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The Value of Philanthropy: Some Economic and Ethical Perspectives from Adam Smith to the Post-World War II Era

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3.1 Introduction

Corporate Social Responsibility (CSR) is regarded as an important business practice that assists in obtaining the Sustainable Development Goals. This chapter contributes to a discussion of the value of philanthropy as a part of CSR (Carroll 2008). Philanthropy, however, is not always regarded as the best way of practicing CSR (Levy 2002). It has been said to be paternalistic, which results in recipients becoming dependent on the donors, and therefore more helpless in controlling their own lives. Archie B. Carroll called it "the icing of the cake" in his metaphorical CSR pyramid (Carroll 1991). To do good came as an extra dimension on top of being profitable, obeying the law and following ethical obligations with regard to what is right and fair. Later the four categories were reduced to three, because philanthropy was collapsed into ethics (Carroll 2008).

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Still philanthropy need not only be charity or giving money and smaller gifts to others who are in acute need. It can be strategic, giving the company a better reputation and therefore a valuable tool for the companies. When someone gets a donation to help start up a firm, or a fishing-boat to give them the opportunity to feed themselves, this can be a great way to contribute to getting a better life. A capitalist society, with philanthropic instead of greedy companies, can make the whole market system more acceptable to people.

The relation between corporate philanthropy, CSR and sustainable development has changed over time and varies among countries as well. CSR has played a far less prominent role in the European welfare states than in the USA. There, the main part of CSR rested on the shoulders of corporations, because governments preferred less intervention in the private sector. But private philanthropy has been important in many countries. In fact, it can be difficult to draw up a line of demarcation between corporate and private philanthropy. Very often a businessman, who has become rich through his company, later in his life decides to share some of his money with others.

Not all studies see philanthropy as an inferior part of CSR. An interesting perspective on the value of corporate philanthropy can be found in von Schnurbein et al. 2016. They argue that corporate philanthropy has a special role to play outside of the classical CSR concept. Based on the economic, motivational, creative and moral characteristics of corporate philanthropy, the authors establish a clear distinction between the two concepts.

3.2 How to Define the Value of Philanthropy in Economic Theory?

Value is a multidimensional concept (Mooya 2016). We can speak of market or economic values, but also of spiritual and moral values. Many things are valuable to us without having a price. The classical economists in the nineteenth century meant that value was created by, and could be measured in, man-hours of work. Value was not identical with market price. The neoclassicals from the late nineteenth century explained value as subjective utility of the individual and regarded prices in competitive markets as a measure of these values. In our days, Amartya Sen, an outstanding economist who also refers to Adam Smith, emphasizes ethics as a part of economic theory (Sen 1977). The value of philanthropy has been said to increase because it develops mutual trust in the community (McKean 1975).

3.2.1 Overview of Economic and Ethical Perspectives on the Value of Philanthropy over the Last 250 Years

Philanthropy has been practiced for a long time throughout history. To what degree certain economic actions are valuable to individuals and the society is an important part of what economists study. Textbooks in main stream economics do not often take up CSR. The discourse of philanthropy is a bit different in CSR literature and economic theory. In the first, whether philanthropy is strategic enough for the company is often discussed. Theoretical economists look at this in a broader perspective. They see philanthropy as one way in which transactions that have consequences for resource allocation, macroeconomic activity levels, income distribution, and utility and happiness for the single member of the society can be achieved. Investigating how economists have defined and discussed philanthropy can give us a better understanding of its value, also in a CSR perspective. Table 3.1 gives an overview of different economic approaches to the value of philanthropy in economic theory.

