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M. Todd Henderson

Anup Malani

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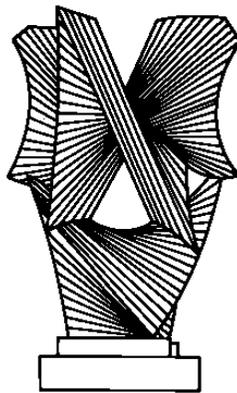
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Corporate Philanthropy and the Market for Altruism

M. Todd Henderson and Anup Malani

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Corporate Philanthropy and the Market for Altruism

M. Todd Henderson and Anup Malani*

Abstract

Academics and businesspeople have long debate the merits of corporate philanthropy. It is our contention that this debate is too narrowly focused on the role of corporations. There is a robust market for philanthropic works – which we call the market for altruism – in which non-profit organizations, the government, and for-profit corporations compete to do good works. We describe this market and the role corporations play in satisfying the demand for altruism. We conclude that corporations should only engage in philanthropy when they have a comparative advantage over non-profits and the government. Moreover, the government must avoid discriminating – particularly when setting tax policy – between non-profits and corporations that do good deeds.

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Introduction

Should corporations be permitted to engage in philanthropy, and, if so, should they do so? These questions have spawned a decades-long debate among academics and corporate executives. Milton Friedman fired the first salvo in 1972 with a New York Times Magazine article in which he asserted that corporations should only make money, distribute it to shareholders, and let them decide where to spend it.¹ Bill Gates joined the fray last year in his commencement address at Harvard University, when he argued corporate philanthropy (that is, doing things other than making the most money possible) is necessary to help those whom markets cannot help.² (For the record, courts side with Mr. Gates, though for less lofty reasons.³)

To answer the question whether corporations should engage in philanthropy, we must first understand why they do it. On this topic scholars have taken three sides. The first side argues corporate philanthropy is an example of managerial graft: executives spend corporate profits on their pet charities rather than returning that money to shareholders. Another side – led by Michael Porter of Harvard Business School – claims that philanthropy does not siphon profits, it begets them. The reason offered is philanthropy buys goodwill from consumers, employees, and regulators. (Both of these first two sides are consistent with Friedman’s normative view that corporate philanthropy is only appropriate if it increases shareholder wealth.) The final side – the so-called “corporate social responsibility” movement – believes corporations have a duty to do good for others, even if it comes at the expense of the bottom line.

All three sides in this debate miss the forest for the trees. To understand why *corporations* engage in philanthropy and to know whether they should, one must return to first principles and explain why *anyone* engages in philanthropy.⁴ The answer is altruism: people feel good when others’ lives are improved.⁵ Whether an individual donates money to help the a poor child in Africa or volunteers to mentor a troubled teen, the reason for the charitable action is the happiness (or, to an economist, the utility)

¹ Milton Friedman, “The Social Responsibility of Business is to Increase its Profits,” NY TIMES (MAGAZINE), Sept. 13, 1970.

² Gates’s speech is available at <http://www.gatesfoundation.org/MediaCenter/Speeches/Co-ChairSpeeches/BillgSpeeches/BGSpeechHarvard-070607.htm>. As it turns out, while this is a good reason for philanthropy, it is not a good reason for *corporate* philanthropy. Nor did Mr. Gates truly put his money where his mouth is. His main contributions to social causes are funneled through the Bill and Melinda Gates Foundation.

³ This is not exactly correct. As discussed below, state statutes specifically authorize corporate philanthropy and courts take a generally hands-off approach, but there are cases that purport to command a shareholder-wealth-maximization norm. *See, for example*, Dodge v. Ford Motor Co., 204 Mich. 459 (1919). *Dodge*, however, does not create a substantive standard that is enforceable in court, but rather an aspirational goal for corporate directors. The business judgment rule, which applies to philanthropic decisions just like any other corporate decision, insulates firms from judicial review of decisions that allegedly do not maximize shareholder value.

⁴ After all, the current debate the just begs the question why managers engage in altruism or why consumers, employers and regulators offer good-will in exchange for it.

⁵ Altruism is well documented, but explanations for its origins are debated. *See, for example*, H.A. Simon, A Mechanism for Social Selection and Successful Altruism, 250 SCIENCE 1665 (1990); R.L. Trivers, The Evolution of Reciprocal Altruism, 46 QUARTER. REV. BIO. 35 (1971). This debate is beyond the scope of this essay. We take it as non-controversial that some individuals are altruistic.

that the individual draws from knowing someone has been helped along.⁶ With total charitable activity (money, in-kind, and volunteer donations) totaling nearly \$1 trillion in the United States last year, the demand for altruism is obvious.⁷

Knowing that individuals demand altruism or charitable utility, we then must ask how individuals satisfy this demand. At a basic level, altruism is like anything in the economy that individuals demand; they can produce it themselves or use an intermediary to deliver it.⁸ Putting self-production to the side for now,⁹ the typical individual satisfies the demand by donating time or money to non-profit organizations. One can, for example, volunteer at a soup kitchen or donate money to the Red Cross. A second approach is to pay taxes so that the government can help the downtrodden with programs like Medicaid and public housing.¹⁰

For-profit corporations can also deliver altruism to individuals, and their role in doing this has increased dramatically in the past few years.¹¹ The conventional, narrow definition of corporate philanthropy is the donation of cash by corporations to non-profit organizations, which then in turn are used to help others. Here firms are acting as aggregators and second-order intermediaries between individuals (that is, shareholders) and non-profit charities. As discussed below, this is the least compelling, and the smallest component of how we define “corporate philanthropy.” We use a broader definition that includes any activity by corporations that helps others without regard to the bottom line, what we call “corporate social action.” Corporations do not merely channel funds to non-profits, but do many things to help others at the expense of corporate profits.¹² Firms now produce so-called green goods, voluntarily reduce environmental emissions, and directly help provide medicines to uninsured. To see why these are charity, consider corporate commitments to reduce carbon dioxide emissions, which are estimated to cost firms tens of billions of dollars per year. Since there is currently no law or regulation requiring these reductions, there is simply no difference between a firm donating \$100 to an environmental charity and a firm spending \$100 to voluntarily reduce carbon dioxide emissions; both reduce the firm’s profit by \$100 with the goal of improving social welfare.¹³ We outline these works and their scope in the

⁶ There are actually two separate altruistic motivations that we define and unpack a bit more below. Economists call the two possible motives pure altruism and warm glow. “Pure altruism” is a desire that other people’s lives be improved, whether or not one contributes to that improvement. “Warm glow” is a desire actually to contribute to that improvement. Together economists call these preferences, “impure altruism.” For simplicity we will call them altruism.

⁷ See Appendix for specific estimates of charitable contributions.

⁸ Food is an obvious example. Individuals can grow their own, but most rely on specialization to deliver food at lower prices and with less effort than self-production would require. The same arguments can be applied to altruism.

⁹ There are no good estimates of the amount of good individuals do for others without using an intermediary, so our discussion of the market for altruism ignores self production in the same way that measures of the size of the economy and competition within it ignores individual self production of goods and services.

¹⁰ Although taxes are mandatory, individuals can engage in various levels of compliance and tax avoidance, and can, of course, politically support higher or lower tax burdens.

¹¹ See Appendix for a discussion and rough sizing of the relative market share of the various altruism intermediaries.

¹² It even includes payment of corporate taxes that support good works by the government, though that behavior cannot be deemed voluntary.

¹³ This may not be literally true, in that there are numerous benefits to managers, shareholders, customers, employees, and other individuals that must be added up on both sides to determine the true

Appendix A, showing that they equal the amount of good works done by non-profits. To ignore these activities is to ignore the full scope of a corporation's charitable work.

Although there should be nothing troubling about firms delivering a new product, corporate delivery of altruism is controversial because of how corporations "sell" altruism. We can see this by comparing the sale of altruism with how firms sell regular products, like toothpaste or iPods. Ordinarily, corporations obtain financing from shareholders, use it to purchase labor from employees, who in turn manufacture products that are sold to consumers. At the end of the day, consumers obtain a product in return for their payment, employees receive a wage for their labor, and shareholders get back a financial return on their investment. The production of altruism adds a layer of complexity to this process. When the corporation engages in philanthropy, this may satisfy the altruism demand of shareholders, employees, and consumers alike; every corporate stakeholder may feel good knowing that the firm is helping others. All three parties also pay: consumers may pay more for the corporation's products, employees may take a lower wage to work for the corporation, and shareholders may accept a lower return on their investment. In other words, whereas only consumers benefit from and pay for ordinary goods, all stakeholders benefit from and pay for altruism. It is precisely this contortion of the usual producer-consumer relationship that makes corporate philanthropy controversial.

If non-profits and the government already help others, and corporate giving is so contentious, why do people seek altruism from corporations? An advantage that corporations have over non-profits is that their ordinary profit-making activities sometimes give corporations an edge at helping the less fortunate. For example, Starbucks' procurement of coffee beans puts them in a great position to identify and encourage productive small farmers in the developing world. Starbucks can offer its coffee consumers the ability to help these farmers by purchasing fair trade coffee. Economists call this "economies of scope," and it is something corporations likely have that most non-profits do not.

An advantage corporations have over the government is that different corporations can offer different types of altruism to different people. Those who like the environment can deal with Patagonia, which has pledged about one percent of profits to environmental causes, while those who are concerned about poverty in developing countries can engage with Google, which has made a similar pledge for this cause. The government by contrast is limited by the political compromises of the entire electorate.

Whatever the reasons behind the rise of corporate philanthropy, its presence highlights that people "purchase" altruism like they do other goods. Unlike automobiles, accounting services, or cell phones, however, three types of organizations—non-profits, the government, and for-profit corporations—provide individuals opportunities to buy altruism. Each competes on price and quality to sell altruism to consumers, just as corporations compete when selling other goods. We call this dynamic the "market for

social value of these options. For example, reducing carbon dioxide emissions may preempt more costly regulatory intervention, and thus reduce the firm's ongoing expenses, while donations to charity may be more conspicuous and generate goodwill for the firm, which also may reduce future costs or increase future revenues. If such overcompliance is intended merely to forestall government regulation, then it more like government social work outsourced to corporations. If, however, it is overcompliance to engender the goodwill of private stakeholders, then it is no different than donations to a non-profit or direct social action.

altruism,” since there is competition for altruism dollars just as there is for all other goods and services in the economy.¹⁴

This recharacterization and framework helps us answer the two questions that drive the debate over corporate philanthropy. First, a corporation should only engage in philanthropy when it is efficient for it to do so, that is, when it has a comparative advantage over other corporations and, importantly, non-profit organizations and the government.¹⁵ When a corporation is acting merely as a pass through—simply donating corporate profits to non-profits—it must justify why it should not step out of the way and let shareholders make these donations directly.

Second, the government should not prohibit or discourage corporate philanthropy in general, since firms are important and often efficient providers of altruism. We show below that for-profit firms help complete the market for altruism by offering individuals who would not otherwise be able to satisfy their altruistic preferences an opportunity to do so. For a well-functioning market, however, the government must do more than this – it must be careful not to discriminate without good reason among various providers of altruism. One source of discrimination is government favoritism of itself. The government is, unusually,¹⁶ a competitor in the market for altruism, and because it can compel individuals to purchase altruism from it through taxes, it may favor itself at the expense of charities or firms wanting to help others. This potential for crowd out of potentially efficient providers of altruism is real and should be resisted, but it is not the most serious concern.

The government also writes the rules for philanthropy, largely through tax benefits for certain types of philanthropy, and it may discriminate in an inefficient manner here too. For example, a taxpayer that itemizes her deductions can deduct a charitable contribution to a non-profit from her taxable income, but she cannot deduct a charitable purchase from a for-profit corporation. This discrimination is just as bad for competition – and consumers – as if the government favored General Motors over Ford in the market for cars. If the tax rules are not tailored to reflect the relative merits of the different delivery mechanisms or providers, consumers would not choose the product that is best for them, but rather the product that is favored by the government. The recipients of altruism may also be hurt, since they would get less or lower quality aid than if the tax rules were nondiscriminatory.

Our bottom line is simple: companies exist to deliver value to employees, customers, and investors, and firms are providing these stakeholders increasing opportunities to satisfy their demand for altruism as a component of this value. Asking why firms produce altruism is like asking why Toyota produces the Camry or Apple produces the iPod Nano. The answer is because there is consumer demand for it and the company is able to produce it at competitive cost. Government, which is both a competitor and rule setter in this market for altruism, is acting inefficiently along several dimensions, and reforms are needed to level the playing field in the market so that altruism is delivered efficiently to individuals demanding it and those who benefit

¹⁴ We discuss some elements of this market competition in detail below. It is important to note here that this “market” is not exactly like the market for automobiles or accounting services. We explore these differences below.

¹⁵ See section IV.

¹⁶ Non-profits and the government compete in the market for education and all three occasionally compete in the market for health and health insurance.

from it. To make our argument, the rest of this essay proceeds as follows: Section I reviews the existing debate over the merits of corporation philanthropy, asking why corporations engage in philanthropy and whether they should. Section II presents the foundation of our theory of corporate philanthropy. It describes why people demand charitable works and how corporations provide them. Section III considers the roles of non-profits and the government as the traditional suppliers of altruism. Section IV then examines corporate philanthropy, showing how firms may have a comparative advantage over non-profits and the government at delivering altruism in certain circumstances. With the importance of corporate philanthropy in the market for altruism established, section V shows how government discrimination in the market for altruism – in favor of itself and of certain types of giving – is inefficient and needs to be reformed to ensure altruism is delivered in an efficient manner.

I. The Existing Debate

The bulk of the academic literature on corporate philanthropy tackles the question why corporations engage in philanthropy. One's answer to this question is a good predictor of one's answer to question that occupies public discourse, should corporations engage in philanthropy. We review the sides in this debate to set the stage for our theory of philanthropy.

A. Why Do Corporations Engage in Philanthropy?

Prominent scholars such as Michael Porter argue that philanthropy helps the bottom line and can be a source of competitive advantage.¹⁷ Numerous studies claim to support the link between giving and profit.¹⁸ The mechanism is generating good feelings from customers, suppliers, or employees;¹⁹ reducing turnover of employees;²⁰ or decreasing the risk of government or activist action.²¹ Whether the source of the goodwill and increased profits is the advertising benefits of doing good or something else is beside

¹⁷ Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV. 58 (Dec. 2002) (arguing that “social and economic goals are not inherently conflicting but integrally connected.”).

