

# PROFITS AND PROGRESS

THE constant upward movement in prices which has confronted the peoples of many countries since the end of the war is without precedent in modern economic history. While, no doubt, the great bulk of the Australian community are fully conscious of the impact of this new phenomenon on their daily lives—indeed often to their personal discomfort—from time to time this new background to the current economic scene flares up into special prominence and attracts special interest in the daily press and elsewhere. A multitude of causes, many of them conflicting and contradictory, have been advanced in an attempt to explain rising prices. The causes advanced vary from the one extreme of assigning the whole reason for rising prices to what is said by the socialist to be an inherent selfishness in the private enterprise system itself, to the other extreme of attributing the blame solely to the indolence and utterly irresponsible attitude of the worker at the bench.

Of course, neither of these extreme views, taken in isolation, affords any real explanation of rising prices. The falsity of the claim that the drift in the value of the Australian pound rests solely on the shoulders of private business as a result of the allegation that selling prices contain an unduly high profit element was exposed in an article entitled "High Prices and Company Profits" in the last issue of Review. That article also showed clearly that indirect taxation such as Sales Tax, Customs and Excise Duties, etc. exerts a much greater influence on prices than do company profits. Further careful examination of the available data and statistics of company profits and of the relationship of dividends to incomes, reveals that *any limitation of company profits to, for example, 5% on shareholders' funds, or even their complete abolition could not improve the worker's lot one iota; nor could it, except in isolated cases, materially reduce the incomes of the wealthier sections of the community.*

## THE INVESTOR'S ROLE IN FOSTERING ECONOMIC PROGRESS

From profits, and from profits alone, must come any reward which an individual may hope to obtain in return for placing his savings at the disposal of someone else to use in enlarging the real wealth, or the services, available to the community. Those who continually decry the investor as a social parasite should take stock of the economic history of Australia. At the turn of the century much of our industry and commerce was conducted on relatively small scale lines. But, with the industrial growth and development of this century, increasing numbers of people have contributed their savings toward the cost of establishing new industries or extending the old, until today, there are between seven hundred and eight hundred public companies with share capital amounting to nearly £500 million listed on the Melbourne Stock Exchange alone.

These millions are invested in factories, public utilities, mines, warehouses, store and retail establishments which provide employment for hundreds of thousands of people and producing a steady flow to the general public of the everyday necessities of life, the regular supply of which is now taken for granted by everyone.

*These great strides in production and distribution, which doubled the standard of living of the ordinary Australian citizen within the short space of half a century, would not have been possible without the investment of an enormous amount of subscribed share capital. The scale of the new techniques required by 20th century industry and commerce necessitated a volume of finance quite beyond the resources of any one person. In order to secure the funds for expansion, the founders of many enterprises were obliged to adopt the limited liability form of company organisation. In consequence, profits and risks were spread over fresh thousands of individuals engaged in all walks of life, and in varied degrees of financial circumstances.*

*Under this system, no matter how limited his finances a man can establish an enterprise to meet what he feels is a need of the community. Such a venture may, or may not,*

become profitable but at least this system provides the means whereby the initiative and genius of individual men and women is turned to practical use for the benefit of the community as a whole. It has resulted in a great diversification of economic activity and in the satisfaction of the numerous everyday wants and whims of the community which would not be possible if investors were not prepared to risk their savings. And, if the austere socialist planner objects to the satisfaction of the whims of the community as distinct from what he conceives ought to be its real wants, let him remember that any bunch of people—like any individual—will have its whims satisfied somehow.

Also, it is to be remembered that, amidst the great story of progress of Australian industry and commerce during this century, are many cases—most now forgotten—of ventures which failed to satisfy a need, and therefore failed to become profitable. But the resultant losses fall upon individual members of the community instead of upon the people as a whole, as, of course, is inevitable in the socialist state with its socialised structure of industry and business.

