★ *Owing to the very strong inflationary situation in Australia company profits are very much before the public eye. A number of misleading statements have been made about the size of profits and their general trend over the post-war period. This article attempts to clear up these misconceptions and shows that company profits have had a negligible influence on present-day prices.*

HIGH PRICES AND COMPANY PROFITS

THE consumer is paying today distressingly high prices for practically all the things he purchases. A pound of rump steak costs 3/- compared with 1/9 in June, 1947; a man's tailored suit £25 compared with £10 before the war; the price of gas is now 10/3 per 1,000 cubic feet; in June, 1947, it was 6/1; an average 5 or 6 roomed house now costing £4,000 could be bought before the war for less than £2,000.

Moreover these prices never stand still. Almost month by month, to the dismay of the housewife and breadwinner, they go higher and higher. No wonder the subject of high prices generates so much heat that it is difficult for anyone to reach a calm and balanced view of the problem.

Profits, particularly company profits, have been singled out as one of the main causes of rising prices. How far is this criticism justified? Is the present abnormal level of prices largely due to excessively high profits, or is it in the main due to other factors?

Many people reading the newspaper headlines of record profits jump to the conclusion that the mounting cost of living is accounted for by high profits, and that if profits were reduced the cost of living could be substantially lowered. *Two basic misconceptions lie behind this belief—first, that profits over the whole of industry are, in general, excessively high; and second, that profits constitute a large element in prices, and thus in the cost of living.*

Let us deal first with the notion, widely held, that business profits are today at *unduly* high levels.

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Newspaper headlines which speak of "record profit" usually refer to the total money profits of a particular company, not to the profit made by the company on each unit of the product it sells, or to the profit made in relation to the total capital employed in making it. But a little reflection will show that total profits are not a fair standard by which to judge the size of profits, *unless they are considered in relation to the volume of sales and to the amount of capital invested in the business.* These are facts well known to the businessman, but they are frequently overlooked, and sometimes perhaps conveniently forgotten, by those who indulge in sweeping condemnations of business profits.

To take a simple example! A motor-car distributing firm selling, say, 10,000 cars will naturally make a great deal more profit than if it sold only 1,000 cars, other things being equal. But that, by itself, surely, is no reason for angry criticism of the firm and its profits. The community is clearly much better off when it is in a position to purchase 10,000 cars, than it would be if only able to buy 1,000 cars. The real test of whether the motor-car company's profits are excessive is the amount of profit it makes on every car sold. If it sells a great number of cars it may make good profits in total *even though the rate of profit per car is comparatively small.*

In prosperous times when people have plenty of money to spend, business profits increase, not necessarily because businesses are making a greater profit on the things they sell, but simply because they are selling many more things. A time of good business profits is invariably a time of economic prosperity for the community as a whole. When profits are low and many businesses are making losses, then there is a state of economic depression and unemployment. Nobody wants that. Prosperity for the community means good profits for businesses. Profits are certainly high today, but so are wages. The statistical records show that profits and wages invariably rise and fall together. If there should be a large drop in profits, unemployment and short time would begin to appear and earnings above award rates would be eliminated. How would the community benefit, then, if profits were greatly reduced?

THE ACID TEST.

The acid test of whether profits are fair and reasonable is the rate of profit earned on the capital invested in the business taken in conjunction with the conditions under which the business is operating. A person who has invested £10,000 in a business is obviously entitled to expect a greater total return on his money than one who has invested only £1,000. Similarly a company with a capital of £1,000,000 will usually make, and must make if it is to survive, a greater total profit than a company with a capital of £100,000. The real test is how much these profits amount to compared with the capital required to earn them.

Nobody wants to argue that there are no instances of excessive profits, or that some companies are not enjoying great bounties because of fortuitous circumstances such as record overseas prices, which, incidentally, are beyond our control. But taken over the whole range of activity these cases do not constitute a large proportion of total profits. To determine which companies are making excessive profits would involve an examination of the circumstances under which each individual company is operating.

