

# ONE



## Introduction and Summary

IN 1964, business corporations in the United States reported \$729 million in gifts and contributions on their income tax returns. In that year the gross national product was \$629 billion. This meant that, of every \$1,000 spent by all purchasers of goods and services in the country, \$1.16 was used to support the recipients of corporate philanthropy. These recipients, in turn, used these contributions to provide society with health and welfare services totaling about \$320 million, educational services totaling about \$280 million, civic and cultural services totaling about \$40 million, and other philanthropic services totaling about \$90 million.

The growth in giving from the pre-Depression period has been large. For 1929, like 1964 a year of high levels of corporate activity, corporation giving has been estimated at \$22 to \$32 million.<sup>1</sup> In 1929, only \$0.21 to \$0.31 of every \$1,000 spent in the country was used for corporate philanthropy, compared with the \$1.16 of 1964.

Direct and comprehensive data on corporation giving begin in 1936, when contributions were first reportable on corporation income tax returns and so entered the statistical tabulations of the Internal Revenue Service. For this reason this study examines in detail the growth in giving from 1936 through 1964, the most recent year for which data are presently available.

### ORIENTATION OF THE STUDY

The purpose of this study is to examine the growth of corporate giving and, insofar as possible, to measure the separate effects of

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<sup>1</sup> F. Emerson Andrews, *Corporation Giving* (New York: Russell Sage Foundation, 1952), p. 35, and U.S. Department of Commerce, *U.S. Income and Output, A Supplement to the Survey of Current Business* (Washington: 1958), Table 1-12, pp. 134-135.

changes in corporate attitudes and giving behavior and of developments of a more strictly economic character. Changes in corporate attitudes toward giving reflect changes in the role of the business corporation not only as an economic unit but also as a social institution shaped by noneconomic forces. In the literature, increasing attention has been paid to the complex noneconomic role that the corporation—particularly the large corporation—plays in the broader society. The corporation is viewed as a citizen responsible to its several constituencies of employees, shareholders, customers, suppliers, government, and general society. In these discussions, philanthropic giving has figured prominently.<sup>2</sup>

The changing institutional basis for greater giving has been accompanied, and perhaps encouraged, by liberalization of the legal right of corporations to make contributions. Such liberalization has affected not only the amount of contributions, but their diversity, as contributions have shifted, in part, from those of demonstrable, direct, and immediate benefit to the corporation to those that confer a more uncertain, indirect, and deferred benefit. Such legal and institutional developments are reviewed in greater detail in Chapter Three.

Changes in the legal and attitudinal bases for corporate giving have taken place concurrently with a number of important economic developments, which have also played a significant role in the growth of giving. The effects of these economic developments have been strong and will be measured so that the role of noneconomic factors may be gauged with some degree of precision. Over the quarter-century from the late 1930's to the early 1960's, there were great changes in the economy, changes affecting the business corporation as an engine of production, an earner of profits, and a taxpayer. The gross national product rose from \$87.0 to \$560.4 billion a year during this period. Before-tax profits, for corporations with net income, rose from \$8.8 to \$59.0 billion a year. The net after-tax cost of tax-deductible contributions declined as marginal tax rates on corporate income rose from 15 to 19 to 38 to 52 per cent. The tax rate increase was accelerated during two wartime periods of excess-profits taxes. In the

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<sup>2</sup> See, e.g., Richard Eells, *Corporation Giving in a Free Society* (New York: Harper & Bros., 1956; W. Homer Turner, "The Emerging Pattern of Corporation Philanthropy," Management Seminars on Company Contributions, Princeton, New Jersey, October 16, 1956, and October 29, 1957; Covington Hardee, "Philanthropy and the Business Corporation, Existing Guidelines—Future Policy," in Frank G. Dickinson, Editor, *Philanthropy and Public Policy* (New York: National Bureau of Economic Research, 1962).

first of these, the maximum rate reached 91 per cent, and, in the second, 82 per cent. After-tax profits, for corporations with net income, rose from \$7.7 to \$36.9 billion a year.

The growth and proliferation of company-sponsored foundations may have affected the trend in contributions. Although such foundations typically serve as pass-through devices, to facilitate the administration of corporate contributions programs, some have been built into substantial endowments. Where this has occurred, the timing and size of the contributions flows have been affected. Some measurement of the size of this effect will be attempted in the final chapter of this book.