#### PROFITS AND WELL BEING OF EMPLOYEES GO HAND IN HAND

*Wages and profits have a common interest in the prosperity of business. When profits are buoyant it will generally be found that wages and conditions for employees are best.\* Wide awake unions in the United States of America have not been slow to realise that "bad" companies are those which make insufficient profits to ensure future employment and prospects for their members. In their view "good" companies are those which make surpluses that are adequate to earn the confidence of both investors and employees. For, if an enterprise fails to make adequate profits it is doomed to stagnation. It will have insufficient funds to put back into the business—the most economical method of financing the expansion and modernisation of its plant and in the long run the most beneficial to its employees—and it may fail to attract the attention of investors in supplying further capital from outside. There is something here to be learned by trade union thought nearer home. Much adult economic education is*

\* See graph on Page 53 showing the trend of wages and profits since 1928.

urgently required to explain the true role of profits, and to place the nature of their size and distribution in its true perspective.

### WHAT HAPPENS TO PROFITS ?

While most people are willing enough to concede the enormous economic progress that has been achieved under the present system of corporate financing through the issue and sale of shares, many allege that because too few own company shares the system leads to a gross inequality in incomes. There could be no more erroneous conception.\*

Apart from private and proprietary companies limited by statute to 50 shareholders each, over all there are now about half a million people who hold shares in public companies in Australia. The average shareholding in our largest companies is usually between 300 and 600 shares, providing an income of, say, from £25 to £50 per annum, which is in many cases subject to tax at varying rates. Life assurance companies are investing their funds to a considerable extent in the shares of public companies. Every person who holds a life insurance policy, however small, has an indirect interest in the dividends paid on these shares. The increasing tendency of many companies to issue 5/- shares also provides a valuable opportunity for the small man to acquire a stake in Australian public companies—a tendency which, incidentally, would not have been in evidence had shareholdings comprised, in the main, large blocks of shares. *When all the facts are taken into consideration, namely that by far the majority of the capital originates from the savings of small investors; that we have a growing recognition of profit sharing by various means, such as employees' shares, it is evident that we are making considerable strides towards a wide distribution of wealth.*

There is a good deal of misunderstanding about the ultimate destination of profits. The profits earned by companies are not distributed entirely to shareholders. Out of profits companies must pay heavy taxes (in aggregate nearly 40% of their income). They must also reinvest a large

\* See Table in I.P.A. "Review," May/June, 1949, Page 90, showing that there are more shareholders than employees in a number of the larger Australian public companies.

proportion of the remainder of their profits in order to obtain up-to-date, efficient equipment, to provide for expansion and to guard against hard times.

But the story does not end here. It becomes even more illuminating when dividends are traced to their ultimate end, i.e. to the individual shareholders who receive them.

## WHAT HAPPENS TO DIVIDENDS?

The final destination of company dividends is a matter of considerable public interest. Unfortunately, there is such a lag in assessing this particular form of income that the latest year for which reasonably complete data is available is 1942/3. In that year, companies distributed a total of £49m. in dividends as follows:—

	£m. approx.
Australian Residents .....	32
Companies .....	12
Overseas .....	5
	<u>49</u>

From information published by the Taxation Commissioner and further details supplied by the Commonwealth Statistician it would appear that dividends to Australian resident shareholders in 1942-3, were distributed in the following manner:—

### DISTRIBUTION OF DIVIDENDS.

	£m.	£m.
1. Included in income tax statistics .....	19.8	
2. Received by exempt civilians (low incomes) .....	2.8	22.6*
3. Received by non-taxable institutions .....	1.0	
4. Exempt dividends (Div. 7, gold mining, etc.) .....	5.0	
5. Received by exempt members of forces .....	.2	
6. Received by taxpayers omitted from statistics (incomplete assessment) and evasion .....	2.9	9.1
		<u>31.7</u>

This table shows that about 2/3 of dividends were subject to taxation in the hands of shareholders. No taxation was assessed on the remaining 1/3, because it comprised in

\* See analysis by income groups in the next table on Page 48.

the main, dividends of gold mining companies and certain private companies (specifically exempted by the Income Tax Assessment Act), dividends paid to religious, scientific, charitable and educational institutions and to persons earning less than £105 per annum.

