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ON

PROFITS HEARINGS

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Bailey, George D., past president, American Institute of Accountants; partner, Touche, Niven, Bailey & Smart, Detroit, Mich.
Ballantyne, John, chairman board of directors, Philco Corp., Philadelphia, Pa.
Batcheller, Hiland G., president, Allegheny-Ludlum Steel Corp., Pittsburgh, Pa.
Billings, Dwight B., controller and assistant treasurer, Pacific Mills, New York, N. Y.
Bradley, Albert, executive vice president, General Motors Corp., New York, N. Y.
Bradley, J. E., vice president, Pacific Mills, New York, N. Y.
Coyle, M. E., executive vice president, General Motors Corp., Detroit, Mich.
Cruikshank, Nelson, director, Social Insurance Activities, American Federation of Labor, Washington, D. C.
Donner, Frederick G., vice president, General Motors Corp., Detroit, Mich.
Dunlop, Robert, president, Sun Oil Co., Philadelphia, Pa.
Fairless, Benjamin F., president, United States Steel Corp., New York, N. Y.
Francis, Clarence, chairman of the board, General Foods Corp., New York, N. Y., accompanied by W. C. Marks, controller.
Greer, Howard C., executive vice president, Kingan & Co., Indianapolis, Ind.
Harris, Seymour, economist, Harvard University, Cambridge, Mass.
Holman, Eugene, president, Standard Oil Co. of New Jersey.
Milham, Donald L., controller, General Electric Co., New York, N. Y.
Montgomery, Donald, chief, Washington office, United Automobile Workers, CIO, Washington, D. C.
Montgomery, Robert, director and secretary, American Woolen Mills, Boston, Mass.
Nixon, Russ., United Electrical Radio and Machine Workers of America (CIO), New York, N. Y.
Olds, Irving S., chairman, board of directors, United States Steel Corp., New York, N. Y.
Paton, William A., member, committee on accounting procedures, American Institute of Accountants; professor, University of Michigan.
Pogue, Joseph E., vice president, Chase National Bank, New York, N. Y.
Ruttenberg, Stanley H., director, department of education and research, Congress of Industrial Organizations, Washington, D. C.
Scattergood, Margaret, member, research staff, American Federation of Labor, Washington, D. C.
Schmidt, Emerson P., director, Department of Economic Research, Chamber of Commerce of the United States, Washington, D. C.
Schmidt, John, vice president and comptroller, Armour & Co., Chicago, Ill.
Slichter, Sumner H., economist, Harvard University, Cambridge, Mass.
Vance, Harold, chairman of the board and president, The Studebaker Corp., South Bend, Ind.
Voorhees, Enders McC., chairman of finance committee, United States Steel Corp., New York, N. Y.
Wilson, Charles E., President, General Electric Co., New York, N. Y.

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PROFITS

REPORT OF SUBCOMMITTEE ON BUSINESS PROFITS OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT

In October 1948 authorization was given by the chairman of the joint committee, Senator Robert Taft of Ohio, to select a subcommittee and hold hearings on certain aspects of business profits. Hearings began on Monday, December 6, and were concluded on Tuesday, December 21.

The desirability of holding these hearings was self-evident. The joint committee is charged with the study of the Economic Reports of the President to the Congress. Repeated references have been made in these reports to the unprecedented and rising profits accruing to business in the United States. It was not merely the President's reports and messages which called attention to this matter. It was the subject of extended comment by financial journals, economists, and business writers.

These great profits have been a stimulating factor in demands for wage increases and an important element in the continuing inflationary spiral, whether that spiral be considered as being energized by high prices which justify higher wages, or by high wages which necessitate higher prices.

Furthermore, the tremendous and unprecedented demands for Government expenditures arising out of the aftermath of the war bring the whole tax problem into the foreground of debate and legislation for the Eighty-first Congress. The high business profits seemed to offer an ample reservoir from which increased Government income can be drawn to balance the budget, even at the high rates of expenditures in prospect.

Still further and in general, the largest and best established industries seemed to have fared well profitwise, and questions are therefore raised as the continued strengthening of existing economic empires if at the expense of the smaller business units of the Nation. This raises further questions as to whether reduction of these profits by higher wages or lower prices can be met competitively by smaller firms in the same business without weakening or even bankrupting them in some instances.

Continued price advances without corresponding gains in volume of production have led to the suggestion that allocation, and even price-fixing and rationing, may be necessary to control the continuing inflation. These proposals likewise have their roots in current reports on business profits which would seem to make possible a restraint of advancing prices without harm to the economy as a whole.

The subject we have been investigating therefore has important relations with the work of the Finance Committee of the Senate and

the Ways and Means Committee of the House, the Labor and Public Welfare Committee of the Senate and the Education and Labor Committee of the House, the Banking and Currency Committees, the Interstate and Foreign Commerce Committees, and the Judiciary Committees of both Houses, which we trust they will find useful.

It is important to note also that the hearings did not include witnesses for consumer groups, financial, insurance, and investment firms, nor the area of "small" business in the sense that term is generally used. All these are areas with particular concerns in the matter of profits, their use and impacts on the economy. However, in the short time afforded for hearings (10 days) it was impossible to develop further lines of inquiry and these may well be taken up by the joint committee in the new Congress.

The plan of the hearings was first to call in expert witnesses of different views, from professions outside of business itself. From them we hoped to receive, and did receive, valuable suggestions as to the line of questioning to be followed. These witnesses included two economists, Dr. Sumner H. Slichter and Dr. Seymour Harris; two accountants, representing different points of view, Prof. William Paton and George D. Bailey; and four witnesses from organized labor, Nelson H. Cruikshank, of the A. F. of L., and Stanley Ruttenberg, of the CIO, Donald Montgomery, economist, of the UAW-CIO, and Russ Nixon, representing the UEW-CIO.

The business witnesses were chosen from the industries to which public attention had particularly been drawn. They represented so far as possible a dominant company and one of intermediate size in each of the industries chosen. These industries were petroleum, foods, automobiles, steel, meat packing, and electrical goods. While this by no means covers all the important industries of the country or those from which large earnings have been reported, it appeared to be as good a sample as it was possible to obtain and examine in the time available.

This report includes in its following pages condensed summaries of the testimony given. A reading of these summaries indicates, on prima facie examination, that a considerable part of the profits reported have been spent in maintaining inventories at ever-increasing costs and are not currently available for other distribution. There is also indicated a practice on the part of some companies of laying aside reserves for depreciation and replacement which are larger than those authorized by the Internal Revenue Bureau for tax purposes. This has been done in view of the increased costs of replacing equivalent productive capacity as it wears out or becomes obsolete. In some cases these increased reserves are already in process of being used up in current replacement and expansion as a result of costs greatly exceeding those which were estimated when the operations were authorized.

Corporation profits have been used to expand productive capacity. There was a sharp divergence of opinion between the two economists who appeared before the subcommittee as to whether business as a whole is expanding at too rapid a rate. It cannot be expected that the mere expansion of existing types of plant and facilities will result in a corresponding increase in production so long as a condition of practically full employment continues. In that sense it may be argued that increased capacity has been obtained at the expense of

consumer production. On the other hand, investment in more highly productive equipment creates additional consumer goods.

Finally, it appears that some of the profits of those corporations whose representatives testified, have been used to acquire existing productive capacity of other corporations, although such acquisitions have been made in some cases by exchanges of corporate stock.

The subcommittee has noted that in 1939 about 75 percent of the corporate profits after taxes were distributed to stockholders as dividends. In 1947, however, less than 40 percent of such profits were distributed in the form of dividends. The profits of business, judged on the cases presented, seem to be going back into the market place to purchase more goods and services at higher prices, just about as fast as these profits accumulate. Capital investment has been at such a rapid rate, however, that some firms with the highest profit records in history have yet judged it necessary to borrow, since they found their liquid resources insufficient for maintaining current business operations and for financing what seemed to them to be prudent and limited plans for expanding or improving productive equipment for the immediate future.

A recurrent theme in the hearings was the drying up of the security market for equity issues and the increasing dependence on institutional borrowing, such as that which might be obtained from the big banks or the insurance companies. Great divergence was evident in the testimony of the witnesses as to the causes and cure for this situation.

Several witnesses suggested that a conference between representatives of labor, agriculture, and management should be held, for the purpose of establishing principles of economic statesmanship, to which these great groups in our national economy would subscribe. It is hoped that guidance by these principles might bring inflationary pressure under control, and result in more stable economic conditions. The subcommittee is unanimously in favor of carrying out this suggestion.

While it is hoped that this report, including the condensed summary of testimony, will have immediate usefulness, the subcommittee has in preparation a very full and careful index of the verbatim reports of the hearings to be published in due course. Thus indexed, we hope that these hearings will prove to be of value to the committees of the Senate and House already enumerated, and will also serve to give it wide circulation and use among all to whom the subject of business profits is a matter of concern.

RALPH E. FLANDERS, *Chairman*
ARTHUR E. WATKINS,
JOSEPH E. O'MAHONEY,
JESSE P. WOLCOTT,
CHRISTIAN A. HERTER,
WRIGHT PATMAN,
WALTER B. HUBER.

INTRODUCTION TO SUMMARY OF TESTIMONY

A short time prior to the opening of the Hearings on Profits, those invited to testify were furnished with an outline of the general purpose of the hearings and a list of topics designed to focus attention on specific subjects on which the subcommittee was seeking information (appendix G). While each witness prepared his statement in his own way and different witnesses emphasized different aspects of the subject, the topics and questions and the interrogation by members of the subcommittee served both to give unity to the hearings and to make the material submitted somewhat comparable.

The 12 sections under which the hearings are grouped represent the main distinguishable subjects found in the record. This topical summation should serve two main purposes: (1) To bring together related or conflicting testimony on the same point of discussion; and (2) to eliminate that large part of the record which is repetitious or not on the main points of the hearing.

The staff has endeavored to make a fair and objective summary of the testimony, practically always in the exact words of the witnesses. Occasionally, in order to attain the requisite brevity, a few appropriate words were inserted, or different parts of the testimony were joined together, or, very rarely, a summary in the words of the compiler was substituted.

The 12 sections are not altogether complete and independent treatments of the topics and headings are indicated by their titles. In a covering paragraph preceding each section we have endeavored to indicate the most closely related sections. However, there is necessarily considerable overlapping in the actual presentation. While a reading of all the 12 sections should give a fair representation of the entire record of the hearings, a reading of any one section may not give a complete treatment of any one topic. There is, of course, a definite interrelationship among the several topics and some of the witnesses presented their points with different degrees of emphasis and would occasionally cover more than one topic in a short paragraph.

This summary contains approximately one-third of the wordage of the full record. The printed report of the hearings should be used by any one seeking the full record and complete statements of all the witnesses.

This summation is not to be regarded as an analysis of the testimony or as a presentation of the pros and cons. No conclusions are drawn or recommendations made. It is intended to be useful in sifting the record and having the salient arguments close at hand.

In the preparation of this summary, acknowledgment is made of the services rendered by Dr. Gustav Peck, Julius W. Allen, and Hamilton Gewehr, of the Legislative Reference Service, Library of Congress.

Role of Profits in the Economy

The witnesses who appeared before the subcommittee accepted the necessity of profits in the American economy and averred that they were concerned to improve the operation of the profit system and to make it work better in promoting the common good. Statements which treat of profits as a necessary source of funds for investment and expansion are collected in a later section. This section

deals principally with the part played by profits in energizing the flow and the direction of the economy.

Charles E. Wilson, president, General Electric Co.

Mr. WILSON. Profit, whether plowed back or paid out in dividends and reinvested, is the food on which American industry has grown to an unchallenged position of leadership and usefulness in the world's economy. Profits sufficient not only to keep its facilities up to date in an expanding economy, but also to underwrite that security and to help to provide that standard of living, must be our goal in the public interest as well as our own. Industry does not ask that these profits be guaranteed. It will earn them, if given a fair chance. And the free play of competition, plus the long-range interests of the producer, as he seeks the consumer market, will assure that the profits which are earned are not excessive and are equitably divided among the appropriate groups.

It is our belief that unless General Electric's profits are high enough to prevent impairment of our facilities and to provide growth capital for the future demands upon us, while at the same time reducing prices and paying high wages, we shall not be able to perform adequately our part of the industrial job in America.

Joseph E. Pogue, vice president, Chase National Bank

Mr. POGUE. Few business terms are less understood than "profits." The expression is often thought of as representing the funds left over after providing for all expenses and available in their entirety for removal from the business in the form of dividends. This is rarely true in ordinary times and entirely false in times of inflation.

The term "profits" is a popular expression, the technical counterpart of which is "net income." Net income, or profit, however, at best is an accounting interpretation or abstraction, not a reality or tangible quantity such as "cash in the till." According to accounting practice, it is determined by taking the total income received by an enterprise and deducting the operating expenses and taxes, and then subtracting an estimate of the extent to which the capital assets employed have been extinguished; that is, worn out and used up. The sum thus set aside out of the total cash produced is supposed to be sufficient to replace the facilities of the business so that it can continue as a going concern. It is obvious that the adequacy of the sum thus set aside for replacement determines the reality of the reported net income. It is equally clear that "profits," depending for their computation on an estimate (for depreciation) are themselves not an absolute quantity.

There are four basic conditions which should be clearly held in mind by anyone seeking to analyze the size and significance of profits.

1. In times of inflation, or rapid change in the purchasing power of the dollar, "profits" as reported on the basis of established accounting practice are in effect overstated by the amount of the rise in replacement costs over the sum set aside to cover capital extinguishments—depreciation, depletion, and the like.

2. In times of inflation, reported "profits" cannot properly be compared with previous years because of the shrinkage in the purchasing power of the dollar. Only by correcting for the changing length of the yardstick can this be done with any semblance of accuracy.

3. In times of inflation, the rate of return on the capital employed, ordinarily a very useful standard, cannot be used as a criterion of the magnitude of profits because the rate of return is a ratio between two sets of dollars of different values. It is a mathematical error to strike a ratio between things of a different kind. Only by adjusting either the capital employed or else the "profits" to like dollars is such a ratio permissive.

4. In all times, inflationary or normal, the most effective criterion to apply in the judgment of "profits" is their adequacy or inadequacy in the process of capital formation. Our entire economy is dependent upon the formation of sufficient capital funds to maintain and expand the country's productive capacity. As capital costs rise, "profits" are called upon to supply increasing amounts of these funds.

Nelson Cruikshank, A. F. of L.

Mr. CRUIKSHANK. The American Federation of Labor has long recognized that the profit motive is vital to the continuance of a free enterprise economy. It is the mainspring of business incentive and in a really free and really enterprising economy where there is competition among business units the system benefits workers by bringing about constant improvement in productive technique and processes. These create the increased income necessary to raise wages. When the representatives of our unions sit at the collective bargaining table with employers it is not their policy to demand wage increases that will destroy any chance for profit. Working people have no desire to kill the goose that lays the golden egg of wages. Likewise, when we think of national fiscal policies we have no desire to establish programs that will destroy the system by which all of us in America have profited. By the same token we expect the representatives of business to accept the principle that a decent living standard for workers and the maintenance of their purchasing power is essential to the continuance of the system by which they profit. We expect that they should recognize that this purchasing power must not be destroyed either by wage cutting or by charging unreasonable prices.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. The incentive to increase production and expand capacity is considerably curtailed by the present level of corporate profits. Industry realizing that it can make high levels of profits without expanding or increasing production has no drive to meet the ever-increasing demand for many American products. This is an extremely dangerous development, and if we are to maintain a dynamic economy production must be increased and capacity expanded.

When industry is pushed to reduce costs to make reasonable profits, it is more inclined to modernize, improve efficiency, and expand than it is when consideration does not have to be given to cost factors to keep the business operating at an extremely profitable level.

It is fairly obvious that high profit levels have created greater maladjustments between prices and income as well as distortions in our national income. These distortions are creating economic situations which result in the destruction of production incentives and many other factors which lead to economic chaos.

M. E. Coyle, General Motors Corp.

Mr. COYLE. In seeking to persuade as many customers as possible to buy our products, we hope to earn a profit. We realize, however, that a profit is simply what is left after the costs of the business have been met and that profits, over the long run, can be increased only through lower costs, greater efficiency in running the business, and higher volume. The hope of making a profit is fundamentally responsible for industrial progress. This is the incentive function of profits—an incentive to efficiency as well as to product improvement. As long as a business continues to produce products of high quality at competitive prices, profits also serve as an effective measurement of efficiency. Unless we presume that the forces of competitive selling should no longer control the level of prices, the more efficient producer is bound to make more profits than the higher-cost producer. The automobile industry is an example of the operation of competitive pressures. Beyond this, the function of profits is to compensate investors for the use or risk of their money, to attract new capital when it is needed in the business, and to provide funds required for the future needs of the business.

General Motors is a case example of the role profits play in our economy. The business was started and the necessary funds risked in the hope that the investment would be profitable. There was no assurance that it would be. But over the years General Motors has been a profitable business not only for those who have their savings invested in it but for all concerned.

In 1908, the year our business was started, fewer than 100,000 workers were directly employed in making automobiles. Today the industry employs more than a million men and women in good jobs at wages that are among the highest in industry. In addition, the automobile has created an estimated 8,000,000 new jobs in supplier, distribution, and highway transport industries. General Motors' contribution to this expansion of job opportunities is illustrated by the fact that our employment has risen from 10,000 in 1910 to the current figure of more than 380,000.

General Motors buys materials, parts, and supplies from 12,000 suppliers. Of this number a great many are businesses employing fewer than 500 people. Our relationship with these businesses illustrates the fundamental fact about American enterprise, which is that industry in this country is interdependent. Small, medium, and large business progress together.

A progressive business such as General Motors is profitable in the broader sense to a great many other businesses, large and small, and to the people employed in these businesses. As a matter of fact, the automobile industry has created thousands of new opportunities for small business. All dealerships are in this category, as are most automotive service businesses—garages, repair shops, automobile laundries, filling stations, et cetera. It is estimated that some 1,300,000 people are employed in automobile sales and servicing.

Finally, and most important, General Motors has been profitable for customers. That is basic. Under our competitive system, no business can last, much less produce a profit for its owners for any prolonged period, unless it is able to provide for its customers the ever-better values which, in a very real sense, represent a profit for them.

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General Motors and its achievements over the years demonstrate the role profits play in our economy. The business would not have been started except for the hope of profits. Its growth and ability to produce increased benefits for all would not have been possible without the realization of profits.

Robert Dunlop, Sun Oil Co.

Mr. DUNLOP. One of the most dangerous concepts is the idea that profits are a sort of inert residue that remains after a company's books are closed—a form of booty to be divided up among avaricious owners. Nothing could be more mistaken.

Profits must be seen as a working part—an essential working part—of the dynamic institutional structure we call our free competitive enterprise system. As such, profits perform definite and vital functions.

First, profits serve as the wages or rental that a company pays for the plant and tools supplied by stockholders—the plant and tools on which productivity is based and which are the very foundation of well-paying jobs.

But, as you know, profits in a competitive-enterprise economy perform many other functions. They are the gages in our general office control rooms which signal the economic temperatures and pressures of the times.

For example, profits, when they become large, signal the need for expansion in those lines of production in which demand is increasing. Contrariwise, a lack of profits indicates the necessity of contraction in those industries which have been overexpanded or whose products are in diminishing demand.

Not only do profits signal the need for expansion, but profits induce people to risk their savings in those enterprises which will produce goods and services that the rest of us want and are able to buy.

Profits serve as the most important method of accumulating funds which are needed for new capital investment. This is true whether the profits are reinvested in the business or paid out to stockholders. In either instance, they are the means for capital formation which is essential to all industrial expansion.

Once an investment has been made, the margin of profit serves as a recorder or yardstick of the efficiency of the managers of the enterprise, unless the latter enjoys some kind of monopoly position. Thus to maintain reasonable profits in a competitive industry, the managers must be alert to improve quality and services, increase volumes of sales, and offer prices as low as those of their rivals.

Adequate profits are essential for business and industry to fulfill their responsibilities to serve the general welfare. And let there be no misunderstanding. Our interest in a competitive economy is not as an end in itself, but as a means to an end, the end being an improved standard of living for the American people.

Profits stimulate expansion and competition, thus providing more and better goods with consequent lower prices. They give people an incentive to invest their savings. And they act as a guide and a regulator of the flow of capital funds.

As long as profits are permitted to perform these functions, our economy will remain dynamic and strong, serving the needs of the American people.

The heart of the profit system is the price mechanism which in a free market adjusts the supply and demand for goods and services. You are all familiar with the operation of the law of supply and demand in our competitive-enterprise economy. You know that in accordance with that law the American people cast "dollar votes" every day for the goods and services of their choice. When those "votes" favor a particular industry, as shown by strong demand leading to increased profits, it can properly consider that it has a mandate from the American people to expand its facilities and increase its output of favored products.

The economic cycle operates in the following manner. A significant rise in demand leads to higher prices, making possible increased profits, which in turn induce expansion of productive capacity. After that comes the second phase—the newly increased capacity leads to greater supply, reducing prices and causing profit margins to fall.

Eugene Holman, Standard Oil Co. of New Jersey

Mr. Holman. Profit—or net income, which is the same thing—is a matter on which there is much confusion.

Perhaps the principal misconception is that profit represents a sum of money—actual cash—lying idle in a vault and waiting to be dipped into. Of course, such a mental picture is entirely inaccurate. "Profit" is a term of accounting. To get a clear idea of what this term means, let us look beyond bookkeeping for a moment and examine what goes on in a business enterprise.

A company sells its products or services and gets paid for them. This is the main source of its receipts. The entire amount of money taken in by the company during a year is its total income for that year.

But a company not only takes money in; it also pays it out. Under accounting practice, some of the money it spends is deducted from total income—and the balance is labeled "profit." However, not all the money a company pays out is deducted from total income to arrive at the profit figure.

Wages, taxes, purchases of materials, and similar sums are, of course, deducted. Also, an allowance for wear and tear and obsolescence, based on the original cost of the equipment, is subtracted from total income. But if more than this allowance must be spent to replace the equipment because of higher costs, or if a company increases its capacity to produce goods, the money expended for these purposes is not charged against current income. Even though this money is paid out, it still is included in the profit or net income figure.

I think it needs to be emphasized, therefore, that profit is not the same thing as money in the bank. A company's reported net income is not the same as the company's cash account. It often happens that a company will pay out more money, not counting dividends, than it takes in during a year and still will report a substantial profit. Profits are not something taken out of the stream of economic activity for the benefit of a few. They are an essential working part of the whole process of production. They are the means by which our productive facilities expand. As such, they benefit the entire community. They provide jobs for the people who put up new plants and who make new machinery. They provide jobs for the people who work in those plants and at those machines.

By making possible better tools and more tools per worker, they increase individual productivity, which is the only way that real wages can be increased. By making possible greater output of goods, they benefit the consumer.

The profit which is reinvested in a business may be compared with the seed corn which a farmer sets aside for future production. In a very real sense today, profits represent industry's seed corn. In a growing nation such as the United States there is constant need for greater quantities of seed corn.

As a percentage of either total income or of investment, profits in the oil industry tend to be higher than in many other industries. This is a reflection of the nature of the business. Profits for the oil industry have to be higher than in many other lines of work if the industry is to do its job, especially during periods of increasing requirements. Petroleum is a natural-resource industry. As the consuming public uses up the oil from existing fields, it is the industry's business to find and develop new fields. Oil companies have the twofold task not only of turning out products to meet the needs of today's consumer but of developing resources and facilities to meet the still greater needs of future consumers.

In my estimation, the truly significant measure of profit is people's needs. Other comparisons may be interesting, but I do not think they are particularly useful. As an illustration of what I mean, take, for example, a hospital which may be twice as large now as it was 10 years ago. But if the population of the town where it is located has increased four times, the hospital still may not be big enough. It is people's needs which are important, not figures.

Applying the yardstick of people's needs to the operations of Jersey Standard, we think that we have done a good job. I may say that a less profitable business could not have done what we have done. To supply the public with the oil products they want and need has not been an easy task during the postwar years. Doing our share of it has required every dollar of our net earnings over reasonable dividends to the owners of the company. In addition, we have had to borrow, draw on our working capital, and sell assets.

Looking ahead, I believe it is now beginning to appear, for the first time since the war, that the tremendous rate of expansion which has been required of the industry may lessen somewhat. We think that the demand for petroleum will continue to rise, but that the rate of increase which has marked the postwar years may taper off. If that judgment should prove correct, it follows that demand for new capital formation in the petroleum industry may level out. As long as an over-all inflationary situation continues, however, every proposed expenditure, both public and private, should be carefully scrutinized to see whether it can be deferred. If the expenditure is for a nonproductive purpose, even if desirable or worthy, deferment should be seriously considered. If it is for productive facilities already in adequate supply, deferment again seems desirable.

John Schmidt, vice president and comptroller, Armour & Co.

Mr. SCHMIDT. We believe that the economic forces of our democracy, if unrestricted and unhampered in their operation, automatically determine a proper and equitable level of profits for our company and

other industries. We do not believe that it is possible to develop an artificial yardstick or formula for determining a proper and equitable level of profits for our company or any other company. Nevertheless, in an attempt to be helpful in these deliberations, we suggest that any such determination must permit profits that would:

(1) Provide for at least maintaining the individual company's position in its field and thus protect its stockholders' investment against deterioration. It seems obvious that, except for a few possible rate exceptions, no company can remain static and continue to survive indefinitely. New processes, new products and, consequently, the need for new equipment are being developed continuously. Any company must be in a position to finance this development to meet its competition and survive.

(2) Provide for the payment of dividends to its stockholders in an amount sufficient to afford them a fair rate of return on their investment.

(3) Provide for part of the increase in working capital required during periods of high-price levels, which, in turn, insures that the company can maintain inventories, extend credit to its customers, and promptly discharge its obligations to its employees, its suppliers, its investors, and the various taxing bodies.

Clarence Francis, General Foods Corp.

Mr. FRANCIS. Adequate profits for our company are those which will assure financial soundness and continuity of policy as well as operations.

A profit is what is left after conducting business during a specific period. That profit has at least three major jobs to do. None of them will get done without a profit, and unless they get done this whole society will lose its vitality at the very period when that vitality is the hope of the world.

1. Profit must pay a sufficiently attractive return to the man who has saved his money to turn that money into risk capital. General Foods and thousands of other American companies are publicly owned. They are ventures in economic democracy. Some 68,000 stockholders have invested their savings in General Foods. We want to conduct our business in such a fashion as to attract many, many more to participate with us in this productive enterprise. To make this kind of economic democracy work, we've got to furnish the same incentives as we must furnish to attract high caliber employees. We've got to make it worth while. The first of the three functions of profit as we see it is to make investment not only in General Foods, but in American productive enterprise, worth while.

2. Second, out of that residual called profit must come enough capital to provide for part of the needs of a growing business. This is a growing country. Every day the people of this country and of the whole world are discovering new needs and new wants. You will recall the list of new plants and plant additions which just our own company has made in the last 4 years. Each of these plants has provided greater volumes to satisfy the wants of more people. Each of these plants has provided increased employment. Each of these plants has paid taxes to its community and to the Nation. A large proportion of these plants has been built out of that share of the

residual known as profit which has been retained in our business. We think that's an important function of profit.

3. The third positive function of profit is to keep General Foods in a good working capital position to enable it to have on hand the inventories it needs to meet its customers' wants and to handle the increased receivables that come from a growing business. We think that's an important function of profit.

A high level of prices for raw materials, plant, labor, and so forth, means different criteria of adequate dollar profits from low levels of prices. So far these functions have been listed on the positive side. I would like to say that an inadequate profit can destroy the hopes that the world places in our productive capacity, can destroy the economic democracy of a publicly owned economic system, and can cast the blight over the prospects of your neighbor and mine for steady employment and for a sound future.

Prof. Seymour Harris, economist, Harvard University

Professor HARRIS. I would say first that I believe in the profit system. I think it has contributed greatly and importantly to the development of our economy. Since 1800, national income of this country has risen by 400 times from $500,000,000 to over $200,000,000,000, and it is also true that we support 27 times as large a population as we did in 1820, and at a standard of living which is 10 or more times as high. I think that is a tribute to our system of private enterprise, which depends on the profit incentive.

Prof. Sumner Slichter, economist, Harvard University

Professor SLICHTER. I would like to point out, however, that although replacement cost comes closest to being a satisfactory measure, it is not a conclusive answer to the question, "Are profits too high or too low?" One reason why it is not conclusive is that present profits are not necessarily an indication of future profits—and it is the prospect for future profits, not the volume of present profits, which determines the willingness of capital to enter industry. Another reason why present return on replacement costs does not tell us whether profits are too high or too low is that it does not indicate whether investment is occurring as fast as the community would like to have it occur or needs to have it occur. If investment is not occurring as fast as the community would like it to occur, one must conclude that the prospect for profits is too unfavorable—unless there is some special reason unrelated to profits which prevents investors from making a normal response to the good prospect for profits. On the other hand, if investment is occurring faster than the community wishes for it to occur, one must conclude that the prospect for profits is too favorable.

How does one determine whether or not investment is occurring as fast as the community would like it to occur or faster than the community would like it to occur? There is no entirely satisfactory measure. One way is to observe the actual demand of the community for goods. If industry is producing at capacity and if people bid up the prices of goods, this indicates that people are willing to spend more for goods than they have been spending and that they are willing to take more goods at the prevailing prices than industry can produce.

Hence the rise in prices and in profits is conclusive evidence that people wish industry to increase its productive capacity. The size of the rise in prices and in profits is a measure of the urgency of the public demand for more goods and hence for more productive capacity. Of course, when profits are obtained by a restriction of production this reasoning does not apply. During the last several years, however, industry has been operating at capacity and has increased its work force as rapidly as men have become available. Profits which are not the result of restriction of output and which merely express the community's desire for an expansion of output and of productive capacity cannot be regarded as excessive—unless one is prepared to find fault with the community for wanting more goods and more productive capacity.

Profit Levels and Their Evaluation

This section contains the most important data (along with that found in appendixes A, B, C, D, E, H) on the profits of individual companies and of corporate industry as a whole, the criteria for measuring profits, and explanations and evaluations of profit levels. There was no universal agreement among the witnesses as to what the proper criteria should be in respect to profit levels. Some prefer to emphasize the relationship of profits to net worth; others emphasize their relation to sales, purchasing power, or other yardsticks. All witnesses agreed that most of the measures have some shortcomings.

Hiland G. Batcheller, president, Allegheny-Ludlum Steel Corp.

Mr. Batcheller. Profits of Allegheny-Ludlum are now undeniably higher in dollars than they were before the war; but they should be, because by any yardstick the company is now much larger. In spite of this growth, however, if the company profits are adjusted for the decreased purchasing power of the dollar, as measured by the cost-of-living index, they show no increase whatsoever. Data regarding sales and profits and other financial information requested by your committee are shown in table I of appendix D, all figures for the year 1948 being, of course, partially estimated. Included therein are the various ratios between profits and sales, profits and net worth, and so forth, which were suggested and which represent the conventional yardsticks frequently applied to profits.

Consider, for example, our profit margins as measured by percent of profit to sales. That is shown on table I of appendix D. Professor Slichter made it clear that profits begin to accrue only after certain fixed expenses have been met; and, consequently, one would expect profits to rise faster than sales during periods of expansion. On this basis, our percentage of profit to sales should be considerably greater than in 1940, since our operations are now running at capacity levels, while operations in 1940 were at only 62 percent of capacity. In 1947, however, the ratio of profits to sales was only 5.6 percent; and in 1948 it is expected to be between 5 and 5½ percent, against better than 7 percent in 1940.

This suggests also that our present profits and those of all the steel companies should be judged in the light of present operating rates. Obviously, it is not possible for the capacity of steel producers to be

exactly related to the capacity of their customers. Customers' demands rise and fall with the seasons and with variations in demand for their products. If these customers are to be able to place orders for steel when they need it and receive reasonably prompt shipment, there must be some flexibility in the steel industry. Consequently, the industry just cannot continue to operate for any extended period at 100 percent of theoretical capacity, as is now the case, because, if demand continues, competition will force the construction of that additional capacity which will permit reasonably prompt fulfillment of an order. As a practical matter, therefore, operations at 75 to 80 percent of theoretical capacity probably represent the practical maximum operating level for the industry in peacetime, except for short periods.

Senator FLANDERS. Are you speaking of the whole steel industry, or only of your particular company?

Mr. BATCHELLER. I am speaking of the industry, Senator, and I have gone back to 1914; and never in peacetime, from 1914 until 1947, did the steel industry operate at over 90 percent capacity. It operated at over 90 percent only in these years: 1916, 1917, and then it jumped to 1941, 1942, 1943, the war years, 1944, and in 1947.

Now, when any company is operating at or close to 100 percent of theoretical capacity, fixed expenses are spread lightly over the cost of a maximum number of units, and profits are consequently much higher than they would be at normal operating levels of 75 to 80 percent of theoretical capacity when the burden of fixed charges in cost is much greater. As a matter of fact, I firmly believe that the present cost-selling price relationship on steel products generally is such that little if any profit would be earned by the industry at the 75 to 80 percent operating level to which I am personally sure we will inevitably return.

See table I of appendix D.

Harold Vance, chairman of the board and president, the Studebaker Corp.

Mr. VANCE. In 1940, on sales of $84,164,000, we made a net profit after taxes of $2,125,000.[1] The ratio of net profits to sales in that year was 2.5 percent. In the first 9 months of 1946, on sales of $278,099,000, we made a net profit after taxes of $13,393,000, a ratio of 4.8 percent. Although our profit margin doubled between 1940 and the first 9 months of this year, from no point of view is our current rate of profit excessive. On the contrary, our 1940 rate of profit was too low. In that year, as in other prewar years, we deliberately sacrified profit margin for what we believed to be a more important objective—namely, an improvement in our competitive position against the so-called Big Three companies in our industry, which at that time were getting about 90 percent of the total business.

The improvement which has occurred in our competitive position, expressed in terms of increased volume, is of vital importance to the security of our company and equally to the security of our employees. We have a way of looking at our business which may be somewhat unorthodox; but, in our opinion, is realistic. We have substantial fixed charges which must be met before any profit can be made. That

[1] See appendix D, table XI, for profit data submitted by the company.

point of transition between loss and profit, our break-even point, in 1940 was 7,834 unit sales per month. Our total unit sales in that year averaged 9,959 per month. Thus, in 1940 we built and sold an average of nearly 8,000 units each month just to break even, and 2,000 units on which we made a profit. It follows, of course, that all of our profit in 1940 was made on the final 20 percent of our sales units. A ratio of 4 to 5 between break-even sales and total sales is much too narrow for security.

In the first 9 months of 1948, our break-even point was 7,788 sales units per month, almost the same as in 1940. However, in this latter period our total sales were at the rate of 18,953 units per month. So, in the first 9 months of 1948, we have built and sold about 8,000 units to break even, and 11,000 units on which we made a profit.

The significance of these figures is brought out by the following tabulation:

Average per month

	Total units	Units required to break even	Profit-making units sold
First 9 months of 1948	18,953	7,778	11,165
1940	9,959	7,834	2,125
Percent increase	90		425

The tabulation points out that although total units as between 1940 and the first 9 months of 1948 increased at the rate of only 90 percent, profit-making units increased at the rate of 425 percent. This ratio of 4 to 9½ in 1948, compared with 4 to 5 in 1940, between nonprofit and total sales, is more significant than any other comparison between the two periods and, I believe, makes it clear that our greater margin of profit in 1948 was principally the result of increased volume.

Robert Montgomery, director and secretary, American Woolen Mills

Mr. MONTGOMERY. It seems to us obvious that a mere comparison of dollar profits of 1946, 1947, or 1948 with 1940, or any other prewar year, is no criterion at all in determining whether the profit was too high or too low.[2] The comparison proves nothing. For one reason, the profit in 1940 was much too low, judged by any criterion that could be fairly adopted. For example, the 1940 profit was only 4.1 percent of the company's net sales and only 3.99 percent of invested capital; and no one would seriously contend that on either standard the level was a proper and equitable one.

Moreover, the comparison is invalid unless we compare the relative value of the dollar earned in 1948 with the dollar earned in 1940. We find that for the purpose our company uses its profits the 1948 dollar is worth much less than half the 1940 dollar. Taking that part of our earnings that go into inventory, we could buy as much Australian wool for 97 cents in 1940 as we can for $2.05 today, and the hour of labor that cost 57 cents in 1940 commands $1.43 now; and so on.

If we plow back part of the earnings into new plants, it will take $2 to $2.50 in 1948 to acquire what $1 would acquire in 1940 in the way of bricks, mortar, lumber, cement, and skilled and unskilled labor that go into construction. If you buy new machinery and equipment,

[2] See appendix D, table II, for financial data submitted by the company.

prices are up at least 65 percent. Similarly, that part of our earnings that are distributed in dividends do not do the job that a 1940 dividend did because our shareholders, who have a cost-of-living problem like all of us, have to have $1.73 in 1948 to do the work that $1 did in 1940; and if we take into account the effect of increases in income taxes between 1940 and 1948, a dividend would have to be more than doubled to give the stockholder the real income he had in 1940.

We submit, therefore, that comparison of the dollar aggregate of 1948 with the dollar aggregate of 1940 is unsound because profits that year were substandard by any test, and also because the 1948 dollar is really 50 cents or less in terms of the 1940 dollar.

It seems clear that the dollar-volume of corporate profits must increase during an inflationary period just as the dollar-volume of wages must increase. A corporation has its own cost-of-living problems and when it buys new machinery or replenishes inventories, it, like its employees, finds that the 1948 dollar will not go as far as the 1940 dollar.

No equitable result can, in the case of this company, and others in the wool-textile industry, be attained by taking the result of any one year, or any relatively short period of time.

The criterion must be applied to average results for a comparatively long period because unless a manufacturing company in this industry is allowed to reap the advantage of its investment and of the economies of large-scale production by getting a relatively high manufacturing profit in times of prosperity, it will be ruined in times of adversity. The history of this company offers ample proof of this statement.

From its organization in 1899 to 1916 profits were modest, covering with a small margin the preferred stock-dividend requirements, with nothing paid on the common stock. During World War I and for a period ending in 1923 profits were large enough to permit the payment of dividends on the common stock and to lay up a considerable surplus. From 1924 to 1939 the company lost nearly $35,000,000 net in operations and a very large sum in the liquidation of about half of its mills. To eliminate the deficit on the books, the par value of the outstanding common stock was reduced from $100 to a declared value of $5. Since 1940 the company has made profits and has been able to resume dividends on its common stock which received nothing from 1924 to 1946. The company was in good financial condition at the end of 1923 because of its earned surplus and of two stock issues in 1920 and 1923. Otherwise, it would undoubtedly have been one of the casualties of the depression. Taking the entire history of the company from 1899, we find that the average earnings from its invested capital is less than 4 percent annually and that the common stockholder has received an average of little more than 1 percent on his original investment.

Dwight B. Billings, controller and assistant treasurer, Pacific Mills

Mr. BILLINGS. The criteria of net worth and invested capital are often used in determining what is a proper and equitable level of profits and at first glance there appears to be considerable justification for this. The justification loses its force, however, during a period of inflation because necessarily the number of dollars earned during an era of increasing prices bears a larger and larger percentage to the number of dollars invested when prices were on a much lower plateau.

For example, the original capital of this company was invested in 1899 and there were additional stock issues of both preferred and common stock at various times until at the end of 1923 there was outstanding $50,000,000 of preferred and $40,000,000 of common. This capital went into the purchase and construction and equipment of manufacturing plants at prices and costs very much below present day reproduction values.[3] Accordingly, both our invested capital and our net worth are now represented in large part by property valued at its original cost in 1908, or 1920 or 1923, and having little relation to present values. In fact, some of the productive equipment of this company has a book value of a small fraction of its present reproduction cost.

In a period of inflation it is manifestly unfair to restrict the earnings of the company to a percentage of that original cost, unless the percentage is adjusted upward as costs rise.

The criterion which we think should be adopted is that of a percentage of sales. This automatically adjusts for differences in the value of the dollar from year to year and permits the accumulation of larger aggregates of dollars in years of great activity to offset the results of bad years. The percentage that should be used is one that would, over a period of several years, permit the company to average enough to pay reasonable dividends on its securities and to accumulate a surplus for reinvestment in the business and for a cushion against hard times.

The percentage should be commensurate with the risks of the business, and ours has been proved to be one of the riskiest.

The percentage should also be sufficient to yield average profits on an adequate volume so that new equity capital could be obtained if required. If inflation continues, we shall need more and more dollars for working capital and to invest in inventories and for capital expenditures. For a time these can be acquired by bank loans, but there is a limit to bank credit because each loan reduces the ratio of quick assets to liabilities, which is the margin that protects the lender. . . .

We have never had any experience with profits that were too high and in this industry, which is the most competitive imaginable because of its great productive capacity as compared with the ordinary peacetime demand, we are sure that competition and the old law of supply and demand will make short work of profits that anyone considers too high. Our problem has been, and will be, to make enough money to stay in business.

It may be alleged that profits in any one year or over a few years are too high. My personal opinion is that only by taking a number of years together, approximating the business cycle, can the true earnings be determined. If Pacific's past record is included, the company, in spite of good profits of the last 7 years, has averaged only 4.91 percent after taxes on its investment over the last 19 years.

I think perhaps the hue and cry about the huge corporation profits arises from ignorance of the effect of inflation upon corporation assets as well as from the inadequacy accountingwise of expressing the results. I doubt if anyone could prepare a suitable yardstick to determine at what point profits become too high. I can only express

[3] See appendix D, table IX, for financial data submitted by the company.

a personal opinion that a company over a business cycle should earn enough profits to—

First, pay fair wages and salaries to its personnel.

Second, put enough aside to replace its equipment and to provide extra working capital when necessary.

Third, pay a reasonable dividend to the owners who put up the money.

Fourth, put aside a small amount for a "rainy day."

What is "reasonable" for stockholders probably is determined by the risk involved; for example, a low return on riskless Government bonds against a high return on something like prospecting for oil. Pacific's history over the last 19 years, I believe, shows that textiles may well be considered speculative and, therefore, entitled to a high return on the investment.

The profits that have been made since 1940 have benefited not only the stockholders and the employees but also the general public. They have enabled the company to resume dividends and permitted the building up of its once weak financial position. During the period, over $27,000,000 of new equipment and plants have been purchased, not for expansion but for modernization.

This is currently resulting in lower costs which increase our chances of making money, and in this way make the jobs of our employees more secure. The public benefits by having a textile industry that is no longer sick and which ultimately due to competition, will be able to give better merchandise at lower prices.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. Profits are now soaring to new all-time dangerous highs because (1) American industries are involved in the process of gouging the public, that is, in self-interest, they are making as much as they can make while the making is good; (2) corporations are engaged in protecting themselves against the future depression which they feel is inevitable; (3) corporations think they must show the stockholders a better profit picture each succeeding year regardless of the implications for the stability of our economy which this practice carries; (4) corporations are raising prices with little regard whatsoever to existing costs but with concern almost solely for what the market will bear.

These four factors combined represent the self-interest, short-sighted, depression-producing thinking of American industry that must be altered if we are to avoid serious economic dislocations.

Robert Dunlop, president, Sun Oil Co.

Mr. DUNLOP. We believe that the most relevant yardstick to use in measuring profits is profits as a percent of the sales dollar, for this shows the profitability of our current operations or, in other words, how much money we are making on the volume of business we are doing. This ratio has the advantage of measuring reasonably comparable units. However, it also is subject to limitations in that it does not reflect the overstatement of profits arising from the inadequacy of charges for capital extinguishment, such as depreciation and depletion.

As a general observation, I would say that our postwar profits have been reasonably adequate to permit us to fulfill the responsibility resting upon us of maintaining and expanding our facilities to help meet the increased demands of the public and of the armed forces for petroleum products. In order to do this, however, it has been necessary for us to retain an increasing proportion of our net earnings.[4]

John Ballantyne, chairman, board of directors, Philco Corp.

Mr. BALLANTYNE. We believe that earnings per dollar of sales is the only fair basis on which to evaluate a business such as ours, and it is the criterion by which we measure our performance. Our sales increased from $52,300,000 in 1940 to $194,200,000 for the first 9 months of 1948; and the net earnings are shown below, of $2,200,000 in 1940, up to $6,600,000 for the first 9 months of 1948; and below are shown the ratios of net earnings to sales, in 1940—4.30, and so on, across to 3.42 for the 9 months of 1948.[5]

We have set a goal for ourselves of achieving a margin of 6 percent on sales after all charges and Federal income taxes. We did not attain this margin in 1947 because we were starting up our new refrigerator plant in Philadelphia, training a labor force of 4,000 men and women for this highly exacting work, and trying to overcome the usual difficulties that a new mass production operation is certain to encounter.

It appears at this time that we will not achieve a 6 percent net return on sales in 1948, either, because we have had to shoulder heavy developmental expenses in television and the cost of training several thousand service and installation experts.

The use of return on net worth, which might be suitable in the case of a steel company or a railroad, would be misleading when applied to the type of business Philco is in. We say this for three reasons:

1. The amount of invested capital we require in our business is not large compared with the volume of business we do. Our entire plant account in 1941 was valued at only $3,333,947 after depreciation and at the end of 1947 its book value after depreciation was $16,651,972, although it would probably cost $35,000,000 to build and equip our factories today. Yet with these plants we are able to do a $270,000,000 business. The principal reason we can do this lies in our flexibility, in subcontracting, and the rapid rate at which we turn over our working capital.

2. The business risks that we must take in view of our increased volume of business are far greater than ever before. Particularly in the case of the new art of television, technological progress is very rapid, and we must constantly bear in mind the possibility that some new method will be developed by our engineers, or those of another company, to produce satisfactory receivers at a lower cost than can be achieved on the basis of what we know today. We must not forget that Philco and other television manufacturers have a heavy responsibility to service the large number of receivers already in the hands of our customers, and this obligation can prove to be a very substantial one that is not fully reflected in current earnings statements.

3. Our most valuable asset is our name, our reputation for quality merchandise and the acceptance for our products that has been built

[4] See appendix D, table XII, for net income data submitted by the company.
[5] See appendix D, table X, for data on sales and earnings submitted by the company.

up over the past 30 years. Since we adopted the name Philco we have sold over $1,200,000,000 of civilian products and $400,000,000 of war materials. We have invested well over $70,000,000 since 1919 in advertising Philco and Philco products. No part of this large amount of money appears in our balance sheet and we do not carry good will at even $1. If we tried to approximate the many millions that represent the true value of our good will and wanted to put this in the balance sheet, we would get a pretty good estimate of the return we are earning on the money that has gone into our business.

The resource that is vital to Philco is not bricks or mortar, or even working capital, but it is the creative talents of our research people and our development and design engineers who are able to provide new ideas in the form of more attractive products year after year.

Charles E. Wilson, president, General Electric Co.

Mr. WILSON. I should like to direct your attention to certain points that seem to me to be significant.[6]

1. The volume of our business, goods produced, but expressed in terms of dollars, is currently running at a rate approximately 3¼ times that for 1940.

Even if we adjust these figures to cancel out the effect of the inflation on the market prices during the intervening years, thereby putting our current sales figure on a 1940 price basis, we are turning out well over twice as many goods in units as we were in 1940.

2. In comparison with this sales volume of about 3¼ times that for 1940, the annual rate of our net income, that is, the income remaining after all costs, expenses, and taxes, is only about twice that for 1940.

3. To handle this increase in sales volume and meet the country's demand for our products, which we think is our primary responsibility, and to obtain this small increase in net income, we have been obliged to increase the total amount of money at risk in the business, that is, total assets, by nearly 2½ times and to more than double the permanent capital investment in the business. By permanent capital investment I mean the money originally invested in the business by the stockholders plus earnings which were reinvested in the business instead of being paid out to the stockholders in dividends, and plus the amount of long-term borrowings. This total permanent capital investment has increased from approximately $331,000,000 in 1940 to nearly $680,000,000 at the end of September, 1948.

4. In comparison with the doubling or more than doubling of these items, the rate of dividends currently being paid to our 250,000 stockholders, now at the rate of $2 per share, is only 8 percent over that of the dividends paid to stockholders in 1940. While the dividends have thus gone up 8 percent, the cost of living has gone up 74 percent, and wages of our hourly rated employees have gone up approximately 90 percent.

5. By thus doubling our capital investment and increasing our productive capacity we have provided approximately 100,000 new jobs since 1940, as shown in the preceding table.

It is, from the foregoing, quite evident that our profit rate today is considerably below that of the prewar years. For the year 1947, we

[6] See appendix D, table V, for data submitted by the company.

earned a profit of 7.2 percent on each dollar of sales, and for the 9 months of 1948 we earned 7.4 percent on each sales dollar. This compares to a ratio of 12.4 percent in 1940, 12.5 percent in 1939, 9.3 percent in 1938, a depression year, and 15.2 percent in 1936. It is our serious conviction that the present margins are lower than they should be to provide the necessary cushion to protect us against any sudden drop in the market and to assure us of the opportunity to continue with our endeavor to show progress in the field of industrial achievement.

I should like also to point out that the popular yardsticks for measuring or determining excessive profits are fallacious in that they do not bear on the true test of the adequacy of profits, namely, whether a corporation's profits are bringing about as fast an expansion of industrial capacity as the community desires. Thus, the much discussed relation of profit to investment is an extremely fictitious and unrealistic standard. This is so because it tends to measure today's profits on the basis of yesterday's investment dollar. To do this would ignore the fact that the replacement cost of our plant at today's prices is estimated to be more than $300,000,000 in excess of the actual cost. Such a standard also overlooks the fact that the return realized on capital depends as much upon the efficiency with which the capital is employed, as for example the frequency with which a manufacturer can turn over this capital, as on the element of profit included in the selling prices, and also that the return realized on equity capital varies greatly with the methods used to finance the business.

Eugene Holman, president, Standard Oil Co. of New Jersey

Mr. HOLMAN. Merely to say that our profit is three times that of 1940 has no more meaning than saying to a fisherman: "You caught 100 fish in 1940 and 300 fish this year, so you are three times better off." One question to be asked is: "What size fish were they?"

Inflation has changed our fish—the dollar. Therefore many comparisons and relationships which were useful during periods of stable currency value are meaningless today. Worse, they may be misleading. When comparisons are to be made with prior periods, we feel cash earnings are significant, rather than accounting profit.

