Profits and the National Welfare

THE tighter money market has come as an unpleasant shock after the long period of plenty. Both governments and private industry have been compelled to cut down important programmes of development because current savings are not high enough to sustain them. Loan raisings fall far short of government works expenditures, and even long-established companies are experiencing difficulty in obtaining adequate finance for new activities.

The immediate cause of the scarcity of capital is the 40% drop in savings which occurred in 1951/52.* The fall in savings is in turn due to the sharp down-turn in export income, the falling away in internal business activity, and to the inroads of heavy taxes and rising prices on the incomes of the investing public. But, basically, the problem is more deep-rooted. Familiar springs for the refreshment and expansion of industry have been drying up for some time, choked at the source by high taxation on investors and companies. This trend was concealed until recently because of the great accumulation of funds by private and institutional investors over the war and early post-war years, the abnormal level of wool prices, and the large inflow of capital from abroad. For instance, life assurance companies which poured millions into private and public projects in the years following the war are now short of money to invest. Free enterprise may be passing into a new and difficult era marked by a chronic shortage of risk capital.

Since private business is responsible for the employment of about 80% *of the national labour force it is surely commonsense to ask ourselves how industry can be encouraged and enabled to give the optimum in efficient service to the*

* Undistributed profits and personal savings. As a considerable part of personal savings is used to finance the purchase of motor cars and dwellings and to repay advances previously used for these purposes, the volume of savings available for other investment purposes probably dropped by much more than 40%.

community. One plainly essential condition is that in one way or another industry must be able to obtain adequate capital for expansion and for the improvement of its methods and processes.

While the great part of industry is privately controlled, this can only be achieved via the medium of profits. Unfortunately the whole approach to profits in this country tends to be determined by emotion based on false premises rather than by a realistic assessment of economic needs. To many people the idea of more profit is synonymous with exploitation and inequality of incomes. This popular view overlooks the fact that steep taxation on companies and high income earners severely rations the amount of income from profit which eventually reaches the pockets of investors. Excessive incomes from dividends are easily netted in the hands of the ultimate recipients. But a real change in public opinion will only come about through a wider understanding of the central role of profits in the economic mechanism in stimulating investment. After a large slice of profit has been taken in taxes (at present 9/- in the £ on the greater part of the incomes of public companies), the balance must be delicately apportioned between dividends and reserves. *Dividends must be high enough to encourage fresh capital; but not so high at a given level of profit as to jeopardise the future stability and progress of the company. Something has to be kept aside for contingencies and for expansion. Unless profits amply cover requirements for dividends and reserves, new investment must inevitably be retarded and the community will suffer.*

THE provision of new industrial plant and the carrying out of research into new methods of production are thus linked closely to the level of profits. Now that the volume of private savings in the higher income brackets is so much smaller than it used to be, the small and medium investor must be encouraged to lend their money in greater amounts. Profits must therefore be high enough to enable a return by way of dividend which is well above the level of interest on government bonds and mortgages. Otherwise the small saver is not likely to be interested in incurring the extra risk of investment in company shares.

But an even more imperative reason for increasing the general level of profits is that better profits will enable companies to become more independent of the vagaries of the investment market. So long as the volume of personal savings is meagre and precarious, highly important ventures must be postponed until better times. With ample reserves from ploughed-back profits, companies would be prepared to carry out new building projects when activity was slack and costs lower. As it is now, companies are forced to expand mainly when it is easiest to obtain capital from the public. This is generally at the height of a boom and the inflationary scramble for scarce men and materials is thus intensified.

THE LEVEL OF PROFITS HERE AND OVERSEAS

To obtain the true earning rate of any company it is established practice in financial and accountancy circles throughout the English-speaking world to relate profits to funds employed, namely Shareholders' Funds. Shareholders' Funds represent the book value of assets after deducting all liabilities, in other words the net worth of the business. Such statistics are compiled in aggregate from published company reports by the Securities and Exchange Commission and the National City Bank of New York for the United States, by "The Economist" for the United Kingdom,* and by the Commonwealth Bank for Australia. These statistics indicate that profits in Australia, after providing for taxation, are well below American and British standards in many cases, despite the much higher level of taxes in the United Kingdom. Because of the high level of company earnings in America, companies are able to finance the great part of their capital improvements and expansion out of reinvested profits. American concerns are able on average to retain two-thirds of net profits (after tax) and still leave shareholders well satisfied with their dividends. On the other hand most Australian public companies are forced to pay out much more in dividends than they devote to reserves, in order to maintain yields on their shares and to retain the interest of investors in future issues. In the case of some leading companies the distribution reaches as high as 80% of earnings after taxation.

* Only available since the passing of the new United Kingdom Companies Act, 1948.

The following table is indicative of the trend of profits, after taxation, in manufacturing in U.S.A. and Australia.