3.3 Eighteenth Century–1870: Classical Political Economy

3.3.1 Adam Smith

In the early phases of the industrial revolution and capitalism one saw increasing poverty among many people in England. As a consequence of

Table 3.1 Economic and ethical perspectives on the value of philanthropy—overview of the three periods

Period	Central economists	Keywords	Value
Classical political economy—eighteenth and nineteenth century	Adam Smith Robert Malthus David Ricardo Jeremy Bentham John Stuart Mill	Self-interest The invisible hand Beneficence, sympathy, The impartial observer The law of population The iron law of wages Utilitarianism	Use and exchange value isolated Does income redistribution have value?
Neoclassical economics late nineteenth century to 1950	Henry Stanley Jevons Carl Menger Leon Walras Lionel Robbins	Economics as physics Subjective utility approach Homo economicus Pareto optimality Ordinal utility	Marginal utility as value Value in models of self-interest Value-free economics
Neoclassical and ethical economics 1950–1980	Kenneth Arrow Gary Becker Kenneth Boulding Edmund Phelps William Vickrey Amartya Sen	Interactive utility functions	The value of unselfish behavior Value in interactive utility functions

this, philanthropy became widely debated among economists and others in eighteenth-century England (Wootton 2018).

Landreth and Colander 1994, 68, stated that "*Adam Smith has often been called the father of economics*" and his *Wealth of Nations (WON),* published in 1776 has been looked upon as the first modern economic textbook (Mooya 2016; Landreth and Colander 1994). In his book, Smith proposed that self-regulating markets (*the invisible hand*) would bring about the maximum good for society. Since then, Smith's view has had relevance for how economists have interpreted philanthropy. He argued that when each person follows his or her private interests, this will also unintentionally realize the public good. Smith writes:

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from regard to their own interest. We address

> ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. Nobody but a beggar chooses to depend chiefly upon the benevolence of his fellow citizens. (Smith 2004/1776, 12)

But 17 years before WON, he gave out his other famous book, *The Theory of Moral Sentiments (TMS)* (Smith 1976/1759). There he claimed that man has many motives, not only self-interestedness. He writes:

> *How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.* (Smith 1976/1759, 9)

It has been claimed that there is an apparent incongruity between TMS—which appears to recommend and endorse sympathy—and WON, which appears to recommend and endorse selfishness (McLean 2006). In TMS, we see that Smith believed that people would often naturally offer a helping hand to those who needed it (Otteson 2013).

We can easily be a bit confused about to what degree Adam Smith valued philanthropic acts. A closer study of the relation between economics, self-interest and morality in his works can help us in explaining how he valued philanthropy. Smith's principle of sympathy seems to imply that he values altruistic acts very much. The use of the phrasing 'the pleasure' implies that Smith presents a moral and psychological explanation for why we act ethically and that philanthropy also has value for the donor.

How did Smith explain our non-egoistic motives? According to him, our faculty of sympathy was not in itself strategic, and he distanced himself from the egocentric explanation of his time, inspired by Thomas Hobbes' writings (Khalil 2001). Smith meant that self-interest (*virtue of prudence*) and interest in others (*virtues of beneficence*) came from the same source but differed in degree. Sympathy for oneself is very high, and for others its relative intensity is proportional with proximity-related factors.

This social proximity is analogous to genetic proximity, the inclusive fitness hypothesis that we will address below. The value of philanthropy is higher for the donor if the recipient of the donation is socially closer to the donor. And Smith did not view beneficence as rooted in any moral dictum, maxim or canon of duty. This is not what will give value to the donor, according to Smith. It always has to be voluntary and never forced upon one (Smith 1976/1759).

The core of his argument is that we are impartial and reflective spectators who are acting from another (what he calls) 'station' in a role that examines and judges our own acts. Sympathy is stronger when others are close to us. Then the value to the donor will be higher. We do not see things only from the other person's 'station' either, because that would mean that we fully adopt the needs of others, while at the same time dismissing our own needs and wants as illegitimate, immoral and selfish (Smith 1976/1759, III.3).

3.3.2 Thomas Robert Malthus

More critical to philanthropy was the economist and clergyman, Thomas Robert Malthus (1766–1834). He argued that an increase in relief for the poor would fail to have any benefits (Backhouse 2004). The relatively young Malthus got into a dispute with his father about improving the conditions of average families in England. From the son's famous *Essay on population from 1798*, man had to live on a subsistence level, procreating during good times and starving during the bad. An improvement of their income level would result in more children and as a result of that people would fall again to the subsistence level of income. Human betterment therefore was impossible; poverty and misery were inevitable for the majority of people in every society. So, from this economist's view, it seems that philanthropy has little value for the recipient and the society.