¹⁸ See Madhu Khanna & Lisa A. Damon, *EPA's Voluntary 33/50 Program: Impact on Toxic Releases and Economic Performance of Firms*, 37 J. ENV. ECON. & MANAGE 1, 14 (1999) (donating to charity leads to greater returns on capital); see also, Seema Arora & Shubhashis Gangopadhyay, *Toward a Theoretical Model of Voluntary Overcompliance*, 28 J. ECON. BEHAVIOR & ORG. 289, 305 (1995); L. S. Moir & R.J. Taffler, *Does Corporate Philanthropy Exist?*, 54 J. BUS. ETHICS 149, 156 (2004) (analyzing gifts to the arts by 60 firms, and finding that were justified almost entirely by profit maximization).

¹⁹ Lisa Atkinson & Joseph Galaskiewicz, *Stock Ownership and Company Contributions to Charity*, 33 ADMIN. SCI. QUART. 82, 100 (1988) (describing how good feelings of customers, suppliers, and employees leads to greater brand value).

²⁰ Daniel W. Greening & Daniel B. Turban, *Corporate Social Performance as a Competitive Advantage in Attracting a Quality Workforce*, 39 BUS. & SOCIETY 254, 261 (2000) (finding that corporate giving reduces employee turnover); see also Jeanne M. Logsdon, et al., *Corporate Philanthropy: Strategic Responses to the Firm's Stakeholders*, 19 NONPROFIT & VOLUNTARY SECTOR QUART. 93, 104 (1990) (same).

²¹ David P. Baron, *Private Politics, Corporate Social Responsibility, and Integrated Strategy*, 10 J. ECON. & MANAGEMENT STRATEGY 7, 18 (2001) (finding that giving reduces risks of government or activist action).

the point.²² All that matters is that the firm is actually doing some public good and that the act of doing this helps not only strangers to the firm but also its shareholders.²³ Even Milton Friedman, who famously claimed that the “only . . . responsibility of business [is] to use its resources and engage in activities designed to increase its profits,” acknowledged that corporate philanthropy may be justified when it is necessary to maximize long-run profits.²⁴

Other scholars argue that philanthropy is simply managerial graft, and in this way no different than a CEO using a fancy corporate jet.²⁵ Managers are spending other people’s money, and, because monitoring by shareholders is imperfect, managers will do so in ways that maximize their own utility not that of the shareholders. Numerous studies claim to support this view.²⁶ The agency-costs account is supported by the fact that the law does not require corporate gifts to charity be disclosed to shareholders and that many firms do not do so.²⁷ Proponents of this view call into question the causal connection between donations and profits relied on by the opposing camp. They argue that profits, or their expectation, may allow corporations to be more generous thus explaining the observed correlation between corporate success and philanthropy.

The empirical research is not conclusive, but suggests that corporate philanthropy reflects a blend of these motives. Even studies finding evidence consistent with profit-

²² Peter Navarro, *Why Do Corporations Give to Charity?*, 61 J. BUS. 65, 73 (1988) (concluding that corporate contributions represent a form of advertising, as firms that spend more on advertising also tend to give more to charity).

²³ Indeed, Einer Elhauge has suggested that shareholders may draw non-financial utility from corporate social actions even if they lower corporate profits. See Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005).

²⁴ Milton Friedman, “The Social Responsibility of Business is to Increase its Profits,” NY TIMES (MAGAZINE), Sept. 13, 1970.

²⁵ See, for example, F.S. Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 586 (1997). See also J. Boatsman & S. Gupta, Taxes and corporate charity: empirical evidence from micro-level panel data 49 National Tax J. 193, 200 (1996) (examining changes in firm contributions in response to a change in marginal tax rates and concluding that charitable contributions go beyond what would be profit maximizing); James R. Boatsman & Sanjay Gupta, Taxes and Corporate Charity: Empirical Evidence from Micro-Level Panel Data, 49 NAT’L TAX J. 193 (1996) (data on corporate philanthropy consistent with managers’ utility maximization rather than profit maximization); Bill Shaw & Frederick R. Post, *A Moral Basis for Corporate Philanthropy*, 12 J. BUS. ETHICS 745, 747-48 (1993) (concluding that the empirical evidence suggests that corporate giving is primarily motivated by citizenship interests); Jayne W. Barnard, *Corporate Philanthropy, Executives’ Pet Charities and the Agency Problem*, 41 N.Y.L. SCH. L. REV. 1147 (1997) (disregarding any profit or tax motives, and imputing much of donation to the personal (largely selfish) motives of CEOs); Jill E. Fisch, *Corporate Philanthropy from the Perspective of Corporate and Securities Law*, 41 N.Y.L. SCH. L. REV. 1091 (1997) (concluding that corporate giving is motivated by management self-interest because studies that fail to find a link between giving and profitability).

²⁶ See Eric Helland & Janet Kiholm, “Corporate Philanthropy,” Working Paper, available at <http://ssrn.com/abstract=472161>. See also L. Atkinson & J. Galaskiewicz, *Stock ownership and company contributions to charity*, 33 ADMIN. SCI. QUART. 82 (1988) (finding that among about 70 public firms in Minneapolis, companies with a higher percentage of ownership by the CEO or with a large blockholder give less to charity); Bruce Seifert, et. al, *Having, Giving, and Getting: Slack Resources, Corporate Philanthropy, and Firm Financial Performance*, 43 BUS. & SOCIETY, 135, 143 (2004) (finding that generous firms have much higher free cash flow at the discretion of managers).

²⁷ For example, the New York Stock Exchange lists charitable organizations as relevant in determining the independence of directors, see NYSE Listed Company Manual Section 303A(b)(2)(V), and requires firms to adopt governance guidelines including, *inter alia*, consideration of payments made to charities affiliated with directors, see *id.* at Section 303A(b)(9).

maximizing motives,²⁸ also find companies with lower agency costs—greater monitoring by creditors, more independent boards, less free cash available to managers—gave less to charity than other firms.²⁹ We think these studies fairly capture reality: both positive theories are more or less true and will be present at various levels in most cases.³⁰ Just a CEO’s decision about the use of a corporate jet may be motivated by both personal and shareholder concerns, it would be surprising if decisions about doing good for others were not mostly based on mixed motives.

In light of the inevitable mixed motives and the inability of courts *ex post* to distinguish between “good” and “bad” philanthropy made by firms *ex ante*, the law takes a very agnostic view. This was not always the case. Prior to 1960, donations to charity were considered beyond the power of the firm.³¹ But how is a court to determine whether a donation to Princeton University or a commitment to pay higher wages to autoworkers or a decision to not install lights at Wrigley Field is a profit maximizing decision or a charitable one?³² After all, a decision to refrain from polluting beyond that required by law is as much charity as a gift to the opera, and if courts are in the business of making these distinctions, regulatory laws become not only minimums but maximums. In this way, the law’s permissive attitude toward corporations doing good (in all forms) is an inevitable result of the business judgment rule—courts stay out of the business of second-guessing business decisions in an attempt to minimize the sum of decision costs and error costs, and the decision to act charitably, whether it is by donating money or not acting badly, is a quintessential business decision.³³

B. Should Corporations Engage in Philanthropy?

It should not be surprising that scholars who believe that corporate philanthropy helps the bottom line support it and scholars who believe corporate philanthropy is an example of managerial graft oppose it. The common goal in both camps is the promotion of shareholder interests.

²⁸ See Helland & Kiholm, “Corporate Philanthropy,” at 23, *supra* note _____. See also Theodore Eisenberg, et. al, *Larger board size and decreasing firm value in small firms*, 48 J. FIN. ECON. 35, 41 (1998).

²⁹ See *supra* note _____. Other evidence, like larger relative giving by firms in regulated industries, conceivably cuts both ways: regulated firms may be giving to build goodwill with regulators (and thereby reduce regulation and increase profits) or may simply face less competition and therefore have greater managerial discretion over cash flows. See *id.*

³⁰ See Peter Navarro, “Why Do Corporations Give to Charity?” 61 J. BUS. 65 (1988) (arguing that profit maximization and agency cost explanations are not mutually exclusive).

³¹ See F.S. Kahn, *Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 582 note 7 (1997).

³² See *AP Smith Mfg. Co. v. Barlow*, 13 NJ 145, 98 A.2d 581 (NJ1953) (holding that gift from plumbing supply company to Princeton justified as reasonable and calculated to benefit shareholders); *Dodge v. Ford Motor Co.*, 204 Mich. 459 (1919) (holding that increase in wages for workers—Ford’s famous \$5-dollar day—was not impermissible charitable donation); *Shlensky v. Wrigley*, 95 Ill. App. 2d 173 (1968) (holding that decision to not install lights at Wrigley Field to benefit baseball and the local neighborhood was permissible exercise of business judgment).

³³ Today, nearly all state corporate law statutes specifically authorize boards “to make donations for the public welfare or for charitable, scientific or educational purposes.” See, for example, D.G.C.L. section 122(9). This protects specific donations; corporate activities that improve social welfare, like the overcompliance with environmental laws, are protected under the business judgment rule.

There is, however, a third camp in the normative debate over whether corporations should engage in philanthropy. Comprised mainly of progressive academics, this camp champions the cause of “corporate social responsibility.” Their argument is founded on either a moral claim (firms have an abstract moral duty to do good) or a historical one (firms are licensed by the State, and therefore must serve it). Whatever the case, they assert that managers have an obligation to focus on more than profits, the more being some unspecified amalgamation of the interests of employees, communities, governments, and other “stakeholders”.³⁴ Although undoubtedly opposed to managerial graft, the proponents of corporate social responsibility may simply view this as a cost that is exceeded by the benefits of corporate philanthropy. They do not care about the impact on corporate profits.

Milton Friedman summarizes the opposing view:

If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest? Is it tolerable that these public functions of taxation, expenditure, and control be exercised by the people who happen at the moment to be in charge of particular enterprises, chosen for those posts by strictly private groups?³⁵

Friedman’s criticism is basically that one needs an underlying theory of political philosophy to make sense of the call for, in the abstract, greater corporate contribution to the public good.³⁶ Managers installed by shareholders to make money for shareholders are poorly positioned to know what the public good is or to know how best to deliver it.

While we agree with the critics of the corporate social responsibility movement that firms should give shareholders and customers only what they want, we believe that this demand increasingly is for corporate social action designed to make the world a better place. In other words, while Friedman believes shareholders care about only profits, we believe they increasingly care about utility, which is the sum of financial returns and the good feeling that comes with knowing their investments are doing good for others. (Evidence that shareholders care about utility, not just money, is evidenced by the rise of the socially responsible investing, which we describe below.) The practical result of our view may not be that different from what the corporate social responsibility movement desires, but will be more focused on the efficiency of altruism delivery as opposed to imposing it on every firm. We will take this as license to focus our attention on whether philanthropy promotes the corporate rather than social interest. Since this boils down to why corporations engage in philanthropy, we now offer our own answer to this question.

³⁴ See, e.g., John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 2 (2005).

³⁵ FRIEDMAN, *supra* note 1 at 133-34.

³⁶ See David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 2 (1979).

II. The Demand for Altruism

Existing explanations for why corporations engage in philanthropy all pass the buck. Proponents of corporate philanthropy argue that it engenders goodwill from shareholders, employees, consumers or regulators. (In doing so philanthropy lowers the corporation's costs or raises the price it can charge.) But this just raises the question: why does philanthropy engender the goodwill of these other parties? Opponents of corporate philanthropy make the same error. They assert that philanthropy is an example of managers wasting shareholder money on their pet charities. But why do managers spend it on charity rather than, say, a bigger office or more lavish corporate parties?

It is our contention that to understand why *corporations* engage in philanthropy, we need a theory for why *anyone* – from shareholders to consumers to regulators – engages in philanthropy. Our answer starts with the premise that at least some people feel better when they help others.³⁷ This pleasure may derive from being the giver or from knowing that someone received a gift. In economic terms, utility derived from giving is called “warm glow,” and the utility derived when someone's welfare is improved is called “pure altruism.”³⁸ Philanthropy exists because individuals have preferences for altruism and philanthropic organizations are simply third parties that offer individuals the opportunity to satisfy these preferences in an efficient manner (relative to self production).

We show below that firm stakeholders (employees, customers, investors, etc.) get utility from firm actions designed to help others at the expense of wages, product value, or profits. For example, employees may accept lower wages, customers may pay more for the same product if bundled with altruism, and investors may accept lower returns.³⁹ Whether this utility is “warm glow” or “pure altruism” is impossible to know and is largely irrelevant. Some stakeholders will do this because it makes them feel good that others are helped, some will do so because they like the way it makes them feel being associated with a firm that does good, and some will do so for a mix of these reasons. Whatever the case, the firm is simply delivering altruism to these individuals, just as if they got only money from the firm, and then made donations on their own.

Under this view, all that existing proponents of corporate philanthropy are saying is that corporation satisfy the altruistic demands of shareholders, employees, consumers and regulators when they engage in philanthropy. Likewise, opponents merely assert that managers use corporate assets to satisfy their own demand for altruism.⁴⁰

³⁷ We recognize this is a complex question, and that much ink has been spilled debating whether individuals are inherently selfish or altruistic, and, if the latter, what the evolutionary reason is for this. See, for example, H.A. Simon, *A Mechanism for Social Selection and Successful Altruism*, 250 SCIENCE 1665 (1990); R.L. Trivers, *The Evolution of Reciprocal Altruism*, 46 QUARTER. REV. BIO. 35 (1971). We don't weigh in on this debate, but rather simply look at the amount of charitable contributions and activities in the market—about \$1 trillion last year—as evidence of some individual preferences for altruism.

³⁸ Together these two types are called “impure altruism,” since the warm glow component is considered a selfish motive. For simplicity, we refer to the combination simply as “altruism.”

³⁹ We document evidence for these tradeoffs in the Appendix.

⁴⁰ Cynics will argue that managers are not truly altruistic. Rather they engage in corporate philanthropy only to bolster their own image in the community. But, again, this just begs the question:

Opponents would surely argue that our recharacterization does not fully capture their claim, which is that managers should not be allowed to use corporate assets for any purpose, including altruism. We will address this point when we describe how corporations produce altruism. The lesson of this section is that our simple claim about the demand for altruism captures both sides of the debate over corporate philanthropy.