The Income Tax Statistics also refute the claim that dividends are only earned by the rich. The following table shows the distribution of dividends, before and after tax among various income groups:—

DISTRIBUTION OF DIVIDENDS TO SHAREHOLDERS BY INCOME TAX GROUPS 1942/43.

(Individual Resident Shareholders Only)

Income Group all Sources	Dividends Received		Estimated	Shareholders'	Dividends % of Total After Tax
	Before Tax	% of Total	Tax on Dividends	After Tax	
	£m.		£m.	£m.	
Under £105	2.80	12.40	—	2.80	20.93
105- 300	1.57	6.95	.12	1.45	10.84
301- 500	1.75	7.75	.37	1.38	10.32
501- 800	2.31	10.23	.62	1.69	12.63
801- 1,000	1.23	5.45	.43	.80	5.98
1,001- 2,000	4.23	18.73	1.78	2.45	18.31
2,001- 5,000	4.69	20.77	2.79	1.90	14.20
5,001-10,000	2.27	10.06	1.65	.62	4.63
10,001-20,000	1.00	4.43	.81	.19	1.42
20,001-30,000	.26	1.15	.22	.04	.30
30,001-50,000	.21	.93	.18	.03	.22
Over 50,000	.26	1.15	.23	.03	.22
	22.58	100.00	9.20	13.38	100.00

NOTE: (a) The figures for dividends received by persons earning less than £105 p.a. were supplied by the Commonwealth Statistician. The remaining dividends which were liable for taxation were derived from the 26th Report of the Taxation Commissioner. The taxation on dividends was estimated from the figures of property tax paid on the property income (including the property element of composite income) of each group.

(b) This table excludes dividends received by overseas shareholders (£5m.), companies (£12m.) and dividends not assessed for taxation, other than low incomes.

Because of the heavy property rates of taxation which were levied on dividends, especially during the year 1942/43, to which these statistics relate, very little income from shares remained in the hands of people earning above £2,000 a year, after paying their taxes. Of the £13.38m. shown in the table above as being net dividends retained by shareholders, *about 20% belonged to people earning less than £2 per week, i.e. persons such as married women and retired people. Only about 20% was received by persons earning above £2,000 a*

year. The remaining 60% of dividends are paid to ordinary members of the public, in all grades of society, whose earnings lie between £105 and £2,000 per annum, the majority of whom are in the lower groups earning up to £800 p.a.

Quite contrary to popular belief, income from shares owned by the higher incomes, say those earning over £5,000 a year, is relatively small in size. This is quite clear from a study of Table I on page 51.

In 1942/43 (the latest year for which it is possible to obtain complete information from the Taxation Commissioner), there were 1,962,756 resident taxpayers. Collectively they earned a total taxable income of £733.8m., apportioned as follows:—

From Personal Exertion .....	£m. 666.1	% 90.8
From Dividends .....	19.8	2.7
From Other Property .....	47.9	6.5
<b>Total .....</b>	<b>733.8</b>	<b>100.0</b>

The share of these incomes received by people earning over £5,000 per annum was earned in the following manner:—

Income from Personal Exertion .....	£m. 13.0
Income from Dividends .....	4.0
Income from Other Property .....	2.9
<b>Total .....</b>	<b>19.9</b>

The average income from dividends (after deducting taxation) of all persons earning over £5,000 per annum from personal exertion, dividends and other property combined in 1942/43 was as follows:—

Income Group All Sources £	No. of people in Group.	Av. Gross Dividends before Tax. £	Amounts taken by the State in Tax. £	Average net Dividends to the Share- holder after Tax. £
5- 6,000 .....	735	1,023	716	307
6- 8,000 .....	719	1,378	1,003	375
8-10,000 .....	293	1,796	1,376	420
10-12,000 .....	142	2,435	1,942	493
12-15,000 .....	124	3,019	2,424	595
15-20,000 .....	77	3,673	3,017	656
20-30,000 .....	48	5,404	4,527	877
30-50,000 .....	24	8,592	7,425	1,167
Over 50,000 .....	8	32,502	28,641	3,861