### UNRECORDED PHILANTHROPIC INVOLVEMENT

In this study, the descriptions and analysis have, of necessity, been based mostly on tax return data. It should be noted, however, that the dollar amounts of contributions reported on tax returns understate the size of corporate philanthropic involvement, possibly by a considerable amount. One important element in corporate philanthropy not reflected in the tax return data is the value of the services of corporate officers in fund-raising and other charitable activities. Much of this is done on "company time" and is regarded as a normal and, indeed, an expected part of a manager's corporate duties. These activities, therefore, are as much a part of the corporation's explicit commitment to philanthropy as is its budget for cash contributions. Nor does the contributions budget always fully measure the size of a corporation's cash outlays for philanthropy. Expenditures having significant elements of philanthropic motivation and effect, but which also contain an even greater element of ordinary business motivation and effect, are likely to be reported as business expenses. The valuation and accounting treatment of gifts in kind may also lead to an understatement of corporation giving or, under certain circumstances, to an overstatement.<sup>3</sup> In interpreting the findings of the study, these data limitations should be kept in mind.<sup>4</sup>

<sup>3</sup> See Orace Johnson, "Corporate Giving: A Note on Profit Maximization and Accounting Disclosure," *Journal of Accounting Research*, Spring, 1965, pp. 75-85.

<sup>4</sup> A related corporate commitment to philanthropy is the handling of employees' contributions to charitable activities. Corporate resources thus occupied are usually not included in contributions budgets. The contributions of employees are classified as personal and, of course, do not appear in the statistics of corporation giving.

## SUMMARY OF FINDINGS

*The Growth of Corporation Giving*

Chapter Two describes in detail the growth in giving from the late 1930's to the early 1960's. Over this period, reported corporation giving grew from an annual rate of \$31 million to \$595 million. Relative to total economic activity, as measured by the gross national product, its share increased threefold, from one-thirtieth of 1 per cent in 1936-1940 to one-tenth of 1 per cent in the period 1960-1964. The increase in share was not a gradual one, however; rather it took place in the four war years 1940 to 1944. Since 1944 the share has moved within a relatively narrow range about one-tenth of 1 per cent.

Measured against corporate net income or profits, the observed growth pattern departed significantly from that measured against national product. Gifts as a percentage of income rose sharply during World War II. However, the two postwar decades witnessed not merely a maintenance of the historically high percentage then achieved but a growth to much higher levels.

Corporate net income was chosen as the base for most comparisons of giving ratios for several reasons. First, income represents a tolerably useful measure of the scale of corporate activity. Second, income has direct operational significance in the giving decision. Corporate income is the only legal source of funds from which contributions may be drawn. Careful distinctions are made by corporations between distributions of capital as against income, and the prior claims of creditors and owners in the distribution of the corporation's capital are subject to detailed safeguards. In addition, the net income basis is recognized in the Internal Revenue Code requirement that not more than 5 per cent of income may be deducted as contributions in determining taxable income.<sup>5</sup>

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<sup>5</sup> In relating contributions to corporate net income, the record for only those corporations reporting a positive net income will be summarized. Corporations with positive net income accounted for 98.6 per cent of total contributions over the period, and so the loss in coverage from excluding corporations with losses is small. It is more than compensated for by the gain in comparability of giving-to-income percentages that are free from the fluctuations produced by period-to-period variations in the loss experience of corporations.

A comparison of the trend in giving-to-income percentages for all corporations and for net-income corporations is provided in Orace Johnson "Corporate Philanthropy: An Analysis of Corporate Contributions," *Journal of Business*, October, 1966, Figure 1, p. 493. This chart shows that, while the levels of the two series differ, the slopes of trend lines fitted to the series would be very close to one another, and no systematic divergence over the period is indicated.

The trend in corporate giving as a percentage of corporate income and of the national product is summarized in Table 1. Column 2 shows that, aside from the 1950–1953 Korean War period, corporate givings' share of the gross national product rose only slightly from 1946–1949 through the years 1960 to 1964. By contrast, columns 3, 4, and 5 show that corporate giving rose markedly as a percentage of corporate income (variously defined). Columns 6 and 8 reconcile the large increase in share of net income with the slight increase in share of national product. They show that both before- and after-tax corporate income, as a percentage of gross national product, declined from 1946–1949 through 1960–1964. Had corporate contributions merely been maintained at the same percentage of corporate income, their share of gross national product would have been lower by a factor of about one-third.