Cash earnings are the sum of net income plus depreciation, i. e., depreciation, depletion, amortization, and retirements. These are the funds available for dividends, for replacement of crude reserves and worn-out equipment, and for expansion and improvement of facilities. They are the only funds available for these purposes from current operations. Additional funds are only available from drafts on previous cash savings, outside financing, or sale of assets.

The 1940 profit was 1⅓ cents per gallon. This year—on a basis comparable to 1940, that is, income available for dividends and expansion—the figure would be approximately 1⅔ cents per gallon. However, in terms of what the company can buy with this money, the amount per gallon this year is only about eight-tenths of a cent per gallon in 1940 dollars.

The cash dividend figures shown in appendix E, table VI, amount to six-tenths of a cent per gallon in 1940 and four-tenths of a cent this year. In terms of what the stockholder can buy this is equivalent to one-quarter of a cent per gallon, in 1940 dollars.

Joseph E. Pogue, vice president, Chase National Bank

Mr. POGUE. The reported net income of 30 oil companies was $763,000,000 in 1946 and $1,219,000,000 in 1947, an increase of $456,000,000, or 60 percent.[7] On the face of it, this increase appears large. But the charges for capital extinguishments (depreciation, depletion, etc.), designed to recover the capital funds extinguished during the year were inadequate to replace the physical counterpart of this capital at prevailing higher costs. Profits were therefore called upon to make up the discrepancy and part of the reported total was diverted to this purpose. Thus profits computed by accounting procedure were larger than *de facto* profits. In other words, the increased cost of replacement appeared on the books as a profit.

The extent to which reported profits were thus in effect overstated can be determined approximately by adjusting the capital extinguishment charges, which are expressed in historical dollars, so that they reflect current dollars, or the cost of the physical capital to be replaced. If this is done, we find that the adjusted net income becomes $418,000,000 in 1946 and $513,000,000 in 1947, an increase of 23 percent. These figures are, respectively, $382,000,000 less and $763,000,000 less than the reported figures which are accordingly magnified by inflation to the extent of 91 percent in 1946 and 149 percent in 1947. It thus becomes apparent that the changing value of the dollar distorts the income account so that the reported net income ceases to be synonymous with profit.

The absorption of part of the reported net income by the higher costs of replacements is indicated by a 1947 rise in capital expenditures of $699,000,000, and by a decline in the percentage of net income paid to stockholders from 43.4 percent in 1946 to 34.9 percent in 1947. By way of comparison, this ratio was 66.3 percent in 1938.

Our analysis has thus far been confined to 1947 and previous years because adequate data are not yet available for 1948. It is recognized, however, that reported oil profits for 1948 will be substantially larger than in 1947. For example, it is estimated that the reported net income for 30 oil companies will amount to $1,410,000,000 for the first 9 months of 1948, an increase of $563,000,000 or 67 percent over the corresponding period of 1947. The rate of increase for the full year, however, will be less than for the first three quarters, because oil company earnings reached their peak in the second quarter of the year.

All financial transactions are ordinarily expressed in monetary units. The dollar, of course, is our standard of value just as the yard is one of our standards of length. Profits are expressed in dollars. But these dollars are no longer the same from year to year; their purchasing power or value has changed. Thus it is not proper to say that the profits of 30 oil companies have increased from $763,000,000 in 1946 to $1,219,000,000 in 1947. One can say with propriety, however, that these profits increased from 763 million 1946 dollars in 1946 to 1,219 million 1947 dollars in 1947. This consideration suggests that a more correct view of the change in profits can be gained if the dollars are adjusted to reflect the same purchasing power.

This adjustment can be made with a fair approach to accuracy by dividing the reported dollars by the Bureau of Labor Statistics Index

[7] Financial and operating summary for 30 oil companies, appendix B, tables IV, V, and VI.

of Wholesale Prices of All Commodities. If this is done, the adjusted net income, expressed in dollars of prewar purchasing power, becomes $509,000,000 in 1946 and $648,000,000 in 1947, the latter figure showing an increase of $139,000,000, or 27 percent, from 1946. Thus it is found that 33 percent of the reported profits for 1946 and 47 percent of the reported profits for 1947 were absorbed by the shrinkage in the value of the dollar.[8]

For the 30 oil companies in 1946 and 1947, the rate of return on borrowed and invested capital indicated by the reported figures rose from 9.3 percent to 13.2 percent. But this computation is erroneous. The error, however, can be eliminated if the numerator and denominator of the ratio are expressed in like dollars. When this is done, the adjusted rate of return becomes 6.5 percent for 1946 and 7.7 percent for 1947.

Representative HUBER. Mr. Pogue, do you feel the present petroleum company profits are excessive?

Mr. POGUE. Without earnings which would appear to the layman to be high, the facilities constructed in 1947 and 1948 would have been inadequate to give us the more comfortable supply situation that we now have. Therefore, I would say that in terms of the criteria outlined here, profits have not in general been excessive. In terms of the job they did, I think that profits functioned well; and it was more important to have the job done through the profit route than it would have been to have had less profits and the job half done. But I do not believe in looking at it that way. The words "excessive" or "large" have meaning only relative to other factors.

Senator FLANDERS. I get out of this, Mr. Pogue, that if you had not had these perhaps excessive profits, we would not have gotten the oil. I also am comforted by your belief that when we find less need for expansion in the industry, these profits will go down and prices will go down.

Mr. POGUE. There is no question about that, Senator, and the only thing that would prevent that would be a violent renewal of the inflationary forces which would so increase the costs of capital expenditures that the cycle would go up and we would face another mountain range.

Clarence Francis, chairman of the board, General Foods Corp.

Mr. FRANCIS. We have included in appendix D, table VI, the invested capital by years and have computed the ratio of profits to such invested capital. The invested capital base has been determined under the provisions of the Internal Revenue Code for consolidated excess-profit-tax purposes. On this basis our invested capital is $324,000,000.

The technical concept of net worth omits the factors of real value which have been paid by the company in acquiring some of its branded products. Sound judgment indicates the lack of realism of this basis for computation of profit. The net-worth figures increased from $78,000,000 in 1938 to $152,000,000 in 1948. The percentage of profit indicated on this basis fluctuates from 18.8 percent in 1939 to 12.9 percent in 1947, and on the basis of the current profit estimates

[8] See appendix B, table VI, for selected financial data of 30 oil companies.

will be 17 percent in 1948. Once again you will notice that even this unrealistic ratio is lower in 1948 than it was 10 years ago.

In the years 1938 to 1948, General Foods sales have grown from $126,000,000 to an estimated $466,000,000 in 1948. In the first 3 years of this decade, 1938, 1939, 1940, we earned 10 to 11 percent on net sales. This rate had fallen to a range of 4½ to 6½ percent in 1945, 1946, and 1947, and the "guesstimate" for 1948 is 6 percent. This means that we are earning this year about 6 cents on each dollar of sales, or from 4 to 5 cents less per dollar of sales than we earned in the 3 prewar years.

There is no formula we know of which can justifiably express adequacy of profit in static percentage figures.

All profits are probably never too high—whatever too high means. Too high in reference to what? Too high morally? Socially? Economically?

Certainly, profits cannot be arithmetically too high if they are made competitively in fair dealings in a competitive economy. Once again we use the term "residual." Profits are what in second-grade arithmetic we call the remainder. If we were to sell for $1 what cost us 99 cents to produce, including taxes, we would make 1 cent or 1 percent on sales. But if on that item we could get our cost down to 98 cents, a mere 1 percent reduction, we would have doubled our profits. I leave the question to you, gentlemen, would we, under those circumstances, be profiteering because we had doubled our profits? So much for the arithmetic of profits.

Economically, profits can be too high in periods of scarcity. The situation can only be solved fundamentally by increased production. However, I hardly have the courage to generalize even about the profits in the food-processing industry, much less for all industry. Year after year, in our own relatively stable business, our "profit mix" varies far more than our "product mix." One year cereals may be our best ball carrier doing especially well in profits. In another year, coffee; in another, desserts; in another, our chocolate and cocoa products; and so on. In every year throughout my experience in the food business, we have had very meager or no profits in some one or more fairly important lines. This is also true in the profitable year of 1948.

Are profits ever too high socially? They perhaps might be if the investor was unduly rewarded at the expense of other classes in the community, or if profit contributed unduly to the cost of living. However, I challenge you to find any evidence that the owners of General Foods have received anywhere near the fruits of their investments that have gone to employees, governments, and so forth. I have also tried to lay the ghost that we set prices on the basis of expected profits.

Because of scarcities there has been an almost universal seller's market most of the time since Pearl Harbor. Dollars have been competing for goods instead of goods competing for dollars. We are emerging from that era. Soft spots are now occurring and more will come.

You ask if anything should be done about the profits of 1948 and you imply the question: Who should do it? We regard this as a fact-of-life question. We respect you for having the courage to ask it and we would deserve less than your respect if we did not answer

with all the candor and force at our command. First, something is already being done about the profits of 1948. The consumers have, for some time, been doing something about it. In those industries where a high-priced supply has more than caught up with demand, the laws of competition are at work.

We believe that inflated prices where they exist, and inflated profits where they exist, are directly related to, and will not be solved until, some semblance of peace and stability descends upon the earth. Most Americans are prepared now to accept the interdependency that they have one upon another. We perhaps have been a little slow to accept the equally inevitable fact; that the interest of the American consumer, investor, worker, and the American Government itself are all interrelated with the problem of world peace.

We believe that as long as we are required by the troubled international situation to maintain a huge military budget, as long as we spend more and more money on goods for economic recovery in other areas of the world, inflated price and profit levels are apt to remain with us in a few fields.

Your final question in the level of profits category suggests that some industries made relatively large profits in 1947 operating at or near capacity, yet their profits increased in 1948. What, you ask, is the justification for such increased profits? Once again we cannot generalize either to justify or to condemn high or higher profits. You already know that General Foods profits in 1948 are higher than those of 1947 but not because of undue rates of profits in any of our lines.

I have called your attention to one reason for our increased profit in 1948—the big mistake we made in 1947 which severely curtailed profits in one important line. Fortunately we didn't repeat that mistake in 1948.

Another fact is that housewives have bought most gratifying amounts of our desserts this year. There has been no restraining factor to our production of these desserts. But also there has been no undue profit per case. And so it goes. Our rate of net profit for 9 months is still under 6 percent of sales against the all-time low record of 4½ percent of 1947.

Nelson Cruikshank, A. F. of L.

Mr. CRUIKSHANK. The results of the high-price policies followed by so many businesses in the postwar period are now being seriously felt in various sectors of the economy. Workers' average real wages have been declining during the postwar period.

From May 1945 (VE-month) to August 1945 (VJ-month) the decline in buying power of the weekly pay envelope of the average factory worker was 10 percent. From August 1945 to October 1948 (latest figure) the average factory worker's buying power has declined another 2½ percent. But the factory worker has fared better than the average consumer, because unions have advanced his pay. Figures from *The President's Midyear Economic Report* show that the per capita disposable income of the American people in the first half of 1948 was 10 percent below 1945 and 7 percent below 1946. This decline has been due entirely to the price rise, since average money

wages and the per capita money income of the American people have advanced steadily in the postwar period.

This cutting away of the people's buying power by the high prices which created today's high profits is having dangerous consequences for the American economy. First of all, it means a serious injustice to the millions who saved their money and bought war bonds in wartime. The buying power of their savings has been reduced by at least one-fourth, and by one-third if the bonds were bought early in the war. Similarly, those who depend on social security find that their benefit payments are so reduced in buying power that they no longer provide even a bare subsistence.

Secondly, this reduction of buying power is cutting the support from under the market for the products of American industry. We must have a realistic understanding of what is necessary to reach our common goal of maintaining our economy at levels of maximum production and employment. So-called full employment means a steady increase in employment year by year as population increases and more workers come into the labor force seeking jobs. This means a steady increase in production of goods and services, for production is raised both by the larger number of workers and by their rising productivity. And now we come to the vital point in the whole problem of maintaining an economy of maximum employment, namely, the purchase of the products and services of industry. For, unless these products are bought and taken off the market, production will be cut back, workers laid off, and full employment will be replaced by rising unemployment with immense loss to everyone.

On whom does the American economy depend to buy its product? Before the war in 1939, consumers bought about 75 percent of it; Government 14 percent; business bought about 10 percent for maintenance, improvement, and expansion of its plants, and about 1 percent represented net exports to foreign countries. With rising postwar prices, consumers were able to buy only 71 percent in 1947, but the slack was taken up by business, which bought unusual amounts for plant and equipment, and by foreign countries, which in early 1947 still had enough capital to buy for reconstruction purposes. As we look ahead to 1949, a very different picture presents itself. Consumers are no longer able to buy even 70 percent of the total product—in the first three quarters of 1948, they bought only 69.8 percent; business purchases for plant and equipment, which have taken up the exceptionally high proportion of 15 percent in 1948, are expected to drop away in 1949; foreign net purchases for private account have dropped to an insignificant amount as their funds were exhausted. The result is that the whole economy turns to the Government to support the market for its products. This is a serious and dangerous situation, and the root cause of the maladjustment is high prices which cut off consumer buying power.

The following table shows the distribution of the gross national product, both in dollar amounts compared by various years, 1929 to 1948, and percentagewise.

Gross national product of United States of America, showing by whom it is purchased

Year	Total gross national product	Consumers	Business firms	Net exports (private accounts)	U. S. Government
Dollars (billions):					
1929	103.8	78.8	15.8	0.8	8.5
1939	90.4	67.5	9.0	.9	13.1
1946	209.3	147.4	26.5	4.7	30.8
1947	231.6	164.8	30.0	8.9	28.0
1948 (¾)	255.9	178.5	39.0	.7	37.7
Percent:					
1929	100.0	76.4	15.3	.1	8.2
1939	100.0	74.6	10.0	.9	14.5
1946	100.0	70.4	12.7	2.2	14.7
1947	100.0	71.1	13.1	3.8	12.0
1948 (¾)	100.0	69.8	15.2	.3	14.7

Source: U. S. Department of Commerce.

The market is being supported at present, as this table shows, by Government purchases for the European recovery program and the military program. But we cannot go on indefinitely expanding these programs to take up the slack in consumer purchasing power. We are told by competent business observers that "very small declines in civilian demands will offset very large increases in defense demand."

The serious shortage of consumer buying power is emphasized even more when we realize that consumers are forced to depend to a large extent on borrowing and on the use of past savings to meet current expenses. Consumer short-term credit has increased at the rate of $3,000,000,000 a year since the war and is now 80 percent above the previous all-time peak in 1939. War bonds and savings bonds are still being redeemed at the high rate of almost 3.8 billion dollars per year; postal savings have declined by $67,000,000, or 2 percent, in the year ending September 1948; in mutual savings banks, in the first 9 months of 1948, withdrawals have risen by $425,000,000, while new savings rose by only $369,000,000. All these are signs of the pressure of high prices, particularly on low-income groups. The Federal Reserve Board study of consumer finances in 1948 showed that half of all spending units had drawn on their savings for the purchase of nondurable goods, which is an indication of the extent to which families have had to draw on savings to meet ordinary living expenses. In the very low income groups (under $2,000) three-fourths of all savings drawn were for such purposes:

John Schmidt, vice president and comptroller, Armour & Co.

Mr. SCHMIDT. The ratios of profits and losses to invested capital, net worth, and sales are shown below. The information for the specific years requested by the committee, as well as the averages, and high and low for the 10-year period are tabulated:

	Percent profit or loss to—	
	Invested capital	Net worth
1940	4.30	5.03
1946	9.65	14.45
1947	9.79	15.11
1948	.21	−.97
Average (1939–48)	4.80	7.07
High (1947)	9.79	15.11
Low (1948)	.21	−.97

	Domestic meat	Balance of operations	Total
Profit or loss (millions of dollars):			
1940	2.73	6.90	9.63
1946	7.39	20.29	27.68
1947	8.09	22.82	30.91
1948	−12.63	10.66	−1.97
Average (1939–48)	1.41	12.28	13.69
High	(1947) 8.09	(1947) 22.82	(1947) 30.91
Low	(1948) −12.63	(1939) 5.64	(1948) −1.97
Sales dollars (millions of dollars):			
1940	503.1	230.8	733.9
1946	721.8	461.7	1,183.5
1947	1,362.3	594.2	1,956.5
1948	1,400.5	590.9	1,991.4
Average (1939–48)	888.8	402.6	1,291.4
High	(1948) 1,400.5	(1947) 594.2	(1948) 1,991.4
Low	(1939) 481.8	(1940) 230.8	(1939) 715.3
Percent profit or loss:			
1940	.54	2.99	1.31
1946	1.02	4.39	2.34
1947	.59	3.84	1.58
1948	−.90	1.80	−.10
Average (1939–48)	.16	3.05	1.06
High	(1946) 1.02	(1946) 4.39	(1946) 2.34
Low	(1948) −.90	(1944) 1.60	(1948) −.10

We direct your attention to the profits in the years 1946 and 1947, which were considerably higher than in any of the preceding 7 years. In making comparison of these years with preceding years, consideration should be given to the fact that there were sharp rises in price levels in those years. The rate of profit on the total sales of all products was only 2⅓ cents and 1⅞ cents per dollar of sales in such years, respectively.

We also direct your attention to the net profit or loss per pound of domestic meat sales, as shown in table III of appendix D. This table shows that profit is extremely small and that it is not a factor of consequence in the price of meat. For the entire 10-year period, the profit averaged only thirty-six one-thousandths (about one twenty-eighth) of a cent per pound of sales. The rate of profit per pound of domestic meat sales in the two highest years—1946–47—was still extremely small, being approximately one-fourth and one-fifth of a cent, respectively. The rate of profit per dollar of domestic meat sales was slightly more than 1 cent per dollar and about three-fifths of a cent per dollar in such years, respectively.

The domestic meat operations for the year 1948 resulted in a very substantial loss, and the profits from our other operations were considerably lower than the preceding year, with the result that the company sustained a loss in 1948 from its total operations. A strike which suspended or severely curtailed operations at all of our most important packing plants for a period of 10 weeks was an important

factor in the unfavorable results from domestic meat operations. As a whole, prices at the end of the year 1948 were somewhat higher than at the beginning of that year. During the year, however, there were several sharp declines in prices. These sharp declines were offset by gradual increases. The declines came for the most part during the period of our heaviest accumulation of inventories, with the result that we sustained substantial losses that we were unable to recover in the subsequent period of gradually rising prices and relatively lower inventories.

Enders McC. Voorhees, chairman of finance committee, United States Steel Corp.

Mr. VOORHEES. United States Steel's income (percent of sales) in 1947 was record-breaking in one respect: It was a record-breaking low amount for any year of comparable rates of operation experienced in United States Steel's entire peacetime history.[9] For the first 9 months of 1948 it was even lower.

In 1940, United States Steel's finished steel shipments were 15 million net tons. It is a coincidence that the tons shipped for the first 9 months of 1948—15.1 million tons—were almost exactly the same. The quantities of various goods and services sold by United States Steel, although not necessarily identical, were, nevertheless, approximately equal in the two periods by this measurement. This coincidence thus provides the opportunity to compare the financial results of approximately equal quantities to discover what has occurred between these two periods. The operating rate this year is, however, substantially higher than in 1940, so that, other things being equal, the profit rate could properly be greater now than in 1940.

In the first 9 months of 1948, United States Steel received from customers $1,754,700,000. This was $675,600,000 or 62.6 percent more than was received for approximately similar quantities of goods and services in 1940. The question is, Who got what proportions of that $675,600,000? The answer is readily ascertainable by comparing the cost aggregates for the two periods. The computations follow.

[In millions of dollars]

	1940	1948, 9 months	Increase or decrease	Percent of $675.6
Sales	1,079.1	1,754.7	+675.6	100.0
Costs:				
Employment	464.3	739.3	+275.0	+40.7
Purchases	358.3	705.8	+347.5	+51.4
Wear and exhaustion	72.6	106.0	+33.4	+4.9
Interest	13.6	1.8	−11.8	−1.7
Taxes	68.1	113.8	+45.7	+6.8
Total costs	976.9	1,666.7	+689.8	+102.1
Income	102.2	88.0	−14.2	−2.1
Dividends	60.0	51.5	−8.5	−1.3
Reinvested	42.2	36.5	−5.7	−.8

	Million net tons
Finished steel shipped, 12 months, 1940	15.0
Finished steel shipped, 9 months, 1948	15.1

[9] See appendix D, table XIV, for financial data submitted by the company.

In 1947, United States Steel's income was 6 percent of sales; for 9 months of 1948 it was slightly less. Our operating rate has been over 90 percent. How do these income percents compare with the income percents in previous years of comparable activity? We have made such a comparison covering all prewar peacetime years. This is what we find: In such past years when the operating rate was over 90 percent the income percent averaged 18.2—or three times as much as in 1947. For years when the operating rate was between 80 and 90 percent, the income percent averaged 11.8—or double the 1947 rate. Putting it another way, the amount earned in 1947 (6 percent) was the percentage that was characteristic of prior years when the operating rate ranged from 40 to 50 percent. Historical comparison, in the absence of statistical distortions, can yield only one conclusion: United States Steel's current rate of profit is exceptionally low in the light of its present full capacity rates of operation.

United States Steel made another record, but on the low side. Its income as a percent of sales was 6 percent—the smallest for any year of anywhere nearly comparable rates of operation in United States Steel's entire peacetime history. For the first 9 months of 1948 the return on the basis of sales was even smaller, namely, around 5 percent. So much, then, for the time being, in correcting any misunderstanding about the 1947 profits of United States Steel having been "record breaking" on the high side.

Donald Montgomery, UAW-CIO

Mr. MONTGOMERY. The members of our union have a very real interest in profits. We have said, and we still say, that we want wage increases without price increases, and we want other workers to win wage increases without price increases, because we believe that prosperity must be built from the bottom up, and that the foundation on which it must be built is purchasing power in the hands of the people.

We believe present profits are far too high. We believe this because we are convinced that present profits will destroy the purchasing power base which is essential to maintenance of prosperity and full employment. Already we see consumers unable to buy the total output of full employment in various soft-goods lines and some durable goods, and we see the beginning of lay-offs. We see the attempt being made to hold prices up while production falls off.

In the automobile industry there appears to be a strong demand for most kinds of cars even at present high prices. But we know that this will not last forever, and that the day will come when present profit policies will spell trouble for the workers in our industry.

Industry spokesmen justify present high unit profit policies on the ground that hard times will follow good times. They are geared to a belief in boom and bust. The profit policies which they derive from this belief will bring to pass that which they anticipate.

This is why auto workers and most other workers throughout the land are deeply concerned about high profits. They know that their wages continue only when times are good. They cannot collect "excess" wages during good times to tide them over during hard times, as the managements of corporations plan to do. Management's excess profits, now being collected against hard times ahead, reduce

the current purchasing power of wages, so that even before hard times arrive workers have been forced to consume their savings and to go into debt.

The only industry policy that can avoid this vicious cycle is one that is geared to small unit profits on a large output, to highest possible wages and lowest possible prices. How far industry might go in this direction if that were its policy, no one can say today with too much assurance. We can give specific examples of what certain auto manufacturers might do right away. But these figures would not prove all that might be done to raise wages and reduce prices. All industry has been operating in a fool's paradise. Inflation has made it fat. Profits come too easily. Management has not been compelled to manage efficiently. The temptation of quick profits has created black markets, and black markets have created further inefficiencies.

Buying power saved by consumers during the war years and the great unfulfilled demand for goods gave industry its opportunity. Industry chose to get while the getting's good and to let the future take care of itself. It converted a ready-made prosperity into a real danger of depression. Economists look only to Government spending for defense and overseas aid to hold the system together for a few more years.

Emerson P. Schmidt, Chamber of Commerce of the United States

Mr. SCHMIDT. Insofar as our problem has been excessive demand in the market place, the combined purchasing power of workers and farmers has been about seven times as potent as the purchasing power in the hands of corporations or dividend receivers.

Actually in a sense we are all to blame—our method in the depression and war deficit spending which we all accepted, more or less, is, of course, at the root of the rising prices.

With some $225,000,000,000 national money income, every dollar of which gets or tends to get spent for something, it is hard to see how the current high prices can be ascribed to the 9 percent of the purchasing power taking the form of profits, and ignore the other 91 percent (wages, salaries, farm income, and so forth) which is in the market fighting for goods and services.

Russ Nixon, United Electrical, Radio, and Machine Workers of America, CIO

Mr. NIXON. Nine years of rampant profiteering have brought the American people to an economic crisis. Congressional inquiry into this profiteering record faces an urgent challenge if the dangerous economic rush of profit-induced inflation is to be checked. In the 9 years since 1940, the price structure has been so bloated as to provide reported corporate profits of $202,000,000,000. Each American family in this war and postwar period has paid prices providing about $5,000 in profit for the corporations of our country.

At the war's end, American industry forced the complete opening of the floodgates of profits and inflation. Monopolistic American industry and finance used its political and economic power to destroy all controls on prices and distribution, eliminate the excess-profits tax, ease corporate taxes, exact huge tax rebates, and take over Government-

owned facilities and surplus at bargain prices. This period of soaring concentration of economic power and corporate enrichment is only very partially measured by the profits reported by the corporations themselves to the United States Treasury.

In 1948, the bonanza profit peak of all times is reached with a distorted price and cost structure creating profits at the rate of $35,000,000,000 a year—profits equivalent on an annual basis to $830 for each of the 42,000,000 families now in the United States. Today the monopoly profiteers are waging a stepped-up political, economic, and propaganda fight to preserve these profits and to avoid the wrath of the public who are beginning to learn how much "they've been had" these past years.

The annual rate of return on stockholders' investment was 18.7 percent for the first 9 months of 1948 in the large manufacturing corporations, exceeding the 16.1 percent reported for the corresponding period in 1947 and far in excess of the 22-year average (1925–46) of 8.4 percent. In other words, the present rate of profit on investment is so high that the total corporate profits in a 5-year period will equal the stockholders' investment [10] (National City Bank of New York Monthly Letter, March and November 1948).

The popular and expensively nurtured misbelief that wages can't be paid from profits is achieved by hiding facts such as the following: Profits before taxes per manufacturing worker amount to about $1,145 in 1947. Wage increases raised BLS weekly earnings in manufacturing $7 a week since 1947 or by about $364 a year. These increased wages could have been paid from profits, but instead prices of manufactured goods were increased about 19 percent. For every $5 in wages paid in manufacturing, about $2 in profits are created.

The rate of profits before and after taxes in 1948 for the electrical industry as a whole is 18 percent above the record 1947 profits. The current rate of profits before taxes amount to more than four times the profits of the boom year 1929; profits after taxes are three times those of 1929.

Electrical machinery industry [1]

	Profits before taxes	Profits after taxes
1948 rate estimated	$911,000,000	$543,000,000
1947	766,000,000	460,000,000
1945	593,000,000	194,000,000
1939	185,000,000	148,000,000
1929	208,000,000	178,000,000

[1] Profits for 1929–47 from U. S. Department of Commerce; profits for 1948 estimated from percentage increase in 9-month profits reports for 25 electrical companies.

In 1948, even with net worths inflated by previous years excessive undistributed profits, companies were earning 20 percent on their net worth as revealed by a sample survey of 25 leading companies in the industry. This was far above previous levels.

[10] It should also be noted that this return on investment of 18.7 percent is based on a net worth figure which is constantly being swelled as an increasing part of excessive profits remain undistributed in the surplus account.

Percent of net profit to net worth [1]

	1948 [2]	1947	1945	1939
25 electrical companies	20.0	18.7	12.0	10.5

[1] Based on net worth consisting of capital stock, capital surplus, and surplus at beginning of fiscal year.
[2] Estimated net profit figures.

Profits before taxes per employee in the electrical machinery industry are at the current annual rate of $1,234. Although profits per employee in the industry came to $1,005 in 1947, which could easily have absorbed the 1948 wage increase in the industry of approximately $240 on an annual basis per worker, price increases of up to 11.9 percent added to the rate of profit.

	Profits per employee per year [1]
1948 rate	$1,234
1947 rate	1,005
1945 rate	708
1939 rate	521

[1] U. S. Department of Commerce profit data divided by Bureau of Labor Statistics employment.

Prof. Sumner H. Slichter, economist, Harvard University

Professor SLICHTER. During the last 3 years American corporations have overstated their profits by about 16.4 billion dollars.[11] This is the amount by which the reported statements of profits exaggerate the amount of income available to pay dividends, to expand plant, to increase wages, or to reduce prices.

Senator O'MAHONEY. You refer to the entire 3-year period, I assume?

Professor SLICHTER. Yes. It is an estimate for 1948, but 1948 is nearly over.

In 1946 profits were represented as being nearly twice as large as they really were; in 1947, profits were overstated by about 51 percent; in 1948, profits will be overstated by approximately 25 percent. Naturally, it is highly misleading to stockholders, employees, customers, and the public to have the amount of income available for dividends, plant expansion, wage increases or price reductions so greatly overstated.

In 1946, the actual amount of corporate income available for dividends, wage increases, plant reductions, expansion of plant, or price reductions, was about 6.4 billion dollars instead of 12.8 billion dollars as actually reported. In 1947, the amount of corporate income available to pay dividends, increase wages, reduce prices or expand plant was approximately 12 billion dollars instead of 18.1 billion dollars as actually reported. During the first 6 months of 1948, reported profits have been running at the annual rate of 19.8 billion dollars a year.

Senator O'MAHONEY. May I inquire whether or not, in 1946 and 1947, the corporations paid their taxes upon the overstatement of their profits, or on the statement which you say they should have made?

[11] See appendix A, table XVI, for tabulation on overstatement of profits.

Professor SLICHTER. On the overstatement. The amount of income available to pay dividends, increase wages, reduce prices, or increase plant has been running at the annual rate of about 14.9 billion dollars. The overstatement of income during the last 6 months of the year will be less than the first 6 months. When the final figures for 1948 are available, it will probably be found that real profits are approximately 16 billion dollars, but that reported profits will be between 20 and 21 billion dollars—an overstatement of roughly 25 percent.

According to the reports of American corporations, profits in 1948 are running roughly 3.17 times 1940. Corporate sales in 1948 are running roughly 2.6 times above 1940. Consequently, profits as reported by business organizations have risen slightly faster than sales since 1940. Actual profits in 1948 were running about 2.4 times 1940 during the first 6 months and will run about 2.5 times 1940 for the year—about 16.0 billion dollars in comparison with 6.3 billion dollars. Hence, actual profits have risen at a slightly lower rate than corporate sales since 1940. The purchasing power of real corporate profits in 1948 is less than 50 percent more than in 1940, despite the fact that corporations are producing about 70 percent more physical product than in 1940.

Why are there such wide discrepancies between the real profits of American corporations and their reported profits? There are two principal inaccuracies in reports on profits. One arises from the fact that most corporations insist on counting a rise in the cost of replacing inventories as profits. The other is that most corporations count the rise in the cost of replacing plant and equipment as profits. It is obviously ridiculous to count a rise in costs as profits and yet most corporations do it, and still pay taxes on the amounts so reported.

Prof. Seymour Harris, economist, Harvard University

Professor HARRIS. Excessive profits, such as we have now, are a threat to economic stability. They account for an unprecedented level of investment (a highly inflationary factor), an increase in the pressure on trade-unions to ask for higher wages, and an encouragement of uneconomic expenditures which will be costly once the inflation ends.

One point that ought to come out of this discussion that I think is very important, and as far as I know has not been discussed, is that the emphasis is always on corporate profits. As far as I can discover, there has been a larger rise in noncorporate profits than in corporate profits, and there has been a very large rise in professional income.

Now, a substantial part of the inflation is the result of the profits in the noncorporate and professional area. I can give you an example, where in recent years we have had an increase of 200 percent in total expenditures for medicine, we have had an increase in the number of physicians of only 5 percent. If you compare profits of unincorporated business with corporate profits after taxes, you can see that unincorporated profits have gone up even more than corporate profits.

(1) Business and professional incomes are up from 8.3 billion dollars in 1929 and 6.8 billion dollars in 1939 to 23 billion dollars in 1947 and 26 billion dollars in the second quarter of 1948 (annual rate).

This compares with a rise of corporate profits before taxes from 9.8 billion dollars in 1929 and 6.5 billion dollars in 1939 to 29.8 billion dollars in 1947 and 29.5 billion dollars in the second quarter of 1948

(annual rate); and from 8.4 and 5.0 billion dollars to 18.1 and 18.0 billion dollars, respectively, after taxes.

It should be observed that business and professional incomes (not subject to corporate tax) have increased almost 3.0 times since 1939, whereas corporate profits after taxes rose by but 2.6 times.

(2) The rise of all profits, inclusive of professional income, is from 20.1 billion dollars in 1929, or 23 percent of national income in 1929, to 53 billion dollars, or 26 percent of the national income in 1947 and 55.5 billion dollars, or 26 percent in the second quarter of 1948 (annual rate).

(3) We should also observe that there are important differences among industries. There has been a large relative rise in the income of certain services, that is, wholesale and retail trade, and a decline in others:

Income—Percentage rise, 1929 to 1946

1. All	100
2. Manufacturing	116
3. Wholesale and retail trade	150
4. Finance, insurance, and real estate	22

In part, these very large relative movements reflect a long-run change in the status of various industries and occupations. Undoubtedly, continued inflation and pressure from Government upon financial groups contributed to the deterioration in the position of the finance, and so forth, group.

The marked absolute and relative improvement of income of traders is a phenomenon of inflation periods to which the Government ought to give its attention. There is no evidence that the rise in the position of wholesale and retail trade is explained substantially by an increase in the numbers engaged. The rise in the number of persons engaged in all production from 1929 to 1946 was 25 percent; in wholesale and retail trade, 30 percent.

William A. Paton, professor of accounting, University of Michigan

Mr. PATON. I would like to call attention to the fact that it should be expected that the total stream of corporate dollar earnings for the country would increase with a great increase in business activity and dollar volume of sales. Indeed, if the total reported earnings of all stockholders of the United States were to remain constant or decline in a period of large production and sales such a development would be cause for alarm as far as the future of private business enterprise were concerned. We must be on our guard not to form opinions carelessly on the basis of aggregate figures representing earnings of stockholders, earnings of factory employees, or of any other group.

Only as the available data are carefully sifted, analyzed, and compared is it possible to form reasonable conclusions as to what is going on with respect to the relative positions of the various economic groups making up the Nation.

This means, of course, that the pertinent question regarding the current level of reported corporate profits—earnings of stockholders—is: Are such profits large relative to other factors? Do such profits represent an increasing share of the national product? Are current developments enhancing the economic position of those who furnish risk capital and pinching other important groups?

In my judgment, a careful study of the available data discloses that a negative answer to any such question is clearly called for. The fact of the matter is that the forgotten man of the present era is the common-stock holder, the chap who provides risk capital. His showing is poor whether it is expressed in terms of his share of reported corporate earnings or in terms of what he has left from any dividends he receives after personal income taxes thereon—his take-home pay.

No other important group in the community has been squeezed as much as has the investor, and this includes the furnisher of risk capital as well as the investor in bonds and other dollar contracts. One very clear evidence of this squeezing is seen in the continuing difficulty of raising new money for business expansion through the issue of common stock—and the existing layer of risk capital in many cases has been thinned by the issue of senior contractual securities to the point at which new common stock money is badly needed.

An important aspect of the present situation is that corporate net earnings as currently reported are generally overstated to a significant degree, particularly from the standpoint of the use of such figures for the purpose of measuring the relative economic positions of those furnishing funds and those furnishing personal services.

The accountant records cost in terms of the dollars shown by the invoices and other underlying documents at the time the cost is incurred. Thereafter he absorbs this recorded cost into operating charges and ultimately into expense or cost of revenue. Occasionally, he adjusts recorded costs downward to reflect declining prices, before final disposition of the commodities or other cost factors involved, but as a rule he does not make adjustments of recorded data to reflect advancing prices.

This limitation of conventional accounting is not a serious matter in periods of reasonably stable prices, but it is serious, in my judgment, in a period such as we are now experiencing.

In the corporate income statements of 1948, for example, total revenues or receipts from customers are being shown in 1948 dollars, although not all in year-end dollars. Similarly, labor costs and other charges for current services, deducted from revenues in determining net earnings, are shown roughly in terms of 1948 dollars. But certain other costs, notably depreciation, are in many cases being deducted in terms of plant expenditures made when the construction dollar was worth two or three times what it is now. The result is overstatement of real earnings, in some cases significantly.

It must not be forgotten that although in many industrial companies the reported depreciation cost figures is not a large fraction of total expenses it may be an important figure when compared with net income.

In my judgment the change in the value of the dollar has been so marked, and return to an earlier dollar has become so unlikely—I am sticking my neck out there a little, but I believe that very firmly—as to warrant changes in accounting procedure to meet the situation.

George D. Bailey, partner, Touche, Niven, Bailey & Smart, accountants

Mr. BAILEY. "Why have American corporations so generously overstated their profits during the last few years?"

I want to say that that is an economist's overstatement, if it exists. It is his definition of what constitutes profits and not either the accounting definition or the businessman's definition.

The principal reason is probably that accounting is a conservative and conventional art and accountants are slow to adopt their methods to new conditions and new problems. Accountants are not used to taking into account the permanent changes in the price level. Accountants have been criticized for not developing some scheme to meet this inflationary problem. The plain fact is that accountants are conservative enough so that they want to know where they are going, if they give up the old conventions they had been using for many years.

The economic claims on corporate profits as reported, or what I have called the economic restrictions, have importantly changed the significance of corporate profits as reported and the amount that has to be invested because of the new price level, if the price level still is maintained, has to stay in the investment and can never get to the stockholders. Nor, in fact, can such restricted profits be used for anything else but working capital and inventories and tools. These two restrictions are only part of the economic restrictions. The amount of capital which must be tied up in every other asset of the corporation is also increased, and thus there are needs for additional working capital beyond those for inventory and plant. Those needs must be satisfied from profits if a corporation is to live and keep healthy. Those needs are just as real with small companies who have no means of getting outside capital as they are for large companies who may, even though they should not, get additional capital at the expense of diluting ownership of present stockholders.

Inventory Profits and Inventory Reserves

Generally speaking, accountants and bookkeepers, in arriving at the profits of a corporation, disregard fluctuations in the value of the domestic currency. A consequence of this practice is that in periods of significantly rising prices, reported profits, like other incomes, tend to show extraordinary dollar gains. At such times, costs, calculated on the book values of yesterday, fall short of the amounts needed to provide the physical replacement of inventory and plant used up in current production. Conversely, in periods of rapidly falling prices, as in the early 1930's, profits expressed in dollars tend to be understated, and operating losses, not uncommon at such times, tend to be magnified.

The United States Department of Commerce estimates the profit distortion resulting from changes in inventory valuation at upward of 5 billion dollars in each of the years 1946 and 1947. That is to say, had the corporations charged the same sales prices that they did charge in 1947, but had they universally followed the practice of charging to expense the amounts needed to replace the physical volume of inventory used up, corporate "profits" would have been 5.1 billion dollars less than they were.

Under the impetus of rapidly rising prices, the valuation of inventories by the "last in, first out" method has gained acceptance as a device narrowing the differences between the cost and sales dollars.

Other companies, which do not use LIFO, have set aside special resources from profits upon which taxes were paid. Whether inventory appreciation is properly labeled "profit" and taxed as such appears a matter upon which opinions differ among the several witnesses. The hearings developed, however, that these "paper" gains are not available for disbursement in cash without contraction of the scale of a company's operations while the sharp rise in general prices continues.

Prof. Sumner H. Slichter, economist, Harvard University

Professor SLICHTER. In the year 1946 profits were overstated by 5 billion dollars because of failure to deduct the rise in the cost of replacing inventories. The estimate is that of the Department of Commerce. In 1947, failure to deduct the rise in the cost of replacing inventories caused profits to be overstated by 5.1 billion dollars. In the first two quarters of 1948 the overstatement, for this reason, has been running at the rate of about 3.9 billion dollars. For the year as a whole, the overstatement because the corporations have counted the rise in the cost of replacing inventories as profits, will be about 3 billion dollars.[12]

Some firms do not charge increases in the cost of replacing inventories against profits because they assume that the rise in prices creates inventory gains. The fact that the cost of replacing inventories has risen does not necessarily mean that the firm will be able to recover the cost in higher prices for finished goods. It may or it may not. Even if the firm is able to raise its selling prices sufficiently to offset the cost of replacing inventories, there is no net addition to profits. There is simply enough additional income to offset the higher replacement cost of inventories.

The way in which failure to charge increases in the cost of replacing inventories against profits causes the statement of profits to be inflated can be made plain by a simple illustration. Let us assume that an enterprise makes no operating profit at all. Let us assume, however, that there is an advance in the price of raw materials so that there is a rise of $100,000 in the cost of replacing the inventories consumed during the period. This increase in the cost of replacing inventories does not, of course, mean that the enterprise will be able to raise its selling price sufficiently to recover this additional cost. Perhaps it can, and perhaps it cannot. Let us assume that the enterprise is able to raise its selling prices by exactly enough to offset the rise in the cost of replacing its inventories. As most corporations report profits today—although the corporate income law does not require it—this firm would not charge the rise in the cost of replacing inventories against the gain of $100,000 from the rise in its selling prices. The management would report a profit of $100,000. It is obvious that this report would be misleading to its stockholders, its employees, and its customers, because the $100,000 is not available to pay dividends, to increase wages, or to reduce prices. It is needed in order to enable the enterprise to maintain the same physical volume of inventories—that is, to the volume required by its current rate of operations. If the enterprise were to distribute all or part of the $100,000 in dividends, for example, it would really be making a dis-

[12] See appendix A, table XVI, for tabulation on overstatement of profits.

tribution of capital because it would be reducing its capacity to produce. Hence it would be compelled either to curtail operations or to borrow in order to maintain its inventories and its capacity to produce.

George D. Bailey, partner, Touche, Niven, Bailey & Smart, accountants

Mr. BAILEY. While we are talking about profit and this business of economic restrictions on profits, I would like to move over a moment to this Department of Commerce figure of $5,000,000,000 in relation to 1947 corporate income. The Department has been quite aware of this problem, that profits reported by corporations are not profits determined by inflationary prices. It was pointed out for the last several years that there is an economic restriction on those profits. The figures for 1947, for instance, in round amounts are reported to be some $18,000,000,000, and then it pointed out that $5,000,000,000 was necessary as an inventory adjustment. There has been some misunderstanding about this figure. This does not mean that business made $5,000,000,000 more profit as a result of the advancing trend of prices than it would have made on the stable price level. That, I think, you should have clearly in mind. In many cases, profits do not include a specific attempt to include the replacement cost. But this $5,000,000,000 does mean that of the $20,000,000,000 which corporations have reported for 1947, or $18,000,000,000, there is an economic restriction on $5,000,000,000 of that profit which has had to be reinvested in inventories to maintain the same number of individual items.

So that of that $18,000,000,000 profit, the report of the Department of Commerce figure is that they have had to save out $5,000,000,000 of that profit because it cost us $5,000,000,000 more to carry the inventories than it did at the beginning of the year.

Not all companies have followed the accounting conventions on inventories that I have indicated, that is, the first out or average that I have talked about. Some have accepted a convention well recognized and accepted, dealing with inventories on what is called a LIFO basis. This is a little repetitious, but it may be worth while. This, to a certain extent, considers that the last goods acquired are those that are sold first, and thus more closely relates costs to current prices. This does incorporate in the accounts some of the economic restriction referred to, since it continues to carry inventories at an old level of prices instead of current inflated prices. While there is a very substantial number of companies who follow this convention, particularly where inventories are along in process, there is a comparatively small percentage of the total companies; also, techniques of calculating prices under this method vary considerably, mostly because of the basic dates on which the calculations were first started. The fact that not more companies follow this procedure is an interesting phenomenon which is due, I think, in part, to the fact that most inventories have a fairly quick turn-over and mark-ups are planned with relation to cost; in part to the attitude of the Bureau of Internal Revenue, which was not liberalized until recently; in part to the dislike of starting such a plan on current price levels; and in part to general inertia in changing the fundamental accounting principles for the individual companies. The importance of this point from your com-

mittee standpoint is that in comparing individual companies you must be alert to the problem of whether inventories are calculated on a LIFO basis or not, and that you may want to consider a further liberalizing of the tax laws with respect to this point. The great majority of the companies do not follow this LIFO method and therefore have an economic restriction upon their profits for reinvestment in inventory. The effect of the difference may be indicated by the figures presented by two of our major department store groups who have carefully calculated the difference in inventory amounts between the first-in. first-out basis and the LIFO basis, had that been established at January 31, 1941. That arises from this attempt to have it allowed, and having it disallowed, and now they have gone back to recalculate it. One of those groups reported that the inventory would have been $12,000,000, or 25 percent, lower under LIFO, and that the difference in profit for each of the last 2 years would have been $1,700,000 and $2,400,000, respectively. The other group reported a reduction in inventories of something over $12,000,000, or about 33⅓ percent, and a reduction in profit for the last 2 years of $1,700,000 and $1,000,000, respectively.

Now, please understand those are calculations of what would have been the effect of the LIFO if it had been allowed. It makes quite a lot of difference in comparing the results of one company with another, to know whether they are on the LIFO basis or whether they are not.

William A. Paton, professor of accounting, University of Michigan

Mr. PATON. I want to mention the problem in connection with inventories. It is the same in character but to my mind less serious than the depreciation problem that I mentioned, because of the relatively short time the particular batch of merchandise or materials remains in the business. Of course, where there is a sharp and sustained advance in material costs, and costs are absorbed as charges to revenues on the assumption of a first-in, first-out flow, it is fairly obvious that a portion of the reported net earnings period by period will represent funds needed to provide the increased number of dollars that must be devoted to replenishing the same old stock of goods, and will in no sense constitute a basis for dividend distributions.

Harold Vance, chairman of the board and president, the Studebaker Corp.

Senator FLANDERS. Am I right in supposing that the other factor on which it has been testified that profits are overstated—namely, the increased sums which have to be put into inventory due to the increased costs—am I right in believing that that does not affect your industry as much as it does some other, in that you have a very fast turn-over in inventory, so that——

Mr. VANCE. Yes, sir; we turn over our entire inventory roughly every 6 weeks.

Senator FLANDERS. So that your inventory in and your inventory out is really practically on current costs all of the time?

Mr. VANCE. That is correct; yes, sir.

Senator FLANDERS. Nevertheless, even the cost of carrying it for that short time has risen, and it is a part of your increased cost of doing business?

Mr. VANCE. Yes, sir.

Senator FLANDERS. And it is a part of your requirement for increased working capital of which you spoke?

Mr. VANCE. Our inventories are up greatly, but the rate of turnover of inventory has not lengthened materially from what it was prewar.

Robert Montgomery, director and secretary, American Woolen Mills

Mr. MONTGOMERY. Between the taking of the orders and completion of delivery a period of 6 to 8 months elapses. This long period between the booking of orders and delivery makes it necessary for us to purchase wool and other supplies well in advance of use and to take the risk of changes in the price of wool and other supplies and also increases in wages. The enormous inventories we must carry constitute a risk that, in the past, has often resulted in heavy losses to us after periods of inflation.

In recent years the industry in this country has consumed over 1,000,000,000 pounds of wool each year. Domestic production of wool is running around 300,000,000 pounds, leaving at least 700,000,000 pounds that must be imported, if our present consumption continues. Moreover, there are certain fabrics that of necessity must be made from foreign wools, such as bleached white, pastel shades, and so forth. Due to the length of time that it takes to obtain wool from abroad, a large investment must be made considerably in advance of manufacture in any particular season.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. It has been claimed by representatives of industry and business, and also claimed again the other day by Dr. Sumner Slichter, that profits are not as high today as the dollar figures indicate them to be. This they say is true because a large amount of corporate profits are really fictitious profits secured through inventory adjustments. This is just an argument devised by management and business representatives in an attempt to explain away the present high level of corporate profits. In the judgment of the CIO, profits are profits regardless of the source from which they are derived. Inventory profits are money and the money can be used by the corporation for whatever purpose they see fit.

Many corporations have shifted their accounting practices so that they no longer reflect inventory profits. This has been done through the adoption of the LIFO method of accounting. On the other hand, corporations that have not adopted LIFO have a tendency to understate the values of their inventories and in this way discount inventory profits. If inventory profits are not to be considered real profits, what are they to be considered? In the light of the current economic situation we must consider that profits are profits regardless of how they are derived.

Dwight B. Billings, comptroller and assistant treasurer, Pacific Mills

Mr. BILLINGS. In the textile industry, it is necessary to carry large inventories and to have a substantial investment in equipment. In a period of rising prices, there is a speculative profit in the inventory because a portion of this inventory is ultimately sold at higher selling prices. That is why a company not on LIFO shows more apparent profit than a company employing this method.

It must be remembered, however, that this speculative profit must be reinvested in raw materials now at higher levels. The published profits, therefore, are overstated, although it is difficult to say by how much.

If this speculative profit, which must later be invested in higher raw materials, is paid out either to its stockholders or to its employees, it is obvious that the company will not have sufficient funds to buy an equal quantity at the new higher prices.

Watching with alarm increasing raw material prices, the company, which is not on LIFO, started a reserve for contingencies in 1941 and has added to it as raw material prices have risen. This reserve approximates the amount of profit which was necessary to invest in future raw material inventories at higher costs and is an approximation of the overstatement of published profits due to the inventory appreciation.

This reserve has been set up after taxes and is no part of our cost of goods. We are not unmindful of the possibility of sharply lower values, and if confronted with this problem, will charge such inventory losses to this reserve. If by chance it is not needed, it will be credited to earned surplus.

Russ Nixon, United Electrical Radio and Machine Workers of America (CIO)

Mr. NIXON. The simple fact is that [inventory gains] are profits. They are an increase in the wealth of owners which arise due to inflationary prices. They are additions to the value of property owned by the corporation whether or not they are in immediate liquid form for distribution. That inventory value gains might require special financing to achieve distributable status does not change the fact that profit is realized. Suggesting that the test of profit is for added value to be in a form immediately ready for distribution, is to set up a unique and unwarranted single test of profit. This seems particularly unwarranted when only 35 percent of net profits as reported are being actually distributed to stockholders at the present time.

The company's [General Electric's] price policies have resulted in increased profits on its inventories. But the company has set up a huge reserve totaling over $94,000,000 out of profits to cover "possible price declines," "unrealized intercompany profits," and "possible losses on inactive and excess stocks." Some $33,000,000 of these were set up in 1947.