EACH BUSINESS MUST BE CONSIDERED INDIVIDUALLY.

A profit of 10% on capital might, for instance, be regarded as excessive for one company, but quite reasonable, perhaps even inadequate for another. It depends entirely on the circumstances under which the businesses are working and these circumstances vary widely from one company to another, even between companies engaged in the same line of business. Company A for instance, may have been established for generations, built up large reserves from profits ploughed back and generally have achieved an almost impregnable financial position. Company B on the other hand may have only recently been established, and consequently have had insufficient time to strengthen its finances by earmarking funds for reserves. Can it be rightly argued that a profit that may be excessive for Company A is also excessive for Company B?

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Again, one business may be engaged in the production of goods and services for which demand is fairly constant no matter what the state of business conditions. But another company may be concerned with the production and sale of commodities or services for which the demand is acutely sensitive to changing economic circumstances. The latter company may need to make very high profits in boom conditions to cover the low profits or losses it will incur in times of business depression. But over a long period of time covering booms and slumps, the first company may average a higher rate of profit. Thus, before it can be established definitely whether or not profits are excessive, one must consider the age of companies, the type of business they conduct, the risk involved, the efficiency of their operations, the cost of their assets and the depreciation allowances accrued, payments for intangible assets such as goodwill and a host of other factors which are familiar only to the expert in company finances. You cannot lay down for general application a figure such as 5% or 10% or 15% on capital employed and say that anything above that figure is excessive. The important point is that each business has to be considered on its merits.

However, what is of practical concern to the man in the street is not so much whether profits are higher than they should be, but the connection between profits and the prices he pays for the goods he buys over the counter. The crux of the matter is whether or not profits constitute a large part of the final selling price to the consumer.

To judge profits in their proper perspective one must forget for the time being the isolated instances of excessive profits and survey the whole national economy and consider the story told in the aggregate statistics published by official authorities such as the Taxation Commissioner, the Commonwealth Statistician, and the Commonwealth Bank. An impartial examination of these figures will show conclusively that profits are a relatively minor element in total costs, and therefore in selling prices.

NATIONAL INCOME ESTIMATES.

The best statistical presentation of the items which go to make up the cost of goods and services sold to the Australian public is given in the 1949-50 National Income Estimates prepared by the Commonwealth Statistician for the information of members of the Federal Parliament. The Estimates show the division of the proceeds of the net sales of goods and services (after paying for imports), made by all trading enterprises (financial enterprises such as banks and mutual life assurance companies are excluded), amongst all the people and institutions who contributed their property and their labour and skill to the national production stream. Taking the first post-war year, 1945/6, as a base it is relatively easy to ascertain who have profited most from the great rise in the value of sales from £1243m. in 1945/6 (just before controls were relaxed) to £2422m. in 1949/50. (Not all of this increase, of course, represents higher prices; a good proportion of the rise is due to a greater volume of output).

DIVISION OF THE PROCEEDS OF TRADING ENTERPRISES BEFORE PAYMENT OF INCOME TAX.

	1945/6	1948/9	1949/50	Increase 1945/6 to 1949/50	
	£m.	£m.	£m.	£m.	%
1. Employees	537	867	965	428	80
2. Farmers & Unincorpd. Businesses	250	569	730	480	192
3. Governments	132	216	257	125	95
4. Companies	134	215	230	96	72
5. Property Holders	94	114	121	27	29
6. Depreciation Funds	60	94	125	65	108
7. Government Undertakings	36	2	—6	—42	—
TOTAL	1243	2077	2422	1179	95

It is quite clear from this table that the greater share of the proceeds of production is paid to workers, both brain and hand workers, and not to employers and property holders. In 1949/50 about four tenths was paid to employees in wages and salaries (See item 1 in table), another three tenths (except for a small proportion representing a return on invested capital) was paid to farmers, shopkeepers, professional men, contractors and independent craftsmen for their labour and skill (See item 2). After the Government reaped a tenth in sales tax, customs and excise tax, flour tax, entertainment tax, etc. (See item 3), only two tenths was left as a reward other