The patterns for the World War II and the Korean War periods deserve separate comment. As shown in Table 1, very high corporate income and excess-profits tax rates and very high levels of contributions were evident in both periods. Both were characterized by ratios of contributions to disposable income that rose significantly above the trend. This pattern is examined in more detail in Chapter Two.

The percentage of income remaining after the payment of income taxes declined considerably over the period, reflecting the rise in tax rates (*column 7*). Corporate contributions, averaging less than 1 per cent of before-tax income, could have done little to offset this decline, even considering the fact that an increasing proportion of contributions was "paid for" by the government through tax deductibility.<sup>6</sup> On this construction, after-tax income was taken as the more meaningful measure of corporate ability to make contributions.<sup>7</sup>

As a percentage of corporate income before taxes the growth in giving was substantial, the percentage in the period 1960–1964 being more than three times that of 1936–1940 (1.00 compared with 0.31 per cent). Measured relative to after-tax income, the increase was of course much greater. In 1960–1964, gifts as a percentage of after-tax income (*columns 4 and 5*) were about four and one-half times those

<sup>6</sup> Tax deductibility, of course, did play a role in the growth of giving over a period of rising tax rates. Its effect on the net after-tax cost of contributions is treated separately, and is summarized below.

<sup>7</sup> Giving is expressed as percentage of after-tax income defined in two ways: before contributions and after contributions (*see note b to Table 1*). Although the former, in concept, is more fully the equivalent of corporate disposable income, the distinction makes little difference in the empirical description of trends. See also Appendix Table II.

**TABLE 1 Relation of Corporate Gifts and Contributions to Gross National Product, Corporate Before-Tax Income, and Corporate After-Tax Income, 1936-1964, by Subperiod<sup>a</sup>**

Period	Gifts and Contributions as Percentage of						Corporate Net Income After Taxes, Before Gifts and Contributions, as Percentage of
	Average Annual Reported Contributions (Millions of 1936 dollars) (1)	Gross National Product (2)	Corporate Net Income Before Taxes (3)	Corporate Net Income After Taxes, Before Gifts and Con- tributions <sup>b</sup> (4)	Corporate Net Income After Taxes, and Con- tributions (5)	Corporate Net Income Before Taxes as Percentage of GNP (6)	
1936-40	\$ 28	0.032	0.310	0.363	0.364	10.43	85.5
1941-45	121	0.088	0.645	1.275	1.280	13.63	68.9
1946-49	129	0.095	0.709	1.032	1.038	13.43	9.23
1950-53	183	0.111	0.848	1.503	1.511	13.10	7.38
1954-59	178	0.094	0.833	1.388	1.397	11.26	6.76
1960-64	237	0.105	0.998	1.584	1.597	10.50	6.62

<sup>a</sup> Based on constant (1936) dollar data aggregated for given time periods.

<sup>b</sup> Computed by adding to corporate net income after taxes, after gifts and contributions (as presented in the U.S. Treasury Department's *Statistics of Income, Corporation Income Tax Returns*, for the several years), an estimate of the net after-tax cost of reported gifts and contributions. These estimates are presented in Appendix Tables II and III.

**TABLE 2 After-Tax Net Cost of Gifts and Contributions as Percentage of Corporate Net Income After Taxes, Corporations with Net Incomes, 1936-1964, by Subperiod (Dollar values in millions of 1936 dollars)**

Total for Years	Gifts and Contributions (1)	Average Price <sup>a</sup> of \$1 in Contributions for Period (2)	Estimated Net After- Tax Cost of Gifts and Con- tributions (3)	Corporate Net Income After Taxes, Before Gifts and Contributions (4)	Column 3 as Per- centage of Column 4 (5)
1936-40	\$ 141.9	\$0.77	\$109	\$39,115	0.28
1941-45	606.8	0.27	164	47,588	0.34
1946-49	516.7	0.59	306	50,091	0.61
1950-53	733.9	0.36	265	48,825	0.54
1954-59	1,069.9	0.48	515	77,081	0.67
1960-64	1,184.0	0.48	573	74,732	0.77

<sup>a</sup> Complement of the weighted average marginal tax rate paid by corporations accounting for the preponderance of contributions.

for 1936-1940, rising from 0.36 to 1.60 per cent. Also of significance has been the sustained increase over the period since World War II. From 1946-1949 to 1960-1964, giving as a percentage of after-tax income increased by 54 per cent, from 1.04 to 1.60 per cent.