It should be noted that while the company report to its stockholders indicates that such a reserve has been set up, the amount is not set forth, as it is in the company's report to the United States Securities and Exchange Commission.

Donald Montgomery, United Automobile Workers, CIO

Mr. MONTGOMERY. Corporations are naturally embarrassed by the size of their profits or, more accurately, by the public attention which has been attracted to profits as a result of their current size. Financial journals, in fact, have referred to profits as "embarrassingly large."

The result, naturally enough, is that various devices are invented to minimize the size of profits.

Earlier in the course of these hearings, Prof. Sumner Slichter of Harvard University testified to the contrary. He claimed that American corporations have "generally overstated their profits during the last few years." He attributed this alleged overstatement, in part, to "the fact that business managements take an understandable pride in showing large earnings."

With all due respect to Professor Slichter, this statement hardly checks with either human nature or our experience. It is unlikely, to say the least, that corporations embarrassed by the size of their earnings would incur further embarrassment by overstating them. Moreover, the recent crop of corporate reports stands in direct contradiction to Professor Slichter's statement. We have occasion to examine hundreds of financial reports each year in connection with negotiations. Far from exaggerating profits, there is hardly a device developed by accounting ingenuity to minimize profits which does not appear in the reports we see.

Among the most common are special inventory reserves and deductions for "additional depreciation" and "extraordinary obsolescence." But these by no means exhaust the gamut. There are charges of capital costs to current operations. There are reserves for unspecified contingencies and reserves for losses from foreign operations, as well as other varieties of reserves which the accounting profession condemns and which the United States Treasury refuses to recognize for tax purposes.

If experience with wartime reserves is any guide, these new reserves will, at some later date, be quietly slipped into surplus without ever having appeared as profit in the income statement.

Many of the devices used to minimize profits are too unsavory for the accounting profession to endorse despite the financial dependence of its members upon the corporations.

As Prof. Seymour Harris noted in these hearings, the accountants are "under pressure from business." The accounting journals these days are full of the reflections of that pressure as the accountants debate among themselves how much ground they can yield and still maintain their self-respect.

The staggering profit totals reported by the Department of Commerce hardly result from "overstatement" by the corporations, Professor Slichter to the contrary notwithstanding. Indeed, in the face of the varied and ingenious devices used by industry to conceal profits, there can be little doubt that the Department of Commerce seriously understates the profit total. The personnel of the Office of Business Economics would probably have to be multiplied several times over if it undertook to ferret out all profits from their multifarious hiding places in financial reports which are designed more to mislead than to inform.

If profits are "overstated" it is in spite of rather than because of the corporations. Professor Slichter, however, feels that the corporations are entitled to more help in minimizing profits than their accountants have been willing to provide. With one bold stroke he slices 16.4 billion dollars off the profits of the past 3 years.

The legerdemain by which these profits are caused to vanish involves first the deduction of so-called "inventory" profits and secondly the deduction of additional depreciation based on present replacement costs.

Before examining the fallacies involved in making these deductions, it should be noted that their equivalents are in use by many corporations already to minimize profits. Professor Slichter's subtractions therefore further reduce a total that has already, to some extent, been "adjusted" in accordance with his ideas.

"Inventory profits" are not now reported by corporations using the LIFO method and there are still other corporations that deduct "inventory reserves" before reporting net income. Similarly, there are large numbers of corporations which report profits after additional deductions for depreciation, over and above those the Internal Revenue Bureau allows.

It should also be noted that some corporations are inconsistent as to simultaneously set up inventory reserves and to compute depreciation on the basis of current replacement costs. The first, of course, assumes a fall in the price level, while the second assumes that prices will, at least, remain at their present levels. Corporate zeal to minimize profits is so great, despite Professor Slichter, that logical consistency is thrown to the winds.

With regard to Professor Slichter's argument on inventory profits, we think it best to let Harvard answer Harvard. The September 1948 issue of the Harvard Business Review included an article by Charles A. Bliss, professor of business administration, Harvard Business School, which definitively establishes that inventory profits are no different from other profits in that they result from buying cheap and selling dear. Professor Bliss shows conclusively that an inventory profit does not arise, as business would have us believe, merely from rising prices of materials. He proves that an inventory profit can appear on the books of a company only after that company has made a business decision to raise its own prices.

There is nothing automatic about inventory profits. They result from a decision of the management to price its products at higher levels because the prices of materials in their inventory have gone up, even though the cost of those materials is just what it was when they were purchased at the earlier price levels. If management believes it should not be taxed on inventory profits, it has a very simple and entirely legal method for avoiding such taxes. It can continue to price its products on the basis of the actual cost of its materials. There will be no inventory profits. There will be no taxes on inventory profits.

I am sure this committee, in reporting to the Congress, will deal forthrightly with this attempt of some witnesses to make the public believe that inventory profits are forced upon business and that business can't help earning inventory profits in a time of rising prices and that therefore it is unfair to tax those profits.

Professor Harris, also of Harvard, apparently shares Professor Bliss' doubts about the validity of deducting inventory profits. Without dwelling further on the matter, it is sufficient to note that among the Harvard men who know accounting best, it's two to one against deducting inventory profits.

Senator FLANDERS. One of the things that I believe we had clearly in our minds as a result of the discussions by Professors Slichter and Harris, and Mr. Paton who is a member of the committee on accounting procedures, whose report you read, and Mr. Bailey, past president of the American Institute of Accountants, was this: With the possible exception of Mr. Harris, there was no question in the minds of any of those four men about the fact that increasing cost of inventories required more and more money to be kept in the business.

We did not discuss with any of them this question of making, setting aside, reserves for drop in inventory. We confined ourselves to the contention that Sumner Slichter raised that firms actually had to retain more money in the business to carry higher and higher cost inventories; that under ordinary accounting procedures those sums which had to be put back in to keep up the inventories were classed as profit and that the Government taxed them on those profits.

There was no difference of opinion whatsoever among the three men I mentioned as to the fact that that money had to be retained in the business, was not available for distribution, and was taxed as a profit.

I do not find that you have met that universal statement of actual business necessity in your discussion.

Mr. MONTGOMERY. Sumner Slichter's proposal, as made to you, as we have read it and as it came out and went to the public is that the provision of this extra capital that will be required as inventories rise in value, is a proper charge before you arrive at income and that profits are not as high as they seem to be because this charge should have been made.

I do not know how Paton stands on that, or Bailey. I do know the accountants as a whole do disagree with Slichter and so does Harris and so does Bliss.

Nobody can deny that if you have inflated values you are going to require more working capital in the form of inventory and Professor Bliss faces up to that and says either you convert cash to inventory or if you have to raise additional capital to carry the inventory then that is what you do and the only proper charge against income is the service that you pay on that additional capital.

Senator FLANDERS. That is aside from the question on which both Mr. Paton who took one side of the accountants' position and Mr. Bailey who took the other agreed on. They both agreed that a considerable part, varying with different businesses, of reported profits, were not available for distribution under any circumstances simply because they had to be tied up in inventories which increased in cost.

The difference in viewpoint between them was that Mr. Paton, taking the conservative view, felt that the methods of bookkeeping should not be changed, but that the significance of those features should be pointed out in footnotes. While Mr. Bailey felt that accounting procedure should have some change. So that was the difference between them, but neither of them denied nor did Mr. Harris address himself, so far as my recollection goes, to the point of

proving that there was not a considerable part of reported profits which could not be distributed.

Mr. MONTGOMERY. I think there are two questions. I talked about one and I will talk now about the other. It seems to me that both Paton and Bailey, however they handle the accounts, as you state their case, I assume that if more capital is necessary to carry inventory in a time where, because of increased prices it must be done, then business should look to profits for that increase in capital. That is the point where we disagree with them.

We do not believe that the consumers, the profit that you take in must necessarily provide the increased capital which that business is going to need. We used to think that investors were the source of increased capital and that seems to have become old-fashioned.

Senator FLANDERS. You would suggest that under these conditions a business should go into the capital market to raise funds for carrying inflated price inventory? Is that your suggestion?

Mr. MONTGOMERY. That is right.

From what I understand, the life-insurance companies are looking for some one to borrow their money, because there is no place to put it.

Senator FLANDERS. I wonder if they would consider that a safe investment?

Mr. MONTGOMERY. The proposal these men make is that the taxpayers produce it.

Senator FLANDERS. No; that proposal was not made except that attention was called to the fact that under the LIFO method the Government does, under certain circumstances, permit the use of the last-in first-out process and in that case it does not tax these undistributable profits.

Mr. MONTGOMERY. I know they do. I think that is very unfortunate that they were pressured into doing that. I think that was a great mistake.

Senator FLANDERS. I just want to make clear for the record that there is a considerable percentage of reported profits which are undistributable.

Mr. MONTGOMERY. Undistributable if you assume that they have to supply the additional capital that the company needs.

Senator FLANDERS. They are still undistributable.

Mr. MONTGOMERY. Not if they go and raise capital to carry their inventories. Certainly you can get a bank loan these days and it is not unheard of. There used to be commercial banking in this country and I think there still is.

Senator FLANDERS. These particular conditions are, however, of a different sort. You would be in a position in the case under any ordinary business thinking of getting a capital issue for the sake of paying out all of your profits or a larger percentage of your profits. I doubt if that would be an attractive issue.

Mr. MONTGOMERY. What the corporations are saying too is that we have made enormous profits during this period by promoting inflation. We got price control killed in 1946 and now we want to keep all those profits because our own inflation has made us need more inflation.

I do not know where that can end; it is a fine joy ride. The point I want to make very clear now is that I hope this committee, reporting to Congress, will make clear that these profits have not been over-

stated for the reasons given by Sumner Slichter, and there is official opinion against it.

Senator FLANDERS. I think Sumner Slichter would be willing to put this statement in his presentation; that it is a general assumption that profits can all be distributed but that assumption is false and some of them cannot be; that is another way of overstatement from his standpoint.

Clarence Francis, chairman of the board, General Foods Corp.

Mr. FRANCIS. General Foods has not set aside any such special allowances or reserves. In no cases have any reserves or allowances been made which would not be allowed for tax purposes. No such reserves or allowances have been taken into our product costs. The only reserves entering into calculation of our net profits are the normal and approved reserves such as of depreciation, bad debt, and so forth.

Our balance sheet shows a reserve for contingencies. It is an appropriation of surplus. This reserve serves as a warning to stockholders and investors to the potential danger in our inventories due to very high raw material prices.

Howard C. Greer, executive vice president, Kingan & Co.

Mr. GREER. Although some of these companies are known to have employed the last-in-first-out method of valuation as to at least part of their inventories, it would appear from the consolidated balance sheets that to some extent market values must have become a substantial factor in inventory valuation. The combined inventories of these companies showed a book value of $463,000,000 at the end of 1947, as compared with a book value of $240,000,000 at the end of 1940. This means that whatever profits were realized in the interim were reinvested either in more or higher-priced inventories to the extent of some $223,000,000.

This alone is more than 50 percent of the combined profits of these 14 companies for the 7-year period 1941 to 1947 inclusive. In other words, more than half the stated profit has produced no cash funds available for distribution, but has merely been put back into the business to finance a higher-priced stock in trade.

DEPRECIATION ON ORIGINAL VERSUS REPLACEMENT COST BASIS

From the testimony before the subcommittee, it appears that there is no general agreement by competent authorities regarding the proper procedure for arriving at a figure for net profits under conditions of sharp increases in construction and equipment costs. In part, the differences arise from different objectives; accounting is primarily a recording and reporting science, whereas economics deals with real costs and real income. The material in this section, which overlaps somewhat the discussion in the prior section on inventories, deals with the problem and the pros and cons of setting up greater reserves for the replacement of plant and equipment than those permitted for tax purposes by the Internal Revenue Bureau. Wherever these greater reserves have been set up to cover current replacement costs, they of

course affect profits shown in corporation statements. It was generally reported by witnesses that reserve adjustments, when used, should be clearly set forth and their purposes explained in the profits statements of corporations.

Prof. Sumner H. Slichter, economist, Harvard University

Professor SLICHTER. Corporate profits are also overstated because the rise in the cost of replacing plant and equipment is treated as profit.[13] It is difficult to estimate the precise amount of this overstatement, but it is substantial. Part of the difficulty arises from lack of precise information concerning the rise in replacement costs during the last 8 years. Of course, one cannot know accurately today what will be the cost of replacing plant and equipment which is partly worn out today, but which may not have to be replaced until 5 or 10 years hence. There can be no doubt, however, that the cost of replacing plant and equipment has risen substantially. The average wholesale price of finished goods in 1947 was 79 percent above 1940. Today finished goods on the average are selling about 100 percent above 1940.

An enterprise which expects to continue in business must obviously replace its plant and equipment as they wear out. If it distributes in the form of dividends, higher wages, or lower prices, income needed to replace plant and equipment, the enterprise is, in effect, living off its capital, because it will have to bring in new capital to maintain its productive capacity. In other words, only after management has set aside enough of current income to maintain the productive capacity of the enterprise does it have funds which may be properly regarded as available for dividends, higher wages, or lower prices.

Despite the large rise in the prices of finished goods during recent years, the depreciation charges of American corporations have risen very little. In 1947 they were only 20 percent above 1940—4.6 billion dollars as compared with 3.5 billion dollars in 1940. In 1946, depreciation charges of American corporations were 4.3 billion dollars. Since one does not know the ultimate cost of replacing present plant and equipment, one can only make a rough estimate as to what present depreciation charges ought to be. Possibly the movement of prices during the next few years will be downward—though I am skeptical that this will be the case for most finished goods, because wages, as measured by hourly earnings, have more than doubled since 1940, and, therefore, there has been only a moderate rise in output per man-hour. Certainly it is conservative to assume that the wholesale price level for finished goods, which is now 100 percent above the war, will average at least 60 percent above prewar in the foreseeable future. Hence, if one may assume that depreciation charges of American corporations were approximately correct in 1940, they should be at least 60 percent larger today. This assumes that there has been no appreciable increase in the size of the plant to be depreciated although some increase in the size of the plant has occurred. If depreciation charges had been 60 percent above 1940, they would have been about 5.6 billion dollars in both 1946 and 1947 instead of 4.3 billion in 1946 and 4.6 billion, as they were in 1947.

In other words, failure to charge adequate depreciation led corporate profits to be overstated by about 1.3 billion dollars in 1946 and 1 billion

[13] See appendix A, table XVI, for tabulation of overstatement of profits.

dollars in 1947. There is no evidence that many corporations have corrected this understatement of their depreciation charges. Hence, the understatement for 1948 will probably be no less than in 1947.

George D. Bailey, partner, Touche, Niven, Bailey & Smart, accountants

Mr. BAILEY. Now, as to plant facilities, the economic restriction on earnings because of changes in the price levels of plant facilities and the requirements for replacement which are not taken care of by depreciation on cost is also serious, and the necessary restriction on current earnings for many companies is important. Depreciation under current accounting conventions is figured on cost—but on costs, in many cases, that are of an entirely different generation. In spite of the tremendous additions that have been made to plant facilities during the last 3 years, the great percentage of plant facilities shown by the financial statements of American business are costs of the prewar era, and, in many cases, of a long time before the war. If depreciation costs are figured in in determining current selling prices only at old prices, then prices, too, would be fixed without regard to current cost.

There is in this area a twofold problem—one, which is the accumulation of funds to take care of the price rise that has already taken place, with respect to which it is seldom possible to provide; and the other, which is the consideration of the effect on profits for a year were depreciation to be figured on the replacement cost. Both of these things are very real. In my experience as an accountant I have seen the cash reserves of many companies eliminated and borrowings required because the necessary replacements of plant had to be made at current high prices. And that has happened many, many times in the last 2 or 3 years. They were companies which had built up very substantial cash reserves to have money for replacement, who found that they not only were not sufficient but that they were forced into borrowing large sums of money to complete their replacement or raise additional capital in other ways. It is not an academic thing. It has just been felt all through our business structure. The last year or two have seen many companies change from a position of large cash reserves to one of large borrowings, simply because of this change in the price level for tools required for replacement and mandatory expansion.

I have here with me a recent study of the condition of 14 of our largest American manufacturing companies, which estimates the difference between the current book values for plants and the 1947 replacement price to be some 6 to 7 billion dollars, or 50 to 60 percent. That is a very important figure. In other words, the depreciation on cost will fail to provide for replacement costs by 6 to 7 billion dollars, and there is already an economic restriction on accumulated earnings for perhaps half of that amount.

Senator FLANDERS. Those figures might be shaded somewhat on the basis of replacement of equal production rather than replacement of the same number of units?

Mr. BAILEY. That is very true. That is a weakness in an index figure—one of the reasons the accountants have had a serious problem in substituting something else for this depreciation on cost. The

technological improvement in facilities makes quite a little difference. You just cannot take index figures. But that is why I have used the replacement problem throughout rather than the change in the price level. The index figure gives you an indicative amount, and it gives you an idea of the problem, but it just does not give you the answer.

Now, on depreciation for the year 1947, the difference between depreciation for the year on the two bases is something over $250,000,000, or, again, 50 to 60 percent. Thus, for those 14 companies there was an economic restriction on last year's earnings for this item, of $250,000,000. Some of those companies did reflect within the accounts some measure of this difference, but most of them did not. Those that did, the auditors had to say that the procedure was not in accordance with generally accepted accounting principles.

It is not possible to generalize and say that the depreciation should be increased 50 percent or 100 percent on an average, or to say that the difference between cost and replacement is 50 to 60 percent on an average. This problem differs very greatly with different industries, and in many industries it differs between companies; but the figures do show that the economic restriction on earnings is important. I would like to read this quotation from Business Week:

> Fundamentally, we are inclined to sympathize with the attitude of Big Steel and the other companies that want to allow for extra depreciation before they give a figure for net income. A businessman thinks of himself as a going concern. And profit isn't profit to him if he has to plow it back just to keep his plant intact. But we can see at least two things that a businessman should consider carefully before he whittles down his income figures to allow for inflated plant costs.
>
> First, there is no systematic or generally recognized way of doing it. Nobody knows what replacement costs will be in the future. Hence, any allowance now has to be arbitrary. And when you start making arbitrary adjustments you open the door to all sorts of trouble. The financial statement becomes less and less an unbiased report of what happened during the year and more and more a picture of what the company officers want the stockholders to think happened.
>
> Second, as soon as you abandon the strict rules of accounting you lay yourself open to a charge of monkeying with the books—no matter how good your intentions are. And that can do you a lot more harm than the misunderstandings that may arise from presenting the figures just the way they come out. Surveys show that there already is a widespread suspicion of corporate reports. If that's reinforced by a rumor that companies generally are doctoring their accounts, no amount of explaining will undo the damage.

That is basically the reason why the American Institute of Accountants took the position that this was not the time to change the basic accounting convention of depreciation on cost.[14]

William A. Paton, professor of accounting, University of Michigan

Mr. PATON. In my judgment the change in the value of the dollar has been so marked, and return to an earlier dollar has become so unlikely, as to warrant changes in accounting procedure to meet the situation. The remedy, as I see it, is systematic revision of recorded costs to bring them into line with present prices in all cases in which the recorded data are so far out of line as to render income statements based thereon inadequate and misleading. Many accountants would not agree with this recommendation, but I believe all accountants recognize that present-day earning reports are subject to serious limitations and should be read with due recognition of their shortcomings.

[14] See appendix F for bulletin of the American Institute of Accountants, Depreciation and High Costs.

There has been, as might be expected, a great deal of controversy in accounting and business circles regarding this matter. As I see it, the really important point involved is the definition of cost. To me cost is not just a nominal term but a measure of economic sacrifice or force incurred. Actual, significant cost is an economic quantum, not just a monetary expression. If this is a reasonable view it follows, for example, that if a building was built 10 years ago at a cost of $1,000,000 in terms of 1938 money, and the same building would now cost $2,500,000, in terms of 1948 money, it is no longer reasonable to describe the cost of the building as $1,000,000 in making a financial statement that purports to be set up in 1948 dollars, and that the reader is expected to interpret in terms of 1948 dollars. And similarly it is no longer reasonable to describe the portion of the cost of the building deducted from revenues as depreciation of 1948 as a fraction of $1,000,000.

Enders McC. Voorhees, United States Steel Corp.

Mr. VOORHEES. The next largest cost, amounting to $106,000,000 for 9 months of 1948, is wear and exhaustion of facilities. Of that amount 39.7 million dollars is not presently deductible for Federal income-tax purposes. Since the propriety of this cost and the manner of its measurement are the subject of a growing interest and controversy, it is appropriate to discuss it in some detail.

Wear and exhaustion, or depreciation, represents the extent to which plants and facilities have been worn out or have lost economic usefulness in the accounting period. Building plants and maintaining facilities are just as much expenditures that are necessary to doing business as buying the materials to activate those plants. The only significant distinction is that whereas the materials are quickly consumed and quickly replaced, a facility is used up more slowly and hence is less quickly replaced. The problem is thus first one of assigning to each accounting period the portion of the facility's total physical or economic usefulness that has been used up in that period; and it is, second, the putting of a dollar figure—a cost figure—against that experienced diminution in the facility's total usefulness.

The first step is a matter of engineering and economic estimate because no one knows for sure what is going to happen in the future. Nevertheless, a number of systems have been worked out on the basis of experience and have been deemed acceptable for distributing between accounting periods the physical wear and usage of facilities. This brings us to the second matter of placing a dollar figure on the physical cost for the purpose of combining it with other costs and receipts to determine the over-all income or loss experienced in the accounting period.

The easiest way of doing this is to refer back to the number of dollars spent for the facility, that is, to the original cost. Those dollars are then distributed over the accounting periods in proportion to the estimated physical consumption of the facilities. The reasoning is that if the facility cost, say, $1,000 in 1937 and one-twentieth of it is used up in each year, then in any subsequent year such as 1947 the value consumed is also one-twentieth, or $50.

This is perfectly valid and no quarrel can be found with it *so long as one very important, but too often forgotten, fact is remembered.* It is, in

the example, that the annual cost is actually 50 *1937* dollars—not necessarily 50 *1947* or any other year's dollars—and that should be emphasized. It is 50 1947 dollars *only if 1937 and 1947 dollars are identical with each other.* If they are different then there is no more validity in the 50 dollars counted in 1947 than in a proposition that because a 20-year facility formerly cost 1,000 American dollars, its present annual usage equals 50 Chinese dollars.

Since the only purpose of dollars is to exchange them for useful goods and services, the similarity or dissimilarity of dollars is measured exclusively by the comparative quantities of such goods for which they are exchangeable. If it takes more dollars to buy the same goods, then the dollar has shrunk and it takes more of them to be the equivalent of any physical thing. Over periods when the buying power of the dollar is substantially stable this consideration is unimportant and errors of cost measuring resulting from adherence to the number of dollars originally expended as the financial basis of depreciation are probably within the errors of engineering estimates upon which that cost is distributed to accounting periods falling within the life of the facility. When, however, the buying power of the dollar is subject to marked change, then a blind adherence to original cost results in gross over- or under-statement of depreciation cost, hence, to gross over- or under-statement of true income, hence to gross over- or under-calculation of income taxes and also to management's gross, if unwitting, self-deception and public misrepresentation. Saddest of all, it can promote a hidden erosion of the Nation's tools of production.

In 1933 the Government adopted an irredeemable paper money standard. The supply of dollars in the form of check deposits and currency outside banks has since then, particularly during the war, been multiplied nearly six times.

Since then the buying power of the dollar has fallen about halfway to zero. This has been reflected in rising construction costs as well as in all other costs. The construction cost index published by Engineering News Record shows that construction costs by the fourth quarter of 1947 had increased 77 percent over 1940 and most recently the increase is nearly 100 percent. United States Steel has been confronted continuously with the necessity of revising upward the amounts necessary to complete projects presently under way. On projects begun since VJ-day such increases over amounts originally authorized total some $146,000,000.

There might be interest in some examples of the increases over initially estimated cost of projects. A Bessemer steel plant, blooming and billet mills in Ohio, estimated at 34.5 million dollars in November 1945, is now estimated at 57 million dollars, or an increase of 65 percent. The corresponding increase in cold reduced sheet capacity in the Chicago district since November 1944 is 57 percent. Increase on cost of a seamless pipe mill since September 1945 is 69 percent.

Our engineers have made studies concerning the increased cost of replacing at present prices equipment purchased before the war. In some instances current prices are 2½ times the prewar prices. For example, they found that the lowest competitive bid received this year to build a blast furnace at our Edgar Thomson works was 110 percent greater than it actually cost us to build an identical furnace in 1941. The increase for a blooming mill in Geneva over a similar

mill's 1943 cost at Homestead was 167 percent. Cost of coke-oven capacity per ton on the basis of actual experience was 173 percent greater than it was in 1939.

The item "Added to cover replacement cost," on United States Steel's income statement is designed to restore realism in the measurement of depreciation cost in the light of the dollar debasement transpiring between the time facilities were originally purchased and current accounting periods.

What is involved is simple recognition of the fact that regardless of the number of dollars in the original transaction that which was actually exchanged for facilities was a given amount of buying power. It is the buying power rather than any particular number of dollars that is therefore to be distributed as depreciation cost over the accounting periods in proportion to the physical wear and waning economic usefulness of the facilities. In accounting terminology, it is equivalent purchasing power that is to be "recovered in depreciation," rather than an equivalent number of dollars. The two will be the same if the buying power of the dollar remains constant; but otherwise the number of dollars in any accounting period, representing the buying power to be recovered, will of course be greater if the buying power of each dollar has declined, and less if it has risen, in the interval.

In 1947 United States Steel recognized that its true wear and exhaustion cost was represented by a greater number of the current "small" dollars than the 87.7 millions of dollars based on prior expenditure of "bigger" dollars. It was found that it took at least 30 percent more of those 1947 "small" dollars to equal the "bigger" dollars of the past. Therefore, as fully disclosed and explained in its annual report, United States Steel recorded its wear and exhaustion cost as 30 percent more than 87.7 million dollars, or as 114 million dollars. This was a step toward stating wear and exhaustion in an amount which will recover in current dollars of diminished buying power the same purchasing power as the original expenditure.

If a business is to continue it is necessary to recover the purchasing power of sums originally invested in tools of production so that the tools may be replaced as they wear out. Therefore the difference between the 87.7 million dollars and the 114 million dollars, or the 26.3 million dollars added to cover replacement cost, was carried as a reserve for replacement of properties. It is a simple truth that to buy similar tools of production takes many more dollars today than formerly; to count as profits, rather than as cost, the added sums required merely to sustain production is to retreat from reality into self-deception. Calling a cost a profit does not make it so.

The 30-percent increase in the provision for wear and exhaustion was determined partly through experienced cost increases and partly through study of construction cost index numbers. Although it is materially less than the experienced cost increase in replacing worn-out facilities, it was deemed appropriate in view of the newness of the application of purchasing power concepts to the costing of wear and exhaustion. The use of index numbers for cost purposes gained recognition early in 1947 in a Tax Court decision in *Hutzler Brothers Company, Petitioner* v. *Commissioner of Internal Revenue, Respondent.* Although this case deals only with costing short-term inventories (stocks of goods), the principles set forth are just as applicable to costing the wear and exhaustion of long-term inventories (machinery, plants, and mines).

While awaiting accounting and tax acceptance, United States Steel believed that it was prudent for it to give recognition to these increased replacement costs rather than to sit idly by and witness the unwitting dissipation of its business should inadequate recording of costs result in insufficient resources to supply the tools required for sustained production.

The continued increase in the cost of goods and facilities during 1948 demonstrated that the 30-percent rate for added depreciation was no longer sufficient to cover the true cost of the property currently consumed. In view of this situation, effective as of January 1, 1948, the additional charge was advanced from 30 to 60 percent of the depreciation based on original cost. Such total added amount for the first 9 months of 1948 was 39.7 million dollars.

It is a very real and very simple fact that corporate understatement in costs of the worth of the tools of production that are consumed in production can mean in the end nothing but hidden and serious erosion of the Nation's tools of production. Yet those tools are vital to the welfare of all of us. They should be expanded, or at the very least, they must be kept intact.

In my opinion the replacement of facilities should be a part of the cost, and that turn-over or that cash should be recovered in the selling price for the people who obtain the product and therefore the service. Now if, on the other hand, you are increasing the volume or bringing in new products, then I think that you are justified in getting new capital, but not on the basis of replacement.

Harold Vance, chairman of the board and president, the Studebaker Corp.

Senator O'MAHONEY. Dr. Slichter has told the committee that corporate profits are grossly overstated by the corporations because they have not adopted some new accounting system, for which neither Professor Slichter nor the accountants who appeared before the committee have been able to present any formula. I am trying to get your opinion upon that matter.

Mr. VANCE. Senator, frankly, I had hoped to avoid that question, because I am in the position of the small-business man from the West who does not pretend to be an economist.

Senator O'MAHONEY. Unfortunately, the members of this committee cannot avoid the question, and while I am not going to try to force you to answer at all, I am sure that we would all appreciate any contribution you can make.

Mr. VANCE. There are many different points of view, sir, from which one may look at depreciation. Our point of view is this: With one single exception, the actual book depreciation which we take currently is slightly less than the depreciation which the Bureau of Internal Revenue allows us. Now, the reason why it is less is because at the time of our reorganization we had an appraisal made of the assets taken over by the new company, and that was in 1933 when current values were low; I mean to say values at what things would sell for at that time; and the result is that the initial values which we put on the books of the new company were substantially less.

Now, we look at depreciation from this point of view: We consider it as a deferred charge; that is to say, it is spreading the cost of equipment over its estimated useful life, and we do not try to anticipate

anywhere from 14 to 40 years ahead what it may cost to replace that equipment. I might say that one reason why we do not try to anticipate what it may cost 14 years hence to replace a machine is that we very seldom replace that machine in kind. Over the period of depreciation, the improvements which the machine-tool builder makes, the new ideas which we develop for better or more efficient manufacturing, more often than not mean that we do not replace the machine with a new one of exactly the same type. Therefore, we make no attempt to determine when the useful life of the machine we install today comes to its end or how much it will cost to replace it.

Senator O'MAHONEY. I can see that you cannot very well do that, and depreciation at best is merely an estimate. There is nothing exact about it, is there?

Mr. VANCE. Yes, sir; I think that there is. I think that I can illustrate my point best in this way: Depreciation in our case is in dollars and cents greatly exceeded by what we call amortization. Now, amortization and depreciation are pretty much the same thing, except in our business amortization applies to what we call tools, not to the machines themselves but the dies and the jigs and fixtures and patterns that are required to produce a certain model, and we know that model has a very definite limitation as to life. Its life is much shorter on the average than the life of a building or a machine tool or a press or anything of that sort. Our experience indicates that the average life of a set of tooling is 2 years. Design, in other words, obsoletes the tooling on the average at the end of that time.

Senator FLANDERS. Does the Bureau of Internal Revenue agree with you on that?

Mr. VANCE. Yes, sir; they do; and so we have a practice of writing off our tooling over a period of 2 years. In other words, we bring out a new model and we spend, as we did the last time, $11,000,000 for tooling, and we write it off at the rate of one twenty-fourth per month, our experience being that that is the average useful life of a set of tooling.

At the time we make the expenditures we capitalize them. When we spent the $11,000,000, we added it to our plant and property account, and then each month we charge to expenses one twenty-fourth of that total in the form of amortization or depreciation, if you will, and credit our plant and property account accordingly. It seems to me quite obviously that is a deferred charge. It is spreading the cost over the estimated useful life of the equipment.

Senator O'MAHONEY. So, while it is being spread over the estimated useful life of the equipment, it is also spread over the cost of the product during that time?

Mr. VANCE. During the whole time, that is correct.

Senator O'MAHONEY. You said the cost of the product. I meant also the price of the product.

Mr. VANCE. That is correct. Suppose, for instance, that in a period of 2 years we produced half a million cars and had spent $10,000,000 for tooling for those cars. By our process of amortization the cost per car is uniform throughout the period, and it is at the rate of $20 a car.

On the contrary, if we had not deferred that charge and not spread it over the period of useful life, if we had charged it off as the expense was incurred, we might have had in that year and would have had

in that, if production was uniform, a $40 charge per car and nothing in the succeeding year.

Senator O'MAHONEY. So that when the cost of the plant or equipment is spread over the estimated useful life of the plant or the equipment, it is also spread over the prices which the customers pay during the period which is selected?

Mr. VANCE. That is quite correct, sir.

Senator O'MAHONEY. So that your customer, in buying your product—and now I speak generally and not of Studebaker alone—is paying to you a sum which will include a sufficient amount to take care of this investment, this capital investment in plant and equipment, is that right?

Mr. VANCE. That is right, sir.

Senator O'MAHONEY. And, of course, by the degree to which productivity is increased, the capacity to make profit upon that is increased also?

Mr. VANCE. As volume increases, the load of the fixed charges including depreciation is less per unit.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. It is claimed by representatives of industry and big business as well as by Dr. Slichter that profits are not as high as they are indicated to be because industry does not charge off all of its actual costs. This has reference to the whole problem of depreciation allowances. It is claimed by these representatives that industry should be permitted to depreciate old property and old equipment at what it would cost to replace such equipment today. The regulations of the Bureau of Internal Revenue permit industry to depreciate the original cost of plant and equipment. It must be understood that there is nothing in the Bureau of Internal Revenue's regulations or in the tax laws that prohibits corporations from depreciating plant and equipment at current costs if they build such plants at current costs. However, if they build such plants at the cost of 5 to 10 years ago, it would be unfair and extremely fallacious to permit them to depreciate these plants at costs other than actual costs. Would industry make this point about depreciating equipment at current-day costs if current-day costs were less than they were 10 years ago? We do not think that industry and their representatives would come before this committee and make such a claim if construction costs were less today than they were 10 years ago. They are making the claim solely in an effort to explain to the public the high levels to which profits have soared. Put another way, what if prices start to decline tomorrow? How would business adjust a depreciation policy to a fluctuating price base? Industry can depreciate its equipment and plant at current-day costs as long as it constructs them at current-day costs.

Dwight B. Billings, controller and assistant treasurer, Pacific Mills

Mr. BILLINGS. Although the replacement of plant extends over a long period, the effect of inflation is exactly the same [as with inventory]. Perhaps an example might illustrate industry's problem.

As you know, the Bureau of Internal Revenue allows a recovery through depreciation of the original cost, let us say $10,000 for a given machine. Suppose the price level at the time a replacement machine is purchased is the same. The $10,000 acquired through depreciation on a tax-free basis is therefore sufficient. Now suppose that the new cost of the machine is $20,000; $10,000 is available from depreciation reserves but an additional $10,000 of new capital must be found.

Unless it is new equity money, it must come from net profits after income taxes. To supply $10,000 of net profit after taxes at the present rates requires the company to earn $16,600 before taxes. Thus to replace the identical machine, it now costs the company $26,000, or an even higher amount if taxes are further increased.

I believe that the Congress should give careful thought to some type of relief from this inequity as this state of affairs can only stimulate industry to keep their old equipment and let their plants run down, thus hurting the stockholder, the employee, and, in the long run, the general public. As this extra cost of replacement is really a charge against profits, here again the published profit statements are overstated.

Charles E. Wilson, president, General Electric Co.

Mr. WILSON. For example, in the prewar period, depreciation constituted 4 to 5 percent of our total costs. In 1948, even though the dollar amount of depreciation has increased from an annual amount of 17 million to one of 36.5 million dollars, depreciation constitutes only 2.6 percent of out total costs. It takes little imagination to foresee what a burden this fixed depreciation charge would be in the event of an appreciable decline in sales volume. Our current margin seems even narrower when we think of the rapidity with which events can happen these days—events wholly or in large part outside the control of management but which can have an important effect on earnings—such things, for example, as strikes, material shortages, freight embargoes, and so forth.

In this connection, it should be noted that under present-day conditions a large percentage of the figures reported as profits are not available for distribution, since a portion of those profits must be used to offset the rise in the cost of replacing inventory and the increased cost of replacing plant and equipment. It is only after we have set aside enough of current income to maintain the productive capacity of the enterprise that our funds may properly be regarded as available for dividends, higher wages, or for lower prices.

Robert Dunlop, president, Sun Oil Co.

Senator FLANDERS. In the matter of replacement of equipment, the point has been brought out at these hearings two or three times that the rational basis on which to reckon the replacement is not in the cost of replacement of units themselves, but of their replacement of equal productive capacity. Are there such improvements in distilling apparatus, for instance, or other elements in your productive equipment, that you would properly recognize these reserves you are setting up from the standpoint of productive capacity rather than of the units themselves?

Mr. DUNLOP. We recognize generally productive capacity as being the controlling factor. Of course, as you appreciate, our industry is really in a way four industries. We are engaged in the production of oil, the transportation of oil, the refining of oil, and the marketing of oil. So that in the production department, in effect, you replace wells for wells. In the transportation department, speaking now of the matter of ships, there is a technological improvement that takes place in ships: As you gentlemen recall, during the war the ship which was commonly built was a T–2 tanker, which had a dead-weight tonnage of about 16,600 tons. That was the larger type of ship then in use. Currently, the industry is thinking in terms of upward of 26,000 dead-weight tons. So in effect, you replace a ship or several ships with a ship having greater capacity and improved design, and such factors as that.

The same thing is true in the refinery. As Senator O'Mahoney will recall from our hearings before the TNEC, one of the facts that we sought to demonstrate was the very rapid technological improvement in that particular branch of our industry, and you do not exactly replace unit for unit. If you go back to this Toledo example, we are contemplating there a unit which will have 30,000 barrels capacity. The unit which is just about fully depreciated and one of these days will go out of operation is also a 30,000-barrel capacity. But the new unit is different in design because it embraces the technological improvements that have taken place in the 8-year period between the construction of the existing unit and the new unit which is contemplated.

Last year we decided that we would be less than prudent if we failed to give recognition to the inadequacy of depreciation to provide for the replacement of existing facilities at current high construction costs by setting up a replacement reserve. Consequently, to supplement the depreciation reserve, we set aside $4,800,000 in 1947 and $3,500,000 in the first half of this year as an additional reserve toward the replacement of fixed assets.

Our method of determining the size of this replacement reserve is first to compute the replacement cost of our plant and equipment through the use of what we believe are sound construction-cost indexes. Our normal depreciation rates are then applied to the difference between the original cost and the replacement cost of the facilities. The result is the deficiency of depreciation expense, which we appropriate out of income and set up as a replacement reserve.

Eugene Holman, president, Standard Oil Co. of New Jersey

Mr. HOLMAN. Expert witnesses already heard by this committee have brought out that present accounting profits are not comparable with those when the purchasing power of the dollar was quite different. The points which have been made on this subject apply to the reported financial results of our operations. While our profits are not appreciably inflated by inventory evaluations, they are overstated because no special depreciation reserve has been set up.

In making comparisons of Jersey's operating results, we must bear in mind:

First, the dollar is not worth as much today; it is worth only half what it was in 1940.

Second, we are supplying consumers with almost twice as much oil. As we have worked harder, spent larger sums, and done more business, we have naturally taken in more money.

Third, our depreciation allowances are based on original costs. Therefore, our accounting profit does not give now, as it did before the war, a measure of the funds available for increased capacity and for dividends. Before we can even consider dividends or expansion today, a large portion of our accounting profit must be used for replacement of crude-oil reserves and for replacement of worn-out and obsolete equipment. The net income of Jersey Standard has risen substantially in the postwar years. During these years, every dollar of our profit over and above conservative dividends to stockholders has gone into new equipment and facilities to meet consumers' needs for oil.

If our company and others in the oil industry had not made the very great expenditures for new facilities which they have, there would be rationing of oil in this country right now. Thus, an important beneficiary of our profit has been the public.

Joseph E. Pogue, vice president, Chase National Bank

Senator O'MAHONEY. Page 2 of your statement under the subtitle "Fundamental Principles Affecting 'Profits'." Paragraph No. 1 reads as follows:

> In times of inflation, or rapid change in the purchasing power of the dollar, "profits" as reported on the basis of established accounting practice are in effect overstated by the amount of the rise in replacement costs over the sum set aside to cover capital extinguishments—depreciation, depletion, and the like.

When you speak of replacement costs, are you talking in terms of productive capacity or in terms of the replacement of the exact facilities?

Mr. POGUE. I think both elements come into it, and I am glad that you brought that point up now, because it is very important. The accounting theory recovers the monetary capital that you put in and that is fixed in contractual and legalistic procedures. It is very difficult to alter that. The theory or procedure evolved in more normal times, when the monetary capital recovered was sufficient to replace the wear-out and use-up of the capital, so that you maintained a going concern.

Now, that replacement must—and I say "must," and there is no equivocation on this—must be supplied by the enterprise itself. You cannot call on outside funds to do it. If you do, you are on the way to bankruptcy. If you do, and do it long enough and strong enough, you wipe out your capital.

Senator O'MAHONEY. And yet, if the Government does not derive revenue enough to keep the budget balanced, then the Government is on the way to bankruptcy.

Mr. POGUE. All right; now, naturally the Government does not want to become bankrupt, nor does the industry. It would be a misfortune if either happened.

While I say "you cannot," you can, of course, but I mean if you invade replacement funds, whether they are derived from accounting theory or come out of profits, you are then living on capital.

I suspect that much of that sort of thing is going on in Great Britain; that part of its problem is the use of capital. I surmise that

part of its problem is the use of capital. Now, one of the aspects of our economy is that we can do that sort of thing and get away with it for quite a while before we pay the penalty. There are various devices that permit that. But we must—or I will put it this way: The backlog of our economy is industry. It must at all costs be kept strong, even at the expense of lessened expenditures by the Government, no matter how urgent they seem.

You can make the contrary argument, but I believe the fundamental thing is our productive capacity, whether viewed from a defense angle or from the angle of our whole economy or from the public welfare or from any other aspect. That is my whole interest. I am not too interested in taxes one way or the other, but I am concerned in doing what I can to explain how one great industry functions. That is all that I have attempted to do, feeling that if I could throw even a little light on that subject it would be helpful to those decisions which might either aid or impair the functioning of this essential industry.

Senator O'MAHONEY. May I ask you, then, whether in your opinion the price structure as it now exists in the petroleum industry has been sufficient to maintain the industry from the point of view of replacement and dividends and wages, to say nothing of taxes?

Mr. POGUE. It appears to me that the price structure which has prevailed in 1948, as reflected in profits—because they are the result—has been adequate to do the job. The job has been compounding; it has been a replacement job, an expansion job, and it has been a make-up-for-lost-time job, and it would seem to me reasonable to expect that the job ahead, barring renewed inflation, would not have the same magnitude.

I think that you came in later in the testimony, and I tried to make the point that our supply has now been stimulated to the point where demand is covered rather amply, that our bottlenecks have been broken, pipe lines have been built and tankers constructed and new oil wells drilled, and the supply-demand situation looks much more comfortable than it did.

Senator O'MAHONEY. That being the case, and the petroleum industry having built the pipe lines and built the tankers and sunk the wells by the expenditure of current dollars since 1945, do you believe that the petroleum industry should ask for depreciation allowances in terms of the dollar of 1939, let us say?

Mr. POGUE. I do not know the answer to what would be the best policy from the point of view of accounting. The American Institute of Accountancy has studied that problem and came up with reports, and they differ. I doubt, myself, whether you can successfully work out an accounting procedure that will solve this problem. I think if you do not, then our attitude toward profits should be sufficiently flexible to recognize the extent to which they are not a reality.

One could easily write a formula that would change the reported profits. I am not an accountant, but any accountant could do that or almost anybody could do that. Suppose you did it? It would not change any of the facts; it would simply change the names.

Now, I made three points in my testimony which had to do with precision of names, to the effect that we were calling different things by the same names. It does not make any difference; you could call them by anything you wanted, but names do not alter the facts, although it may alter administrative procedure on the part of the Government.

I will admit that. But the essence of the thing lies behind these names, and has to do with the things that you can measure and count, and it has to do with the cash dollars. But do not let the calling of things by the wrong name cause us to think there is something there that isn't.

Senator O'MAHONEY. That is precisely why I have been questioning you, because I do not want the public which may read the reports of this hearing to get the idea that the testimony of Professor Slichter or anybody else, about the overstatement of corporate profits, is anything but an abstract economist's statement, and not a factual statement of actual profits.

Mr. POGUE. I do not think that that follows, Senator, from either what I have just said or from my testimony.

Senator O'MAHONEY. This statement or this declaration that profits are being overstated, it seems to me, has been designed for the purpose either of deterring labor from asking for increased wages out of these large profits in current dollars, or of deterring Government from obtaining the revenue it needs in these current dollars. If it is not designed for that purpose, it seems to me to be a very strange coincidence that the discussion is coming at precisely the time that the Congress is to assemble which must determine whether or not we balance the budget while making the tremendous expenditures that are necessary for the national defense, for the care of veterans who came out of World War II, for the payment of interest upon the national debt, for the general national obligations, or whether we are just going to treat the corporations very easily upon the ground that, "Why, their profits are overstated," when no accountant has been able to come before this committee, and no expert, and tell us how to measure this overstatement.

Mr. POGUE. Well, I do not know about all of that. I think that I have shown how you can adjust for it. But I do not think, Senator, that anyone with any approach to a comprehension of the facts and the way our economy operates, could respond to a request to discuss the subject without hitting upon this relationship of capital formation to replacement.

Howard C. Greer, Kingan & Co.

Mr. GREER. The testimony of previous witnesses has emphasized the heavy drain on cash resources occasioned by the need for replacement of plants and equipment at high cost levels. There is no doubt that this is an extremely serious factor, and one which perhaps should be dealt with by appropriate relief provisions in any new income-tax legislation.

In actual practice, the increases in the cost of direct facility replacements are rather hard to distinguish from the requirements of plant expansion and modernization to meet changing competitive conditions. Since fixed assets are seldom replaced with others exactly like them, it is not easy to determine how much of the purchase cost of new buildings and machinery represents replacement and how much represents improvements and expansion.

In an effort to get some measure of the relative weight of these factors in our own business, we prepared the analysis presented in table I. Since this is a rather theoretical calculation, it requires some explanation.

TABLE I.—*Kingan & Co., Inc. (subsidiaries excluded)—Comparison of depreciation allowances and estimated fixed asset replacement costs, years 1939 to 1948, inclusive*

BUILDINGS

Fiscal year	Index	Depreciation taken	Ratio replacement to original cost	Estimated replacement cost	Additional investment required
1939	100.0	$113,231	100.0	$113,231	
1940	102.7	114,576	102.7	117,670	$3,094
1941	107.1	115,374	107.1	123,566	8,192
1942	112.6	118,369	112.6	133,283	14,914
1943	115.8	170,918	115.8	197,923	27,005
1944	118.8	171,365	118.8	203,582	32,217
1945	121.1	170,639	121.1	206,644	36,005
1946	132.9	179,207	132.9	238,166	58,959
1947	158.5	177,698	158.5	281,651	103,953
1948	180.0	224,982	180.0	404,967	179,985
Total		1,556,359		2,020,683	464,324

MACHINERY

1939	84.9	$68,847	100.0	$68,847	
1940	86.3	77,551	101.6	78,797	$1,246
1941	91.7	69,205	108.0	74,741	5,536
1942	98.5	97,247	116.0	112,807	15,560
1943	99.8	177,058	117.6	208,220	31,162
1944	102.8	180,544	121.1	218,639	38,095
1945	104.1	187,538	122.6	229,922	42,384
1946	126.1	186,323	148.5	276,690	90,367
1947	156.8	198,032	184.7	365,765	167,733
1948	164.5	247,495	193.8	479,645	232,150
Total		1,489,840		2,114,073	624,233

UTENSILS

1939	84.9	$40,309	100.0	$40,309	
1940	86.3	43,350	101.6	44,044	$694
1941	91.7	44,674	108.0	48,248	3,574
1942	98.5	75,148	116.0	87,172	12,024
1943	99.8	59,986	117.6	70,544	10,558
1944	102.8	61,158	121.1	74,062	12,904
1945	104.1	73,316	120.6	88,419	15,103
1946	126.1	78,985	137.5	108,604	29,619
1947	156.8	73,518	159.2	117,040	43,522
1948	164.5	109,821	164.5	180,656	70,835
Total		660,265		859,098	198,833

OFFICE EQUIPMENT

1939	86.8	$10,078	100.0	$10,078	
1940	89.8	10,838	103.5	11,217	$379
1941	95.6	11,169	110.1	12,297	1,128
1942	101.9	10,563	117.4	12,401	1,838
1943	102.3	13,266	117.9	15,641	2,375
1944	104.1	15,379	119.9	18,439	3,060
1945	105.2	17,171	117.1	20,107	2,936
1946	120.9	17,566	126.5	22,221	4,655
1947	146.9	17,914	144.2	25,832	7,918
1948	155.6	22,609	152.1	34,388	11,779
Total		146,553		182,621	36,068

TABLE I.—*Kingan & Co., Inc. (subsidiaries excluded)—Comparison of depreciation allowances and estimated fixed asset replacement costs, years 1939 to 1948, inclusive*—continued

MOTOR VEHICLES

Fiscal year	Index	Depreciation taken	Ratio replacement to original cost	Estimated replacement cost	Additional investment required
1939	100.0	$54,267	100.0	$54,267	
1940	98.0	50,561	98.0	49,550	$1,011
1941	111.5	32,830	111.5	36,605	3,775
1942	121.6	26,438	121.6	32,149	5,711
1943	132.9	32,088	135.6	43,511	11,423
1944	135.0	42,295	121.1	51,219	8,924
1945	138.4	39,433	113.9	44,914	5,481
1946	160.8	41,032	121.0	49,649	8,617
1947	169.2	74,959	125.3	93,924	18,965
1948	178.2	116,409	128.7	149,818	33,409
Total		510,312		605,606	95,294
Grand total		4,363,329		5,782,081	1,418,752

NOTES ON MEASURES EMPLOYED

Buildings—Index: Engineering News-Record, 1939=100; average life=40 years.
Machinery—Index: Marshall & Stevens Industrial Equipment, 1926=100; average life=16 years.
Utensils—Index: Same as machinery; average life=5 years.
Office equipment—Index: Marshall & Stevens Commercial Equipment, 1926=100; average life=5 years.
Motor vehicles—Index: International Harvester Price List, 1939=100; average life=3 years.

Using the year 1939 as a point of departure, we set down the amount of depreciation charged in each subsequent year on each of the five major classes of fixed assets used in our business. Then we estimated what it would have cost at the then-prevailing price levels to replace exactly that much worn-out property of each type. The difference may be assumed to represent the additional cash which would have been required for this purpose if we had kept up an even and uniform program of plant replacement throughout the period, and had done nothing more.