There is the residual question of which side is correct: does corporate philanthropy serve shareholders, employees and consumers or it does it serve top managers? Our answer is “all of the above.” Some corporations – Occidental Petroleum⁴¹ comes to mind – may favor managers over other stakeholders. But others – such as Toyota with its hybrid cars or Target with its charitable contributions – probably favor consumers or employees over others. We do not believe all corporations are the same. Different corporations serve different consumer groups, even in the case of altruism. Nor do we believe that all corporations are behaving optimally. Some may be too generous to managers’ pet charities and others may be overinvested in green consumer products.

The only thing we resist is unconditional claims that corporations should always engage in philanthropy or always abstain from it. Just as with ordinary products, a better approach is a case-by-case analysis of when corporations should enter a specific altruistic market and when it should remain on the sidelines. A key step in this analysis is identifying its potential competitors. This is the topic to which we now turn.

III. The Supply of Altruism

Altruism is like anything else that individuals demand, it generates production by suppliers in a market. Viewed in this way, a non-profit charity soliciting donations to help victims of a hurricane is selling “altruism,” that is, satisfying some combination of donors’ desires to be involved in helping the victims and have the victims be helped. The same is true when the government collects taxes to pay for social programs and when for-profit firm takes actions that sacrifice profits in the public interest. In all these cases, individuals demand something, in this case utility from giving and doing good, and suppliers provide it for them.

There are of course important differences between the three producers of altruism. Non-profit organizations are – as their name suggests – prohibited from distributing profits to their stakeholders. They are also limited in the activities in which they can engage. In return for these restrictions, they are exempt from corporate income taxes.⁴² (Consumers who purchase altruism from non-profit organizations through donations of cash or assets are also given certain tax breaks, but we shall address that topic in Section V.)

Because the activities non-profits are permitted to do (those with “religious, charitable, scientific, testing for public safety, literary, or educational purposes”) overlap with much of the demand for altruism, non-profits are thought to be the primary

why does such philanthropy help the reputation of managers? The answer is that other members of the community value philanthropy and exchange their respect for philanthropy engineered by the manager.

⁴¹ Armand Hammer, the head of Occidental Petroleum, had the board donate one-third of the firm’s profits in one year to build a museum to house his personal art collection. *See Kahn v. Sullivan*, 594 A.2d 48 (Del. 1992) (finding no wrongdoing in the gift).

⁴² I.R.C. § 501(c)(3) (2000).

producer of altruism. Indeed, the conventional notion of corporate philanthropy – donations by corporations to non-profits – implicitly accepts the market dominance of non-profit organizations.

The second major producer of altruism is the government. It is unusual to find the government participating as a producer in any market, especially in America, where the public believes strongly in the primacy of private enterprise. The reason for the government participation in the market for altruism is that pure altruism – one of the two drivers of the demand for altruism – is a public good⁴³ and is therefore under-supplied in private markets.⁴⁴ Government actions that substitute for charitable endeavors can help solve the free-riding problem because the mandatory nature of charitable giving to the government (that is, taxes).

The free riding problem can be understood by recalling that “pure altruism” is one individual’s concern about the welfare of another. The purely altruistic individual experiences joy whenever his preferred beneficiary receives money, even if that money did not come from the pure altruist. All that matters is that the beneficiary’s welfare is improved. Ironically, this idyllic state of affairs leads to rational free riding by the pure altruist. If anyone’s contribution to the beneficiary confers joy upon the pure altruist, it is entirely rational for the pure altruist to wait for others to help the beneficiary and save his income for personal consumption. Since all rational pure altruists will behave this way, the beneficiary will lack for care and no pure altruist will be satisfied.⁴⁵

The usual solution to free riding problem is to make contributions to public goods mandatory. The government does this by imposing taxes and using the proceeds to produce public goods. This can explain a good portion of government production of altruism. If the government did not provide medical care to the indigent through Medicaid, it is very unlikely that the private sector would completely fill the gap. Even if one cared about the health of the poor, why donate money to the cause when someone else’s contribution provides the same altruistic satisfaction as your own? The government appreciates this and funds Medicaid via (mandatory) tax revenues.

Although government spending largely targets pure-altruism activities that are prone to free riding, the government still competes to some extent with the non-profit sector. For example, Arthur Brooks’s research on private charity finds that, after controlling for income, education, age, religion, gender, marital status, race, and political views, those in favor of government action to improve social welfare are 10 percentage points less likely to give to private charities than those who do not favor a

⁴³ A public good is one that is non-rival (one person’s consumption does not preclude another’s) and non-excludable (one person cannot stop another from consuming the product). See Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387 (1954).

⁴⁴ Implicit in this argument is that, while certain activities can satisfy both warm glow and purely altruistic preferences, they do not always do so. There may be some activities which are driven largely by warm glow and other that mainly satisfy purely altruistic preferences. Examples of the former are the construction of a fancy University building, which gives the donor warm glow but only marginally benefits students, or a personal act of kindness that is not revealed to and thus cannot confer purely altruistic benefit upon others. An example of the latter is an anonymous donation to pay for an especially sick child’s surgery. The limited cost of the surgery caps the number of people who can donate and obtain warm glow, while press coverage of the surgery permits the entire population to draw purely altruistic benefits from the child’s care.

⁴⁵ This is an obvious overstatement, but it is likely true on the margin, meaning there will be some rational free riding and thus less altruism than optimal.

government role. He concludes that “[p]eople who favor government income redistribution are significantly less likely to [give to charity] than those who do not.”⁴⁶ This is not a recent phenomenon. Jonathan Gruber’s research suggests that half of the nearly 30 percentage point drop in gifts to private charity during the Great Depression were the result of government extensions in serving the needy.⁴⁷ Economists call this “crowd out” since mandatory contributions reduce (or crowd out) voluntary contributions from other sources. There is less evidence as to the government’s ability to crowd out corporate philanthropy, but we offer some evidence below in support of this too. Interestingly, crowd-out in this market is a two way street. Because the government grants tax breaks for donations to non-profits and, in some cases, corporate philanthropy, patronage of these two sectors decreases taxes paid to the government. The result is a form a reverse crowd out.⁴⁸

The third competitor in the market for altruism is the for-profit corporation. In the next section, we describe how corporations produce altruism and explore the comparative advantage they have over their non-profit and government competitors.

IV. The Corporate Supply of Altruism

Corporate philanthropy has a rocky history. One of the most famous corporate law cases of all time involves a dispute about the alleged eleemosynary motives of Henry Ford in increasing wages to the famous \$5 day.⁴⁹ Ford’s plan was not really charity, but was motivated by purely business interests, namely to reduce chronic turnover in his factories.⁵⁰ Nevertheless, the Michigan courts interjected themselves to some degree, and established an aspirational standard of shareholder wealth maximization for corporate boards to follow, although not an enforceable legal standard.⁵¹ Modern courts and legislatures are more permissive, allowing or specifically authorizing corporate donations to charity. But the cases, statutes, and academic criticism focus largely on corporate donations to charities, as opposed to the good works that firms do themselves.

⁴⁶ ARTHUR C. BROOKS, WHO REALLY CARES? THE SURPRISING TRUTH ABOUT COMPASSIONATE CONSERVATISM, 55-57 (2006). See also J. Schiff, *Does Government Spending Crowd Out Charitable Contributions?*, 38 NATIONAL TAX J. 535, 540-41 (1985) (finding that states that increase spending on the needy see a reduction in charity).

⁴⁷ Jonathan Gruber & Daniel M. Hungerman, “Faith-Based Charity and Crowd-Out During the Great Depression,” Working Paper No. 1132, NBER 2005, <http://www.nber.org/papers/W11332>.

⁴⁸ There is an international component of this story too. While European and Asian governments contributed more in absolute dollars (and much more on a per GNP basis) than the American government to aid the victims of the 2004 tsunami (for example, Germany gave \$674 million and Japan gave \$500 million compared with only \$350 million from the U.S.), private contributions by Americans made up for the difference: “Americans donated more than \$1.5 billion in cash and gifts.” BROOKS, WHO REALLY CARES?, *supra* note ____ at 117. Extrapolating back to the homefront, this suggests a view of welfare that is the sum of public and private efforts, with the United States relying on a mix with a heavier weight of private efforts.

⁴⁹ See *Dodge v. Ford Motor Co.* 204 Mich. 459 (1919) (establishing a shareholder wealth maximization norm for corporate boards).

⁵⁰ See M. Todd Henderson, “The Story of *Dodge v. Ford Motor Company*,” in CORPORATE LAW STORIES, Mark Ramseyer, ed. (forthcoming 2009). The link between corporate charity for workers and the bottom line was also a key feature of company towns, which were ubiquitous for the five decades after the Civil War. See M. Todd Henderson, “The Nanny Corporation,” Univ. of Chicago Law School Working Paper (on file with author).

⁵¹ See *id.*

This latter type of philanthropy has grown dramatically over the past few decades, and a reconsideration of the manner in which it is delivered and why is both timely and important to getting the rules right. It is to these issues that we now turn.

A. How Corporations Produce Altruism

In Economics 101 students learn how corporations provide goods like toothpaste for consumers. Corporations use financial capital from shareholders and labor from employees to manufacture toothpaste and then sell that toothpaste for a price to consumers. The price that the consumer pays reimburses the shareholders for their capital and the employees for their labor. Shareholders and employees exchange capital and labor, respectively, in exchange for money. The consumer exchanges money for toothpaste. At the end of the day, only the consumer is left with a consumable good, which in this case satisfies a demand for clean teeth and fresh minty breath.

How corporations satisfy the demand for altruism is dramatically different. Shareholders may still provide investment capital, the employee may still provide labor, and the consumer may provide purchase money, but the corporation's good works may provide a consumable good for all three stakeholders. When Microsoft gives free computers to schools, all the stakeholders may be happier; workers and investors may benefit from participating in a firm that does good works. We offer empirical evidence for the willingness to trade cash (either in labor or investment income) for charitable utility in Appendix A.

Just as consumers are charged for toothpaste, shareholders may be asked to accept a lower return on their capital, employees may be asked to accept a lower wage per hour, and consumers – they just do as they did before – pay a purchase price, but in this case one that exceeds what they would otherwise pay. Since shareholders and employees are paying for (and receiving) some of the altruism the corporation produces, the consumer does not pay for (and receive) all the altruism the corporation produces.⁵²

The lesson is that, in the case of philanthropy, the clear lines between who does the producing and who does the consuming may be blurred. This blurring is controversial simply because it is non-traditional. Some people think that corporations harm shareholders when they engage in philanthropy; but they ignore that shareholders may also benefit from that philanthropy. The shareholders provide capital and get back both a financial returns and altruistic consumption. If the shareholders don't value the altruism, they can go invest in another corporation that only offers a financial return. Not surprisingly, we observe this segmentation of the market – some investors choose socially responsible investment funds, which necessarily earn a lower return and thus embed a charitable contribution in the investment, while others may go simply for the monetary return.⁵³

⁵² An interesting implication is that when a corporation produces altruism, it is behaving like a producer cooperative, albeit with specialized workers. There is a large economics literature that documents how cooperatives behave differently – and perhaps less efficiently – than shareholder-owned firms producing widget. *See, for example*, Philip K. Porter and Gerald W. Scully, *Economic Efficiency in Cooperatives*, 30 J. LAW & ECON. 491 (1987). What is less clear is whether this implies that corporations are more or less efficient than non-profits or the government at producing altruistic goods.

⁵³ *See* Appendix A for a discussion of the socially responsible investing phenomenon.

The following graphic illustrates the various players in the market for altruism and our estimates of the relative sizes of the mechanisms through which altruism is demanded and delivered. We derive the numbers referenced in Appendix A.

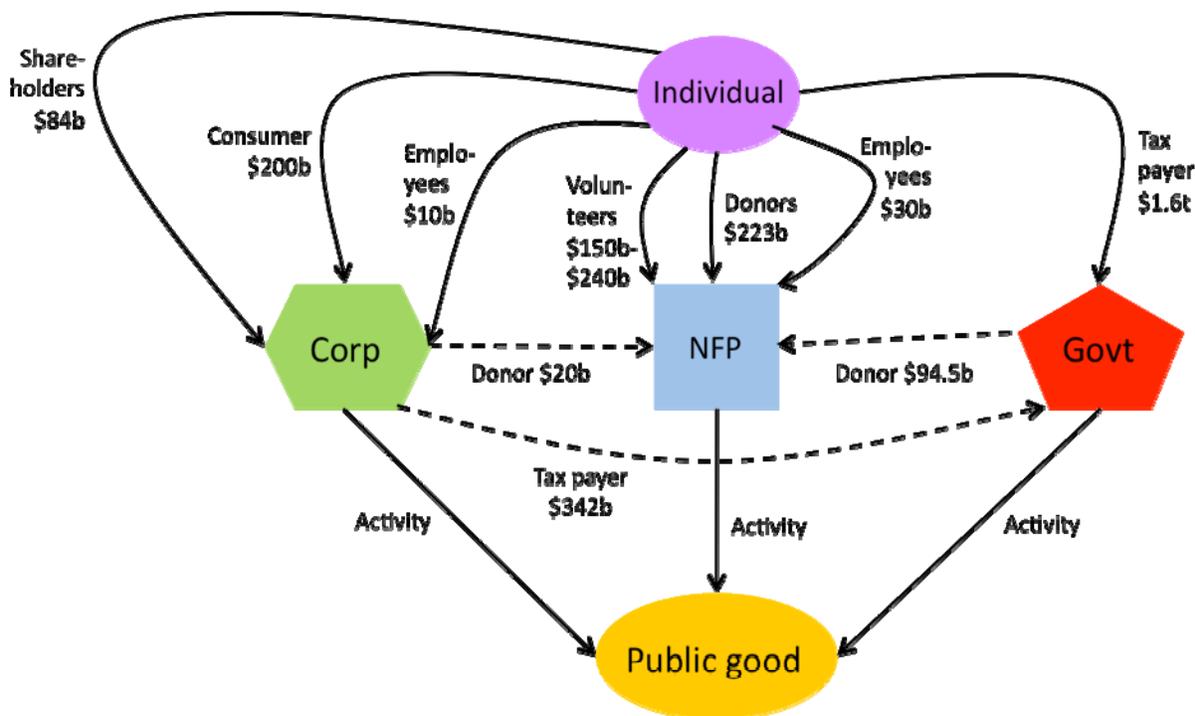


Figure 1. The Market for Altruism

B. The Comparative Advantage of Corporations

We have already explained why governments and non-profits participate in altruistic markets. What is less clear is why corporations do. Why don't they – as Milton Friedman once suggested – focus on turning profits off widgets? The reason is that corporations may have a comparative advantage over both non-profits and the government in producing certain altruistic goods, and therefore in satisfying the altruistic utility demand of corporate stakeholders.