3.3.3 David Ricardo, Jeremy Bentham and John Stuart Mill

The classical period lasted till around 1870. Malthus' view on subsistence wage as the highest possible for workers was dealt by his colleague and friend, David Ricardo, because of the harsh competition for jobs among workers (*iron law of wages*—Ricardo 2004/1817).

But as classical economy became influenced by the utilitarian philosophy of Jeremy Bentham (1748–1832) and John Stuart Mill (1806–1873), views changed. Bentham believed that a society should maximize happiness for all of its members, also by redistributing income. Mill took in many matters a middle course between Smith and Malthus and went far towards social capitalism, where income distribution was a political matter that could not uniquely be decided by the market forces. He put more emphasis on the value of equality, also for women (Pressman 2014). He became a spokesman for an ethically informed economy and objected strongly to the relative powerlessness of the workers (Galbraith 1987).

The value of philanthropy in the period of classical economy from Adam Smith till about 1870 is attached to the naturalist political idea of a free and rational individual against the medieval religious governed men and the economic ideas of the unregulated markets against mercantilism. Ideas and beliefs (Zeitgeist) in this period reflected this. People to a large extent had to master their own faith, and not to any large degree rely on support from the authorities and their fellow men.

3.4 1870–1950: Utilitarianism and Neoclassical Economics

3.4.1 Background

In the end of the nineteenth century, we had come to the age of the Second Industrial Revolution, when national income in many countries grew, technology became more advanced and workers' organizations and people's movements grew stronger. From about 1870, mainstream economic theory changed from classical to a neoclassical tradition. We saw more rivalry between political and economic ideas, especially between conservatives and socialists. The labour and cost-based value theory of the classical political economists was replaced by a subjectivist utility and preference-based value thinking. A good service had its value decided by a subjective feeling of utility from the individual who consumed it. Marginal utility of consuming was falling when people consumed more of a product, and marginal utility of income for people was also falling. Value was linked to the utility of, and demand for, the marginal or last unit of a good.

3.4.2 Henry Stanley Jevons (1835–1882), Carl Menger (1840–1921) and Leon Walras (1834–1910)

The marginalist revolution was a discovery made independently by these three persons from England, Austria and France (Pressman 2014). Neoclassical economics had its roots in Adam Smith's invisible hand and was based on laissez-faire, but his idea regarding sympathy from TMS in 1759 was not included. Neoclassical economics was based on methodological individualism, formal reasoning by mathematics and the utilitarian philosophy of nineteenth-century philosophers mentioned above. Jevons was inspired by physics in his analysis of the economy (Pressman 2014). With the help of mathematics, based on profit maximization and individual utility maximization, Leon Walras tried to prove that Adam Smith's metaphor of the invisible hand or market forces could lead to an equilibrium with the optimal economic situation for the society. The consequences were that the neoclassicals strongly supported the idea of a *homo economicus,* acting on self-interest, and tended to assume away many of the social and moral aspects of economic life. The economic policy recommendations were still Adam Smith's invisible hand, but without his reflections on ethics.

3.4.3 Lionel Robbins (1898–1984) Dissociation of Economics and Ethics

Jevons and some other early marginalists believed in *cardinal utility*, which implied that utility could be measured by a number, and therefore one could still make interpersonal utility comparisons. Later this approach was replaced by an *ordinal utility* approach (Pressman 2014). The influence of Pareto-optimality and ordinal utility coincided with the view that interpersonal comparison of utility was not feasible. This also crowded out evaluations on the value of philanthropy in the neoclassical models. According to the influential British neoclassical economist, Lionel Robbins, it was necessary to dissociate economics and ethics (Fontaine 2007). Welfare in neoclassical economy was based on the isolated individual's utility maximization and on Pareto-optimality, where income distribution became defined away from the models. Economic analysis was now supposed to be neutral and value free.