For items of more than 10 years normal life (such as buildings and machinery), we assumed that we were all square at the beginning of 1939—that is, that the replacement-cost values on that date were approximately equal to the average of the actual costs over the period of acquisition. For equipment of shorter life (utensils, motor vehicles, and office equipment), we took account of the more rapid turnover of the assets, and the extent to which depreciation allowances automatically rise with replacements at higher cost levels.

For each of these classes of assets, we obtained an index of changes in average costs during the 8-year period (the source of the data is indicated in footnotes to the tables). The cost of replacements was then estimated as having risen to the extent of the advance in the cost index, either from 1939 (on the long-life items) or from the average of purchase (on the short-life items).

Donald Montgomery, United Automobile Workers, CIO

Mr. MONTGOMERY. There is as little substance to the argument for deduction of additional depreciation based on current replacement costs as there is to the argument for deduction of inventory profits.

The accounting profession has officially refused to endorse depreciation charges based on current replacement costs. The profession has also expressed its disapproval of another device designed to accomplish the same purpose; namely, "immediate write-downs of plant costs by charges against current income in amounts believed to represent excessive or abnormal costs occasioned by current price levels."

Both aspects of the profit-minimizing replacement-cost theory of depreciation are rejected in Accounting Research Bulletin No. 33 issued December 1947 by the Committee on Accounting Procedure of the American Institute of Accountants. Yet, despite Professor Slichter's belief that corporations exaggerate their profits, replacement-cost depreciation is widely in use for exactly the opposite purpose.

It has been noted, in fact, that current depreciation charges are excessive rather than insufficient. An article by Frederick B. Taylor in the October 1948 issue of the Journal of Accountancy considers the case of an automobile purchased in 1943 when it was assigned a life of 5 years.

"By 1948," says Mr. Taylor, "it will have been entirely depreciated when actually it may have a market value today of 80 percent or 100 percent, or even more, of original cost. The depreciation charges made on the company's books were excessive."

There are other more glaring instances of excessive depreciation charges which run directly counter to Professor Slichter's claim that depreciation is understated. Corporate assets are currently being depreciated for the second time, though they have already been fully charged off. I refer to capital investment made under wartime certificates of necessity which were written off under special wartime accelerated depreciation provisions. In many cases these assets have been brought back on the books at original cost less normal depreciation, and the normal depreciation is now being charged to current income.

The public has already paid the cost of these assets in its role as taxpayer. The public is now being forced to pay that cost a second time in its role as consumer. Yet, we hear endless argument about the inadequacy of present depreciation charges.

Until the recent rise in the profit level created an incentive to conceal profits, there was practically universal agreement among accountants and among the corporations as well that depreciation charges were intended to recover original cost rather than to meet replacement cost. The replacement-cost fad is directly related to the "new look" in current profit rates.

The theory behind depreciation is that investment in productive equipment is one of the costs of production. Depreciation charges record this cost by charging to production throughout the useful life of the asset the portion used up in any given period. Depreciation charges are merely a device to measure the income produced by the machine against the original cost of the economic resources devoted to creating it.

Depreciation charges were never intended to provide for replacement of the equipment whose cost was written off. Ours is not a static economy, as it would be if we confined ourselves merely to replacement. The fully depreciated machine bought 10 years ago will rarely be replaced by an identical one. Technological progress makes it almost certain that a new machine designed to produce the same quantity and quality of goods will require less economic resources to create it than the old one.

No one can determine today the kinds of equipment which will be used several years hence to replace our existing machinery or the quantity of economic resources which will be required to bring it into being. The machine installed today or tomorrow will be depreciated under present theory and present law in accordance with its actual costs to society and the enterprise. To attempt to depreciate on the basis of replacement costs is to depreciate yesterday's machine at tomorrow's costs. This is hardly the purpose of depreciation.

Weakness of the logic behind replacement-cost depreciation is laid bare in a letter written by an executive of a Canadian steel corporation which appears in the current issue of Business Week. Says the writer:

* * * assuming that the fixed assets were purchased with borrowed funds—that is, assuming that the company had a sizable bond issue which was made for the purpose of financing expansion at some prior period—would you then argue that the shareholder is entitled to figure depreciation at replacement cost when, in truth, his only obligation is to return to the bondholder the same number of dollars as he borrowed in the first instance, regardless of the fact that in the interim their purchasing power has decreased?

The case for charging depreciation at replacement cost is in reality a case for imposing on the consumer and the taxpayer the burden of meeting industry's future capital needs rather than past costs represented in current production. In the article by Mr. Taylor cited earlier, it is noted that "There is no law or other requirement which says that new funds must come principally from either depreciation charges or retained earnings."

Russ Nixon, United Electrical Radio and Machine Workers of America, CIO

Mr. NIXON. If physical equipment is to be depreciated at replacement prices rather than original historical costs, then of course this will, to the extent of the increased depreciation, lessen the profit reported annually. But Professor Slichter ignores the fact that such a procedure would require the declaration of an increase in the equity of the owners, in the nature of a windfall inflationary profit due to the rise in the value of the capital equipment. This windfall profit would exactly balance the increased depreciation charges and leave the actual profits unchanged.

In addition, of course, there are the familiar arguments for using the historical cost base for depreciation. These are that it is impossible to estimate correctly replacement costs; that the new replaced productive capacity cannot be equated to the productive capacity used up, and that the purpose of depreciation is to systematically spread costs already incurred, not to finance replacements. The basic fact is that the owners invested a certain amount of money and

in their capital consumption during production are using up a portion of that investment which is a cost of production. The margin between the cost and the price is the profit.

Need For, and Sources of, Investment Funds

The record contained testimony on the great need for additional capital for a variety of purposes in the postwar period of pent-up demand, high purchasing power and production, and shortages and bottlenecks. This section contains most of the distinguishable testimony on these points; but it should be read along with the section on "Retained earnings and dividends," since retained earnings have been the principal source of funds for expansion of productive facilities, and to meet requirements for a greatly increased volume of business at higher price levels.

Howard G. Greer, executive vice president, Kingan & Co.

Mr. Greer. The company has faced several major developments, each of which has made serious demands on its financial resources. These include the following:

(1) An increase in the total volume of meat production, in which it wished to participate.

(2) The need for decentralization, rehabilitation, and modernization of its plant facilities.

(3) The necessity for replacement of worn-out buildings and equipment at substantially higher price levels.

(4) The need for additional working capital to finance a larger volume of business at substantially higher price levels.

To meet all these demands, the amount of capital supplied by the profits of the period have been wholly inadequate. The same thing is true for the industry as a whole, as will be noted later.

To illustrate this point, the sources and disposition of the capital funds of our business during the 8-year period 1940–48 have been summarized in table V of appendix D. The figures have been drastically condensed, and present the aggregate of many lesser changes during intermediate periods, but they will serve to indicate the major factors in the situation.

The table is divided into three sections, to show, first, the amounts obtained from operations; second, the amounts obtained from liquidation of investments of various types, and, third, the amounts obtained from borrowings and increases in trade accounts payable and accruals. Opposite each of these sections is shown the application of cash funds to the various needs of the enterprise which ordinarily should be satisfied from the sources indicated.

Operations normally produce cash to the extent of the net profits plus the amount of depreciation of fixed assets deducted in arriving at those profits. This sum should be available in cash for (*a*) reinvestment in the replacement of worn-out plant and equipment items, (*b*) necessary increases in working capital, and (*c*) dividend distributions to stockholders.

In recent years, the cash obtained from profits (before depreciation deductions) have been insufficient to meet the three requirements above mentioned. Even what looks like a fairly high profit doesn't

go very far toward the replacement of fixed assets at two or three times their original cost, and the maintenance of accounts receivable and inventories at comparable price levels, to say nothing of distributions to stockholders. The problem has been further complicated by the need of many industries for more and better plants and equipment, to handle a larger volume of business efficiently and economically. . . .

To replace the fixed assets which were out during this 8-year period and to provide better located and more efficient plant facilities, Kingan & Co. paid out during the 8 years about $8,900,000. Depreciation allowances for the period were about $4,300,000. In other words, the company included in its costs, and recovered in its selling prices, less than half the amounts it was necessary to spend to renew and improve its plants, and to equip them for the demands of modern meat-processing operations.

This using up of older, low-cost facilities has held down aggregate operating costs, as previously noted, but has produced an acute financial problem. It was noted above that the excess of profits over income taxes and dividends was only $3,000,000, leaving the company about $1,800,000 short of the outlays which normally should be met out of operating income.

Since the company also had need for additional sums to finance much larger accounts receivable and inventories, it found itself compelled to liquidate certain investments in related lines which were not essential to the continuance of its main business. The second section of the table shows the amounts obtained from profit on the sale of a subsidiary enterprise, realizations from the sale of nonoperating fixed assets, and realizations from the liquidation of merchandise inventories (associated with the sale of the subsidiary above mentioned). These sources provided a part of the capital required to finance a large increase in customers' accounts receivable and in inventories of operating supplies.

It is apparent from table V, appendix D, that there was still a deficiency in the capital required to operate the business. This was met by increasing short-term borrowings from banks, by the larger use of trade credit on material purchases, and by the deferment of payment of certain accrued expenses (of which Federal income taxes are a not insignificant item). The net result was a moderate increase in cash balances, made necessary by the larger volume of sales currently being handled. * * *

The entire meat-packing industry has faced these same needs and demands. Other industries, in which plant and equipment are an even larger factor, have encountered the condition in even more exaggerated form. It probably is the most significant single problem in business enterprise today—where to obtain the capital to replace worn-out facilities, to expand volume, and to modernize and improve facilities, so that industry may keep pace with technical progress and consumer demand.

The vital questions are (*a*) whether profits are sufficient to provide for the additional investments required, (*b*) whether it is desirable that they should be, and (*c*), if not, whether other sources of capital are available.

The profit record of the meat-packing industry as a whole is considerably better than that of our individual company. For the entire

industry, however, profit margins have been narrow and the return on investment small and uncertain. Profits never have been a significant factor in the price of meat, the price of livestock, or the earnings of packing-house employees.

In none of these figures is there anything to suggest that the industry has accumulated any more capital than it needs, or has distributed to its owners more than a moderate return on their investment. On the contrary, profit distributions have been necessarily moderate, and replacement and modernization of worn-out plant facilities will present a serious problem during the coming years unless price levels generally show a substantial decline.

This brings us back to the fundamental question of where and how American industry can obtain the capital necessary to provide the renewed, improved, and expanded facilities required for the production of an adequate supply of goods essential to the maintenance of a high standard of living. It is self-evident that every expanding industry will require more and better plants, and that it will need a lot of capital to construct and equip them. To preserve a system of free, independent, competitive enterprise, this must be equity capital, derived from profits retained in the business or from new capital-stock purchases by individuals out of personal savings.

In many industries the sources of this vital equity capital have been gradually drying up over a long period of years. When corporate profits are small and heavily taxed, and when risks are magnified by Government policies and public hostility to business, the average concern is hard pressed to retain enough profit-capital for its needs, or to attract enough risk-capital from new investors.

In the meat-packing industry, for example, it is obvious that even its somewhat increased earnings in recent years have not kept pace with its additional capital requirements. Furthermore, the average earnings record of the industry has been so unsatisfactory that no one is anxious to invest new equity capital in such a hazardous and speculative enterprise. For the past 20 years, it has not been possible for any large packing company to market a public offering of new capital stock, and in only two instances have very minor increases in capitalization been achieved through private subscription.

This puts the problem right straight up to the public and its representatives in Washington. Any policy decisions which reduce profit opportunities or tax away larger portions of business income will inevitably restrict plant rehabilitation and expansion and curtail the effectiveness of industry as the source of jobs and the satisfier of material wants. Industry is simply a lot of us working together in groups, and without savings to buy tools we can't produce very much. Savings out of corporate profits apparently will have to carry an increasing share of the load.

There is some complaint that purchasers of goods should not be required to pay prices which will insure profits sufficient to replace the facilities worn out in producing these goods, or to modernize and expand them for greater usefulness. There also are contentions that more money should go to wage earners and less to owners, on the theory that the employees need it and the "capitalists" don't.

Both these arguments overlook the fundamental fact that the required capital has to come from somewhere, and that it won't cost any more to provide it through small contributions to corporate

profits than through Government loans financed by increased taxation or printing-press inflation. Tools can be provided from corporate or private savings, or from Government revenues or borrowings, but eventually we have to pay for them or do without.

It seems to be the view of some representatives of consumer and labor organizations that because their members would enjoy spending more for consumer goods, or getting more for what they do spend, that all they have to do is to squeeze something out of business profits to achieve their aims. The fact is, however, that if the money goes into these channels, instead of into reinvestment in industrial and commercial facilities, there ultimately will be fewer and poorer factories, older and less adequate machines, fewer jobs for factory workers, and a smaller and less satisfactory supply of consumer goods. It won't help wage earners to have more money to spend unless there are more goods to spend it on, and there won't be more goods unless the Nation's factories can be rebuilt and reequipped as they wear out.

To make this possible, there must be profits sufficient either to provide the necessary capital from inside the business or to attract additional investment from outside the business. All the evidence indicates that neither of these conditions has prevailed during recent years, in spite of the apparently high level of business profits. Those responsible for Government policy as to taxation, prices, wage rates, and business controls will find this an inescapable factor in the problems they are called on to solve.

Clarence Francis, General Foods Corp.

Mr. FRANCIS. Our principal source of funds was the retained earnings of $50,000,000 plus additional sums of $32,000,000 for stock, $27,000,000 in notes, and about $22,000,000 representing an increase in payables, mostly current accounts payable. Seventy million dollars, by far the largest share of this new money, has gone into inventories. This is, of course, just another way of saying that under existing conditions it takes more money to be able to meet the requirements of the American consumer. Fixed assets of plant and equipment have absorbed $30,000,000 (this figure is net after depreciation and retirements); our current receivables, $17,000,000, and our current cash position has increased by $14,000,000.

Since 1938, when our working capital was 43.9 million dollars, that figure has been increased by over $70,000,000, until on September 1, 1948, it represented 115.8 million dollars. The increase has been fairly uniform, and for the years requested by the committee the figures are:

[In millions of dollars]

1940	48.2	1947	111.0
1946	94.7	1948	115.8

There was a steady climb of our investment both in raw materials and in finished stock. A sizable portion of this increase is not due to volume, but to increased prices of the commodities we buy.

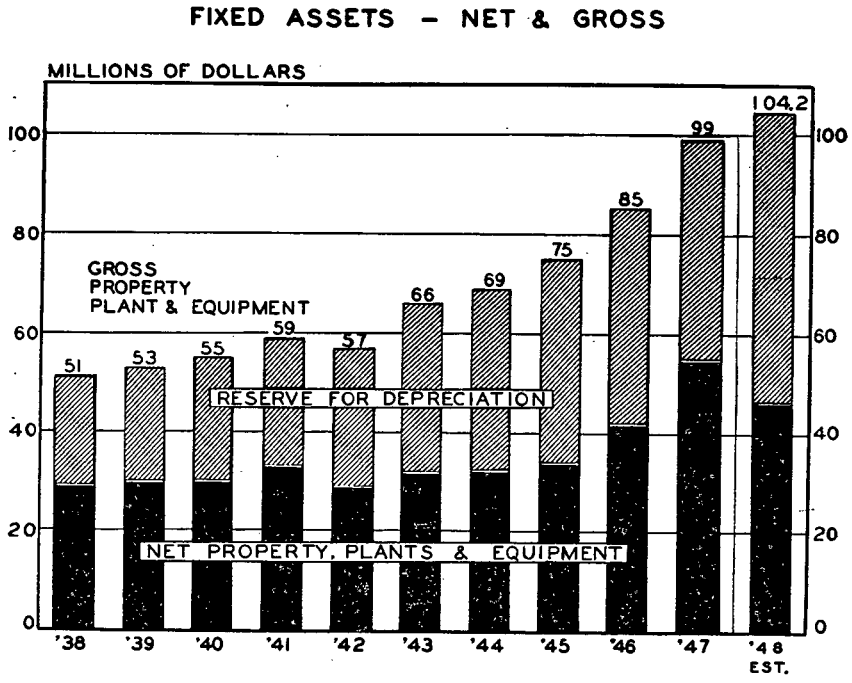
There was also an increase of $17,000,000 in our receivables for money owed to us.

The $30,000,000 figure which represents the funds invested in net fixed assets does not truly reflect all of the funds so invested. In arriving at that $30,000,000 figure, we have deducted from gross pay-

ments the amount representing depreciation and assets which have been retired. During the past 4 years alone, General Foods, a company which represents about 2 percent of the American foods-processing industry, has spent approximately $50,000,000 in replacing worn-out or obsolete buildings and equipment and in acquiring new properties needed to handle an expanding volume. We think ours is only typical.

Chart 1 shows the growth of our own fixed-asset accounts in the past 10 years. The following list represents principal additions to our plants made during the past 4 years, since practically no major additions could be made during the war years.

CHART 1



The list follows:

Maxwell House, Hoboken, N. J.: Soluble-coffee plant, soluble-coffee water-extraction plant.
Gaines Dog Food plant, Kankakee, Ill.
Birds Eye-Snider plant, Albion, N. Y.
Walter Baker warehouse, Dorchester, Mass.
Milk-processing plant, Evart, Mich.
Grain-storage facilities, Pendleton, Oreg.
Franklin Baker coconut-processing plant replacement in the Philippines. (This was destroyed by the Japanese.)
Franklin Baker plant purchased at Hoboken, N. J.
Acquisition of Alfred Bird & Sons, Ltd., England.
Maxwell House coffee plant purchased at Houston, Tex.
Birds Eye-Snider processing plant at Walla Walla, Wash.

Each of these new facilities represents new tax-paying, food-producing, employment-providing facilities.

When we have replaced worn-out buildings and equipment, we have found that the amount which we obtained under our normal depreciation rates was inadequate to cover the cost of replacing the equipment.

Let me give you some examples:

A thermo roaster which in 1939 cost $5,000 was replaced in 1948 at a cost of $9,000.

A coffee-cooling unit which in 1939 cost $830, in 1947 cost $1,600.

An extractor in coffee processing purchased in 1946 for $3,000 could not be duplicated in 1948 at less than $3,850.

While the items used here for illustration are small in amount, the same trends and problems existed throughout our company whether we were paying $2,000,000 to build a new plant or to replace a single dynamo.

Joseph E. Pogue, vice president, Chase National Bank

Mr. POGUE. Capital is a word with two meanings. It represents monetary funds which are held or expended, and it represents plant and facilities for which the expenditures are made. We shall refer to financial capital as capital funds and to physical capital as plant and facilities.

Capital originates out of savings—production in excess of consumption. There is no other source. Savings may be made by productive units, such as corporations, and by individuals; and, through the intervention of credit, furture savings can be transferred to the present.

Capital formation is the process whereby capital funds are accumulated and converted into physical capital. Economic progress depends largely upon the rate of capital formation; and, therefore, the process is indispensable to our standard of living. Measures which interfere with capital formation are harmful.

Let us examine the bearing of profits upon capital formation in the petroleum industry. We shall use the record of 30 oil companies for the illustrative figures.[15]

In 1947, this group of oil companies generated cash out of its own operations to the extent of $2,160,000,000. This sum was segregated by conventional accounting procedure into $1,219,000,000 of net income and $941,000,000 of depreciation, depletion, and so forth. The latter item represents an estimate of the capital worn out and used up during the year, but was inadequate to replace this capital because costs had gone up. In addition, the group obtained $743,000,000 of outside funds, as follows: long-term debt issued, $476,000,000; sales of common and preferred stock, $206,000,000; and sales of assets, and so forth, $61,000,000. Thus the group in 1947 generated and obtained $2,903,000,000 of funds.

What became of these funds?

By far the larger part, $2,076,000,000, or 71 percent, went into capital expenditures. Therefore, this amount represented physical capital formed. The remainder of the funds was disposed of as follows: $175,000,000 to working capital;[16] $197,000,000 to the retirement and refunding of debt; and $455,000,000 to stockholders and minority interests.

[15] See appendix B, table VII, for statement of source and disposition of working capital of 30 oil companies n 1937.

[16] The additions to working capital also represented capital formation, at least in large part.

This analysis of the source and disposition of funds reveals the anatomy of capital formation in the petroleum industry. And the figures are all expressed in dollars of like vintage—1947 dollars—with one exception. The item of capital extinguishments is estimated on the basis of past dollars; and, therefore, part of the net-income dollars must be allocated to this item when it becomes converted into physical replacement of the capital worn out and used up.

Some additional relationships are striking. The $2,076,000,000 of capital expenditures match closely the $2,160,000,000 of cash internally generated; and the same is true of the $455,000,000 of payments to stockholders and minority interests and the $476,000,000 of money borrowed. Does this mean that the group had to borrow the money to pay dividends? The accountant would certainly not admit this, for dividends can only be paid from surplus, but capital expenditures can be made from borrowed funds. But it is certain that without borrowings there would have been hardly any funds for dividends if capital expenditures had remained unchanged. And if capital expenditures had been less, the oil "shortage" would have been prolonged.

In view of these circumstances, it can scarcely be claimed that the earnings of the oil industry were "too great." The earnings played an essential role in the process of capital formation. Nor was too much capital formed in 1947. It can be stated with assurance that it was the magnitude of capital formation in 1947, and again in 1948, which has converted the petroleum situation from one of scarcity into one of abundance. What could be more important?

It may be observed in passing that the amount of capital expenditures was vastly inflated by the rise in construction costs. We have computed that 60 percent, or $1,236,000,000, out of total 1947 capital expenditures of $2,076,000,000, was occasioned by the rise in costs, a penalty imposed by inflation. In prewar dollars, $840,000,000 would have done the same job.

If it is clear that oil profits play an important role in the essential process of capital formation, then the item of cash dividends to stockholders remains to be examined, for this amount passes out of the stream of corporate savings and into the hands of the public. Cash dividends for the group of 30 oil companies amounted to $331,000,000 in 1946 and $425,000,000 in 1947, an increase of $94,000,000, or 28 percent. These dividends, however, were in shrinking dollars. Correcting for income taxes and the changing value of the dollar, we find that the adjusted dividends retained were $186,000,000 in 1946 and $208,000,000 in 1947, an increase of 12 percent. The 1947 adjusted figures are less than either the actual or similarly adjusted levels in 1936 and 1937. The dividends, therefore, did not keep pace with the rise in the cost of living.

As the year 1947 drew toward its close, it became evident that the industry was to witness great difficulty in supplying the demands ahead and that the process of capital formation would be called upon to accelerate. It became evident then that oil profits would have an even larger job to do in 1948 than in 1947.

John Schmidt, vice president and comptroller, Armour & Co.

Mr. SCHMIDT. We have not been able to do any equity financing. We would like to because, compared with the industry, we have a high ratio of senior securities. In the last 10 years we have done a considerable amount of refunding of senior obligations to effect lower interest costs. In each case we have had to go into the bond and debenture markets.

The capital structure of our company breaks down as follows:

[Dollars in millions]

	Fiscal year end			
	1938		1948	
	Amount	Percent	Amount	Percent
Working capital (1938=100)	$100.15	100.0	$173.10	173.0
Capital securities:				
Long-term debt and guaranteed preferred	133.34	50.1	137.63	40.7
Preferred stock	59.25	22.3	50.00	14.8
Common stock, surplus, and surplus reserves	73.35	27.6	150.36	44.5
Total	265.94	100.0	337.99	100.0

You will note the increase of some $73,000,000 in our working capital in the 10 years. We have already shown the need for that additional working capital in financing higher values of receivables and inventories. You will also note that this need for capital was met by retention of earnings. Our only other alternative would have been to shrink our business—by, perhaps, as much as 50 percent. To do that would have been suicidal.

We could not take the chance of paying out our retained earnings in dividends to our common-stock holders in the hope that they would reinvest those dividends in additional common stock in our company.

Hiland G. Batcheller, president, Allegheny-Ludlum Steel Corp.

Mr. BATCHELLER. Except for the current pressure for expanded capacity, the popular impression of steel is, I am afraid, that it is a fully matured industry from which few new developments are to be expected. The exact opposite is true in the case of our company and many others. In many ways our business bears a closer resemblance to the chemical industry than to basic steel. Many of our alloy steels have been in existence for only a few years and we have barely begun to scratch the surface in the way of uses for these products. New developments, both in alloys and production methods, are constantly appearing.

Let me cite a few specific examples. You may recall that in the early twenties you had to have your automobile valves ground every two or three thousand miles and it was not until special metals were developed by our company that you obtained the trouble-free automobile engine of today. Our pioneer work in automotive-valve steels

led us naturally into airplane-valve steels, and then into the development of superalloys, and, as science progressed, into high-temperature metals for jet planes and gas turbines.

The latest development of years of research in electrical materials is a discovery which will reduce the weight and size of certain electrical apparatus and simplify the production of many electronic products. Meanwhile, nearly four times as much stainless steel is being used today as was used in 1937.

The dynamic character of this trend is plainly shown by chart 2, which contrasts the growth of stainless steel with that of basic steel. It shows that whereas the stainless has increased about 300 percent since 1937, the increase in carbon steel is about 45 percent.

It is obvious that a company concerned in developing and manufacturing products of this type would be faced with the problem of continuing sizable capital expenditures. Not only do we need capital for new products, but in addition we must also keep abreast of technological change. Old facilities bought many years ago must be replaced with new equipment purchased at today's high prices. We are now engaged in our company in a program of rehabilitation, improvement, and expansion of the plant and facilities involving about $25,000,000. For comparison, it is interesting to note that the net value of our plant at the time the program started late in 1945 was only $11,800,000.

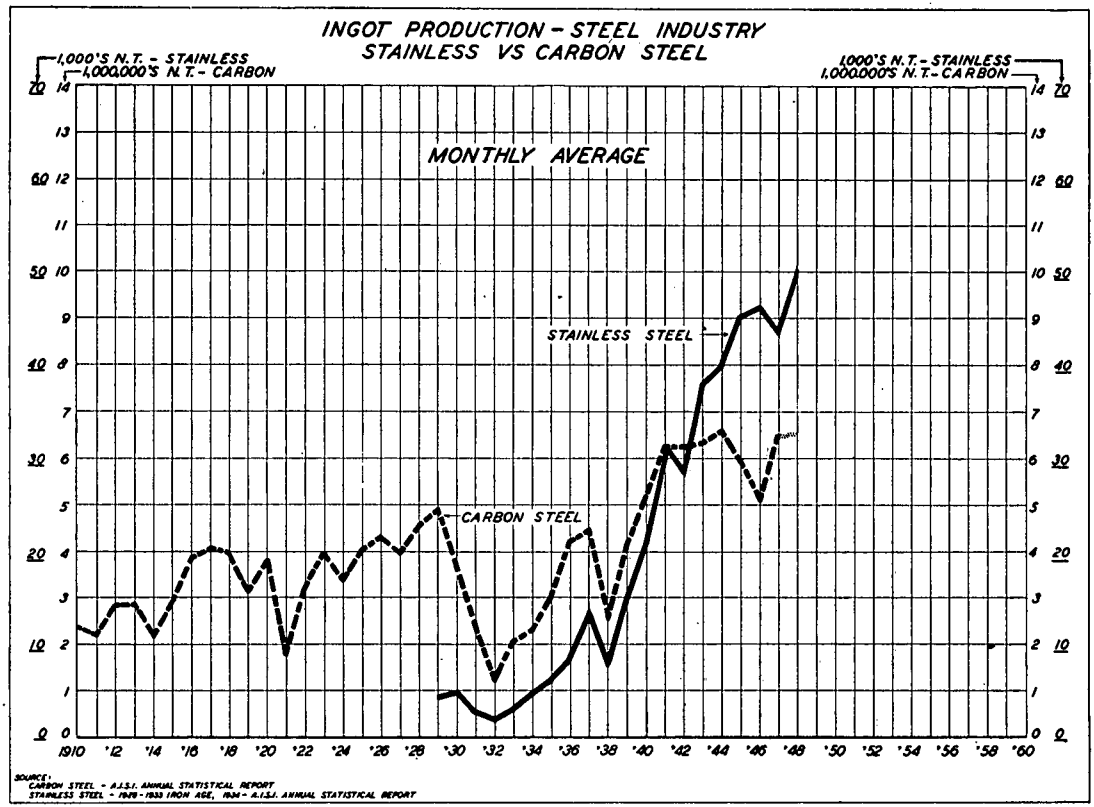
In recent months we have undertaken, at the urgent request of certain customers—that could be more properly stated "certain industries"—a further expansion program in carbon-steel melting facilities which will almost double our total ingot output within another 6 months.

An important part of this new output will be used to relieve the intense shortage of pipe in the oil industry. This program will require a further capital expenditure of about $5,000,000.

It is not only plant facilities, however, that require capital investment; the working capital requirements of Allegheny-Ludlum have also increased very materially since 1940 when our sales were only about $54,000,000 a year. We are currently shipping material at an annual rate of close to $150,000,000 and to do this we have to have about twice as much money in inventory and three times as much money in cash as we did in 1940. Even though our working capital has increased from about $13,000,000 in 1940 to about $29,000,000 at October 31, 1948, the plant program now under way and further capital requirements for inventories next year are expected to reduce our cash resources to a point where borrowing may be necessary by the middle of 1949. This is the case in spite of the fact that we have retained in our business about $16,000,000 in earnings since January 1, 1940, and further obtained over $10,000,000 by the sale of equity capital, preferred stock in April 1948.

The necessity for obtaining additional capital to assist in financing the program I have described became apparent to us in the latter part of 1947. At that time we made a careful study of our probable capital requirements over a 5-year period. We counted on a continuation of present tax rates. We also anticipated that we would have substantial earnings in this 5-year period. Our study indicated, however, that about $10,000,000 in additional capital should be obtained by the

CHART 2


INGOT PRODUCTION - STEEL INDUSTRY
STAINLESS VS CARBON STEEL
1,000'S N.T. - STAINLESS
1,000,000'S N.T. - CARBON
MONTHLY AVERAGE
STAINLESS STEEL
CARBON STEEL
1910 '12 '14 '16 '18 '20 '22 '24 '26 '28 '30 '32 '34 '36 '38 '40 '42 '44 '46 '48 '50 '52 '54 '56 '58 '60
SOURCE:
CARBON STEEL - A.I.S.I. ANNUAL STATISTICAL REPORT
STAINLESS STEEL - 1949-1955 IRON AGE, 1934 - A.I.S.I. ANNUAL STATISTICAL REPORT
CHART 10 1224

company. We considered securing these funds through borrowings, but it was our view, under all the circumstances, that our requirement was for permanent capital and that it should be obtained through the sale of preferred or common stock.

Investigation of the possibilities of a stock issue disclosed that the sale of additional common stock or a straight preferred stock in a steel company did not appear to be feasible on a basis that would not be unfair to our existing stockholders. It did appear that the market might take a convertible preferred stock, although on terms somewhat less favorable than for companies other than steel producers, and in April 1948 we issued 107,000 shares of such stock.

I think it might be interesting to you, sir, as a side comment, to tell you that we saved about 1 percent on the interest rate of that security [107,000 shares of preferred] because we are not hidebound in the production of basic steel, which is penalized in the investment market. When we first inquired for a rate at which we could sell a preferred stock, the bankers said, "5½ percent," and I nearly fell out of my chair, because I knew that they were then selling or about to underwrite two issues in other industries on a 4-percent basis. And I said, "What is the matter with our company? We are solvent, we are all right, we can take care of our dividends" and they said, "Yes; but you are in the steel business, and the steel business is a prince or a pauper, and it doesn't enjoy a high rating in the investment market." I got that down from 5½ percent to 4½ percent because we are getting into supersteels.

This was accomplished, however, only after the proposition had once been completely abandoned because of the condition of the financial markets at the time.

We think that we are unique in the steel industry in having been able to do some recent equity financing. We found in doing it that the markets did not appraise steel-company earnings at a very high level. We doubt very much that if we were starting from scratch today we could do what we did last April on as favorable terms as we obtained at that time. Perhaps the talk of higher taxes and the threat of a fourth-round wage increase may be contributing somewhat to this situation, but I believe fundamentally it is due to the fact that, in the face of high operating levels and high facility costs, the present earnings and earnings prospects of the steel companies are just not high enough to interest investors.

Robert G. Dunlop, president, Sun Oil Co.

Mr. DUNLOP. Fortunately, when we entered the war, we had some surplus capacity which was largely responsible for our being able to meet wartime military and civilian needs. The construction of new capacity, however, was seriously curtailed by shortages of critical building materials and by fixed prices of petroleum products. Thus, the industry was ill equipped to take on a sharply accelerating postwar demand.

Petroleum demand has risen from 3,400,000 barrels a day in the prewar period to just below 6,000,000 barrels a day in 1948.[17]

Basic, of course, is the fact that the population has increased and, more important, that people have more money to spend. Increasing appreciation of the clean, labor-saving, space-saving economical char-

[17] See appendix B, chart I, for oil consumption data submitted by the company.

acteristics of fuel oils is another reason. In addition, these facts should be noted:

There are an estimated 6,000,000 more automobiles and trucks on the road today than in 1941. There are 50,000 more busses and over 1,000,000 more tractors today than 7 years ago. There are more commercial air liners; more Diesel locomotives; and there has been a striking increase in the number of oil burners installed. As of the close of this year, 1948, it is anticipated that there will be some 4,000,000 central-heating-plant oil-burning units established in homes. For that we must give the Office of Price Administration a bit of credit, for it was largely as a consequence of OPA-created disparities between coal prices and prices of petroleum and its products that the rush took place following the war; to install oil burners and to convert to oil industrial plants previously burning coal.

To keep up with the increase in demand, the oil industry not only has been required to maintain its existing facilities but has been forced to pursue an expansion program far greater than any undertaken in the past. Therein is the crux of the industry's problems.

The replacement of existing plant and the expansion of facilities must be made at costs which today are greater than twice prewar construction and equipment costs. This constitutes a serious problem for all industry, but it is extremely serious for petroleum where capital investment per employee and per dollar of annual sales is substantially greater than in other industries, such as steel, rubber, and automobiles.

Further, while current depreciation allowances recognized by the Bureau of Internal Revenue are sufficient to recover the original cost of plant construction, they are grossly inadequate to provide for its replacement at today's prices. Failure of industry to replace and keep modern and efficient its existing facilities means retrenchment, less production, fewer jobs and a consequent inability to meet customer demand.

In order to keep existing plant and equipment up to present standards and to expand facilities to meet the increased demands for petroleum products, the industry in the last 2 years has made capital expenditures averaging more than $2,000,000,000 annually. Such expenditures are at a rate twice the average for the war period and approximately three times the average for the 5 years immediately preceding the war.

Were it not for the fact that petroleum industry profits have been rising, the source of funds for the replacement and expansion reflected by this huge capital expenditure would create a critical problem. But the forces of demand, which have resulted in higher prices and a need for increased facilities, at the same time have generated greater dollar net earnings available for use for replacement and expansion of plant to fulfill that demand.

Harold Vance, chairman of the board and president, the Studebaker Corp.

Mr. VANCE. In the 5 years prior to the war (1937 to 1941, inclusive), Studebaker's production of passenger cars and trucks represented only 2½ percent of the industry's total. But we are growing. Since the resumption of automobile production following the war, we have

materially improved our competitive position. In 1946 we accounted for 3.86 percent; in 1947, for 3.99 percent; and in the first 9 months of this year, for approximately 4.5 percent of the industry's total.[18]

In 1940 we produced and sold 119,509 passenger cars and trucks; in 1948 our production and sales will total about 230,000 units. In 1940 we employed 9,400 people; we now employ more than 19,000. In 1940 our pay roll was $17,500,000; today our pay roll is running at the rate of $80,000,000 a year.[19]

How was this growth accomplished? Many factors have contributed. Some of these, important though they may be, such as increased public acceptance resulting from our introduction of the first completely redesigned postwar passenger car models, are not pertinent to this inquiry. There are two, however, which, in our opinion, are pertinent. The first is expansion in facilities and working capital, without which we could not have obtained the increase in our business. The second is the sources of funds required for that expansion.

Our expenditures for plant and property have been particularly heavy since the war. This has been due in part to the fact that in the years immediately after reorganization in 1935, lack of funds forced us to defer all but the most necessary expenditures of this character. There has been an increase of $23,000,000 in our net plant investment from January 1, 1945, to September 30, 1948. In that period our net profit, after taxes, aggregated $26,745,000. In the same period we paid dividends of $5,880,000, leaving $20,865,000 for reinvestment.

Prof. Sumner H. Slichter, economist, Harvard University

Professor SLICHTER. At present there is a great need for more industrial capacity because (1) there has been an abnormally slow increase in the quantity of plant and equipment per worker for the last 20 years due to depression and war; (2) there has been a rapid increase in the labor force; (3) wage demands of organized labor will be greater than ever, which will require a much more rapid rise in productivity than in the past in order to avoid a steady rise in prices; to achieve this faster increase in productivity, more and better capital per worker is required; (4) a large and growing public demand for goods is superimposed upon the rapidly growing private demand for goods. If we were to be in a position to achieve the same increase in plant and equipment per worker during the 20-year period 1929–49 as occurred in the preceding 20-year period, the plant and equipment of industry should have been increased by about $70,000,000,000 more than they have been.

The proportion of the net national product represented by net private investment in the United States has been large by past standards—just over 10 percent in the first half of 1948, 7.6 percent in 1947, and 7.4 percent in 1946 in comparison with 7.4 percent in 1929, 4.2 percent in 1937, and 4.9 percent in 1940. Hence, it appears plain that industry as a whole has done a good job of expanding plant and equipment during 1946, 1947, and 1948. One cannot criticize profits for failing to bring about as rapid an expansion as the capital goods industries were capable of meeting.

[18] See appendix B, table X, for sales data submitted by the company.
[19] See appendix D, table XI, for statistical data submitted by the company.

Prof. Seymour Harris, economist, Harvard University

Mr. HARRIS. In view of the increased effectiveness of capital, and the fact that the service industries, which are becoming more important in our society, require less capital per laborer than the manufacturing industries, it appears doubtful that as much as 50 to 70 billion dollars' worth of capital is needed to make our capital plant as effective as it was in 1929. Business is in fact investing too much these days.

I am not convinced by this argument for higher profits, first, because investment has been too high; and the moderation of the rate of profits would keep investment down and thus reduce the weight of one of the greatest inflationary factors.

It is well to recall that gross private domestic investment, which was $16,000,000,000 in 1929, was $26,000,000,000 in 1946 and $30,000,000,000 in 1947, and was running at the rate of $37,000,000,000 in the first half of 1948.

Second, these expenditures, relative to the great inflationary year of 1929, are large even when allowance is made for price movements; for against the rise of prices we must put the greater effectiveness of a dollar of investment as well as the larger part played by Government in investment; that is, financing the excess of exports. On the increased effectiveness of a dollar of investment, we should point to the investment in plant of $20,000,000,000 in 1940–45, which made possible a rise of income of 200 percent.

Third, it is well to point out that in the last few years bank loans have increased at a disconcerting rate, and even the capital market has shown increasing signs of life. This is to say, business has relied substantially on these sources of capital.

Fourth, business is not so short of resources as is frequently assumed. In the year ending June 30, 1948, business did not reduce its large holding of liquid assets, although in the preceding 1½ years they sold about $7,000,000,000 worth. These are relatively small losses when compared with the vast accumulation of liquid assets in the war period.

A large part of the rise in money and Government securities from 1939 to 1945 accrued to business; and the total expansion was from about 100 to 300 billion dollars. In the years 1941–48, undistributed profits of corporations totaled $55,000,000,000 (1948 estimated); and in the years 1942–45, total domestic private investment was $10,000,000,000 less than business depreciation funds.

The excess of funds spent by business in the years 1946–48 over current receipts out of own resources for investment was certainly substantially less than the accumulations of corporate and noncorporate business over the years 1941–48. (In 1947, the excess of expenditures was 10.6 billion dollars.) And, besides, business was spending too much.

COST-PRICE-PRODUCTION AND PROFIT RELATIONSHIPS

A number of the witnesses presented data on sales volume in relation to profit margins, unit costs in relation to different levels of production, increased costs in relation to prices, changes in price

levels and profit margins, and the wage-cost-price-profit relationship in their particular company or in corporate industry as a whole. This section deals with these aspects of prices and profits as distinct from profit levels resulting from actual prices or the pricing policies summarized in the preceding section.

Howard C. Greer, executive vice president, Kingan & Co.

Mr. GREER. The meat-packing industry is characterized by rapid turn-over and narrow margins. Out of each sales dollar taken in, meat packers normally pay out more than 75 cents for livestock and other raw materials. Of the remainder more than half is required for wages, salaries, and social-security costs. Profits before income taxes have seldom exceeded 2 cents per dollar of sales, with profits after taxes running between 1 and 1½ cents per dollar of sales in good years, and zero or less in poor ones.

The break-down of the Kingan sales dollar for the fiscal year 1948 was: Profit before income taxes was 1 cent; after income taxes 0.6 cent. Profit after taxes was equal to 22 cents per hundredweight of product sold, less than a quarter of a cent a pound.

	Cents		*Cents*
Raw material cost	82. 3	Miscellaneous selling and administrative	0. 6
Wages and salaries	8. 6	Income tax	. 4
Supplies, power, etc	3. 6	Profit	. 6
Plant occupancy	1. 3		
Transportation and delivery	2. 6	Total	100. 0

Table VIII, appendix D, shows that the company has experienced some increase in physical volume and a very large increase in sales value. The latter is due chiefly to the advance in meat prices which has taken place over the past 8 years. As shown by the center section of the table, the average wholesale value of 100 pounds of our products was $38.42 in 1948 compared with $13.70 in 1940, an increase of 180 percent.

Though wholesale meat prices in 1948 were nearly three times as high as 8 years previous, gross margins (difference between meat selling value and livestock cost) were not quite twice as great, and operating expense per hundredweight had increased by only about 75 percent. Packing-house wage rates have more than doubled in the interim, but other expenses have been held down, through larger volume and through the continued utilization of plant facilities acquired at lower price levels, as noted subsequently.

It will be noted from the table that in none of those years was net profit after taxes as much as one-fourth cent per pound or as much as 1 cent per dollar of sales. It will be noted also that profits per employee in the best of these years (1948) amounted to about $4 per man per week. It is evident that the company has operated on profit margins so narrow that they are close to the vanishing point at all times. This unfortunately is a normal characteristic of most meat-packing operations.

Hiland G. Batcheller, president, Allegheny-Ludlum Steel Co.

Mr. BATCHELLER. While the year 1947 was a record year for profits of some industrial concerns, this was not true for Allegheny Ludlum, due largely to our hold-the-line price policy. Our sales reached a new peacetime high, but rising labor and material costs, which were not passed on to the customers, had caused a reduction in profits as compared to 1946, in spite of the progress made in the installation of new equipment to reduce manufacturing costs and in spite of the adoption of new methods resulting from research.

Although substantial increases had occurred in every one of this company's major items of cost, no material change had been made for about 2 years in the price of stainless steel, the company's major product. On other products only moderate increases had been made in selling prices and these were not sufficient to offset more than a minor part of the cost increases. As a result, by the end of 1947, the company was actually absorbing cost increases which had occurred during that year to such an extent that monthly operating earnings had declined over 40 percent to a point where such earnings were well below the average for the preceding 10 years.

Cost increases have continued throughout 1948.[20] In particular, the third round of wage increases, which in our case became effective in July, raised our labor cost by about $275,000 per month and undoubtedly had much to do with the further upward surge in the cost of the materials we buy which followed immediately thereafter. In the aggregate, all these advances occasioned a total cost increase of about one-half million dollars per month. It was absolutely impossible for Allegheny-Ludlum to absorb such additional cost increases without some offsetting increase in its prices or without complete abandonment of its modernization program and a serious threat to the continued operations of the company. I make this statement advisedly, having in mind specifically the financial results of operations of July, for the wage increase became effective in the middle of that month and our selling prices did not change for several weeks thereafter. In that month, net profit was only about 2 percent of sales. Had the wage increase been in effect for the entire month, net profit would have been practically wiped out. If, in addition, the other cost increases that promptly followed the third round of wage increases had been effective during July, operations would have shown a sizable loss in that month. In the face of these rising costs, therefore, we had no choice but to advance our prices.

Senator WATKINS. Do you think that earnings are high enough to justify another round of wage increases without raising the price of steel and steel products?

Mr. BATCHELLER. No, sir; I do not. I think that another round of wage increases will result in another round of price increases. I do not see how, reducing this to our case now, and I am not attempting to speak for the industry, in my case I do not see how I can absorb another round of cost increases from any source—and the big item in costs, of course, is labor—without doing one of three things. If I

[20] See appendix D, table I, for financial and statistical data submitted by company.

absorb that, I take it out of the 5 percent which I now make on a dollar of sales, which I submit is not excessive. I either reduce the dividend to my 13,000 stockholders, which is only $2 a share—and while we have no way of knowing what the average price paid for our common stock by those 13,000 stockholders is, by the best rule-of-thumb guess that we can make we are of the opinion that $2 a share is a reasonable annual return to them on their investment in our company—I must either take that away, or I must curtail my expenditure for new plant and better plant to make better steel faster. I must do that, or I must give up some of the research and development work, and that would be the last thing that I would give up if I had my choice.

Senator FLANDERS. What about an increase in the normal corporate tax, as suggested by Professor Harris, running the present 40 percent up to 50 or 60 percent? What would that do to you?

Mr. BATCHELLER. Senator, anything that takes the money that I have available, what you call earnings, I must either take away my $2 dividend or give up something else, must I not? I must cut back on my plant-expansion program, and I do not think that that is a good thing, or I must cut back on research and development or something else.

Robert Montgomery, director and secretary, American Woolen Co.

Mr. MONTGOMERY. Our principal costs are raw materials, principally wool, and labor and overhead. The proportion of each varies to some extent among different fabrics and may change from year to year. Roughly, overhead is about 15 percent, raw materials 40 percent to 50 percent, and labor 35 percent to 45 percent. It is apparent that any increase in the costs of any of these factors is directly reflected in the cost of our products.[21]

The percentage of mark-up for manufacturing profit applied to estimated cost is designed to give a reasonable profit and has not varied greatly in the past few years. We think the average should be between 12 percent and 15 percent, so as to permit profits after taxes of 8 percent to 10 percent; and it is not always possible to sell goods with a full mark-up.

After the prices are determined, orders are taken. If the volume of orders is smaller than anticipated, the actual profit realized will be less than the mark-up and may run into a loss. On the other hand, if the volume of orders taken is more than anticipated, our profit will be increased.

In many seasons from 1924 to 1939 the volume was so small that it was impossible to make any profit at all.

So far as prices are concerned, our chief problem, of course, has been rising costs. Since 1940 there has been an increase in all our costs which can be illustrated by the following percentages:

Costs in 1948 compared with costs in 1940

[1940=100]	*Percent*
Fine Australian wool out of bond	211. 3
Fine Territory wool	194. 6
Manufacturing labor (average per hour)	250. 1
Overhead (all items)	223. 0

[21] See appendix D, table II, for data submitted by the company.

We had to deal with a new set of costs in 1948. Wool and other supplies continued to rise—wool is now at an all-time high—and labor costs were increased 20.6 cents, 15-cent general increase plus fringes, per hour effective February 1. Price increases had to be made.

Under the conditions existing in 1946, 1947, and in the early part of 1948 we certainly could have charged more for our fabrics. The demand was insistent and our production had to be allocated among our customers who needed great quantities of fabrics for their own businesses. Doubtless, they would have stood for more of an advance had we asked.

We believe that profits should be a percentage of cost and to that extent our mark-up will increase prices proportionately when costs are rising. However, the amount of our profit does not depend upon price alone but is largely determined by the volume sold.

When there is a buyers' market, fabrics are sold at best available prices, regardless of costs, in order to obtain business. * * * * * * The only way we can make money is to run our machinery at a high degree of capacity, and the only way we can do that is to sell. Now, we sell everything in advance; we take orders for them. We do not manufacture for stock. Because of the changing styles and the changing prices, it would be foolish for us to run our machinery to pile up a large inventory of finished goods. So we only run our machinery when we have orders on hand to fill.[21a] The only thing that reduces our production is when we cannot get enough orders. * * * We would disregard our profit margin entirely if it were necessary to cut our price to get our share of the business, and we have done it time after time. * * * We feel it is probably better to lose money running our machinery than to lose it shutting it down.

Nelson Cruikshank, A. F. of L.

Mr. CRUIKSHANK. During the entire postwar period, unions have been struggling to keep wages abreast of the drastic price rise. Except for a few months when prices temporarily declined a little, then rose again, wages have fallen steadily behind in the race with prices ever since VJ-day. Two years after the war's end living costs were up 24 percent, wages only 18 percent; by October 1948 (latest figure) living costs were up 34 percent, wages only 31 percent.

Prices have been raised more than enough to cover any added cost due to wage increases, and the result has been that business profits have reached new peaks. With each postwar year a smaller and smaller portion of the income created by American industry has gone to workers and a larger and larger part to profits. For example, wage and salaried workers in 1939 received 65 percent of the income created by industry; in the first postwar year, 1946, the share paid to workers had dropped to 63 percent, and declined further to 61.3 percent in 1947 and to 60.8 percent in the first half of 1948. Meanwhile the share going to profits of both corporate and unincorporated business increased steadily in each postwar year. The share going to profits was 29 percent in 1939 and 37 percent in 1948 (first half). The figures are from the United States Department of Commerce.

[21a] Through a mechanical error of transposition this sentence was incorrectly quoted in the preliminary mimeographed issue of the report. The error has been acknowledged to the witness by the staff and correction made in this printed copy.

Robert Dunlop, president, Sun Oil Co.

Mr. DUNLOP. Our company is both a buyer and a seller of petroleum, but in either case our pricing policies are basically the same. We attempt to evaluate the competitive condition of the market and to ask or to offer, as the case may be, prices justified by the underlying economic situation.

Bearing in mind our responsibilities to the public, our contractual obligations to our customers, and what we deem to be the long-range best interest of our stockholders, we seek to ascertain for ourselves the price that will bring supply and demand into balance and result in firm market conditions.

We do not act capriciously or arbitrarily in this matter of pricing our products. Neither do we search opportunistically for situations of local supply-demand unbalance in order to take advantage of a temporarily upset market condition. Let me give you an example.