The rise in contributions as a percentage of after-tax income did not mean that their net cost to corporations rose in the same proportion. Over the period the marginal tax rate on corporate income rose from an average of 23 per cent in 1936-1940 to 52 per cent in 1960-1964. Because of the deductibility of contributions, the net after-tax cost of one dollar in contributions declined by almost two-fifths over the period (*Table 2, column 2*). An important part of the growth thus represents an increase in the share of total contributions that has been absorbed by the general public, as represented by the tax collector, over a period of rising tax rates. The 1960-1964 gross flow of contributions was 8.3 times that of 1936-1940.<sup>8</sup> The growth in the net after-tax cost of these flows was considerably smaller: the average for 1960-1964 was only 5.3 times that of 1936-1940.

A much larger part of the growth in contributions represents an increase in the share of after-tax income that corporations have chosen to be out of pocket in their distributions to philanthropy. This may be seen in column 5 of Table 2, which shows that, as a percentage of the after-tax income base for giving, the after-tax cost of their

<sup>8</sup> In dollars of constant (1936) value.

reported philanthropic distributions rose from 0.28 per cent in 1936–1940 to 0.77 per cent in 1960–1964. Expressed in different terms, the growth in “real sacrifice” might be described as follows: Had corporations chosen to make the same out-of-pocket outlays relative to disposable income in 1960–1964 as they had in 1936–1940 (0.28 per cent), they would have made only 36 per cent of the gifts and contributions that they actually reported for 1960–1964. Instead of an average of \$589 million per year, in current dollars, they would have contributed only about \$212 million per year.

Chapter Three examines some of the factors that might account for the rise in giving described in Chapter Two. First there is analysis of the relationships between giving and possible causal economic factors, as revealed by their behavior over time. Then there is an analysis of cross-sectional data. In both analyses the technique of multiple correlation is used to identify the several relationships.

### *Economic Determinants of Giving*

Three principal factors in giving were distinguished and an attempt was made, using time-series data, to measure their separate effects. The first was the net income of corporations, taken as the most relevant available measure of the scale of corporate activity. The second was the net after-tax cost or “price” of a given dollar amount of contributions. The third was the group of other factors that affect giving, of which the giving propensity of corporations is presumably the major component.

It was hypothesized that, with price and giving propensity held constant, contributions should bear a proportionate relationship to the scale of corporate activities over time. A priori, few reasons could be found for expecting that the growth in the scale of corporate activity, taken alone, would result in either a less than or more than proportionate growth in giving. The hypothesis thus predicts a scale elasticity of giving of one. The multiple regression analysis supports this hypothesis, with measured scale elasticities exhibiting values close to unity.

An attempt was made, going beyond the preceding hypothesis, to measure the effect on giving of the percentage rate of return on shareholders investment. This was done by including net worth as a variable in the multiple correlation analysis. Because income and rate of return were highly intercorrelated, it was difficult to separate neatly the scale and rate of return effects. The findings, although thus sub-



ject to a considerable degree of qualification, nonetheless suggested that the short-run responsiveness to changes in percentage rate of return was not large. The findings of the cross-sectional analysis, as reported below, also suggested a relatively low elasticity with respect to this variable. This is probably to be expected. Corporations might regard years of unusually high or low rates of return on investment as essentially temporary, and not significant enough to warrant a fully compensating adjustment in contributions.

Changes in corporate tax rates over the period meant that the net after-tax cost or "price" of a given dollar amount of contributions was subject to corresponding changes. Contributions serve to create a favorable public image of the corporation, and to encourage a social and political environment conducive to its survival and prosperity. As such they are properly regarded as one of the profit-enhancing inputs to the corporation, and their use might be determined by the same principles that determine the use of other such inputs. However, their benefits in this respect are more uncertain and often much longer deferred than that of other inputs. As a result, the immediate and certain tax savings that accompany contributions may weigh more heavily in a corporation's contributions decision.

