

Investing in Good Deeds Without Checking the Prospectus

 nytimes.com/2006/06/15/business/15scene.html

TYLER COWEN

June 14, 2006

DONORS to charities, it seems, do not behave rationally. Increasing evidence shows that donors often tolerate high administrative costs, fail to monitor charities and do not insist on measurable results — the opposite of how they act when they invest in the stock market.

The charitable sector now represents more than 2 percent of gross domestic product in the United States. So, improvements could bring significant value to American higher education, religion and the arts, which have come to rely on donations.

But before we can improve our charity, we must first understand it. John A. List, an economist at the University of Chicago, is studying fund-raising campaigns toward this end. Professor List, combining his career as a researcher with a role as part-time consultant, introduces variations into real world fund-raising campaigns and studies the results. This reflects his core method of the "field experiment," which he has applied to topics as diverse as competition between the genders, how contestants cooperate on television game shows and how markets work in baseball card trading. Steven D. Levitt, co-author of "Freakonomics" and a colleague at the University of Chicago, refers to Professor List as the young economist most likely to win a Nobel Prize.

Professor List's research implies that most donors do not respond when they have opportunities to be more effective in their giving. For instance, it is well known that a "matching pledge" — if one donor gives a dollar, some other donor pledges to give a dollar more — increases charitable contributions. Donors are enticed by the idea of "more bang for the buck." Yet Professor List finds ("Does Price Matter in Charitable Giving?", co-written with Dean Karlan, an economics professor at Yale University, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=903817) that the size of the match does not seem to matter. When the pledge is for \$2 or even \$3 to match an outside dollar, donors do not, in the aggregate, give more money.

Professor List's work more generally suggests that people become rational in their spending only through the repeated experience of trading in markets. This trial-and-error process, with the accompanying feedback, is absent when people give money to a distant charity. Once the money is gone, donors do not personally bear direct costs from bad charitable decisions. Nor is it easy to learn what went wrong.

Professor List has yet to delve into the specifics of donor motives, but the obvious conclusion is that donors do not behave like customers. Customers take great care to learn about the merits of different expenditures, on cars or on homes, for example.

But donors often give to charities for reasons of pride. Monitoring a charity means worrying about the wisdom of contributing to that charity. Many donors would instead prefer simply to feel good about their generosity and thus they deceive themselves into thinking that all is going well. Furthermore, many donors seek a sense of affiliation and wish to be a part of large and successful organizations – the "winning team," so to speak. Again, these donors do not focus on how, or if, they actually end up improving the world.

If donors are not looking at results, they may end up choosing charities on the basis of extraneous qualities. Professor List conducted another experiment ("Toward an Understanding of the Economics of Charity" (<http://www.nber.org/papers/w11611.pdf>), with Craig Landry, Andreas Lange, Michael K. Price and Nicholas G. Rupp) on charitable giving. He and his research team ran a door-to-door fund-raising trial, using a variety of methods, across nearly 5,000 households. The team then measured the difference between the most effective fund-raising method (selling lottery tickets) and the least effective method (just asking for money).

For purposes of contrast, Professor List and his team then increased the attractiveness of the woman who asked for the money. The more attractive women (a "one standard deviation increase in attractiveness," in statistical terms) had as big a positive impact on giving – in the range of 50 to 100 percent – as moving from the least successful fund-raising method to the most successful.

The philanthropic sector is showing a growing awareness of these sorts of institutional failures, so initiatives are under way to improve their performance. The Robin Hood Foundation in New York City pledges that its board will cover all overhead expenses; remaining donations go to antipoverty programs. The charity College Summit raised \$15 million by going to Wall Street with a plan for growth and fund-raising, much as a venture capitalist might do. Geneva Global encourages donors to think of themselves as investors; it measures and reports results for each of its programs.

It remains to be seen which particular innovations will stick or spread, but well-informed and self-critical donors are probably a key to improvement for nonprofit organizations. If donors do not abandon failing causes, those efforts will continue. Perhaps the content of donor pride needs to change. Rather than taking pride only in their generosity, donors should also take pride in their willingness to confront unpleasant news. Many individual donors are reluctant to take such steps, but the result would be better charities and greater real generosity all around.