Last winter after taking care of our contractual commitments we found ourselves with a small margin of "extra" heating oil on hand in some regions where temporary shortages had developed. Presumably, we could have asked and obtained premium prices for this oil, since supply and demand were unbalanced, and, in strict conformity to economic principles, higher prices were in order. But we chose to sell the "extra" heating oil at our regular prices because we believed that the local discrepancies between supply and demand at that time were not indicative of fundamental market changes.

In establishing the prices we ask for our products, costs have no immediate relevancy. The market does not permit us to set such prices as will cover our costs by a certain margin. In a strict sense, we are not free to set prices at all. It is much more accurate to say that we attempt to find the market price as set by the forces of supply and demand, and, having found it, we must accept that price whether we happen to like it or not. Of course, over a period of time we have the alternative of shifting our productive facilities to other products, if the market price for a particular product is not satisfactory to us.

We buy from independent producers somewhat less than half of the crude we use. With regard to the price we offer for crude oil, our immediate consideration is the necessity of maintaining adequate stocks to meet the requirements of our refineries. We offer whatever price is necessary to gain that objective, taking care, of course, not to offer a higher price than we must.

Once in 1946 and again in 1947 we found it necessary to initiate price increases in order to keep adequate supplies of crude coming to us. The fundamental correctness of our interpretation of the supply-demand situation on those occasions is attested by the fact that other buyers of crude found it wise to follow our lead and the price increases held. As I have already said, these price increases were instrumental in encouraging increased production, hence in providing greater supply for all users of crude.

Of course, petroleum-product prices have been affected by inflationary forces just as have the prices of other goods. Until recently in these postwar years, our product prices have tended to move upward, and this, coupled with an increase in the volume of our sales, has resulted in increased dollar profits for our company.[22]

[22] See appendix D, table XII, for income statement submitted by company.

From 1946 until the beginning of the present unstable price situation, the general level of crude-oil prices rose six times, one of which was authorized by OPA, for a total increase of $1.40. None of these increases, except that granted by OPA, directly resulted from the fact that someone merely thought a price rise would be a good idea and then acted. In each instance there was a very real and aggressive demand pressure by someone needing crude oil that forced the price up. Each increase reflected a tight industry-wide supply-demand situation. If that were not true, the increased price would not have held.

In each instance, the obvious public desire was for larger supplies of oil products which, of course, required increasing supplies of crude oil. Chart 3 sets forth the historical trend of well drilling as it follows the pattern of crude prices. You will note the lower line is the line of average crude-oil prices by years. The upper line, unbroken line, is representative of the well completions; and you will note that there is a very sharp correlation between price and well completions, which, as you gentlemen appreciate, are the source of oil production. Thus, even though demand factors dictated the price increases, it was believed that they would prove to be incentives for stimulating increased crude production.

This precisely has happened. Well drilling last year was 13 percent greater than in 1946, and this year it is estimated the additional wells completed will show an even greater increase.

Since February a year ago, the month just prior to the first 1947 price increase, domestic crude oil production increased from a daily average of 4,810,000 barrels to a new high average of 5,679,000 barrels daily for November of this year. That chart indicates the production over the 3-year period. You gentlemen may wonder why there was a sharp drop in December of this year. That was occasioned by the strike existing on the west coast, wherein there was a drop of approximately three-quarters of a million barrels per day during the course of that strike.

Meanwhile, stocks have been increasing, and our inventories today of gasolines, kerosenes, and heavy and light fuel oils are 72,000,000 barrels larger than they were a year ago. In addition, crude oil stocks have increased 11,000,000 barrels in the same period.

Obviously, therefore, increased prices have had the effect of increasing supplies of oil and this is what the consuming public has desired. But has the public, as a few critics have suggested, been forced to pay "through the nose" to get these increased supplies? The answer is to be found in a comparison of oil prices with prices for other commodities and the general price pattern of the Nation.

Although generally posted crude oil prices, on the basis of East Texas crude, advanced 112 percent from 1941 to the fall of this year, admittedly a sharp rise, wholesale raw material prices on an average increased 116 percent and average wholesale farm product prices 130 percent during the same period.

Increases in crude oil prices have been reflected only in part in increased prices to consumers for gasoline, heating oils, and other petroleum products. At service stations across the Nation, for example, motorists today are paying an average of only 35 percent more, including tax, for gasoline than they did in 1941. Meanwhile

the Government's consumers' price index, covering such things as clothing, groceries, and furniture, in the same period rose 65 percent. This is shown in chart 5.

Although it is perhaps too early to be definite about it, we may be entering the final phase of the economic cycle, with supply outrunning demand and reductions of oil prices and oil profits in prospect. Dr. Joseph E. Pogue testified to that effect before you last week. In my opinion there is much evidence to support this point of view.

For example, my company recently reduced prices of fuel oils by up to three-tenths of a cent per gallon for heating oils and by 22 cents per barrel for heavy oils. Later in the current month we reduced the wholesale price of most greases, and on the 10th, last Friday, we lowered the wholesale prices of a long list of lubricating oils by $1.05 per barrel.

Increased dollar profits have resulted from these high prices. In fact, oil's increased profits in aggregate dollars are larger than at any time in the history of the industry. But whether these profits are evidence of a healthy economic situation remains to be seen in view of the attendant circumstances. For to be properly appraised, these earnings must be related not only to the general economic situation, the general oil supply-demand picture, the purchasing power of the dollar, but finally and most importantly, to the obligations, involving replacement and expansion problems, resting on the industry to supply the oil needs of the consuming public. Only as this is done can current oil profits be made meaningful and significant.

Eugene Holman, president, Standard Oil Co. (New Jersey)

Mr. HOLMAN. Clearly, then, as a matter of self-interest, we would like to see an end to inflation. Recognizing that prices of oil are an element in the prices of things we must buy, our company has, as you know, resisted price increases in our industry. We resisted increases in prices of crude oil by not attempting to outbid other buyers and by publicly expressing our opinions on the undesirability of crude price rises.

We found, however, that refusal to pay going market prices resulted in our losing crude supplies in amounts which jeopardized our ability to meet customers' needs for heat and power.

On two occasions in the past year and a half, therefore, we were forced to pay more for crude.

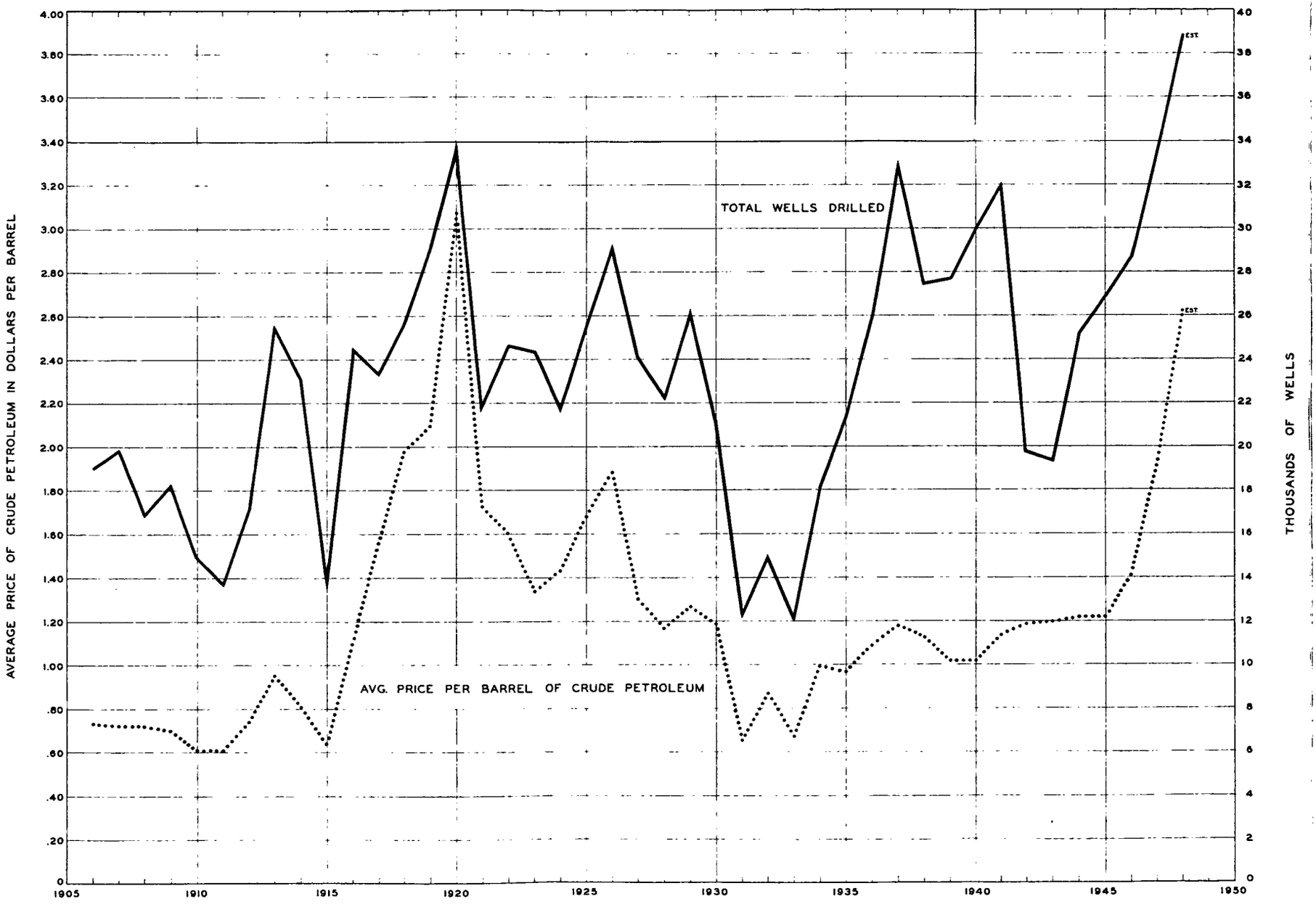
This experience demonstrates how crude-oil price is determined by supply and demand through the action of a large number of suppliers and purchasers in the market place. Some may lead; some may lag; but, in the final analysis, all must adopt substantially the going price established by the competitive market.

Petroleum prices are the expression of the public's desire for products and for new facilities to provide additional products. They will be high enough to bring in the needed marginal supplies. They will be low enough to exclude those firms whose costs are too high and whose added production is not needed.

Our product price increases in the last year and a half have reflected approximately the higher price for crude oil. During this period there has been a wide spread between the quotations of various suppliers in the principal refining market—the Gulf coast. At times

U. S. DRILLING OPERATIONS AND AVERAGE PRICE OF CRUDE PETROLEUM

BY YEARS FROM 1906 U. S. BUREAU OF MINES

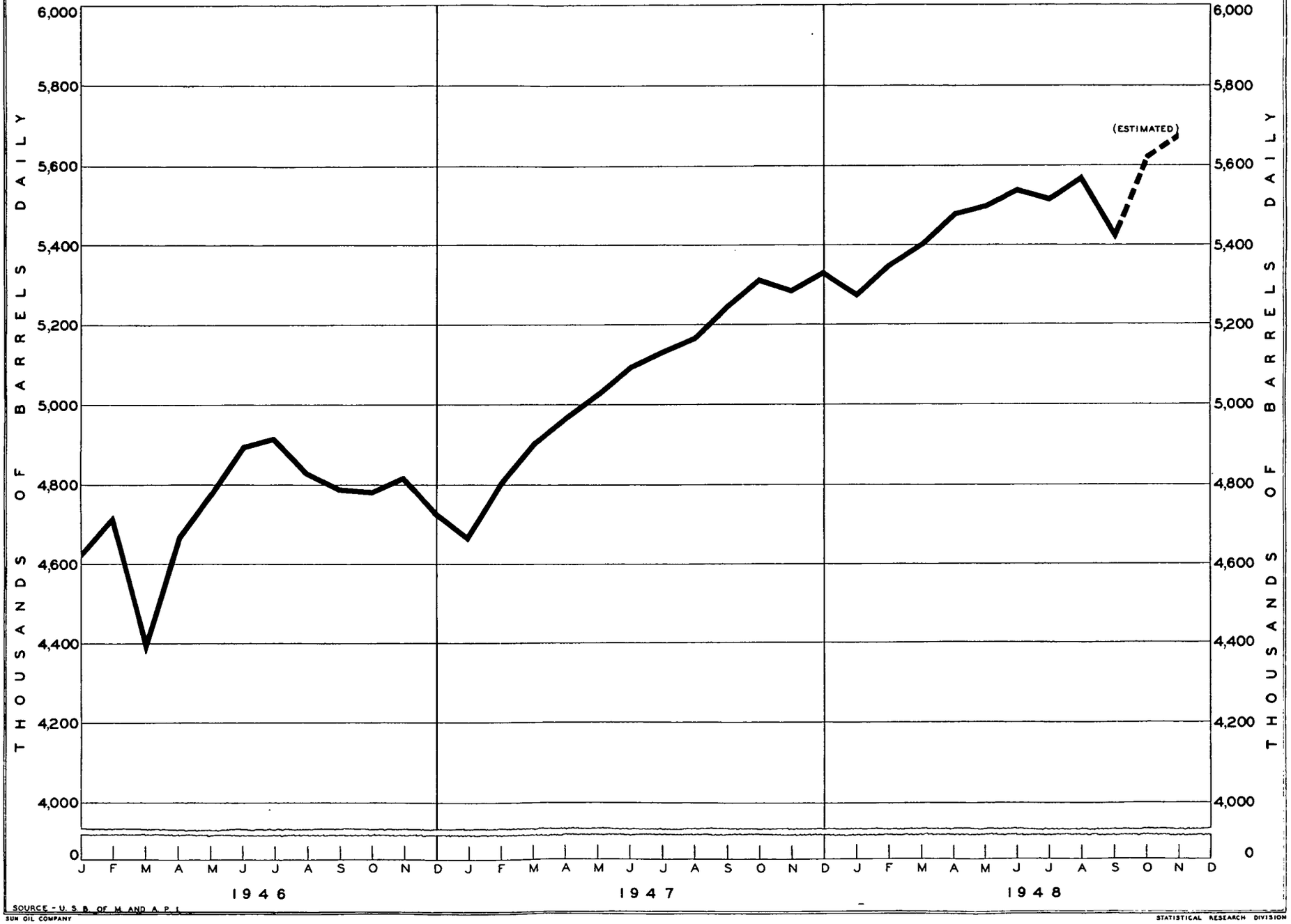


SUN OIL COMPANY STATISTICAL RESEARCH DIVISION

83457 O - 49 (Face p. 86) No. 1

UNITED STATES CRUDE OIL PRODUCTION

BY MONTHS 1946 - 1948



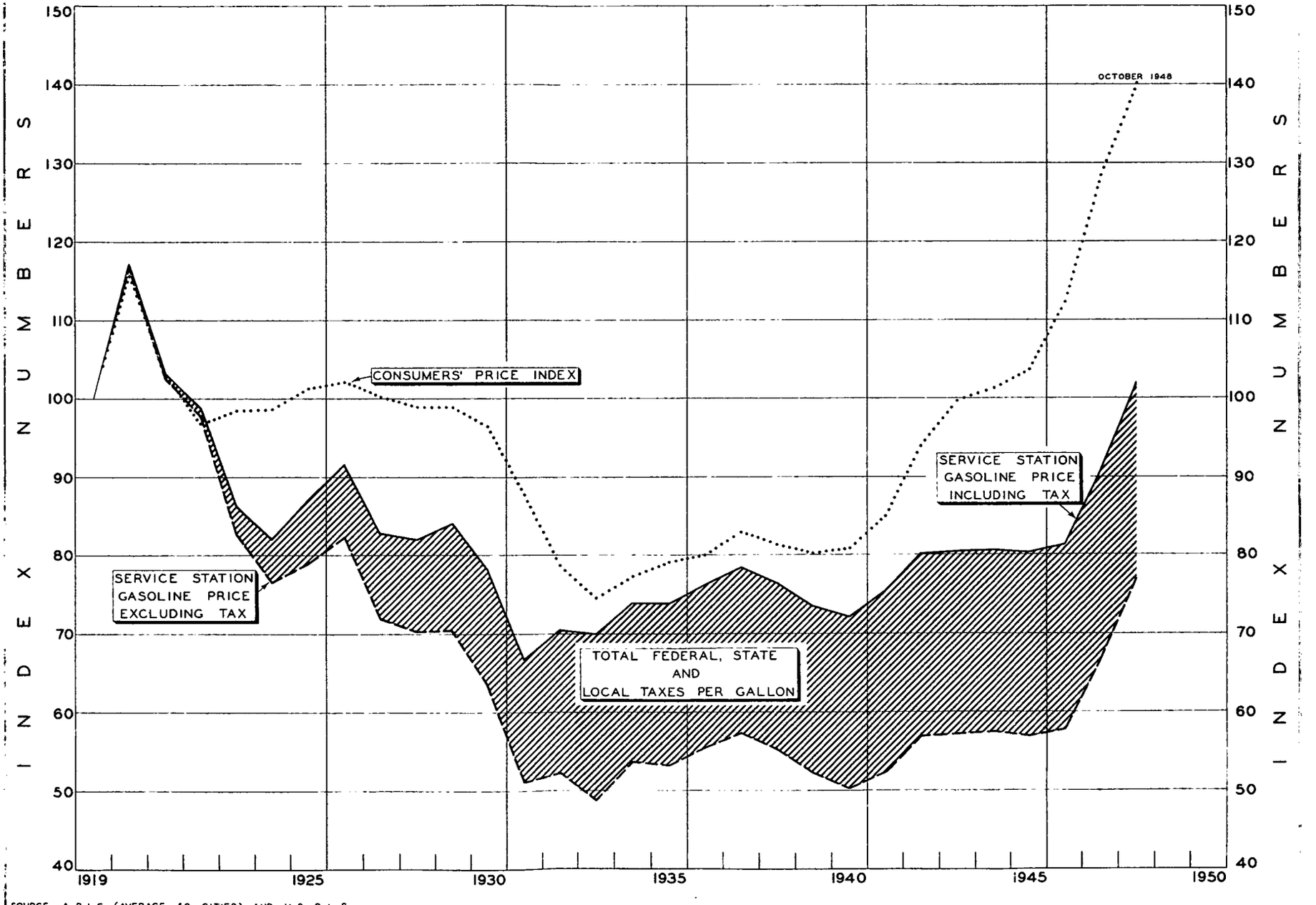
SOURCE - U. S. B. OF M. AND A. P. I.

SUN OIL COMPANY

STATISTICAL RESEARCH DIVISION

AVERAGE HOUSEBRAND GASOLINE PRICE INDEX AND CONSUMERS' PRICE INDEX

ANNUALLY FROM 1919 — BASE PERIOD 1919=100



SOURCE - A P I C (AVERAGE 50 CITIES) AND U S B L S

SUN OIL COMPANY

STATISTICAL RESEARCH DIVISION

the difference between high and low quotations has been as much as 6 cents a gallon, and even today in most products the differential is from 2 to 5 cents a gallon. Our prices, gentlemen, have been consistently at the low of the market. To our knowledge, no company has sold below us.

Comparisons are often made between wages and the general price level. In our case, salaries, wages, and benefits per employee have gone up appreciably more than our prices.[23]

Clarence Francis, chairman of the board, General Foods Corp.

Mr. FRANCIS. General Foods is a sales-minded company, and no salesman likes to increase prices. Even in the face of increased cost, an enthusiastic salesman resists the urging of his financial advisers that prices need to be increased. In the highly competitive food business a sales-minded company will do everything to avoid creating a price advantage for a competitor or a price advantage to a substitute product. We have already indicated that our long-range purpose is the establishment of stable and expanding franchises.

It is on the basis of all known or probable costs and on more or less reasonable assumptions about the decisions which competitors will make on their prices or their promotion or their new products. The general economic picture, our own market research into distribution possibilities, everything that we may want to do for specific products or that we can estimate about Government policies, the vagaries of nature, the labor situation, and so forth, must be taken into account in setting a price.

The cost of the raw materials in our business is the prime factor, however, of price determination with labor as the second most important item. Thus, our prices are determined in the main by farmers, by governmental support prices, by barriers to world trade, and other such factors. Price policy is made in consultation between our general managers and our operating vice presidents and usually with the approval of our president or myself.

A very large part of the cost of the goods we sell is virtually beyond our control. We have to pay the market prices for those goods.

Some of the factors outside our control which have influenced our cost, and hence our profits, have been the whims of nature, domestic and foreign governmental policies as they affect agricultural production and prices, the gyrations in wheat, corn, coffee, and cocoa prices, changes in prices and availability of sugar and vegetables and containers, the relative prices of meat and fish, the availability of foreign products like coconut and tapioca, as well as of cocoa and coffee—all of these have affected our 1947 and 1948 profits, are affecting both the prices we have to pay for the commodities we use, and the consumer market for our products. For instance, the current high prices of chocolate products has certainly curtailed consumer purchases and our profits from that area during 1948.

Over the long run we plan for production and promotion of each product on the assumption that we can turn it out at prices that will meet competition and at the same time cover our costs with a reasonable profit.[24]

[23] See appendix D, chart 1, submitted by company.
[24] See appendix D, table VI.

John Schmidt, vice president and comptroller, Armour & Co.

Mr. SCHMIDT. In answer to your request for cost data we have prepared and submit a table (appendix D, table IV) which shows the segregation of the company's sales dollar for the 10 years (1939–48), in total and in cents per dollar of sales. This table shows costs and expenses segregated as between cost of material—livestock, and so forth, cost of supplies, payments to employees, sales freight, depreciation, taxes, interest, and all other expenses.

We call to your attention the very important fact that over the 10-year period we paid from 71.34 to 79.44 cents out of each sales dollar for the purchase of livestock and other raw materials.

Senator O'MAHONEY. Now, do you fix the price of meat or determine the price, the asking price of meat, on the basis of the cost of the entire animal or on the cost of that proportion of the animal which goes into meat?

Mr. SCHMIDT. Well, on the entire animal, because all of the by-products are credited to the animal.

Senator O'MAHONEY. Then you want us to understand that the return which you obtain from the sale of byproducts reduces the price which must be paid by the consumer for the meat?

Mr. SCHMIDT. That is correct.

Senator O'MAHONEY. Have you a table which you can furnish to the committee, showing how this differentiation is made?

Mr. SCHMIDT. The byproduct credits? Yes, sir; we can do that.

Senator O'MAHONEY. I think it would be a very valuable table to have, if you will furnish it to the committee, please.

Mr. SCHMIDT. We will do that.

Mr. BERQUIST. Do your profits figures, in fraction of the cent per pound or dollar, include all of the profits of all of your operations charges against your total pounds of meat?

Mr. SCHMIDT. That is correct.

Senator FLANDERS. Let me put this another way: Are your total profits on all of the products that come from the live animal as it goes into your slaughterhouse, are the total profits divided into the pounds of meat sold, so that when you say that you have a profit of so much per pound of meat, it represents your profits on the entire animal?

Mr. SCHMIDT. That is correct.

Enders McC. Voorhees, chairman of finance committee, United States Steel Corp.

Mr. VOORHEES. In an effort to aid in stemming the tide of inflationary forces, United States Steel in April 1948, voluntarily reduced its prices for most steel products. The general price increase which United States Steel was reluctantly forced to make last July, after this endeavor to stop further inflation had failed, was made necessary by increasing costs—higher employment costs, higher transportation costs, higher prices for scrap, coal, tin; and the many other goods and services which United States Steel must buy from others in order to conduct its business.

It is sometimes contended that price increases following a substantial wage increase have been more than adequate to take care of the higher employment costs resulting from that wage advance. Al-

though plausible to some, this completely overlooks the fact that, in the case of United States Steel at least, the cost of goods and services purchased by it from others about equals its total employment costs. As wages advance across the country in a new round, so do the prices of the goods and services purchased by United States Steel. During the first 9 months of 1948, the employment costs of United States Steel aggregated approximately $739,000,000. The cost to it of purchased goods and services during this same 9 months' period was approximately $706,000,000. About this same relationship between these two principal classifications of cost prevailed during 1947.

Although profits were not record breaking in 1947, no matter how they are compared with past years, there were a number of record-breaking features for peacetime about United States Steel's affairs in that year.[24a] For example:

(1) United States Steel broke all its earlier records for the production of steel ingots.

(2) United States Steel's shipments of products constituted the largest tonnage in its history.

(3) United States Steel provided employment for a record-breaking number of people.

(4) United States Steel had the largest annual pay roll in its history.

(5) The average hourly earnings of its employees were the highest on record.

(6) The cost of goods and services purchased by United States Steel reached a new all-time high.

(7) United States Steel's expenditures for plant and equipment to help meet the steel needs of the Nation were the greatest in its history.

(8) United States Steel's taxes were the highest for any peacetime year.

Lastly, United States Steel made another record, but on the low side. Its income as a percent of sales was 6 percent—the smallest for any year of anywhere nearly comparable rates of operation in United States Steel's entire peacetime history. For the first 9 months of 1948 the return on the basis of sales was even smaller; namely, around 5 percent.

M. E. Coyle, executive vice president, General Motors Corp.

Mr. COYLE. At the end of the war General Motors was among the first to feel the pressure for higher wages. Realizing that a higher wage level would mean higher prices and an added twist to the inflation spiral, General Motors suffered a 113-day strike rather than yield to this inflationary pressure. During the period of the strike our costs and expenses continued at the rate of $1,000,000 a day. Our plants were shut down; reconversion was delayed; and we were prevented from doing business for nearly 4 months. The strike was settled after the pattern had been set by a wage agreement in the steel industry accompanied by an increase in the OPA ceiling price of steel.[25]

Successive wage increases throughout industry which have followed this first round have materially affected General Motors' costs. Not only have direct labor costs increased, but substantial increases in material costs must be attributed to the general rise in wages for the

[24a] See appendix D, tables XIII and XIV, for financial and operating data submitted by the company.
[25] See appendix D, table VII, for financial data submitted by the company.

reason that most of the materials and parts General Motors purchases on the outside have a high wage content.

From January 1941 to October 1948, wages in General Motors as measured by average hourly earnings have increased about 77 percent. Wage rates, under the terms of our current agreements with unions, are now tied to the cost of living. In the same period prices of a group of basic industrial raw materials, compiled by the United States Bureau of Labor Statistics, increased about 100 percent. Nonferrous metals and some other raw materials used in the manufacture of automobiles increased much more. On the other hand, prices of General Motors cars currently average 75 percent above those of the 1941 models.

The increase in the prices of GM cars has been little more than the increase in the cost of living, as measured by the BLS consumers price index, which has amounted to 72 percent since January 1941. On the other hand, prices of such important commodity groups as farm products, foods, and textiles—which play an especially important role in determining the over-all cost of living—have increased far more than automobile prices. An interesting side light is that in January 1941 it took nearly 2,000 pounds of round steak at 38 cents per pound to equal the price of a Chevrolet. Today it takes only 1,400 pounds of round steak at 93 cents per pound to equal the price of a Chevrolet. Many other cost-of-living items have gone up more than car prices.

The increase in car value is evidenced also by the fact that while in 1928 it took an average factory worker nearly 1,200 hours to earn the price of a Chevrolet, in 1941 it took only a little more than 1,000 hours. Today, it takes less than 1,000 hours.

Russ Nixon, United Electrical Radio and Machine Workers of America (CIO)

Mr. NIXON. From this allegation [the low rate of profit per sales dollar] is drawn the conclusions that prices could not be reduced in any significant degree by a reduction in profits and that there is virtually no margin available to pay wage increases. This is a convenient conclusion for profiteers and their apologists. Any person with an elementary knowledge of economics knows that such a simple exposition distorts the economic relationship of profits, prices and wages.

A finished product before being sold to the final consumer is sold a number of times, passing from the raw material supplier to manufacturer to retailer and each of these transactions are counted as sales. On the average, a product which sells for $10 to the final consumer has the processors ringing up $30 of sales. If this double counting of sales is avoided and only the value added by each processor is considered, profits before taxes plus the salaries and bonuses of corporation officials amounted to approximately 30½ cents out of each dollar of final product produced by corporations in 1947. Thus the leeway in considering price reduction was not 6 cents or 7 cents as the NAM would have the public believe but 30½ cents.

The NAM and its members draw the pious conclusion from a 7-cent return on sales that there is no possibility of reducing prices or granting wage increases. The facts are that simultaneous reduction by all corporations could reduce prices by 20 percent and still leave profits and executive salaries one-third greater than in 1939. When we have the final figures for 1948, the margin will be even greater.

Retained Earnings, Dividends, and the Market for Equities

The retention in a business of a substantial segment of net earnings has come to be regarded by most corporations as preferable to reliance on the market for the sale of new equity securities. Funds held out of earnings for expansion are, of course, in addition to the reinvestment provided by depreciation allowance. The subcommittee inquired of various witnesses for the facts behind this widespread conviction that the equity market was relatively unattractive. While the evidence was not always conclusive as to the causes, the fact was made amply clear that most expansion funds for business are now being, and are expected to be, provided through retained earnings. [See previous section on Need for and Sources of Investment Funds.]

Donald Montgomery, United Automobile Workers CIO

Mr. Montgomery. Industry has been retaining a larger and larger share of its profits and reinvesting them. Nearly two-thirds of the profits earned are now retained, which reduces dividends to a point that makes it difficult to attract equity capital from the investing public. Consumers rather than investors have become the main source of new capital for industrial expansion.

To distinguish this from the equity capital obtained from investors, we may call it *inequity capital*, since consumers (1) do not invest it willingly, but have it taken from them, and (2) having invested it they retain no equity in the corporations to which they have donated it.

I believe that the intent of corporations to acquire capital from the consuming public through high prices and profits has been quite frankly admitted to this committee by some of its witnesses. I can also refer you to Barron's Weekly of last August 18 where a review of the electric-utility industry points out that customers, not investors, will contribute some 85 percent of the funds for the industry's $5,000,000,000 construction program over the next 5 years. High rates charged for electric service, the review says, are the means by which these funds will be obtained from consumers. As stated to you by Clarence Francis, chairman of General Foods, these reinvested earnings are "costless capital." This is a terse way of making the whole thing clear. Consumers who have been paying the prices for General Foods products which include these capital contributions may not share with Francis the view that it has been costless.

An undistributed-profits tax could remedy this situation and force corporations to pay out the greater part of their earnings as dividends, thus restoring vitality to the investment market. Equity capital would not then be so hard to come by. Furthermore, corporate managements would have to compete one with another for the favor and confidence of the investing public. This is in the spirit of the alleged free enterprise and the dispassionate role of the market place which fills so many columns of type in, for example, the National City Bank Monthly Letter.

If competition is not restored to the investment market by this means or some other, then we suggest for the consideration of this committee that it should consider how the present contributors of "inequity capital"—the consumers—may acquire some equity in what they have financed. Only the Government, obviously, is in

position to represent the consuming public in such a matter. We submit that, if the present mode of financing industry is to continue, the Government is obligated not only to inquire into, but to have some say about, the decisions of corporate management which determine how the public's funds are invested. It should know what industries are expanding, and why. Especially it should know why in certain basic industries private management withholds the funds which it has collected and will not reinvest them to provide much needed expansion of productive capacity.

If this seems revolutionary, it is a revolution already brought about by corporate management and now justified by witnesses who have appeared before you with their new theory of depreciation. We merely point up the obligation which these developments place upon our Government, representing all of us.

George D. Bailey, partner, Touche, Niven, Bailey & Smart, accountants

Mr. BAILEY. Corporate profits, or earnings, or income, are not the same as distributable profits. A substantial proportion of the dollars reported as profits must be kept for the business itself and cannot reach the individual stockholder. This is true even with a stable price level, but in a period of rapidly increasing prices as a result of inflation this necessity for retention of profits as determined by accounting conventions is greatly accentuated.

With a monetary unit fluctuating only as it did prior to the war, prudent business management required that corporations retain part of their earnings as a general protection against the fluctuations of business activity and to provide the improved tools and facilities necessary to increase production and reduce costs, and to provide for necessary increases in working capital.

In this inflationary period, those particular needs have increased in importance and, in addition, the impact of inflation itself requires the retention of additional amounts of profits or earnings. This impact is at two major places.

First, as prices go up, a corporation is required to invest more dollars in its inventories in order to have just the same quantities as it had before, and profits need to be withheld to provide for that additional investment.

Second, in a very great many companies, including almost all manufacturing companies, machinery and facilities are constantly wearing out and have to be replaced. With price levels constant, depreciation on cost is presumed to provide for necessary replacements, presumed to provide enough money to provide those facilities that have to be replaced.

But with the increased prices today, the replacement of facilities costs very much more than the original cost of the article being replaced. Profits should be retained in the business to offset this increased cost if business is to maintain its productive capacity. To distribute all earnings, or even to consider as increments of investments, amounts required to replace inventories and plants at the higher price levels would be a quick and sure way of weakening our industrial capacity.

William A. Paton, professor of Accounting, University of Michigan

Mr. PATON. Now, the reason some companies have gone to the insurance companies, and issuing preferred stock with sinking-fund requirements, is precisely because they are finding difficulty in issuing common stock. In the utility field, which has such enormous fixed capital, the equities have been thinned, in my judgment, to a perilous point by the issue of bonds and preferred stock, and I think it is generally recognized that what these companies need very much right now to keep them in the kind of position that they should be in is more buffer equity money. You cannot have a legitimate preferred stock or bond, for example, unless you do have a substantial buffer equity. You have to bear in mind in a general way, for one reason or another, the inclination to invest in new common-stock money is minimized considerably at the present time. I think that that is the actual fact of the case.

Senator O'MAHONEY. I still feel that a good deal of the cause of this arises from the fact that long-term financing is not as available to new business and local business from commercial banks as it is from large institutions, and that has resulted in a growing demand for Government finance.

Dr. PATON. Well, it is an extremely interesting situation there, and the main thing I would stick to is that we are not getting the flow of common-stock money that I would like to see. I think the continual borrowing and borrowing without adding to the buffer is not a good financial situation.

Readers of 1947 and 1948 corporate statements have been in some cases suggesting that a larger share of reported earnings should be distributed in dividends. One reason, of course, for the retention of earnings in substantial amounts in recent years is the great need for funds for replacement and expansion of facilities, coupled with the difficulty of securing new equity capital, but it is fair to say that a partial explanation of the prevailing relation between dividend disbursements and reported earnings in many cases is found in the fact that reported earnings are larger than they would be if all costs were measured in the same kind of dollars as are represented in recepits from customers.

It is a well-known fact that new financing through issue of common stocks has only been a trickle for years and there has been little or no improvement in this situation in such supposedly good years as 1947 and 1948. This is a serious situation, and does not suggest that now is the time to try to pick a little more meat from the stockholder's bones—unless it is deliberately intended to use this as a means of making the position of private risk capital completely untenable.

The unfavorable condition and prospect of stock equities is further evidenced by the state of the securities markets. The shares of many of our best companies, many of these large companies that are supposed to be doing so well, are actually selling at a low price by comparison with the showing in earlier periods.

They are selling, for instance, now in terms of 1948 dollars, for much less than their prices in 1946, in terms of 1946 dollars. If you take a 10-year period you find a showing there that I think is discouraging. If these few companies are doing so well they at least

ought to be able to raise money by the issue of common stocks, and all the evidence that I am able to get hold of that that is extremely difficult to do.

I think the official figures of the Securities and Exchange Commission show that the financing of recent years has been almost entirely bonds and preferred stocks and that people with money to invest do not want to take the position of the common stockholder.

Joseph E. Pogue, vice president, Chase National Bank

Mr. POGUE. In keeping with the rise in net income in 1948, which is subject to all the qualifications outlined above in this statement, capital expenditures and additions to working capital will also be greater by 600 to 700 million dollars, thus drawing off most of the increment and converting these funds into physical plant, equipment, and inventories. The extent to which this process was essential can best be measured by estimating the ratio of cash dividend disbursements to reported net income for the full year 1948. This estimate can be made with considerable accuracy because the dividend record for practically the entire year is now available and only the fourth-quarter earnings need be approximated. It thus appears that in 1948 only 24 percent of reported net income will be paid out in the form of cash dividends compared with 35 percent in 1947 and 43 percent in 1946. This drop in the rate of disbursements is pretty conclusive proof that the industry was "strapped" for cash in 1948 despite the magnitude of its income, and that earnings were further converted into fixed assets.

Senator FLANDERS. There are one or two other questions that I want to ask you. One of our witnesses so far has suggested that if business concerns paid out a larger percentage of their profits in dividends—you make a good case for saying it would have been impossible, but let us suppose the oil companies could have done so—that oil stocks would have been more attractive to the public and that the ratio of preferred and common—they are lumped together here—to the long-term debt would thereby have been changed materially; the common-stock element in the new financing would have been much larger, and the long-term debt would have been smaller or would have disappeared.

Can you make any observations on that idea?

Mr. POGUE. Well, Senator, I think that I will have to put it in several ways. It is notorious that our capital markets have been crippled and that they behave quite differently from the behavior in the past. There are many theories to account for that. In the first place, the markets are regulated. Those closest to the markets think that they are overregulated.

In the second place, the flow of savings from the investor to the market has been seriously diverted in respect to this objective by the personal income tax.

In the third place, the groups that have obtained the greatest increases in income have for some reason never become interested in investments, and those sums, which are very great in the aggregate, are

not going into the market. If some genius could find a way for tapping those funds, the savings of the more prosperous of the middle and lower brackets, we might see a different kind of market.

Now, many of us have thought that if some way could be found for improving the equity markets then more funds could be obtained from that source and less of these funds need come from profits, which of course are a product of prices and volume. So that if you could take measures to improve the liquidity and vigor of the equity markets, I think there would be little question that the result would be lower prices for goods.

Now, so far as the oil industry is concerned, it looks to me as if, putting ourselves into this same moment of time last year, the oil industry, the economy in general and the public were faced with an emergency. There just was not enough oil. People were about to go cold. And even if there had been a master mind sitting at the helm steering the course, which there wasn't—what happened was the composite result of many individual actions—he would not have indulged, with the ship sinking, in theoretical excursions and explorations; he would have done, I think, exactly what the composite result was. He would have taken the materials at hand and done the job with those tools.

Now, on the plateau or downswing, we can take things a little easier and theorize about them.

Senator FLANDERS. I realized I was asking you a theoretical question, in view of the case you were making, that you could not have spared any more for dividends.

Mr. POGUE. It seems to me that, if ways can be found to unregulate the markets so that they will function, a lesser burden will fall upon price. Furthermore, on the debt side the oil industry has a ratio, I think, of about 14 percent of debt to its total borrowed and invested capital. That is a very sound ratio.

Now, it so happens that the more regulated an industry is, the higher the debt ratio, the more precariously the industry is situated to meet the fluctuations that lie ahead. You can just think through the industries, and the debt ratio tends to bear some relationship to the degree of regulation of the industry.

The railroads are the most notable example of a high debt ratio. They did not generate their own capital to any large degree in their growth.

The oil industry has and does, and I submit that of the two procedures, the self-generation of capital is better than the other method. As a matter of fact, all that happens when you get capital from the outside is that you have got to get it from some other source, and all industries can't do it, because they simply would then be taking in each other's washing. There is a fallacy in that.

So I think that the generation of much of your capital from your own operations is the soundest way to do it.

Now, the oil industry, as I have indicated, does a reasonable amount of borrowing. I should be making a case for larger borrowings, because I am a merchant of credit, and I should be plugging for my own business.

Hiland G. Batcheller, president, Allegheny-Ludlum Steel Corp.

[See also statement by Mr. Batcheller in section on Need for and Sources of Investment Funds]

Senator FLANDERS. The suggestion has been made before this committee that if the dividend rate had been higher, that the cost of equity capital on the market would have been lower and you could have financed by the sale of equities. What is your point of view on that question?

Mr. BATCHELLER. My point of view is from the practical viewpoint, Senator. I do not see any sense in taking money beyond a reasonable rate of return to your stockholder, that you need for improvement or expansion or research, and turning it out to the stockholders, and then going out and raising or selling more stock to acquire more money and bring it back in. The only effect of that is the cost of the financing being lost to both the company and the stockholder, and the Internal Revenue Department takes a bigger bite out of the amount the individual receives of that extra dividend. I do not think it does any good, because investors do not pay as much attention to the current return they receive on securities as they do to the prospects of a continuing return and an increasing return in the building up of an equity.

Senator FLANDERS. Of course, it is true that the Internal Revenue takes a tax out twice instead of once if we go through the investor circuit back into the company again. Do you feel that that is one of the factors in the situation? In most industries, traditionally, I suppose it has been true that the payment of dividends and reinvestment by investors has been a traditional process over many years, not to the exclusion of plowing back by any means; but speaking from what you know of the steel industry, has that circuit from profits to investors back into investment been more active in previous years than it is at the present time? That question would be answered, I suppose, if you had any information on the percentage, in past periods, of equity capital as distinguished from plowed-back capital.

Mr. BATCHELLER. I do not have that, Senator, and I have no doubt it has some effect, but I think the greater effect is the lack of enthusiasm on the part of the investing public for steel company securities, because steel is a prince or a pauper, and it is rarely a prince. And just before I came over here I looked at the November 1948, letter of the National City Bank, giving a compilation of the percent of earnings to invested capital in all of the principal industries, for the first 9 months of this year; and the steel industry is at the bottom of the list, with 12.6 percent. I do not think the steel industry has ever known how to sell their product or price their product, and I think it has handicapped the industry and it has been bad for the national interest.

If I could get, or if I could today take out of the earnings of my company another $7,000,000 or $8,000,000 to do research and development work on the utilization of iron from sources not now usable in blast furnaces, I think that I could lick the job, and it should be done.

Senator FLANDERS. Are you speaking of the so-called beneficiation of ores?

Mr. BATCHELLER. No, I am not. I am thinking of the utilization of the high-grade magnetites of the Adirondack region, which contain up to 30 percent of titanium oxide, and they have been sitting there, and that titanium oxide is a deterrent to the use of those ores in blast furnaces. The ore balls up and sticks, and I do not know what the problems are, I am not a blast-furnace man, but they do not use them.

Ways have been found to extract about 20 percent of the titanium oxide, and it is going into paint to replace the lead that is all gone, but there is another 10 percent of titanium oxide in there that they cannot get out.

Well, it can be gotten out, and it can be turned into metallic titanium. And what do you do then with your steel situation? You have a new metal that is in plentiful supply. All over this country there is stuff containing titanium oxide in the crust of the earth. It weighs half as much as steel and it is twice as strong. And I would just love to have the money available to use the iron content of that ore, to recover the remaining titanium oxide and to turn that into a new and useful metal. But I have not got it in my earnings, and I cannot go into the New York Stock Exchange and get it, and you cannot get money for a scheme like that. That risk capital just is not there.

So I have got to go very slowly. We take every penny of our earnings that we can, after paying a reasonable amount to our stockholders—that comes first, in our opinion—and apply it to that sort of work.

Harold Vance, chairman of the board and president, the Studebaker Corp.

Mr. VANCE. The ability to retain in the business a substantial portion of its earnings has been of particular significance to Studebaker. In fact, its very existence today can be attributed to that. In March 1933 the Studebaker enterprise went into receivership. The immediate cause was lack of working capital and inability in the situation then existing, to borrow money. When reorganization took place 2 years later, in March 1935, the new company started business with a minimum of working capital—obtained through the sale of long-term notes. During the ensuing years, until 1943 when the last of the original debt was retired, no dividends were paid to stockholders. All of the profits earned until the end of 1942 were retained in the business or were used to retire debt. Since 1943 and up to the present time the company has declared dividends aggregating $4 per share, or a total of $9,360,000. Thus, in the nearly 14 years since reorganization, out of profits amounting to approximately $51,000,000, less than 20 percent has been paid to stockholders in the form of dividends. The balance of the profits retained in the business, together with borrowings, have been used to expand and improve facilities and to provide necessary additional working capital.[26]

Senator FLANDERS. I note that you obtained money, in part for your plant expansion and improvement and in part for your additional working capital by borrowing.

Mr. VANCE. Yes, sir.

[26] See appendix E, table VIII, for statement on disposition of profit and new investment submitted by the company.

Senator FLANDERS. I take it that that was bank borrowing. It was not the sale of bonds, but straight bank borrowing?

Mr. VANCE. I have a note on that subject that I would like to read, because I do not want to rely on my memory for these dates and figures.

During the war we met our working capital needs by obtaining a V–T loan. In July of 1945, when a substantial part of our war production orders had been canceled, we paid off the balance of the V–T loan by obtaining a loan of $12,000,000 from commercial banks.

In September of 1946, we called a special meeting of our stockholders to authorize a preferred stock issue. We hoped to use the proceeds to retire our bank indebtedness. When we found that this preferred stock could not be sold on any reasonable terms, we obtained a $15,000,000 loan from the insurance companies to retire the bank debt and to make a further small increase in our working capital.

In the early part of 1948, we purchased a Government-owned plant, and gave a note as part payment. The unpaid balance was $2,730,000 on September 30.

Naturally, we would have preferred to do equity financing to meet our needs, had it been possible to do so on any reasonable basis.

Senator FLANDERS. Have you any thoughts in your mind as to why it is difficult for a company, which has been making such good progress as the Studebaker Corp. to obtain equity financing?

Mr. VANCE. I am not an expert on the stock market, and I do not know what it takes to make people buy industrial securities. But I am sure that a high rate of dividends alone will not do the job. It is my personal opinion that equity securities are hard to sell because potential buyers lack confidence and are concerned about the future.

Robert Montgomery, director and secretary, American Woolen Mills

Mr. MONTGOMERY. There are two sources of equity capital, both dependent on good earnings—one is to plow back earnings, the other, to sell stock. Sales of stock should be at prices fair to present stockholders which means they should not have their interest diluted by sales at prices less than the book value of their shares. Whether this can be done depends upon the market appraisal of the value of our earnings. Certainly, it could not be done now. The market says our common stock, even when it earns $15 per share and pays $8 or $10, is not worth more than $38 which is little more than half of its book value, $73, and less than its net quick asset value, $41.42. I think the market this morning was 36 and a fraction. Judged by this, the current percentage of profit to sales, about 8.8 percent, is too low to be the basis of a stock issue. Certainly it is not excessive. Table I, appendix E, shows we have paid out a very large portion of earnings during the past 3 years. We have not made any effort to raise equity capital since 1923.

The owners of the business, the stockholders, also have cost-of-living problems and to give them enough dollars to maintain the purchasing power they had in 1940, companies must now earn several times as much as would have been necessary in 1940.

It may be said that we are not interested in maintaining the purchasing power of stockholders, but we are; and it is a selfish interest because unless we can do that, we must give up hope of attracting

equity capital to enterprises; and upon equity capital and the reinvestment of profits, our company and whole American system of business and economy must depend for existence.

The present income-tax law with its system of double taxation of corporate profits is a great obstacle to equity financing. In 1923 when we sold our last issue of equity securities, the corporation was paying 12½ percent in income tax as compared with 19 percent in 1939 and 38 percent in 1948. To pay a $100 dividend in 1923, we would have had to earn $114 before Federal taxes; in 1939, $123; and in 1948, $161.

In 1923 a stockholder, single, with a net income of $10,000 from other sources could add a dividend of $100 to his income at a cost for Federal tax of only $2; in 1938 it would have cost him $7; in 1948 the cost is $29.92 or approximately $30. So, when we hold out the prospect of a $100 dividend to a taxpayer in this comparatively modest income tax bracket, we are offering him only $70, and $70 in 1948 is only worth $40 in terms of 1940 purchasing power.

If we take a stockholder with other income of $50,000, and much of the venture capital would ordinarily come from people in that bracket and higher brackets, we find that such a stockholder would retain out of $100 dividend, $77 in 1923; $65 in 1939; and only $34 in 1948.

In an effort to maintain the purchasing power of the stockholders we paid $12 in 1946, and we paid $10 in 1947, and we are going to pay $8 in 1948.

We felt that we should distribute as much to stockholders as we could with safety to the business. I honestly don't believe that we could get this stock up in market value to a point where we could have a successful equity financing without paying out more than that.

Nelson Cruikshank, A. F. of L.

Mr. CRUIKSHANK. During the postwar period, the American businesses have been depending on profits retained in the business to furnish about 70 percent of the new capital necessary for new equipment, working capital and other needs. This is in marked contrast to the prewar period when new capital was furnished to a much greater extent by the sale of securities to investors. This change in business practice affects our entire economy. It means in actual fact that by keeping prices high, companies actually take their new capital from consumers who pay out needed cash involuntarily to meet high prices, instead of borrowing it from investors who willingly invest their savings. A large proportion of the consumers who pay for this new capital are low-income groups who have to meet high prices by cutting down their purchases of living necessities. Qualified persons have recently pointed out that there is no reason to believe adequate capital could not be obtained through new security issues. Actually the volume of new capital raised by issuing new securities has increased steadily, as a comparison of 9-month periods in the three postwar years will show. It increased from 2.0 billion dollars in 1946 to 2.8 billion dollars in 1947 and 4.2 billion dollars in 1948. (Commerce Department figures.) However, this 4.2 billion dollars compares with 13 billion dollars spent for new plant and equipment by American corporations in the first 9 months of 1948; and the actual volume of capital obtained from new securities this year is only about three-fourths of that of 1929, although the amount spent

for plant and equipment is almost double that of 1929. Through prices paid for consumers goods, buyers are providing capital for industries over which they have no control and from which they receive no dividends. This is a form of taxation by corporations without representation.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. Industry claims that it cannot secure venture capital on the open market. This claim, in our judgment, is fallacious. Industry has not made the kind of effort which they should make in order to develop sources of venture capital. Of course, to look at the figures of the amount of new money secured through new securities issues, one would conclude that not much new capital is secured through flotations of stock. Considerable portions are secured through bonds and notes. However, we must look further and deeper into this problem. Just an examination of the statistics of new security issues does not answer the problem or permit us to draw satisfactory conclusions. For example, the present stock market does not reflect the profitability of American industry. From all reasonable points of view, based on the current profit picture of American industry, the level of stock prices should be much higher than it now is. Stock prices have not risen in relation to rising prices. This has resulted in the hesitation of people to invest in the stock market. With this hesitation goes the scarcity of equity capital.

But we must ask ourselves why the stock market does not reflect the profitability of American industry. Of course, the stock market is discounting the future. If the future were more promising in terms of there being the opportunity to maintain full employment and full production, the situation of the stock market might be altered, but it is the lack of faith in the future of America which is being discounted by the American investor.