1. Economies of Scope

One such advantage is that for-profit corporations may be more efficient at producing certain altruistic goods because of economies of scope between the private goods they typically produce and the altruistic good.⁵⁴ An obvious example is that Starbucks may be better at providing income support to Third World coffee farmers than non-profits or governments that simply donate cash to the same farmers.

⁵⁴ There are economies of scope between the production of two goods if the produce can lower its costs of producing one of the goods by also producing the other good. For example, goods A and B may each cost \$1 to produce separately, but cost \$0.75 each to produce together.

Starbucks pays fair trade prices (typically 75 percent above competitive prices) for farmers who produce coffee rather than simply transferring money to them. This encourages farmers to work in order to receive welfare; unconditional welfare might discourage work and encourage dependency.⁵⁵ What's more, Starbucks already has a distribution channel to farmers in place, meaning it can deliver social action at less cost than a provider that must make an investment in a redundant distribution network. Non-profits do not have such low-cost access to these farmers, nor does the government.

Another example of economies of scope is the monitoring of working conditions in factories in developing countries by clothing and footwear manufacturers. After negative press coverage of Nike's use of factories with unsafe conditions and employing children, consumers demanded better working conditions for workers in developing countries. The government or non-profits could have been used to satisfy this altruistic demand, but the most efficient mechanism for delivering this public good was through for-profit corporations. Nike created an internal department to monitor the health, safety, and environmental conditions in over 700 of its factories in 50 countries.⁵⁶ Nike is clearly the most efficient party to design, implement, and monitor higher standards for these nearly 600,000 workers, since it would be highly costly for a non-profit to put in place systems and monitors at all of these locations.⁵⁷

The production of hybrid cars by automobile companies is yet another example of economies of scope. Consumers are increasingly demanding a solution to the problem of climate change, and automakers are meeting this altruistic demand.⁵⁸ Hybrid cars can be thought of as simply a bundle of a fuel-efficient car and a donation to pay for research and development expenses on hybrid engines or to help the environment. (We know this because hybrids are more costly than equally fuel efficient gas-only cars. The only explanation for this additional payment—as opposed to a simple donation of the difference in price to an environmental charity—is that consumers are contributing to a public good, namely research on hybrids.⁵⁹) Clearly car manufacturers are in a better position than non-profits or the government to research hybrid engines, if for no other reason than that they need to merge those engines with the rest of the cars they produce.⁶⁰

⁵⁵ See, for example, LAWRENCE M. MEAD, *BEYOND ENTITLEMENT* (2001).

⁵⁶ See Dara O'Rourke, *Outsourcing Regulation: Analyzing Nongovernmental Systems of Labor Standards and Monitoring*, 31 *POLICY STUDIES J.* 10 (2003). Another example is Ikea, which monitors the use of child labor by suppliers of its rugs from India. See *id.*

⁵⁷ Michael Vandenbergh's important work on private provision of public goods is instructive here. See Vandenbergh, *The Private Life of Public Law*, 105 *COLUM. L. REV.* at 2035-36, *supra* note ____.

⁵⁸ The need for action by for-profit firms arises in part because the lack of a political solution to the problem. This is related to the problem discussed below about diversification. The point is simply that political consensus may be difficult to reach on certain issues, and firms can meet this demand more efficiently. See M. Todd Henderson, "The Nanny Corporation," Univ. of Chicago Law School Working Paper (on file with author).

⁵⁹ It is true that the federal government provides tax breaks to promote sales of hybrids. However, these breaks do not fully offset the additional cost of hybrids. For a list of tax breaks, see http://www.fueleconomy.gov/feg/tax_hybrid.shtml. Moreover, the tax breaks have expired for many cars, but demand has not. See *id.*

⁶⁰ This advantage comports well with an account of strategic corporate philanthropy made by Michael Porter and Mark Kramer. See Kramer & Porter, *supra* note ____ at 68 ("[T]he more closely a company's philanthropy is linked to its competitive context, the greater the company's contribution to society will be. Other areas, where the company neither creates added value nor derives benefit, should

Other examples are readily available, but we should not overstate the case. Corporate social action is not a perfect substitute for other types of charitable or governmental good works, but rather are complimentary and sometimes only moderately so. Corporate philanthropy will work better or worse at some times for some causes and by some firms. At other times it won't work well and may be a sign of managerial graft. Competition in product, labor, and capital markets should help sort these successes and failures in a fairly efficient manner.

2. Bundling to Reduce Free Riding

A second advantage that for-profit corporations have is that they may be better than non-profits – though not the government⁶¹ – at reducing free riding in the production of pure altruism. The reason is that corporations bundle private goods with altruistic public goods.⁶² Because of economies of scope between the two goods, their combination changes the relative prices of the public and private goods in ways that lead to a greater production of public goods than if the two goods were offered separately. Bundling will either (a) lower the relative price of the public good and make it more attractive for direct purchase, or (b) will make the private good more attractive and, because of the bundling, more of the public good will indirectly be purchased.

To see this, consider the corporate bundles we used above: Starbucks fair trade coffee bundles regular coffee with a transfer to Third World farmers; and Toyota's hybrids bundle a regular car with a contribution to the environment in the form of lower carbon dioxide emissions or research on fuel-efficient engines. The companies offer these bundles because it increases the total value of the sum of the two separate items above their value if sold separately. Consumers could purchase each component (coffee and monetary transfer to farmers; car and contribution to the environment) separately, but buy them together because there are economies of scope between bundled components.⁶³ This implies that, for the same amount of money, consumers can buy

appropriately be left – as Friedman asserts – to individual donors following their own charitable impulses.”).

⁶¹ Recall that the government solves free riding with mandatory contributions to altruistic public goods.

⁶² Another reason that corporations may be able to reduce free riding is, ironically, managerial graft. The main argument against corporate donations is that they are given by managers serving their own preferences (or reputation) rather than those of shareholders. But even purely altruistic shareholders have an incentive to free ride. So when a manager ignores shareholders' preferences, they also ignore the incentive to free ride. Thus managerial graft may, fortuitously, reduce free riding. There are two limits to this reasoning that keep us from including it in the main text. First, it requires managers to be motivated by warm glow (or reputation) while shareholders are motivated by pure altruism. Otherwise they too would simply free ride on others production of pure altruism. But why would managers have different preferences, especially since they too are shareholders in other companies? This disconnect is partly bridged by the fact that managers are spending shareholders' money and even pure altruists would buy a free public good. Yet all models of managerial wage under asymmetric information find that graft to some extent trades off with wage, that is, that higher opportunities for graft is a form of compensation that reduces wages. Therefore managers' donations are not entirely free. Second, manager's preference among charities might not match those of shareholders. For example, managers may like the local opera while shareholders like helping soup kitchens.

⁶³ This point is different than the first comparative advantage we have highlighted. The first was that corporations, because of economies of scope, may be able to produce the altruistic public good more

more of each component than they could if the components were not bundled. This in turn implies that the bundle changes the relative prices of the two components.

This change in prices or amounts is illustrated in Figure 2. Unbundled goods can be purchased at an exchange rate of q parts private good (x) for 1 part altruistic public good (y). Assuming the consumer's income M is 1, this relative price yields a linear budget constraint labeled C . So the consumer can buy $1/q$ units of the unbundled private good or 1 unit of the unbundled public good or some combination along C . We have drawn the consumer's indifference curve U so that she chooses combination x_c and y_c .

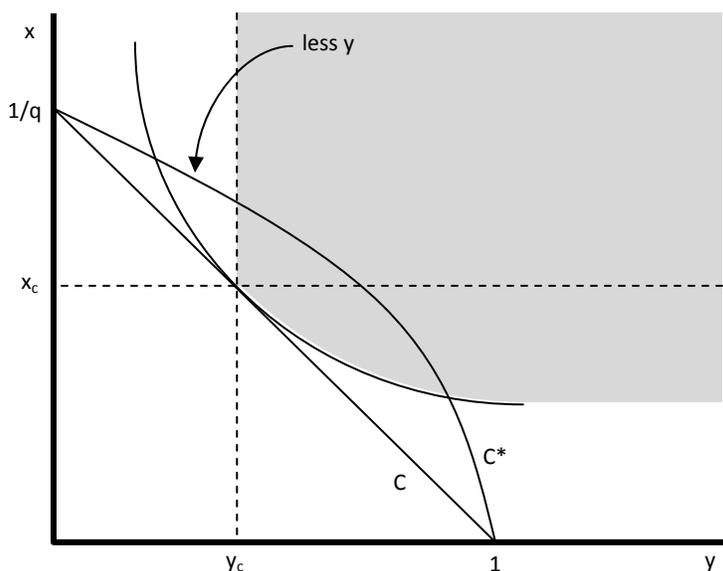


Figure 2. Effect of bundling on purchase of altruistic public good.

For bundling to be attractive, the budget constraint must expand to some C^* that lies to the right of C .⁶⁴ Any combination of private and public goods that is on C^* and to the right of the consumer's original indifference curve U will improve the consumer's utility. The consumer will abandon her original choice (x_c, y_c) only for one of these combinations. If the consumer's indifference curves are such that they touch C^* to the right of y_c , that is, in the shaded portion of Figure 2, the consumer will purchase more public good. If the consumer chooses a point on C^* where the slope of C^* is flatter than C , then the consumer's choice is driven a lower relative price of the public good, that is, the consumer is substituting from buying private good to buying the public good. If the consumer chooses a point on C^* where the slope of C^* is steeper than C , then the consumer is buying more of the private good, but getting more of the public good simply

efficiently, whether the demand for that good is driven by warm glow or pure altruism. The current point is that this joint efficiency helps reduce free riding when consumers are driven by pure altruism.

⁶⁴ We have arbitrarily drawn such a C^* . In contrast to our smooth and continuous depiction, C^* may be a single point or piecewise linear. This will not affect our conclusion.

because they are bundled. Either way more altruism is produced through bundling than could be produced by buying altruism alone.⁶⁵

The main lesson to take away from Figure 2 is that bundling—due to economies of scope—increases the purely altruistic consumer’s expenditure on the altruistic public good because it either reduces the relative price of that good or increases consumption of the private good, which fortuitously is bundled with the altruistic public good. Either way, the result is less free riding on other consumers’ contribution to that public good.⁶⁶

3. Diversification

A third advantage that corporations have is that they are able to narrowly tailor altruism delivery to the specific idiosyncratic preferences of individuals in ways that the government cannot. The government is limited by the political compromises of the entire electorate, meaning contributions to the public good will be made only in cases of broad political consensus or to serve particularly powerful political interest groups. In contrast, different firms, just like different non-profits, can offer individual employees, customers, and investors the opportunity to purchase different kinds of altruism. Environmentally conscious individuals can choose to work for, invest in, or buy from firms committed to sacrificing profits to help the environment, while those interested in delivering medicines to the Third World or improving schools in local communities can engage with firms that make those commitments. Dozens of for-profit firms have made public commitments for each of these causes, and there are nearly as many social causes as there are firms. An individual can satisfy almost any altruistic preference through for-profit firms because of the large number of firms, and because, like for consumer products and services, firms compete by offering differentiated types of altruism opportunities.

This last point is worth emphasizing. Just as in normal product markets where firms try to offer differentiated products in the hope of getting market share and thus profits, so too do firms offer differentiated altruism opportunities so as to maximize the value the firm can deliver to its stakeholders. If every firm donated to or did work to improve the environment, other charitable causes would suffer, and the benefits (be they goodwill, warm glow for managers, or altruism utility for customers, shareholders, and employees) from a firm choosing another cause would increase. This is analogous to the concept of supply and demand curves in normal product markets.

⁶⁵ The astute reader will ask: might not the consumer land in the region above U on C^* but to the left of y_c , a segment we have labeled “less y .” Although this would decrease the altruistic efficiency of bundling, it is very unlikely to happen because of the nature of public goods. Matthew Kotchen’s work on “green markets” shows that an important feature of free riding is that the larger an economy is, the more free riding on public goods there will be. Matthew J. Kotchen, *Green Markets and Private Provision of Public Goods*, 114 J. POL. ECON. 816, 826-827 (2006). In other words, there will be less y_c purchased by each individual. In the extreme, y_c will fall to zero, and thus bundling that raises the budget constraint to C^* can only increase the consumer’s expenditure of the altruistic public good y . But this is a rather technical point that does nothing more than preserve the main argument from all but the most improbable circumstances.

⁶⁶ See Henry N. Butler & Fred S. McChesney, *Why They Give at the Office Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Firm*, 84 CORNELL L. REV. 1195, 1203-04 (1999) (“Shareholders would prefer to give at the office precisely because giving through the firm forces all others who will also benefit from giving at the office too.”).

This responsiveness to the demand signals from the market is important not only in what is offered but also in what is not offered. Political programs, like Medicare or farm subsidies, are notoriously sticky – once a political consensus on a particular public good is achieved, it is difficult to do away with the program. Firms, which face constant competition, are likely to be agile in offering stakeholders the particular altruism outlets that they demand at a particular time. Philanthropy that increases stakeholder utility will be offered, and that which does not will soon disappear.

A final observation on this point is that we should expect firms to deliver altruism in areas or at times when they have some comparative advantage over other firms. As noted above, Starbucks clearly has the distribution channels to help poor farmers in coffee-growing countries, while Toyota naturally is connected with the environment. It is possible that the employees of the outdoor clothing firm Patagonia would get utility from the firm doing good for persecuted Christians in the Sudan, but it is much more likely that their utility is linked more closely with the environment. Here then is a cautionary tale for corporate watchdogs: corporate philanthropy is more suspect where firm efforts to help others are not correlated with an obvious comparative advantage or the logical preferences of firm stakeholders.

