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Taxes, Charity, and Evasion

The amount of charitable contributions reported by U.S. taxpayers on their individual income tax forms responds strongly to marginal tax rates. Individuals in higher tax brackets tend to report higher charitable contributions than individuals in lower brackets, even if their beforetax incomes and other characteristics are the same. This is not surprising, since the cost of giving $1.00 to charity is 85 cents for someone in the 15 percent bracket but only 72 cents for someone in the 28 percent bracket.

Of course, the same marginal tax rate that reduces the net cost of charitable giving will increase the incentive for individuals to evade taxes by overstating charitable contributions. It is possible, then, that the measured responsiveness of charitable contributions to tax rates in part represents the response of overstatement rather than of actual giving. However, NBER Research Associate **Joel Slemrod** finds that the responsiveness of charitable giving to tax rates does not represent tax evasion. In **Are Estimated Tax Elasticities Really Just Tax Evasion Elasticities? The Case of Charitable Contributions** (*NBER Working Paper No. 2733*), Slemrod finds that IRS auditors make upward as well as downward adjustment to the reported amounts of charitable giving on forms that they check. The upward adjustments represent 1.7 percent of charitable giving, and the downward adjustments are 8.9 percent. That is, charitable giving is overstated by about 7.2 percent overall.

Surprisingly, the relative downward adjustments by IRS auditors *decrease sharply* with increases in adjusted gross income. The total downward adjustment of reported contributions was more than 10 percent for taxpayers with income between $20,000 and $50,000 (in 1982 dollars), versus 4 to 10 percent for taxpayers with income between $50,000 and $1,000,000, and only 1.1 percent for taxpayers with income over $1,000,000. If evasion were a strong factor in reported charitable giving, one would have expected the opposite pattern since individuals with higher incomes are in higher marginal tax brackets and thus have a stronger incentive to evade taxes.

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Slemrod finds that a 10 percent decrease in the net (aftertax) cost of giving one dollar to charity is associated with a 20 percent increase in the amount of reported charitable giving. That same 10 percent decrease in the cost of giving is associated with a 23 percent increase in the amount of charitable giving after adjustments made in IRS audits. In other words, IRS auditing adjustments for reporting errors imply that charitable giving is even more responsive to price than we had thought.

Slemrod also finds that as taxpayer income goes

up, so do charitable contributions, but the percentage of income donated to charity declines. A 10 percent increase in income is associated with a 3 percent rise in contributions. In 1982, the average taxpayer with $10–20,000 in income gave $704, taxpayers with $40–50,000 in income gave $979, taxpayers with $100–200,000 gave $3980, and taxpayers with incomes over $1 million gave an average of $90,400. Slemrod also reports that contributions rise with the age of the taxpayer, and that married taxpayers contribute more than single taxpayers.

Slemrod uses data from 1982 tax returns audited under the IRS's Taxpayer Compliance Measurement Program. Marginal federal tax rates that year ranged from 12 percent to 50 percent. DRH

Strikes and Stock Prices

Strikes can cost workers lost earnings for days off the job and can cost firms lost output and sales, and lower profits. Now a new NBER study by **Joseph Tracy** finds that firms that experience strikes also will see the price of their stock suffer.

In **Testing Strategic Bargaining Models Using Stock Market Data** (*NBER Working Paper No. 2754*), Tracy reports that in the days before an anticipated strike, the price of the firm's shares declines slightly. On average, the announcement of a strike reduces the value of a firm's equity by 0.5 percent. The company's stock price tends to fall for as long as the work stoppage continues.

The overall reduction in stock price ranges from 1 percent for strikes lasting less than one month to nearly 6 percent for strikes lasting between three and four months, Tracy calculates. When a new labor contract is finally approved, stock prices rise by an average of 0.2 percent on the day of signing and then continue to rise slightly over the two days following the settlement.

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In as many as 15 percent of all contract negotiations between unions and management, strikes occur before a new contract is signed. When union and management continue to bargain and to work past the expiration date of the contract, the average stock price does not fall. However, Tracy finds that in such situations the average value of the firm's equity declines by 0.2 percent during the three trading days following the contract settlement.

Tracy analyzes a sample of 2166 major contract negotiations covering at least 1000 workers that occurred between January 1970 and December 1981. Of these, 212 included a strike. For this study, Tracy links the complete chronology of the bargaining that was available for each negotiation with daily data on stock prices. ML

Commodity Prices as an Indicator of Inflation

Changes in commodity prices can dramatically affect developing countries that receive much of their export earnings from primary commodities. However, there also may be a large effect on industrial countries if increases in commodity prices signal future increases in consumer prices.

In **Commodity Prices as a Leading Indicator of Inflation** (*NBER Working Paper No. 2750*), Research Associate **William H. Branson** and **James M. Boughton** ask how well commodity price indexes have predicted consumer price inflation in the large industrial countries (excluding the United States). They find that there is no long-run relationship between the *level* of commodity prices and the *level* of consumer prices. However, six of the nine turning points in consumer price inflation in these countries since 1970 *were* preceded by turning points in commodity price inflation.

"There is no long-run relationship between the level of commodity prices and the level of consumer prices."

While *changes* in commodity prices tend to precede *changes* in consumer prices, this relationship depends on the sample period or on the method for calculating the index. For example, past prices of commodities that are denominated in terms of a broad currency basket rather than in U.S. dollars predict consumer prices better than past consumer prices do.

Branson and Boughton explain why commodity prices might lead consumer prices. Commodities

are traded in "auction" markets, where prices adjust very quickly to changes in supply and demand, while industrial prices adjust more gradually. Thus, commodity prices reflect imbalances between aggregate supply and aggregate demand more quickly than consumer prices do. Information about future consumer prices that is not reflected in current consumer prices thus will appear in current commodity prices.

Branson and Boughton use several indexes of the prices of 40 commodities, with weight given by shares in world trade or consumption, or estimated statistically. They compare movements in these indexes with movements in a weighted average of consumer prices in the so-called G-7 industrial countries—the United States, Japan, West Germany, France, the United Kingdom, Italy, and Canada.

Industrial Concentration and the Quality of Exports

Industrial concentration may help to speed the transition of newly industrializing countries (NICs) from standardized, labor-intensive products to sophisticated, skill-intensive products, according to a new study by NBER Research Associate **Dani Rodrik**. Large companies with substantial market shares are better able to counteract the inherited reputation for shoddy goods that serves as a barrier to entry into world markets for most NICs, he finds.

In **Industrial Organization and Product Quality: Evidence from South Korean and Taiwanese Exports** (*NBER Working Paper No. 2722*), Rodrik compares Taiwanese manufacturers with the large conglomerates or "chaebul" that dominate the Korean economy and rapidly are becoming household names in the United States. The Taiwanese firms typically are small and anonymous, generally entering the U.S. market through private brand operations.

Although both South Korea and Taiwan have had phenomenal success in expanding and diversifying their manufactured exports, Taiwan is actually more developed economically by most relevant criteria. Per capita gross domestic product in 1983 was $2670 in Taiwan versus $2010 in Korea, and Taiwanese life expectancy at birth was 72 years, versus 65 years in Korea. Yet Rodrik finds that Korean exports to the United States are of systematically higher quality than the Taiwanese exports, at least when measured by unit value (that is, dollars per unit of product). In 30 of the 49 product groups where either country's exports exceeded $100 million, the unit value of Korean shipments was higher than the value of the Taiwanese goods. The average differential was 27 percent. Moving up the scale from low-end to high-end products, the Korean quality advantage generally increased.

"Industrial concentration may help to speed the transition of newly industrializing countries (NICs) from standardized, labor-intensive products to sophisticated, skill-intensive products."

Rodrik suggests that the price a firm can get for its product in international markets is related to the perceived quality of its output. That perception lies somewhere between the actual quality of the specific product and the *average* quality of the home country's exports. Firms with higher-than-average quality face external costs that decline as their market share increases. In other words, a company with a large market share exporting high-quality products will pull up the *average* quality of the home country's exports. Thus, the information gap between actual and perceived quality will be closed. The higher a firm's market share, the more likely it is to enhance its reputation through advertising. In turn, says Rodrik, "When firms have the ability to build reputation and brand loyalty, the expectation is that the quality differential between concentrated and unconcentrated industries will be even larger."

Rodrik notes that developing countries can expect to derive some important benefits from the shift to production of high-quality products. For one thing, the premium price that high-quality products command means higher export profits—and higher national income. In addition, says Rodrik, high-quality exports require a range of skills and technological sophistication that could have broad application elsewhere in the economy. LB

Recent NBER Books

Two International Volumes Available

Two of the four volumes reporting on the NBER's Project on Developing Country Debt, edited by Jeffrey D. Sachs, are now available from the University of Chicago Press. *Developing Country Debt and the World Economy* is nontechnical, and presents condensed versions of the studies of eight countries and eight papers on the international financial system. It should appeal to anyone interested in the problem of developing country debt and could be a useful classroom tool. It is priced at $50 for the clothbound edition and $16.95 for the paperback.

Developing Country Debt and Economic Performance, Volume 1: The International Financial System focuses on the international financial system as a whole. Its eight papers look at: the history of international lending and its implications for reform of the current system; alternative designs for stabilization programs; problems of debtor countries in adjusting to the debt crisis; and the financial institutions in developed countries. This book should interest economists in government, banks, international financial institutions, and universities. Also, since one paper looks at the political obstacles to adjustment strategies, this volume should appeal to political scientists and others interested in the political economy of developing countries.

The price of Volume 1 is $45. Volumes 2 and 3, containing the eight in-depth studies of debtor countries, are scheduled for publication this spring.

Sachs, editor of this series and director of the debt project, is a research associate in the NBER's Program in International Studies and a professor of economics at Harvard University.

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Individual copies of the NBER Working Papers summarized here (and others) are available free of charge to Corporate Associates and other supporters of the National Bureau. For all others, there is a charge of $2.00 per paper requested. Prepayment is required for all orders under $10.00. Please do not send cash. For further information, please contact: Working Papers, NBER, 1050 Massachusetts Avenue, Cambridge, MA 02138; (617) 868-3900. Abstracts of all current National Bureau Working Papers appear in the **NBER Reporter.**