

ABSTRACT

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How sensitive is the average tax-payer to changes in the tax-price of giving?

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Abstract:

A fundamental problem in estimating the responsiveness of donations to tax incentives is that the price of donating \$1 is a function of the level of donation, and hence is inherently endogenous. One approach in the literature estimates the tax-price elasticity of donating using data on itemized tax returns for those whose other tax deductible expenditures are such that the price of donating is not a function of how much they donate. This approach solves the endogeneity problem, however, the tax-price elasticity estimated on this sub-sample reflects the responsiveness of the average person who files their tax return, a group which is significantly wealthier than the average tax-payer. As such other researchers have sought to estimate the tax-price elasticity of the average taxpayer based on survey data. Results from both studies present a counter-intuitive conclusion; the responsiveness of the average tax payer is larger than that of the average, wealthier, itemizer. We provide theoretical and empirical evidence that this conclusion results from a heretofore unrecognized downward bias in the estimator of the tax-price elasticity using survey data when non-itemizers are included in the sample. An intuitive modification to the standard model used in the literature is shown to yield a consistent and efficient estimator of the tax-price elasticity for the average tax payer under a testable restriction. We find empirical support for this restriction and estimate a bias in the price elasticity of the average taxpayer in the standard model of around -1. Our results suggest an inelastic tax-price elasticity for the average taxpayer, where a statistically significant and elastic price response is found only for individuals in the top decile of income.

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