In the regression analysis, the variable used to measure the tax effect was the complement of the marginal tax rate. This could be viewed as the "price" of, say, one dollar in contributions. The observed response of contributions to changes in tax rates (i.e., "price") produced elasticity coefficients that ranged around  $-1.0$ . This finding suggests that tax rate changes, and corresponding changes in the immediate and certain tax savings that accompany contributions, were an important factor in explaining the variation in giving.

The influence of long-run changes in other factors was the third element in the time-series analysis. The most apparent of these other factors was probably an increase in corporate propensity to give. Public pronouncements on the issue, as well as relaxations of legal restrictions over the period, suggested that corporations had become progressively more receptive to the notion that they should make contributions. To determine whether such apparent changes in underlying conditions were accompanied by a corresponding change in behavior, a trend variable (in effect, the equivalent of a secular or long-run residual factor) was included in the analysis. This was taken as a proxy for the change in the propensity to give, as well as for progressive changes in any other factors that might have influenced giving.

In the multiple regression analysis, the trend variable exhibited consistently high and significant values. This suggested that developments associated with the passage of time, other than scale and price, made an important independent contribution to the growth in giving. Although the trend variable could reflect progressive changes in factors other than the propensity of corporations to make contributions, no other factor presented itself as likely to have had as important an effect.

As an independent test of the effects of some of the factors examined in the time-series analysis, and to measure the effects of other factors, cross-sectional data were also examined. With changes over time removed from the analysis, the effects of such time-related factors as changes in tax rates and giving propensities could not be tested. However, the cross-sectional analysis permitted measurement of the relationship between giving and corporate size (measured by net assets as well as income), rate of return on investment, and the importance of labor versus capital in production.

The relationship between the size of a corporation and the amount of its contributions was examined first. It will be recalled that the estimated scale elasticity of giving was found to be about one. The implication was that size of corporate activities was proportionate in its effect on the percentage of income given. The cross-sectional analysis supported this finding, also producing scale elasticities close to one.

The degree to which a corporation employed people, as contrasted to capital, also appeared to have an important influence on the percentage of income given. This is probably not surprising, as much of corporation giving is employee-related. Contributions to local health and welfare drives are often based on the number of the company's employees in the community. College scholarship grants and matching grants to employee alumni contributions also reflect this emphasis. The analysis did, in fact, find that corporations engaged in labor-intensive production gave proportionately more than those engaged in capital-intensive production.

This finding has relevance in evaluating the growth in corporate giving propensities discovered in the time-series analysis. As corporate activity has become more capital intensive, the pressure to give arising from employee-related programs presumably has declined in relative importance. If this is the case, the growth in giving propen-

sity was even greater than that measured by the time-series analysis. Unfortunately it was not possible explicitly to include the trend toward capital-intensive production in the time-series analysis.

### *Company-Sponsored Foundations*

Beginning with World War II, and principally since 1950, corporations have made widespread use of company-sponsored foundations in their giving programs. It was estimated that, in the 1956–1965 decade, about one-fourth of total corporate contributions were channeled through company-sponsored foundations. Such foundations usually serve only as conduits for corporate giving and as reservoirs to permit the stabilization of payments to philanthropic recipients. Some foundations, however, have accumulated substantial endowments well in excess of those needed to stabilize income-outlay flows. Where this has occurred, there is an initial lag in the corporation's contributions to charity, as a large part of contributions are used to build endowment. This is followed by an increased flow of funds to charity, as investment earnings on endowment augment the corporation's contributions.

Most of the endowment growth of company-sponsored foundations took place in the early 1950's, years when the Korean War excess-profits tax provided a strong incentive to contributions. It is estimated that the endowment of all company-sponsored foundations increased by about \$400 million in that period. Since then the growth has been much slower, but considerable, nonetheless. In 1956–1960 it is estimated to have grown by \$65 million, and from 1961 to 1964 by \$90 million.

The effect of endowment building on the over-all flow of contributions to philanthropic agencies generally has been small. In the period from 1956 through 1964, despite an estimated \$155 million applied to increase foundation endowments, philanthropic agencies received about 3 per cent more than corporations gave in the period. The difference, of course, reflects investment earnings applied to philanthropic programs. Probably only in the early 1950's did endowment building have a significant effect. The estimated \$400 million applied to increase endowments in that period meant that philanthropic agencies received about 11 per cent less than corporations gave. Barring a return to extremely high tax rates, it seems unlikely that such a pattern would appear again.