

# PHILANTHROPY: INTEGRAL PART OF THE ECONOMIC AS WELL AS SOCIAL THEORIES<sup>1</sup>

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*“The noblest question in the world is what good may I do in it? “  
Benjamin Franklin, 1737*

## Introduction, methods, research questions

The topic of philanthropy has been receiving attention internationally for several decades. Like other areas of non-profit studies, charitable giving and volunteering are attracting more and more attention from researchers in a wide variety of disciplines including economics. Even though philanthropy tends to be considered a sociological theme rather than an economic one, it poses a lot of questions that challenge economists too.

My research questions are as follows:

*How can economists contribute to the theories related to philanthropy?*

*Can we consider voluntary giving a demonstration of generosity rather than market-based solutions?*

Firstly, I intend to examine the terms that are used in the theory of public economics and to use them to look at the issues of philanthropy. They are e.g. the Samaritan's Dilemma; the Prisoner's Dilemma; or the Free-rider Problem.

Next, I try to answer the second question by means of sociological theory. The economists who investigate philanthropy are repeatedly faced with the obvious fact that it does not involve any buying and selling; it is not a marketplace operation. We have to look for, and identify, social values of donors and volunteers rather than economic values because the economists are not able to explain empathy, altruism and helping behaviour through economic principles.

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## Theoretical background

At the beginning of this article I would like to explain the term philanthropy. It seems to be clear, but in many theories there are a lot of disparities. These disparities appear not only in theories, but in people's understanding and thinking as well. Independently of these various meanings, we often use philanthropy as a synonym for giving, but it covers not only traditional types of charitable giving, but also a range of ways in which people may show their general goodwill to society. *“Essentially, philanthropy is the mechanism through which people express their humanitarian impulses, and confirm their membership of a wider society.”*<sup>2</sup>

Philanthropy, for all its good intention, does not necessarily imply a personal connection with the needy person. Philanthropy is often defined, unlike charity, as more institutional giving.

Let's see, how philanthropy is defined in Wikipedia<sup>3</sup>:

*“Philanthropy derives from Ancient Greek, meaning “to love people”. Philanthropy is the act of donating money, goods, services, time and/or effort to support a socially beneficial cause, with a defined objective and with no financial or material reward to the donor. In a more general sense, philanthropy may encompass any altruistic activity intended to promote good or improve human quality of life. One who practices philanthropy may be called a philanthropist. Although such individuals are often rich, people may perform philanthropic acts without possessing great wealth. Philanthropy is a major source of income for fine arts and performing arts, religious, and humanitarian causes, as well as educational institutions.”*

There are a lot of concepts as to why, how and to whom people give. For example, I can indicate the cultural paradoxes to be found in a comparison of giving in the United States and the United Kingdom. The word philanthropy is very popular in the US, but it is hardly ever used in the UK. In the UK charity and charitable giving are the preferred terms<sup>4</sup>. Charitable

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<sup>2</sup> Lloyd, T.: *Why rich people give*, 2001

<sup>3</sup> Wikipedia: <http://en.wikipedia.org/wiki/Philanthropy>

<sup>4</sup> Jas, P.: *A gift relationship? Charitable giving in theory and practice*, 2000

giving takes up different places in either country. It proposes two paradigms – generosity in the US and altruism in the UK.<sup>5</sup> These two models are summarized below.

**Generosity** (US) – “Charity begins at home”

- Giving is heavily interlaced with self-interest (with social approval)
- Giving is more public than a private activity
- Giving is an expression of personal and social identity and goals
- Giving and volunteering are significant components of civic involvement
- Giving modes a intentional, “planned” and yield high average gifts
- Predominant focus: particular causes in which donors are directly involved
- Predominant moral motivation: individual initiative and reciprocity

**Altruism** (UK) – “Charity for all”

- Giving is more private than a public activity
- Giving is generally marginal to social identity and goals
- Giving is generally marginal to civic responsibility
- “Spare change” is the dominant mode of giving, yielding low average gifts
- Predominant focus: universal causes in which the donor is not directly involved
- Predominant moral motivation: social (collective) duty

Although I would like to make use of the two terms in the following part, for the time being I abstract from the differences and don’t make distinctions between the expressions charity, philanthropy etc.

In the literature, we can find a lot of definitions of philanthropy. Many authors define the term through the reference to state. For example Bromley’s<sup>6</sup> definition is: “*The social objectives which the state and the law seek to fund and address through the voluntary contributions and activities of citizens and which the state will encourage and protect by extending legal and fiscal privileges to individuals and institutions funding and carrying out those objectives.*” Bromley notes, that although philanthropy must be voluntary and not compelled by the state, the influence of state is much more important than citizens generally realize.