3.5 After World War II: Incorporating Unselfish Behavior into Economic Theory

3.5.1 Growing Interest in Philanthropy in the USA in the 1950s

After World War II, politicians in the USA started to be interested in philanthropy due to tax questions (Madrakhimova 2013). The tax status of private foundations had come under attack for misuse of money. In the early 1960s, an inquiry into grantmaking of those foundations was launched, and this led economists to engage themselves in the issue (Fontaine 2007). This political and institutional process led to new perspectives among theoretical economists. Philanthropy was attached to how income distribution could influence the economic system, and the assumption of the self-interested '*homo economicus*' found itself challenged. It was also studied as a part of public finance questions (Vickrey 1975). Economists started to construct mathematical formalized utility functions, which included the attributes of other people (Schwartz 1970; Becker 1974). In the early 1960s, a handful of economists articulated views on philanthropy (Fontaine 2007). They played a pioneering role in overcoming the limitations imposed by economists' earlier concentration on selfish motives when analyzing human behavior.

Utility functions that also include the utility of others had not been completely ignored by neoclassical economists like A. C Pigou (1877–1959) and Irving Fisher (1867–1947), but previously nothing had been done with it (Becker 1974). Emphasis on utility interactions, however, had been common at a far earlier point in the work of Thorstein Veblen (1857–1929), a more heterodox and sociologically oriented economist (Sandmo 2011). Veblen rejected the idea of the rational man early on and strongly criticized neoclassical economy in his time (Pressman 2014).

3.5.2 Kenneth Boulding (1910-93), Gary Becker (1930-2014) and Edmund Phelps (1933-)

Three works played a central role in the new interest among economist in unselfishness after World War II (Fontaine 2007). They were Kenneth Boulding's *The Economy of Love and Fear (*Boulding 1973*)*, Gary S. Becker's *A Theory of Social Interactions (*Becker 1974*)* and Edmund S. Phelps' *Altruism, Morality, and Economic Theory* (Phelps 1975). To some extent, this could be seen as a view that brought one back to ethics in economics, but the neoclassical approach to the value on philanthropy in this period was different from the earlier moral approach of Adam Smith.

Becker's view on interactive consumer functions was more egocentric than Smith's. He assumed that giving away money gives the donor negative utility but is offset against his pleasure (value) of seeing the other getting more utility. Boulding studied the economics of grants and public choice and saw philanthropy in light of empathetic identification (Boulding 1973). Edmund Phelps's Altruism, Morality, and Economic theory (Phelps 1975) has often been greeted as instrumental in the upswing of interest in unselfishness. Phelps regarded the "economics of altruism" as another effort in the extension of the domain of economics. He was one of many economists that (from observing the economic development at that time) had been become more critical to classical liberalism and the neoclassical invisible hand theory. About ten years before, Mancur Olson argued that the invisible hand had severe limits (Mancur

Olson 1965). Some economists argued that the invisible hand theory without Smith's moral ideas in TMS was wrong (Stovall et al. 2004).

3.6 The Theories Behind Interactive Utility Functions in the 1960s and 1970s

The rest of this chapter shows how some of the economists have explained the individual's interest in other persons' welfare, instead of only self-interest. Table 3.2 above gives an overview of the different explanations.

3.6.1 Kenneth Arrow (1921–2017): Implicit Social Contracts

The neoclassical Nobel Prize laureate in economics, Kenneth Arrow, proposed a positive relation, one of altruism rather than envy among people. He thought that the welfare of each individual depends not only on the utilities of himself and others, but also on his contributions to the utility of others (Arrow 1975, 17). Each individual is in some ultimate case motivated by pure egoistic satisfaction derived for the good accruing to him, such that each performs duties for the other in a way calculated to

Table 3.2 Theories of why utility function are interactive

Theory	Central economists	What determines utility from philanthropy
Implicit social contracts	Kenneth Arrow	Altruism rather than envy
Game theoretical approach	Robert Axelrod	Tit-for-tat dynamics
Behavior theory	Bruce Bolnick	Social psychology. Avoid mental discomfort
Social and biological relations	Adam Smith (1759) Daniel Friedman David Wilson	Increasing utility with social or biological proximity
Ethical perspectives Commitment	Amartya Sen	Second-order preferences take precedence over first-order preferences (desired self-identity)

enhance satisfaction for all. The value or satisfaction is what the donor gets from seeing that others increase their welfare, but also from the fact that s/he donates to an anonymous recipient, for instance as in the case of blood donations.