Although this discussion is focused mostly on how firms are advantaged vis-à-vis the government, firms may also have an important role here compared with non-profits. Although there are many non-profits and thus a diverse array of altruism opportunities, non-profits offer only opportunities for donations (of cash or in kind) and volunteering. Firms help complete the market for altruism by offering individuals who have altruistic preferences other ways of satisfying them. For example, the transaction costs⁶⁷ for some individuals of volunteering or writing a check to a charity that helps Ethiopian farmers may exceed the benefits. But these individuals may be willing to add \$1 to each cup of coffee to support these same farmers. Although rational individuals would be indifferent between donating \$200 via a check to a non-profit and buying 200 cups of fair trade coffee, behavioral heuristics may make the former unappealing or less likely for some individuals. The evidence discussed in Section V below about the tax treatment of the purchase of products bundled with charitable contributions supports this – the individual paying a \$200 premium for fair trade coffee over the course of a year cannot take a tax deduction for this contribution to charity, but may be able to if she gave a cash donation for a charity to achieve the same end. Since the purchase of a product-charity bundle is clearly inefficient for the individual from a monetary standpoint, there must be other reasons that explain the choices of individuals. And it is satisfying the altruism of these subrational individuals where firms provide an important component of the market for altruism.⁶⁸

⁶⁷ We mean this in the Coasian sense – transaction costs includes any money, psychic, or other cost that individuals experience when deciding on a course of action. One of these in this context might be some notion of commodification and the belief that a donation is in some sense a bribe or payoff, while paying a bit more for a product is not. We do not know what is in the minds of individuals making these choices, but we observe behavior that is inconsistent with purely rational behavior. A full consideration of the reasons is beyond the scope of this paper.

⁶⁸ The same argument applies equally to working for or investing in firms committed to doing good.

4. Agency costs

A fourth, but more contestable, advantage that for-profit corporations have over non-profit organizations and the government that they may be able to reduce agency costs that are an inevitable part of giving through an intermediary. Individuals who donate to non-profit charities suffer an agency problem: how to ensure the charity is using donations to efficiently transfer value to beneficiaries? Perhaps charities are spending too much on administrative expenses or are not providing the right sort of value to beneficiaries, for example, sending poor African kids computers instead of food or medicine.⁶⁹ Corporations may be able to help. By aggregating a number of different shareholders' and consumers' donations, they have greater leverage over charity managers. They can use this leverage to demand disclosure of activities and accountability. A useful analogy is to institutional investors, who are thought to discipline a corporation's managers on behalf of their own investors and, indirectly, the individual shareholders of the corporation.⁷⁰

Indeed, corporations may be better at directly providing the charitable products that stakeholders demand than non-profits are at serving their donors because corporations are more regulated and scrutinized than non-profits. Unlike for-profit firms, non-profits are not subjected to intense scrutiny by investors, regulators, plaintiff's lawyers, academics, and activists in terms of governance and accountability. In addition, federal securities laws and the Sarbanes-Oxley Act, which require enormous transparency and impose strict liability and large penalties for non-compliance, do not apply to non-profits.⁷¹ The result of less legal and market oversight is plain. There is widespread criticism about the accountability of non-profits to donors,⁷² and non-profits are widely regarded as much less well governed and subject to much less oversight than the average public company.⁷³ There are some third party organizations that provide information for donors about non-profit governance and conduct,⁷⁴ but these pale in

⁶⁹ See, for example, Eric Posner, "The Strange Case of One Laptop Per Child," University of Chicago Law School Faculty Blog, Jan. 7, 2008, available at <http://uchicagolaw.typepad.com/faculty/2008/01/the-strange-cas.html>.

⁷⁰ See, for example, Theodor Baums, ed., *Institutional Shareholders and Corporate Governance* (1993).

⁷¹ See, for example, <http://www.ncna.org/index.cfm?fuseaction=Page.viewPage&pageId=429>; see also Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 UC Davis Law Review 205 (2004); Bill Birchard, "Nonprofits by the Numbers: In the Wake of Embarrassing Revelations, High-profile Scandals, and Sarbanes-Oxley, Nonprofit CFOs are Striving for Greater Transparency and Accountability," CFO MAGAZINE, Jul. 1, 2005, available at <http://careers.cfo.com/article.cfm/4124836>.

⁷² See, for example, Ron Dixon, *Bottom Line for (RED)*, NY TIMES, Feb. 6, 2008 (noting that detractors "criticize a lack of transparency at the company and its partners over how much they make from Red products" and noting that "Red companies had collectively spent as much as \$100 million in advertising and raised only \$18 million.").

⁷³ See, for example, Janet Greenlee, et al., *An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents*, 36 NONPROFIT & VOLUNTARY SECTOR QUART. 676, 677 (2007) (estimating total fraud at about 13% of all donations).

⁷⁴ See, for example, www.charitynavigator.com (listing, *inter alia*, "ten charities drowning in administrative costs" and rating financial health of over 5000 charities); www.charitywatch.org (reporting results from American Institute of Philanthropy in evaluating charities based on fundraising efficiency); William P. Barrett, "Genuinely Needy," FORBES, Dec. 8, 2003 (describing annual survey of 200 large charities), available at <http://www.forbes.com/maserati/246.html>.

comparison with the investors, analysts, watchdogs, and government agencies monitoring every move made by large, for-profit firms. All else being equal, an individual might believe a for-profit firm is a better monitor, that is, has lower agency costs, in a giving transaction.

Given well known examples of fraud by corporate managers (think Enron, WorldCom and Tyco), we freely admit that our claim about agency costs is debatable. At best corporations merely replace agency problems between a donor and a non-profit (or taxpayers and politicians) with agency problems between a shareholder-donor and the corporation's managers. In a well-governed corporation, the corporation may have a leg up on direct contributions to a non-profit or tax paid to the government. But in other cases, a donor should take her chances with the non-profit and the tax payer should prefer the government. What's more, the non-profit and the government offer the altruist a backstop – the non-profit cannot distribute profits to its managers and politicians cannot skim off tax revenues – that limits the amount of misfeasance in which they can engage. Our point is only that the well-governed for-profit corporation may, in some cases, be more responsive to stakeholder's altruistic desires than non-profits are to donors and the government is to taxpayers.

5. Network Effects

A final corporate delivery benefit is the ability of firms to use their greater size to more efficiently produce network effects in warm glow. What do we mean by “network effects”? Simply that warm glow rises in either the number of other contributors or the amount donated to a particular social cause.⁷⁵ In economics, this is known as a network externality. A classic example of a network externality is e-mail—the more people that use e-mail, the more potential value the service may have to any individual user. Moreover, the addition of any new user provides a benefit (that is, a positive externality) to existing users. We argue the same effect exists in the market for altruism. An individual's \$1 donation to a project to which another person also donates \$1 gives more than \$1 of warm glow to each giver. And, like in e-mail, the addition of another \$1 by someone else after the original donation may provide some warm glow (as well as pure altruism) to original donors. This is because a small donation alone can do very limited good, but when an individual's \$1 is added to many other donations, the amount of pure public good the \$1 can do, and therefore the amount of warm glow it can deliver, is higher.⁷⁶

⁷⁵ Our suggestion warm glow production generates network externalities is supported by some empirical evidence. Studies examining the effect of matching contributions on giving by donors show donors give more to charity when told their donation will be matched by their employer or some other donor. *See, for example*, John A. List & Daniel Rondeau, “Matching and Challenge Gifts to Charity: Evidence from Laboratory and Natural Field Experiments,” NBER Working Paper No. W13728 (2008) (“We observe that a challenge gift attracted 23 percent more donors and increased total dollar contributions 18 percent when compared to the identical campaign in which no announcement of leadership gift was made.”). If a donor did not obtain some warm glow from the matching contribution, it should have no effect on the donor's contribution. In fact, if the donor had purely altruistic preferences, the matching contribution might actually lower her own donation, because she can free ride on the public benefits it provides.

⁷⁶ This positive externality in warm glow may justify subsidies to encourage delivery in this aggregated way.

There are two implications of network effects in warm glow. The first is warm glow may be even more effective at offsetting free riding than previously thought. When there are economies of scale in the production of a good, this encourages higher levels of production of that good. The economies of scale we highlight in the production of warm glow means there will be incentives to produce more of it. Because a by-product of the delivery of warm glow is the production of pure altruism, a second implication is there is a return to agglomeration in the production of warm glow and thus altruism generally. Agglomeration is possible in all three sectors, but there may be advantages that corporations, which are generally much larger than non-profits, have in performing this function.

Corporations may be better able to take advantage of scale than non-profit firms because they are generally larger than non-profits. The size difference may be due, in part, to the fact that non-profit firms rarely merge. There is little reward for increasing the efficiency of a non-profit since the managers cannot share in the income from those efficiencies. Moreover, non-profit entrepreneurs may be driven to directly control the good works of the organization—just another form of warm glow—but this desire for control also may discourage mergers.

Ostensibly the U.S. government, which is bigger than any one corporation, has likewise an advantage over any for-profit firm at capitalizing on network externalities in warm glow. Another feature of warm glow, however, limits the efficiencies of government provision of altruism. James Andreoni, who popularized the idea of warm glow, has demonstrated that warm glow declines in the number of beneficiaries that share a contribution.⁷⁷ More precisely, the warm glow from a contribution to a fund that benefits N persons is greater than the warm glow from that contribution when the fund benefits $N+1$ persons. Because contributions to the government (that is, taxes) are shared by all beneficiaries of government public good programs, this diminishes the network efficiencies of warm glow. In contrast, a corporation can target its social action towards a smaller group of beneficiaries, thereby capturing the signal amplification of warm glow in giving without reducing it by dispersing the impact across many recipients. In other words, there are increasing returns to a larger fund but negative returns to a larger number of beneficiaries. The government has a larger fund than any corporation (and all corporations in the aggregate) but it cannot limit the number of beneficiaries. Thus in many cases a corporation—especially a large one—may have a comparative advantage over the government at delivering warm glow.

V. The Merits of Corporate Philanthropy

Having proposed a new framework for understanding corporate philanthropy, and its relationship to the non-profit sector and government programs, it is time to return to the basic questions that motivate this paper: should corporations engage in philanthropy and how should the government regulate this activity?

A. Should Corporations Engage in Philanthropy?

⁷⁷ See James Andreoni, Gifts to Groups: How Altruism Depends on the Number of Recipients, 91 J. PUB. ECON. 1731 (2007).

Business schools teach its students – the future leaders of for-profit corporations – that companies should only enter a market if they have an edge over their competitors. Otherwise they will sacrifice their bottom line and perhaps fail. Given that the central theme of this paper is that there is a market for altruism like there is for other products, the same lesson applies to altruism.

To wit: Corporations should only engage in philanthropy if they have a cost or quality advantage over other competitors in that market. This includes other corporations *and* over non-profits and the government. Of course it is a little complicated to determine how competitive the government is. After all, contributions to government production are mandatory, so people (and corporations) do not have much of a choice over whether to purchase government altruism.⁷⁸ So the more nuanced version of our claim is that a corporation should engage in a particular philanthropic activity only if demand for that activity is not already satisfied by the government and if the corporation is better able to perform that activity than both other corporations and non-profits.

Although the debate over the merits of corporate philanthropy does tackle social work by non-profits or the government, our framework has normative implications for these actors as well. A non-profit should only engage in a specific philanthropic activity if it is not crowded out by the government and it has a comparative advantage over other non-profits and for-profit corporations. The government should only engage in a specific altruistic activity if that activity is subject to free riding and is therefore likely to be undersupplied by corporations and non-profits. (This is just a variant of the typical economist's claim that the proper, narrow role of government is to provide public goods.) Of course, this is a necessary but not sufficient condition for government action. If the government's cost of addressing the undersupply is greater than consumer surplus from that additional supply, then the government should remain on the sidelines.

B. How Should the Government Regulate Corporate Philanthropy?

The market for altruism is distinguished by competition across three sectors of the economy. Since one of the sectors is the government, there is the risk not only that the government will regulate the market for altruism to favor itself, but that it will not treat each of its competitors equally. The main area of concern is regulation through tax policy. The following examples illustrate our point.

Donations versus purchases. If a person wants to “buy” altruism via donation to a non-profit and she itemizes her deductions, her purchase may be deductible from her taxable income. This means that she effectively gets a price discount on altruism equal to her marginal income tax rate. If the same person wants to “buy” altruism by purchasing a so-called “green good” from a for-profit corporation, her purchase is not tax deductible and thus no price discount.⁷⁹ This discrepancy implies

⁷⁸ This “crowd-out” of private altruism by government altruism is offset to some extent by a “reverse crowd-out” effect since some – but not all – philanthropic activities are tax deductible and thus reduce government revenues. Plus corporations – unlike §501(c)(3) non-profits – can lobby the government to stop engaging in altruistic activities that compete with corporate philanthropy.

⁷⁹ It should be noted that the costs from self-production of altruism, e.g., giving change to homeless person, cannot be deducted from taxable income and thus, also, not privileged with a discount.

that, even if green goods provide a more efficient form of altruism than traditional non-profit activity, consumers may still donate to the non-profit.

Donations versus ownership. If a person wants to donate assets to a non-profit, there are two options. If a person itemizes her deductions, she can donate cash and deduct it from her income. This provides a price discount equal to her income tax rate.⁸⁰ If the person “buys” altruism, however, by owning shares in a corporation that sacrifices some shareholder profits to engage in philanthropy, the person would draw two benefits. First, the corporation is permitted to deduct the philanthropic expenses as either contributions to a non-profit charity or a business expense, lowering its corporate income tax bill. Second, the person would lose some corporate profit which would reduce her capital gains tax bill⁸¹ (if she sold appreciated stock) or her personal income tax bill (if the corporation issued dividends). The net effect is that altruism purchased via share ownership affords a price discount that includes the corporate income tax rate and the capital gains rate. Thus the discount from donating cash to a non-profit is the personal income tax rate while the discount from owning shares in a for-profit is a combination of the corporate income tax rate and the capital gains rate. Typically the latter combination is greater than the personal income tax rate, so tax policy favors corporate philanthropy over donations to a non-profit.⁸²

These examples are just the tip of the iceberg. Table 1 summarizes the disparate treatment tax treatment of altruistic purchases from the different sectors. (The specific rates are derived in Appendix B.) It highlights not just disparate treatment across sectors but also disparate treatment of different methods of purchasing altruism *within a sector* and disparate treatment *across people* for a given purchase of altruism. For example, itemizers get to deduct cash donations to non-profits but (usually less wealthy) non-itemizers do not. Thus, itemizers get a discount, but non-itemizers do not. Another example is that volunteers who are paid an hourly wage likely get a discount equal to their personal income tax rate, while volunteers who are salaried do not. The reason is that the reduction is work hours due to volunteering lowers the income and thus tax bill of hourly workers, but not salaried workers.

⁸⁰ Alternatively, she can donate an appreciated asset, deduct not only the full value of the asset from her taxable income, but also avoid paying capital gains tax on the appreciation. (To see the capital gains benefit, imagine the person sold the stock and donated cash instead of the stock. She would have to pay capital gains tax on the appreciation.)