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<sup>5</sup> Wright, K.: *Generosity versus altruism: Philanthropy and charity in the US and UK*, 2002

<sup>6</sup> Bromley, E.B.: *Religion, reformation, remedial and renaissance philanthropy*, 1994

We can't find a definitive answer to what is philanthropy. Some consider philanthropy as "giving back with more than money", others say "It is love of man, love of humanity. Not just writing a check but the love, care and concern behind the money." Which is true?

Many of us think of philanthropy as a luxury on which people spend money only after they have paid for necessities like food, housing, medical care etc. This would mean that the poor would give nothing to others. But it isn't so. Powell<sup>7</sup> notes: "*Both the absolute level of giving and the percentage of total income given to philanthropy would then rise as income rose*".

We should realize that people can support non-profit, charitable and other organizations through donations of time, goods, expertise, not only through money. All of these are crucial elements of the voluntary sector, but many reports focus specifically on gifts of money. When we talk about philanthropy we can't forget thousands of charities, philanthropies, churches and funds, summarily called non-profit organizations. But not all of these organizations depend on voluntary giving. We can write a lot of books describing the term non-profit organization or non-profit sector. This is not the goal of this article.

Philanthropy is often associated with the terms that are used in the theory of public economics. These are e.g. the Samaritan's Dilemma or the Prisoner's Dilemma. **The Samaritan's Dilemma**<sup>8</sup> refers to a possible problem that people can face when they try to help the poor. Sometimes the effort to help the poor can lead to a continuation of behaviour that keeps them in poverty. Payton<sup>9</sup> explains that the principle of reciprocity assumes that we will want to help someone in need if we can anticipate that we might need help ourselves someday. But another way of thinking about the needs of others is not reciprocal at all. It is the simple and powerful feeling of shared suffering and the sense of vulnerability; it is the feeling that causes us to say - or at least to think - "I know how you feel. I've been there." That experience of shared suffering may be the most effective motivator for philanthropic activities.

Stones<sup>10</sup> says: "*The Samaritan's Dilemma calls on us to restore the public sphere as a place where citizens can fulfil their moral aspirations. If government helps the neighbours, citizens will once again want to help govern.*" With unforgettable stories of how real people think

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<sup>7</sup> Powell, W.: *The nonprofit sector: A research handbook*, 1987

<sup>8</sup> Wikipedia: [http://en.wikipedia.org/wiki/Samaritan%27s\\_dilemma](http://en.wikipedia.org/wiki/Samaritan%27s_dilemma)

<sup>9</sup> Payton, R. L.: *Philanthropy and the Good Samaritan*

<sup>10</sup> Stone, D.: *The Samaritan's Dilemma: Should Government Help Your Neighbour?*, 2008

and feel when they practice kindness, Stone shows that everyday altruism is the premier school for citizenship. Helping others shows people their common humanity and their power to make a difference.

The next economic term concerned with philanthropy is the **Prisoner's Dilemma**. The Prisoner's Dilemma is presented<sup>11</sup> as follows: Two suspects are arrested by the police. The police have insufficient evidence for a conviction, and, having separated both prisoners, visit each of them to offer the same deal. If one testifies (defects from the other) for the prosecution against the other and the other remains silent (cooperates with the other), the betrayer goes free and the silent accomplice receives the full 10-year sentence. If both remain silent, both prisoners are sentenced to only six months in jail for a minor charge. If each betrays the other, each receives a five-year sentence. Each prisoner must choose to betray the other or to remain silent. Each one is assured that the other would not know about the betrayal before the end of the investigation. How should the prisoners act?

The dilemma arises precisely because each prisoner must decide what is best for him without knowing the decision of the other. If what is best for him is defined solely in terms of individual self-interest, the best decision is not to cooperate with the other prisoner and accept the offer of immunity. If what is best for him includes the interests of the other prisoner, he should cooperate with the other prisoner and remain silent, provided that the risk to self-interest of conviction is tolerable.<sup>12</sup> Charitable decisions typically involve repeated interactions between people who know each other. A basic result from game theory is that optimal behaviour in a situation where people interact repeatedly can be very different from that in a one-shot setting.<sup>13</sup>

The research in philanthropy consists of a set of basic questions: What do we know about the people who give money to non-profit organizations? How much do individuals give to charity today? What are the main ways in which the public gives to charity? Why do people give to charity? Which causes does the public support? Etc. The aim of this article isn't to provide up-to-date information in each of these areas. The title of my article is: Philanthropy: integral part of the economic as well as social theories. To verify this statement I will answer only one of these questions: Why should people give to charity today?