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than for labour and skill. Of this companies took one tenth as profit on their operations (See item 4), and a final tenth remained to provide for replacement of capital assets and to remunerate those people and institutions who loaned money or rented out property (See items 5 & 6). *It is interesting to note that from the proceeds of production, governments are taking today in indirect taxation £27m. more than was taken by company profits.* Company profits represent such a minor proportion of the total sales value of goods and services that it would require an extremely large increase in profits to have any material influence on the course of prices. *Between 1948/49 and 1949/50 total profits increased only by £15m. whereas the value of sales increased by £345m.*

Although the value of sales has nearly doubled since 1945/6, company profits have not increased proportionately. Apart from increased physical turnovers, the factors mainly responsible for the higher money sales are returns to farmers (due to the sharp rise in export prices since 1945/6) and increases in wages and salaries since the lifting of wage-pegging in 1946.

The statistics bear out the conclusion of the Commonwealth Bank in its latest annual report that *"while part of the increase in prices (over the last year) was directly or indirectly attributable to higher prices for imports and exportable products, much of it appears to have been due to the continued pressure of internal demand on domestic production operating largely through increased pressure for, and willingness to grant wage increases."*

It is difficult to see how profits can be blamed for the increase in prices between 1948/9 and 1949/50, when company income increased by only £15m.

Shareholders, of course, will derive little immediate benefit from this increase in company incomes. Most of the additional £15m. will go to the Taxation Commissioner in company tax or will be reinvested in stocks, buildings and equipment, thus providing further employment. This is indicated by the trends in the distribution of the profits of all companies, including banks and life assurance companies, between 1948/9 and 1949/50.

DISTRIBUTION OF INCOME OF ALL PRIVATE AND PUBLIC COMPANIES IN AUSTRALIA IN 1948/9 and 1949/50.

	1948/9 £m.	1949/50 £m.	Increase 1948/9 to 1949/50 £m.
Company Tax	74	85	11
Dividends to People Resident in Australia	46	50	4
Dividends and Undistributed Profits Accruing Overseas	21	23	2
Undistributed Profits	86	85	—1

As all shareholders are taxed on their dividends at property rates, and many of the incomes fall into the top income tax brackets of 12/- to 15/- in the £, a good proportion of dividends paid out by companies ultimately also finds its way into the Treasury. *The increase in dividends in 1949/50 of £4m. compares with a £135m. rise in all wages and salaries.*

PROFITS ONLY A SMALL PART OF TOTAL COST.

Public Opinion Polls conducted both here and abroad suggest that very few people have any idea how large profits really are, and that the public is only too ready to accept exaggerated versions of the size of profits. The remedy is fuller information about profits by government statisticians and by individual companies. Unfortunately most official data is very scanty and is often out-of-date when published. The 28th Report of the Taxation Commissioner has only recently made public the taxable incomes of companies in 1945/6.

Using this data (for want of better) and information published by the Commonwealth Statistician it is possible to demonstrate the relative insignificance of company profits in relation to the total sales of manufacturers. Although this cannot be illustrated with companies other than manufacturing (because information is unavailable) the story would still be very much the same. The following table sets out the main elements, including company profits and taxation, which went to make up the cost of manufactured goods in 1945/6.

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MANUFACTURING—AUSTRALIA 1945/6.

1	2	3	4	5	6	7
Industry.	Wages and Salaries. £m.	Materials, Power, Repairs. £m.	Coy. Taxes. £m.	Profits all coys. after tax. £m.	Public Co. Profits over 5% on Funds after tax. £m.	Value of Output. £m.
Engineering & Metals ..	89	145	4.6	9.7	0.8	274
Textiles & Clothing . ..	31	64	2.1	4.8	0.4	115
Food, Drink & Tobacco ..	29	170	6.2	12.1	1.3	232
Paper and Printing	11	21	1.7	3.5	0.3	42
Rubber, Leather, Timber, Furniture	20	48	1.1	2.4	0.2	80
Gas and Electricity	4	12	0.7	1.4	0.1	26
All Other	22	55	4.4	8.3	0.9	98
TOTAL	206	515	20.8	42.2	4.0	867