PROFITS IN MANUFACTURING

	Return on Shareholders' Funds (After Tax)	
	U.S.A.	Australia
	%	%
1939	8.5	8.5
1946	12.1	6.3
1947	17.0	7.8
1948	18.9	8.1
1949	13.8	7.7
1950	17.1	8.2
1951	14.4	8.2

Source: Commonwealth Bank Statistical Bulletin, National City Bank of New York Monthly Letter.

It will be observed that while the rate of return on shareholders' funds in manufacturing was the same in both U.S.A. and Australia in 1939, the post-war trend of profits is widely divergent. American profits reached a peak well over twice 1939 and are still appreciably higher, despite stiff tax increases in 1951 to help finance the immense rearmament programme.

The higher rate of profit in U.S. manufacturing companies flows from a variety of causes. But in the last analysis it boils down to an enlightened public attitude towards profits. Organised political pressure for any severe limiting of profits is almost non-existent. Indeed, trade union leaders in U.S.A., readily acquiesce in the making of high profits which are promptly reinvested for the betterment of the working conditions of their members. American labour is not alone in this bold commonsense attitude. Swedish trade unions in 1947 also insisted that their labour-controlled government provide adequate fiscal concessions for the making and ploughing back of profits in Swedish industry. They reasoned that this would mean more jobs and eventually higher real wages.

One of the most disconcerting aspects of the Australian position is the low earning rates of the oldest and soundest companies which must provide employment for a high proportion of the labour force and which produce most of our basic goods and services. The following table shows the average rate of net return (after tax) in 1951, in U.K. & U.S.A., in various fields of manufacturing, and the comparative figures for Australian leaders in the same lines of activity.

Industry	Australian Company	% Return on Shareholders' Funds after Provision for Taxation Aust.	U.K. (All cos.)	U.S.A. (All cos.)
Iron and Steel	Broken Hill Pty.	6.4	7.7	12.3
Glass	Aust. Cons. Inds.	6.4	8.4*	15.3
Cement	Aust. Cement	5.9	8.2*	14.1
Paper	Assoc. Pulp and Paper Mills	5.3	11.3	16.1
Rubber	Dunlop Rubber	10.0	8.5*	16.1
Textiles	Felt and Textiles	7.4	7.0	8.3
Electrical	Amalgamated Wireless	7.8	8.1	16.2
Tobacco	British Tobacco	7.8	12.5	9.8
Brewing	Carlton and United Breweries	4.5	6.1	11.8
Sugar	Colonial Sugar Refining	3.6	8.9*	12.1
Food Preserving	Henry Jones	9.4	7.4	11.6

* Based on results of leader in the field.

Sources: Melbourne Stock Exchange Record, Records and Statistics Supplement to the Economist, Economist Intelligence Unit, National City Bank of New York, Monthly Letter.

Notes:

1. Shareholders' funds are as at January 1st for U.S.A. In the case of Australia and United Kingdom, they are average funds used over the year.
2. Profits in the U.S. textiles and tobacco industries were abnormally low in 1951, whilst earnings in the U.K. paper and tobacco industries were much higher than usual.

Sufficient data is not available to show earnings comparisons for particular industries before making provision for taxation. However, the following table covering all manufacturing is indicative:—

	% Profits on Shareholders' Funds in 1951 Before Tax	After Tax
Australia	15.4	8.2
United Kingdom	22.1	7.8
United States	27.7	12.2

Notes:

1. The Australian figures after tax were compiled by the Commonwealth Bank, from published company balance sheets. The figures before tax are based on an analysis made by the Institute covering the companies included in the Commonwealth Bank sample which disclose their taxation payments or provisions and whose results are republished by the Sydney Stock Exchange Statistical Bureau.
2. The data for United Kingdom was extracted by the "Economist" from published company reports and reclassified by the Institute to accord with the Australian and American definitions of shareholders' funds or net worth. The main reasons for the large discrepancy in results before and after taxation in United Kingdom are as follows:—
   (a) Company taxes are much higher;
   (b) British companies possibly make much larger appropriations from net profit (after tax) to provide for obsolescence and replacement of assets, including stocks, than appears to be the case in U.S.A. and Australia. This has the effect of reducing disclosed profits below taxable profits.
3. The American statistics were compiled by the Securities and Exchange Commission. They cover a larger range than the National City Bank of New York study and the results after tax are slightly lower.

Profits before taxes in United Kingdom and U.S.A. average 20% to 30% on shareholders' funds. By contrast in Australia they are only about 15%. Judged by overseas levels therefore, company profits in Australia are far from high, but rather appear to be inadequate to sustain the pace of development overseas and hence maintain competitive standards and jobs for Australian workers.

Latest balance sheets suggest that the flush of inflationary profits is over and that stiffer times are ahead for most companies in Australia. Present government attitudes on price control and company taxation and other aspects of public planning may have to be revised in the light of the changes in company finances since before the war. To disallow an adequate margin of profit is merely to obstruct and slow up the whole rate of technical advancement and of national economic progress. *Not the employer or the investor, but the wage-earner and the consumer, stand to lose most from financial policies based on a vague hostility to business profits.* This is plain economic truth, not special pleading.

★ ★ ★