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<sup>11</sup> Wikipedia: [http://en.wikipedia.org/wiki/Prisoner%27s\\_dilemma](http://en.wikipedia.org/wiki/Prisoner%27s_dilemma)

<sup>12</sup> Chervenak, F. A. ; McCullough, L. B.: Dilemmas of cooperation for physician leaders, 2007

<sup>13</sup> Mayr, U., Harbaugh , W. T., Tankersley, D.: Neuroeconomics of Charitable Giving and Philanthropy, 2008

## Concepts of altruism

The question why people give to charity has led to a need for an economic theory to explain it. Generally it is considered that at the beginning is focus on human behaviour and motivations of behaviour. Maybe that is the reason why we can find the relevance of philanthropy for many disciplines across the social sciences and further afield. There is a lack of theoretical and empirical work in this area although. Especially in the Czech Republic we don't have any analyses of economic theories of charitable behaviour that is inspired by altruistic motivations.

Behaviour, including charitable behaviour, is often linked to **self-interest**. Altruistic behaviour is explained through self-interested agents realizing gains from cooperation. Now I would like to explore the concepts of altruism. What does it mean, how should it be modelled, and what does it tell us? At its core, the concept captures according Rutherford<sup>14</sup>: “*a concern for others that is not linked to a concern for oneself. This is an internal state, and is not directly observable.*”

If we read this definition, an important question comes to mind. Can we infer altruism from observing so-called “altruistic” behaviour? There are huge differences between the acts we observe and the internal state. For example a rich philanthropist may give big amounts without a real concern for those the donation is helping. If we call the giving or observed altruistic behaviour generosity, than there is a divide between the act of generosity and the internal state of altruism.

The debate about the role that altruism plays in economic behaviour was launched by Titmuss<sup>15</sup> in 1970, with a specific example of blood donation. Titmuss wrote about the collection of blood donations that were paid for. The conclusions of economics are clear: the introduction of paid blood donors would increase the supply of blood. But Titmuss was of another opinion. He suggested that this argument was false because it worked only with self-interest and ignored the significant role that altruism plays in many types of transaction. Titmuss claimed that the introduction of payment for blood donation would decrease both the

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<sup>14</sup> Rutherford, A.: *Get by with a little help from my friends: A recent history of charity in economic theory*, 2008

<sup>15</sup> Titmuss, R. M.: *The gift relationship from human blood to social policy*, 1970

quantity and quality of blood supplied. Economists at the time largely disagreed, for example Kenneth Arrow. He used the utility theory<sup>16</sup> and identified three motives for action that could lead to altruistic behaviour. These are:

- Social contract – where agent's utility doesn't depend on others, but the cooperative behaviour is efficient,
- Pure altruism – where the utility of one agent directly influences the utility of another,
- Impure altruism – where an agent derives utility from the act of helping another.

### *Charity as a social contract*

Charitable giving wasn't explicitly connected with altruism in the seventies (1970-1980). The prevalent theory focused on self interest as the driving force. This theory describes charities as a result of a social contract to overcome some failure that would otherwise lead to inefficient outcomes.<sup>17</sup> The literature falls into two categories: Government failure and Contract failure.

Government failure describes the situation, when private firms are unable to provide public good effectively and the government endeavours to solve this through intervention. But there are a few constraints leading to the failure of the state. Young<sup>18</sup> outlines five constraints<sup>19</sup>. The theory of government failure suggests that the development of non-profit organizations is the response to these constraints. The second failures are market failures that results from information asymmetry between buyers and sellers. I don't consider this theory relevant to this article, and so I don't pay any more attention to it.

### *Pure altruism*

Attentive readers will have observed that the theory of social contract seems to be unsatisfactory for the explanation of altruistic behaviour. How can we add altruism to a rational self-interested motivation? The theory of pure altruism gives our answer.