NOTE:—The classifications adopted by the Statistician and the Taxation Commissioner are only approximately comparable. Columns 2, 3, and 7 were extracted from the Production Bulletin—Secondary Industries No. 40., and columns 4, 5 and 6 were extracted from the Taxation Commissioner's 28th Report. The figures in column 6 were derived from statistics compiled by the Taxation Commissioner under the operations of War-time Company Tax. This tax was imposed on all public companies, i.e. predominantly those listed on the stock exchanges and to which attention is often drawn in newspaper headlines. Private or proprietary companies and co-operatives were expressly excluded and the tax was levied on profits in excess of 5% of capital employed, after other taxes had been deducted.

The figures in Column 6 provide some answer to the suggestion that company profits are grossly excessive. Assuming that 5% on funds employed is a reasonable rate of profit for manufacturing industry as a whole—and many would argue that it is inadequate—of the earnings of public companies only £4m. out of a total manufacturing output of £867m. fell outside this category.

These figures of course relate to 1945/6. Up-to-date statistics on the profits of public companies engaged in manufacturing are published periodically in the Commonwealth Bank Statistical Bulletin. According to this source, profits in manufacturing industries as a percentage of shareholders' funds increased from 6.3% in 1946 to 7.8% in 1949—(for 218 companies compared with 306 companies surveyed by the Taxation Commissioner in 1945/6). Preliminary figures suggest that the final figure for 1950 will be about the same as 1949. It is a fair inference to draw from the Commonwealth Bank data that profits in 1950 though higher than in 1946 are still not so much higher as to invalidate the general conclusion that profits in manufacturing, in excess of 5% on shareholders' funds, are an insignificant element in the total cost of manufacturing output.*

The total elimination of profits over 5% on shareholders funds for public companies engaged in manufacturing would not reduce the cost of goods by more than 1d. to 2d. in every £'s worth of goods.

The minor role played by profit in the determination of the ultimate selling price of any commodity or service is further illustrated on pages 20-21, with examples taken from the actual results of leading companies engaged in manufacturing, distribution and other activities in 1950.

It will be observed from the table that materials are the largest item in costs—approximately 10/- in the £ of manufacturing cost and upwards of 15/- in the £ of retail selling price. Manufacturing payroll averages about 5/- in the £, and allowing for overhead expenditure such as advertising, depreciation, rent and interest, the margin to cover taxation, dividends and profits re-invested, rarely exceeds 2/- in the £ of sales. Dividends range as low as ½d. in the £ of net income —averaging about 6d. in the £. In most cases the Taxation Commissioner reaps a larger share of each £ of sales than do the Company's shareholders.

The predominant items in costs are clearly wages and salaries and the cost of materials. In the final analysis 80% of costs are labour costs.† While wages and salaries continue to rise prices must rise in line, unless productivity is greatly stepped up. All the misleading propaganda in the world cannot get away from these facts substantiated by the statistics of the Taxation Commissioner, the Commonwealth Statistician and the Commonwealth Bank.

* Profits of manufacturing companies in the Commonwealth Bank sample exceeding 5% on shareholders' funds appear to have increased from £3m. in 1946 to £7m. in 1949. But, at the same time, the value of manufacturing output has risen from £867m. in 1945/6 to £1425m. in 1948/9.

† See Appendix on page 18.

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APPENDIX:

Labour Costs as a Proportion of Total Production Costs

In the article "High Prices and Company Profits" the statement is made that "around 80% of costs are labour costs."

During January, an interesting dispute was reported in the "Argus" between Mr. Anderson, State President of the Liberal Party and Mr. F. Crean, M.L.A., on this subject. Whilst Mr. Anderson maintained that wages represented about 80% of costs, Mr. Crean pointed out that wages and salaries constituted only 54% of national income in 1950 and that this fact disproved Mr. Anderson's claim.

