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PROFITS

BY ANY MEASURE one can conceivably use, profits have been shrinking in recent years. Profits after taxes in 1941 constituted 9 per cent of the national income: in 1961 they constituted 5+ per cent of the national income. Profits as a percentage of dollar sales averaged 5½ per cent in the period 1947-1949; now they are averaging 2½ to 3½. Profits as a percentage of net worth averaged 11 to 13 in the period 1947-1949; now they are averaging 6 per cent to 7.

Are Profits Now Too High or Too Low?

Can we deduce from this information that profits are now too low or that they were once too high and are now just right? This is a complex question and calls for a complex and serious answer.

The first problem is to define what is meant by "too high" and "too low." Unfortunately, total dollar figures tell us almost nothing; as a matter of fact, neither do percentage figures of the kind I have given above. I am no more justified in using those figures to prove that profits are now too low than a trade union economist would be in using them to prove that profits were once too high.

The percentage share of profits in the national income of a country is largely determined by the relative abundance or scarcity of entrepreneurial capital and talent. In a country where capital is scarce and business leadership talent is in short supply, profits will and must command a larger share of the national income than in a country where both capital and talent are relatively abundant. The failure to recognize this fact is the single most important deterrent to economic growth in the underdeveloped countries of the world today. The governments of those countries, inspired in part by the anti-profits bias of both

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the socialists and the modern liberals, have tried to keep profit levels low, or have punished or nationalized the high-profit firms. In doing so, they have dried up the wellspring of all economic development: vigorous, aggressive entrepreneurship.

It follows as well that as an economy matures and becomes relatively better blessed with capital and leadership, the percentage share of the national income represented by profits will decline. Thus, the figures I presented above do not necessarily prove that profits are now too low.

The Concept of "Normal" Profits

So let us abandon our inquiry into total figures. Where can we turn? One technique of explanation frequently employed is that of evaluating profit figures for the individual firm. If, for a given firm or industry, profits as a percentage return on sales or investment are found to be significantly higher than for other firms or industries, profits are said then to be "too high"; if much lower than for other firms or industries, they are said to be "too low."

This technique seems on the surface to be a valid one, and its validity is apparently attested to by the fact that even businessmen use it when they want to prove that their firms or industries are in need of help or are suffering under special handicaps.

One assumption here is that normal profits (as determined by the statistical average of all profits) are the right or "just" profits and that profits above or below normal are thus "too high" or "too low."

This approach is often used by trade unions to show that a given group of firms has been making abnormally large profits and thus can and should pay higher wages.

It is extremely unfortunate that this point of view on profits has received such wide acceptance in all groups in our society. It implies that businesses should be permitted (perhaps even assisted) to make a "normal" or "fair" profit, but become suspect once they earn more than this statistical norm.

This approach rests on a serious misunderstanding of the function of profits and losses in a free market economy. It is true that, in the long run, and in a competitive market, each firm will be making profits no more and no less than it could make in alternative activities. This is true because if the typical firm in the industry were making higher than normal profits, other firms would enter the industry and profits would be driven down. If the typical firm were making lower than normal