Say we have two persons Ann (A) and Ben (B). Their utility we denominate  $U_A$  (Ann's utility) and  $U_B$  and the quantities of X consumed by Ann  $X_A$  respectively  $X_B$ . The basis of the theory we can summarize in following formula:

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<sup>16</sup> Phelps, E. S.: *Altruism, morality, and economic theory*, 1975

<sup>17</sup> Rutherford, A.: *Get by with a little help from my friends: A recent history of charity in economic theory*, 2008

<sup>18</sup> Young, D. R.: *Government failure Theory*, 2001

<sup>19</sup> These are: Categorical, Majoritarian, Time horizon, Knowledge and Size constraint.

$$U_A = f(X_A, u_B(X_B))$$

What does it mean? It is very easy. Ann's utility is influenced not only by her consumption of good A but also by Ben's utility (his consumption of good A). When Ann has a quantity of X, while Ben has none, Ann gives a part to Ben in order to maximize her utility. This formulation evidently gives us the possibility how to examine altruism. In other words, the standard model assumes that people care about the level of the public good only insofar as it contributes to their own consumption.

This model draws attention to the **Free-rider Problem**. In economics, collective bargaining, psychology and political science, "free riders" are those who consume more than their fair share of a resource, or shoulder less than a fair share of the costs of its production.<sup>20</sup> Free riding is usually considered to be an economic "problem" only when it leads to the non-production or under-production of a public good (and thus to Pareto inefficiency), or when it leads to the excessive use of a common property resource.

Ann cares only about the absolute quantity (utility) that Ben receives, whether she gives it to him or not. Ben can be supported by another subject (person). When Ann reduces in this context her transfer to Ben, their utility will increase. (She doesn't include the loss of other people's utility to her marginal utility.) This incentive to free-ride will result in low transfers made to Ben.

This model of altruism is deservedly called "theory". In practice we cannot measure the utility of people we have never met. We would expect free-riding to be a real problem in charitable giving or in the provision of charitable services. But free-riding seems to be much less prevalent in practice than is predicted in theory. People give small donations to charity, where the marginal effect of their contribution is slight. The theory of pure altruism doesn't explain this.

### *Impure altruism*

When people make donations to public goods, such as charity, there may be many factors influencing their decision other than altruism: social pressure, guilt, sympathy, or simply a

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<sup>20</sup> Wikipedia: [http://en.wikipedia.org/wiki/Free\\_rider\\_problem](http://en.wikipedia.org/wiki/Free_rider_problem)

desire for a „Warm Glow“. People often say that “they want to make a difference”, or that they get a good feeling from making a sacrifice that benefits others.

To explore the lack of free-riding in charitable giving the economists introduced the concept of a “**Warm Glow**”. In the late 1980s, an economist called James Andreoni<sup>21</sup> argued that the internal motives for giving were indeed more important than many people had acknowledged. He introduced his idea - the “Warm Glow” theory. In the Warm-Glow view of philanthropy, people aren’t giving money only to help e.g. to save the whales; they’re also giving money to feel the glow that comes. People will give money not just because they know the supported project or the supported organization’s work, but because they like being the kind of person that supports.

The model of pure altruists suggests that the recipients are unknown to the donors and we can’t know their consumption. It is the reason why activities undertaken by charitable organizations tend to involve a separation between donor and recipient. In the concept of impure altruism it is not important. For the impure altruists care only about the means not ends.

Behavioural implications of Warm Glow are known in theory as the **Crowding out Effect**. It means that if the contributions to a public good or to charity increase, the transfers by others get reduced. We can distinguish between individual and public support. Individual support: since the donor only cares about the total benefit to a recipient, the increase in other contributions will reduce his voluntary donations. Public support: public spending on public goods will crowd out private spending.

Andreoni’s proposal for Warm Glow giving included utility only from the means but not the ends as a solution to the problem of free-riding in charitable provision. But Rutherford<sup>22</sup> says: “*Answering the question of – Why do people give money? – with – Because they enjoy it – begs the question – Why do they enjoy it?. Can we really separate analysis of the means from the ends in this way? And can the enjoyment of giving without regard to the purpose of the gift really be called altruism?*” Possible answer<sup>23</sup>: if we pursue the Warm Glow effect, we are no longer altruistic.