⁸¹ This assumes that the individual would have shared in corporate profits by selling her shares. If the corporation instead issued dividends (which are taxed as ordinary labor income), the philanthropic activity would reduce her personal income tax bill.

⁸² Of course, the conclusion may be reversed if the person donates appreciated stock. See *supra* note 80. It may be reversed back if the corporation distributed all its profits via dividends. See *supra* note 81.

Table 1. Tax treatment of altruism purchased in non-profit and for-profit sectors

Sector	Method of purchase	Discount for typical consumer
Non-profit	Donating cash	t_p if itemizer (0 otherwise)
	Donating appreciated stock	t_p plus a rebate equal to appreciation times t_{cg}
	Donating time	0 (t_p if volunteering reduces hours worked and earnings)
	Working	t_p
For-profit	Owning shares	$t_c(1 - t_{cg}) + t_{cg}$
	Buying green product	0
	Working	t_p

Notes. t_p is the personal income tax rate, t_{cg} is the capital gains tax rate, and t_c is the corporate income tax rate.

Before one can address any of these forms of discrimination, one must decide how much one wants to subsidize altruism. For example, if the right subsidy is the personal income tax rate (t_p), then we should try to increase the discount for buying green goods by making those purchases tax deductible and perhaps decrease the discount for owning shares by eliminating the corporate tax (t_c). Alternatively, if the right subsidy is zero, then the appropriate strategy is to eliminate any tax deductions for contributions of cash or stock to a non-profit. We do not take a position on which level of subsidy is appropriate – that is outside the scope of this paper. Our particular claim is that whatever the level of subsidy, the government should provide it as uniformly as possible across (and within) sectors and people.

There are two caveats to our contention that the government should eliminate tax discrimination between producers of altruism. The first is that eliminating tax discrimination is costly.⁸³ For instance, giving a tax break for the altruistic component of a green good requires that the government estimate the altruistic component of that good. That is, the government must determine, say, how much more Starbucks pays farmers for fair trade coffee than for regular coffee or how much of the additional cost of a hybrid car is attributable to its ability to lower greenhouse gases. Perhaps the government could rely on corporations to self-report these costs. But because even philanthropic corporations care about profits, they have an incentive to exaggerate the “green” portion of green goods. After all, doing so lowers the effective price of those good to consumers and increases philanthropic corporations’ profits. Of course the government already relies on self-reporting of costs and expenses for most of its tax

⁸³ A related point is that eliminating discrimination sometimes has collateral consequences. For example, addressing the disparate treatment of owning shares in a philanthropic corporation and donating cash to a non-profit requires abolishing the corporate income tax. If there are benefits to that tax outside the market for altruism, then eliminating this form of discrimination will have as an unintended consequence the loss of those benefits. Therefore, we must insert the following condition to our argument against tax discrimination in the market for altruism: if cost of eliminating tax break is greater than the inefficiency from the tax discrimination, we should leave the discrimination in place.

collection. Instead of checking each return, checks a handful and punishes violators with heavy fines.⁸⁴ It could do the same with respect to self-reporting of the costs from green goods.

The second caveat to our position against discriminatory tax treatment of altruistic producers is that some discrimination cannot be eliminated. For example, so long as there is a capital gains tax or personal income tax, one cannot eliminate some benefit to purchasing altruism by owing stock in a philanthropic corporation. Whenever that corporation sacrifices shareholder profits to engage in philanthropy, the shareholder will lower either capitals gains or dividends, which will lower her tax bill. Of course, the inability to eliminate all discrimination is not a persuasive argument against trying to eliminate any discrimination. Otherwise perfection will become the enemy of progress.

General statements about the evils of discrimination are fine, but specific suggestions are more helpful. So what would we recommend? Assuming that the optimal price discount for altruism is the personal income tax rate, we have three proposals.⁸⁵ First, the government should allow all consumers to deduction the charitable component of the green goods they purchase. Producers of green goods should estimate that component for the government and provide consumers with a separate receipt for that component. This is exactly what non-profits currently do for donors of non-cash assets. Second, the government should allow all consumers to deduct donations of cash or assets to non-profit organizations. These deductions should not be restricted to itemizers. In other words, all contributions to non-profit charities should be privileged with an above-the-line deduction. Third, the government should tax donations of stock and other appreciated assets the same as donations of cash to non-profits. There are two ways to accomplish this: do not exempt appreciation of donated stock from capital gains taxes or only permit donors a charitable deduction from labor income equal to their basis in the donated stock.⁸⁶ (The latter reform works by encouraging donors to sell stock and donate the proceeds, after paying capital gains taxes, as cash.)

⁸⁴ The government also requires accounting firms to sign off on corporate income tax returns and holds those accounting firms liable if the corporate returns are inaccurate. This incentivizes accounting firms to police corporations. The same could be done with green goods.

⁸⁵ It should be noted that some components of the plans below have previously been proposed by scholars and policy advocates. Joseph Cordes, et al, "Extending the Charitable Deduction to Nonitemizers: Policy Issues and Options," URBAN INSTITUTE, CHARTING CIVIL SOCIETY SERIES, No. 7 (May 2000) (arguing for above-the-line deduction for all charitable contributions); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains*, 56 TAX L. REV. 1 (2002) (find no persuasive argument for permitting deduction of fair market value of appreciated stock); see also, Joint Committee on Taxation, *Options to Improve Tax Compliance and Reform Tax Expenditures* 293, JCS-02-05 (Jan. 27, 2005). There are other, more normative proposals, that we do not consider. See, for example, Andrew Chamberlain & Mark Sussman, *Charities and Public Goods: The Case for Reforming the Federal Income Tax Deduction for Charitable Gifts*, TAX FOUNDATION SPECIAL REPORT No. 137 (Nov. 2005) (advocating the denial of a deduction for donations to charities that do not in fact contribute to the public good). The full set of reforms, however, has not been proposed before. The reason is that previous scholarship has not grasped the breadth of the market for altruism, seen the full range of inequalities, and thus sought to pursue true tax neutrality.

⁸⁶ Dan Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains*, 56 Tax L. Rev. 1 (2002).

Conclusion

Individuals have preferences for altruism, and they can turn to three providers in what call the “market for altruism” to satisfy these preferences. Non-profit charities and the government are the typical intermediaries that help individuals satisfy these preferences, whether individuals are seeking pure altruism, warm glow, or some mix of both. For-profit corporations have historically provided cash donations to charities, but their role is increasingly to do good works to help others themselves. This new and bigger role has been criticized and praised, but neither backers nor skeptics have properly framed the debate. Corporations aren’t increasingly acting charitably simply because it increases profits (good) or because managers are acting selfishly (bad), but rather because their stakeholders—investors, employees, and customers—are demanding that they do.

The market for altruism we define is not like other markets. For one, the government is both a player and a rule setter in this market, which means that there may be crowding out of private production and unfair competition across sectors depending on tax and other regulatory policies. The market also has suffers the classic problem of free-riding on public goods—that for-profit firms may be uniquely positioned to solve through bundling of altruistic goods with non-altruistic goods. We show how firms may also have other comparative advantages that allow them in some cases to more efficiently deliver altruistic goods than either non-profit charities or the government. In other cases, these other competitors may be better suited for this job.

With no clear theoretical basis for choosing the most efficient competitor for delivering altruism, we should expect neutral tax treatment so as not to bias altruism purchasing decisions based on taxes. We show not only is the tax law not neutral among competitors (not to mention other potential laws and regulations that may introduce non-efficiency based biases), but the current tax laws are incoherent. Certain mechanisms for giving within a sector are favored over other mechanisms without any clear efficiency basis for this distinction. For example, donations of appreciated stock or ownership of shares in philanthropic corporations are the most tax favored, while separate rules exist for donations of money and time to non-profits, pro bono work, and, most importantly, products bundled with charity and sold by corporations. . Seeing no justification for this, we offer several reform proposals with an eye toward leveling the competitive playing field and setting the right incentives for the production of altruism in the economy.

Appendix A

In order to understand the magnitude of the market for altruism and the manner in which the various sectors (the government, non-profits, and for-profits) compete through different delivery mechanisms (donations, investments, labor, and purchases), we provide an examination of the inputs and outputs of this market.

1. Inputs

i. For-profit Sector

There are three primary stakeholders in any firm: investors, employees, and customers. Individuals, whether they are contributing capital, helping turn the capital into goods and services, or buying goods and services from firms, may be willing to “pay” firms to do good on their behalf. This intermediary role for the firm is analogous to that served by non-profit charities, which solicit donations from individuals to do good on their behalf. We consider the inputs provided by each of these constituencies in turn. As we show, a rough estimate of the total inputs to corporate social action is several hundred billion dollars.

Investors. There is some evidence that shareholders are willing to forgo profits by investing in firms that are committed to acting in a socially responsible fashion. An entire industry, known as socially responsible investing (SRI), has developed to identify and invest in firms acting in socially and environmentally responsible ways.⁸⁷ There are over 500 mutual funds and other institutional investors focusing entirely on this type of investing.⁸⁸ The major stock exchanges also have special indices, like the FTSE 4Good Index and the Dow Jones Sustainability Index, which track the performance of these firms.⁸⁹

The amount of investment in firms committed to relatively more social welfare than the average firm is staggering. In 2005, over \$2.3 trillion was invested in socially responsible investment funds, which is about 10 percent of total assets under management in the United States.⁹⁰ Because the filtering process screens out potentially profitable investments, investors in these funds necessarily forsake potential profits. These opportunity costs are in effect a charitable contribution by the investors to social welfare. In a recent analysis, Christopher Geczy, Robert Stambauh, and David Levin find investments in socially screened funds underperform alternative investments in

⁸⁷ SRI primarily involves applying ethical screens to personal and institutional investments to ensure that funds are directed toward sustainable activities and away from unsustainable ones. Funds can use “negative” screens, meaning that they prohibit investment in companies or funds involved in specific activities such as tobacco production or nuclear power. “Positive” screens, a more recent SRI tool, encourage investments in companies that generate economic activity consistent with sustainability, such as solar power or microfinance.

⁸⁸ See Social Investment Forum, available at <http://www.socialinvest.org/>.

⁸⁹ See, for example, http://www.ftse.com/Indices/FTSE4Good_Index_Series/index.jsp; <http://www.sustainability-indexes.com/>.

⁹⁰ See Social Investment Forum, available at <http://www.socialinvest.org/>. Of this, about \$180 billion is in socially responsible mutual funds, while the remainder is individually managed accounts of individuals or institutions. See id.

unscreened firms by 35 basis points.⁹¹ In other words, investors in these funds contribute about \$85 billion per year (\$2.4 trillion times 3.5 percent) to social welfare by limiting their investments to funds committed to doing good (or not doing bad).

If we are correct that shareholders get utility (in the form of altruism) from the firms they invest in doing social good, then this \$85 billion figure surely underestimates the total amount of this form of giving. This estimate includes only a small and very specific subset of investments in public firms, and thereby excludes other types of investments and investments in small or private firms. In addition, socially responsible investing is growing dramatically, rising over 300 percent over the past decade.⁹² If recent history is a gauge, this is true even in times when overall investment in equity markets declines. For example, according to Lipper, in the first quarter of 2003 investors added nearly \$200 billion to socially responsible mutual funds, while regular mutual funds experienced a net decrease of over \$13 billion.⁹³ Over 50 percent of Fortune 500 firms provide social responsibility reports, and hardly a week goes by without some company announcing what it is doing for the world's environment. Adding this all together, we estimate that shareholders "contribute" at least \$100 billion per year in forgone capital appreciation by investing in socially responsible firms.⁹⁴

Employees. Just as investors can forgo equity returns in return for altruism, so too can a firm's workers contribute to social good by accepting a lower wage from a firm committed to social action. If the market clearing wage for an store manager is \$100, but an environmentally conscious one agrees to work for a firm like Patagonia for, say, \$80, then the \$20 difference is equivalent to a donation to charity. In other words, all else being equal, the individual store manager would be indifferent between working for Sears and donating some portion of her salary to an environmental charity, and working for Patagonia.

The empirical evidence supports a claim employees are willing to give up financial compensation in return for working for a firm committed to social action. David Montgomery and Catherine Ramus surveyed about 300 MBAs and used conjoint analysis to estimate their willingness to forgo financial benefits for a variety of firm

⁹¹ See Christopher Geczy, et al., "Investing in Socially Responsible Mutual Funds" Wharton Working Paper (2005), available at SSRN: <http://ssrn.com/abstract=416380>. This finding is consistent with the views of industry experts. A study by the consultancy Mercer finds that investors recognize that "SRI could reduce returns and increase risk" as well as be "costly in terms of money and staff time." <http://www.mercer.com/summary.jhtml?idContent=1207675>.

⁹² See "Socially Responsible Investing Grows Rapidly," WorldWatch Institute, available at <http://www.worldwatch.org/node/5481>.

⁹³ DAVID CROWTHER & LEZ RAYMAN-BACCHUS, PERSPECTIVES ON CORPORATE SOCIAL RESPONSIBILITY 163 (2004).

