Small world economics in a big society

Are public policies towards charities keeping up with the information revolution? Kimberley Scharf argues that more attention needs to be paid to the many forms of social interaction that influence voluntary giving.

Now that the proposed cap on tax relief for charitable contributions has been abandoned, are we all happy that public policies for the charitable sector are as they should be? Well, there have been longstanding noises about reforming Gift Aid. And there is talk about changing other tax incentives – on gifts of land, buildings and shares; payroll giving; and legacies.

But is there anything else that we should discuss with respect to charities and public policies? Maybe we should think in new directions to keep up with the fast changes in the way that information flows in a world more connected than ever.

Here are some facts about people who give to charity: 16% give in a place of worship; 13% give in the workplace; 18% sponsor friends and family; and 7% give to pub collections (DCLG, 2009). These all involve social interactions that happen for reasons other than giving.

So how do social interactions shape voluntary giving? It could be that we give to impress friends and colleagues or to show them that we are nice people. A less cynical take is that empathising with people we know can make us sensitive to causes that would otherwise not worry us. Or it could be that we can more easily share information about worthwhile causes with people we know.

Whatever the reason, voluntary giving is a quintessentially social phenomenon. Charities are well aware of this fact and they take account of it in their fundraising strategies. Add to this the ease of communicating through modern social media, and it could be that the social side of giving is more central to charity than ever before.

Yet the way economists and policy-makers have traditionally thought of giving completely ignores its social connotations: it is studied as an individual choice, mainly determined by selfish or altruistic motives and by such factors as tax breaks, which affect the cost for individuals to give. This approach to the analysis of philanthropy is at odds with the evidence and how people working for charities view giving.

Voluntary giving is a quintessentially social phenomenon

Isn't it time to ask questions about how social connections shape giving to help us understand how better to target private and public resources aimed at encouraging more charitable contributions? I can answer with an emphatic yes: the study of the relationship between giving and non-giving social interactions is long overdue.

Let me be a little more precise about the difference between giving interactions and non-giving social interactions. The former is an interaction based on a direct relationship between a person and a charity: direct debit contributions to one's favourite association; give as you earn schemes; and so on. Non-giving social interactions might include open garden schemes run for charity, church services and beer and skittles evenings – activities where giving happens but it is not the main event.

Charitable giving frequently happens because of non-giving social interactions – at work, in church, down the pub, etc.

Do social connections always promote giving? Not always. For example, people we know might share information with us about worthy causes or good providers, but if we know lots of people, then the advice of each one could end up lost in the noise of the crowd. If this happens, there are implications for efficiency and thus for public policy.

In a recent study of the effect of social structure on information diffusion and giving, I develop an economic model of giving where people share overlapping social neighbours – as with Facebook where I have friends and my friends have friends (Scharf, 2011). I ask if the number of social connections that individuals have affects the way that information about the quality of charity provision is diffused – and, if so, what the implications are for total giving.

My main conclusion is that information transmission about giving opportunities is undermined by 'free-riding' incentives – we all count on neighbours to convey the information and

so save on the effort of doing it ourselves. The consequence is that the more social neighbours that people have, the less information sharing there is and so the lower is the aggregate level of giving.

Remember that this is a theoretical prediction that shouldn't be taken to imply that more 'social connectivity' discourages giving. On the contrary, it implies that there is more giving in smaller, closer-knit groups of individuals who share common interests. What matters is the closeness of social interactions: large loosely connected groups share information less effectively than smaller, better integrated groups.

While tax incentives can encourage giving, they might crowd out private incentives to share information

But my research makes more than a general statement about information flows in social networks: it also generates testable predictions that have direct implications for public policy. One is that even though tax incentives can encourage giving, they might crowd out private incentives to share information. In such cases, government subsidies for fundraising efforts – such as Catalyst endowments – might achieve a higher level of charitable contributions than tax incentives.

What can we learn from the charitable sector's own approach? Fundraisers have long understood the importance of non-giving social interactions as a determinant of success at fundraising, and there are lots of resources devoted to targeted relationship-building. Yet fundraisers face obstacles both in being effective and in maintaining charity-donor relationships once they have been established.

Why? It may be that fundraising efforts are not as effective as they could be simply because nobody really understands the information channels through which non-giving social interactions affect giving. But there may be other reasons too and we don't really have a proper understanding of the causes and effects.

Can economists help? Only if they move beyond a focus on the incentives for individual giving and stop leaving social interactions out of the picture. This criticism is nothing new: almost 40 years ago Gary Becker published an influential study, in which he complained that obsession with formalism meant that a lot of important things, such as non-giving social interactions, were being ignored by economists (Becker, 1974).

Economic research is now starting to take notice of social interactions. In addition to my study, recent work on social information and social norms finds that giving behaviour is influenced by how much others give and by how many others are giving (Frey and Meier, 2004). This means that the effectiveness of giving incentives depends very much on the types of givers.

Other research looks at the effects of social pressure on giving. A recent study finds that people give more when pressured (giving goes up) but social pressure creates incentives for people to avoid situations where they might be pressured (giving goes down). The overall effect is ambiguous: giving can rise or fall depending on which effect is stronger (DellaVigna et al, 2009).

Other economic research takes a less charitable view of donors. For example, signalling models presume that people are naturally greedy and make contributions out of concern for reputation or status (Benabou and Tirole, 2006).

Can we do better than this? I think so, not only from a research perspective but also from a policy perspective. Even though policy-makers seem to be picking up the scent of a winning horse, beyond generic endorsements of the value of the 'big society' and/or 'small world economics', there is nothing in current policies to reflect the role of social interactions in charity.

To sum up, the provision of charitable goods and services frequently happens because of non-giving social interactions. Charities have long known this, but economists and policy-makers are both lagging behind. Given the growing reliance of service provision on private donations, public policies directed towards charity have never been more important. And given the recent explosion of social networks, there is no longer any excuse for economists and policy-makers to leave social interactions out of the picture.

Kimberley Scharf is a Professor of Economics at the University of Warwick.

Further reading

Gary Becker (1974) *'A Theory of Social Interactions'*, Journal of Political Economy 82(6): 1063-93.

Roland Benabou and Jean Tirole (2006) *'Incentives and Pro-social Behavior'*, American Economic Review 96(5): 1652-78.

DCLG (2009) *'Citizenship Survey: 2008-09 (April 2008-March 2009), England 1'*, Cohesion Research Statistical Release 8, Department for Communities and Local Government.

Stefano DellaVigna, John List and Ulrike Malmendier (2009) *'Testing for Altruism and Social Pressure in Charitable Giving'*, NBER Working Paper No. 15629.

Bruno Frey and Stephan Meier (2004) *'Social Comparisons and Pro-social Behavior: Testing Conditional Cooperation in a Field Experiment'*, American Economic Review 94(5): 1717-22.

Kimberley Scharf (2011) *'Private Provision of Public Goods and Information Diffusion in Social Groups'*, CEPR Discussion Paper No. 8607.