We may safely conclude, therefore, that abolition of company profits and their distribution elsewhere would not (save in a relatively small number of instances) materially increase or decrease anyone's income. (That is true if in all other respects the status quo were maintained. But what is undoubtedly true, is that the mere hint of such a move would cause an unprecedented fall in the living standards of all classes). Most shareholders depend on salaried employment for their livelihood. *If dividends after tax earned by the top income groups were distributed amongst the low incomes, the latter would not benefit by more than a few pence per week.*

NOTE:

It is to be regretted that the latest year for which reasonably complete details are available, showing the distribution of dividends among income groups, should be as long ago as 1942/43. Unfortunately complete figures on this subject have not been published since the 26th Report of the Commissioner of Taxation released in May, 1947.

The latest annual report of the Commissioner (29th) was tabled in the House of Representatives in March, 1951. This report covers the income year 1946-47, but it does not contain statistics of dividends received by individual taxpayers. The Commissioner advises that it was not expected that such dividend figures would be extracted for quite some time.

Aggregate dividends are higher today than in 1942/43. However, the reduction in property rates of taxation since 1942-43, particularly on the high incomes, has been proportionately less than on the lower incomes. It is considered, therefore, that whilst average dividends after tax may be higher today than in 1942-43, the pattern of dividend distribution among income groups today, would be very much the same.

**TABLE I.**

**AVERAGE INCOMES BEFORE AND AFTER TAXATION OF PERSONS  
EARNING OVER £5,000 PER ANNUM.**

**BEFORE TAX.**

Annual Income all Sources £	Personal Exertion £	Dividends £	Other Property £
5- 6,000 .....	4,143	1,023	833
6- 8,000 .....	5,105	1,378	1,119
8-10,000 .....	6,385	1,796	1,489
10-12,000 .....	7,483	2,435	1,827
12-15,000 .....	9,635	3,019	1,987
15-20,000 .....	11,973	3,673	2,025
20-30,000 .....	16,169	5,404	3,404
30-50,000 .....	24,655	8,592	2,735
Over 50,000 .....	34,233	32,502	17,091

**AFTER TAX.**

Annual Income all Sources £	Personal Exertion £	Dividends £	Other Property £
5- 6,000 .....	1,390	307	249
6- 8,000 .....	1,480	375	304
8-10,000 .....	1,603	420	347
10-12,000 .....	1,762	493	372
12-15,000 .....	1,896	595	381
15-20,000 .....	2,362	656	361
20-30,000 .....	2,587	877	552
30-50,000 .....	3,494	1,167	372
Over 50,000 .....	4,099	3,861	2,035

**SOURCE: 26th Report of the Taxation Commissioner.**

**NOTE: The figures after tax are estimates based on the total tax paid by each group on each type of income.**



TABLE II.

ANALYSIS OF THE SHARE REGISTER OF A MEDIUM SIZED  
AUSTRALIAN PUBLIC COMPANY.  
HOLEPROOF LTD.

SIZE OF SHAREHOLDINGS.

No. Shares Held	No. Shareholders	%
1- 100 .....	1,445	49.5
101- 250 .....	684	23.4
251- 500 .....	522	17.9
501-1,000 .....	177	6.0
Over 1,000 .....	94	3.2
<b>Total</b> .....	<b>2,922</b>	<b>100.0</b>

Average No. of Shares Held approximately 285.

OCCUPATIONS OF SHAREHOLDERS.

	No.	%
Married Women .....	951	32.6
Professional Men .....	369	12.6
Industrial Employees .....	250	8.6
Clerks, Salesmen, etc. ....	246	8.4
Business Executives .....	192	6.5
Retired Persons .....	171	5.9
Estates, companies and other corporations .....	147	5.0
Agricultural Employees .....	62	2.1
Other Occupations .....	534	18.3
	<b>2,922</b>	<b>100.0</b>

NOTE: This analysis is based on shareholdings as at 31st December, 1950. Since that date the £ ordinary shares of Holeproof Ltd. have been converted to five shilling units.