In the "Argus" of the 18th January, a statement from Canberra was published, suggesting that wages represented only 25% of the cost of manufactured goods. It would, however, be palpably incorrect to infer from this statement that wages comprise only 25% of the final price of a manufactured article. The predominant part of the costs of the manufacturer consist of the prices he pays for his raw materials, fuel and power—according to official statistics about 60%. But the cost of all these items is in turn very largely made up of wages and salaries incurred in the course of their growth or extraction, processing and transport to the factory gates. The true cost of the manufacturing process, *considered by itself,* is the cost incurred in transforming the raw or semi-finished materials into the finished product. Of the cost of this process wages and salaries comprise the major proportion —again about 60%—and this, incidentally, ignores the large element of wages and salaries in the manufacturer's overhead, which includes such items as advertising and insurance.

Taking national production as a whole (not just manufacturing production), the National Income Estimates of the Commonwealth Statistician suggest that the figure of 80%

put forward by Mr. Anderson is not very far out. In 1949/50 employees received 52½% of the national income in wages and salaries, whilst property incomes, i.e. profit, rent and interest took 15½%. The remaining 32% represents the incomes of farmers, shopkeepers, professional men such as doctors, and self-employed persons. A large part of the incomes of these people strictly speaking represents a payment for work and skill and not for the ownership of property. According to Mr. H. P. Brown, former Director of Research of the Commonwealth Bureau of Census & Statistics, at least three-quarters of the incomes of this group must be regarded as being in the nature of a payment for labour and skill. On this basis, therefore, something like 75% to 80% of national income would represent payments for personal effort and in that sense constitute a labour cost.

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DISTRIBUTION OF EACH £ OF REVENUE OF LEADING AUSTRALIAN PUBLIC COMPANIES.

<table>
<tr><th rowspan="2">Company</th><th rowspan="2">Materials</th><th rowspan="2">Payroll</th><th rowspan="2">Other Expenses</th><th rowspan="2">Taxation</th><th colspan="2">Profit</th></tr>
<tr><th>Paid out in Dividends</th><th>Reinvested in Business</th></tr>
<tr><td>MANUFACTURING—</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Aust. Paper M'fers</td><td>7/8</td><td>5/6</td><td>5/2½[1]</td><td>9½</td><td>8</td><td>2</td></tr>
<tr><td>Berlei Corsets</td><td>8/10</td><td>6/2</td><td>3/2</td><td>10</td><td>7</td><td>5</td></tr>
<tr><td>Brighton Gas Co.</td><td>10/7</td><td>6/–</td><td>2/2</td><td>5</td><td colspan="2">10[2]</td></tr>
<tr><td>Carlton & Un. Breweries</td><td>1/9</td><td>1/5½</td><td>2/5</td><td>13/7[3]</td><td>6½</td><td>3</td></tr>
<tr><td>Electronic Inds.</td><td>12/8</td><td>3/8</td><td>2/9</td><td>7</td><td colspan="2">4</td></tr>
<tr><td>General Motors</td><td>11/5</td><td>4/5</td><td>2/5</td><td>1/4</td><td>½</td><td>4½</td></tr>
<tr><td>Goodyear Tyre</td><td>9/2½</td><td>3/11</td><td>3/2½</td><td>2/6</td><td>8</td><td>6</td></tr>
<tr><td>Holeproof Hosiery</td><td>10/5</td><td>6/5</td><td>1/8</td><td>9</td><td>5</td><td>4</td></tr>
<tr><td>ICIANZ</td><td>15/2</td><td>3/–</td><td>6</td><td>5</td><td>7</td><td>4</td></tr>
<tr><td>Jantzen Knitwear</td><td>9/6</td><td>5/–</td><td>3/6½</td><td>10</td><td>4</td><td>9½</td></tr>
<tr><td>National Radiators</td><td>10/2</td><td>4/6</td><td>3/1</td><td>11</td><td>8½</td><td>7½</td></tr>
<tr><td>Rocla Pipes</td><td>6/6</td><td>7/9</td><td>3/10½</td><td>9½</td><td>7½</td><td>5½</td></tr>
<tr><td>Valley Worsted Mills</td><td>9/4</td><td>5/–½</td><td>2/9</td><td>1/4</td><td colspan="2">1/6½</td></tr>
<tr><td>Yarra Falls</td><td>9/10</td><td>4/5</td><td>2/10</td><td>1/4</td><td>8</td><td>11</td></tr>
<tr><td>Colonial Sugar</td><td>—</td><td>—</td><td>19/6½</td><td>—</td><td>5</td><td>½</td></tr>
<tr><td>Henry Jones—Jam etc.</td><td>—</td><td>—</td><td>19/2</td><td>—</td><td>4</td><td>6</td></tr>
<tr><td>DISTRIBUTION—</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Department Stores—</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Foy & Gibson</td><td>15/4</td><td>—</td><td>3/6½</td><td>5</td><td>4½</td><td>4</td></tr>
<tr><td>Mantons</td><td>15/2</td><td>—</td><td>3/11</td><td>6</td><td>3</td><td>2</td></tr>
<tr><td>Myer Emp.</td><td>15/2</td><td>—</td><td>3/9</td><td>8</td><td>3</td><td>2</td></tr>
<tr><td>David Jones</td><td>13/8½</td><td>4/2</td><td>11</td><td>7½</td><td>2½</td><td>4½</td></tr>
</table>