If the American economy could be made to operate on a fair and equitable basis whereby the mass of American people could buy the mass-production goods of American industry, we would have a prosperous and profitable Nation in which there would be no scarcity of equity capital and no problem of the stock market discounting the future of our Nation.

One reason why industry is not floating new security issues and not receiving equity capital has to do with the dividend policy of American corporations. In the prewar years, corporations were distributing a large share of their profits after taxes. However, in 1929, 70 percent of the corporate profits after taxes was distributed to stockholders in the form of dividends. A little larger proportion was distributed in the prewar years 1936–39. However, in 1946, approximately 40 percent of the corporate profits after taxes was distributed in dividends, and in 1947 less than 40 percent; and, currently, about 35 percent of the corporate profits after taxes is being distributed in dividends. Maybe the stock market would reflect current profitability of American industry if the shareholders participated in the distribution of dividends to the same extent which they did in the prewar years.

Of course, industry argues that it cannot distribute dividends because it must retain its earnings in order to meet its greater need for capital. On the other hand, if industry did distribute dividends, the

equity-capital market might be considerably different from what it is today. It seems as if we have the problem of which came first, the chicken or the egg. However, we are firmly convinced that the dividend policy of American corporations as well as the lack of faith in America's future has something to do with the equity market.

Senator FLANDERS. You bring up the question whether stock market prices should be reckoned on the basis of the net earnings of the company or the dividend distribution of the companies. The stock prices at present are low. You say that, from all reasonable points of view, the level of stock prices should be much higher than they are now, and this has resulted in the hesitation of people to invest. Now, has that resulted in the hesitation of the people to invest or is that a result of the hesitation of the people to invest?

Mr. RUTTENBERG. Well, it is the result of the hesitation of the people to invest, but the point which I was trying to make was that in a bullish market investors as well as corporations and industries floating stocks become very active in the market. For example, in 1945 and 1946, when we had a bullish market, the numbers of new issues went up considerably. The moment you got a bearish market, the investor did not come into the market, nor did the person floating the stock come into the market. Now, the reasons why, as I indicated, it might be the chicken or the egg which came first, but actually it is to the advantage of the corporations to float stocks when the prices are low. I mean it is to the advantage of the stockholders and not the corporations, but the corporation at that point gets all involved in this whole process of wanting to retain earnings; and, therefore, it is not interested in getting venture capital.

Charles E. Wilson, president, General Electric Co.

Mr. WILSON. One of our major economic problems today is to induce individuals to provide the layer of risk capital to meet the needs of an expanding economy. Expansion of plant and equipment in recent years has been financed necessarily in large part by the plowing back of corporate earnings and by the sale of bonds and notes rather than by the sale of equity securities.[27]

Senator FLANDERS. Would you prefer to have sold equities of one form or another, or is this your choice?

Mr. WILSON. Such additional money as we had to obtain, it was desirable to borrow. We didn't think the atmosphere was good for trying to raise more risk capital by an additional stock issue.

Eugene Holman, president, Standard Oil Co.

Mr. HOLMAN. In 1940, when stockholders received 7.8 cents per dollar of total income, our cash earnings were more than adequate to meet both dividends and expenditures for replacement and expansion. In 1946 and 1947, cash earnings were insufficient to provide for these payments.[28]

As a result, there was a large draft on savings and other sources in these 2 years. In 1948, you will note there will be a further draft on previous savings, although a lower amount because cash dividends were cut in half.

[27] See appendix D, table V, for financial data submitted by the company.
[28] See appendix E, table VII, for statement on depreciation of earnings submitted by the company.

Taking the three postwar years together, our cash earnings will have failed to meet our cash requirements by a total of $158,000,000.

There is another comparison which may be of interest to the committee, the increase in our actual physical output compared with cash earnings expressed in 1940 dollars. While production has practically doubled since 1940, our cash earnings in terms of purchasing power have increased only 25 percent.

In connection with these figures, I would like to make a few observations as to why our company finances a substantial part of its capital program from earnings.

Our practice in this respect is rooted in the nature of our business. As I stated earlier, we are in a natural-resource industry. Our business, further, has been one requiring continuous expansion. And, because an oil field may take months or years to develop even after oil is discovered, it requires very long-range planning. Also, obsolescence is high, especially in oil refining, because of rapid technological progress.

We must be assured, therefore, that funds will be promptly available to finance new developments as they become possible and necessary. Many of the ventures which an oil-producing company must take are speculative and are not suited to borrowing. As for raising equity capital, there have been many times in the past 20 years when it would have been extremely difficult, if not impossible, to obtain such financing at reasonable rates.

In Jersey Standard, however, we have not relied solely upon retained earnings and depreciation [for investment funds]. At the end of 1947, we had funded indebtedness of 213 millions as compared with 188 millions at the end of 1940. We have sold physical assets and long-term investment holdings to obtain capital. Further, we have, in effect, used equity financing by paying our dividends partly in stock in order to conserve cash to pay for added facilities. Thus, we have used all the customary methods of obtaining funds to get the capital we need to conduct our business.

Nevertheless, we prefer, wherever possible, to finance new ventures without recourse to the capital market. We believe that the policy of retaining substantial proportions of earnings in the business, in order to assure prompt availability of capital when needed, benefits the consuming public and the stockholders.

I might mention that, as Jersey has grown through this policy of plow-back, the number of people owning the company has also grown, rising from about 136,000 shareholders in 1940 to 200,000 at present.

As I have indicated, our need for large amounts of capital arises both from the fact that we have a big job to do and that our costs, like the individual's cost of living, have gone up sharply. An example will illustrate how inflation has affected us. One of our affiliates is building a new refinery in Billings, Mont., to help take care of the growing needs of that part of the country. This refinery has been under construction for over a year.

By the time it is finished next year, its total cost will be at least $25,000,000. A comparable refinery built in 1940 would have cost about $12,000,000. This is typical of what we face. Even though our income has mounted, we have not put any money away, because of rising costs. On the contrary, as you have seen, there has been a heavy drain on our cash reserves.

John Ballantyne, chairman of board, Philco Corp.

Mr. BALLANTYNE. Because of our growth we have found it necessary to follow a rather conservative dividend policy.[29] In 1946, we raised about $10,000,000 through the sale of 100,000 shares of preferred stock to pay for part of the cost of our plant-and-equipment-expansion program. But, in addition to more plant and equipment, we have had to build our working capital up substantially to handle the increased volume, because this has meant larger inventories of raw materials and work in process, and a considerably greater dollar volume of receivables on the books. It is an interesting and significant fact that at the end of 1948, after doing the largest volume of business in our history at a reasonable profit, we will actually have less cash on hand than a year ago.

Representative HERTER. I take it that in the financing of your business, except for the sale of this preferred stock and possibly bank borrowings from time to time, you have built up your business entirely out of plowed-in earnings?

Mr. BALLANTYNE. That is exactly right, and in effect we have sold approximately 200,000 shares of common stock by our payment of dividends in common stock in the last 2 years, last December and this December. There have been approximately 200,000 shares of additional stock issued.

Representative HERTER. Using it for acquisition purposes?

Mr. BALLANTYNE. No. What we did was to pay it to our common stockholders to keep the cash in the business to handle our increased volume of sales. I do not know whether you understood that we have declared a stock dividend last year of 5 percent, and this year of 7 percent, which in effect is turning from our surplus into our capital account almost 200,000 shares of stock.

Representative HERTER. I take it you have more than the five original stockholders.

Mr. BALLANTYNE. There are over 10,000 at the present time.

Robert Dunlop, president, Sun Oil Co.

Mr. DUNLOP. We retained for business purposes 61 percent of our earnings in 1940, 70 percent in 1941, 82 percent in 1946, the same in 1947, and 88 percent in the first 6 months of the current year. With these retained earnings, we have sought to maintain and expand our productive capacity. Expenditures have been undertaken to improve our research facilities, to step up our exploration activities, to increase our production of crude oil, to enlarge the capacities of both of our refineries, and to make sizable additions to our transportation equipment.

A break-down of the uses to which we have put our retained earnings and funds arising from replacement reserves shows that in 1946, 1947, and the first half of this year we spent a total of $47,500,000 on new fixed assets such as refinery units, tankers, research laboratories and other such facilities as are necessary for the successful operation of an oil company.

During the same period, we increased our inventory through the application of retained earnings by $10,000,000 and reduced our outstanding debt by $3,700,000.

[29] See appendix E, table VI, for statement on use of earnings submitted by the company.

Altogether this year, using retained earnings and other funds, we are spending $70,000,000 to maintain and increase our capacity and ability to serve the American people. This includes $22,000,000 for the proving and development of prospective oil fields.

It is traditional with Sun Oil Co. that capital funds for purposes of expansion must come from internal sources. In this, we have followed a conservative practice, for we have permitted growth to take place only as fast as our company developed the internal ability to provide the means of growth. As a consequence, we believe that our company has maintained its characteristic qualities of independence and self-reliance, making it a stronger competitor in the oil industry and a more stable member of the business community than it otherwise might have been.

Owners of the oil industry, the stockholders, to whom profits rightfully belong, have permitted their companies to reinvest a major portion of their profit money to provide facilities for meeting the demand and thus, in time, lowering prices, and the ratio of profits to the sales dollar.

Consequently, the cost of replacement in excess of depreciation allowances and of plant expansion to a great extent is provided for by the stockholders through foregoing a dividend return that rightfully belongs to them. Their motive is the hope of future profits through increased volume and the desire to safeguard their original investment through maintaining the dynamic structure of the enterprise.

While capital funds may be secured in various ways, capital itself cannot be created except through savings, that is, expending less than is produced or earned. It is a fundamental concept that corporate enterprise to survive in the long run must create, as a result of its operations, the capital necessary to effect its reproduction. Therefore, the higher the degree of internal creation of capital, the sounder the industry is generally, and the greater its stabilizing influence on the entire economy. Traditionally, the oil industry has generated most of the capital funds needed for its expansion over the years.

Entirely aside from the historic practice of the industry, current rates of taxation and credit restrictions place limitations on the availability of outside financing.

But, irrespective of whether funds come from within or from outside the industry, a level of profits commensurate with the capital funds needed to meet demand is essential to obtain them. Loans must be repaid, and additional stock issues require additional earnings in order to maintain the value of the securities. * * *

Senator FLANDERS. In your statement you spoke of profits as a stimulant to the investment of savings. I take it that that is a general observation, because later on you said that it is the policy of the Sun Oil Co. to make its new investment by plowing back profits. So that the incentive to invest, so far as outside investment is concerned, does not exist in your company.

Mr. DUNLOP. Well, I think that the incentive to invest exists, Senator. The statement to which you referred was a general statement of economic principle. That is a role which profits serve in our free-enterprise economy. In other words, they prove the stimulant for investors to put their funds into business enterprise.

Senator FLANDERS. You apparently have no experience, or have indicated no experience, in endeavoring to get equity capital in the

market and of failing to get it, as, for instance, Mr. Vance this morning indicated.

Mr. DUNLOP. We have had no recent experience, Mr. Chairman. The last time we sought equity capital—and that was considerably before my connection with the company—was in 1925, at which time the stock of our company became a public issue in the sense that it was listed on a national exchange and shares were offered for public sale at that time. Since that time, however, there have been no public offerings of stock.

Senator FLANDERS. Do you want to make any observations of personal opinion as to the cause of the present weakness of the public market for equities?

Mr. DUNLOP. Well, it would just be an observation because, as I say, I have had no direct experience as yet. My observation would be this: That equity capital is at a disadvantage with regard to what we might term "debt capital." It is at a disadvantage from several points of view. One, of course, is the rate of return. The availability of capital—and I use this in the broad sense—the availability of capital through bank loans has been very great, at substantially low rates of interest. As you also appreciate, under the taxing statutes, interest is a deductible expense for corporate purposes. If you go out into the equity market and seek to raise capital, the return on that equity capital applies after you have determined your Federal income tax, and therefore, from a cost point of view to a corporation, I would presume that would be a factor of considerable concern.

Clarence Francis, chairman of the board, General Foods

Mr. FRANCIS. In 1938 retained earnings were 2.5 million dollars and represent about 20 percent of the total amount of earnings that year. In 1946 General Foods had its biggest retention, $10,000,000, or about 48 percent of all net profits.[31]

During the 10 years 1939 through 1948, we have paid each shareholder on an average of $1.875 per share per year. The current rate of payment is $2 per share.

During the period 1938 to 1947, there was no over-all debt retirement by General Foods. In 1944 an issue of preferred stock was retired, but an even larger issue of preferred stock was issued in 1947.

In the 10 years 1938 through 1947 about $50,000,000 has been retained in our business out of earnings. This is an average of about 32 percent of all profits.

But even this $50,000,000 has not been sufficient to meet the capital requirements of an economically sound and healthy General Foods. During these same years, we borrowed an additional $27,000,000 in long-term notes and obtained another $32,000,000 by issuing additional stock. This adds up to $109,000,000, about $65,000,000 of which was obtained in the past 4 years.

We have raised in the domestic market since the war, through the issuance of securities, about $35,000,000 net in new capital. Of this amount some $25,000,000 was equity capital which we raised early in 1947 through an issue, practically at the peak of the market, of $3.50 preferred stock. We issued $25,000,000 of long-term notes in 1945 but used $15,000,000 of the proceeds to retire $4.50 preferred

[31] See appendix E, charts 1 and 2, for statement on retained earnings submitted by the company.

stock. In the past 4 years we have raised nearly $34,000,000 through earnings retained in the business. Thus the net amount raised in the security market since the beginning of 1945 is almost identical with the amount secured through retained earnings.

I have no idea what it might have cost us to issue common stock. Its cost would have made it unattractive, and we did not seriously consider it.

"Is the small proportion of profits paid out in dividends itself a deterrent to obtaining equity capital through the capital market?"

Our answer is "Yes," even though we could probably sell more common stock provided we don't care what new equity capital costs us. Here again, however, a generalization is dangerous considering how many other factors have been affecting all stock-market prices.

And finally, your very last question, "Have you made an effort to raise equity capital in the postwar period? If so, with what results?"

Our answer is that we did, and, as I suggested earlier, we just got under the wire. Early in 1947 we marketed $25,000,000 of $3.50 preferred stock.

Before the year was up, the stock had dropped from 100 to 87. The range so far for 1948 has been between 96 and 87¾.

Senator FLANDERS. The fact is that equity money comes high, and you have to pay more for it than in getting your capital by retained earnings, for which you pay nothing, in a sense.

Mr. FRANCIS. Yes. But I would rather state that if you give it all to the stockholders, by what rhyme or reason do we assume that they are going to save enough and have it ready for you when you want it? If each year we have to go out and get equity money, and in addition to all of the other speculations of business we have to wait until we know we get it—and possibly we won't be able to get it, perhaps, at almost any cost—I think we would be putting a very great damper on the entire operation, the entire economy of this country. I do not know how to answer you in any other way. It is a question of opinion. You give it all out as you earn it, and hope to get it back when you need it. I think that we have to take calculated risks in business, but as an administrator I would not care to take that risk.

Senator FLANDERS. Of course, you can stop at some point short of paying it all out.

Mr. FRANCIS. We have done that; we have taken one-third, relatively.

Senator FLANDERS. Do you see any possibility of any improvement in the general health of the equity market by a general business policy of paying out a somewhat larger percentage of earnings rather than plowing them back in?

Mr. FRANCIS. I would much prefer to have you talk to me about the coffee market, or perhaps the corn or the wheat market. I make no pretense of being a market specialist; and I am not side-stepping your question, sir. I believe, however, that, unless the investors think that they are going to get an adequate return for their investment, they are going to be wary about making the investment.

I think that today perhaps that has something to do with it, plus the general world uncertainty as to what is going to happen in the whole scheme of things, and what is going to happen with taxes and what the residual is going to be.

Howard C. Greer, executive vice president, Kingan & Co.

Mr. GREER. Though profits were very limited throughout the period, the company was able to increase its net worth—capital stocks and surplus—from about $12,000,000 in 1940 to a little over $16,000,000 in 1948.[32] This was accomplished by retaining in the business the bulk of the profits earned during the period. Distributions to stockholders were limited to a 4-percent annual dividend on the preferred stock plus one extra payment of $10 per share in partial satisfaction of dividend arrears for years prior to 1940. Total distributions to stockholders for the 8-year period were equal to about 40 percent of net operating income for the period.

John Schmidt, vice president and comptroller, Armour & Co.

Mr. SCHMIDT. Table II in appendix E shows that for the 10 years 1939–48 earnings amounted to 136.9 million dollars; dividends paid amounted to 58 million dollars; and earnings retained in the business amounted to 78.9 million dollars.

In the 10 years 1939–48 we brought into our business $191,388,000 of additional funds through credit sources and retained earnings, as follows:

From short-term credit: Notes and accounts payable		$51, 782, 000
From long-term credit: Debentures	$60, 071, 000	
From retained earnings and unexpended charges against earnings such as depreciation provided in excess of capital expenditures, etc	79, 535, 000	
		139, 606, 000
Total		191, 388, 000

and that in that period those funds were applied in our business as follows:

To finance higher values of receivables and inventories		$124, 730, 000
To finance additional investments—principally long-term receivables	$4, 204, 000	
To redeem preferred stock	62, 454, 000	
		66, 658, 000
Total		191, 388. 000

It will be noted that our principal requirement for funds was to finance higher values of receivables and inventories—$124,730,000. $51,782,000 of this requirement was met by increases in our short-term credits. The balance of $72,948,000 was provided out of retained earnings.

The $6,587,000 balance of retained earnings and the $60,071,000 of increase in long-term debt was used to finance the redemption of $62,454,000 of preferred stock and to finance the additional $4,204,000 of investments.

You might question why, with a heavy debt structure, we would increase our debt to retire preferred stock. In effect, we were refunding what amounted to a debt obligation because $55,782,000 of the preferred stock redeemed was the preferred stock of Armour & Co. of Delaware, a 100 percent owned subsidiary. The 7 percent divi-

[32] See appendix E, table V, for statement on disposition of funds submitted by the company.

dends on this preferred stock were cumulative and payment was guaranteed by the parent company, Armour & Co., an Illinois corporation.

It will be seen from the above that we have not gone the route of investing retained earnings in new plant and equipment—not that we would not like to, but because we have had more urgent need to invest retained earnings in our working assets. We are certain that replacement of some of our old plant and equipment would pay dividends.

While our capital expenditures for the 10 years were somewhat less than the depreciation we provided, they were, nevertheless, considerably in excess for the last 2 years—1947, 1948.

Enders McC. Voorhees, chairman of finance committee, United States Steel Corp.

Mr. VOORHEES. Consider next what happened to the income earned. Out of income of 88 million dollars for the first 9 months of 1948, 51.5 million dollars was paid in dividends. This was 3 percent of sales and less than one-fourteenth the amount for employees. The remaining 36.5 million dollars became available to meet in part the 200.4 million dollars of property expenditure and debt retirement, the latter amounting to less than 2 million dollars. Toward that expenditure there was also available 105.9 million dollars recovered in wear and exhaustion. The two combined, however, fell short by 58 million dollars of meeting the bill. In short, we spent 58 million dollars more on property in the first 9 months than the sum of our income after dividends and recovery through depreciation. Such facts should dispel any notion that profits, and especially profits after dividends, represent a block to the flow of purchasing power. The opposite is the truth insofar as the current facts about United States Steel reveal.

Since amounts for reinvestment, depreciation recoveries, and property expenditures vary from year to year, a record over a longer time span of the disposition of income may be of interest. I therefore give below the results of adding together the sales, the costs, the income and its disposition figures for the past 20 years, 1928–47 inclusive.[33]

	Millions of dollars	Percent of receipts
Receipts for customers	22,363.9	100.0
Costs:		
Employment	9,864.3	44.1
Purchases	8,148.4	36.5
Taxes	1,481.6	6.6
Wear and exhaustion	[1] 1,555.6	6.9
Interest	147.8	.7
Total	21,197.7	94.8
Income	1,166.2	5.2
Distribution of income:		
Dividends	1,013.0	4.5
Reinvested in business	153.2	.7

[1] Compares with capital expenditures of 1,594.2 million dollars.

[33] See also appendix D, table XIII.

This tabulation shows that out of goods and services sold in the amount of 22.3 billion dollars (in the years 1928–47, inclusive) 5.2 percent represented income. The amount of income after dividends available for reinvestment in the business was only 0.7 percent of sales, or 153 million dollars. Any conclusion that income reinvested constitutes an alarming source of uncontrolled expansion is thus utterly unwarranted by these facts. On the contrary, the real concern is that there is so little income to reinvest.

Senator FLANDERS. How long is it since you have sold equities of any form in United States Steel?

Mr. VOORHEES. Equities were sold to the stockholders in 1928 or 1929. That is the last time. * * *

The matters which I have discussed with you point up the problem as we see it—the problem we in United States Steel face for the future—and the even greater problem faced by your committee. For us it is a serious and continuous search for the wherewithal to do business and to proceed with our facility and improvement plans.

I cannot express too strongly the need for objective thinking and for proper measurement and appraisal of income and costs.

Guarding the Nation's tools of production is the duty of all of us—legislators, employees, and owners alike. It is, let me repeat, upon these tools of production that America must place its reliance: In wartime these tools constitute our indispensable protection; in peacetime they constitute our source of abundance.

M. E. Coyle, executive vice president, General Motors Corp.

Mr. COYLE. Postwar, General Motors has followed its traditional and sound management philosophy of setting aside funds out of profits to meet these needs. For 15 years prior to World War II, General Motors reinvested in the business, on the average, 18 percent of its net earnings. Since the war, in spite of reinvesting $334,000,000 or some 45 percent of its earnings, General Motors has found it necessary to obtain additional funds on the outside amounting to $223,000,000. It is the combination of reinvested earnings and added capital obtained outside that has enabled General Motors to meet these needs and increase its capital.[33]

From the beginning of 1928 to date, General Motors has plowed back into the business a total of nearly $900,000,000. This represents 25 percent of the earnings over these years and is about half of the total net capital employed today. This reinvestment of earnings has protected the interests of all concerned—employees and customers as well as stockholders—by providing the means for keeping plants up to date and efficient and by allowing expansion of the plant to enable the company to meet competition and to serve expanding customer needs.

The fact that General Motors has had to reinvest a substantial portion of earnings in the business since the war meant that stockholders have only received 55 percent of earnings since the end of the war, even though $223,000,000 of new capital was secured from outside the business, as compared to 85 percent in the period immediately prior to World War II.

[33] See appendix D, table VII, and appendix E, table IV, for statements on earnings and dividends submitted by the company.

It is one thing to discuss abstractly the advantages and the disadvantages of securing new capital through the sale of equity securities rather than retaining earnings in the business. It is quite another thing, in our case, to raise our dividends by a hundred million dollars and then go to our stockholders and through them to the securities market for a hundred million dollars of new capital. We came to the conclusion that the retention of a greater than normal percentage of earnings during a period of sharp inflation, of great uncertainty and of admittedly restricted equity capital markets was a wise decision.

Russ Nixon, United Electrical Radio and Machine Workers of America, (CIO)

Mr. NIXON. The suggestion is made that unless today's excessive rates of return on investment are maintained, that capital cannot be raised in the open market. To this argument, it must be observed that the corporations themselves are following a policy of not distributing profits to the owners and permitting them to make the decision of whether or not to invest but have arrogated that authority to themselves. This corporate inbreeding indicates a lack of confidence in free private enterprise as it traditionally operates in a free capitalist economy. More seriously, this very practice limits the inducement of the investor to invest not because there is inadequate profit on his investment but because there is a drastic limitation on the portion of the profit he receives as dividends.

It is groundless to assert that new stock issues cannot be floated in circumstances where on the one hand, established American companies are making from 10 percent to 20 percent on invested capital and where on the other hand, savers are having to put their funds in banks or in bonds at 3 percent interest or less. These facts explain why there has been no serious effort to float a stock issue which has failed in recent years. Under these circumstances, it is the purest of rationalization to try to justify the 35-billion-dollar-profit record as being needed to provide for capital formation, risk or otherwise in the United States.

Prof. Sumner H. Slichter, economist, Harvard University

Professor SLICHTER. Profits have been sufficient to enable industry to increase its plant and equipment at a reasonable rate. This expansion of plant and equipment has required plowing back profits, since outside sources of funds have proved inadequate. Money raised from the outside has come mainly from the sale of bonds rather than from the sale of equity securities and has come principally from institutional buyers rather than from individuals. The advisability of increasing the proportion of profits to be paid as dividends as a means of inducing individuals to buy more corporate stock is questionable. It is doubtful whether higher dividends would encourage any substantial increase in stock purchases. The willingness of corporate management to plow back a substantial proportion of profits has also had great advantages for the Nation, because (1) it has enabled industry to make large expenditures on much-needed increases in capacity, despite the inadequate supply of outside funds; (2) it has

limited the extent to which industry has financed capital expenditures by methods which would have brought about an expansion of credit; (3) larger dividend payments would have an inflationary effect; and (4) the reinvestment of profits has made industry more competitive because it increases the productive capacity of industry.

One must wish that industry were less dependent upon internal funds for expansion and that it were able to give stockholders a larger proportion of current earnings, and that the American public were more willing to put its savings into the stocks of American corporations.

The Government tax structure substantially discourages the ownership of stock in corporations, and the problem will probably not be solved until the Government is willing to modify its tax policies. Reform of the Federal tax system, however, though necessary, is not likely to be sufficient to solve the problem.

Even before the income tax became stiff and before there was double taxation of income distributed in the form of dividends, corporations found outside funds insufficient for their needs. The kind of securities which industry offers does not seem to appeal to the large number of potential investors in the middle and lower middle income brackets who wish a considerable degree of security, some chance to participate in the gains of expansion and technological progress, and some protection against a possible long-run rise in prices.

Possibly investment trusts can supply the answer; possibly the answer is to be found in a new type of security, a participating preferred stock or something of that sort. Until a solution is found, the largest single source of money for plant expansion in American corporate industry will have to come from retained earnings.

Investment of Profits and Concentration of Enterprise

The retention of earnings from stockholders has a bearing on the growth of enterprises, the use of such funds to acquire related or competing companies or Government plants, and the concentration of industry. This section contains relevant testimony of witnesses on these matters.

Nelson Cruikshank, A. F. of L.

Mr. Cruikshank. Although the major part of the new capital obtained by business from retained profits has been used for the constructive purpose of expanding plant and improving equipment or supplying needed working capital, nevertheless, there has been a marked tendency on the part of large corporations to use their high profits for the purpose of buying up smaller concerns. A study just issued by the Federal Trade Commission shows that in the period from 1940 to 1947, 2,450 formerly independent manufacturing and mining companies with an asset value of 5.2 billion dollars have disappeared as a result of mergers and acquisitions.

Representative Patman. In connection with Senator O'Mahoney's suggestion about the private enterprise system, which I know that you want to preserve, do you fear that any of our businesses are getting so big now that they might be detrimental to the private enterprise system?

Mr. CRUIKSHANK. When a business gets so big that the concentrated controls and power of one group can control an effective part of the market for the products of that, you have really departed from the free enterprise system.

Representative PATMAN. Do you not find that true in reciprocal trading, where one large concern trades with another large concern?

Mr. CRUIKSHANK. It can be true. Of course, just size itself is not always detrimental. It is size in relation to the other units and size in relation to the market for that product. Some big concerns can be more efficient than smaller concerns. But there is a point at which, in relation to the other concerns in the same market, the size needs to be taken into account.

And what you say is true, if I may use the expression, "making book" between certain big concerns can be a serious detriment to the consumer and be out of the spirit of our whole free enterprise system.

Clarence Francis, chairman of the board, General Foods Corp.

Senator FLANDERS. Now, another question which your testimony raises relates to this continuous series of acquisitions. One point that has been raised in the testimony has been that this process of plowing back profits, in the industries favorably situated and of sufficient size and of sufficient earnings, due presumably to their efficient operation both in the production and in marketing and purchasing, is resulting in an undue concentration of industry in a few units. And the question has been raised as to whether that policy of continuous acquisition from retained earnings may not be socially undesirable, or economically undesirable.

You seem to be, Mr. Francis, a case in point.

Mr. FRANCIS. I do not recall a single instance in our acquisitions which were purchased from retained profits.

Senator FLANDERS. Yet you have retained a lot of profits. Can you segregate in any way the cost of acquisition from the nature of the profits which has made that acquisition possible?

Mr. FRANCIS. For example, here are two companies, each with a certain amount of assets and stock, and the stock is swapped on the basis of the assets, and then you proceed from there with your merged companies, hoping by the merger you are going to increase your efficiency. But it has not come through profits.

Senator FLANDERS. In general, then, the acquisitions have not been made on the basis of an outright sale, the extinguishment of the ownership of the previous stockholders and their payment in cash. It has been made by an exchange of securities, in general?

Mr. FRANCIS. Yes; and somebody may underwrite those securities, but that is not our money.

Senator FLANDERS. If the exchange is made on that basis, or as far as that goes, on any basis, the stockholders of the company acquired must have agreed to the acquisition on the basis of their own self-interest.

Mr. FRANCIS. Oh, yes; I presume that everyone has the opportunity to vote.

Senator FLANDERS. Do you feel that you have made any distress acquisitions? I do not mean your distress; I mean their distress.

Mr. FRANCIS. You are asking me if we made any mistakes in the acquisitions. The answer to that would be "Yes."

Senator FLANDERS. Can you give us any idea as to what proportion of the food industry your company represents?

Mr. FRANCIS. About 2 percent of the food-processing industry.

Senator FLANDERS. In spite of your great size, you do not think of yourself as being a dominant factor in the food industry on that basis?

Mr. FRANCIS. We certainly do not, sir.

Senator FLANDERS. Do you reckon that 2 percent on sales?

Mr. FRANCIS. Yes, sir.

Russ Nixon, United Electrical Radio and Machine Workers of America, CIO.

Mr. NIXON. Feeding and feeding on the bonanza profit period American Big Business has grown bigger out of the war experience. As early as June 1946, the War Assets Administration reported that six giant corporations (United States Steel, International Harvester, Allied Chemical & Dye, General Electric, General Motors, and Bethlehem Steel) had received 48 percent of the war plants the WAA sold or leased. In 1939 these six corporations had less than 10 percent of the gross capital assets of all manufacturing corporations.

In reporting on the trend of corporate mergers, the Federal Trade Commission said that—

at the end of 1945, the 62 largest listed manufacturing corporations held 8.4 billion dollars of net working capital, which was largely in highly liquid form. This amount was sufficient to purchase the assets of nearly 90 percent of the total number of all other manufacturing corporations in the United States.

Later in its summary report on The Merger Movement, the FTC stated:

No great stretch of the imagination is required to foresee that if nothing is done to check the growth of concentration, either the giant corporations will ultimately take over the country, or the Government will be impelled to step in and impose some form of direct regulation in the public interest.

To a major extent, the $35,000,000,000 profits of 1948 are monopoly profits. They do not arise from anything remotely like competitive free private enterprise. The profit drive and the monopoly drive are in reality economic Siamese twins.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. The contention is made that there is a scarcity of venture capital and that as a result portions of net profits must be retained to be used to modernize and expand production facilities. An extremely serious situation is aggravated when industry reinvests its own retained earnings in an expanding operation. It is dangerous because of the monopolistic tendencies involved. When retained earnings are used, for example, to expand capacity, the present owners of the business continue to be owners of a larger and expanded business. This means that a limited number of people continue to control a larger proportion or a larger share of that business' operations.

Senator O'MAHONEY. May I interrupt to say that the difficulty, I think, is a little bit broader than what you have stated. The investment of retained profits is not confined merely to the expansion of existing facilities. It also reaches out into the expansion of particular businesses into nonrelated lines and industries, bringing about the concentration under one management of groups of enterprises which in themselves have no relation to one another.

Mr. RUTTENBERG. I am glad that you elaborated on the point, Senator. I agree completely that that implication is involved and is as serious, if not more serious, than the one which I have indicated.

If, on the other hand, new venture capital is secured from stock issues, a larger number of people become shareholders and the managers of the business become responsible to the enlarged number of owners. As long as industry, however, does not secure new venture capital to modernize its facilities and expand capacity, it is engaging in a serious monopolistic practice which is not in the best interest of a dynamic economy. This practice of expanding by the use of retained earnings has a tendency to eliminate new competition because if the large producer does not receive equity capital through stock transactions, it becomes extremely difficulty for any new businessman to enter the scene in an attempt to float a new series of stocks to the public. If, on the other hand, large companies did secure equity capital from the public, it would tend to make the problem of securing new capital much easier for the small and the new businessmen.

Howard C. Greer, executive vice president, Kingan & Co.

Senator FLANDERS. Do you see in that shift from equity capital to plowing back profits anything which tends to consolidate the position of the older companies and to make it difficult for newer and smaller companies to get into the business?

In other words, is that situation one which tends to the maintenance of older industries and is a deterrent to the development of new ones?

Mr. GREER. In our own industry, Senator, the reverse has been true. There has been some new capital put into smaller meat-packing enterprises and practically none into the larger ones. Some of the smaller family-sized ones in the meat-packing business have been able to attract some capital but the larger ones have not.

Senator FLANDERS. Has that taken place to any extent since the end of OPA?

Mr. GREER. I believe it is still going on to some extent. Although the growth of some of these smaller enterprises was very marked during the OPA control period, I still read frequently that two or three people have gotten together and built themselves a small meat-packing plant. I do not believe, although I do not recall the figures too exactly, that the larger companies in the industry have any larger share in the total meat business than they did 10 years ago. I am speaking from impression and without having checked the figures with any care.

In theory what you have suggested might be true. I can speak only as to our own industry where I would say that it does not seem to be true. In other words, the inability of the larger companies to attract equity capital has held down their growth until it has no more than matched the relative increase in the volume of the smaller companies.

Senator FLANDERS. In the first place, is there any definition we can make to segregate the big corporations and if we can make that definition, are there any figures available as to the percentage of the total production which has gone to those companies over a period of years, say, from 1939 on?

Mr. GREER. Yes; those figures can be obtained from these reports of the packers and stockyard division to which I have referred. They have the total sales and total profits of the companies from which they receive reports (there are nearly 1,000 of them) and they make them up into classes by size and kind of business. It would be possible to trace the relative position, although I have not done it, but it is possible to do that.

Senator FLANDERS. You quite evidently have a competent statistical staff of some sort. Would you mind having that put into the record, so far as the proportion of the total business is concerned in those three groups in which you say the Department of Agriculture statistics are divided?

Mr. GREER. I will be glad to have a table prepared on that and submitted to the committee.[34]

PRICES AND PRICING POLICIES

It is, of course, axiomatic that the pricing policy of a company—the prices it charges for its products or services—will have a direct bearing upon its profits. The corporation spokesmen in general showed what cost factors—raw materials, wages, overhead, etc.—went into determination of prices as well as the demand factors that entered into the picture. Each industry, not to say each company, has its particular cost and demand problems which affect its pricing policy. In meat packing, for example, the cost of livestock to the company is the most important cost factor; in automobile manufacture wages costs are equally as important as material costs. The possibility of spreading overhead over volume varies in different industries. Traditional profit margins differ in different industries and these have been influenced differently by the impact of inflation. This section also contains the controversy over the degree to which low profit margins and large volume is a dominant factor in pricing policies.

Hiland G. Batcheller, president, Allegheny-Ludlum Steel Corp.

Mr. BATCHELLER. Major pricing-policy decisions are reached by consultation between our top management officials, guided particularly by those responsible for sales and finances. When a price change is under consideration, attention is first given to cost. We would like to obtain a profit on everything we sell. On some products this may not be possible because our equipment may not lend itself to their production as well as the equipment of a competitor. On the other hand, we may be able to obtain substantial margins on other products where our equipment is particularly well suited for their manufacture.

After studying costs, we have to consider what price our customers will be willing to pay for these products. This involves a study of what similar products are selling for, or, if the products are being offered by others, what the market prices are for identical products.

Except in unusual circumstances, therefore, established market prices of similar or identical products set a top limit for our prices and our anticipated costs set a bottom limit. Within these limits we strive to set prices which will encourage the greatest use of our products.

[34] See appendix I, table 1, for sales of meat packing companies, 1929–47.

Use of our major product, stainless steel, is growing very rapidly, and we hold its price as low as possible in order to encourage even greater use. We appreciate that we may earn greater total profits with large volume and low selling prices than with high prices and small volume, and this was a major consideration in establishing our policy of holding the price line on this product until the cost pressures developing in 1947 and the first half of 1948 forced a change in August 1948.

Harold Vance, chairman of the board and president, the Studebaker Corp.

Mr. VANCE. Our prices, as well as those of every other automobile manufacturer, are considerably higher than they were before the war. So is the price of practically everything else. A detailed comparison of the prices of our present models with those we produced prewar is difficult to make. All of our current passenger-car and truck models are entirely different from what they were in 1940. The differences are too numerous to mention, but in the main the current models embody improvements in design, handling, riding quality, and other accommodations, and represent greater value to the buyer.

Our selling prices for cars and trucks—wholesale to dealers—today average 110 percent more than in 1940. Our actual costs for material, labor, and factory overhead, exclusive of fixed charges, average 111 percent more than in 1940. It is quite obvious from these figures that although our prices are up substantially since 1940, the rate of increase has not exceeded that of our costs.

Our pricing policy since the war has been that prices should be increased only in proportion to the increase in actual costs. We have not charged all that the traffic would bear. The best evidence of this is the black market—one of the industry's greatest headaches—where new cars have been selling at a considerable premium over our retail prices.

In 1939 I testified before the Temporary National Economic Committee on the subject of prices. I stated at that time that the growth of the automobile industry could be attributed to its constant efforts to offer greater value for less money. This policy has benefited both the public and the industry. The public has obtained better transportation at lower cost and the industry a broader market for its products. To quote directly from my testimony before the TNEC, I said:

> The way to increase profits or to create them to take the place of losses is not by increasing prices, but by protecting and increasing volume. By the same token that increased national income is a better solution to our governmental revenue problem than are increased taxes, so an increased volume of production is a better solution of an industrial revenue problem than are increased prices.

The policy of 1939 and prior years is still sound and we look forward to the time when the trend of costs will be reversed and we can resume the practice of offering a constantly increasing value at a lower price as the best and only way of permanently broadening our markets.

While our costs are our first consideration in setting prices, we are always conscious of the necessity of being competitive, not so much in prices as in values, because we sell a proprietary article designed by ourselves and no competitor offers to the public precisely the

same thing. We are always conscious of the fact that in our efforts to secure a better competitive position in our industry we can do so only if we offer competitive values.

It is perfectly obvious that the competitive pressure today is less than it is normally, and less than it was and less than it will be.

But I might say in that connection that we are conscious of it even in these times, because in our business clientele is important just as it is to the doctor or the grocer, and it is the friends we make today who determine the kind of business we do when competition returns.

As a matter of fact, our experience in the past has been that two-thirds of our sales are repeat sales, made to people who are already driving or operating our product.

Senator FLANDERS. Now, looking ahead to the extent that you are able to, can you conceive that any of your large competitors might be able to set prices 2 or 3 years from now which would give them a profit but which would seriously handicap your sales?

Mr. VANCE. I hope not, sir.

Senator FLANDERS. Well, there are two parts to that question. The first is, Do you think that they could; and the second is, Do you think that they will?

Mr. VANCE. I do not think that they will, and my reason for that is this, that the more we can lift ourselves out of the 2½-percent class, our participation in the industry's total prewar, the more we can increase this spread between our break-even point and what we are actually doing, the more secure our position is.

I point out to you that in 1940 when 80 percent of our sales were required to break even, that a 20-percent reduction in our business would have thrown us into a loss; whereas at the present time, when that ratio is 4 to 9.5, we could sustain a reduction of almost 60 percent in our business and still stay out of the red.

Senator O'MAHONEY. You said that the Studebaker Corp. has not attempted to charge all that the traffic would bear, and you spoke also of the black-market headache of the manufacturer. What steps do you take, and what steps does the industry take so far as you know, to persuade dealers to maintain your stated prices which are at a level less than what the market will bear?

Mr. VANCE. So far as dealers' delivered prices are concerned, we check them carefully and urge our dealers not only to sell cars at a normal mark-up, but we try to point out to them, as we know so well ourselves, that the time will come when the friends they make today will be valuable to them.

We have on a few occasions where dealers have flagrantly violated the policies that we have laid out for them, canceled their contracts. It is a very difficult thing to police all of the details of the relationship between a dealer and his customer.

Senator O'MAHONEY. Naturally, of course.

Mr. VANCE. As to whether or not his used-car allowance is adequate and so on.

Senator O'MAHONEY. But you endeavor to convince your dealers that it is good business not to charge all that the traffic will bear, and in some instances where you have been convinced that the violation of the policy which you have laid down has been flagrant, then you have canceled the contract with the dealer?

Mr. VANCE. That is correct.

Senator O'MAHONEY. In other words, you have taken punitive action to enforce upon the dealer adherence to a pricing policy, a price ceiling, to use a word which has been very much used in recent years, which you have set down?

Mr. VANCE. Yes, sir.

Senator O'MAHONEY. Now, that means, does it not, Mr. Vance, that wherever the automobile industry has done that, it has abandoned the so-called free market?

Mr. VANCE. No, sir; I don't follow you.

Senator O'MAHONEY. Well, the free market, as I understand it, is the market in which supply and demand will fix the price, in which the price will not be fixed by the Government or by any private agency. Now, here we have an industry which, according to your testimony, does privately fix the price, does privately advise its dealers not to take the market price which is what the traffic will bear, the balance between supply and demand, but to take only the price which the manufacturer deems the best to maintain good customer relationship and to keep the flow of the commodity running easily and regularly into the future, is that not right?

Mr. VANCE. Yes, sir. I would like to paraphrase your question if I may.

Senator O'MAHONEY. Surely. We are just asking for the information.

Mr. VANCE. I would like to do that by saying very definitely that we think it is bad business for our dealers to try to take advantage of the kind of situation that has existed during the past couple of years, and in the long run it will hurt them and hurt us.

Senator O'MAHONEY. I think that you are quite right.

Mr. VANCE. Now, if that is fixing prices, then my answer to your question is "Yes."

Senator FLANDERS. Do you have an uneasy conscience on that matter?

Mr. VANCE. No, sir. I would like to repeat, Senator, what I said before, because it is constantly in our mind; in this business of ours clientele is the all-important thing.

Senator O'MAHONEY. I asked you the question merely to bring out—and I think that you have brought it out very clearly—that price fixing, whether it be by Government or whether it be by a private industry, is still price fixing, and when a ceiling is laid down, whether it is done by public authority for all of the people or by private authority for some of the people, it is still price-ceiling fixing?

Mr. VANCE. Yes, sir.

Nelson Cruikshank, A. F. of L.

Mr. CRUIKSHANK. The American Federation of Labor recognizes that in a free-enterprise economy the organizations of basic productive groups—employers, labor, and farmers—cannot expect the Government to lift from them the burden of their own responsibility for constructive policies in regard to prices. The American Federation of Labor clearly stated its policy at the end of the war, of asking wage increases which could be granted without raising prices; and we seek today a situation in which it will be possible to carry out that policy.

But in view of the drastic price rises and the policy of many companies to charge all the traffic will bear, labor cannot refrain from asking maximum wage increases unless we have assurance from employers that they will meet our sacrifice by following policies which will avoid price increases and permit prices to decline where they are unduly high. The great voluntary organizations which determine wage, price, and production policies cannot function in an effective way on a national scale unless they meet together to discuss the current situations and decide upon policies, meeting again at intervals to review programs and consider new problems. When individual units act separately, no one of them can have determining effect, no matter how great the desire may be to act for the general good. The constructive act of one unit may be completely offset and negated by the act of another. It is for this reason that the executive council of the American Federation of Labor has called for a joint conference of business, labor, and farmers to examine facts and propose a joint voluntary program in cooperation with the Government to stop inflation.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. We maintain that industry has raised prices with no regard to increases in costs but only with regard to what the market will bear. In other words, industry sets prices on the basis of making a profit at a low level of production, it wants to make a profit even though its operations are curtailed from present levels. This means that prices must be considerably out of line with costs of production when operations are at present-day high levels.

Again this self-interested thinking on the part of American industry is the kind of thinking which inevitably will lead to the lower levels of production—lower levels which spell unemployment, reduced income. In brief, they spell depression with its misery and chaos. It is the old false notion of making profits through moderate levels of production and high prices instead of making the same level of profits or at least a reasonable level of profits through low prices and maximum production.

If industry could be made to realize that a stable, dynamic economy could be perpetuated in America on the basis of maximum production and low prices it would be a major accomplishment. But instead, industry figures that some day production will have to be curtailed and on that day it still wants to make a profit. To accomplish this, therefore, industry sets its prices to make a profit at the low level of production. Consequently, as production increases and costs decline, profits soar. The resultant profits derived from prices established on this basis creates distortions between demand and supply which inevitably lead to imbalances that bring on economic reversals.

Dwight B. Billings, controller and assistant treasurer, Pacific Mills

Mr. BILLINGS. Prices are fixed or determined in the final sense in the market place by the supply-demand ratio. Yet it is not as simple as that in the distributive flow of fabrics. We manufacture items such as sheets, pillow cases, and towels that go to the consumer in the form we make them. The bulk of our fabrics, however, are further

processed by other manufacturers who cut and sew the finished products before they are available to the consumer.

Retail price brackets necessarily play a large part in our price determination. The apparel manufacturer must purchase fabrics which will fit into his established price brackets so that this has a heavy bearing upon price determination. Those in the company who are charged with the responsibility of pricing fabrics have to take many factors into consideration.

Among these factors are the price brackets, the general price level of competing fabrics, the quality, eye-appeal, the cost and the volume of business necessary to maintain full employment and operating efficiency.

Our 1948 pricing policy has been aimed to meet the broad competitive market. In the wide variety of fabrics that we make, our prices naturally were mixed. Many went down sharply, some advanced, some are the same as compared with 1947 prices. It depended upon the circumstances that surrounded each product.

Declines resulted from a lessening of demand from domestic and export buyers, or because we anticipated a declining demand. Inventories in many lines have sharply increased. Our prices on printed percales, for instance, since the first of this year have declined about 33 percent.

On the other hand, the very appreciable rise in the cost of wool forced us to advance woolen and worsted cloth prices. On some rayon cloths our prices have not changed.

During this year, our sheet prices are unchanged despite the fact that for most of the year and at the present time we are from 4 to 10 percent under the market price on most of this product. Where we have advanced prices, we have advanced them as temperately as we could against our cost background. When we reduced them, we did so to keep ourselves competitive in a falling market.

There is no question but that the money supply, both domestic and foreign, has exerted a sizable influence upon the profit of our company. Its primary effect was to put more money into the pockets of the average American consumer.

When this was coupled with scarcities or other lines, the consumers not only became willing to spend more than in the past on goods and services that were still available, but they actually did. The consumers did not have to do it. Their wardrobes during the early years of the war were still well stocked, but in the absence of other goods consumers snapped up any merchandise or service that they could lay their hands on.

This desire to buy practically anything exerted a terrific upward pressure on prices and permitted manufacturers to sell all they could make even at capacity levels. Higher prices automatically resulted in high profit which was divided among those who contributed or benefited from the production of goods and services. These high profits were shared by the farmers, the manufacturers, the distributors and also by the Government in the form of higher tax collections.

Cost is one of the most important though by far not the only determinant of prices. The importance which is ascribed to costs depends upon the conditions at the time the prices are being established. At the present time costs are beginning to play a more important part in pricing than they did, for instance, in 1947.

As selling prices are falling in many lines ever closer to the break-even point, costs have to be carefully checked to determine whether a reasonable profit commensurate with the risk can be made, whether the line will have to be radically cheapened or whether we should withdraw from the market entirely. Management opinions in regard to the future course of business are beginning to be less optimistic and thus the individual fabric costs are of increasing importance.

We could have charged more for our products and have realized substantially higher total profits. Our prices conservatively stated could well have been 5 percent to 10 percent higher had we chosen to get all the traffic would bear. This is not our policy, however. Our profit expectations, in our opinion, are not responsible for increased prices.

Prices, as previously mentioned, are made in the market place and are the result of supply and demand. The higher prices that have hitherto existed have enabled the more efficient producers to make larger profits at prevailing prices than the less well-equipped mills. If, as we have, we have been able to reduce our costs, we believe that we are entitled to this legitimate increase in profit. * * *

J. E. Bradley, executive vice president, Pacific Mills

Senator FLANDERS. You are now reducing prices heavily?

Mr. BRADLEY. I have a list of the principal cotton goods that are sold in the market. This list shows the contract price of these goods at the time OPA controls went out. It shows the highest price since OPA and it shows prices as of December 7.

Practically every one of these is right around OPA level. Some of them are a penny or two higher and several are several cents a yard lower. It is a pretty thorough liquidation of the price bulge.

Senator FLANDERS. Does this unsalable inventory situation result in 5 or 10 percent or what percent decrease of the capacity that you normally would be running at in a good market?

Mr. BRADLEY. Well, it is somewhat scattered, Senator, and difficult to express in percent. It might be as high as 10. It is a question to a very large extent of our coming out of this period of high price in a period of some years where very long forward commitments were made, commitments by customers in terms of 6 months, 9 months, or a year, down to where they are buying 30 days ahead. They have their own inventory problems, the retailer is liquidating inventory and the cutter is liquidating inventory and the shoe is over on the other foot.

We are going back to where we, as the textile industry, have to hold a lot of inventory which we were not holding during the war on account of the big demand.

There seems to be a fear on the part of many customers despite the sharp break in price as to whether it is thoroughly liquidated and they are very reluctant to make forward commitments and they are trying to turn inventory as rapidly as possible. It has some elements of good in it, because it is a reversal from a thing that was bad and yet if carried indefinitely it has elements of great weakness.

Senator FLANDERS. I do not know how it applies to your business but it has occurred to me in the past few weeks as the price situation has softened in this, that, and the other lines, and the shift is apparently

in process of being made from a seller's market to a buyer's market, that there is a need for a wise downward price adjustment which shall not be so great as to lead to excessive holding off of buying from the standpoint of a panic situation developing in the seller, but at the same time shall be sufficient to encourage the continued movement of goods.

This whole thing is so much a matter of psychology. We have had economists here talking to us and as I listened I always remind myself of a conclusion that I came to years ago; that fundamentally economics is a story of human behavior, it is not a mathematical science at all.