⁹⁴ See also Hart Dowell, et al., Do Corporate Global Environmental Standards Create or Destroy Market Value, 4 MANAGEMENT SCI. 1059, 1065 (2000) (finding that polluting reduces stock price); see also A. King & M. Lenox, Does it Really Pay to be Green? Accounting for Strategy Selection in the Relationship between Environmental and Financial Performance, 4 J. of Industrial Ecology 4 (2001) (analyzing 652 manufacturing firms over the time period 1987-1996, and finding a relationship between low pollution and higher valuation); S. Konar & M.A. Cohen, Does the Market Value Environmental Performance?, 83 REV. ECONOMICS & STATISTICS, 281 (2001); J.T. Hamilton, Pollution as News: Media and Stock Market Reactions to the Toxics Release Inventory Data, 28 J. ENV. ECON. MANAGEMENT 98, 106 (1995) (finding listing on EPA toxic release inventory reduces stock price 9.7 percent). For a comprehensive list of studies on this subject, see International Network for Environmental Compliance and Enforcement Bibliography of Sources Discussing Benefits and Costs of Environmental Enforcement, Compliance, and Performance http://www.inece.org/links_pages/onlineresourcesCost.html.

characteristics.⁹⁵ They find employees willing to give up about 8 percent of their expected total compensation to work for firms committed to environmental sustainability and caring for stakeholders.⁹⁶ This amounts to an implicit donation of nearly \$10,000 per employee per year.⁹⁷

A reasonable analogy can be made to volunteering. When an individual volunteers, they show a willingness to forgo financial benefits equal to the difference between the wage for the particular task and zero. These forgone dollars are their donation to charity. As discussed below, individuals forgo about \$200 billion in wages by donating time to non-profit charities. Since this figure is calculated using a very low wage—about \$15 per hour—and most volunteers are very high wage earners, this estimate approximates the wage discount found by Montgomery and Ramus. (In fact, the total value of the volunteering is about \$2000 per year per person, which is only one-fifth of what the MBA survey suggests is the willingness to pay for some employees.) It is not unreasonable to suggest that employees at firms donate a comparable amount of labor to firms by accepting wages below those of the market-clearing price to work at firms committed to doing good. If a significant number of employees have the same willingness to pay as those in the MBA survey, then this implicit donation could be quite large. For example, if only 1 percent of employees took a wage discount as large as that suggested by this research, the total donation to charity from this behavior would be about \$10 billion.⁹⁸

Customers. One need only look at the grocery store shelves or visit a local coffee shop to see the manner in which customers donate through firms for the purpose of social action. Firms are increasingly offering so-called “green” products for sale at a premium price. These are ordinary items that are manufactured, distributed, used, or disposed of in a way that is more socially sensitive than the regular version of the same product.⁹⁹ Fair-trade coffee, biodegradable household cleaners, and hybrid cars are examples. According to one independent market analyst group, about 10 percent of all new product introductions are green products.¹⁰⁰ Another survey finds that about 30 percent of consumers consider whether the firm is “doing good” as key factor in purchasing decisions.¹⁰¹

These products are nothing more than a bundle of two separate goods—a regular good and donation to charity or to improve social welfare. To see this, consider fair-trade

⁹⁵ See David B. Montgomery & Catherine A. Ramus, “Corporate Social Responsibility Reputation Effects on MBA Job Choice,” Stanford Research Paper No. 1805 (2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=412124.

⁹⁶ See *id.* at 6.

⁹⁷ See *id.* (finding MBAs willing to give up \$5500 to work for firms committed to environmental sustainability and \$3700 to work for firms committed to other stakeholders, based on an expected compensation packages of \$115,000). A 2004 survey of 800 MBAs in North America found that 97 percent would be willing to give up an average 14 percent of pay to work for socially responsible firms. See Institute for Global Ethics Newsletter, Aug. 2, 2004, available at www.globalethics.org.

⁹⁸ This estimate is probably conservative. According to the Census Bureau’s American Community Survey, about 10 percent of the workforce has a “graduate or professional degree.” See American Community Survey 2004, available at www.censusbureau.biz/acs/www.

⁹⁹ In our usage, a “green” product may help social causes other than the environment.

¹⁰⁰ See Matthew J. Kotchen, *Green Markets and Private Provisions of Public Goods*, 114 J. POL. ECON. 816, 817 (2006) (citing study by Marketing Intelligence Service).

¹⁰¹ See Dale Kurchiner, “5 Ways Ethical Business Creates Fatter Profits,” BUS. ETHICS 21, Mar./Apr. 1996.

coffee. Starbucks pays Ethiopian farmers significantly more than the going wage for coffee beans and charges a premium price, for example, selling regular Ethiopian coffee for \$10 and fair-trade Ethiopian coffee for \$15. The extra \$5 is just a “donation” to help the Ethiopian farmers, administered through Starbucks instead of a non-profit charity.

The market for fair-trade products exceeds \$1.5 billion, and is growing dramatically—estimates are that it will exceed \$15 billion by 2012.¹⁰² This is just a fraction of the overall value of goods and services provided by firms that bundle some sort of social welfare improvement with a regular product.¹⁰³ Some of these products explicitly bundle donations. Examples include the (RED) campaign in which various firms committed to donate a portion of sales to treat AIDS in Africa.¹⁰⁴ Other products implicitly bundle a donation. Examples include “green” household products and paper products made from recycled materials. One estimate puts the value of all goods and services embedding a commitment to sustainability at around \$200 billion.¹⁰⁵

There are innumerable examples of recently introduced and widely popular products embedding social action. The Toyota Prius is a prominent example. The Prius (and all hybrids for that matter) are marketed as being good for the environment because of reduced fuel consumption over a given distance. Toyota has sold over 500,000 Prius vehicles in the United States over the past few years, each at a premium of about \$4000 to \$7000 over a comparably equipped vehicle.¹⁰⁶ Some part of this premium is the equivalent of a donation to an environmental charity. (Admittedly there is also a purely private consumption part: the expected cost savings in terms of fuel.) If we assume about half of the premium is environmentally motivated (a conservative assessment perhaps given the way these cars are marketed), Prius owners alone have donated the equivalent of about \$2 billion to environmental sustainability.

ii. Non-profit Sector

The inputs to non-profit charities are more familiar. Individuals hoping to do good and feel good about doing it can opt to donate cash or time to non-profit charities committed to doing good. There are therefore three inputs—donations, volunteering, and working—and they amount to more than \$600 billion per year.

¹⁰² See Michael J. Hiscox, “Fair Trade as an Approach to Managing Globalization,” Memo prepared for the conference on Europe and the Management of Globalization, Princeton University, February 23, 2007, available at http://64.233.167.104/search?q=cache:YRAvWRFqGY8J:www.princeton.edu/~smeunier/Hiscox_Fairpercent2520Tradepercent2520andpercent2520Globalization.pdf+market+size+percent22fair+tradepercent22&hl=en&ct=clnk&cd=36&gl=us&client=firefox-a.

¹⁰³ The (RED) campaign has raised about \$60 million raised for charity. See Ron Dixon, *Bottom Line for (RED)*, NY TIMES, Feb. 6, 2008. The lack of transparency about how the funds are raised, how much is spent on advertising, and so on has raised concerns about the campaign. See *id.* As we discuss below in Part III, this is not unique to the (RED) campaign.

¹⁰⁴ See *id.*

¹⁰⁵ See Lifestyles of Health and Sustainability (LOHAS) market, available at <http://www.lohas.com/about.html>.

¹⁰⁶ See Jerry Garrett, *Pick of the litter: Which hybrids are hot? Which are not?*, SAN DIEGO UNION-TRIBUNE, May 20, 2006 (describing how Toyota is considering adding Prius premium to other hybrids); see also http://en.wikipedia.org/wiki/Toyota_Prius (describing over 500,000 Prius cars sold in United States).

Donations. Total cash contributions to non-profits were about \$295 billion in 2006.¹⁰⁷ About 75 percent of this was direct donations by individuals, with the remaining coming from bequests, donations by corporations and foundations.¹⁰⁸ Total contributions have grown at a rate of about 9 percent per year for the past 15 years.¹⁰⁹ As we discuss below, cash donations to charities are tax privileged, since they can be deducted from total taxable income.

Volunteering. The estimates of volunteer time vary. According to one study, in 2006, about 62 million Americans volunteered for non-profit charities. The average volunteer donated about 130 hours, meaning a total of over 8 billion hours of free labor was provided to non-profit charities. Each of these hours was unpaid, meaning the difference between the wage rate for the task performed and zero (the amount paid for the work) was a donation to social good. According to the non-profit trade group the Independent Sector, the estimated average value of this time (and thus donation) is about \$19 per hour.¹¹⁰ The total value of this input is therefore over \$150 billion. Another estimate puts the number of volunteer hours at over 15 billion, implying a donation of almost \$240 billion.¹¹¹

Working. Just as individuals may work at a discount for for-profit firms committed to doing good, employees of non-profits may demand less in wages because they work for non-profit charities. We are not aware of any attempts to quantify the size of this donation to social good. To estimate it, we would want to know the difference between what individuals are paid to perform similar tasks for employers not committed to doing good. If we assume the average employee of a non-profit is doing about what the average employee of a for-profit is doing, we can then estimate the wage discount by comparing the difference between the total percent of the labor force employed by non-profits and the total percent of wages paid to non-profit employees. According to one source, about 7.2 percent of all employees in the economy worked at non-profit charities, while they earned only 6.6 percent of all wages.¹¹² If this amount represents a wage discount, as opposed to a lower human capital of these employees,¹¹³ it amounts to an additional \$30 billion contribution by non-profit employees.¹¹⁴

¹⁰⁷ See "U.S. Charitable Giving Reaches \$295 Billion in 2006," Giving USA, Press Release, June 25, 2007 (describing report *Giving USA 2007*).

¹⁰⁸ About \$23 billion in bequests; \$13 billion in corporate donations; \$37 billion in donations from foundations (individual and corporate). See id.

¹⁰⁹ See *Giving USA 2005*, SA-T562, available at http://www.aafrc.org/gusa/gusa_order.htm.

¹¹⁰ See http://www.independentsector.org/programs/research/volunteer_time.html.

¹¹¹ See Independent Sector, "Giving and Volunteering in the United States 2001," available at <http://www.independentsector.org/programs/research/gv01main.html> (reporting 15.5 billion hours or about 9 million full-time equivalents in 2001 survey).

¹¹² Lester M. Salamon & S. Wojciech Sokolowski, "Employment in America's Charities: A Profile," Nonprofit Employment Bulletin Number 26, Johns Hopkins Nonprofit Employment Data Project, Dec. 2006, available at <http://64.233.167.104/search?q=cache:kZ6AwUM82-sJ:www.jhu.edu/~ccss/research/pdf/Employment+percent2520in+percent2520Americas+percent2520Charities.pdf+2004+Center+policy+studies+non-profit+7.7+percent25&hl=en&ct=clnk&cd=2&gl=us&client=firefox-a>.

¹¹³ The non-profit literature reveals mixed results on the question of whether the lower wages were the result of a wage discount or lower human capital. See, for example, Anne E. Preston, *The Nonprofit Worker in a For-Profit World*, 7 *J. Lab. Econ.* 438, 446 (1989) (controlling for human capital and other work variables, finds a negative wage differential of 20 percent); Femida Handy & Eliakim Katz, *The Wage Differential between Nonprofit Institutions and Corporations: Getting More by Paying Less?*,

iii. Government Sector

The government receives “contributions” in the form of taxes from individuals to improve the social welfare by investing in public goods. These contributions are not entirely voluntary, since paying taxes is mandatory and subject to financial and criminal penalties. In 2006, the federal government collected about \$2.4 trillion in taxes, which is consistent with a historical trend of about 19 percent of gross domestic product.¹¹⁵ In addition, state and local governments collected about \$1.2 trillion in taxes.¹¹⁶ Not all of these taxes are provided by individuals, and not all of those provided by individuals are dedicated to providing social welfare in the sense of delivering altruism to individuals.

Social insurance (that is, Social Security, Medicare, etc.) might be viewed as the government selling insurance to consumers, and therefore a private good of sorts. State and local taxes are also more likely to be private goods, since these receipts are more likely to go to things like fixing local potholes and maintaining local courts to enforce contracts. So, roughly, if we take out social insurance and state and local taxes, the government collects about \$1.6 trillion in taxes.¹¹⁷ Not all of these tax revenues are used to produce public goods or deliver altruism, be it warm glow or pure altruism. For example, the United States Post Office is certainly not a public good, while the money spent to defend the country and to clean up the environment certainly are. The best we can do is put this figure of \$1.6 trillion as an upper bound on the amount the government collects to do charitable social good.

Working for the government may also be a contribution to the public good, just as working for a firm or a non-profit can be. The government at all levels employed about 22 million people in 2006, or about 15 percent of all workers in the United States.¹¹⁸ Most of these government workers were employed at the state and local level (87 percent of total). These workers are somewhat less likely to be involved in creating pure public goods. The wage discount question is complicated with government workers. Some government workers undoubtedly take a wage discount to work for the government, but the tradeoffs may be for more leisure, better benefits, more responsibility, more job security, and so on.¹¹⁹ In addition, it is not at all clear that the overall government wages

26 J. COMPARATIVE ECON. 246, 251 (1998) (finding that lower wages are “adopted by nonprofits to generate positive self-selection among its managerial staff”).

¹¹⁴ The median household wages in the United States in 2006 was about \$48,000. The total number of households were about 113 million. See Current Population Survey, http://pubdb3.census.gov/macro/032007/hhinc/new04_001.htm (Table HINC-04. Presence of Children Under 18 Years old--Households, by Total Money Income in 2006, Type of Household, Race and Hispanic Origin of Reference Person, U.S. Census Bureau, Current Population Survey, 2007 Annual Social and Economic Supplement, http://pubdb3.census.gov/macro/032007/hhinc/new06_000.htm (Table HINC-06. Income Distribution to \$250,000 or More for Households, U.S. Census Bureau, Current Population Survey, 2007 Annual Social and Economic Supplement).

¹¹⁵ The U.S. GDP was about \$13 trillion in 2006. See <http://www.bea.gov/national/index.htm#gdp>.

¹¹⁶ See <http://www.census.gov/govs/www/qtax.html>.

¹¹⁷ See Office of Management and Budget Report (2006), SA/T461, available at _____.

¹¹⁸ See http://www.data360.org/dsg.aspx?Data_Set_Group_Id=228; see also, Office of Management and Budget (2006) SA/T447, SA/T569).

¹¹⁹ For a comparison of the benefits, see <http://www.cnn.com/2006/US/Careers/10/11/cb.government/index.html>.

are in fact less over a range of jobs. Comparing the national average wage and the government wages for eleven randomly chosen job classifications, the government salaries are on average 4 percent higher.¹²⁰ This is certainly not conclusive evidence, but this coupled with the arguably greater benefits that comes with government jobs, suggests that the altruism contribution component is small or non-existent.

2. Outputs

Non-profit charities act directly to do social good, whether it is through feeding the poor in soup kitchens or buying land to set aside from development. The largest component by dollar volume is religious activity (36 percent), which likely includes a variety of social services. Education (15 percent), human services (10 percent), and health (9 percent) are the next largest activities of non-profit charities. The government does direct social activities too, but it also acts as an intermediary and issues grants to non-profits (about \$95 billion in 2006), for them to do good. Judging from the magnitude of inputs, the total amount of altruism generating activity from these two sources likely exceeds \$2 trillion.

The traditional accounts of corporate philanthropy focus on corporate donations to activities by non-profit charities (about \$20 billion in 2006). The largest component is about \$13 billion in direct gifts from firms to non-profit charities.¹²¹ The deductibility of direct gifts is capped at 10 percent of taxable income, and the average firm gives between 1 and 2 percent of pre-tax profits.¹²² Some firms, like Patagonia and Whole Foods, pledged a gift of up to 10 percent of profits to charity, but these are rare acts of generosity.¹²³

The rest of corporate giving is about \$8 billion in grants from corporate foundations.¹²⁴ Five of the biggest ten foundations were established by operating companies, most of which are pharmaceutical companies. Firms also donate billions to charities and other non-profits in the form of employee matching grants.¹²⁵ In absolute terms, firm direct giving has increased three fold since 1970, but as a proportion of profits has remained steady at about 1.5 percent.¹²⁶

¹²⁰ See <http://www.cnn.com/2006/US/Careers/10/11/cb.government/index.html> (noting average wages for the following jobs: attorney, financial manager, economist, microbiologist, architect, accountant, librarian, human resources manager, nurse, tax specialist, and medical technician).

¹²¹ See Giving USA, *Giving USA 2006*, available at http://www.aafrc.org/gusa/gusa_order.htm.

¹²² See Internal Revenue Code section 170(b)(2). Legislation proposed in 2003 would have raised this to 20 percent gradually over the next several years. See <http://www.independentsector.org/programs/gr/hr7.html>. See also Giving USA, *Giving USA 2007*, available at http://www.aafrc.org/gusa/gusa_order.htm.

¹²³ See <http://www.patagonia.com/usa/patagonia.go?assetid=2927> ("at least 1 percent of sales or 10 percent of pre-tax profits – whichever is more"); <http://www.wholefoodsmarket.com/contact/community.html> ("While the exact amount varies from year to year, we are committed to giving at least five percent of our annual net profits to charitable causes.").

¹²⁴ See FC 2005, available at _____.

¹²⁵ While we know of no data on the amount of employee matching programs, nearly every major company has a very generous matching program. See, for example, General Electric Employee Matching Program, Part IV.A.4 (matching up to \$50,000 per employee per year), available at http://www.ge.com/foundation/grant_initiatives/mg_guidelines.html.

¹²⁶ Direct giving is up over three times since 1970.

Focusing only on corporate donations, however, dramatically underestimates the amount of good works, and therefore altruism, firms deliver. To see this, consider the most obvious firm activity creating public goods: overcompliance with environmental laws. Countless high-profile companies have committed to lower emissions of carbon dioxide at the cost of several billion dollars,¹²⁷ and experts estimate these costs are at least \$30 billion and rising dramatically.¹²⁸ These costs are charitable contributions, since they are voluntary expenditures intended to improve social welfare in ways not obviously linked with shareholder value. After all, every dollar spent on reducing green house gas emissions is intended to improve the global environment instead of earning the most possible money for shareholders. A number of other corporate activities, including overcompliance with health, safety, and product regulatory rules, also fall within this category.¹²⁹

¹²⁷ Examples include: General Electric, *see* http://www.gepower.com/corporate/ecomagination_home/ge_position_uscap.htm (describing commitment by General Electric); Coca-Cola, *see* Michelle Conlin, "From Plundered to Protector," *BUS. WEEK*, Aug. 16, 2004 at 62 (describing plan to phase out ozone-depleting chemicals); Federal Express, *see* Marc Gunther, "Tree Huggers, Soy Lovers, and Profits," *FORTUNE*, June 23, 2003 at 99 (noting that FedEx converted its entire fleet to hybrid vehicles); UPS, *see id.* (noting conversion of 18,000 vehicles to alternative fuels); Motorola, *see* A. Revkin, "U.S. is Pressuring Industries to Cut Greenhouse Gas Emissions," *N.Y. TIMES*, Jan. 20, 2003, at A1; Alcoa, *see id.* (describing plan to cut by 25 percent); Waste Management, *see id.*; Proctor & Gamble, *see* Roger Cowe, "Improving Quality of Life and Profits," *FIN. TIMES*, Aug. 13, 2002 at 12 (noting commitment to reduce carbon emissions by two-thirds); DuPont, *see* Carey, "Global Warming," *BUS. WEEK*, Aug. 16, 2004 at 62 (describing 65 percent reduction in emissions since 1990, and plan to cut by additional two thirds).

¹²⁸ Interview conducted with experts on environmental law on January 10, 2008.

¹²⁹ *See, for example*, Michael Vandenbergh, *The Private Life of Public Law*, 105 *COLUM. L. REV.* 2029 (2005) (showing that private contracts are frequently replacing or supplementing traditional government oversight on environmental and other regulatory compliance issues).

Appendix B

The following discussion derives the tax rates reported in Table 1.

1. Non-profit sector

The dominant method of purchasing altruism from charities is to donate cash or other real assets.¹³⁰ If a taxpayer already itemizes deductions, she can deduct her donation from her taxable income. This deduction (called an “above-the-line” deduction) amounts to a discount on the price of altruism equal to her personal income tax rate. If the taxpayer does not itemize her deductions, however, the donation (called a below-the-line deduction) will not actually reduce her taxable income and the donation is not at all subsidized.¹³¹ Since only about 35 percent of taxpayers itemize their deductions,¹³² most donors do not actually enjoy any tax break for their donations. Itemizers are, however, responsible for a disproportionate share of donations, because they have higher incomes and thus likely demand more altruism,¹³³ and because higher income earners pay a higher average tax rate and thus enjoy a larger price discount on donations.

A second method of contributing to non-profit charities is to donate one’s time, also known as volunteering. The tax treatment of volunteering depends on what an individual would have done had she not volunteered her time. For hourly workers that could choose to work an extra hour and earn additional wages, volunteering reduces taxable income by the foregone wages. In that case, volunteering essentially offers the taxpayer an above-the-line deduction, that is, a discount on the price of altruism equal to the volunteer’s personal income tax rate. For salaried workers or those who would choose leisure instead of volunteering, no income is forgone by volunteering, and therefore there is no favorable tax treatment or discount on the price of altruism.

A third method of purchasing altruism from the non-profit sector is to donate appreciated stock or other investment property. A taxpayer who donates, for example, stock that has increased in value since its purchase does not have to pay any capital gains tax on the appreciation and can deduct the full value of the stock as if it were a

¹³⁰ We exclude volunteering and appreciated securities. These receive separate tax treatment and are discussed below.

¹³¹ Donations are taxed differently if they are made at the time of an individual’s death. (Roughly 10 percent of contributions to charity are bequests. Center on Philanthropy at Indiana University, *Giving USA 2004: The Annual Report on Philanthropy for the Year 2003 (2004)*; Congressional Budget Office, *The Estate Tax and Charitable Giving 1-2 (2004)*.) Like the treatment of donations (other than stock or time) during an individual’s lifetime, donations at death are deductible from the taxable estate. Because the estate tax schedule differs from the personal income tax schedule (for example the estate tax schedule currently maxes out with a 48 percent tax bracket while the personal income tax schedule maxes out with a 35 percent tax bracket), donations at death afford a different price discount.

¹³² IRS, *Statistics of Income – Tax Stats, Individual Income Tax Returns Publication 1304 (Complete Report), Tables 1.2 and 2.1 (2005)*, available at: <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=134951,00.html> (checked Feb. 19, 2008) (reporting that 47,775,427 of 134,372,678 filers itemized deductions).

¹³³ Itemizers account for 80.5 percent of all income tax revenue raised in 2005. *See id.* (reporting that itemizer paid \$753 billion of the total \$934 billion in income tax paid). Altruism is likely a “normal good,” that is one for which demand increases as incomes rise.

cash donation.¹³⁴ This donation is more favorable than the donation of cash, regardless of whether or not a taxpayer itemizes deductions. If the taxpayer does not itemize deductions, then the appreciated stock donation reduces capital gains taxes. If the taxpayer does itemize deductions, then the appreciated stock donations afford both the deduction of a cash donation plus the capital gains tax break.

The final method of contributing to non-profits is to work as a paid employee of a non-profit. Working can be thought of as a donation if the non-profit pays a lower-than-market wage for equivalent services. The size of the donation is the difference between the market wage and the non-profit wage. Because this foregone income lowers taxable income by the same amount, it generates a tax break equal to an above-the-line deduction in the amount of the foregone income. The result is, again, a price discount on altruism equal to the earner's personal income tax rate.

2. The For-profit Sector

The tax treatment of altruism purchased from for-profit firms is much more complex. One way for the taxpayer to obtain altruism through firms is to own shares in a company that either donates to non-profits or directly engages in social action. Either way, the purchase of altruism is deductible to the company as a charitable donation¹³⁵ or as a business expense. This gives the company a discount on the price of altruism equal to its corporate income tax rate.¹³⁶ Whether or not the company pays firm-level income taxes,¹³⁷ the company's social action reduces its net income and thus the shareholder's investment earnings. If corporate income is distributed as dividend, the shareholder will see a reduction in her taxable income. Thus corporate social action affords the shareholder a further tax break equal to an above-the-line deduction. If the investment earnings were accrued as capital gain, the shareholder would see a reduction in her taxes in proportion to the capital gains tax rate rather than the personal income tax rate. Because the capital gains rate is smaller than the labor rate for most investors,¹³⁸ accruing investment returns as capital gains affords a smaller discount for altruism than distributing those returns as dividends.

With so many moving parts (firm-level taxation, distribution of investment earnings), it is hard to describe succinctly the tax treatment of purchasing altruism through shareholding and corporate social action. Because the investment income most

¹³⁴ If the had not risen in value since the taxpayer purchased it, there would be no capital gains tax to begin with and the stock donation would be treated just like an equivalent cash donation.

¹³⁵ Corporate donations have the additional benefit that they can be depreciated immediately. These donations, however, are capped at 10 percent of net income. See Internal Revenue Code section 170(b)(2). Few corporations hit this threshold, since the average donation is about 1.5 percent of corporate profits.

¹³⁶ See, for example, Linda Sugin, *Theories of the Corporation and the Tax Treatment of Corporate Philanthropy*, 41 N.Y.L. SCH. L. REV. 835, 856-57 (1997) (noting that the tax code may privilege corporate giving over shareholder giving, and concluding that this is inefficient in light of managerial control over firms).

¹³⁷ If the company is taxed at the firm level, this discount is equal to the corporate tax rate, which is nominally 35 percent for the largest companies. If the company is able to opt out of Subchapter C, then its income is not taxed at the firm level and it enjoys no discount on the price of altruism.

¹³⁸ The capital gains tax rate will rise to 20 percent in 2010, but will fall to 10 percent for taxpayers in the 15 percent personal income tax bracket. See Tax Increase Prevention and Reconciliation Act of 2005, H.R. 4297, Public Law No: 109-222 (2005).

readily available to tax payers involves companies that pay corporate income taxes¹³⁹ and because most shareholders accrue investment earnings via capital gains, we shall use these features to simplify our characterization of the tax treatment of shareholder altruism. In this baseline case, buying altruism from a firm triggers two levels of discount, first by the corporate tax rate and then by the capital gains rate. Because the discounts are sequentially applied, the full discount is roughly $t_c(1 - t_{cg}) + t_{cg}$ where t_c is the effective corporate income tax rate and t_{cg} is the capital gains tax rate. By contrast, a cash donation to a non-profit yields a discount of t_p equal to the effective personal income tax rate. If investment earnings were distributed as dividend, which is taxed at the personal income tax rate, it is clear the tax treatment of shareholder altruism would be more favorable than the tax treatment of individual donations to non-profits. But since most investment gains are accrued as capital gains, it is possible that individuals with high personal incomes and thus $t_p > t_c(1 - t_{cg}) + t_{cg}$ might find donations to non-profits less costly than donations via stock.

A second way for individuals to obtain altruism from for-profit companies is to purchase green goods. Although this is a rapidly growing portion of total purchases of altruism, it is highly disfavored by the tax code relative to other forms of giving. Individuals buying green goods, such as fair trade coffee, do so with after-tax income, and therefore get no tax benefit under current tax rules. Consider two ways in which an individual can help poor coffee farmers in Africa: (1) buy a regular coffee and make a cash donation to a non-profit charity that gives aid to the farmers or (2) buy fair trade coffee that bundles a donation with the purchase of regular coffee. All else being equal, the first way is more efficient for the individual because the cash donation can be deducted from income, while the donation part of a fair trade bundle cannot. If an individual choose option (1), this leaves the individual able to donate more to charity or consume more other goods or leisure per dollar earned than the individual buying green goods.¹⁴⁰

The final way that individuals can purchase altruism through a for-profit outlet is to work at a company that does good deeds. Altruism purchased in this manner typically generates an above-the-line deduction regardless of whether the employee is an itemizer. For instance, if the company has a program that matches employees' donations to a non-profit charity, a profit-maximizing company lowers the wage it offers by the amount of the donation it makes on the employee's behalf.¹⁴¹ This reduction in wage lowers the employee's taxable income. Alternatively, if the company has a program that pays employees to do volunteer work, also called pro bono work, presumably the profit-maximizing company presumably lowers the wage it pays on non-volunteer hours to account for the lost productivity during the volunteer hours. Again the result is a reduction in the employee's wage. In this regard, altruism purchased through

¹³⁹ Any company with publicly traded shares is taxed according to subchapter C, that is, pays corporate income taxes.

¹⁴⁰ Certain green goods, such as hybrid cars, are the target of government subsidies, but this treatment is the exception rather than the rule.

¹⁴¹ The company is indifferent between donating a matching amount or paying the employee more. Either way the expense is deductible, assuming the 10 percent cap on corporate charitable donations does not bind.

employment at a for-profit company is treated as volunteer work that reduces the hours worked by an individual paid on an hourly basis.¹⁴²

Readers with comments should address them to:

Professor M. Todd Henderson
University of Chicago Law School
1111 East 60th Street
Chicago, IL 60637
toddh@uchicago.edu

¹⁴² There are two caveats to this description of the tax treatment of altruistic employees. First, if the company's shareholders do not dock the altruistic employee's wage by their matching donation or paid volunteer hours, they in effect decide to pay for altruism themselves. In that case it is the shareholder that is paying for part of the employee's purchase and it is the shareholder that receives a tax break. Second, it is difficult for a company to adjust the wage of each individual employee based up the employee's participation in a work-sponsored charitable program. In general it can only adjust the wages of all employees based on the participation of the average employee. This generates a sort of moral hazard where each individual employee has an incentive to donate or volunteer more than average because there is no cost in terms of lost wage. Indeed, there is a subsidy equal to the after-tax wage rate. To limit this moral hazard, companies have to cap the number amount of matching donations or the amount of pro bon work they permit.

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