Arrow remarks that the third hypothesis is in the spirit of the philosopher Immanuel Kant's *categorical imperative* or the philosopher John Rawls view in his theory of justice. Arrow adds that, in real life, emphasis must be put on the *implicit nature of the social contract. H*e writes:

> *One gives good things, such as blood in exchange from a generalized obligation on the part of fellow men to help in other circumstances if needed.* (Arrow 1975, 18)

3.6.2 Robert M. Axelrod (1943–): Game Theoretical Approach

A game theoretical approach claims that altruism is not always behind philanthropy and explains the value of altruism in a game theoretical perspective with 'greedy actors'. In a repetitive game, tit for tat is usual. Many economists quote the political scientist work about cooperation here (Axelrod 1981). Altruism is seen as a kind of equivalent retribution. We learn to act with generosity because this can give us value later. People often act in ways that would be consonant with altruistic motivations, and businesses do engage in philanthropy, but this may equally well arise rather from fairly specific trends that evolve from enlightened self-interest or public demand (Phelps 1975; Hammond 1975).

3.6.3 Bruce Bolnick: A Behavior Theory of Philanthropy

Economists have also explained the value of philanthropy for donors through social psychology (Bolnick 1975). Individuals donate in order to avoid the 'social costs' of noncompliance with the shared norms of their in-groups. It is the magnitude of the 'social costs' in question which determines the *implicit value* of donating. The higher the social cost of dereliction, the greater the value that will be ascribed to the potential philanthropic action in question. The opportunities for application of social pressure are better and the implicit value of philanthropy is higher for the donor (McKean 1975). If the contribution to helping the recipient is remarkable, the expectation from society can also be higher. If each individual's contribution is small, free riders are more common. To be philanthropic thus has lower implicit value.

Value is higher if donating comes under the heading of widespread acceptance of rules or traditions (McKean 1975). These rules can vary between cultures and arise from different variables, for instance religion. Very often they are backed in perceived gains to most persons, opportunity application and social pressure, for instance in small communities, where violating good traditions will be more noticed.

3.6.4 David Sloan Wilson (1949–): Social and Biological Relations

Biologists speak about inclusive fitness, individual selection and kin selection in order to explain philanthropy (Friedman 2008). David Wilson, an evolutionary biologist, argues that altruism exists, and that the biological mechanism of group selection is responsible. He attaches this to evolutionary thinking (Wilson 2015). He writes: *"Selfishness beats altruism within groups. Altruistic groups beat selfish groups"* (ibid., 71).

It has, on the other hand, been argued that Wilson promotes a strong form of pervasive altruism, which seems to be inconsistent with many economic phenomena (Robson 2017). Other economists, however, have pointed to social and psychological relationships in groups (Bolnick 1975). They argue that group mechanisms that lead to philanthropy exist to a larger degree in smaller groups, where the members more often seek satisfaction, gratification, self-identification, and pleasure from the others. It is strongest in primary groups, with face-to-face personal contact between the members. It can also be strong among colleagues, neighbors, affect-oriented groups, in which the relationship between members is the major object of group activity. Not all economists agreed with these group explanations in the 1970s (Bolnick 1975, 200).

3.6.5 Amartya Sen (1933–): Ethical and Moral Perspectives

Ethics among economists is usually described as stimulating fair play, common courtesy and lawfulness (Phelps 1975). Traditions and rules of etiquette arise in order to reduce external costs that we would otherwise inflict on each other. People tell their children that "honesty is the best policy" (McKean 1975, 31). According to Sandel (2013), market reasoning is incomplete without moral reasoning.

An early ethical approach to the understanding of the value of philanthropy after World War II came from the economist and Nobel Prize laureate, Amartya Sen. He criticized the behavioral foundations of neoclassical economics (Sen 1997). Sen also claims that Smith's famous "butcher and baker" passage of self-interest in WON is over-quoted. According to Sen, Adam Smith did not see the invisible hand:

> *as a microcosm of all economic activities, but just an example of a case of pure exchange of commodities for which the pursuit of self-interest entirely suffices as a motivation. But there are many other economic situations, where a broader motivation comes in.* (Sen 1997, 7–8)

Sen introduces the concept of *commitment*, which he defines as a situation where people in practice do things that are not in their true self-interest. He notes that people for instance wish to be environmentally friendly and will sort their trash even if they could have been lazy free riders. This is what we called second-order preferences. We may prefer lamb instead of vegetables at the restaurant, but still we choose a vegetarian menu, because we feel morally uneasy with the consumption of animals. Sen writes:

> *Commitment is of course closely connected with one's moral in a broad sense … covering a variety of influences from religious to political, from the ill-understood to the well-argued.* (Sen 1977, 329)

According to Sen, commitment drives a wedge between personal choice and personal welfare, and much of the traditional economic theory relies on the identity of the two (ibid, 329). He characterizes people who always act in their own interest and from their one-side preferences as rational fools (ibid., Sen 1977, 336). Sen writes:

> *A person thus described may be 'rational' in the limited sense of revealing no inconsistences in his choice behavior, but if he has no use for this distinction between quite different concepts, he must be a bit of a fool. The purely economic man is indeed close to being a social moron.* (Ibid., 336)

Altruism is without doubt a significant factor in our lives, but it is impossible to distinguish between wisely needed concern for others, and enlightened self-interest, which recognizes that one collects rewards if one helps others (McKean 1975). We have to conclude that the value of philanthropy for the donor, the interactivity of the utility models, depends on many interrelated factors.

3.7 Summary and Conclusions

Philanthropy has been seen as a part of CSR but not always as the best way of practicing it. It has also been regarded as a unique strategy with high value for the companies. This chapter has discussed the value of philanthropy from a perspective of economic theory. This includes values of philanthropy for the donor, the recipients and for the society as a whole.

The father of modern economics, Adam Smith, in his W*ealth of Nations*, argued that following one's self-interest in business would create economic growth. In *The Theory of Moral Sentiments*, he also claimed that we are impartial and reflected spectators in the community, and therefore can feel sympathy with our fellow men. Smith saw beneficence as a virtue that contributes to a more sustainable market economy.

In the nineteenth century, there were different views on the redistribution of income from rich to poor among the classical political economists. According to Thomas Malthus and David Ricardo, the majority of the people of necessity had to live at a subsistence income level. Jeremy Bentham and John Stuart Mill were more positive to redistribution policy.

After the classical political economists, two main interpretations of Adam Smith's approach to market economy have influenced the economic theory of the value of philanthropy. One is his theory of the self-interested market actor (*homo economicus*), an assumption of the neoclassical models of utility, especially in the period from 1870 to around 1950. The ambition of the neoclassicals was to develop a value-free economy, as a superstructure of unregulated competitive markets and with self-interested actors. There was no room for ethics, and therefore valuing of philanthropy was missing in this approach.

After World War II, a critique of the assumptions of the self-interested or selfish actor in economic models led to the development of interactive utility functions in which the individuals also got utility or value from giving to others. Enlightened self-interest, game theory and social behavior were the explanations for this philanthropic orientation. Amartya Sen, in an Adam Smith tradition, saw economics and philanthropy in an ethical perspective.

We can understand the rise of CSR as a movement against global neoliberalism (Levy and Kaplan 2008). Neoliberalism coexisted with a shareholder approach in business with more weight on profits for the owners. The proposal of my chapter is that this represents a narrow interpretation of Adam Smith's invisible hand, one that lacks reference to his moral values. Adam Smith should, as a consequence, not be used as a defense for this type of capitalism.

The emphasis on profits for the owners led to a loss of legitimacy in the society for business, and the stakeholder approach, which purported that companies must take care of the interests of all parties affected by them, was strengthened. CSR has been defined as: *"rather broadly to include topics such as business ethics, community investments, environment, governance and accountability, human rights, marketplace, and workplace"* (Carroll

2008, 38). The proposal here is that this must to a greater extent be identified with the moral approach of Adam Smith to capitalism. Therefore, the conclusion of the chapter is that capitalism with CSR is more in harmony with him.

One of the reasons for writing this chapter is also my conviction that interaction between CSR analysis and economics will not only bring more plurality to economic theory, but also improve CSR analysis of the values of corporate and individual philanthropy. In that way it can also be useful for those who work practically in governments, businesses and idealistic organizations while benefitting donors, recipients and, in accordance with Adam Smith, the market economy and society in the short and long run.

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