But, there does seem to be a need right at this particular time, when we are shifting in so many lines from the sellers' to the buyers' market, for very wise price policy which will walk the narrow line between those two dangers. Move the goods but don't arouse suspicion that there is a collapsing market in prices.

Another question I wanted to ask you is with regard to prices. You have indicated price reductions in your goods; do you see any stickiness in the passing on of those price reductions to the finished goods which the consumer buys over the counter?

Mr. BRADLEY. Well, there is the normal time lag. I think on some of these prices it takes a few months for them to get all the way from the mill to the consumer. Inventory has to be moved and lines have to be moved; the retailer himself has some inventory problems that he wants to get out of the way. I think there is the normal time lag.

Now in your large department stores and in your chain stores that time lag is pretty short. In your smaller stores and smaller areas it is quire a bit longer and I think probably there is some of it there. It will take a little time for the smaller retailer to work out of his inventory situation. The same would be true probably of the smaller wholesaler or the smaller cutter.

Charles E. Wilson, president, General Electric Co.

Mr. WILSON. In these days of more or less standardized wage rates and high prices of materials and components, any larger or smaller profit we could make, as compared with any of our competitors, would be due to the relative ingenuity, experience, and energy we put into supplying the customer with what we have found he wants.

So it is that it is in the interest of our company and of every company, to seek to pass on to the customer as many as possible of the savings resulting from increased efficiency and output, from the economies of mass production and standardization, in order thus to increase the demand, enlarge the sales, create new jobs, and again reduce the costs of production. Certainly it is this passing on of benefits to consumers in lower prices which must be the only healthy answer to what the chairman, in opening these hearings, has properly termed, "the major economic problem of our time, which is to find some way to halt inflation that does not involve considerable unemployment."

It has been the consistent attempt of the General Electric Co. to keep its prices as low as prudent, even during this period of a so-called seller's market. As I shall point out at greater length later, our prices at the present time average only 40 percent above those of 1940. I am sure that most of you are familiar with the fact that on

January 1, 1948, General Electric voluntarily reduced its prices by approximately 10 percent on a substantial portion of our products.

In April of this year we again reduced prices, in part the very prices which had already been reduced on January 1, and also on other lines of products which we could not prudently include in the earlier reductions. We did this at a time when I think it is fair to say we could have obtained even higher prices than we had been charging for these products. But we felt that there was a good chance, in light of the appeal of the President, made to business generally, that it was the psychological time to try to hold and, if possible, reverse the inflationary trend that had been growing stronger almost monthly since the end of World War II. Unfortunately, we were not able to retain those reduced prices in all cases. The third round of wage increases took effect, prices of the materials and components that we buy were increased, and we were forced to restore most of the price reductions that we had put into effect and in some cases raise prices higher than they had previously been.

Now, on the question of sharing with labor—wage increases. As evidenced by the foregoing illustration, the objective of passing on to the consumer his proper share of the benefits of progress through price reductions has—particularly since the war—been greatly impeded by the erroneous belief of some that all such gains belong to employees to the exclusion of consumer and owner alike. It is, of course, desirable and just that a fair part of the benefits of labor-saving machinery should accrue to the advantage of the worker in both shorter hours and higher wages.

Yet there is considerable evidence in recent years that the substantial part of our productive economies have been paid off in the form of higher wages, rather than in lower prices or increased dividends. In our own company, in fact, recent increases in wage rates have exceeded many times any savings that could have been justified by any possible increasing efficiency.

A recent example of this practice occurred a year or so ago when there was a major controversy over the so-called ability-to-pay theory under which all rises in profits were to be siphoned off into wage increases.

It should be apparent that to give to labor all the gains of technological improvement would eliminate the incentive for future risk-taking on the part of capital; it would deprive the consumer of lower prices and increased purchasing power—with the inevitable result of ultimately discouraging further technological improvements and prolonging the inflationary cycle.

Constant raises in wages and salaries, to the extent they are not balanced by a comparable increase in output per man-hour, can only result in higher prices. It follows that unless prices are to keep on climbing, higher wages can be paid only out of the increased productivity of labor. And to achieve that there must be greater capital investment per worker. So it is that in the long run labor can gain only as American industry itself continues to prosper and expand.

Now, I will proceed to the subject of sharing with the owners—higher dividends. It is, of course, fundamental to the whole subject of profits that the investment of so-called risk capital must be accompanied by at least a reasonable expectation of a return.

The common stockholder is in reality the keyman in the corporate undertaking. Industry operates on capital supplied by risk-taking investors—including the employee, the butcher, the baker, the teacher, and the cop on the corner. Of the 250,000 shareholders in our own company, no one holder owns as much as 2 percent of our stock. It has been estimated that there are 12,000,000 corporate stockholders in America today. It is this typical American, it must be remembered, who is the owner of the business. It is he who furnishes the essential layer of risk capital. He has no assurance that the earnings which he receives will be at any particular level; he has, in fact, no assurance of any earnings at all. The amount of his earnings will depend on the relation of the various cost and price factors arising from the entire aggregate of economic conditions.

Unless those conditions are such as to indicate a reasonable prospect of earnings, it is not to be expected that individuals will invest their savings in any business.

One of our major economic problems today is to induce individuals to provide the layer of risk capital to meet the needs of an expanding economy. Expansion of plant and equipment in recent years has been financed necessarily in large part by the plowing back of corporate earnings and by the sale of bonds and notes rather than by the sale of equity securities.

It is today abundantly apparent that the interests of each of these groups are substantially intermingled and that no one of them can be given the exclusive benefits of our progress. The greatest long-range benefit to both the consumer and the worker will result from the preservation of the proper share of the stockholder. Any consideration of the problem of profit must recognize the fact that unless investment by the stockholder is encouraged, the interests of our entire national economy will suffer.

Clarence Francis, chairman of the board, General Foods Corp.

Mr. FRANCIS. "Could you have charged more for your product and thereby realized greater total profit?"

We certainly could have charged more for some of our products and realized greater total profits. We couldn't have done it for all of them because competition would have eaten into our volume in cases where our competitors had the capacity and the will to increase production and undercut us on prices. There certainly have been periods in the last few years when our total profits could have been materially increased if we had been willing to charge what the market would bear. This is true on Jell-O and our dessert products for instance. It would not have been true in the case of flour. Once again, the real answer to your question is a product by product story, not an over-all story.

"What profit level do you expect to achieve when prices are determined?"

I cannot answer that question. It implies that we set a profit rate, and, having determined what the profit will be, then set a price to achieve it. This is not what happens with us—quite the contrary.

We set a price within the range permitted by competition and by our costs, and then we have to live within the profit which that product can achieve under these conditions.

On the one hand, we have the requirements for reinvestment, addition of capital to run our business, requirements for dividends, and so forth. On the other hand, we have the individual products which must be sold to provide funds to carry out over-all company objectives. Then begins the task of cutting the cloth to fit the garment. * * *

Our pricing policy for 1948 was founded on the same business practices as during every other year of the existence of General Foods. Our objective has always been in pricing to consider the cost of raw material prices, wages and salaries, freight rates, competition, and many other factors. We have priced to maintain a sound franchise for volume production over the long run at levels which will achieve stabilized consumption, stabilized employment, and some incentive for ownership of General Foods stock.

In direct answer as to 1948 prices, we did all three things mentioned: some prices we have reduced; others we have raised; others have been kept unchanged.

The operating heads of our various product lines have had to make their pricing decisions within the framework of the corporate policies referred to above.

"How are prices fixed; what factors are taken into account; what officer or officers has specific responsibility for saying, 'This will be the price'?"

On the basis of all known or probable costs and on more or less reasonable assumptions about the decisions which competitors will make on their prices or their promotion or their new products, the general economic picture, our own market research into distribution possibilities, everything that we may want to do for specific products or that we can estimate about Government policies, the vagaries of nature, the labor situation, etc., must be taken into account in setting a price.

The cost of the raw materials in our business is the prime factor, however, of price determination, with labor as the second most important item. Thus, our prices are determined in the main by farmers, by governmental-support prices, by barriers to world trade, and other such factors. Price policy is made in consultation between our general managers and our operating vice presidents, and usually with the approval of our president or myself.

"Discuss factors which have influenced the profits in your company—for example, money supply."

A very large part of the cost of the goods we sell is virtually beyond our control. We have to pay the market prices for those goods.

Some of the factors outside our control which have influenced our cost, and hence our profits, have been the whims of nature, domestic and foreign governmental policies as they affect agricultural production and prices, the gyrations in wheat, corn, coffee, and cocoa prices, changes in prices and availability of sugar and vegetables and containers, the relative prices of meat and fish, the availability of foreign products like coconut and tapioca, as well as cocoa and coffee—all of these have affected our 1947 and 1948 profits, are affecting both the prices we have to pay for the commodities we use and the consumer market for our products. For instance, the current high prices of chocolate products has certainly curtailed consumer purchases and our profits from that area during 1948.

Our sales are definitely related to the general economic picture. Therefore, an economy of high demand, high purchasing power influences our profits in one way; a recession in that purchasing power would influence profits another way. Enlightened self-interest favors an active, profitable economy.

John Schmidt, vice president and comptroller, Armour & Co.

Mr. SCHMIDT. The price of livestock and the price of meat in a free economy is determined by competition—the keenest kind of competition. On the consuming side, meat is a healthful essential in the diet of many millions of human beings; and, on the producing side, the production of livestock is the business of millions of farmers and ranchers. Add to this the compulsion for movement: On the one hand, once livestock has been raised and fed to market weights additional feeding is very inefficient. On the other hand, once livestock is converted to meat, it must be marketed promptly because of perishability.

It can be seen that the price equation is: (*a*) Many millions of consumers with X dollars to spend for meat against (*b*) day-to-day varying available supplies of perishable meat converted from livestock marketed by millions of farmers and ranchers.

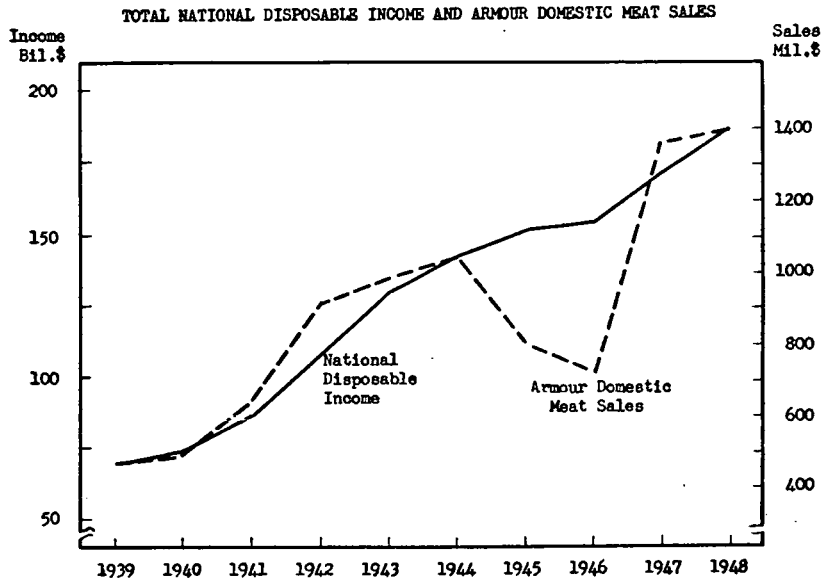
Working within the compelling forces of this equation there are thousands of meat packers who compete in the purchase of the livestock being marketed, who process the livestock into meat, and who distribute and sell the meat, in competition, to hundreds of thousands of retailers. The retailers in turn sell the meat, in competition, to many millions of consumers. At each step of this from-the-farm-to-the-table operation there is a free play of competition—between the farmer and the packer, the packer and the retailer, and the retailer and the consumer.

Getting back to our equation—the one side of that equation was "many millions of consumers with X dollars to spend for meat." Several comprehensive studies have shown that there is a close relationship between the total dollar value of meat consumed and the total national disposable income. The two totals are in close proximity on the up-and-down movements.

To illustrate the proximity of these two factors, we have charted Armour's total domestic meat sales and total national disposable income for the 10 years 1939–48. You will find this chart attached hereto.

The Armour line on the chart includes sales to the armed forces during the war years. Livestock marketings reached a peak in 1944 from which there was a sharp decline for the next 2 years. Armour volume was also restricted in 1945 by the necessity for compliance with OPA ceiling prices on live animals.

CHART 6. ARMOUR & CO.



Data for chart

Fiscal years	Total national disposable income [1]	Armour domestic meat sales [2]	Fiscal years	Total national disposable income [1]	Armour domestic meat sales [2]
	Bil. of dol.	*Thous. of dol.*		*Bil. of dol.*	*Thous. of dol.*
1939	$70.2	$481,813	1944	142.0	1,052,947
1940	74.1	503,084	1945	151.3	801,143
1941	86.9	647,953	1946	153.3	721,795
1942	108.8	918,438	1947	170.9	1,362,331
1943	130.4	997,733	1948	186.7	1,400,515

[1] Total national disposable income is United States personal income less personal tax payments, October to September years.
[2] November to October years.

Source: Quarterly data of U. S. Department of Commerce from 1947 Supplement to Survey of Current Business and subsequent monthly issues.

By 1946 it became legally impossible for Armour to bid successfully on much of the livestock marketed. Then the removal and reimposition of ceilings resulted in farmers holding back livestock. The result was unusually low tonnage in 1946.

With the removal of ceilings and the return of free competition in the fall of 1946, livestock returned to normal marketing channels in substantially increased numbers, consumers returned to obtaining meat through regular channels, and Armour tonnage advanced sharply.

When incomes are low, the prices of livestock and meat are low. Conversely, when incomes are high, the prices of livestock and meat are high. However, prices will fluctuate up and down in both the low-price period and in the high-price period dependent upon fluctuations in the day-to-day supply of meat and fluctuations in the day-to-day consumer demand.

The flexibility in the price of meat has the effect of rationing the constantly changing quantity of supply, and competition forces a quick reflection of changing meat prices on the livestock markets.

The above statement on what the determining factors are in the making of livestock and meat prices shows that it is the consumer who in many millions of individual daily meat purchases establishes the price of meat and consequently the price of livestock. The meat-packing industry has no control over the price of livestock or the price of meat. Its position is one of performing the service of processing livestock into meat and, through its distribution facilities, making the meat available throughout the country. The industry takes the risk of receiving payment for this service in its day-to-day bidding for livestock based on its judgment of what the meat will sell for when it is ready to be marketed.

There was no change in our policy in 1948 from what it was in previous years. We bid for livestock from day to day based on our judgment of what the meat would sell for when it was ready for market, mindful at all times of the need, from the standpoint of overhead, of keeping our plants running. As to selling prices, we knew our costs, and they were a factor along with our day-to-day pulsing of the market in arriving at our asking prices. As against our asking price, the retailer decided what he could afford to pay based on his day-to-day pulsing of what the consumer was willing to pay. The final selling price was traded out with the retailer.

Meat packers have no control over supply. Meat packers' profits are definitely not a factor in the price of meat.

Senator O'MAHONEY. You say, as to selling prices, "We knew our costs, and they were a factor along with our day-to-day 'pulsing' of the market in arriving at our asking prices."

So, evidently, costs are one factor, and there are some others. What are those others, and please describe this "pulsing" of the market. Just how do you do that?

Mr. SCHMIDT. Well, I will state what I said: "A whole corps of men in the selling division—salesmen, branch and division sales managers, and individual products sales managers—all heading up under the vice president in charge of sales, enter into the picture of 'pulsing' the selling market."

In other words, the salesman out in the field calling on the retailer every day, the manager of the branch house, and back into the division sales manager of the territories, the product sales managers—they all enter into the "pulsing" of the market.

Senator O'MAHONEY. I felt that you might perhaps give us a little better idea of what particular steps are taken in "pulsing" the market. It is a new phrase to me.

Mr. SCHMIDT. The salesman is daily trading with the retailer, and that is the "pulsing" of the market.

Senator O'MAHONEY. Well, do the retailers ever object to the prices?

Mr. SCHMIDT. Oh, certainly they do.

Senator O'MAHONEY. And on what basis do they object?

Mr. SCHMIDT. On the basis of their "pulsing" the consumer market.

Senator O'MAHONEY. Can you give us any information as to the particular kind of objection that you get from the retailers?

Mr. SCHMIDT. Well, they know, it is just their "pulsing" of the consumer market from day to day in their sales of meat; and it all

enters into a trade. I mean if meat is moving slowly, the retailer is not interested in adding to his stocks at a high price. That is certain. Because, if he had a large quantity of meat and it is perishable, he has got to sell it; and it is the same compulsion on the part of the packer.

Senator O'MAHONEY. There is a minimum price below which the agent cannot go? How do you determine that?

Mr. SCHMIDT. I don't know that there is a minimum price below which the agent cannot go, because finally we have to sell our meat or it spoils.

Senator O'MAHONEY. I understood you distinctly to say that these field agents were given an asking price, which I assumed to be——

Mr. SCHMIDT. It is not a fixed price. They will have to trade down from that to move their meat if it is not moving. * * *

Senator O'MAHONEY. Who establishes this asking price?

Mr. SCHMIDT. Well, the product sales division heads from their pulsing of the market all over the country, through the channels I have outlined.

Senator O'MAHONEY. Then, do I understand that the heads of the regional houses have this authority?

Mr. SCHMIDT. Well, they enter into the picture because they form a factor in arriving at the asking price. * * *

Senator O'MAHONEY. Who exercises the authority to say to the salesman, "Now, this is your asking price?"

Mr. SCHMIDT. The branch-house manager in the final analysis, the branch-house manager, who has a corps of salesmen.

Senator O'MAHONEY. "In the final analysis." Is not that sort of a qualifying statement?

Mr. SCHMIDT. The branch-house manager, in the final analysis, has got so much meat in his house, and it either moves or it does not and, if it does not, he has got to lower his price to move it, and all of the competitive factors that I have enumerated enter into the picture.

Senator O'MAHONEY. Can that branch-house manager act without reference to Chicago?

Mr. SCHMIDT. Absolutely.

Senator O'MAHONEY. Can he act without reference to the vice president in charge of sales?

Mr. SCHMIDT. Absolutely.

Senator O'MAHONEY. Then what function does the vice president in charge of sales exercise with respect to the disposal of this meat?

Mr. SCHMIDT. The over-all executive administration.

Senator O'MAHONEY. Are these branch houses in competition with one another?

Mr. SCHMIDT. No; but they are in competition with other companies in the industry.

Senator O'MAHONEY. How can you avoid competition between branch houses of your own company in adjoining regions if the branch manager in each region is as completely autonomous as you ask us to believe he is?

If there is complete autonomy of pricing in the head of each region, unless the price is the same, you could have a difference right across the line, the geographical boundary of two adjoining areas; could you not?

Mr. SCHMIDT. I think the competition would level that out. All of the competitive forces I enumerated would level that out.

Senator O'MAHONEY. So that there would be no competition between the two?

Mr. SCHMIDT. Surely; competition is the heart of the whole thing.

Senator O'MAHONEY. You misunderstand me, sir. There is no competition between Armour's manager in territory A and Armour's manager in territory B, which immediately adjoins territory A.

Mr. SCHMIDT. There would have to be to a certain extent when it is contiguous.

Senator O'MAHONEY. Then to what extent do you have this competition among your own branch managers, and what supervision, if any, is exercised over that?

Senator FLANDERS. May I, Senator, put this question perhaps in a little bit different form, as I see it. Suppose, in two contiguous territories, one branch manager has a surplus stock which needs to be moved, and another branch manager has his stocks low, and it is moving. The one whose stock is low and moving might conceivably sell at a higher price then the one whose stock is heavy and needs to be moved. Is there, then, no result so for as your central operations are concerned in sending a heavier supply of meat to the branch office which can give the more favorable price, even though the territories are contiguous?

Mr. SCHMIDT. The meat has got to be moved into consumption so rapidly that we could not take the time of switching it between one branch house and another. Does that answer your question, Mr. Chairman?

Senator FLANDERS. Well, in a way, but the higher prices, however, would naturally move the meat into the area of shorter supply; would it not? Probably that is done through the natural result that the manager with too full a supply would not order as much from your packing house as would the manager who was in short supply.

Mr. SCHMIDT. That is correct. The supply adjusts itself. If there is too much of a supply, he would shorten up on his requirements for shipments into the branch house.

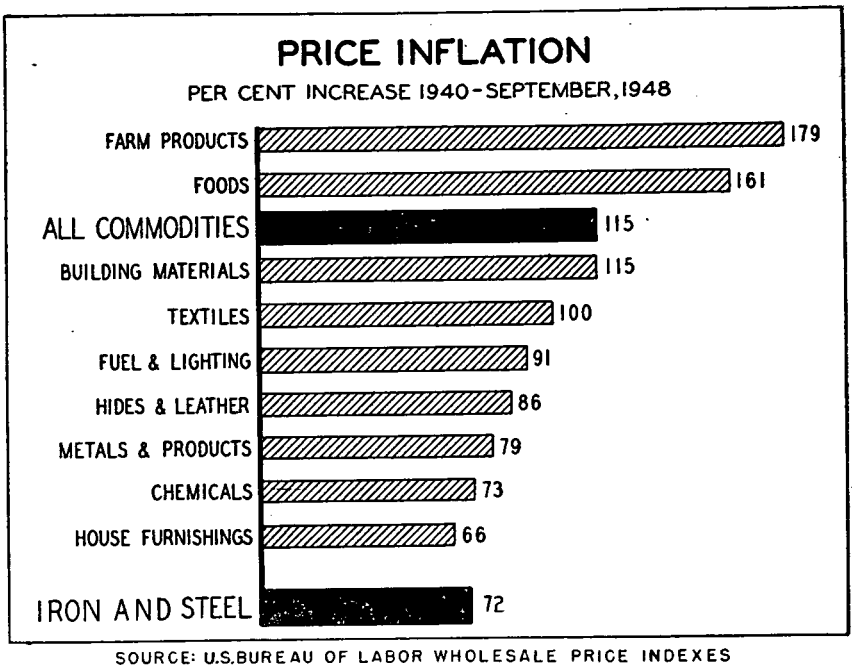
Enders McC. Voorhees, chairman of finance committee, United States Steel Corp.

Mr. VOORHEES. The income of United States Steel is neither record breaking nor exorbitant. United States Steel has not charged for its products anywhere nearly as much as customers are entirely willing to pay. On the contrary, many steel products are being sold by others at prices considerably higher than those charged by United States Steel.

In an effort to aid in stemming the tide of inflationary forces, United States Steel in April 1948 voluntarily reduced its prices for most steel products. The general price increase which United States Steel was reluctantly forced to make last July, after this endeavor to stop further inflation had failed, was made necessary by increasing costs—higher employment costs, higher transportation costs, higher prices for scrap, coal, tin, and the many other goods and services which United States Steel must buy from others in order to conduct its business.

While I am on this matter of price increases, I wish to direct the committee's attention to chart 6 which gives the wholesale price indexes published by the Bureau of Labor Statistics. These indexes

CHART 7. UNITED STATES STEEL CORP.



show that, from 1940 to September 1948, iron and steel prices increased by 72 percent. Those indexes also show that, in the same span of time, prices for all commodities combined increased by 115 percent. The biggest increase, amounting to 179 percent, was for farm products; the next largest increase, 161 percent, was for foods. Iron and steel price increases were in fact less than for any major commodity group, except one, for which the Bureau computes index numbers. Concern about inflation of iron and steel prices is concern about inflation where it is least. Iron and steel prices, to achieve prewar parity with farm product prices, would have to be increased by more than 60 percent.

M. E. Coyle, executive vice president, General Motors Corp.

Mr. COYLE. It has been pointed out that by constant improvement we seek to keep our products attractive in the eyes of the customer. Another factor from the customer angle, of course, is price.

Both the prices for new cars and the prices for used cars establish a market that defines the limit up to which an individual company may set its prices. Under peacetime conditions, General Motors' pricing policy, as set forth on many occasions in the past, may be described primarily as one of seeking expansion of volume on a sustained basis to the maximum extent consistent with stockholder interests. To carry out this pricing policy requires the exercise of managerial skill and judgment in consideration of the fact that employment of the additional capital required for expanding volume may be subject to added hazards and risks and has to be justified by a reasonable pros-

pect for a satisfactory average rate of return over the long term on such additional capital. In evaluating what is a satisfactory return it must be remembered that this return, as a goal, must be set low enough so that the maximum volume economically attainable may be secured.

General Motors' approach to pricing is predicated on a measurement of unit costs calculated on a standard or average volume rate of operations which takes into account plant capacity and the market potential over the long term. This is a most necessary concept in an industry as subject to cyclical fluctuations in volume as is the automobile industry.

In approaching the problem of pricing our products, the unit costs thus will not be affected by short-term fluctuations in volume. Changes in unit costs from year to year will reflect only changes in wage rates and material costs and improved operating efficiencies. In other words, standard volume determines the allocation of the fixed items of cost. This means that prices are not subject to increase in periods of declining volume in an attempt to recoup the higher unit costs actually incurred as a result of such lower rate of volume. On the other hand, in periods of heavy demand, prices are neither subject to increase to take temporary advantage of the market nor are they decreased because of the higher volume realized. The basis for determining unit costs for pricing purposes remains the same in periods of high and low volume.

The effect of volume upon actual unit costs and profits is familiar to all businessmen. The only way that reasonably level prices, in terms of what the dollar will buy, can be achieved over a period is to realize a more-than-average profit rate in years of high volume to offset the lower-than-average profit rate that is the result of low volume. There is no other alternative unless an attempt were made to raise prices to compensate for higher costs as volume fell off. This, we believe all will agree, would be entirely undesirable since volume would be still further curtailed as a result of the higher price.

The automobile industry traditionally has been one of the most competitive in the country. Whatever may be considered to be wise or desirable as a basic pricing policy must adjust itself to this fact. A price methematically calculated to cover costs and return a profit, however accurately determined, does not necessarily mean that the customer will pay that price. No automobile manufacturer can determine prices simply by adding to his cost a predetermined amount for profit. On the contrary, profits are the remainder, the difference, between a competitively determined price and the cost of the product. It follows that a manufacturer in our industry can operate profitably only if he is able to keep his costs below the price he can get in a highly competitive market. This is a basic fact of the automobile industry. In the long run, it determines whether a company will stand or fall.

Senator FLANDERS. What is your notion now—and we are speaking in general terms, philosophically, if that is possible under present conditions—what is your notion about the proper use and proper distribution and proper size of profits which are derived from the most efficient operation in an industry?

Mr. COYLE. We feel that we have got to look at our profits over the business cycle; 1 year and 1 month and 1 day, that is only part

of an over-all picture and unimportant. Our earnings in 1946—nobody paid direct attention to it—but it was $1.76 a share of common stock. In 1947 we didn't do too well. In 1948, with the added increase of inventory and accounts receivable, we did better.

If we were overpricing our product, taking what the market would pay—and we are not, out in the used-car lots, in the dealers' hands, and in the hands of the purchasers, even, the 1941 and 1942 cars with the new grill, and of course that is all we did with the postwar cars—those cars are priced below [used-car prices].

Now, if we were making our profits by reason of overcharging the public merely because of opportunity, that would be one thing. But we have not changed our practice of pricing, either in the prewar period or in the postwar period. It has been on a basis of trying to get our share of the business, to retain public confidence, and to operate on a sound economic basis. We do realize this, and we are very, very conscious of it: that if we were, with 4½-billion-dollars of sales this year—which is twice as much as we ever did in any prewar year—we were to attempt to price so as to make just a nominal profit on that volume of business, we are very conscious of the fact that this level of sales, this level of volume, is not going to maintain over a long, long period. I believe I previously mentioned the demand for our products currently is due to the lack of any production at all in the 4 years of the war, and we are going to catch up with that some day; and when, we don't know. But if we were to attempt to price on the basis of the present high level of volume at a very low profit, we would be placed in the embarrassing position and the impossible position of trying to raise our prices in a reduced economy that is going to come sometime later.

William A. Paton, professor of accounting, University of Michigan

MR. PATON. I think we should try to avoid either marked decline or marked advance in the general level of prices. It is ruinous to have changes in value of money. We have gone through one convulsion, and to go through another downward would be just as bad. I think the impact of prices falling downward is just as bad. I think that the private policy should be toward holding prices just where they are as long as we can. That should be our policy with the minor fluctuations, to take care of the fluctuations in the demand and any particular factors.

PRICES AND PROFITS IN RELATION TO DECLINES IN PRODUCTION AND EMPLOYMENT

Some data and arguments were presented on the effects of high prices and profits on the declining demand for some commodities, the decreases in prices and production in various lines and lay-offs of employees in certain areas and activities. This section contains materials on the question of softening of demand growing out of these developments and on allegations of a possible or incipient recession.

Emerson Schmidt, United States Chamber of Commerce

Mr. SCHMIDT. There is some reason to believe that our economy, our wage-price-cost-income structure has now about grown up to our inflated money supply. Something like the normal historical pattern between the national income and the money supply has now been restored. Inflationary pressures are abating. The cost-of-living index has shown signs of leveling out, and in the last month the index has actually declined by a very small fraction after having been stable in the previous month. Similarly, wholesale prices on the average, are showing signs of having reached their ceiling. There is a growing conviction that we are now confronted with the probability of either greater stability or actual recession. If such recession is threatening, this certainly is not the time to reduce, by further corporate taxes, the incentives to put men to work. The wage motive will cause a man to take a job if the profit motive first creates the job.

In the past 3 years we have heard a good deal about "soft spots" in the economy. As early as 1946, night clubs, costume jewelry, and the fur industries were facing readjustments. We have experienced in 1946–48, what has come to be known as serial readjustments or rotation readjustments. Such soft spots, if they come rapidly, can become cumulative; but if plant after plant and industry after industry makes its readjustment pricewise and in terms of its product-mix, etc., it is conceivable that major recessions for the whole economy can be obviated.

Pipe lines are filling. Sales are becoming more numerous. Fourth-quarter earnings of a growing number of concerns are below previous quarters and below the same quarter of last year. There is general agreement that the current high level of profits will decline in 1949 if present conditions continue into the new year.

Joseph E. Pogue, vice president, Chase National Bank

Senator FLANDERS. In your conclusion you assume that as the necessity for new investment drops, the profit realized by the oil companies will also drop. Do you have sufficient confidence in the competitive conditions in the oil industry to be sure that they will drop?

Mr. POGUE. I have; yes, sir. I have sufficient confidence in the competitive conditions in the oil industry to convince me that they will drop if those circumstances take place. I have more confidence in the competitive forces than I have in my own ability to forecast supply and demand, if I may express it that way.

Senator FLANDERS. That is an interesting observation. You have made yourself a half of a prophet on that because you are not prophesying the conditions, you are merely prophesying the results if the conditions take place.

Mr. POGUE. That is correct. I may say, however, that it looks as if those conditions are showing some initial indications of transpiring. Already the prices of oil products in some parts of the country have shown some measure of weakness and decline.

Senator FLANDERS. That would be shown in an end result of larger dividends, lower prices, or what?

Mr. POGUE. Well, if the prices are lower, the profits will be less.

Senator FLANDERS. If the profits are lower, if they are willing to take the lower profits, the prices can be less; but you are more or less satisfied in your own mind that given the conditions, the results would show themselves to some extent in lowered prices?

Mr. POGUE. I have every confidence, based on what has always happened in the past in the petroleum industry, that supply and demand will play a very important and determinative role in the price of oil.

Clarence Francis, chairman of the board, General Foods Corp.

Senator FLANDERS. You apparently give some indication in your statement of an expectation that prices of your products in general might not be rising greatly from this point on. Am I correct in drawing that assumption?

Mr. FRANCIS. Well, I certainly think that you can draw a lot from them. I do not know whether you get it from that, but I agree with the statement, just the same. I do believe that the trend of upward prices has been reached, and that we will see a downward trend and are seeing it at the moment.

Senator FLANDERS. You say soft spots are now occurring?

Mr. FRANCIS. I was not speaking at that time of our own industry, although they are occurring in our own. Corn is down from a year ago, wheat is down from a year ago. I do not know whether they are going to stay down, but they are down now. We know that potatoes are down, and other things are down. I think because of the great supply that we have had of grains, the ultimate result will be definitely downward.

Senator FLANDERS. There is nothing in your profit policy—which as you have explained it is both rational from your standpoint and complicated—which would lead us to expect that any of these soft spots in your industry would result, so far as your company is concerned, in larger profits to the exclusion of lower prices?

Mr. FRANCIS. I will accept that and answer affirmatively to that statement.

Senator FLANDERS. If I interpret you correctly, we can perhaps envision the possibility that so far as the products in which you deal are concerned, there should be no expectation of higher prices and an addition to the cost of living.

Mr. FRANCIS. The food index is already down in a wholesale way. The trend has changed. I do not think that the index has reached the end of that trend at the moment, assuming nothing unusual is thrown into the picture.

Dwight B. Billings and J. E. Bradley, Pacific Mills

Mr. BILLINGS. I have a situation coming that will not have very much profit in it.

Senator FLANDERS. That is due to what?

Mr. BILLINGS. Due to the sharp drop in selling prices.

Senator FLANDERS. Well, perhaps that answers the criticism which Mr. Ruttenberg made a few days ago to which I referred in questioning the woolen representative this morning.

You actually are now reducing prices heavily?

Mr. BRADLEY. I would like to take over just a minute on that, Senator. I have a list of the principal cotton goods that are sold in the market. This list shows the contract price of these goods at the time OPA controls went out. It shows the highest price since OPA and it shows prices as of December 7.[35]

Practically every one of these is right around OPA level. Some of them are a penny or two higher and several are several cents a yard lower. It is a pretty thorough liquidation of the price bulge.

Senator FLANDERS. The other half of Mr. Ruttenberg's charge was that you were reducing operations. I am not referring to your company specifically but to the industry in general. How is that so far as you are concerned?

Mr. BRADLEY. We have made a very minor reduction ourselves in operations on some lines of goods where we currently have inventory and we are unable to sell it. We are trying not to pile any more of it up. In some instances we are offering those goods at or below the cost and cannot find a market. We are unwilling to increase that inventory so we have done some curtailment along that line.

Just to summarize the total broad woven goods, in 1946, in the first quarter there was 2,275,000,000 yards and in the second quarter 2,316,000,000 yards and in the third quarter 2,190,000,000 yards, and in the fourth quarter 2,355,000,000 yards.

You will note that the third quarter is somewhat lower than the other quarters. Most of the industry is in the South and it is pretty traditional for some shut-down in hot weather and that is responsible for the interference in the third quarter.

For 1947 the figures are 2,483,000,000 for the first quarter, 2,462,000,000 for the second quarter, 2,309,000,000 for the third quarter, and 2,568,000,000 in the fourth quarter. Once again the traditional lesser quantity appears in the third quarter.

Now we get into this year. The first quarter was 2,587,000,000; second quarter, 2,540,000,000; and the third quarter, 2,270,000,000. That is a drop of about 200,000,000 yards. You have your seasonal drop there anyway. It does not indicate a very sharp curtailment to me, and from my knowledge I do not believe that there is a sharp curtailment attempting to hold prices because prices have dropped and production is pretty steady.

Senator FLANDERS. I was wondering if you would give specific examples and the times at which you had made the price decreases? I find, however, some reference to this—you might expand it a little bit if you are able to—in connection with printed percales, prices have declined about 33 percent. That is a pretty heavy decline, is it not?.

Mr. BRADLEY. Yes; it is.

Senator FLANDERS. When did that take place?

Mr. BRADLEY. We were selling, in the first part of the year, printed percales for about 42 cents a yard. By the middle of the summer our prices had started to drop substantially, and we have in the last 60 days sold those equivalent goods at 28 cents a yard.

Senator FLANDERS. Can you give other specific examples of declines?

[35] See appendix I, table II, for list.

Mr. BRADLEY. Yes; rayon gabardines that were selling at 75 to 80 cents a yard 8 or 9 months ago are currently being sold for 60 and 65 cents a yard. Now, some of that is really distress, because it is below cost.

Senator FLANDERS. Will the big cotton crop make any difference in your raw-material prices which ultimately will be reflected in consumer prices?

Mr. BRADLEY. The answer on that finally is Government support of price.

Senator FLANDERS. I am trying to remember whether the Aiken support price or the old support price would affect this year's crop. I guess it is the old?

Mr. BRADLEY. I believe the old support price has to go into 1950.

Senator FLANDERS. Then you will have the price of your raw material supported 92½ percent by the Government, so that from that standpoint we can consider the situation. How high has it been above the support price?

Mr. BRADLEY. It has gone up into around 39 cents, in there somewhere.

Senator FLANDERS. This crop would normally bring it down to the support price?

Mr. BRADLEY. Yes; it is holding around support levels.

Senator FLANDERS. What will that make it, as best you can guess now?

Mr. BRADLEY. Well, around for the type of cotton that we use around 33 or 34 cents.

Senator FLANDERS. As compared with the 39?

Mr. BRADLEY. As compared with 39 to 40.

Senator FLANDERS. Well, there is a drop of considerable extent.

Mr. BRADLEY. Of course that very high price was of not long duration because it was a squeeze between the old crop and the new crop, and it did not maintain for a long period, although it undoubtedly hurt all of us to some extent, because we had to buy some at that price.

Senator FLANDERS. Do you feel that the inventories in the hands of processors and jobbers and retailers are high?

Mr. BRADLEY. I think that they are fairly heavy. I do not think that they are alarmingly high. I think that they are fairly heavy. I think that retailers planned on a pretty heavy business this fall, and their sales have not materialized. The inventories have come in, and they are heavier than they like, and yet the retailers have, with a lot of foresight about the probabilities of textile prices, been pulling their horns in pretty steadily. I do not believe it is a dangerous situation. As you said, it is more psychological.

I think that over Christmas and the January white sales we will see a great deal of this inventory move, and that the retailers will be buying goods.

In cottons, as a general statement, I do not believe that the retailers have bought more than 25 or 30 percent of their estimated spring needs as yet.

Senator FLANDERS. Now, unless this notion of a possible panic situation hits the consumer and he defers his purchases, this situation, then, should iron out in a comparatively short time?

Mr. BRADLEY. I believe it will.

Benjamin F. Fairless, president, United States Steel Corp.

Mr. FAIRLESS. I think two things are going to happen. I would think the demand for steel, the present demand, is not going to continue, and by that I do not want to be quoted as forecasting a depression. There is quite a difference between a depression and receding to some reasonable extent from the present high demands of production. * * *

Representative WOLCOTT. Regardless of the soft spots, there will be sufficient demand to absorb all of the production in 1949, and probably for some years to come?

Mr. FAIRLESS. I was just trying to make only one point, and that is that this great pressure that we are now under because of many people not getting sufficient steel, that that will be relieved to a great extent.

Representative WOLCOTT. Putting it another way, you do not think that these soft spots will become so mushy as to get the demand for finished products down below the 65,000,000 tons of 1948?

Mr. FAIRLESS. I don't think that at all, no, sir, and quite the contrary.

Nelson Cruikshank, A. F. of L.

Senator FLANDERS. Your figures indicate that the percentage of the product taken by business firms in 1939 was 10 percent; and, based on three-quarters of the year 1948, it is 15.2 percent. That is really the big change there, which comes in the percentage of business investment.

Now, do you feel disposed to criticize the volume or to criticize the use of that increased business investment, that being the significant thing in these figures? What have you to say about it?

Mr. CRUIKSHANK. No; we do not criticize that. That represents largely the purchase of new plant and better equipment.

We are only pointing out that we cannot expect it to continue. It represents the taking up of the slack largely of the war period while inventions were being made and new techniques were being developed, and they were not in position to purchase the tools and plant to capitalize on that, so that there is a slack in there that is being taken up, which cannot be expected to continue.

Senator FLANDERS. Then really it seems to get down to possibly your feeling that we should be somewhat more optimistic of the period ahead so far as these shares of the national product that go to nonconsumers are concerned. We would hope, then, that a less high percentage would go to business firms and a less percentage to the Government, and would leave more for the consumer.

Mr. CRUIKSHANK. That is not quite the point of our argument. The point that we attempt to make is that since we cannot expect business proportion to retain this abnormally high level and since we cannot expect or do not desire the Government portion to maintain that high level, the consumer proportion is going to have to reach a higher level than now and at least return to the level of 1929 and 1939, unless the economy collapses.

Do you wish to comment further, Miss Scattergood?

Miss SCATTERGOOD. I wanted to make this comment, Mr. Chairman, that you say a larger proportion would be left to the consumers. Yes, and that would be desirable. It would mean the possibility of a

higher living standard. But, if that proportion is left to the consumers and the consumers are not able to buy it, the result is that it is a drug on the market and it causes an unhealthy collapse in prices, and it causes lay-offs and unemployment.

Senator FLANDERS. It seems to me that each of those positions is tenable. A part of this is forcibly withdrawn from consumption, and the Government at least is taken out without the consumer's explicit permission for any given thing. It is taken out as a matter of national policy. You have not felt, by criticizing too strongly, the percentage that goes to business firms as a temporary necessity; and so you do have, on that basis, something left.

Now, what you want to know is whether, as the Government's share decreases and business firms take out less, prices are going down or wages are going up, or what, so that what remains can go to consumers. That is your concern.

Mr. CRUIKSHANK. Yes, I might just recast it a bit. It leads us back to this old question of underconsumption as related to so-called overproduction—that we want to avoid what might be an overproduction in case any of these factors decline in their purchasing power.

Senator FLANDERS. We have a new aspect of that.

Mr. CRUIKSHANK. We maintain that there never was such a thing as overproduction.

Senator FLANDERS. I agree completely with you on that. There is no conflict between you and me on that subject.

One of the interesting things is that we have, in a way, hit a ceiling of production on the number of hours a week and on the available equipment and facilities of production, so that our problem is that of distributing what we produce, except as we may increase that production volume by new equipment and improved management methods.

Russ Nixon, United Electrical, Radio and Machine Workers of America (CIO)

Mr. NIXON. With profits and prices at an all-time peak, the danger signals of unemployment are arising everywhere throughout the country. Production has begun to meet effective demand. Orders are being canceled; backlogs are being quickly eaten away; and lay-offs are taking place. The people can't buy enough at current profit-inflated prices to keep the factories running. Savings put aside for a new car, refrigerators, or washing machines have been spent to pay profit-inflated prices for food and clothing.

This is particularly true in the appliance section of the electrical and machine industry covered by the UE. In the case of electrical appliances, there have been serious production declines since 1947, as the following table shows:

Production declines,[1] 9 months of 1948 compared to 9 months of 1947

	Percent		Percent
Coffee makers	57	AM radios	21
Hot plates	38	Ironers	10
Heating pads	33	Water heaters	7
Heaters	26	Vacuum cleaners	6
Irons	25		

[1] These are based on sales figures reported by the National Electrical Manufacturers' Association.

As far as refrigerators and washing machines were concerned, although production figures for the first 9 months of 1948 are higher than for the previous year, Business Week, November 20, 1948, reports that "October and November haven't been good to the retailers."

Lay-offs have been reported at the fractional-horsepower motor plants of General Electric at Fort Wayne and Decatur, Ind. The Kokomo, Ind., plant is being shut down. At White Plains, the General Electric garbage-disposal plant is being cut from 110 to 58 workers. One shift has been eliminated at the sink and dishwasher plant at Scranton, Pa. The General Electric plants at Bridgeport, Conn., and Poughkeepsie, N. Y., have also laid off workers. Similarly, lay-offs have taken place in the General Motors and Westinghouse fractional-horsepower motor plants and generally throughout the radio and appliance sections of the industry.

The generally held fears of depression of 18 months ago were quieted by infusions of Government spending for military and foreign-aid political programs. Despite this pump priming, the dangers of collapse were only retarded, and today the peacetime economy is on shaky foundations.

Taxes

Taxation has a twofold significance, both as a source of revenue for the Government and for its effect on the national economy. Both aspects have been considered by several witnesses. The excess-profits tax has received particular attention—some witnesses concerned about its adverse effect on necessary industrial expansion and others about the need for it as a source of revenue and as an anti-inflationary device. In a few cases specific taxes were recommended without much elaboration as to the reasons therefor.

Emerson P. Schmidt, Chamber of Commerce of the United States

Mr. Schmidt. In the short run, when markets are strong and demand is firm, excessive taxation, particularly a high excess-profits tax, or any other tax which falls particularly heavily upon increments of profit, undoubtedly weaken an employer's cost-consciousness. Waste is encouraged, costs are less closely scrutinized, and inefficiencies multiply, and the employer's natural resistance to upward wage drives will be greatly weakened. For this reason, in the short run, additional taxation under the conditions described may be an inflationary stimulant. An equitable excess-profits tax is not only almost impossible to design and to administer, but is without equity as between the small and other stockholders, and so lacks moral sanction.

There is a limit to taxes in a free society. The incidence of corporation taxes is not well understood by our best and most impartial experts. Probably a rise in corporation taxes is inflationary when markets are strong and money is abundant. When markets are weak and confidence is lacking, corporation taxes are just one more cost and hurdle to be overcome and can easily become deflationary, especially in a sensitive situation as the present. * * *

Objective experience in numerous countries in the world shows that, when once the total tax take approaches or equals 25 percent of the national income, the democratic state goes into an inflationary revolt. This seems to be an economic law. Federal, State, and local taxes now absorb 25 percent of our income—the critical level.

If Congress imposes new taxes along with the inevitable increase in 1949 in State and local taxes, the American people may not sit idly by. The pressures developed may reflect themselves in fiscal and monetary policies which lay the basis for further inflation. This seems to be the verdict of history. Just why 25 percent should be the critical level is not clear, but evidence supports it.[3]

George D. Bailey, partner, Touche, Niven, Bailey & Smart, accountants

Mr. BAILEY. Tax statutes, as interpreted by the courts and now accepted by the Bureau of Internal Revenue, permit a recognition of the LIFO method for pricing inventories, and thus do not tax the amount that has to be added to the investment in inventories at higher price levels. That is the general effect. The fact that this had to be liberalized by court decision prevented a great many companies from adopting it before the war, when the basic price levels were such as to give some benefits. To many there seems to be little advantage in adopting such a method at today's high price level. There are suggestions for refinement, and there are suggestions for legislative correction of the injustice done by the Bureau of Internal Revenue's original positions which were later overruled by the courts. In any study of business profits this particular point should have consideration, the fact that LIFO got blocked off from so many people when they tried to have it.

There is no comparable statutory relief for the problem of the earnings that must be retained for plant replacement. Admittedly, it is a difficult and technical problem, but as the procedure stands now it is just not right. Let us assume that a fair allocation of actual cost of facilities to the unit produced would be $1, and a fair allocation of the additional amount required to replace that facility would be another dollar. The corporation would have to save out of its earnings that second dollar in order to keep the same level of productivity. But right now a recovery of that second dollar is taxed at 38 to 40 percent, and only 60 cents would be left. So, if a corporation wished to have a dollar to supplement its dollar of cost so that it could replace its facility, it would have to save out of its profits or recover in its prices $1.60, simply that the Government might get 60 cents in taxes. To me, this is an iniquitous thing and can result in seriously weakening the financial health of our corporations.

The second major point I wish to emphasize is that taxation of corporate profits should be reconsidered from the standpoint of the effect of inflation on the availability of corporate profits with which to pay those taxes. Taxes have to be paid out of cash. Unless profits remain in the business in cash, they are not available to pay taxes.

Congress has made provision whereby taxpayers can minimize the impact of inflation on inventories, through the so-called LIFO method. No such treatment is allowed for the increased cost of replacement of facilities. The result is that a corporation is allowed a deduction for depreciation on cost and then must save from its taxable earnings the additional sums needed on account of the change in the price level. But those sums so retained are subject to taxes.

If a corporation must save $1 from its profits for its replacement problem, it must set aside roughly $1.60 of its profits before taxes in

[3] A Survey of Contemporary Economics, by Howard S. Ellis et al., the Blakiston Co., 1948, p. 197.

order to have $1 left. Thus, in considering the replacement problem and its effect on corporate profits, it is necessary at the same time to consider that the problem is aggravated and accentuated by the tax statutes.

William A. Paton, professor of accounting, University of Michigan

Dr. PATON. A second broad consideration that deserves attention preliminary to a discussion of the present level of stockholder earnings is the tax structure. In my judgment, a basic weakness in our present tax structure, as has often been pointed out by students of economics and public finance, is found in the adoption of the concept that the business corporation is an entity properly subject to income taxation in its own right. This is a most unfortunate development, and one that has no adequate foundation either legally or from the standpoint of economic analysis.

The entity on which taxes must inevitably fall is the natural person, and the only entity that has ability to pay taxes in any meaningful sense is the individual citizen. It is particularly important that this point be recognized clearly in the field of differential income taxation. A moderate flat tax rate applied to some computation of corporate earnings may be viewed as a form of franchise tax on the corporate institution and not be seriously objectionable, but differential taxes at high rates on corporate earnings as such are unsound in my judgment. Such taxes can be justified, if at all, only when applied to the earnings of individual citizens, either in their hands or in the hands of their representatives.

This point of view was reflected in the early income-tax legislation. The early statutes did not set up a tax on a corporation as an independent entity, but instead recognized the corporation as a withholding agent for the purpose of collecting the normal rate of personal tax on the shares of the individual stockholders in the total corporate earnings.

Senator O'MAHONEY. I note you suggest the desirability of a moderate flat tax rate on corporate earnings. Would you apply that, as the phrase would indicate, to all corporations without regard to the size?

Dr. PATON. I would, Senator.

Senator O'MAHONEY. You would make no distinction between big business which to such a great extent in modern times is able to finance its needs out of accumulated reserves and the small corporation which is actually dependent upon the risk capital which is provided by individuals?

Dr. PATON. Well, sir, I recognize, of course, the difference between smallness and largeness, but in this matter of rate of corporate tax I have never been convinced that the rate should necessarily be different. One of the things that I have been hoping that the Congress might experiment with, speaking of large versus small, is an arrangement under which small corporations, defined in some way or another, might be taxed as partnerships are taxed. In other words, no tax on the corporation at all, provided they so elected. In other words, there is quite a road block starting out under the corporate form in a small business now as compared to a partnership because of the tax situation.

I think I might put it this way. I think we all recognize that if there is some practical way of doing it, the patting on the back of the little

fellows without necessarily assuming that there is anything morally wrong with the big fellows is all right.

We want to remember that many small corporations, at least out my way, are suppliers of big customers. Their principal customers are large corporations whom they supply.

I think it is also important, and that is my own feeling, that we have perhaps exaggerated a bit by way of terminology in distinction between large and small, but I recognize the point, and I want to indicate that I have been thinking and worrying about it too, and I feel the subject worthy of your consideration, gentlemen. No doubt some aspects should be in the tax picture.

Here is my modest suggestion taxwise. It is to be hoped that, in revising the Internal Revenue Code, Congress will give serious attention to the possibility of authorizing the use of current replacement cost of materials used and the replacement cost of plant facilities expired, as of the end of the taxable year, as deductions in lieu of deductions based on unadjusted book costs. I understand that developments along this line have occurred in the income-tax statutes of some foreign countries.

Prof. Seymour Harris, economist, Harvard University

Professor HARRIS. The principal anti-inflationary weapons which should be used now are fiscal measures, including an increase in the corporate income tax from the present 40 percent level to 50 or 60 percent. Insofar as broad national objectives will allow, Federal spending should be curtailed. There should be as high taxes as is politically possible and as little spending as is politically possible. If the Government had not cut taxes in 1945 and 1948, the Government might have been making an additional contribution against inflation of $10,000,000,000 annually, and there would have been less spending generally. Inflation would probably have been under control. Corporation profits after taxes would have been one-third less.

John Ballantyne, chairman of the board, Philco Corp.

Mr. BALLANTYNE. Philco is planning a considerable expansion program for 1949 to enable us to increase our television receiver output from under 200,000 units this year to a total of 600,000 next year. This expansion program will cost about $5,000,000. It includes a large addition to our plant at Lansdale, Pa., where we supply part of our requirements of television picture tubes; also a $1,000,000 addition to our radio plant at Sandusky, Ohio, for television receiver production; an addition to our cabinet plant at Watsontown where we produce television cabinets; and added facilities for refrigerator manufacture.

Furthermore, we have recently announced plans to enter the electric range business to round out our line of consumers' durable goods.

The purpose of these capital investments would be to substantially increase our volume of business in 1949. It is a serious question whether we would be justified in assuming these business risks if we are confronted with an obligation to pay greatly increased taxes on this additional business. We are confident that the Congress would not intentionally pass a revenue act which would have seriously de-

pressing effects on business and industry, as would be the case if some of the recent tax proposals were to be enacted.

The consequences would not be limited to Philco, but would also affect all growing companies. From a competitive point of view, the results would fall with even greater severity on some of the smaller companies in our industry than it would on Philco. By the same token, we would be hit harder than some of the larger companies against which we have been competing successfully for many years.

We believe that with the Government's need for revenue in the next few years, this country must have a strong industry and healthy economy. Only in that way can we maintain our standard of living at home and meet our foreign commitments. Federal fiscal policy and Federal tax policy in 1949 will go far to determine whether industry can continue to grow and expand or whether it will be forced to retrench and curtail its operations. * * *

Several of the recent proposals for an excess-profits tax have suggested using the years 1936–39 as the base period from which to measure the increase in earnings. In the case of Philco Corp., this would be inequitable and severely penalize this company and many others that are in the same situation. In the years 1936, 1937, and 1938, our business was limited to the manufacture and sale of home and automobile radio sets, parts and accessories, and a very small number of storage batteries. Also in 1937 and 1938, our operations were adversely affected by strikes. * * *

All during the thirties, we spent large sums of money which in the aggregate totaled several millions of dollars in television research to help develop this new industry. These expenditures were financed out of the profits of our radio business and had the effect of reducing those profits. So if an excess-profits tax based on 1936–39 levels were adopted now, we would suffer in two respects:

1. Our earnings base for 1936–39 was reduced by our heavy development expenditures for television.

2. Because television is a new business that did not exist in 1936–39, the earnings from it might be subjected to heavy and excessive taxation if some of the current tax proposals should be put into effect.

Robert Dunlop, president, Sun Oil Co.

Mr. DUNLOP. There is no room for doubt but that adequate profits, in this industry as well as others, must exist in fact or in promise before replacement or expansion of facilities will occur. A tax which confiscated profits as being "excessive" would have almost the same effect as a law which directly prohibited further industrial expansion.

Are the proponents of the proposed excess-profits tax willing to take the responsibility for halting the enlargement of our productive facilities? Are they ready to tell the American people that we have all the plant and equipment we need to insure our national security and our standard of living?

Already the talk of a so-called excess-profits tax is proving a disruptive force. I shall give you a concrete example of what I mean. Some time ago our company scheduled an expenditure of $16,000,000 to improve and expand the facilities of our refinery at Toledo, Ohio. The original cost estimate of that program has since risen to $18,000,000, and it appears that it may go to $20,000,000 before our plans

can be completed. The matter of rising costs is a serious problem taken by itself, but add to that the reported prospect of an excess-profits tax, and no person in my position could help having grave misgivings about our expansion program at Toledo. I am frank to state that if Congress should pass an excess-profits tax, all plans for expanding our company would immediately have to be reconsidered.

Howard C. Greer, executive vice president, Kingan & Co.

Mr. GREER. A factor limiting the amount of cash obtainable from profits has been the high corporation income tax rate. * * *

It is noteworthy that during the 8-year period the amounts paid out in income taxes (about $4,400,000) have been more than double the amounts distributed to stockholders ($1,900,000). These two items combined absorbed about two-thirds of the $9,000,000 of profits before taxes, leaving one-third (around $3,000,000) available for other purposes.

Harold Vance, president, The Studebaker Corp.

Mr. VANCE. As the chief executive of a small but growing corporation in a big industry, I have been greatly concerned about the possibility of an excess-profits tax. I am concerned because nothing would check our growth more quickly. There is justification for a wartime excess-profits tax. I realize that if Government expenditures continue to expand, there may be a need for increased Government revenue. However, if part of the added revenue required is to be obtained from taxes on corporation profits, I firmly believe it should be done in such fashion that all corporations share the burden equitably. I do not suggest to you that Studebaker's tax burden should be lightened against that of our principal competitors simply because we are a small concern trying to improve our position in a highly competitive industry. Conversely, I suggest to you that the method of taxation used should not be one which would retard the kind of progress we are making. If profits beyond those of some base period, as for example that used in computing the wartime excess-profits tax, are to be deemed excess profits regardless of the fact that as in our case they are not excess profits in any sense of that word, then you will be putting a penalty on legitimate competitive progress.

While I speak only of the Studebaker case, I am sure that there are many other corporations in much the same situation, striving to grow and to improve their competitive positions—both commendable objectives. These enterprises should be encouraged, not discouraged. After all, the growth and progress of small enterprises is the very foundation of our whole economy.

If we had had to pay the wartime excess-profits tax throughout the period involved, our earnings after taxes would have been reduced by more than $12,000,000. Assuming that we had paid the same dividends—incidentally, our stockholders have received less than 20 percent of our profits in the last 14 years—we would have had to borrow, not $18,000,000, but $30,000,000 to carry out our postwar expansion program. However, I am sure that, if the wartime excess-profits tax were still in effect, it would have been impossible for us to borrow all these funds. Therefore, we would have had no choice but

to sharply curtail our program. And I feel that the results would have been much the same had the excess-profits tax proposed in the Dingell bill been in effect. As nearly as we can figure, the rates proposed in the Dingell bill would have reduced our earnings after Federal income taxes, for the 3 years and 9 months, by more than $8,000,000. In other words, what I am saying is that Studebaker's growth in the post-war period would have been greatly curtailed, if not made impossible, under either of these excess-profits-tax plans. * * * *

Senator O'MAHONEY. Now then, I noted your statement, "There is justification for a wartime excess-profits tax." What is the justification for a wartime excess-profits tax in your opinion?

Mr. VANCE. Well, I think the justification is this, sir, that, as in the situation we had in the recent war, industry such as ours completely abandoned the usual kind of production. We did not build any cars or trucks for the public during that period. We devoted ourselves entirely to war production, and had we had in that period an increase in our profits, it would have been directly the result of war production. That is what I mean, and certainly we should not have profited by such a situation.

Senator O'MAHONEY. Then I take it that your meaning is that with respect to that part of its product which industry sells to Government for a general public purpose as in wartime, it would not be justified in obtaining an excessive profit?

Mr. VANCE. That is correct, and I go even further and say this, that during this war period the competitive situation, which in normal times is our great concern, is in a sense frozen, and it could not change during the war period because we were not producing our normal things.

Senator O'MAHONEY. Now, we find ourselves involved in what many public leaders and most headline writers call a cold war. It is a situation which compels the Government to make appropriation for a large proportion of the output of industry, and it is being done to carry on this cold war; that is to say, to maintain the position of the people of the United States, the industries of the United States, in a world in which totalitarianism is seeking to expand.

Now, if it should appear that the expenditures which are, necessarily, to be made by government to carry on that battle for peace, I prefer to call it, have the effect of dislocating the economy because it creates a greater demand than the existing supply, do you not say that at least to the extent to which that is done such an excess-profits tax would be justified?

Mr. VANCE. I don't believe it is possible during the conditions that exist today, Senator, to distinguish between those profits which are the result of, let us say, a cold war, and those which are the result of legitimate business competition. As I said a moment ago, I think the great difference between the present situation, using our case as an example, and a situation that existed during the war, was this: During the war we built aviation engines and trucks and military vehicles and things of that sort, and built them exclusively. Our competitors likewise were engaged 100 percent in war production. We were not building cars and trucks and neither were they. There was nothing that we could do or they could do at that time that would have any effect upon the competitive situation. Today, during the cold war, we are building our regular product; we are striving to im-

prove our competitive situation as we have done recently, and I think to that extent the cold war situation differs from the hot war situation.

Senator O'MAHONEY. Well, do you think then, and I ask this question based upon the opinions which you have expressed, that government would be justified in asking industry to sell its products to government when used for this purpose at a lower price than that which it asks so far as the competitive situation is concerned?

Mr. VANCE. Yes, I do, and that has always been our policy.

Senator O'MAHONEY. To what extent has that been the policy of your corporation?

Mr. VANCE. To what extent?

Senator O'MAHONEY. Yes. In other words, can the Army buy a truck from Studebaker for a lower price than some business man out in Chicago can buy it? And they all like Studebaker products, you see.

Mr. VANCE. Yes, they can.

Senator O'MAHONEY. How much?

Mr. VANCE. Well, it is difficult for me to answer that question precisely, because the trucks that we sold to the Government were not the same kind of trucks that we built prior to the war or thereafter for civilian use. Perhaps I can answer your question best by saying this, that during the war period on several different occasions, for each fiscal year, our books were examined by representatives of the Army for the purpose of deciding whether or not our profits were excessive from the renegotiation standpoint.

At no time were any of our profits considered to be excessive, and while perhaps this remark is out of place, nevertheless it is a fact that people who renegotiated told us that they considered that our profits were on the low side and not on the high side.

Senator O'MAHONEY. Let me compliment you on that. Now, so far as I am aware, there has been no recent proposal from any source that the so-called wartime excess-profits tax should be reinstituted. It has been recognized, I think, that much difficulty is involved in selecting a proper base period, particularly when one takes into consideration the desirability of encouraging small competitive business. I can see how an excess-profits tax might, if it were not properly drawn, operate in such a fashion as to favor the big fellow to the disadvantage of the little fellow. And it was for that reason that, when I proposed an excess-profits tax amendment to the tax bill when it was last pending before this Congress, I sought to change the method of exemption so as to grant recognition to the small business—a recognition of the desirability in the public interest of having small, competitive, unaffiliated businesses grow.

It would be my thought that that should be the principle which should govern any excess-profits tax now.

I desire to ask you now whether, in your opinion, you feel that if the Government found itself confronted with the necessity of levying new taxes in order to balance the budget—bearing in mind that the cost of the civilian Government is less than half of the interest on the national debt, and that the reason the budget will be unbalanced, if it is unbalanced, will be that, to maintain the Army and Navy and to draft the young men into the Army and to build airplanes, the Government has to increase expenditures—in such circumstances do

you wish this committee to understand that it is your opinion that an excess-profits tax should not be imposed in any form at all?

Mr. VANCE. No, sir.

Senator O'MAHONEY. Thank you, sir.

Mr. VANCE. Now, I should like to add, my only objection to the excess-profits tax is that as it has operated in the past, I feel that it has been a very serious retardant to a company like ours that is trying to grow. That is my point.

Senator O'MAHONEY. It should not be.

Clarence Francis, chairman of the board, General Foods Corp.

Representative HERTER. Mr. Francis, in your testimony you expressed some concern with regard to the Federal budget as one of the problems that affected your business.

Would you care to comment at all, in general terms, as to your own views of what would happen in the event that pressures of some kind required American business today to put out its retained profits either in the form of lower prices or higher wages, thereby reducing very materially the taxable gains that the Federal Government could secure its revenues from, thereby unbalancing our present fiscal situation very materially and requiring the imposition of an entirely new set of taxes if we are going to retain a balanced budget?

Mr. FRANCIS. Mr. Congressman, I saw some figures the other day that, in the event our national economy should drop 15 percent, the loss of taxes over-all, Federal as well as State, would be 25 percent. And, as I understand it, the over-all tax is $60,000,000,000, and therefore it would lose $15,000,000,000.

I think we would quickly realize if that happened that we were in a very serious state.

If you reduce industry's profits, you are going to reduce the revenue to the Government. And someone would have to calculate just exactly what that would mean. If it resulted in deficit financing, which I am positively against, I think it would be very bad for this country.

Does that answer your question or not?

Representative HERTER. Let me put it a little the other way. Do you feel that these profits, that clearly in dollars—whether they are inflated dollars or normal dollars—have increased very materially from 1945 to 1948, if they had not been earned and were not taxable, would not Federal financing be a very serious problem at the present moment?

Mr. FRANCIS. I think we would be in a very serious position.

Representative HERTER. If artifically, through pressures of some kind, the businesses that have been making these, you might call them, abnormal earnings, or whatever you want to term them, were required through another round of wage increases or through reducing consumer prices to cut those down materially, might we not face a situation which would be much more serious to our economy as a whole than these figures would indicate as an abnormal situation for industry?

Mr. FRANCIS. I would say "Yes" to that.

Stanley H. Ruttenberg, CIO

Senator O'MAHONEY. You recommend an undistributed-profits tax. What would be, in your judgment, the effect of such a tax?

Mr. RUTTENBERG. Of course, it would depend on the type of undistributed-profits tax, but one of the big problems today is the use of retained earnings for expansion.

Senator O'MAHONEY. May I interrupt to say, as I recall your statement, you recommended both the excess-profits tax and the undistributed-profits tax to tax away speculative profits. Now, with that in mind, I would like to have you proceed to tell us what you think the effect would be.

Mr. RUTTENBERG. I think one of the effects of this kind of a tax proposal would be to cause distribution of dividends, which in effect would have and should have a favorable effect upon the equity capital market.

Senator O'MAHONEY. Would it not also increase the money supply in the hands of stockholders?

Mr. RUTTENBERG. In the hands of stockholders for purposes of equity capital.

Senator O'MAHONEY. It could not be limited to that; it could be used for any purpose they saw fit.

Mr. RUTTENBERG. For all purposes, and it would be in the better interest to have that distributed to the group of stockholders than it would be to retain it in earnings in the corporation.

Senator O'MAHONEY. Why?

Mr. RUTTENBERG. Well, I think it would have two or three kinds of effects. I think first of all, the procedure of retaining earnings and reinvesting them in plant and equipment does, as I indicated in the statement and which you elaborated on, tend to promote the monopolistic trend of the industry. So it is in the best interests of the country as a whole if corporations do not reinvest retained earnings, but get new money on the capital market for such purposes.

Secondly, by distributing their retained earnings, they create a favorable situation for new and small businesses to be able to get money to come into the market to compete with the monopoly interests or the big business groups.

Senator O'MAHONEY. It is primarily as an antimonopoly interest that you would urge such a tax?

Mr. RUTTENBERG. And also from the standpoint of distribution of their earnings in an adequate way.

Senator O'MAHONEY. In other words, as I see it, your contention is that retained earnings have the effect of promoting the concentration of control over the economy; whereas, if earnings are distributed either in dividends or in wages, they will have the effect of creating a supply for venture capital?

Mr. RUTTENBERG. That is right.

Senator O'MAHONEY. What do you have to say about the tax aspect of this? These profits may be distributed as dividends or as wages. They may be taxed by the Government to support the necessary program of the Government. Or they might be retained by the industry for expansion, and then the other factor of distribution in dividends.

Now, which of these is the more important, as you see it?

Mr. RUTTENBERG. One factor which you just omitted from mentioning, which I think you might agree with, not only would it go in the form of dividends and wages, but it could take the form, prior to their creation, of going into lower prices, prior to the creation of the profits to be taxed away, in terms of lower prices, and therefore not being subject to the undistributed-profits or an excess-profits tax.

So I think in the long run, such a tax proposal would have a tendency to prevent price rises because corporations, feeling that if this is going to be taxed away from them there is no point in raising prices anyway, will say "therefore, we will let the price structure stay as it is, or pass on our higher earnings which we derive in the form of lower prices."

Secondly, it would aid in the redistribution of our total national income in terms of increasing the component of the wage segment of our national income in such a way that in the long run you improve the consumer income and thereby create a more stable economy.

Senator O'MAHONEY. Your thought is apparently that in the distribution of profits in a greater measure than they now are being distributed, you will create a supply of capital in the hands both of stockholders and of workers, which in turn could be used to build up competitive industry?

Mr. RUTTENBERG. That is precisely the point, and in connection with that I have referred, for example, to the decreasing proportion of the national income going to compensation of employees and the increasing proportion into profits.

Now, if that increasing proportion going into profits would be distributed—and the way to do it is either excess-profits tax or undistributed-profits tax, or whatever procedure you use—in the long run the tendency would be toward increasing the important segment of our national income, that is, consumer income, as well as dividend income, to promote the kind of full employment and full production economy which is essential in America.

M. E. Coyle, executive vice president, General Motors Corp.

Mr. COYLE. The effect of high corporation income taxes on stockholders and companies must also be kept in mind. During the prewar period prior to the imposition of excess-profit taxes, the corporation tax rate was less than half the current rate of 38 percent. In 1936–41 General Motors' Federal income taxes averaged about $95,000,000 a year. For the year 1948 alone, they are running well above $300,000,000. Total taxes paid by General Motors, including Federal excise taxes on the products sold, as well as local, State and other Federal taxes, were $650,000,000 in the 12 months ended September 30, 1948. This was equal to 14 percent of the corporation's sales.

Taxing a corporation is often spoken of as though the corporation were an inanimate, impersonal object from which funds could be drawn off inexhaustibly without affecting anyone in particular. A corporation represents a method of doing business used when the nature of the business requires more capital than an individual has or is willing to place at risk. It is an effective method of operation wherever large amounts of capital are required as in the automobile industry. It enables many people to pool their savings and their resources and to take a proportionate share of the profits or losses that may

result. Even though single individuals or small groups today had sufficient finances to carry on a manufacturing operation in the automotive industry, it is doubtful if they would be willing to place at risk that amount of capital in a single enterprise.

There is no source of revenue for a government except the collection of taxes imposed upon individual citizens. We may attempt to obscure the end result by directing the tax to be collected from corporations, eventually it is individuals who pay. If the corporation passes the tax on to the consumer indirectly in the price of the goods it sells or directly in the case of an excise tax, then the consumer is the one who is really paying it. On the other hand, if a tax is imposed upon the corporation and not passed on to the consumer, then the stockholders of the corporation pay it. Moreover, the tax does not differentiate among stockholders on the basis of income. The small stockholder is penalized to the same degree as the large.

If the corporation tax results in a rise in consumer prices and volume is thereby restricted, then the effective tax is also imposed upon the employees of the corporation in the form of lower wages or less employment, as well as upon the employees of its various sources of supply and upon its distributing organization. If the tax taken from the corporation restricts or diminishes working capital below the proper level, this too can interfere with normal production and can affect adversely the employment of all groups concerned. Again, if the effect of the tax is to reduce profits unduly in view of the risk involved, then the ultimate effect will be to discourage further investment. This, in turn, will work to the detriment of employees and eventually of consumers by reducing employment and production.

There is a further burden imposed upon stockholders by reason of corporation income taxes, namely, double taxation. Taxes are imposed upon the corporation as such and thereby diminish the earnings of the concern unless the taxes are passed on. Earnings of the concern that are distributed in the form of dividends then become part of the income of the stockholder and are again taxed as part of his personal income. Stockholders are keenly aware of the double taxation they pay on the earnings of the companies in which they have invested their savings. This process of double taxation has not been applied, so far as we know, to any other form of organization.

Senator O'MAHONEY. Do you advocate a flat corporate tax?

Mr. COYLE. Senator, I prefer that over the excess-profits tax, and I will tell you why.

It has been proven in the past, that in the case of General Motors, we would do very well with an excess-profits tax because we have a good profit base. But I don't think that you will ever get the small businesses to grow much if they have to be handicapped by an excess-profits tax. If you put us all on a flat base, we will get alone somehow.

Senator O'MAHONEY. What would be your opinion with respect to a variable rate of taxation, according to the amount of the profits? The income tax on an individual is stepped up according to——

Mr. COYLE. I am very, very conscious of that.

Senator O'MAHONEY. I guess most of us are.

Mr. COYLE. Well, when you speak of it in that way, what about the total amount of invested capital, and so forth? Did you have that in mind, the volume of business, and so forth? You say that a tax on an income is involved. You are one individual and I am

another, and we go up the scale here, and if you earn too much money you have to pay a bigger tax than I do.

Senator O'MAHONEY. I am asking you for your opinion as to whether or not, considering the fact that the Government needs revenue to do the things that the people of the United States want it to do, in those circumstances, you think that it would be desirable, if we have to balance the budget by levying new taxes, to adopt instead of the excess-profits tax, which you do not like, another form of taxation on corporations which would step the percentage of the tax up with the income of the corporation?

Senator FLANDERS. A progressive corporation tax.

Senator O'MAHONEY. Thank you for the phrase, Senator.

Senator WATKINS. The same as the rest of us pay.

Mr. COYLE. I know what you are getting at, but I don't quite follow it as to what your thought is back of it. I can't express an opinion unless I clearly understand it.

Senator O'MAHONEY. I am not on the Finance Committee, don't you see, but one of these days we will have to decide what sort of a tax we are going to levy to get the revenue which the Government needs.

You have a flat corporate tax now, and my question is: Does not that act to the disadvantage of the small corporation and to the advantage of the large corporation?

Mr. COYLE. I don't see how it should.

Senator O'MAHONEY. Tell us what you would do.

Mr. COYLE. Going back to the individual income tax that is used as your illustration, you say that the higher the income the higher the tax should be, on a graduated scale. A corporate concern that would earn $100,000,000 would pay proportionately more than one that would earn $100,000, for example. If each is rendering a service and employing people and distributing goods, they must be of service; otherwise the public would put them out of business, and if you merely started out on the assumption that you are going to charge a graduated scale that would confiscate a larger part of the profit of the fellow that made $100,000,000, as against the fellow who made $100,000 or $1,000,000. Just because he made more money is the poorest excuse I can think of for charging him more, unless you go back and find out what element of risk is in it, and so forth. Do I make myself clear?

Senator O'MAHONEY. Yes, indeed; but my thought is that if it is a justifiable principle when applied to the individual income-tax payer, why should it not be an equally justifiable principle when applied to the corporate-tax payer?

Mr. COYLE. Are we in agreement that it is a justifiable principle, or are we merely saying that it is the law?

Senator O'MAHONEY. Let us take it on the principle that it is the law, and the Congress has found it necessary to levy these taxes to get revenue for the Government. Now, nobody will say that a tax is a desirable or an enjoyable thing. Nobody likes to pay it, and we all like to find deductions which we can legally apply and thereby reduce the burden that we carry. And the Government does not quarrel with the individual or with the corporation that makes a proper, legal, allowable deduction.

It has struck me, however, that with respect to these hearings, some of our witnesses have been trying to persuade us to make additional

deductions legal for the large corporations. I am not talking about you, sir, but that was the whole theme of Professor Slichter's testimony when we opened these hearings; at least that was my impression.

But unfortunately, although these taxes are annoying to most of us, and very burdensome, perhaps, to most of us, they have to be paid or the Government will go out of business, and then nobody will make any money.

So I am asking you just to express your opinion with respect to these three systems: A flat tax, a graduated tax, or an excess profits tax for corporations.

Mr. COYLE. Well, as far as the excess profits tax, I have expressed my opinion there.

Senator O'MAHONEY. Yes, sir.

Mr. COYLE. As far as the flat tax, I have no objection to paying whatever the taxes are as applied to a business.

As far as your graduated scale or progressive scale of taxes on corporations, unless it is related to the risk of business, you are going to discourage venture capital as far as that institution is concerned, because the opportunity of profit and dividends diminish.

Russ Nixon, United Electrical Radio and Machine Workers of America, CIO

Mr. NIXON. [Recommendation is:] Drastic tax reform closing the familiar tax loopholes of the wealthy, raising the corporate income tax and adopting an excess profits tax and an undistributed profits tax.

STEEL PRODUCTION AND CAPACITY

Present steel production, although at record peacetime levels, is still considered a bottleneck in the manufacture of thousands of kinds of civilian goods. A controversy as to the need for substantially enlarged blast-furnace capacity has continued to the present time. Representatives of labor organizations expressed their reasons for holding as inadequate present steel ingot capacity and plans for its expansion, while spokesmen of the steel industry outlined the various means being employed to meet the demand for more steel, not only by a certain increase in blast-furnace capacity but through improvement in production facilities and methods.

Benjamin F. Fairless, president, United States Steel Corp.

Mr. FAIRLESS. Much has been written concerning the steel industry's capacity to produce in relation to current demand and estimated future requirements. The terms "capacity" and "production" have been used as if they were interchangeable, as if they were in fact the same. But no statement could be more fallacious.

Capacity is the theoretical amount which can be produced if raw materials of proper quality and required quantities are made available to run the equipment. Production is the amount of product available for shipment as a result of the operation of the equipment. Production, not capacity, is the means of meeting the needs of the steel consumer. Demands have been made for increased capacity while too little has been said about increased production.[36]

[36] See Appendix B, chart 1, and accompanying table.

I question if many people understand the size of the job which has been accomplished by the steel industry. There has been so much discussion concerning theoretical capacity, current demand, and future requirements that confusion continues to exist and to me it seems essential that we examine the matter from a practical standpoint in order that we may see where we are and where we are headed.

During 1948, the steel industry will produce and ship to consumers 65,000,000 tons of finished products. I say "will"; that is, assuming we are permitted to operate our properties. This is more finished steel products than in any previous year, peacetime or wartime, in our Nation's history.

TABLE II.—*United States Steel ingot capacity, compared with ingot and finished steel product production*

[000 omitted]

Year	Ingot capacity	Ingot production	Tons of finished products
1941	85.158	82.839	60.942
1942	88.886	86.031	60.591
1943	90.589	88.836	62.210
1944	93.854	89.641	63.250
1945	95.505	79.701	56.602
1946	91.890	66.602	48.775
1947	91.241	84.894	63.057
1948	94.233	[1] 88.000	[1] 65.000

	Tons
1942–45:	
Average annual ingot production	86,052,000
Average annual finished product production	60,663,000
1947:	
Ingot production	84,894,000
Finished product production	63,057,000
1948:	
Ingot production estimated	88,000,000
Finished product production estimated	65,000,000
1949:	
Ingot production probable	92,000,000
Finished product production probable	68,000,000

[1] Estimated.

Source: United States Steel Corp., Dec. 21, 1948.

In my judgment, the industry is capable of producing in 1949 a much greater tonnage than I would have considered possible had I been asked for such an estimate in 1946. My guess is that in 1949 the industry can produce 68,000,000 tons of finished steel products. Please understand I am not speaking of theoretical capacity. What I am saying is that the steel industry, if not interfered with by labor difficulties, will be capable of producing and shipping during 1949 approximately 5,000,000 tons of finished steel products more than it shipped during the year 1947, and nearly 7,500,000 tons more than the average shipments during the four war years of 1942–45.

World War II was fought and won with an annual average production of 60,600,000 tons of finished steel. Because of strikes and reconversion problems, the year 1946 was a year of relatively low production—48,800,000 tons. In 1947 the industry had a good operating year; production rose to 63,000,000 tons, almost equaling the best war year.

Now, in the postwar period large sums of money have been spent to increase and improve the availability of raw material and steel facilities. Some of our critics have indicated that they think too little is going into basic steel-making capacity, because of certain ideas currently held with respect to inadequate capacity. This question of capacity is a serious one and one to which we in United States Steel have devoted and continue to devote a great deal of attention—now more than ever before. But when the several members of the steel industry went to work in their own individual way to cure the shortage of steel, a job was done, and is being done, which I, for one, am pleased to see.

Some members increased ingot capacity; some worked primarily on raw materials; some devoted their time and money to more adequate finishing facilities; and some, of course, did some of each. All worked under the pressure of the greatest pent-up demand for steel in the Nation's history, where each pound of steel used to construct steel facilities meant a pound less for the needs of some customer.

Understand, of course, that new construction is still going on. For example, we will add—and by that I mean actually get into operation—during 1949 about 600,000 tons of additional ingot capacity—"we" meaning, of course, the United States Steel Corp. We expect to spend over $250,000,000 for plant and equipment in 1949.

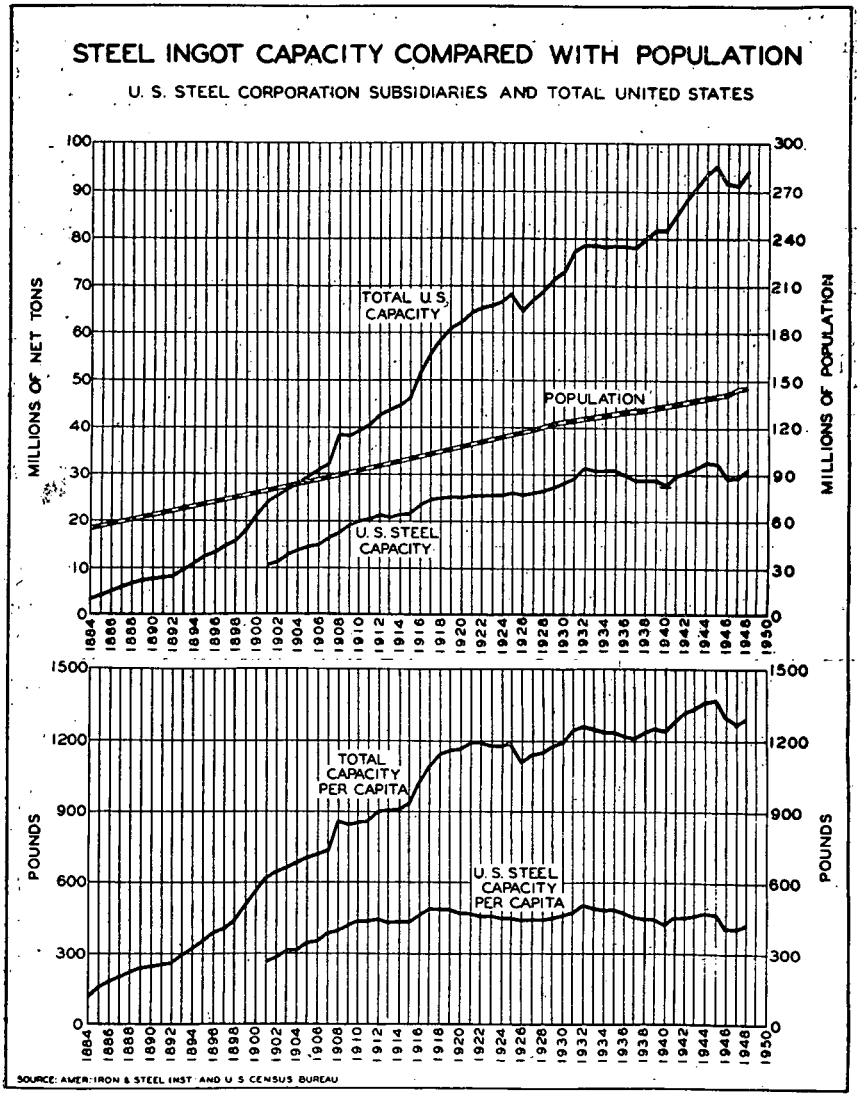
United States Steel Corp. subsidiaries' and other steel producing companies' capacity of ingots and castings

[Net tons]

Year	United States Steel subsidiaries	Other steel producing companies	Total industry	United States Steel percent of industry	Year	United States Steel subsidiaries	Other steel producing companies	Total industry	United States Steel percent of industry
1901	10,562,400	13,476,664	24,039,064	43.94	1925	25,899,800	42,573,422	68,473,222	37.82
1902	11,236,900	14,187,100	25,424,000	44.20	1926	25,479,000	39,271,035	64,750,035	39.35
1903	12,555,843	14,212,157	26,768,000	46.91	1927	25,958,200	41,277,917	67,236,117	38.61
1904	12,934,170	15,278,977	28,213,147	45.84	1928	26,612,800	42,228,112	68,840,912	38.66
1905	14,428,250	15,027,750	29,456,000	48.98	1929	27,105,700	44.332,816	71,438,516	37.94
1906	15,058,400	15,629,600	30,688,000	49.07	1930	28,182,600	44,802,806	72,985,406	38.61
1907	16,550,000	15,370,000	31,920,000	51.85	1931	29,204,000	48,053,803	77,257,803	37.80
1908	17,460,400	20,776,943	38,237,343	45.66	1932	31,182,300	47,598,613	78,780,913	39.58
1909	19,216,000	18,864,000	38,080,000	50.46	1933	30,622,900	47,991,503	78,614,403	38.95
1910	19,986,000	19,438,000	39,424,000	50.70	1934[1]	30,622,900	47,505,516	78,128,416	39.20
1911	20,252,500	20,067,500	40,320,000	50.23	1935	30,622,900	47,829,030	78,451,930	39.03
1912	21,080,900	21,479,100	42,560,000	49.53	1936	29,855,800	48,308,500	78,164,300	38.20
1913	20,715,300	22,964,700	43,680,000	47.43	1937	28,865,100	49,283,274	78,148,374	36.94
1914	21,277,700	23,174,277	44,451,977	47.87	1938	28,885,000	51,300,638	80,185,638	36.02
1915	21,535,900	24,713,246	46,249,146	46.56	1939	28,885,000	52,943,958	81,828,958	35.30
1916	23,342,000	27,940,314	51,282,314	45.52	1940	27,795,000	53,824,496	81,619,496	34.05
1917	24,691,400	30,876,155	55,567,555	44.43	1941	29,915,956	55,242,544	85,158,500	35.13
1918	24,872,000	33,974,418	58,846,418	42.27	1942	30,600,256	58,286,294	88,886,550	34.43
1919	25,020,400	36,000,269	61,020,669	41.00	1943	31,241,492	59,347,698	90,589,190	34.49
1920	25,035,800	37,277,791	62,313,591	40.18	1944	32,537,000	61,317,420	93,854,420	34.67
1921	25,417,200	38,844,827	64,262,027	39.55	1945	32,307,000	63,198,280	95,505,280	33.83
1922	25,417,600	40,009,082	65,426,682	38.85	1946	29,208,258	62,682,302	91,890,560	31.79
1923	25,537,600	40,144,414	65,682,014	38.88	1947	29,547,200	61,694,050	91,241,250	32.38
1924	25,553,400	41,010,115	66,563,515	38.39	1948	31,226,200	63,007,260	94,233,460	33.14

[1] In 1934 and subsequent years only castings made by ingot producers are included.

CHART 8


STEEL INGOT CAPACITY COMPARED WITH POPULATION
U. S. STEEL CORPORATION SUBSIDIARIES AND TOTAL UNITED STATES
MILLIONS OF NET TONS
MILLIONS OF POPULATION
TOTAL U.S. CAPACITY
POPULATION
U. S. STEEL CAPACITY
POUNDS
TOTAL CAPACITY PER CAPITA
U.S. STEEL CAPACITY PER CAPITA
SOURCE: AMER. IRON & STEEL INST. AND U.S. CENSUS BUREAU

The best test of what the industry has done and can do, in my opinion, is to be judged by the products shipped. If we in United States Steel choose to spend many millions of dollars to get better coal so that our coke quality improves and our pig-iron supply is increased, we may not change our rated ingot capacity 1 ton, but the resulting increased production will permit us to ship more tons to our customers. The shipments in 1948 prove that postwar expenditures have meant more steel for our customers.

Senator FLANDERS. You have made a point in your paper of distinction between capacity and production. Do you have the capacity, given raw materials and so forth, for larger ingot production than you are at the present time turning out, or would any large increase above the present amounts or the 1949 amounts require the installation of new open hearths and new blast furnaces?

Mr. FAIRLESS. Well, it is all going on, but the point I am trying to make, Mr. Chairman, and members of the committee, is that too much stress is given to the number of blast furnaces, for example, and not enough to whether the existing blast furnaces can produce more pig iron and how. Now, the steel industry went to work on that basis on the theory that that was the quickest way to get more production if it were possible. Now, you must realize that this steel industry has been running to peak capacity for nearly 10 consecutive years. We never had anything like that happen before in the history of this industry.

Now, in 8 or 10 years what has happened? Our raw materials from a quality standpoint have in many cases been exhausted or nearly exhausted, which means that new coal mines have to be opened, and in many cases the quality of coal is not the equal of the coal that had been extracted from older mines. Obviously, the better quality of coal is always mined first. Also, we have gone through a period of mechanization in coal mining. We are completely away from the old pick-and-shovel days, and today we do machine mining. The machine is not as adept at picking out the impurities in coal as was the miner, with the result that the impurities come out with the coal.

During and since the war we have had a very big drop in our productivity, because those impurities in the coal had to pass through our blast furnaces, along with the coke which resulted from the coal. Immediately, as soon as we were able at the close of the war, we began to install coal-washing equipment, and that is not some simple thing. I am talking about millions of dollars of investment over a long period of time. Now, in our case, those new washers located in West Virginia and Pennsylvania are coming into production, with the result that we are getting a better quality coal, and a 1,000-ton-a-day blast furnace today is producing 1,000 tons or more nearly that, as against the 700 or 750 tons which we had been producing. This is not an alibi, I am trying not to do anything except present the facts. We believe and we have been working on the theory that there is a shortage of steel, and that we know, and we know the causes. We went at this problem on the basis of what is the quickest way to get more steel. This is the course we have pursued, and here are the results.

Senator O'MAHONEY. Mr. Fairless, with respect to the future demand, you say in your statement, "Inability to meet simultaneously all of the extraordinary demands does not mean that the industry is

not progressive, nor that it will not increase its capacity nor is there any proof that the demand will continue indefinitely at the present pace."

That recognizes, I think, particularly when coupled with your statement that for 10 years the steel industry has now been running at a peak, that the demand for steel in the United States is very great.

Mr. FAIRLESS. That is right.

Senator O'MAHONEY. It is so great, is it not, that there has been a very widespread gray market?

Mr. FAIRLESS. There has been some as there is, I believe, in every other scarce commodity.

Senator O'MAHONEY. That is right.

Mr. FAIRLESS. One breeds the other.

Senator O'MAHONEY. That is perfectly true, and there is no implication there that it is only in steel, but, of course, it is a little bit more difficult to carry around a ton of steel in your pocket than it is to carry around some smaller commodity which is dealt with in the gray market. The Small Business Committee of the Senate has been studying this steel problem for a very long time. Recently they completed a survey of the receipts of steel by the agricultural equipment industry, and it shows that during the first 6 months of 1948 agriculture received over 17 percent of its entire steel needs through diversion-steel and gray-market channels.

Back in 1947, that was just a year ago, the percentage was running only about 6.2. Now, conversion steel, as I understand it, is that steel which is produced when the consumer, by hook or by crook, gets scrap or pig and sends it to some plant to have it converted into ingots and then takes the ingots and ships them to another plant and has them converted into sheet or whatever the finished product may be that they need.

Now, this is a tremendous increase from a little over 6 percent to over 17 percent, in the agricultural equipment industry alone. It has been my experience, and I am sure it has been the experience of many other Members of Congress that our constituents are finding it terribly difficult to get steel. Now, what should we do about it? Should we just wait and see what the United States Steel and the other big fellows plan to do about it, or shall we undertake to follow this other suggestion which has been made, that Government capital should be used to build additional steel facilities?

Mr. FAIRLESS. Well of course, I cannot tell you what to do.

Senator O'MAHONEY. You can advise us, of course.

Mr. FAIRLESS. I can advise you what I think that you should do, and that advice is this: Certainly there is not any mystery in your mind or in the mind of any member of your committee what has caused the situation in steel, when you realize that the United States of America is producing 57 to 58 percent of all of the steel that is being produced in the world today.

Senator O'MAHONEY. Well, the United States of America has produced a substantial proportion of almost everything else that is being used.

Mr. FAIRLESS. But never that much steel, and it has not the raw materials to support that rate of production of the world's production of steel, for some day we will regret it very much in my opinion. So,

my suggestion is that you need not sit idly by and hope that we do the job that I have indicated we have been doing and are doing, but keep in touch with us. You don't need to have a hearing in order to have me come down here and talk over the steel situation.

Hiland G. Batcheller, president, Allegheny-Ludlum Steel Corp.

Mr. BATCHELLER. It is obvious that a company concerned in developing and manufacturing products of this type would be faced with the problem of continuing sizable capital expenditures. This is the reason that I have cited these points, to make this point.

Not only do we need capital for new products, but in addition we must also keep abreast of technological change. Old facilities bought many years ago must be replaced with new equipment purchased at today's high prices. We are now engaged in our company in a program of rehabilitation, improvement and expansion of the plant and facilities involving about $25,000,000. For comparison, it is interesting to note that the net value of our plant at the time the program started late in 1945 was only $11,800,000. We are adding $25,000,000 to that now.

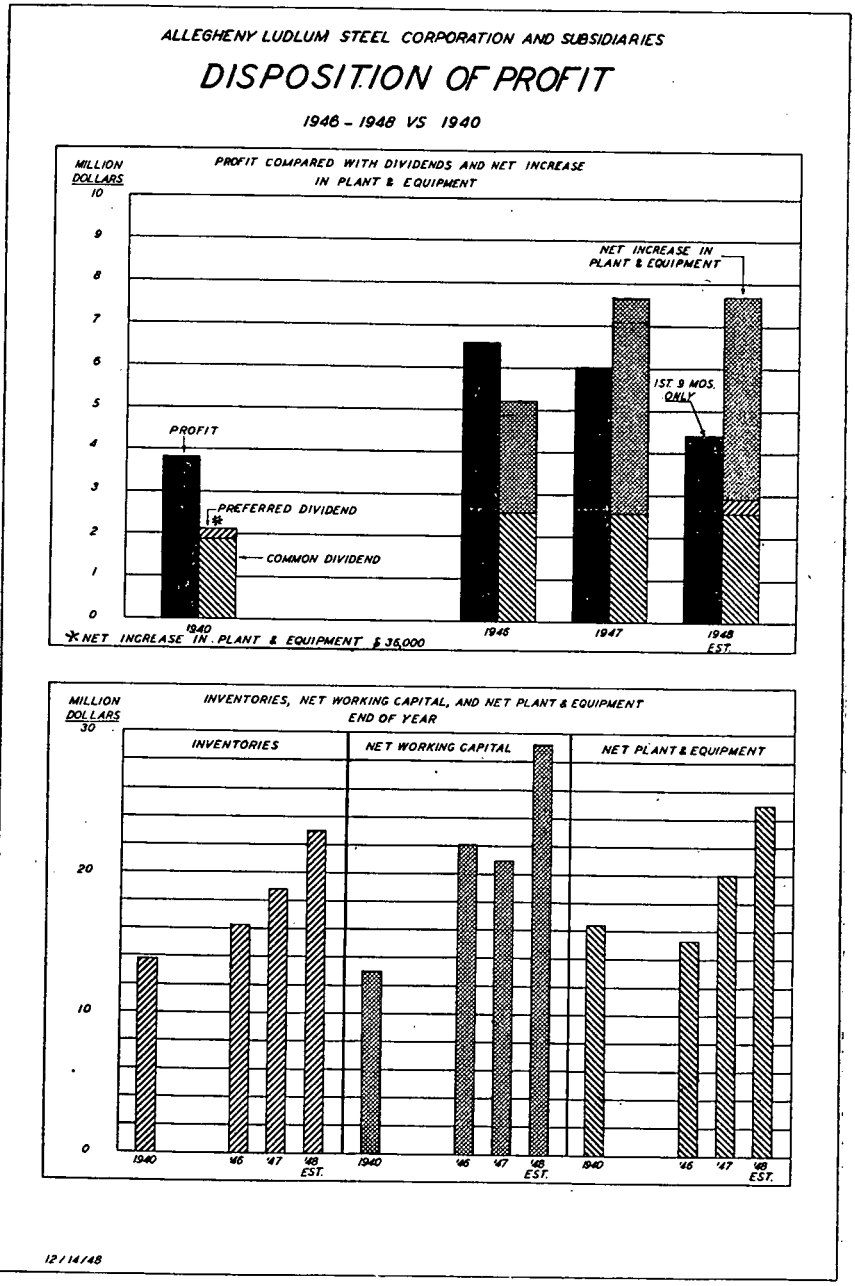
In recent months we have undertaken, at the urgent request of certain customers—that could be more properly stated "certain industries"—a further expansion program in carbon steel melting facilities which will almost double our total ingot output within another 6 months.

It is not only plant facilities, however, that require capital investment; the working capital requirements of Allegheny Ludlum have also increased very materially since 1940 when our sales were only about $54,000,000 a year.[37] We are currently shipping material at an annual rate of close to $150,000,000 and to do this we have to have about twice as much money in inventory and three times as much money in cash as we did in 1940. Even though our working capital has increased from about $13,000,000 in 1940 to about $29,000,000 at October 31, 1948, the plant program now under way and further capital requirements for inventories next year are expected to reduce our cash resources to a point where borrowing may be necessary by the middle of 1949. This is the case in spite of the fact that we have retained in our business about $16,000,000 in earnings since January 1, 1940, and further obtained over $10,000,000 by the sale of equity capital, preferred stock in April 1948.

Chart 9, which is presented herewith, shows investment in plant in the years 1940, 1946, 1947, and 1948 (estimated), the working capital of the company in those years, and compares earnings with combined outlays for dividends and net increases in plant, plant expenditures less retirements and depreciation. It should be noted that these combined outlays substantially exceeded earnings in 1947 and are expected to exceed earnings in 1948. For your information, the moderate dividend paid to our 13,500 stockholders has not been changed in 7 years.

[37] See appendix D, table I, for financial data submitted by the company.

CHART 9


ALLEGHENY LUDLUM STEEL CORPORATION AND SUBSIDIARIES
DISPOSITION OF PROFIT
1946 - 1948 VS 1940
MILLION DOLLARS
PROFIT COMPARED WITH DIVIDENDS AND NET INCREASE IN PLANT & EQUIPMENT
10
9
8
7
6
5
4
3
2
1
0
NET INCREASE IN PLANT & EQUIPMENT
1ST 9 MOS. ONLY
PROFIT
PREFERRED DIVIDEND
COMMON DIVIDEND
1940
1946
1947
1948 EST.
* NET INCREASE IN PLANT & EQUIPMENT $ 35,000
MILLION DOLLARS
INVENTORIES, NET WORKING CAPITAL, AND NET PLANT & EQUIPMENT END OF YEAR
30
20
10
0
INVENTORIES
NET WORKING CAPITAL
NET PLANT & EQUIPMENT
1940
'46
'47
'48 EST.
12/14/48

Senator WATKINS. You speak of a return to 75 to 80 percent operating level. Have you taken into consideration the increased demands for products?

Mr. BATCHELLER. I have, sir, and that is what causes this condition. I do not mean that from a physical viewpoint the industry cannot operate its steel-making facilities at close to 100 percent, but when you get a condition like this, competition forces the bringing in of new capacity. If I cannot serve my customer and my deliveries to him drop back to 6, 8, or 10 months, as has been the case, inevitably someone else comes in and says, "Well, I would like to have your business; I can take care of it. I will build some capacity." And that is what is going on right now in the industry. We have a tremendous expansion in the steel industry.

Senator WATKINS. You have noted the Government demands that there be still more expansion.

Mr. BATCHELLER. I know that, and I would like to comment on that, if I may.

Senator WATKINS. I would like to get your comment, because there has been increasing pressure all of the time for increased expansion of the industry.

Mr. BATCHELLER. The shortage of steel that we have experienced in the last 2 years, which in my humble opinion has had a serious effect on the economy of our country—and I have stated that on a number of occasions—has been caused not by lack of capacity to make steel, but by limitation—temporarily I hope, and it may be permanent—but by limitation of the availability of the materials with which to make steel. In 1947, if I remember my figures correctly, production fell some 3,000,000 tons short of the productive capacity of the industry. Why is that? We could not get the scrap to operate with. Every ton of scrap that we had shipped to the other side—for good reason, of course—during the war years meant the loss of a ton of steel in this country. We were unable to get the high-grade metallurgical coal, with the consequent result of a deterioration in the quality of the coke available for blast-furnace use, in some cases curtailing pig-iron production 7 to 8 or 9 percent below the capacity of those blast furnaces to produce pig iron.

The diminishing supplies of high-grade metallurgical ore in this country are beginning to make themselves felt.

Senator WATKINS. Specifically, just which ones do you mean?

Mr. BATCHELLER. I mean first the high-grade open hearth, the lump ore of high iron content and low in impurities, coming from the Vermillion Range particularly, that could be charged directly into open-hearth furnaces without going through a blast-furnace operation at all. I understand that that has disappeared, and it is not obtainable.

The supply of open-hearth ore is seriously restricted at the present time.

Until the supply of scrap comes back so that it can be used in approximately the ratio that it was used before the war, I think that the steel industry is going to have great difficulty in operating its equipment at capacity levels.

Senator FLANDERS. And yet, Mr. Batcheller, is it not true that at the present time it is running at almost an unprecedented high percentage of capacity—the steel industry?

Mr. BATCHELLER. That is true, sir, and it is being done by the exercise of various ingenious devices that I think are phenomenal. But when we talk about adding another 10,000,000 tons or even another 5,000,000 tons, I cannot see it, not because it is not possible to put in the capacity, but because of the limitation on the availability of the materials, and the time required to correct that situation.

Senator FLANDERS. Running at this very high current capacity, is there any evidence that the steel industry is yet meeting current demands?

Mr. BATCHELLER. I think that there is beginning to be, Senator. