of lower quality than would happen in an environment with more diverse ideas.

Thus, while I agree that there are some qualitative differences between charity and government, they are differences not previously recognized anywhere. A system that includes charity outperforms others in those cases where the inherent limitations of local government diminish the public sector’s effectiveness. For instance, residents’ costs of moving and gathering information about rival jurisdictions can reduce competition between localities, allowing government to be relatively slack and inefficient. In other situations, there is excess competition, as where the mobility of wealthy taxpayers puts fiscal pressure on local jurisdictions that wish to regulate the mobile or redistribute

wealth from them. Charity has a role to play in these scenarios, although as I explain it is a narrower role than the expansive one currently envisioned by federal and state law.

With this new, clearer purpose in mind, we have a better sense of how best to resolve many of the persistent puzzles of charitable law. Among the important issues my analysis here helps resolve are the question of whether the deduction should be prohibited for charities that violate “public policy,” the debate over political participation by charities, and the extent to which a charity’s managers can deviate from the wishes of donors. My refinement also suggests reasons to doubt Malani, Posner, and Henderson’s arguments for for-profit charity, as I set out in more detail elsewhere.

In addition to solidifying and clarifying the law of charity, my analysis also makes a case for government. By identifying where each sector has comparative advantages, I show that the privatization advocates are mistaken. Charity and government work best side by side, not with one or the other on the sideline.

The Article proceeds in five Parts. Part I offers those new to the literature a short overview of why others have claimed we should subsidize charity. Part II explains the inadequacy of these existing justifications in light of federalism and public choice theory. Part III wrestles with the privatization literature, arguing that there is little reason to believe that as a general matter charities outperform government. Part IV develops a more contextual explanation for charity, in which charity becomes an appealing option when there is too much or too little competition between local governments. Part V sets out my view of the basics of a new law of charity, based on the rationale offered in Part

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IV. Part VI concludes with preliminary suggestions for other legal changes that would follow from my arguments here.

I. Theories of the Subsidy for Charity

Section 501(c)(3) of the Tax Code exempts qualifying nonprofit entities from the federal tax on the income of corporations.\textsuperscript{18} Section 170 of the Code also allows individuals who make contributions to those organizations to deduct some or all of their contribution on their federal income tax return.\textsuperscript{19} It is this eligibility to receive deductible contributions that distinguishes (c)(3)’s from so-called “noncharitable” nonprofit organizations, many of whom also are exempt from federal corporate income tax.\textsuperscript{20} Qualifying as a 501(c)(3) also often results in additional state tax benefits.\textsuperscript{21}

Although the rationales for these three separate forms of tax benefit are somewhat interrelated, in this Article I focus on section 170, the federal deduction for donations to qualifying charities (herein “the deduction”), and on parallel state-law deductions. Explanations for why it may or may not be appropriate to tax the incomes of nonprofit corporations are clouded by more general confusion over why our system imposes a separate tax on entities.\textsuperscript{22} Thus, my discussion is conceptually cleaner if it is limited to provisions affecting the taxation of individuals who donate.

\textsuperscript{18} I.R.C. § 501(c)(3); see generally DARRYLL K. JONES ET AL., THE TAX LAW OF CHARITIES AND OTHER EXEMPT ORGANIZATIONS 11--507 (2003) (setting out requirements of exemption for various forms of charitable organization). This Part is derived, at points word for word, from Galle, \textit{supra} note 17.

In this Article I generally use “charity” and “nonprofit” interchangeably, but the reader should be aware that in legal terms a charity is a subset of the general class of nonprofits; charities are those nonprofits eligible for the preferential treatment of § 501(c)(3).

\textsuperscript{19} I.R.C. § 170; see generally JONES ET AL., \textit{supra} note 18, at 1048--76 (describing rules applicable to charitable contributions).

\textsuperscript{20} See JONES ET AL., \textit{supra} note 18, at 728--53.


\textsuperscript{22} For a thorough analysis of exemption issues in a related context, see Daniel Halperin, Income Taxation of Mutual Nonprofits, 59 TAX L. REV. 133 (2006).
There is now widespread agreement that the deduction subsidizes the organizations eligible to receive it.\textsuperscript{23} The deduction allows taxpayers who itemize to reduce their taxable income by the amount of their donation, so that on net each dollar of donation reduces the amount of tax paid by $1 times the marginal tax rate.\textsuperscript{24} Because these deductions reduce the total amount of government money available for other projects, the deduction is in effect a government matching grant to the recipients of deductible donations.\textsuperscript{25}

There have been some commentators who have argued that the deduction is not intended as subsidy and need not be defended on that basis, but that view has overwhelmingly been rejected.\textsuperscript{26} These claims turn on technical arguments about the normative definition of “income” under an ideal income tax.\textsuperscript{27}

Most commentators instead embrace the idea that the deduction is a subsidy, and argue that the subsidy is justified as a tool for encouraging the production of goods that would otherwise be under-produced by the private market.\textsuperscript{28} Mostly these consist of public goods --- goods whose use can be shared by many consumers, and for which it

\textsuperscript{23} Atkinson, \textit{supra} note 1, at 505 (describing this view as “[t]he emerging orthodox account”).

\textsuperscript{24} For example, if I earn $1m, so that I pay $.35 in tax on each dollar earned above about $350,000, a $1,000 donation reduces my taxable income to $999,000, and therefore reduces the amount of tax I pay by $350.


\textsuperscript{27} I refer interested readers to the fine analyses by Gergen and Hansmann. Gergen, \textit{supra} note 1, at 1414--33; Hansmann, \textit{supra} note 1, at 58--64.

would be relatively difficult for the producer to exclude users.\textsuperscript{29} Because of these features, there is a private market failure in the production of public goods.\textsuperscript{30} Since every potential consumer gets the good for free once anyone pays for, individuals have a strong incentive to free ride on others’ consumption, making it difficult for any producer to turn a profit. Even if some goods can be sold, the market will probably produce less than the socially optimal amount of the good.\textsuperscript{31} Subsidies can remedy this market failure by paying consumers to buy more of the under-produced good.

In practice, pure public goods are rare. More common are private goods that also create spillover benefits, or positive “externalities,” for people other than the purchaser. For instance, education is a private good --- schools can limit their services solely to the admitted. But an educated population can be good for others, too. Again, though, purchasers of education might buy too little education from a social perspective because they won’t pay for the benefits to others. Thus, although I refer throughout this Article to “public goods,” the reader should understand that the discussion for the most part also applies more generally to any private good with a significant positive externality attached.\textsuperscript{32}

\textsuperscript{29} On the general theory of public goods, see MUSGRAVE \& MUSGRAVE, supra note 4, at 41--48.
\textsuperscript{30} MUSGRAVE \& MUSGRAVE, supra note 4, at 44--45; Gergen, supra note 1, at 1397--98; Hansmann, supra note 1, at 72.
\textsuperscript{31} E.g., JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 184--85 (2d ed. 2006).
\textsuperscript{32} For fuller explication of the points in this paragraph, see MUSGRAVE \& MUSGRAVE, supra note 4, at 49--50 (explaining equivalency of public goods and private goods with positive externalities, but noting that a smaller subsidy is needed to produce the private goods); GRUBER, supra note 31, at 179 (“It is helpful to think about a public good as one with a large positive externality.”).

Similarly, in some cases some of what I refer to as public goods might more precisely be described as “club goods,” since in theory they could be “fenced” and made accessible only to “members.” Some club goods may also produce externalities for nonmembers, such as a park with historic social significance. The club will under-provide the nonprivate aspects of consumption --- the club will not necessarily use the park in a way that is consistent with historic preservation. For a survey of other arguments for government production of potential club goods, see Amnon Lehavi, Property Rights and Local Public Goods: Toward a Better Future for Urban Communities, 36 URB. LAW. 1, 16--23 (2004).
As Henry Hansmann argues, this justification for the deduction also implies that beneficiaries of the deduction must likely be limited to nonprofit organizations. A nonprofit, in Hansmann’s formulation, is one that is subject to the “nondistribution constraint”: it can make a profit, but must use these profits for internal development, rather than distributing them to investors or managers. The logic is that donors cannot easily judge the quality of public goods, especially where those goods are delivered to someone other than the donor. As a result, it would be easy for managers of the firm to divert donations to their own profit. Knowing this, donors will not give to the firm. In response, the firm voluntarily takes on the nondistribution constraint, so that donors will know that their giving will not be wasted.

Besides spurring the production of public goods, the deduction also might inspire other desirable ends. In one line of commentary, the charitable sector is hailed as a source of diversity and pluralism. In this view, charities are a site for citizens to come together to pursue common goals. They give voice to interests or communities that otherwise would be unnoticed or unfunded, and help participants develop the capacity to

33 Hansmann, Reforming, supra note 7, at 605; see also Atkinson, supra note 1, at 617--18 (explaining this implication of Hansmann’s analysis).
34 Hansmann, Reforming, supra note 7, at 501; Hansmann, Nonprofit Enterprise, supra note 2, at 848--51.
35 Hansmann, Reforming, supra note 7, at 506; see also Atkinson, supra note 1, at 572.
36 Hansmann, supra note 1, at 68--70.
37 Hansmann, Reforming, supra note 7, at 507; see also Rose-Ackerman, supra note 3, at 716.
39 Simon, supra note 38, at 254--55.
be more fully-rounded citizens.\textsuperscript{40} This way, new ideas can slowly “bubble up” from the individual level until they are more generally accepted by the public.\textsuperscript{41}

Even if ideas never reach critical mass, these theorists say, the opportunity to pursue and discuss them in a nonprofit setting offers a chance for participants who otherwise would be shut out of government or the market to take part in deliberative self-determination, a fundamental part of what it means to be human.\textsuperscript{42} And these deliberations are said to be more valuable than comparable experiences with government or board rooms, because members are more closely involved with the decision process and the effectuation of organizational goals.\textsuperscript{43} Similarly, Levmore emphasizes the way in which individual choice by the diverse array of donors to charity can enhance overall social welfare, a process he calls “taxes as ballots.”\textsuperscript{44}

Finally, some supporters of the deduction emphasize its possible role in fostering social justice, particularly in the form of redistribution of wealth from rich to poor.\textsuperscript{45} But while these scholars have offered arguments for why there should be some additional benefits for redistributive charity, they have not explained why the deduction should be withdrawn from other goals, such as research, teaching, or art. Thus, I do not view

\textsuperscript{41} See MICHAEL WALZER, ON TOLERATION 107 (1997); ROBERT DAHL, A PREFACE TO DEMOCRATIC THEORY 133 (1956); Brennen, supra note 38, at 24.
\textsuperscript{43} See PETER L. BERGER & RICHARD JOHN NEUHAUS, TO EMPOWER PEOPLES 2--3 (1977).
\textsuperscript{44} Levmore, supra note 14, at 404--05.
\textsuperscript{45} Anthony B. Atkinson, The Income Tax Treatment of Charitable Contributions, in PUBLIC AND URBAN ECONOMICS 13 (Ronald E. Grieson ed., 1976); Oliver Houck, With Charity for All, 93 YALE L.J. 1415, 1423 (1984); Perry Fleischer, supra note 26, at 3. But see Strnad, supra note 25, at 283 (arguing that charity is a poor mechanism for redistribution).
redistribution as a comprehensive theory of the deduction, but instead only as an additional benefit that might be wrung from it.

II. Inadequacy of Current Theories of the Deduction

Though the subsidy theories of the deduction now are dominant, they have papered over a sizable hole in their rationales. Market failures explain why there must be a government intervention, but they do not explain why that intervention should be in the form of a subsidy for charity, rather than direct government provision of the goods the market fails to offer. Some of the subsidy theorists, such as Henry Hansmann, have been candid in admitting that they can offer no clear reason to prefer charity to government. Others, however, maintain that government fails to satisfy minority preferences, or that government provision alone would not be sufficiently diverse or pluralistic. As I will show in this Part, these claims fail to account adequately for the governance possibilities offered by federalism. Parts II.A. through II.D. sketch out flaws in the prevailing approaches, and Part II.E. summarizes what remains of the argument for subsidized charity after these limitations are accounted for.

A. Government Failure and Multiple Jurisdictions

By far the most common explanation for why there should be a charitable subsidy in addition to government provision of public goods is Burton Weisbrod’s median voter theory. According to Weisbrod, governmental provision of public goods by majority rule will disappoint some minority voters, assuming that voters vary in their

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46 Hansmann, Nonprofit Enterprise, supra note 2, at 896.
47 See sources cited supra note 38.
preferences. In Weisbrod’s model, officials behave according to the standard political-science assumption that they should enact the preferences of the median voter. Government succeeds in providing public goods where the median voter is willing to pay for at least some of a given good, because government can tax would-be free riders. But the median voter will not reelect an official who imposes tax for more goods than she prefers. Voters who would demand even more of the good therefore cannot use the government’s taxing power to overcome the free rider problem. Thus, just as in the private market, democratic government also fails to meet all of society’s preferences for the consumption of public goods. Subsidies for charity then allow voters who want more of the good also to surmount the free-riding barrier.

1. Tiebout and Inframarginal Donors

One glaring problem with this account, albeit one almost totally absent from the nonprofit literature, is that it assumes that disappointed voters who prefer more services have no choice of governments with taxing authority. But in a competing model, first suggested by another economist, Charles Tiebout, voters have a choice between many rival local governments. Thus, rather than having to rely on subsidies, a voter who

49 Weisbrod, supra note 10, at 175--77.
50 Id. at 176. In the simplified two-party universe of the median voter model, rational officials obey the median voter because appealing to anyone else means losing the next election. MUSGRAVE & MUSGRAVE, supra note 4, at 89.
51 As Weisbrod notes, this account also assumes that taxes are “nonbenefit” -- that is, that each voter cannot individually choose the exact level of tax she pays and benefit she receives, as might be the case with a system of tolls or user fees. Weisbrod, supra note 10, at 175.
52 Id. at 188--89; see also Strnad, supra note 25, at 270--72 (describing charities as mechanism for revealing preferences for public goods not expressed through government or private market). But see id. at 285 (suggesting that add-on theory fails if government reduces its own expenditures in response to charitable spending).
preferred more services than her local median voter would simply move to a jurisdiction where the median preference was closer to her own. The reverse would be true for voters with sub-median preferences: they would move to a jurisdiction that imposed lower tax. At equilibrium, assuming that there were enough jurisdictions to choose from and moving were costless, voters in each jurisdiction would actually have identical preferences for public goods, negating the basic assumption of Weisbrod’s model.\(^\text{54}\)

Weisbrod acknowledges that voter mobility is a challenge for his argument, but dismisses it in one sentence. “Since moving is not costless,” he avers, “and locational decisions reflect many considerations other than governmental outputs and taxes, we can think of [the model] as portraying the likely type of situation even after migration adjustments.”\(^\text{55}\) That is, the claim appears to be that citizens will not sort themselves perfectly according to their preferences, so there will always be some residual, unmet demand for public goods, even at the local level.\(^\text{56}\)

While Weisbrod is correct that the “market” for local government is imperfect, he fails to recognize that in a federal system subsidies for charity contribute to two other inefficiencies. First, any significant amount of mobility increase the waste inherent in the subsidy, and reduces its cost-effectiveness. Like most subsidy systems, the charitable contribution deduction is wasteful because it gives money even to donors who would have contributed without encouragement—“inframarginal” donors. For example, consumers with the highest demand for a public good cannot free ride on anyone else,

\[^{54}\text{Weisbrod, supra note 10, at 175.}\]
\[^{55}\text{Id. at 178.}\]
\[^{56}\text{Empirical measures of Tiebout sorting are mixed, but general find that at the margins people do respond to their local mix of taxes and government services. For surveys, see Vicki Been, “Exit” as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 Colum. L. Rev. 473 (1991); William W. Bratton & Joseph A. McCAhery, The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World, 86 Geo. L.J. 201, 239--43 (1997); Richard Schragger, Consuming Government, 101 Mich. L. Rev. 1824, 1830 (2003).}\]
and so will buy at least some of the good without subsidization.\textsuperscript{57} But they, too, can
claim the deduction, meaning that government dollars are spent on them without
obtaining more of the good.\textsuperscript{58} By definition, top demanders spend more and get a bigger
matching grant than anyone else. And donors have no incentive to turn down unneeded
subsidies, since the fiscal cost of subsidies is largely an externality for any one person:
only a tiny fraction of the tax dollars needed to pay for the subsidy comes from their
pockets. Thus, unless government can set a different subsidy rate for each donor, which
is unlikely,\textsuperscript{59} a portion of the subsidy claimed by inframarginal donors is wasted.

Mobility exacerbates the waste problem by increasing the proportion of
inframarginal donors in the donor pool. Again, those with highest demand for a good in
any given jurisdiction are almost always inframarginal. Each person who moves to
obtain more of the good elsewhere reduces the number of potential donors who fall in
between median demand and highest demand.\textsuperscript{60} But these are the donors for whom a
subsidy is useful, so that mobility reduces the proportion of deductions claimed by people
who will increase giving as a result. If Tiebout sorting were extensive enough, there
could be no super-median voters in a jurisdiction except for the top demanders.

So Weisbrod’s argument that there will always be residual demand for a public
good misses the point. Demand may remain, but the need for a subsidy might not. Even

\begin{itemize}
\item \textsuperscript{57} Peter Diamond, \textit{Optimal Tax Treatment of Private Contributions for Public Goods With and Without Warm Glow Preferences}, 90 J. PUB. ECON. 897, 897 (2006).
\item \textsuperscript{59} See Louis Kaplow, \textit{A Note on Subsidizing Gifts}, 58 J. PUB. ECON. 469, 470 (1995) (explaining that if subsidy is determined by observed donor behavior, donors may act strategically to increase their subsidy).
\item \textsuperscript{60} This is true even if the highest demanders leave, since once they depart the next-highest demander becomes the new highest demander.
\end{itemize}

Also, note that the mobility I focus on here is not random relocation, but instead moves by those
who desire more of the good. This form of relocation disproportionately reduces the number of super-
median voters without changing the number of others, which is why the usefulness of the charitable subsidy
declines.
if some whose giving would be increased by a subsidies do not move, a significant portion of each dollar spent on the subsidy could be wasted.

2. Distortionary Effects of Subsidized Charity in Federal Systems

Second, the subsidy is also problematic in a multi-jurisdictional world because it can inefficiently distort donors’ choice of where to live or do business. Of course, the subsidy is supposed to change behavior: it encourages us to give to charity rather than free ride. But this traditional analysis overlooks that there are actually three options, not two: (1) do nothing; (2) give to charity; or (3) move to a jurisdiction where more goods are produced. While the shift from (1) to (2) may be socially desirable, the deduction also induces a shift from (3) to (2). That shift may be welfare-reducing.

As I model more formally elsewhere,\(^6^1\) shifts from (3) to (2) reduce welfare when moving is better for society than forming another charity. In addition to generating positive externalities, charities can also produce negative externalities, including the tax cost of subsidizing them. Some of these externalities would disappear if the would-be consumer of the charitable good would relocate to a jurisdiction where that good is already being produced rather than founding a new organization in her existing home. The deduction reduces the appeal of relocation for the consumer, though, which means that in some cases welfare-increasing relocations will not happen.

The idea that charity can produce negative as well as positive externalities is no new. Kaplow argues that charity might reduce incentives for individuals to work, slowing the economy.\(^6^2\) For example, redistributive charities, such as soup kitchens and


free health care, make it less painful to have a lower income. Shannon MacCormack also notes that individuals can have personal or ideological objections to the production of some public goods.

I would add to Kaplow and MacCormack’s account by noting that, crucially, negative externalities that would arise in one jurisdiction if the good were produced there may not arise at all if the good were instead produced in another. Consider a homeless shelter, which might give material succor or emotional satisfaction to some, but also annoy NIMBY-minded neighbors. Those who view a town with an additional shelter as fairer might be willing to, but prefer not to, have to move in order to effect justice. If they relocated to a like-minded town, those who object would no longer suffer the disutility of living near a shelter. But the shelter-builders have no reason to depart; they do not bear any of the unhappiness of their neighbors.

More prosaically, suppose that the median voter, after applying cost-benefit analysis, determines that the current level of wildlife-protection enforcement is optimal; any greater amounts, she deems, will not be worth the cost of deterring possible business investments. Now suppose some citizens place a higher value on additional increments of wildlife protection, and form a “save the whales” charity to identify and picket offending local business. Here again, the ideal result in terms of social welfare would be for those who favor more wildlife protection to relocate to a region with more stringent wildlife-protection laws. Because they are indifferent to the (negative) effects of their charitable works on other voters, however, they do not go.

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63 Id. at 254--55.
64 Shannon Weeks McCormack, Taking the Good with the Bad: Recognizing the Negative Externalities Created by Charities and Their Implications for the Charitable Deduction, ARIZ L. REV. ____, manuscript at 26, 46--47 (forthcoming 2010).
Subsidies for charity exacerbate these potential negative effects by discouraging individuals from relocating. All else equal, a person will move when the costs of relocation are lower than the costs of paying for charitable production of a good in her existing hometown. Subsidies for charity make charity relatively cheaper, reducing the appeal of a move. The larger is the subsidy, the less likely it is an individual will relocate, as figure one suggests.

In the absence of subsidy, an individual $i$ relocates when her moving costs intersect the marginal cost line, at A, which corresponds to point C on her marginal utility curve: well before equilibrium. In the presence of the subsidy, however, the moving costs curve does not intersect marginal cost until point B, corresponding to point D on the
marginal utility curve: well past the original, unsubsidized, equilibrium. So subsidies shift the moving point, in effect increasing the amount of the public good produced in jurisdiction one.

This change is the key distortive effect of the subsidy, as illustrated in figure two.

In figure two, social surplus from production of the good is represented by the rough triangle formed by the marginal utility and net social cost curves, with its vertex at
point B and extending left to the y-axis; social loss from excess production of the good is represented by the triangle BAH. In the absence of a subsidy, i moves when her marginal utility is at D, where moving costs intersect her marginal cost curve. Since she moves, no additional units of the good are produced in jurisdiction one, resulting in the loss of the surplus represented by the triangle BFJ. But the relocation also prevents i from consuming the incremental units between B and A on her marginal utility curve, avoiding the social overproduction, with welfare consequences represented by the similarly-sized triangle ABH. So on net, the welfare effects of the move are unclear. In contrast, under a subsidy, i does not relocate until her marginal utility reaches G, the point corresponding to the point at which moving and discounted marginal costs are equal. This permits additional overproduction, resulting in the loss triangle BGI. That triangle is obviously much larger than the surplus BFJ, so on net the subsidy is clearly welfare-reducing: it has permitted more losses than it has prevented gains.

More generally, the welfare effects of a subsidy depend on the consequences of a rightward shift in the region affected by a move. If the line running upwards from point E, the moving point under a subsidy, intersects the marginal utility curve in a region where there is still net social surplus, then the subsidy increases welfare: it allows additional production of welfare-increasing public goods. If instead (as in figure 2) point E corresponds to a region in which social welfare is decreasing, then the subsidy is likely to reduce welfare: it allows additional production of welfare-reducing public goods. This effect may be counter-balanced by any surplus that was also created as a result of the rightward shift.
Put more simply, subsidies for charity may well reduce national welfare. Where the welfare from a person’s decision to stay is negative, society would be better off if she moved. But the subsidy discourages her from moving, and the larger the subsidy, the more likely that result.

One final consideration to keep in mind is that public goods that create significant externalities for other jurisdictions may be impossible to obtain by moving. Municipalities might under-produce many public goods benefitting a wide geographical area, since each individual town has incentives to free ride on others’ efforts. It would be surprising, for example, to see one city try to save the world’s whales. The deduction is less likely to reduce social welfare for these kinds of national-in-scope projects, because charities are less likely to have any sub-national government competition. So in that scenario the world looks more like Weisbrod’s model in which there are only two possible sources of a public good, government and charity.

Taking all these factors into account, there is still some justification for a charitable deduction, but it is rather more limited than Weisbrod and those who rely on him believe. Charity has benefits, but also countervailing costs. All else being equal, subsidies for charity are efficient not simply when there are some citizens with preferences different than the median voter, but rather only when the social cost of relocation exceeds the social cost of charity, including the cost of raising taxes to provide the subsidy. Thus, there is a significant possibility that granting the deduction will reduce overall social welfare.


66 I am grateful to Louis Kaplow for this point.
B. Government Failure and Multiple Tiers of Government

Another factor limiting the usefulness of the charitable deduction under Weisbrod’s government-failure model is the possibility of vertical competition between tiers of government. Again, Weisbrod defends his assumption that even multiple governments will leave some voters unhappy with the low level of public goods by suggesting that voters cannot easily move to a rival jurisdiction. Thus, he claims that there will always be some additional policy-making space to be filled by a subsidy for charity.

This account assumes, wrongly, that voters must actually move in order to obtain services from a different government. In a multi-tiered government, such as the U.S. system of federalism, there is policy competition not only horizontally between local governments, but also vertically, between local governments, states, and the national government. In other words, even if the median voter at the national level has preferences that are too low for some voters, it may be the case that the median voter at the state or local level would prefer more services, or vice-versa. In some cases there can be multiple tiers of local government. A single voter could be within a county, a municipality, and one or more “special-purpose” governments such as school or water districts. All of these would represent opportunities to get more public goods than the nation or state provides without incurring any moving costs at all.

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67 Weisbrod, supra note 10, at 178.
68 Id.
As with relocation, Weisbrod considers this possibility but dismisses it out of hand. I concede that there are some plausible arguments that special-purpose governments may fail to maximize social welfare. But the story is more nuanced, and leaves less room for charity, than Weisbrod suggests.

Weisbrod argues that it is costly to establish new governmental entities, so that there may be practical limitations on the citizenry’s ability to create additional layers of government in response to added demands for public goods. Yet it is also costly to establish charitable organizations. It is unclear why we should prefer a subsidized charitable organization to a special-purpose governmental entity, or vice-versa. Financing cannot be the answer, since we could easily design the special-purpose government to operate on subsidized user fees, which would be largely identical to the charitable funding model.

Nonetheless, I agree that even endless tiers of special-purpose governments could fail to account for all preferences. One possible “failure” story along these lines is that special purpose governments are not practical for some kinds of public goods. “Save-the-whales” organizations and their kin—entities with missions that could benefit the whole country—are likely examples here. Where benefits are widely dispersed, only very high demanders of the good are likely to contribute to its production. Since any special-purpose government would have to be drawn to include mostly those who favor production of the good, the district’s borders would have to match the geographic distribution of those who favor production. Yet it is likely prohibitively difficult to

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71 Weisbrod, supra note 10, at 178.
72 See Krashinsky, supra note 12, at 125 (offering user fees as fiscal equivalent of charitable contributions).
73 See Susan Rose-Ackerman, Risk Taking and Reelection: Does Federalism Promote Innovation?, 9 J. LEGAL STUD. 593, 608 (1980). Again, this is because all others would simply free ride on the efforts of those with the strongest preferences. Id.
gerrymander a special save-the-whales district across, say, seven coastal states. Charity might be a more viable mechanism for bringing together supporters.

Another possible failure story is that increasing the number of layers of local government lowers the desirability of any further proliferation. Voters are usually fairly inattentive to political decisions, because they rationally free-ride on the efforts of others to monitor government.74 A thicket of local governments would likely add considerably to the costs of monitoring, compounding the rational ignorance problem.75 This in turn poses the danger that some politicians could either escape accountability, or instead be held to blame for the misdeeds of others inside the thicket.76 Adding extra layers of government could reduce the quality not only of the added special-purpose unit but of government more generally. That would leave us with a trade-off between the welfare gained by satisfying supra-median voters and the welfare lost by muddying government.

Finally, there may be some policy that cannot costlessly be shifted between different levels of government. The choice of where to locate regulatory authority within a federated system involves a series of tradeoffs.77 Some policies may have either economies or diseconomies of scale; that is, they are cheaper or more expensive, respectively, to operate for larger groups of people.78 And bundles of policies can have economies of scope, in which it is more efficient to have the same group of experts work

74 ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY 240--59 (1957); see Stephen Earl Bennett, Trends in Americans' Political Information, 1967--1987, 17 AM. POL. Q. 422, 423 (1989) (finding that voter knowledge was consistently low for 20 years studied).
77 See Oates, supra note 53, at 1120.
on several related problems simultaneously. In short, at times there is already an optimal level of government for producing a particular public good, so that redirecting some of its production to another level requires sacrificing the benefits of its initial location.

Overall, then, the opportunity to choose between multiple layers of government appears to further narrow, but not to eliminate, a role for charitable subsidies. In some cases, voters can get the extra services they want just by asking for them from a different level of government.

C. Government Failure and Public Choice

Another fundamental problem for Weisbrod’s government failure theory is that it is premised on the idea that officials will meet the preferences of the electorate’s median voter. There is now a standard set of critiques of median voter theory, however, which are typically lumped together under the heading of “public choice” theory. Officials are motivated not merely by votes but also by other rewards that they can collect from interest groups. Even purely public-minded elected officials lack perfect information about voter’s preferences --- indeed, those preferences may be unsettled even in the minds of voters. Nonetheless, the average voter will prefer to free-ride on the efforts of others in offering rewards or information to politicians. As a result, political outcomes

80 See Weisbrod, supra note 10, at 175--76.
84 Id.
depend more on intensity of preferences than their raw numbers. Voters who have limited opportunities to free ride --- those who are few in number or feel especially strongly about their position --- will be able to command disproportionate influence on government.

1. The Public Choice Critique

Public choice theory predicts that Weisbrod’s public-goods shortfall can be filled not by subsidized charity, but instead simply by lobbying. Voters with the strongest preferences for public goods will, by definition, comprise a coalition of less than half the electorate, and possibly much less. And, again by definition, these interests will have stronger than average preferences. Thus, in a typical legislative contest between those who prefer the median amount of a public good, and those who prefer more, those who prefer more should prevail. The only cost to those who prefer less of the good is a tax increase. But this tax increase is distributed across the entire population, while the benefits of the additional spending are concentrated among the high-demanders. So in the lobbying contest that ensues, the opposition is rather more likely to free-ride on one another than the spending supporters, leading to spending on projects that command only minority support. Thus, a “save-the-whales” charity could acquire federal funding without a subsidy, because whale lovers will lobby intensely while other voters are fairly inattentive to the costs. This point about the tragedy of the budget commons is familiar

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85 Id.
87 Kingma, supra note 12, at 145; Krashinsky, supra note 12, at 124--25; cf. Levmore, supra note 14, at 404 n.54 (claiming that pluralist argument for deduction fails to take account of public choice theory).
in other contexts, but it has not generally been applied to the need for a charitable
deduction.\(^{88}\)

Mixed goods, as those provided by schools and universities, are especially apt to
benefit from public choice factors. The mixed good is private but provides a positive
externality to others. Lobbying for private goods is especially intense because by
definition the group of beneficiaries is limited.\(^{89}\) So even if no one would lobby for
education generally at the national level, local activists who would benefit from aid to
their university will all push for (targeted) funds, resulting in more education overall.

2. Exceptions to the Critique

As with my other critiques of Weisbrod’s argument, the public-choice approach
still admits of some role for charitable organizations, but on a somewhat different basis
than has been recognized by others. In some cases, lobbying is likely to fail. Where the
extra service is controversial or ideologically charged, there may be an energized and
concentrated interest group opposed to its public provision. Even when there is no
opposition, those who prefer more services may have comparatively scarce resources to
expend on lobbying.\(^{90}\) Each of these scenarios arguably imply some role for charitable
supplements to government spending. For example, a homeless shelter might face tough
opposition from NIMBY neighbors, and supporters may be relatively poor. As a result,
lobbying for a new shelter might be futile, leaving charity as the more viable option.

\(^{88}\) E.g., Ilya Somin, *Closing the Pandora’s Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. 461, 465--66 (2002); Weingast et al., *supra* note 86, at 648--49.


\(^{90}\) See Stephen Loffredo, *Poverty, Democracy, and Constitutional Law*, 141 U. PA. L. REV. 1277, 1328--29 (1993) (arguing that voting power does not necessarily overcome other impediments to political power for the poor, such as lack of resources and difficulty organizing).
In similar fashion, the nonprofit sector might be a meaningful addition to
government when public choice factors suppress spending below the level preferred by
the median voter. To take one familiar example, in a progressive tax system, a
disproportionate share of the government’s budget is borne by the wealthy.91 Where
wealthy voters perceive themselves as receiving little benefit from some programs, such
as transfer payments or other forms of social insurance, they are capable of and likely to
block such programs, even if most voters would have voted in favor.92 This is the
scenario envisioned by a number of commentators, who have argued that charities are
useful mostly as a vehicle for wealth redistribution.93

Lastly, charity may be more efficient than lobbying. Subsidizing charity is
arguably more efficient than lobbying because it requires a smaller subsidy to induce
some entrepreneurs to provide it.94 Lobbying requires entrepreneurs to divide “rents,” or
the rewards from producing public goods, between themselves and politicians, while
charity might allow the entrepreneur to keep all of it.95 Existing legal rules such as the

91 JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 523 (2d ed. 2007). That is, there is a strong
93 See supra sources cited note 45.
94 Cf. Krashinsky, supra note 12, at 125 (suggesting that obtaining public good through charity is preferable
to government if transaction costs of forming nonprofit are lower than lobbying). For descriptions of the
95 See Fred McChesney, Rent Extraction and Interest Group Organization in a Coasean Model of Regulation, 20 J. LEG. STUD. 73, 84–89 (1991) (claiming that politicians can better extract value from highly organized groups, leading to lower overall returns from political organizing). Or, similarly, it might be argued that nonprofit organizations have self-serving internal institutional goals that may conflict with the stakeholders’ policy preferences, so that lobbying by those organizations results in some diversion of effort to these ego rents rather than the group’s mission. See Todd J. Zywicki, Environmental Externalities and Political Externalities: The Political Economy of Environmental Regulation and Reform, 73 TUL. L. REV. 845, 875–78 (1999) (arguing that environmental advocacy groups choose to lobby for enforcement
number of seats in the legislature make officials’ time and attention scarce resources.\textsuperscript{96} Competing lobbying efforts to get on the agenda bid up the price of rents needed to secure government action.\textsuperscript{97} In contrast, the pool of policy entrepreneurs is very unlikely to be as limited; entrepreneurs will enter the field as long as there are rents available.\textsuperscript{98} That will bid down the rent premium needed to attract charitable entrepreneurs.

Overall, public choice theory undermines Weisbrod’s claims, but does suggest that lobbying will leave some gaps. So some controversial or redistributive organizations, such as homeless shelters, remain likely candidates for the deduction. Additionally, to the extent charity is more efficient, charities might be preferable to lobbying even if lobbying were likely to succeed.

\textbf{D. Other Rationales for Deduction}

Weisbrod’s is not the only explanation for why there is charity, but other theories of the charitable deduction also struggle to account for federalism and public choice theory. These other rationales vary in the ultimate goals they ascribe to charity, but they each depend on the existence of policy alternatives to majoritarian government. Most obviously, both pluralism and diversity call for opportunities for new, unpopular, or otherwise unusual views occasionally to produce not just talk but also policy results.\textsuperscript{99}

These theories could be satisfied as easily by multiple governments as by charity. Local governments with some degree of independence from the central government can mechanisms that will increase their own “prominence” rather than those that are maximally effective at reducing pollution).


\textsuperscript{97} RICHARD POSNER, \textit{ECONOMIC ANALYSIS OF LAW} 512 (4\textsuperscript{th} ed. 1992).


\textsuperscript{99} See sources cited \textit{supra} note 43.
give voice to diverse interests and offer a plurality of views, each of which then has potential to bubble up more widely across the nation. These points are worth explaining in a bit more detail.

1. Federalism

The diversity and pluralism arguments are even more vulnerable to the federalism objection than Weisbrod, because they do not require that every jurisdiction offer a full array of policy options. Weisbrod could argue that limitations on relocation left open a space for charity, because his premise was that citizens in each locality might want additional public goods. But society can be diverse or pluralistic overall even if some regions are not.

To review, the diversity and pluralism rationales argue that society is better off when some policy outcomes are the result of many different voices and interests. Part of this gain is to society overall: gains from experiments, innovation, and diversification of risk. Another benefit is to individuals, in that their participation in policymaking helps them to develop as persons.

Federalism, too, can offer both these benefits. Given many competing localities, it is likely that at least some of them will by chance happen to have a majority willing to enact any given good, ensuring some degree of national diversity. The fact that some citizens face barriers to moving does not matter, as long as each policy option can be produced somewhere; the nation as a whole can still reap the benefits of local

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100 Weisbrod, supra note 10, at 178.
experiments.\footnote{Governments can usually copy policies that succeed elsewhere easily. Galle & Leahy, \textit{supra} note 65, at 1347--60.} On the participation side, towns and special-purpose governments, like charities, offer a chance for small-scale, intimate roles in policy-making.\footnote{See \textit{OLIVER}, \textit{supra} note \textit{Error! Bookmark not defined.}, at 5 (arguing for this role for local governments).}

\section*{2. Public Choice}

Public choice theory casts one final cloud over the alternatives to Weisbrod. As we have seen, minority views will often be better equipped to garner political support than others. Thus, while pluralism and diversity are themselves public goods, such that we should expect few to lobby for them in the abstract, there may often be strong proponents in favor of specific deviations from the majority’s preferences.

This dynamic is especially powerful in combination with federalism. Local officials may calculate that those who hold non-standard preferences for public goods would be willing to deliver political rents in exchange for receiving those goods, particularly if they cannot obtain those goods anywhere else.\footnote{\textit{Cf.} Lynn Baker, \textit{Conditional Federal Spending After Lopez}, 95 \textit{COLUM. L. REV.} 1911, 1971 & n.279 (1995) (arguing that voters place very high value on a policy choice where there few other jurisdictions that would offer it).} In order to obtain the rents, the official might offer financial or other incentives in order to help overcome any barriers to relocation.\footnote{\textit{Cf.} Lynn A. Baker & Mitchell N. Berman, \textit{Getting Off the Dole: Why the Court Should Abandon Its Spending Doctrine, and How a Too-Clever Congress Could Provoke It to Do So}, 78 \textit{IND. L.J.} 459, 473--74 (2003) (arguing that policies appealing to minority populations may be competitive tool for states attempting to attract migrants); John O. McGinnis & Ilya Somin, \textit{Federalism vs. States’ Rights: A Defense of Judicial Review in a Federal System}, 99 \textit{NW. UNIV. L. REV.} 89, 109 (2004) (suggesting that state officials compete for migrants in order to build influence with powerful local constituencies).} These incentives cost tax dollars, but that expense can be passed on to all the residents of the jurisdiction, who might well free ride on one another’s

\textbf{E. An Overview So Far}

Given the complex set of overlapping arguments and counter-arguments I have laid out so far, it is helpful to pause to summarize what remains of the traditional explanations for subsidized charity. Both Weisbrod and proponents of the diversity theories offer important insights, but on closer examination their claims are subject to major qualifications. The qualifications are nuanced, so that the strength of each critique is weaker or stronger depending on the nature of the particular public good that is to be subsidized. What is true of soup kitchens is not clearly true for universities or efforts to save the whales. How do all these nuances relate to one another?

In order to simplify the analysis, my qualms about the traditional explanations can be boiled down to four basic questions or considerations. First is the question whether the positive externalities from production of the good are primarily local, or whether they instead spread across many jurisdictions. Nationwide spillovers strengthen the case for subsidies, because they are likely to result in free-riding by any one government. They would also be difficult to produce by drawing a special-purpose government.

The second and third factors depend on the political concentration of the benefits and burdens of the good. These are both basic public choice issues: if a good produces large, concentrated benefits, it is more likely that lobbying could get officials to produce the good without need for charity. That is especially true of private goods with a positive externality attached to them. On the flip side, goods that burden or annoy a small portion
of the population—especially a portion that is already politically powerful—in a
significant way are less likely to succeed even if the median voter prefers them.

Fourth, does the public good in question create negative externalities that are
localized, in the sense that they could be reduced or eliminated if production of the good
were moved somewhere else? If so, I have argued, there is a strong possibility that the
deduction is inefficient. If not, there is still a chance the deduction inefficiently distorts
inter-jurisdictional mobility, but it is less likely.

As a very rough first cut on what remains of the argument for subsidized charity,
then, I simply plot these factors together side by side, in Table 1.

<table>
<thead>
<tr>
<th>Form</th>
<th>Geog. Scope of Positive Externalities (S)</th>
<th>Political Concentration of Benefits (B)</th>
<th>Political Concentration of Costs (C)</th>
<th>Geog. Scope of Negative Externalities (E)</th>
<th>Case for Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Local ↔ Nat’l ↑</td>
<td>Conc. ↑</td>
<td>Conc. ↑</td>
<td>Local ↔ Nat’l ↓</td>
<td>weak</td>
</tr>
<tr>
<td>2</td>
<td>Local</td>
<td>Conc.</td>
<td>Conc.</td>
<td>Nat’l</td>
<td>neutral</td>
</tr>
<tr>
<td>3</td>
<td>Local</td>
<td>Conc.</td>
<td>Diffuse</td>
<td>Local</td>
<td>v. weak</td>
</tr>
<tr>
<td>4</td>
<td>Local</td>
<td>Conc.</td>
<td>Diffuse</td>
<td>Nat’l</td>
<td>weak</td>
</tr>
<tr>
<td>5</td>
<td>Local</td>
<td>Diffuse</td>
<td>Conc.</td>
<td>Local</td>
<td>neutral</td>
</tr>
<tr>
<td>6</td>
<td>Local</td>
<td>Diffuse</td>
<td>Conc.</td>
<td>Nat’l</td>
<td>strong</td>
</tr>
<tr>
<td>7</td>
<td>Local</td>
<td>Diffuse</td>
<td>Diffuse</td>
<td>Local</td>
<td>weak</td>
</tr>
<tr>
<td>8</td>
<td>Local</td>
<td>Diffuse</td>
<td>Diffuse</td>
<td>Nat’l</td>
<td>neutral</td>
</tr>
<tr>
<td>9</td>
<td>Nat’l</td>
<td>Conc.</td>
<td>Conc.</td>
<td>Local</td>
<td>neutral</td>
</tr>
<tr>
<td>10</td>
<td>Nat’l</td>
<td>Conc.</td>
<td>Conc.</td>
<td>Nat’l</td>
<td>strong</td>
</tr>
</tbody>
</table>
Each factor either strengthens (↑), weakens (↓), or has no or an uncertain effect (↔) on the argument for charity. The final right-hand column sums across the various factors in each row. In summing, I assume that political concentration of benefits (B) is somewhat more important than geographical scope of positive externalities (S), on the theory that the political rents from pleasing an activated constituency would overcome any local government inclinations to free ride. “Neutral” results indicate that my analysis does not suggest a different outcome from Weisbrod’s, except to the extent that the waste and geographical distortion of the deduction might reduce welfare even where negative externalities are not localized. “Weak” indicates that the case for charity is weaker than under traditional theories, and “strong” the opposite.

Table two summarizes these results and offers real-world examples of public goods that correspond to each of the sixteen resulting combinations.

<table>
<thead>
<tr>
<th>Form</th>
<th>Factors</th>
<th>Examples</th>
<th>Case for Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SL,BC,CC,EL</td>
<td>Opera; Shakespeare in the Park</td>
<td>weak</td>
</tr>
<tr>
<td>2</td>
<td>SL,BC,CC,EN</td>
<td>Offensive art; political theater</td>
<td>neutral</td>
</tr>
<tr>
<td>3</td>
<td>SL,BC,CD,EL</td>
<td>Fair-housing enforcement</td>
<td>weak</td>
</tr>
</tbody>
</table>
Although I want to emphasize that the results here are only a very rough approximation, they nonetheless are striking. Hospitals, universities, and museums are among the largest of existing charities, and their eligibility for charitable status under existing law is largely unquestioned. Yet the case for subsidies for all three are remarkably weak under my reappraisal of the traditional rationales. For example, although the nationwide public good of a well-educated populace might be subject to free riding among states, universities provide a private good to enrollees, such that we would expect that lobbying could often produce significant expenditures on higher education.

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106 SHERLOCK & GRAVELLE, supra note 58, at 6--11.
Thus the gap between median and high-demanding voters suggested by Weisbrod is unlikely to arise.

A number of other charitable forms score as “neutral,” but that should not be read as an unqualified endorsement of the traditional analysis. For nearly all of the “neutrals,” factors that cut against subsidy are balanced against those that favor it. Whether subsidies are appropriate should depend on a more careful analysis of which factors loom larger for a particular good. For instance, homeless shelters might produce relatively concentrated negative externalities among nearby residents unhappy about the effects of the shelter on their neighborhood, which would depress political support and increase the case for charitable production. But at the same time, the negative externality might be eliminated if shelter donors would instead relocate. We do not know for sure whether the welfare losses from that distortion exceed the gains from spurring more charitable assistance for the poor. Consequently, organizations in the “neutral” category are not necessarily good candidates for subsidy.107

As a result, to this point it appears that the argument that charity fills in where government cannot has been oversold. There are a handful of situations where some level of government will likely fail to provide all of the public goods the population demands, and charitable provision would increase social welfare. But these few scenarios do not justify the vast scale of the current nonprofit sector. Are there other arguments that might?

III. Quality of Outputs I: Structural Differences

107 It is worth noting that my assignment of some organizational forms to particular categories here is certainly open to debate; the examples are supposed to be illustrative, not definitive. For instance, some might doubt whether opera produces negative externalities for its neighbors (I assume crowds and noise might be unwanted), or the same about wetlands preservation (I assume unhappy neighboring landowners).
In the previous Part I showed that for the most part the charitable deduction cannot be justified simply by pointing to failure of the government sector to provide public goods. Yet there may be an argument for charitable provision even in cases where government, too, can provide the good: where the quality of what charity would deliver is superior to what we would expect of government. This seems like an obvious line of attack, but because of the literature’s heavy dependency on Weisbrod and other government-failure theories, it has never seriously been undertaken. Thus, in the next two Parts I catalogue and assess arguments that could justify charity as complement or side-by-side rival with government in situations where provision of public goods by either sector is theoretically plausible. I first consider, in this Part, whether in the abstract charity outperforms government in the delivery of public goods. In Part IV, I examine some more specific scenarios in which the quality of government provision may fall below charity.

Libertarians and other government critics often advocate replacing bureaucratic production of public goods with the private sector.108 Little of this literature focuses on charity per se. Probably the most sophisticated articulations of the libertarian argument for charity have come from a pair of highly accomplished scholars of tax law, Saul Levmore and David Schizer. Levmore argues that charities have better information about popular preferences than does government, and so will be able more closely to satisfy those preferences.109 Schizer agrees, adding that government reflects the “agendas of interest groups and professional politicians.”110 Other commentators also typically assert that because of the low-powered incentives for quality outputs in the government sector,

108 See PINCIONE & TESON, supra note 15, at 228--42.
109 Levmore, supra note 14, at 409--10; Schizer, supra note 14, at 47--52, 60--62.
110 Schizer, supra note 14, at 31.
government employees are less energetic and even less talented than their private
rivals.\textsuperscript{111} If anything, however, government is probably \textit{more} reflective of contemporary
preferences than is charity, is better able to deliberate between competing goals, and in
general is no less capable of enacting them.

\textbf{A. Information}

First, it is unclear why the information provided by charitable donations is
superior to that produced in the political process. As I have argued, the lobbying process,
like charitable contributions, is a vehicle for individuals to reveal the intensity of their
preferences, including any preferences for benefitting others. Thus, lobbying, like
charity, can reveal both self-serving desires as well as information about what policy
would aid those who cannot lobby effectively for themselves. Schizer, evidently
anticipating this argument, suggests to the contrary that “lobbyists are obviously much
less likely than charitable donors to focus on the public interest.”\textsuperscript{112} Schizer does not
elaborate on this point, so at the risk of dueling with a straw version of his claim, I will
take him to mean that the social norm associated with charitable giving is more public-
regarding than the norm of lobbying.

If this is what Schizer intends, his claim is unpersuasive. Some charitable
contributors may be acting out of an internalized social norm of altruism. But by
definition a true altruist should be indifferent to process; it is enough that those in need of

officials, see Daron Acemoglu et al., \textit{Incentives in Markets, Firms, and Governments}, 24 J.L. Econ. &
Org. 273, 288--89 (2008); David Weisbach, \textit{Tax Expenditures, Principal-Agent Problems, and

\textsuperscript{112} Schizer, \textit{supra} note 14, at 52.
aid get it. Thus, to argue that charity is superior because it probably attracts altruists is tautological; altruists are attracted to whatever works.

Alternately, perhaps the argument is that charitable contributors donate in order to appear altruistic. This effort to mimic altruism might reveal private information about popular preferences, and so be a better guide for welfare maximization than government decisions. The problem with this line of argument, though, is that the information that these contributors reveal is not what they themselves believe will improve social welfare, but instead what they think will send the strongest altruism signal. The donor is only guessing about what other people think improves welfare, not what she herself believes. This is precisely the kind of attenuated guess-work about others’ preferences that public officials engage in when they enact laws hoping to be reelected. The official, though, has the benefit of receiving additional information from staff and constituents, while the donor has only herself.

Finally on this point, government is often better able to represent contemporary preferences, as opposed to the preferences of some long-dead donor. Many commentators assert that charity is more nimble than government because it is not tied up

113 That is, the definition of an altruist is one who acts purely in order to benefit another, and not for any self-regarding motive. Rose-Ackerman, supra note 3, at 712. Altruists are therefore to be distinguished from “warm glow” givers, who feel some sense of personal reward from doing good for others. I discuss warm glow giving in more detail infra Part IV.D and IV.E.
114 Cf. Rose-Ackerman, supra note 3, at 701 (stating that altruism could be satisfied through government or for-profit forms if those forms were more effective at delivering services). If the claim were an empirical one that true altruists prefer the charitable vehicle, that would be a quite different, and non-tautological, argument about the informational value of the true altruists’ choice. But to my knowledge no one has ever attempted to show that true altruists do not lobby.
115 For further discussion of this possibility, see infra Part IV.D.
116 Cf. Strnad, supra note 25, at 280–81 (suggesting that prestige-motivated giving could increase welfare if prestige is derived from socially useful projects).
117 Charitable donors might rely on information shared with them by charitable entrepreneurs. Cf. Schroeder, supra note 94, at 54–55 (arguing that entrepreneurs help form political coalitions by collecting information about group’s preferences). At best, then, charity and government operate on comparable information.
by red tape.\textsuperscript{118} That may be true of very new charities, but the process of starting up, organizing, and finding funding for a new venture is itself often long.\textsuperscript{119} And, once money is committed, it is locked into the organizational form.\textsuperscript{120} The more important question then becomes which form of organization can best adapt its existing resources to ongoing public needs and preferences.

Government may actually have more flexibility in its use of existing funds. Public officials, of course, are subject to an ongoing reelection constraint.\textsuperscript{121} While the difficulty of enacting law can lead to lags between the law on the books and the preferences of the enacting coalition, government can mitigate these lags through dynamic statutory interpretation by judges and agencies.\textsuperscript{122} In contrast, the law of charity gives preeminence to the preferences of donors, often in perpetuity.\textsuperscript{123} Although there is some variation from jurisdiction to jurisdiction, in general the law does not permit

\begin{footnotes}
\footnote{There is likely substantial variation in agility across charitable entities. Organizations capable of thriving on little capital might indeed be quicker at their start than any government program. I am grateful to Dan Halperin for this point.}
\footnote{See 2 \textit{Marilyn E. Phelan, Nonprofit Enterprises: Corporations, Trusts, and Associations} 15-16 to 15-19 (2007) (describing limits on repurposing of charitable funds for noncharitable purposes).}
\footnote{For fairly recent evidence on the effectiveness of the electoral constraint on official behavior, see Timothy Besley \& Anne Case, \textit{Political Institutions and Policy Choices: Evidence from the United States}, 41 \textit{J. Econ. Literature} 7, 54--59 (2003) (finding that term-limited governors enact fiscal policy that is closer to preferences of median voter than governors who are subject to reelection).}
\end{footnotes}
deviations from the terms of bequests except in extremely changed circumstances, and even then changes must strive to adhere to the spirit of the gift.\footnote{RESTATEMENT (SECOND) OF TRUSTS § 381 (1959) (summarizing deviation doctrine); id. § 399 (setting out doctrine of cy pres); GEORGE GLEASON BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES § 431 (rev. 2d ed. 2003) (explaining that trust doctrines require uses of restricted funds to hew “as closely as possible” to donors’ intent). \textit{But see} Goodwin, supra note 123, at 103--07 (arguing that in actuality restrictions are only binding to extent they are enforced, and that enforcement is usually lax). Others argue in response to the enforcement critique that reputational concerns discipline charities to comply with gift terms, notwithstanding legal obstacles to enforcement. John K. Eason, \textit{The Restricted Gift Life Cycle, or What Comes Around Goes Around}, 76 FORDHAM L. REV. 693, 719--20 (2007).}

This difference is not an historical accident, but rather is a structural feature of charities. Nonprofit law protects donor intent in order to encourage giving.\footnote{Brody, supra note 123, at 942--43; Manne, supra note \textbf{Error! Bookmark not defined.}, at 265. This is another application of Hansmann’s analysis: donors will not give without assurances that their funds will not be diverted to other uses. Hansmann, Nonprofit Enterprise, supra note , at 503; see also Adam Hirsch, \textit{Bequests for Purposes: An Integrated Theory}, 56 WASH. & LEE L. REV. 33, 52--60 (1999) (noting psychological and other motivations for “intricately detailed” terms of bequests); Robert H. Sitkoff, \textit{An Agency Costs Theory of Trust Law}, 89 CORNELL L. REV. 621, 659--60 (2004) (describing limits on use of donative trust funds as designed to minimize agency costs between settlor and trustee).} Thus, weakening the grip of the dead hand likely comes at the cost of diminishing the size of the charitable sector. Next, firm managers have incentives to continue the operation of an enterprise in which they have developed expertise.\footnote{See Hansmann, Reforming, supra note 7, at 521.} And, lastly, enforcing the conditions of bequests through state law further tightens the hand’s grip. There is empirical evidence that donors are sensitive to trust doctrine.\footnote{Robert H. Sitkoff & Max M. Schanzenbach, \textit{Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes}, 115 YALE L.J. 356, 359 (2005).} As a result, states must compete to attract contributions (and the political rents from affected interest groups they entail) by enacting ever more-exacting controls over the use of donated funds.\footnote{See \textit{id}. at 416--18.}

\textbf{B. Deliberation}

Whatever the possible informational advantages of charities over government, the nonprofit sector fails to maximize welfare as effectively as government because it lacks structures for debating conflicts and coordinating priorities. Levmore and Schizer both
acknowledge straightforwardly that, due to the absence of coordination, charities may sometimes wastefully duplicate each others’ efforts. Schizer also identifies some ingenious governance devices to mitigate that problem, such as obliging each charity to disclose its expenditures on a rolling basis. The more serious coordination difficulty arises when there are multiple needs that cannot all be met under existing resource constraints, or where two or more possible projects conflict. Here, disclosure is not enough; there must be some conflict resolution system. Direct bargaining between hundreds of charities, with thousands or millions of stakeholders, cannot practically be the solution.

For theorists of deliberative democracy, republican government is the solution to these kinds of coordination problems. Republican government brings together those of differing views and goals for shared debate. Those who engage in debate come to agree upon the grounds for evaluating their competing claims, and take shared responsibility for outcomes, helping to legitimate the ultimate outcome. Exchanges of ideas allow for mutual give and take, rather than winner-take-all power struggles.

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129 Levmore, supra note 14, at 393–94; Schizer, supra note 14, at 29.
130 Schizer, supra note 14, at 30, 35–36.
131 Cf. Benshalom, supra note 28, at 24 (arguing that donors may be less skilled than government at choosing between policy alternatives); Pozen, supra note 1, at 561 (pointing out that subsidy is not targeted either to those who would not give without subsidy or to projects that would produce greatest social benefits).
135 Id. at 126.
And, most importantly, the act of coming together to decide forges a community out of a collection of selfish individuals, helping to shape each member’s identity and consciousness, so that each sees herself as part of something greater than herself, and thereby more willing to accept the ultimate outcome. Contests between political leaders can organize and focus these debates and translate them from small-scale discussions to national policy.

Deliberation also improves social welfare because it helps participants develop more full-informed preferences. In studies of deliberation, researchers find that those engaged in discourse with others of varying views learn not only basic facts about the assorted positions (including their own) but also the importance of policy alternatives to those with whom they disagree. Learning that someone else holds another view strongly can weaken the grip of confirmation bias, our tendency to perceive new information selectively in a way that reinforces prior commitments. While group deliberation has risks, those dangers can be engineered and minimized in a way that seems unavailable for inter-group conflict.

137 See SANTIAGO NINO, supra note 134, at 133; Michael S. Kang, Race and Democratic Contestation, 117 YALE L.J. 734, 753--60, 769--70 (2008).
140 Schulz-Hardt et al., supra note 139, at 658.
142 ADRIAN VERMEULE, MECHANISMS OF DEMOCRACY: INSTITUTIONAL DESIGN WRIT SMALL 230--44 (2007); Sunstein, supra note 141, at 1013--21.
Most fundamentally, the turn away from government towards private associations atomizes society, loosening our bonds to each other.\textsuperscript{143} Game theorists and sociologists alike believe that mutual interdependence, the sense that the community will interact time and again, helps to strengthen norms of fairness and reciprocity.\textsuperscript{144} As we walk away from one another, each small unit pursuing its own individualistic notion of the good, our capacity to pursue larger goals as a whole society diminishes.\textsuperscript{145} Yet at some point grand goals are inevitable. Wars, famines, natural disasters, recessions and depressions, all require solutions with large economies of scale, and demand a vast commitment of social resources in which everyone must participate.\textsuperscript{146}

There are those who argue that the nonprofit sector actually strengthens the deliberative character of the community.\textsuperscript{147} To be sure, community groups, universities, and many other charities can be a site for republican deliberation and face-to-face discussion of ideas. The question here, though, is whether they should be preferred to government as the venue for those discussions. Proponents of charitable deliberation seem to envision the interactions that happen there as supplements to or even practice for governmental deliberations.\textsuperscript{148} As I have just argued, it is possible the opposite is true: that charity weakens government deliberation. Further, it is unclear from these accounts

\textsuperscript{143} Cf. Martha Minow, Partners, Not Rivals 153 (2002) (making this point about the education system).


\textsuperscript{145} Cf. Pozen, supra note 1, at 560 (noting that subsidies for nonprofits “may exacerbate factionalism”).

\textsuperscript{146} See Benshalom, supra note 28, at 23.

\textsuperscript{147} Putnam, Bowling Alone, supra note 40, at 288--89; De Tocqueville, supra note 40, at 513--14; Walzer, supra note 41, at 93--112; Brakman Reiser, supra note 26, at 830--31.

\textsuperscript{148} Berger & Neuhaus, supra note 43, at 6; Oliver, supra note Error! Bookmark not defined., at 20; Putnam, Bowling Alone, supra note 40, at 288--89, 336; Brakman Reiser, supra note 26, at 830--31.
why town or neighborhood counsels could not serve the same role, with the added benefit of being more open to differing views of the good.  

C. Personnel

Finally, it is doubtful that there is any significant difference between the individuals who work for charity and those who work for governments. Both sectors traditionally are bound by a nondistribution constraint: they cannot distribute net profits to employees or other stakeholders.  

Both sectors, therefore, will tend to attract individuals who on average are less risk-seeking than private-sector employees, because compensation gains are smaller but more certain. And, similarly, each is likely to appeal to workers who value the opportunity to set policy or make the world better, in whatever subjective sense, and will accept that chance in lieu of profits.

Schizer argues that contributors to nonprofits may be from the for-profit world, and therefore offer important inputs into the charitable sector. But to the extent these outside views are valuable, government, too, can obtain them. Both Congress and agencies, for example, can hold hearings, take testimony, meet with experts, and solicit white papers or other expert reports. If donors are motivated to share their expertise by a desire to influence policy outcomes, it is hard to see why they would be less willing to

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149 See OLIVER, supra note Error! Bookmark not defined., at 5 (arguing for this role for local governments).
150 Schizer, supra note 14, at 45.
153 Schizer, supra note 14, at 47--52.
talk to government. Large donors can have a powerful influence over charity, but so can large campaign contributors. Whether for good or bad, these factors are fairly symmetrical.

A more plausible structural difference between the two sectors is that elected government employees are more subject to monitoring by those whose policy views differ from their own. While there can be internal disagreement between a charity’s managers and stakeholders, charitable organizations by law must have relatively well-defined purposes, as embodied in their founding and governing documents. This feature allows both managers and stakeholders to self-select membership in organizations whose general goals align with their own. Candidates for office, too, can choose which jurisdiction to represent, but electorates are rarely perfectly uniform, gathering information about voter preferences is costly, and there always remains the risk that local preferences will change. Given the electoral advantages of incumbency, it will also be difficult for elected officials to give up a job representing a changing electorate for one where the voters more closely match the official’s preferences.


156 George G. Triantis, Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises, 112 HARV. L. REV. 1102, 1150–57 (2004). While no law is immutable, this feature of charity law is fairly fundamental in that, like other rules governing the use of charitable resources, it is a guarantee and selling point to donors. See Hansmann, Reforming, supra note 7, at 616; cf. Triantis, supra, at 1149 (arguing that increased flexibility of charities would not be optimal, given high agency costs).

One consequence of this difference in constituencies between charitable and governmental managers is that charitable management is more likely to attract the ideologically committed. 158 Given a choice between the two jobs, all else equal, the rational ideologue should choose the position that better enables her to enact her preferences. In addition, with greater mission security, the charitable manager has more incentives to invest in developing mission-specific capital --- to get good at her job. 159 This ideological purity has both plusses and minuses, however.

On the plus side, charities may be somewhat more innovative than government. Absent some intervention from the federal government, policy innovation among local governments is likely to fall below the social optimum, because innovative policy provides positive information externalities to other jurisdictions. 160 Individuals who are more strongly motivated by policy preferences are more likely to internalize the positive externalities of their policies: they are evangelists for their own goals. 161 As a result, an organization led by evangelists will be more motivated, not less, by the possibility that their ideas could be shared by others.

On the other hand, ideologically polarized organizations appear to be less deliberative than others. Of course, there are the familiar perils of groupthink. 162

159 Cf. Jonathan R. Macey, Externalities, Firm-Specific Investments, and the Legal Treatment of Fundamental Corporate Changes, 1989 DUKE L.J. 173, 188-90 (noting disincentives to invest in specific firm or mission, but arguing that these can be contracted around); Lorne Carmichael, Firm-Specific Human Capital and Promotion Ladders, 14 BELL J. ECON. 251, 252 (1983) (describing mechanisms that allow firms to assure employees that firm-specific capital will not be wasted).
160 Galle & Leahy, supra note 65, at 1339--41.
161 See Rose-Ackerman, supra note 3, at 719.
addition, Sunstein and his colleagues offer a series of studies suggesting that when groups contain only similar views, deliberations tend to reinforce rather than challenge the participants’ pre-existing assumptions. Thus, after deliberation the group reaches a more “extreme” position than any of the individual members would have reached alone.

Many of these same traits, however, also are shared by bureaucrats. They, too, are at least somewhat shielded from political oversight. And the bureaucratic workforce tends to attract employees who are motivated by their own policy commitments. Indeed, I have argued elsewhere that for this reason bureaucrats may be more innovative than local politicians.

Thus, to the extent that some policies may benefit from ideological commitment, it may be possible to achieve those benefits without charity. Administrative law also appears to permit more fine-tuning of the balance between zeal and deliberation. Courts can (and, in contemporary law, do) demand that agencies remain open to comments from the public, and respond deliberatively to these outsiders. By adjusting

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164 Id. at 85--86.
166 Knauer, supra note 158, at 994; see Lazer, supra note 152, at 55, 61.
169 See Motor Vehicle Mfr’s Ass’n v. State Farm Mut. Ins. Co., 463 U.S. 29, 43--44 (1983) (holding that an agency rule could only be upheld if the court concluded that it was the product of reasoned
the degree of openness and deliberation the agency must offer, courts can continually recalibrate the right tradeoff between deliberation and ideological commitment. At present, at least, the law of charities has not hit on a mechanism for doing the same.

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In sum, as a general matter the quality of government-provided public goods will be similar or even superior to that of charity. Government is better equipped to reflect contemporary preferences, and to balance ideological commitments against those of competing outsiders in a way that produces healthy deliberation rather than pure social conflict. So far, then, we have yet to see a compelling reason government should raise taxes to fund most charitable endeavors.

IV. Quality of Outputs II: Situational Differences

While government may have some structural advantages over charity, there are still instances where charity is superior, or at a minimum offers something that government provision alone could not. In this Part I consider a handful of the most important cases in which we can predict that government, even within a system of federalism, will fail to maximize welfare, pluralism, or diversity. For example, in some instances we see either insufficient or too much competition between local governments. Insufficient competition may result from barriers to mobility, or political failures, such as oligopolistic or risk-averse behavior among public officials. In these cases competition

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170 Galle & Seidenfeld, supra note 154, at 1974--79.

171 I describe what such as system would look like infra Part V.B.
with charity can serve as the spur to quality and innovation that competition between
governments does not. On the other hand, excess competition, as in the infamous “race
to the bottom,” may produce an environment where public goods are of low quality. In
those situations, charities can fill the resulting gap. My theory, in other words, is one of
comparative advantage, rather than outright “government failure.”

In addition, as many commentators have recognized, some charitable functions
are inimical to government provision. 172 Most obviously, there is the separation of
church and state. 173 Thus, under my theory religious organizations would always be
eligible for a subsidy; I leave aside for now any line-drawing issues in differentiating
pure worship from other activities in which government might reasonably compete.
Accordingly, the discussion that follows addresses only non-church charities.

A. Imperfect Horizontal Competition

Where competition between governments is low, government services may also
have low quality because of weak incentives for public officials to perform at a high
level. A familiar story of federalism is that competitive pressure from other jurisdictions
motivates office-holders to outperform rivals. 174 At times, though, this competition
breaks down. Charity can perform an important social role by offering a new source of
competition for inefficient governments, as I will now detail.

172 Pozen, supra note 1, at 559 (collecting sources).
173 Id.
174 PAUL E. PETERSON, THE PRICE OF FEDERALISM 17--18, 25--26, 46--47 (1996); Douglass North, A
But see Jonathan Rodden & Susan Rose-Ackerman, Does Federalism Preserve Markets?, 83 VA. L. REV.
1521, 1530--36 (1997) (arguing that claim that exit leads to efficient government depends on unrealistic
assumptions about local political process).
1. Charity as Substitute for Intergovernmental Competition

Jurisdictional competition improves the quality of local government. Free-riding and rational ignorance among the local electorate makes electoral control a relatively loose constraint on slacking and self-dealing by the elected.\textsuperscript{175} But a resident deciding whether to relocate to another jurisdiction in order to obtain higher-quality services cannot free-ride on others; only she can move.\textsuperscript{176} Thus, migration based on quality is less subject to collective-action problems than voting based on quality.\textsuperscript{177} The threat of out-migration impacts office-holders both directly, through a smaller tax-base for their pet projects, and indirectly, as a signal to the remaining voters of the office-holder’s performance.\textsuperscript{178}

Where exit costs are high, competitive federalism breaks down.\textsuperscript{179} Frictions on moving limit the extent to which people and firms will relocate to obtain their desired policy.\textsuperscript{180} These frictions include the inevitable barriers to moving that everyone faces: moving costs, cognitive costs of recognizing and evaluating new opportunities, and the fact that laws are not the only reason to choose a place to live.\textsuperscript{181} These frictions loom even larger when the choice is not between policies, but rather only between gradations in the quality of the policy.

\textsuperscript{175} E.g., Joseph P. Kalt & Mark A. Zupan, \textit{The Apparent Ideological Behavior of Legislators: Testing for Principal-Agent Slack in Political Institutions}, 33 J.L. & ECON. 103, 103--04, 107--08 (1990)
\textsuperscript{177} Id.
\textsuperscript{178} See Briffault, \textit{supra} note 175, at 400--401; Lee Anne Fennell, \textit{Beyond Exit and Voice: User Participation in the Production of Local Public Goods}, 80 TEX. L. REV. 1, 26 (2001).
\textsuperscript{180} Oates, \textit{supra} note 53, at 1122.
Nonprofit firms can fill this competition gap.\textsuperscript{182} If a donor can obtain services from the charity of her choice without relocating, she acquires a new, low-cost exit option. In the case of local governments that themselves subsidize charity, donations automatically reduce the tax base of the local government.\textsuperscript{183} Alternatively, the donor may now vote for lower taxes, to reflect the fact that she has shifted some of her consumption of public goods away from her local government.\textsuperscript{184} Thus, in order to protect their tax base, local officials must attempt to out-perform any potential charitable competitors.

It is worth emphasizing that exit costs are not just the price of a moving van. They can span tangible and intangible costs of all kinds, such as lost connections to family and neighbors, or government services available in the old regime but not the new.\textsuperscript{185} Probably one of the more obscure but more important is network effects—the benefits of having lots of things in one place.\textsuperscript{186} Silicon Valley is what it is in part because of its tremendous concentration of human capital; if the geniuses dispersed, much of their collective energy would be lost.\textsuperscript{187} The opportunity to share in those

\textsuperscript{182} Cf. Somin, \textit{supra} note 176, at 15 (noting that privatization may be lower-cost alternative than physical exit).
\textsuperscript{183} Most jurisdictions with an income tax also allow the charitable deduction. \textsc{State of Wisconsin, Legislative Finance Bureau, Individual Income Tax Provisions in the States} 15 tbl.4 (2009), available at \url{<http://www.legis.state.wi.us/lfb/Informationalpapers/4_individual%20income%20tax%20provisions%20in%20the%20states.pdf>}. Other jurisdictions grant charities exemptions from property or sales taxes, so that as the scope of local charity increases, tax revenues decline.
\textsuperscript{184} See Elizabeth Becker & Cotton M. Lindsay, \textit{Does the Government Free Ride?}, 37 J. L. & \textsc{Econ.} 277, 279--80 (1994). There is some empirical evidence of this behavior. \textit{Id.} at 278 (“[D]onations to public colleges and universities result in dollar-for-dollar reductions in government spending….”).
\textsuperscript{186} Stefano Breschi & Franco Malerba, \textit{The Geography of Innovation and Economic Clustering: Some Introductory Notes}, 10 J. \textsc{Ind. & Corp. Change} 817, 817--32 (2001).
\textsuperscript{187} \textit{Id.} at 817--18.
economies of concentration is one of the major factors that keeps people and firms in place, generating locational rents.\textsuperscript{188}

The importance of locational rents might suggest that charity is most essential in urban areas, where such concentrations usually arise,\textsuperscript{189} but there are exit considerations that favor rural charity as well. For workers in urban areas, there are often many different governments to choose from: rings of suburbs surrounding the urban core.\textsuperscript{190} But for those who work in rural areas to change governments, they likely must also change jobs, or at least face very long commutes.\textsuperscript{191} Changing jobs is itself often quite costly.\textsuperscript{192} So both urban and rural residents may face high exit costs, but these costs come in different forms.

\textbf{2. Counter-Arguments: Irrelevant Exit and Crowd-Out}

However, this competition-gap theory raises a number of possible counter-arguments. First, the theory assumes that mobility is necessary in order to generate inter-local competition. There are several alternative sources of competitive pressure other than outright exit. For one, residents can simply threaten to exit unless government reforms.\textsuperscript{193} Additionally, residents can utilize the performance of similar neighbors as a yardstick or benchmark for performance by their own, so that local officials cannot as

\textsuperscript{188} Schleicher, supra note 238, at.
\textsuperscript{189} Id.
\textsuperscript{190} See Stelle Garnett, supra note 75, at 297 (explaining that fragmented governments surrounding urban cores are fertile ground for Tiebout sorting)
\textsuperscript{192} A number of factors contribute to the costliness of changing jobs. Employees develop firm-specific capital, or expertise related to their particular employer, which earns them a premium wage. Carmichael, supra note 159, at 252 (1983). Employers also typically structure wages and benefits to encourage development of this capital. Id. at 251--58. For example, employer-based health insurance produces a significant amount of “job lock”; employees cannot leave without giving up affordable health care. Jonathan Gruber & Brigitte C. Madigan, \textit{Health Insurance and Job Mobility: the Effects of Public Policy on Job Lock}, 48 IND. & LABOR REL. REV. 86, 87--88 (1994).
\textsuperscript{193} Bratton & McCahery, supra note \textbf{Error! Bookmark not defined.}, at 264--65.
easily hide behind the difficulty of measuring the quality of public goods.\textsuperscript{194} A third possibility is fluctuations in the value of property affected by the quality of local government. Anup Malani, for instance, argues that local homeowners who observe poor performance by their government will likely lower their reserve price, driving down home values.\textsuperscript{195} Mismanagement can also drive up a town’s cost of borrowing, diminishing the value of existing bonds.\textsuperscript{196} These price variations are signals to close observers of the government’s poor performance, as well as possible spurs to anger by those who have lost wealth as a result.\textsuperscript{197}

Most of these mechanisms themselves depend on ease of exit, however. Threats to exit are only credible if the government official believes that exit costs are lower than the value of the demands.\textsuperscript{198} Yardstick competition, similarly, probably works mostly as an implicit threat of exit.\textsuperscript{199} Rationally ignorant voters will not bother to compare their own officials with others. So the only residents who are likely to pay attention to yardsticks are those who might move to the better-performing neighbor. And Malani’s predicted decline in home prices rests on the assumption that individuals will be less interested in living in the jurisdiction, driving down demand for housing.\textsuperscript{200} Although there is no obvious exit story to tell about bondholders, in all likelihood bondholders will

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{195}] Anup Malani, \textit{Valuing Laws as Local Amenities}, 121 HARV. L. REV. 1273, 1281--90 (2008).
\item[\textsuperscript{196}] Gillette, \textit{supra} note 176, at 975--76.
\item[\textsuperscript{197}] \textit{PETERSON, supra} note 53, at 17--18; Ethan Yale & Brian Galle, \textit{Muni Bonds and the Commerce Clause After United Haulers}, 115 TAX NOTES 1037, 1044 (2007); Gillette, \textit{supra} note 176, at 952 (“[M]issed payments provide a readily detectable indication of mismanagement….”).
\item[\textsuperscript{198}] See Saul Levmore, \textit{Interstate Exploitation and Judicial Intervention}, 69 VA. L. REV. 563, 601--02 (1983) (stating that state officials’ opportunities to extract rents from firms are limited by firm’s cost of exit).
\item[\textsuperscript{199}] Bratton & McCahery, \textit{supra} note Error! Bookmark not defined., at 265.
\item[\textsuperscript{200}] See Malani, \textit{supra} note 195, at 1288--89.
\end{enumerate}
\end{footnotesize}
free-ride on the monitoring efforts of other bondholders, just as voters do.\textsuperscript{201} Thus, where exit is difficult, charity remains the most promising source of pressure on local government.

A second potential counter to the competition story is that, just as with Weisbrod’s government-failure account, subsidizing charity may be a cure that is worse than the disease. Recall that the subsidy distorts a resident’s choice between moving and charity.\textsuperscript{202} However, the costs of charity are largely externalities for the resident, so that she may choose charity instead of moving, even where that reduces overall social welfare.\textsuperscript{203} It is difficult to predict, as a matter of theory, whether this loss would be larger than the social gains from additional sources of competition for local governments.

When charities are competing with government over quality, though, the potential losses are smaller, due to a phenomenon economists call “crowd-out”.\textsuperscript{204} This is a key difference between the competition rationale and Weisbrod’s supra-median voter story. In Weisbrod’s version, there is no government that provides the public good, so that donors who pay for the service shell out only once. But if the reason the donor gives to charity is simply because she is dissatisfied with the quality of the available good, she is in effect paying for it twice: once through her tax dollars, and again through her donation. For instance, if graduates of my local high school can hardly read, and I want an elite institution in the town, I will have to fund a second school.\textsuperscript{205} Unless I value superior

\textsuperscript{201} See Brian Galle & Ethan Yale, Can Discriminatory State Taxation of Municipal Bonds be Justified?, 117 TAX NOTES 153, 155 (2007).

\textsuperscript{202} See supra text accompanying notes Error! Bookmark not defined.--66.

\textsuperscript{203} I assume here that the positive externality resulting from better competition would be similar under either moving or charity.

\textsuperscript{204} MUSGRAVE & MUSGRAVE, supra note 4, at .

education very highly, I am unlikely to pay so much for it—the existence of the government program, for which I have no choice but to pay, discourages me from buying additional private education. So government provision of low-quality goods may crowd out charitable provision of superior alternatives.\textsuperscript{206}

The double-payment problem enhances the expected value of the deduction.\textsuperscript{207} Crowd-out increases the likelihood that the subsidy is “treasury-efficient,” that is, that $1 of subsidy produces at least $1 of additional public goods. Recall that subsidies run the risk of some waste because of inframarginal purchasers: money spent on people who would have bought the good anyway. But where the cost of purchasing the good is increased as a result of the double-payment problem, the amount of waste decreases, since there will be fewer citizens who are inframarginal—fewer who would have been willing to pay the higher price.

Therefore, although in general the exact welfare effects of a subsidy remain hard to predict, the double-payment problem at least makes it more likely that the subsidy is efficient. While charity is likely over-produced in Weisbrod’s scenario, here crowd-out makes charity more likely to be under-produced, so that the deduction has a better chance of bringing total output closer to the social optimum.

However, this efficiency story is harder to tell in the case where potential donors all reside in the same jurisdiction. In that event, the donors can avoid double payment by

\textsuperscript{206} For discussion of empirical efforts to measure crowd out, see infra Part IV.F.

The charitable deduction does not eliminate double payment. A deduction operates to reduce taxable income, not the tax actually due. Suppose I earn $100,000 and pay a 10% local tax, which for simplicity we can assume is spent entirely on the local opera. If I donate $1,000 to a rival opera, and earn a $1,000 deduction, I reduce my taxable income to $99,000. But that only reduces the amount of tax I pay from $10,000 to $9,900. So my total opera expenditures now are $10,900. Only a dollar-for-dollar credit on tax due, which no state has ever adopted or (to my knowledge) even seriously contemplated, would eliminate the double-payment problem.

\textsuperscript{207} For a mathematical model, see Galle, supra note 61, at 13–17.
the simple expedient of banding together to vote or lobby to cut spending on the low-quality government service.\textsuperscript{208} Although they will face the ubiquitous free-rider problem in their efforts, the subsidy greatly aids their cause by forming charities, which allow donors easily to identify others who are similarly situated, transact face-to-face with those others at charity events, and hire staff who can coordinate their efforts.\textsuperscript{209}

In short, where consumers live close together, the deduction may again over-produce charity. Co-located donors can much more easily combine their donation with a vote to lower their taxes. For example, there is evidence that charitable giving to education reduces local government education spending.\textsuperscript{210} In these instances where charity “crowds out” government, there is no double payment, and so charity is less likely to be cost-effective.

This analysis implies that the amount or availability of the deduction should depend on where its supporters reside. Admittedly, it is hard to imagine how to administer a rule that makes the deduction vary depending on where donors live. I will suggest some practical solutions to this problem in part V.A.

**B. Inadequate Vertical Competition**

Another theme of the federalism literature is that the existence of viable local governments improves the quality of the federal government.\textsuperscript{211} Madison, for example, argued that the States would compete with the national government for the loyalty of the public, with the winner earning the right to deliver services in exchange for political

\textsuperscript{208} See Becker & Lindsay, supra note 184, at 279--80.

\textsuperscript{209} See Robert D. Tollison, Rent-Seeking: A Survey, 35 KYKLOS 575, 590 (1982); cf. Brakman Reiser, supra note 26, at 876--77 (discussing the ways in which membership in nonprofit organization facilitates political action).

\textsuperscript{210} Becker & Lindsay, supra note 184, at 278.

\textsuperscript{211} See sources cited supra note 69.
Here, too, the competitive mechanism may at times break down, leaving a theoretical opportunity for charities to step in as rivals for the affections of the public.\textsuperscript{213} In practice, though, charities likely cannot fill this role. As we have already seen, localities are often unlikely competitors for national government when the scope of the service is national. Each smaller government has incentives to free ride on any effort others might make. A single national government does not have this problem. Similarly, states may be inadequate competition for the federal government because of economies of scale: It can be far more efficient to provide a particular service across huge expanses of territory or population.\textsuperscript{214}

Another breakdown arises from the fact that the optimal level of government for the production of any public good may vary over time. Optimality is the result of a set of tradeoffs.\textsuperscript{215} For example, while there may be economies of scale, larger governments are harder for the public to interact with and control.\textsuperscript{216} Not all of these factors are stable over time. Technological changes might make monitoring government officials easier.\textsuperscript{217} Or the addition of new services at one level or another might create economies or diseconomies of scope with the existing services.\textsuperscript{218}

However, even as the optimal level for the delivery of a good is fluid, the actual provision of the good can be “sticky.” Officials accustomed to receiving political rents

\begin{footnotesize}
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\item[\textsuperscript{212}] The Federalist No. 51, at 291 (James Madison) (Clinton Rossiter ed., 1999).
\item[\textsuperscript{214}] Inman & Rubinfeld, \textit{supra} note 53, at 45--46.
\item[\textsuperscript{215}] Oates, \textit{supra} note 53, at 1120.
\item[\textsuperscript{216}] Ernest A. Young, \textit{The Rehnquist Court’s Two Federalisms}, 83 \textsc{Tex. L. Rev.} 1, 63 (2004)
\item[\textsuperscript{218}] See Carbonara et al., \textit{supra} note 79, at [14--18].
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for delivering a particular service will be unlikely to give up the rents.\footnote{219} Winning budget space for the service from officials in the alternative tier of government will be more difficult, as there is not yet any constituency in that government for the service.\footnote{220} Bureaucrats who carry out the project might resist reassignment because of connections with patrons or peers in their existing organizational structure.\footnote{221} And lobbyists who have purchased relational capital with officials in one government will be reluctant to start over elsewhere.\footnote{222}

Likewise, James Buchanan and his various co-authors have argued that government in general is too sticky. In Buchanan’s argument, increased taxation is a one-way ratchet, so that once we have added to the size of the bureaucracy we have created a political force that will resist its own downsizing.\footnote{223} Buchanan claims that competition between governments can check the forces of expansion, but that collusion between officials at different levels may allow all of them to expand without limit.\footnote{224}

In theory charitable provision of public goods can solve all these sets of problems. As spontaneous organizations, charities can be designed to match the ideal geographic

\footnote{222}{See Jerry Mashaw & Susan Rose-Ackerman, Federalism and Regulation, in The Reagan Regulatory Strategy: An Assessment 101, 133--34 (Gordon Eads & Michael Fix eds., 1984).}
\footnote{224}{Id. 203--12; see also Barry R. Weingast, The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development, 11 J. L. Econ. & Org. 1, 3 (1995) (developing argument that competitive federalism restrains opportunity for governments to appropriate private property).}
distribution of the desired goods.\textsuperscript{225} A charitable enterprise can be scaled up to account for the scope of the problem or for economies of size, as with the Gates Foundation effort to tackle malaria and global poverty.\textsuperscript{226} As the appropriate scale changes, charities can either change their operations or wind up their affairs and transfer their assets back to stakeholders for reallocation. And charities could be a sort of temporary government, adding to society’s capacity to produce public goods in times of great need (in the aftermath of natural disasters, say) without raising the danger of Buchanan’s one-way ratchet.\textsuperscript{227}

In current practice the charitable picture is not quite as promising. Under state laws governing both charitable trusts and corporations, it is extraordinarily difficult to change the charitable purposes of an organization, including the geographic scope of its operations.\textsuperscript{228} For instance, in one famous case, a court refused to allow a charity to broaden its mission beyond a single county in California, notwithstanding the charity’s huge accumulation of resources and the considerable wealth of that county.\textsuperscript{229} State and federal law both sharply limit the use of charitable resources upon dissolution of the charity.\textsuperscript{230} And managers committed and invested in a charitable enterprise can be just as reluctant as bureaucrats to change course.\textsuperscript{231} Indeed, if we think managers self-select

\textsuperscript{225} This is the point Clay Gillette makes in favor of residential associations. Clayton Gillette, \textit{Courts, Covenants, and Communities}, 61 U. CHI. L. REV. 1375, 1388--89 (1994).

\textsuperscript{226} See Atkinson, \textit{supra} note 1, at 583--84.

\textsuperscript{227} Current law includes disaster relief as one of the permissible goals of a 501(c)(3) organization. For an overview and assessment, see Danshera Cords, \textit{Charitable Contributions for Disaster Relief: Rationalizing Tax Consequences and Victim Benefits}, 57 CATH. UNIV. L. REV. 427, 434--62 (2008).


\textsuperscript{230} Treas. Reg. § 1.501(c)(3)-4; PHelan, \textit{supra} note 120, at 15-16 to 15-19.

\textsuperscript{231} See Hansmann, \textit{Reforming}, \textit{supra} note 7, at 521.
based on ideological commitments, and that this is more prevalent in the charitable sector because of the predictable weakness of oversight by those with differing views, managers of charities will be even less flexible than government.

While of course it is possible to reform the law of charity to move towards greater flexibility, that change would carry some costs. As I have already shown, the inflexibility of charity is an asset to many firms, whether in encouraging donations, managerial talent, or the effort of volunteers. Reforming the law of charity to loosen these ties might enable charity to better supplement government, but it would also weaken those charities that do not perform these supplementary functions.

Thus, even though there is a solid theoretical case for charity as a supplement to vertical competition, employing charity for that purpose may ultimately reduce social welfare by undermining the capacity for charity to fulfill other functions, such as its place as a gap-filler for horizontal competition. Still, that does leave charity with the narrow function of offering competition for the federal government in cases where the scope of the good crosses state borders.

C. Excess Competition

It is a familiar point that mobility and jurisdictional competition can produce races to the bottom as well as the top. When capital is mobile, local jurisdictions face choices between their regulatory preferences and their ability to attract investment. Similarly, individuals who prefer not to spend money on redistributive programs, or prefer to free-ride on the redistributive efforts of others, will put downward pressure on

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232 See supra text accompanying notes 155--159.
233 See supra text accompanying notes 124--128, 158--161.
235 E.g., Stewart, supra note Error! Bookmark not defined., at 1211--12.
any efforts to redistribute wealth at the local level. Jurisdictions that do offer redistributive benefits may attract migrants who are net consumers of tax dollars, prompting cuts in benefits or the flight of those who must fund the transfers.

It is less well-known that frictions on mobility permit some level of local redistribution and regulation, but the need to create frictions reduces the quality of those goods. Clay Gillette and others have noted that the cost of moving gives localities the power to exact “locational rents” from mobile firms and residents: that is, redistribution is possible, but is capped by the firm’s exit costs. Roberta Romano adds that in order to induce investment in the first place, a jurisdiction must also credibly promise not to exact all of the value of investment. Since talk is cheap, to be credible this promise must be backed by some guarantee that reneging will be costly. As a result, any effort at local redistribution must include some costly mechanism to commit the state not to tax away future gains, leaving less money available for actual redistribution.

Accordingly, if we rely solely on the government sector to produce redistribution, we are left with two choices, both flawed. Although local redistributive programs are more prevalent than basic economic theory predicts, they persist only at substantial cost. The alternative, of course, would be to run these programs at the federal level. But

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240 Id.
federal production of redistribution, as I have already mentioned, may leave many voters dissatisfied with the level of benefits, and will likely lack pluralism and diversity.

Charitable provision can mitigate some of the problems of local redistribution. Obviously, voluntary donors do not flee, so those with a preference for redistributing their own wealth can do so without fear that high tax rates will drive away those who contribute to the cost of redistribution.

In other respects charity can be subject to similar limitations as government, at least when the charity is focused on a narrow geographic area. Redistribution may change the geographic preferences of beneficiaries, and local governments might reduce their own redistribution yet further to offset that change. For instance, a high-quality homeless shelter might attract new homeless individuals who may be costly to the local government in many other ways, such as through higher Medicaid costs. The government might respond by cutting those other benefits, or otherwise making itself more unattractive to poor newcomers.241 If cuts are not possible, some wealthier taxpayers might exit to avoid higher costs. Similarly, charitable efforts to redistribute away other people’s money, such as through quasi-regulatory charities, might drive away capital.242 Here, again, local government might respond by de-regulating in other areas, or by granting targeted tax breaks that redistribute wealth back to the “regulated” industry.

Offsetting and distortionary effects might be mitigated if the charity carries out its mission more widely. Distributing benefits in many places means that migrants will be

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242 Of course, charities cannot regulate in the sense of exerting the coercive power of the state, but investigation, disclosure, shaming, and boycotts could potentially obtain similar results.
less attracted to any one jurisdiction. And widespread regulation offers “regulated”
capital fewer options for a jurisdiction to which it might plausibly flee.

With these geographic caveats in mind, my analysis does generally confirm the
longstanding tradition of charity as an aid for the poor. I add to the conventional wisdom
by showing that the same logic can also apply to quasi-regulatory public goods. In
addition, by attending to the nuances of what makes charity a good vehicle for
redistribution, I have revealed the limits of that logic. Contrary to some received
wisdom, local jurisdictions can redistribute, but there are many instances where their
efforts will be costlier or of lower quality than charity. It’s there in particular that charity
can make the largest contribution, especially if their focus is not as geographically narrow
as local governments’.

D. Warm Glow

One final qualitative difference between charity and government, which some
commentators suggest may warrant the deduction, is that donations produce a personal
satisfaction for donors that dutifully paying taxes does not.243 For example, Schizer
argues that the act of giving creates some personal satisfaction for the giver, so that
public goods funded by donations result in higher overall social welfare than government
spending alone.244 Following the economic literature, he distinguishes this “warm glow”
from pure altruism.245 An altruist cares only about the welfare of the donee, and so is

243 Kaplow, supra note 62, at 270–71; Schizer, supra note 14, at 4–8, 11–12; see also Rose-Ackerman,
supra note 3, at 717 (arguing that charity is better at creating warm glow than government or for-profits).
But see Gergen, supra note 1, at 1409 (noting that self-regarding motives may result in excessive societal
investment in giving).
244 Schizer, supra note 14, at 5–7.
245 Schizer, supra note 14, at 4. For a review of the warm glow literature, see B. Douglas Bernheim &
Antonio Rangel, Behavioral Public Economics: Welfare and Policy Analysis with Non-Standard Decision
indifferent between two equally effective spending programs. In contrast, the warm-glow giver gets rewards from being the agent of change, whether because she is satisfied at thinking of herself as a good person, or because she enjoys the social approval and status that may come with being seen by others as generous. In the latter view, warm-glow donations are like Gucci handbags: they are a status good.

Schizer acknowledges, but does not confront head-on, Peter Diamond’s critique of the use of warm glow as a normative justification for charity. Diamond argues that even if the warm glow explanation for why giving occurs is correct as a descriptive matter, it does not follow that warm-glow giving increases welfare. Among other points, he observes that apparent warm glow advantages of giving over paying taxes may actually result from donor misperception of the efficacy of government or the framing of how donations, taxes, and spending are structured. Thus, to determine whether warm glow should be added to social welfare, we must decide whether to count these forms of misinformed preferences, a subject on which there is currently no agreement in the economic community. To this one might add that there is also controversy over whether a social planner should take account of “relative preferences,” that is, a person’s desire simply to outdo her neighbor --- say, with a Gucci handbag. Some argue that, in

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246 Rose-Ackerman, supra note 3, at 712.
247 See Rose-Ackerman, supra note 3, at 712; Bernheim & Rangel, supra note 245, at 58. Of course, any given donation may be offered out of a mix of pure altruism and warm glow.
249 Schizer, supra note 14, at 5--6 & n.16 (citing Diamond, supra note 57).
250 Diamond, supra note 249, at 915--17.
251 Id.
252 For a survey of the disagreement and some suggested solutions see Brian Galle, Federal Fairness to State Taxpayers: Irrationality, Unfunded Mandates, and Section 164 of the Tax Code, 106 MICH. L. REV. 805, 818--24, 842--51 (2008).
253 For overviews of the relative preferences debate, see ROBERT H. FRANK, CHOOSING THE RIGHT POND: HUMAN BEHAVIOR AND THE QUEST FOR STATUS 5 (1985); Richard H. McAdams, Relative Preferences, 102 YALE L.J. 1, 26--69 (1992) (describing generally how individuals measure themselves against one another
the aggregate, these preferences are zero sum, and so we cannot count the feelings of superior status as adding to welfare unless we also count the feelings of inferior status that result as reducing welfare.254

Another point mentioned only in passing by Diamond is critical to the tradeoff between donations and taxes. As Diamond and others note, it is possible that what is described as warm glow is actually the relief we feel in satisfying social pressure to be good or generous.255 To the extent that we all feel this pressure, but only some of us can fully satisfy it, the norm may actually overall reduce welfare. On this account, donations are psychologically indistinguishable from paying taxes. A wide literature on tax compliance claims that, given the rarity of tax audits and small size of most sanctions, it is likely that most people pay their taxes because they have internalized a compliance norm, and fear psychological discomfort or social ostracization if they fail to comply.256 Hence, if this picture of warm glow is accurate, charitable giving is no different than paying taxes.

A warm glow justification for the deduction could also be circular. Warm glow results in some measure from meeting the approval of a social monitor, whether internal or external.257 But the expectations of the monitors may themselves be a product of the

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254 See McAdams, supra note 253, at 4--5. It should be noted that the counting does not necessarily net out to zero if positive and negative feelings are asymmetrical, or if some of the points of comparison are outside the society whose welfare we are trying to maximize.


257 See Bernheim & Rangel, supra note 245, at 58; Rose-Ackerman, supra note 3, at 713 n.10, 714.
deduction. Perhaps, as Rob Atkinson has argued, the legal regime for charity helps to establish a social norm and practice of altruism.\(^{258}\) Or perhaps the existence of the deduction (and other supports for charity) has helped the charitable sector to spend resources developing its own kind of brand.\(^{259}\) Thus, while warm glow may be a reason to continue the deduction in existence once it is firmly entrenched, standing alone it is a weak justification for choosing charity over government when we are designing on a blank slate.

E. Treasury Efficiency

A final possible situational argument in favor of charity is that it might be a thriftier use of government dollars than direct spending. For one thing, it is possible that the subsidy is so effective at triggering private spending that each dollar of subsidy results in more than one dollar of giving.\(^{260}\) If that were true, then devoting a dollar to the subsidy would result in more public goods, all else equal, than a dollar of direct government provision. In addition, government provision could crowd out some private giving that might have occurred (for example, because of altruism) if there were no government.\(^{261}\)

Subsidies for charity also have some fiscal disadvantages, though. Charities do not spend all of the money they receive on public goods; much is consumed in

\(^{258}\) Atkinson, supra note 1, at 632.

\(^{259}\) Cf. John Kenneth Galbraith, The Affluent Society 111--12 (40th Anniv. ed. 1998) (arguing that decades of private-sector advertising had convinced public that quality of government services was lower than private sector’s).


fundraising, a cost the government does not incur. Moreover, as noted earlier, subsidies given to inframarginal donors are wasted from a social perspective. Thus, theory is indeterminate whether subsidies are a more efficient use of government treasury dollars.

Empirical research offers only tenuous evidence for the treasury efficiency hypothesis. Studies of the price elasticity of giving have varied widely; one synthesis finds that one dollar of an income tax subsidy produces about $1.10 in charitable spending, while the Congressional Research Service estimated a highly inefficient $.50 spent per $1 in subsidy. Measures of crowd-out also are highly divergent, with one well-known study finding crowd-out of about nineteen cents for every dollar of government spending. That is almost the precise amount an average charity spends on

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262 See Pozen, supra note 1, at 557–58. Of course, the government must collect taxes, but recall that in order to provide the subsidy, the government must raise taxes, so that these tax-collection costs are present for both subsidies and direct provision.

263 See supra note Error! Bookmark not defined.. For examples of the forms of wasteful charities that may arise as a result of over-incentivization, see Rob Reich et al., Anything Goes: Approval of Non-Profit Status by the IRS, Stanford University Center on Philanthropy and Civil Society, Oct. 2009, available at http://pacscenter.stanford.edu/publications.

264 A bit more formally, suppose that under a subsidy the amount spent on public goods is equal to \( e \), the price-elasticity of giving, times the subsidy amount \( S \), plus a voluntary giving amount \( V \), less the costs of fundraising \( F \). On the other side of our inequality, we could put \( G \), the amount of government spending, plus \( V \), minus \( C \), the amount of \( V \) that is crowded out by \( G \). The question then is whether \( e \times S + V - F > G + V - C \), or more simply whether \( e \times S - F > G - C \).


266 Sherlock & Gravelle, supra note 58, at 49. Both of these numbers may overestimate the efficacy of subsidies. It is possible that deductibility merely changes the form or income-tax reporting of contributions, rather than increasing donations. See Ellen P. Aprill, Churches, Politics, and the Charitable Contribution Deduction, 42 B.C. L. REV. 843, 861 (2001). In addition, existing studies do not distinguish between charities that are subject to crowd-out and those that are not. My theory implies higher treasury efficiency for charities that might be crowded out by government, since those are less likely over-subsidized. See supra note Error! Bookmark not defined..

fundraising.\textsuperscript{268} So, at best, charity appears to offer only a small price advantage over government.\textsuperscript{269}

**F. Summary**

Overall, there is a solid case for subsidies for charity as a way of improving the quality of public goods. The charitable sector is a needed competitor for government where moving costs to obtain a particular service are high, where the states cannot easily scale up to rival the federal government, or where the public good in question would distort locational decisions. Even if the charity itself does not actually outperform government, the threat of competition may improve the government’s performance. However, the subsidy and the structure of charities may themselves create some economic distortions. I attempt to synthesize these strengths and weaknesses in the next Part.

**V. Towards a New Foundation for Charity**

If my argument so far is at all persuasive, it is an argument not only for a theoretical reappraisal of charity, but also a legal one. The traditional conceptions of charity have heavily influenced the shape of current U.S. law.\textsuperscript{270} As those rationales evolve, so too should the law. Thus, in this Part I set out a tentative set of ideas for

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\textsuperscript{268} See Hall \& Colombo, supra note 1, at 332--39 (tracing influence of notions of charity on law of § 501(c)(3)).
reforming the system the U.S. uses for allocating subsidies for charity, especially the method for determining what projects qualify as “charitable.” Part V.A. synthesizes the theory so far into a single, more-or-less coherent definition of what activities should count as “charity” eligible for subsidy. Part V.B. offers a legal regime for making that decision, contrasts it with the current regime, and explains the benefits of my proposed procedure. Part V.C. responds to the view, long-entrenched in the existing law, that government cannot be trusted to pass judgment on the merits of prospective charitable organizations.

A. What is “Charity” Under a Comparative-Advantage Rationale?

Under the comparative-advantage theory I’ve laid out here, the legal definition of charity is not a single concept, but instead is the end product of several overlapping policy arguments. Modern U.S. law does have somewhat of a unified conception of charity: most entities can qualify for their subsidy by showing that they provide something for which there is a private market failure.271 But, as I have shown, market-failure is only the beginning of the story. Charity also has costs, and it is uncertain whether these costs outweigh the gains to be had from solving the markets’ paralysis. Some costs could also be contained or eliminated by providing the good through government instead. I have suggested, though, a number of factors that make it more likely any given charity will leave society better off. Given a market failure, the very strongest case for a charitable over government solution is where there are high exit costs for donors, the good in question is provided across a wide geographical region, and it is redistributive in character, as I will now detail.

1. Exit costs

Exit is central to the comparative-advantage rationale. As I have explained, easy mobility from one jurisdiction or another, or the credible threat of it, is vital to high-quality local government. So as moving becomes costlier and more difficult, charity’s role as a substitute for horizontal competition rises in importance. Further, when the cost of moving is high, the net social welfare from charity is higher, because charity saves society the costs of the move.

As I described earlier, though, exit costs can be highly subjective. The value of living in one place may depend on personal ties and tastes, not to mention the structure of a worker’s employment contract. Given the difficulty of assessing these factors on an individual basis, the role of exit is probably to set a general baseline for the need for charity. In a society where exit costs are high overall, such as one in which there are large disparities in locational rents, the case for all forms of charity is stronger, and society should be more generous with organizations seeking the subsidy. More homogenous societies, or those in which labor mobility is easy, might set the bar for obtaining a subsidy higher. The modern U.S. likely falls on the higher end of the exit cost spectrum for individuals, since we have dramatic differences in land values and a fairly sticky labor market.272 A more nuanced analysis of exit costs is possible to the extent that costs also correlate with other important factors, as I will now explain.

2. Broad-Based Services

Exit costs, together with several other points I have mentioned, suggest that the subsidy is more defensible when the good to be subsidized is delivered across a wide geographical area.

a. Vertical Competition

272 See Gruber & Madigan, supra note 192, at 87--88 (measuring barriers to job change in U.S.).
For one, wide distribution raises the possibility of vertical competition—that the charity will compete not only with local governments, but also the national government. Again, charities are especially vital when acting as a potential rival to the national government, because state and local governments cannot easily do so, and often lack incentives to deliver services that would benefit other, competing jurisdictions.

Subsidies are important in a vertical competition story because of the vast fiscal advantages of the national government. The federal government usually enjoys economies of scale and scope compared to charity, although large foundations can turn the tables, albeit only in those few policy areas where they can concentrate their time and resources.\textsuperscript{273} Governments can borrow, giving them huge flexibility in terms of liquidity, responding to urgent needs, and spreading the costs of a long-lasting capital project across the lifetime of the project.\textsuperscript{274} Charities, too, can borrow, but those seeking to borrow in excess of the value of their assets can borrow against only the uncertainty of future donations or revenues, leading to higher borrowing costs than government.\textsuperscript{275}

b. Horizontal Competition

Broad-based services also strengthen the case for subsidy as a support for horizontal competition. Recall that crowd-out makes subsidies more appealing: when a donor must pay twice to get a higher-quality public good, she is rather less likely to do so, increasing the need for a subsidy.\textsuperscript{276} Donors who reside close together can vote or

\textsuperscript{273} See FLEISHMAN, supra note 305, at 3--11.
\textsuperscript{274} See Hansmann, Nonprofit Enterprise, supra note 2, at 894--95 (describing advantages of government financing).
\textsuperscript{275} See Hansmann, Nonprofit Enterprise, supra note 2, at 877; Norman I. Silber, Charitable Debt Calamity: How Nonprofits Fell Into the Auction-Rate Trap; and the Problems that Lie Ahead 6--13 (unpublished manuscript, Jan. 10, 2009) (on file with author) (arguing that bank lending to charities was based largely on expanding value of charitable real estate). Both charities and local governments can offer tax-exempt bonds. T.C. § 103.
\textsuperscript{276} See supra text accompanying notes 202--210.
lobby to eliminate the government-provided good entirely, and pay only once. As a result organizations funded by these donors are more likely inefficient, at least in the case in which there are negative externalities from production of the good that could be eliminated if the organization relocated. These donors may also be over-subsidized. A subsidy that is large enough to overcome free riding when the donor must pay for both charity and similar government service will be too large for other goods.

It is difficult to imagine an administrable system in which an organization’s eligibility depends on where its donors reside, but the nature of the good provided by the charity can be an effective proxy. Many public goods by their nature can only usefully be consumed locally.277 Think of trash collection, policing, fire prevention, and public parks. For these forms of services, at least, we can be fairly confident that the consumers are necessarily bunched closely together. Other services are inherently non-local, such as theoretical scientific research or endangered-species conservation; in all likelihood the funders of such goods are widely scattered and cannot effectively offset their charitable spending with reductions in local taxes. Yet other services are somewhere in between, combining local benefits with additional spillovers that diffuse more widely, such as churches, schools, and public health providers.278 Though there is probably no bright line, the horizontal-competition rationale for the deduction is weaker as services become more local by their nature.

Alternatively, the lack of crowd-out among some donors might be an argument not for elimination of the subsidy, but instead simply for multiple tiers of subsidy.

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Government could grant a lower subsidy to those who do not face double-payment, avoiding the over-subsidization problem. A lower subsidy amount also mitigates the distortionary impact of the subsidy.

c. Public vs. Private Goods

Finally, broad-based services bolster both the horizontal- and vertical-competition stories by making the good purchased look less like a private good. Geographic concentration can be a stand-in for production of mostly private goods, for which no subsidy is necessary. More precisely, a highly concentrated service resembles what economists would call a “club good,” which is a good whose benefits are shared among a finite group. Club groups often can overcome free riding problems, despite pooled benefits, because the small number of players allows for direct negotiations to overcome the free riding problem. Social pressure to pay one’s “fair share” is also a more powerful factor in small groups, especially those, such as a neighborhood, that allow for face-to-face interactions.

Thus, locally concentrated goods might not fully satisfy the threshold condition for subsidies: private market failure. It is likely that many localities would build parks with or without a subsidy, because of the disproportionate benefit that a park provides to its nearest neighbors. But, because of the free riding problem, it is very unlikely that a city would establish a nature preserve to protect an endangered chipmunk whose endearingly fuzzy existence is cherished mostly by conservationists around the world. Thus subsidies are more needed for the nationwide benefit of chipmunk conservation than for the local park.

279 Cornes & Sandler, supra note 277, at 33--34.
280 Lehavi, supra note , at 14.
281 Id. at 25--26, 34--48.
3. Redistribution

A final factor that weighs strongly in favor of a subsidy for a given organization is if its mission includes a significant amount of wealth redistribution. Race-to-the-bottom dynamics among sub-national jurisdictions tend to increase the cost and reduce the efficacy of both pure redistribution and redistributive regulation.\(^{282}\) That leaves a significant opportunity for charity to out-perform government. Note, though, that again highly geographically concentrated redistribution may be problematic, as it may contribute to off-setting redistribution upwards by local governments.

One other caveat to the redistribution factor is that it stands in some tension with the exit costs argument. As I have explained, local governments can redistribute more effectively when the amount of redistribution is less than payers’ exit cost. So as exit costs rise charitable redistribution’s comparative advantage diminishes. This conflict is not inevitable, though. Exit costs need not be uniform; individual donors could face high costs while regulated firms or other payers might be able to move fairly costlessly. In that situation the theoretical case for charity would be at its apex.

4. Objections to Weisbrod, Reconsidered

One additional benefit of these three factors is that they also defeat the objections--federalism, special-purpose governments, and public-choice theory---I raised earlier to the government-failure theories. Obviously, the factors are designed to account for federalism. The factors also favor situations that closely resemble the instances in which

\(^{282}\) See supra text accompanying notes 235--240.
special purpose governments will struggle: when benefits cover a wide geographic area, and when vertical competition is important.\textsuperscript{283}

The factors also diminish the bite of public choice theory, which might otherwise weigh against subsidies for higher-quality services. Because only high-demand consumers would be willing to create a second institution just to achieve higher quality, donors would be relatively unlikely to free ride. Unless one accepts my earlier suggestion that charity is generally more efficient than lobbying,\textsuperscript{284} this would imply that there should be no subsidy to encourage higher-quality public goods, since lobbying alone should suffice.

The public choice critique is weakened, though, when exit costs are high, benefits diffuse, and the good is redistributive. I have already explained the redistribution point: redistributive goods are more likely to generate concentrated and politically powerful opposition.\textsuperscript{285} I have also shown that consumers of geographically dispersed services have lesser political influence, because of the increased coordination costs of assembling and enforcing a coalition.\textsuperscript{286} High exit costs, too, reduce the power of lobbying, by diminishing the political influence of those who could otherwise have threatened exit.\textsuperscript{287}

I should also note that the addition of a comparative-advantage rationale does not undermine the government-failure justification for those narrow categories of charity that survived my earlier critique. The two can be cumulative. But there are few, if any,

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\begin{enumerate}
\item Special-purpose governments are an unpromising source of inter-governmental competition, because higher tiers of government often have both formal authority to limit special-purpose governments, and also informal fiscal and political tools for reigning them in. Ernest A. Young, \textit{The Rehnquist Court’s Two Federalisms}, 83 TEX. L. REV. 1, 74--75 (2004).
\item See supra text accompanying notes 93--98.
\item See supra text accompanying notes 90--93.
\item See supra text accompanying notes 208--210.
\item See Bratton & McCahery, supra note \textit{Error! Bookmark not defined.}, at 265 (explaining relationship between exit threats and voice).
\end{enumerate}
\end{footnotesize}
organizations that would be justified by government failure and not by comparative advantage, so I will omit a separate analysis of government failure going forward.

5. A Summary, and Two Examples

Taken together, the comparative-advantage rationale for charity suggests a fairly coherent legal ideal. As with any subsidy, would-be producers should first show that market production alone would be inadequate. The question then is whether the best corrective to the private market lies in government or in subsidized charity. Although no one factor seems dispositive, a charity can make its strongest argument when government is at its weakest --- as when there are high exit costs, few possible government competitors, or the good is redistributive --- or when charity’s potential downsides are mitigated, such as when the good is shared widely across many jurisdictions and negative externalities are minimal. Part V.B. details how this test could be administered. First, though, it may be helpful to have an example or two of what my proposed legal norm would look like in practice.

Let us reconsider, then, the case for a subsidy for educational institutions. Government failure did not provide a persuasive justification for subsidizing education, since consumers of education at any given institution receive a private good, implying a strong political constituency for funding their school. There is a robust local market for education. And schools create localized negative externalities by increasing noise and traffic and eliminating alternative uses for large land parcels.

In contrast, national universities can make a strong argument for subsidy as potential competitors for government. A school that draws its student body from across

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288 For example, all of the services with “strong” support under the government-failure rationale are nationwide, redistributive, or both. See supra tbl.2.
the country, and sends it alumni out across the globe, will tend to have donors who cannot easily offset their gifts with lower spending on their various state universities. This mitigates the waste of money given to inframarginal donors. The donors also could not easily band together to lobby for higher quality from any one State U.

The case is not as clear for some secondary schools and local community colleges. When parents and alumni are clustered closely together in a single political community, they are rather less likely to free ride, enabling those who choose private school to reduce public spending on schools. Those who seek to create public competitors to existing schools are also more likely to do so, as the charter-school movement suggests. On the other hand, these predictions may fail in larger or more diverse jurisdictions, such as states, rural counties, suburbs that welcome many new migrants, or large cities. Local private schools in those areas could plausibly argue that they offer needed competition that would not otherwise arise.

In either case, schools can strengthen their argument by also serving as agents for social justice. Education can be a powerful leveler, if it available to those of modest means. Thus, private schools offering need-based scholarships, or schools with modest tuition (such as most community colleges) could also make a strong argument for exemption regardless of their geographical focus.

In sum, these kinds of practical questions of politics and geography form the bedrock of my proposed standard. Admittedly, the test may turn on relatively nuanced

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289 University donors are overwhelmingly graduates of the school and/or parents of would-be students. R.G. Ehrenberg & C.L. Smith, The sources and uses of annual giving at selective private research universities and liberal arts colleges, 22 Econ. Educ. Rev. 223, 223--35 (2003).


291 See Richard Briffault, Our Localism, Part II: Localism and Legal Theory, 90 Colum. L. Rev. 346, 400-422 (1990) (contrasting these situations with dynamics in small suburbs).
facts. But to the extent this is a problem, it can be mitigated with a procedure that softens the need for most organizations to summon so much detail, as I will now explain.

**B. Establishing Charitable Status**

Although I have proposed a fairly detailed legal standard, it is possible to design the test for eligibility so that it would be mostly procedural, rather than substantive. The largest problems of the charitable sector derive from the weak incentives of organizations’ principals to account for negative externalities. The application process itself can shape these incentives, screening out many of the worst applicants. Many others---those within the core of the three factors I detailed---could be granted virtually automatic approval, leaving regulators to focus their resources on the relatively small number of borderline cases.

The first way for the application process to shape applicant incentives is if it establishes a “costly screen.”292 Costly screens are a regulatory sorting tool in which applicants for some benefit must incur a modest cost in order to qualify. The tool is most useful in situations in which the benefit-grantor would prefer to limit availability of the benefit to those who value it highly (for example, because it is costly to provide), but the grantor lacks full information about the applicant’s preferences.293 If the process of obtaining the benefit is costly in some way to the applicant, then only applicants who value the benefit at more than the cost of the screen will obtain it. Thus the screen obliges applicants to internalize some of the costs of providing the benefit and to reveal

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293 See Stephenson, supra note 292, at 9--14 (describing use of screen as solution to information asymmetry).
the strength of their preference. Ideally, the screen will have differentiated costs, so that those who value the benefit less will perceive the screen as more costly, but that is not always achievable.

The second way in which the process can shape incentives is by fostering internal deliberation. Scholars of administrative law have shown that when planners know that their decisions will be reviewed by someone who may disagree with their views, and the process of planning is costly, the planners have strong incentives to consider the views of the later reviewers. Thus, requirements to justify internal decisions to outsiders encourage insiders to take account of others’ views. And, as I have described, deliberative theory suggests that when this process has begun, it can genuinely open insiders to acceptance of opposing views. Just as agencies have become more democratic and deliberative as a result of the need to survive review by potentially disagreeable judges, so, too, might charities become less insular and less subject to confirmation bias and groupthink.

Putting these two design features together, would-be charities could be obliged to explain why their organization deserves a subsidy, taking into account opportunity costs, moral hazard, and other possible harms to others. Treasury officials would be empowered to consider these arguments and reject the application of organizations that

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294 Id. at 15.
295 That is, because the screen imposes some deadweight loss even on those whom the government wishes to obtain the benefit, Stephenson, supra note 292, at 22--23, it would be preferable to be able to differentiate the degree of effort required of different applicants.
296 Seidenfeld, supra note 168, at 524.
297 See supra text accompanying notes 132--142.
298 One design question I take no firm position on is whether a would-be charity need consider purely ideological, or even racist, objections. My tentative view is that it should not: if one goal of charity is to foster heterodox views, the mere unpopularity of the organization’s views should not be a strike against it. See Weeks McCormack, supra note 64, at 37, 47, 60--61 (arguing that displeasure of racists and majority groups should not be a reason to reject charity). But, admittedly, the line between ideological and other objections is likely hard to draw.
lack merit, albeit while subject to careful oversight by layers of administrative and judicial review. At least in difficult or borderline cases, outsiders would also be welcome to comment on the officials’ own deliberations. Treasury would apply a sliding scale of scrutiny, with organizations that meet most of the key factors I’ve outlined able to obtain approval with cursory explanation and little scrutiny, while others that appear to offer minimal benefits, produce mostly private goods, or create serious negative externalities would have a significant burden to explain why they are deserving of subsidy.\(^{299}\) Periodic re-certification might ensure that organizations do not get slack after approval.

In this way, charitable governance could be opened to outside views and influences, with concomitant benefits to the quality of their deliberations. And the weaker the benefits the charity would offer, or the larger its harms, the heavier the burden of explanation, and so the higher the costs of application for entrepreneurs (and the supporters who must pay them).\(^{300}\) In all likelihood, many organizations with dubious benefits would not bother to apply at all.

The procedure would likely need at least two important exceptions. First, small charities for whom the application or recertification process would be a major administrative burden could be exempted. In their case, the costly screen is too costly, since it would eat up a disproportionate share of organizational resources, and the cost to society of granting eligibility is small in any event. Additionally, to preserve charity’s

\(^{299}\) Organizations carrying out inherently nongovernmental activities, such as religious entities, would also probably be automatically exempt.

\(^{300}\) In this way, entrepreneurs whose enterprises would create large social value, but small private value for the entrepreneur, may still be willing to undergo the screening process. See \textit{Masur, supra} note 292, at 5 (noting that screening will fail to increase welfare if it there are significant numbers of applicants who would create large social value but assign low private value to applying).
flexibility in the face of sudden new needs, there could be an exception or expedited process for emergency responses, such as earthquake or tsunami relief. 301

One other important feature worth consideration is to make available multiple tiers of subsidy for applicants to choose from. For instance, there might be two or three sub-categories of section 501(c)(3), with contributions deductible at different multiples of the amount donated -- say, 50%, 100%, and 125%. 302 As noted earlier, a lower but non-zero subsidy may be the best solution to the problem that some but not all donors face double payment. Allowing a partial subsidy also gives Treasury officials an intermediate option if they find an organization has a plausible but not overwhelming case for subsidy; borderline organizations could re-apply for higher subsidies after they have built up a track record of service. Furthermore, putting aside the mechanics of the application process, having flexible subsidy amounts allows a more efficient rate of subsidization. Subsidies should be set at the amount that induces the optimal amount of charity, 303 but currently the size of subsidy depends almost entirely on the donor’s marginal tax rate, which has no obvious relation to optimal giving. 304 If Treasury can adjust the multiplier for each tier of subsidy, the subsidy rate can be decoupled from the marginal tax rate.

C. Dangers of Discretion?

I must acknowledge at this point that my suggestion of significant government scrutiny of the purposes of charities is contrary to the views of nearly every other commentator and of existing law. Pluralists, for instance, claim that allowing the

301 I note, however, that current law allows organizations to obtain 501(c)(3) status retroactively, which might make an emergency exception unnecessary. HOPKINS, supra note 271, at 855--56.
302 I am grateful to Kirk Stark for this suggestion.
304 Gergen, supra note 1, at 1402--03.
government to decide which charities may receive the subsidy would leave novel, unpopular, or minority viewpoints unfunded.  

Welfarists suggest that majority control would fail to reveal preferences of voters with supra-majority tastes for public goods.

Based on this logic, it could be further argued that government must grant the deduction equally to all charities that produce public goods, irrespective of their quality. It may be challenging to design a system capable of making fine distinctions between different organizational goals without permitting space for government judgment about the desirability of those goals. For instance, we may think that the comparative-advantage rationale for the deduction is persuasive for producers of opera but not rock music. But granting government the ability to choose which production companies receive the deduction raises the danger that head-banging aria haters at the IRS will do the opposite.

Current law appears to reflect this thinking. In deciding what is “charitable,” officials cannot deny an organization charitable status because they dislike its goals, but instead can determine only whether the entity performs a function that the for-profit market does not. For example, rules for distinguishing permissible “educational” activity from prohibited lobbying at least purport to test only how the organization

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306 Hall & Columbo, supra note 1, at 404; Pozen, supra note 1, at 558–59; cf. Schizer, supra note 14, at 38 (arguing that in this scenario, charities would be forced to lobby for benefits).

307 Atkinson, supra note 1, at 636–37; Perry Fleischer, supra note 26, at 23 (raising and responding to this argument); see Norman I. Silber, A Corporate Form of Freedom: The Emergence of the Nonprofit Sector 5, 48–81 (2001) (tracing history of judicial evaluation of charity, in effort to show that judicial decisions reflect judiciary’s policy preferences).

308 See Hopkins, supra note 271, at 158–63.
spreads its message, not the message’s content.\textsuperscript{309} While there is an exception to the
definition of charity for violations of “public policy,” the Supreme Court has interpreted
that exception to refer only to policies on which there is near-uniform social
agreement.\textsuperscript{310} Thus far, the only disqualifying policies that the Court has identified are
invidious racial discrimination and criminal enterprises; even charities that discriminate
based on gender remain in the clear.\textsuperscript{311} The Court has suggested that the reason the
public policy exception must remain narrow is because government officials cannot be
trusted to decide which charitable endeavors are good policy.\textsuperscript{312}

This vision of charity law fails, however, because concerns about government
bias are overblown. The harm of excluding the occasional borderline group does not
obviously outweigh the benefits of curtailing wasteful subsidies. Further, governmental
review improves, rather than threatening, charity. Excluding harmful and marginal
charities is likely to boost the willingness of the public and government officials to
support the sector. Approval by officials who are accountable to the public at large helps
to ensure that charitable goals are balanced against the possibility of externalities or
consumption of scarce resources that might be better devoted to other charities.
Surviving a formal review can also help the organization to cement its case to a skeptical
public. Plus, the need to justify charity to such officials may in itself lead to more

\textsuperscript{309} Id. at 261--67.
\textsuperscript{310} Bob Jones Univ. v. United States, 461 U.S. 574, 593--95 (1983).
\textsuperscript{311} David A. Brennen, The Power of the Treasury: Racial Discrimination, Public Policy, and “Charity” in
Contemporary Society, 33 U.C. DAVIS L. REV. 389, 391 n.2 (2000); Nicholas A. Mirkay, Is it Charitable to
\textsuperscript{312} Although the court is not explicit on this point, Justice Powell forcefully argued this position in his Bob
Jones concurrence, and the majority’s response was that public policy violations could be found only when
there was widespread social and political agreement. See Bob Jones, 461 U.S. at 593--98 & n.23; id. at
609--10 (Powell, J. concurring). For scholarly assertions of this point, see Buckles, supra note 311, at 457--
59; Daniel P. Tokaji, First Amendment Equal Protection: On Discretion, Inequality, and Participation,
discretion and potential for discriminatory application).
internal deliberation within the charitable organization about the place of its goals within the larger society. For instance, an organization that excludes women should be made to justify its decision against the expressive harms that even its private decision may have on others. And the very act of considering and offering an explanation that could be plausible to outsiders may begin to change the discriminatory attitudes of the organization’s members. 313

These forms of balancing by officials can themselves be subject to review in ways that limit the role of the officials’ subjective preferences. For instance, as I have mentioned, that is one goal of administrative law: to oblige the executive to justify its decisions based on public reasons, taking into account all reasonable competing viewpoints. 314 To be sure, the effectiveness of judicial or other forms of review depend on the reviewers. Administrators may blatantly discriminate against some charitable enterprises, and courts at times may let them. But stare decisis, and norms of duty to follow it, will help to constrain judges who might be tempted to give a pass to harsh administrative treatment of organizations which they themselves disapprove. 315 And an agency that is unable \textit{ex ante} to predict the attitudes of its reviewing judges, and is

\begin{footnotesize}
\begin{itemize}
\item[313] See Seidenfeld, \textit{supra} note 168, at 524.
\item[314] See \textit{supra} text accompanying notes 167--171.
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\end{footnotesize}
reluctant to waste resources on a decision that will be nullified on review, is more likely to act as though judges will hold them to the letter of their obligations.  

In any event, any politicization of charity would not doom unpopular projects. In fact, an extremist charity that fails to win a subsidy is still quite likely to continue its mission, precisely because of the extremity of its positions.  

Recall that distant outliers know that they cannot free ride on the efforts of others; thus, each member is likely to contribute, regardless of subsidy. Each member will lobby more vigorously for political approval. Even if approval is not forthcoming, the government’s refusal further marks the charity as outsider, confirming to its members their inability to rely on other contributors, and strengthening their own resolve to contribute.

On balance, then, it is both plausible and appropriate for the law of charity to distinguish between worthy and unworthy charities. Indeed, current law overstates the need to curtail official determinations of the merits of a charity’s goals. At a minimum, charities that outright discriminate against others should have to justify their exclusionary practices.

VI. Conclusion

I have offered here a new theoretical foundation for the law of charity, one in which charity steps in where government falters, offering competition when frictions reduce the pressure on governments to out-perform local or national rivals. Charity also can supply redistribution from or regulation of mobile taxpayers who otherwise could be

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317 Cf. Bruce A. Ackerman, Beyond Carolene Products, 98 HARV. L. REV. 713, 723--31 (1985) (making this argument as a reason to believe discrete and insular minorities may not require judicial protection).

318 Cf. id. at 730--31 (suggesting that societal prejudice may strengthen political activism of oppressed groups). This is not to deny that government disapprobation may carry a stigma that can both harm the members and, in the long run, undermine their cause.
targeted only at great expense to local jurisdictions. Both of these functions, however, bring with them some costs, such as the danger that charities will generate burdens for others, or allow residents to diminish the tax base for pursuit of their own private goals.

This new formulation of the rationale for charity implies a number of important policy recommendations, such as rules aimed at limiting the possible downside of charitable endeavors. Although it is too early for finely-grained details, I have offered the first draft of a new law of “charity” that attempts to sort more precisely welfare-increasing charities from those that harm others or waste shared resources. The hope is that the process of explaining their goals to outsiders will open charity to a more diverse set of views, and perhaps also educate the public of the unique contributions of each new proposal.

My argument also has implications for a number of secondary rules, such as the compensation and duties of officers in charitable organizations, the role of charity in politics, and the nature of the “public policy” exception to the definition of charity. First, in arguing that more demanding procedures are consistent with the diversity and independence of the charitable sector, I also have shown that current doctrine is likely too timid in dealing with charities that discriminate or otherwise violate “public policy.”

Next, my analysis bears on the controversial questions of political advocacy by charities, and the compensation of their executives. Most commentators have struggled to find any normative grounding for existing restrictions on lobbying and electioneering by charities.319 In my account, however, charity is explicitly justified as an alternative to government, so that allowing charitable dollars to be used for lobbying for government

319 See Johnny Rex Buckles, Does the Constitutional Norm of Separation of Church and State Justify the Denial of Tax Exemption to Churches that Engage in Partisan Political Speech?, 84 Ind. L.J. 447, 452--79 (2009).
services would defeat the whole point of the subsidy. Both these areas deserve more detailed attention, but space constrains me to defer that consideration to future work. Additionally, I have already explained elsewhere that the comparative-advantage rationale implies that for-profit charity, and existing Treasury regulations allowing non-profit executives to be paid compensation “comparable” to executives at equivalent for-profit firms, are wrongheaded and should be revised.320

Lastly, by drawing a more detailed map of the charitable sector, I also have located a place for government. Contrary to the suggestions of some of the privatization literature, government offers significant advantages over charity in many situations. And the ideal, it seems, is a combined system, in which neither wholly displaces the other from a given policy area, but mutual rivalry makes both more effective in their own sphere. I leave development of the implications of these claims for federalism and local government doctrine to future work.

[19,681] [29,994]

320 Treas. Reg. § 53.4958-4(b)(1)(ii); Galle, supra note 17, at 1218--33.