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<sup>21</sup> Andreoni, J: *Impure altruism and donations to public-goods, A theory of warm-glow giving*, 1990

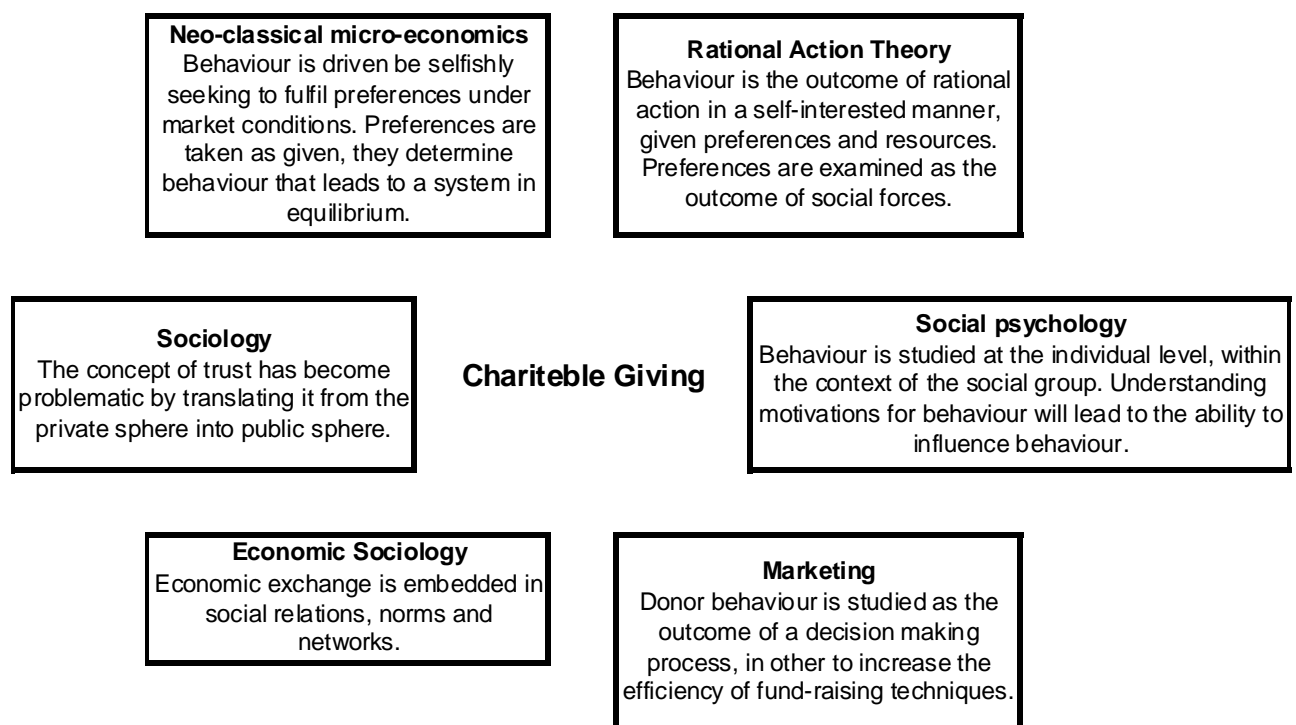
<sup>22</sup> Rutherford, A.: *Get by with a little help from my friends: A recent history of charity in economic theory*, 2008

<sup>23</sup> Economic objectorivism, *How to: Altruism and the “Warm Glow” effect*, 2007

## Theoretical approaches to charitable giving

At this place, I would like to think about philanthropy in terms of theoretical multidiscipline approaches. Various academic disciplines are related to voluntary sector and charitable behaviour in the form of individual giving, and in each discipline there are numerous streams. Jas<sup>24</sup> classifies six key disciplines. These are:

Figure 1 **Theoretical approaches to charitable giving**



Jas, P., 2000

### *Neo-classical micro-economics*

This stream works on the assumption that individual's preferences are one of the primary drives for their behaviour. The basic assumption of behaviour is to be selfish and fulfil one's own preferences. You may suppose that it clashes with the pro-social character of charitable giving. But that is not the case. Many theories have shown that the person can and will actually gain from giving money even if this gain is not material.

<sup>24</sup> Jas, P.: *A gift relationship? Charitable giving in theory and practice*, 2000

This developed into the public-good theory of philanthropy. People give not just in order to selfishly fulfil their preferences, but they are also influenced by their social environment to contribute to the collective. Jas<sup>25</sup> contextualizes: “*When people assume that others in the society are governed by the same rules as themselves, they know that others will also be contributing to the collective good. In addition, contributing to the public good becomes economically sensible; when people realize that they would be able to benefit from the collective resources should they ever need to.*”

For the researcher, the non-material returns can't be measured in terms that are acceptable within the micro-economic framework. That means there is no empirical evidence to either support or refute this theory.<sup>26</sup>

### ***Rational action theory (RAT)***

According to this sociological approach, behaviour is seen as the outcome of rational action in self-interested manner, given preferences and resources. It is an outcome of social interactions. The approach is based on the assumption that individual action is utilitarian and aimed at satisfying preferences. These preferences can be material needs as well as attitudes or beliefs.