Motor Cars—						
Larke Hoskins	13/5	9	1/9	3/3	1	9
Austin Distributors	12/6	7	1/11	3/9	2	1/1
Standard Cars	—	—	16/4	2/10	2½	7½
Other Industries and Services—						
A. G. Healing	14/10	1/9½	1/7	10	4½	7
Ampol Petroleum	—	—	19/-	3	4	5
McPhersons	—	—	18/1	10	5	8
Permewan Wright	—	—	19/4½	3	2	2½
Ansett Transport Inds.	5/11	4/5½	8/-(4)	11½	5½	2½
Burns Philp	—	—	19/9	—	2½	½
Herald & Weekly Times	8/9	5/2	4/6	6		1/1

N.B.—Great caution should be exercised in making any comparison between companies in the absence of information about capital employed and the particular circumstances of each business. The data is compiled from information published or furnished by each company, and is predominantly for 1950. Classifications are not entirely uniform —some companies include indirect taxation as well as direct taxation under the item "taxation", e.g. Taxes paid by Goodyear Tyre include Sales Tax, Primage and Customs Duties and Income Tax.

Where separate figures are not available for materials, payroll or taxation, these items are included with other expenses. Other expenses also includes depreciation.

Notes:—(1) Includes 3d. debenture interest.
(2) 1949. 1950 results show a loss.
(3) Includes 12/11 excise tax.
(4) Includes 2/8½ accommodation paid on behalf of tourists.

CONTROLS, SOCIALISM, AND PRIVATE ENTERPRISE

By PROFESSOR WILFRED PREST

Dean of the Faculty of Economics and Commerce, University of Melbourne

THE restoration of war-time controls over production and consumption prices and wages, appears to be imminent in many countries. In the United States the President has declared a state of emergency and taken power to re-impose rationing, price control and wage pegging. In Australia it is proposed to restore the control of capital issues, but for the time being it is apparently hoped to re-allocate man-power and materials by indirect methods such as the regulation of bank credit.

The prospective restoration of controls so soon after their relaxation (or, in some cases, total abolition) will be a matter for widespread dismay. It is not only that the circumstances of their restoration—re-armament and renewed military preparations—are deplorable. The restoration of controls would also disappoint all those who hoped for the opportunity after the War of deciding for themselves what pursuits they would follow, what goods they would buy and, if employers, how they would conduct their businesses. The restoration of controls would inevitably restrict individual freedom of choice in all these matters. It does not follow, however, as is sometimes alleged, that the restoration of controls is a step towards "socialism."

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Socialism can mean many things and one specialised meaning will be indicated below. A basic element in all socialist programmes, however, is the "social" as distinct from the