There are three main problems<sup>27</sup> connected with the application of this theory to individual giving behaviour. Firstly, the explanations for donating behaviour are likely to be different for different causes. The second problem is caused by the difficulty in measuring preferences. If we ask people to explain their behaviour, it results in retrospective description of the person's motivation, but not reliable description of the motivation at the time of the behaviour. The third problem is that the correlation between behaviour and attitudes doesn't indicate any causal direction (someone without a clear positive attitude towards giving could be persuaded to give in certain circumstances). Halfpenny<sup>28</sup> argues that it is impossible to say whether a preference is the reason for certain behaviour or a result thereof.

### ***Economic sociology***

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<sup>25</sup> Jas, P.: *A gift relationship? Charitable giving in theory and practice*, 2000

<sup>26</sup> Halfpenny, P.: *Economic and sociological theories of individual charitable giving*, 1999

<sup>27</sup> Jas, P.: *A gift relationship? Charitable giving in theory and practice*, 2000

<sup>28</sup> Halfpenny, P.: *Economic and sociological theories of individual charitable giving*, 1999

Economists and sociologists often claim that they study different types of behaviour. However the line of thought called Economic Sociology argues that economic relations are embedded in the framework of social life. Several examples of business communities have demonstrated that many economic activities go beyond formal business contracts. Tonkiss<sup>29</sup> introduced the idea that firms and contracts are the formal means of communication within economic networks, whereas trust is the basis of the informal communication. Trust in turn is based on the shared norms and values that form the core of social networks.

### ***Sociological perspective***

According to sociology the voluntary sector is studied in terms of the concepts trust and confidence. The non-profit sector is largely defined<sup>30</sup> by its values, its function and respect for its activities. The conclusion of sociology is clear: individual giving, of both money and time, is in the first instance based on trust, rather than contractual relationships.

Another discipline that studies human behaviour within the context of the social group is social psychology. According to Batson<sup>31</sup>, there are four possible categories of drivers motivating charitable behaviour: egoism, altruism, collectivism and principalism. Of course they are not mutually exclusive, and they can operate independently (for example, self-interest is compatible with altruism when the donor benefits from the act of giving).

### ***Marketing***

A large collection of empirical data<sup>32</sup> on individual giving formed a model of individual charity giving behaviour. The model describes the decision making process that leads to donations, which can be gifts of time or money. The whole process begins with an organisation's ability to clearly present the brand or the supported project. This step is followed by the donor's evaluation of previous experiences with giving, and their judgement of the outcome of giving for themselves. The criteria by which the outcome of the behaviour is assessed can be emotional as well as material. There are two categories of variables which can determine the decision making process. Extrinsic determinants comprise socio-demographic information, such as income, age, gender and religion. Intrinsic determinants refer to individual motives for charitable giving; these are feelings of sympathy and empathy.

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<sup>29</sup> Tonkiss, F.: *Trust, social capital and economy*, 2000

<sup>30</sup> ICFM: *Draft donors rights charter*, 2000

<sup>31</sup> Batson, C. D.: *Why act for the public good*, 1994

<sup>32</sup> Sargeant, A.: *Charitable giving: Towards a model of donor behaviour*, 1999

## Conclusion

This article examines what science can tell us about people's motivations for charitable giving. The text starts with standard neoclassical utility theory and the implications of the assumption of selfish preferences or what is rather called pure altruism. This model predicts free-riding (benefiting from public goods without contributing to them). Then I explore some alternatives to the pure-altruism model e.g. Warm-Glow models of altruism, where people derive a benefit from the act of giving.

Initially it seems that it is a one-way transaction, whereby money is given away for nothing at all in return. After some time however it becomes clear that in many cases some form of return is expected and received by the donor. Research has shown the possibility that people flaunt their philanthropic activities in order to impress other people with their generosity. This indicates that non-material returns have an important place in pro-social behaviour.

All the different approaches discussed in this paper have shown that philanthropy or charitable giving is a process of exchange that involves both economic and social values and which is driven by both selfish and altruistic motivations. It is clear that the act of charitable giving shouldn't be regarded separately from the public's attitudes towards the voluntary sector, or the position of the sector in society. Changes in society and shared norms and values have their impact on charitable giving. The question of what motivates people to give money to charity is approached from a range of different theoretical and practical viewpoints.

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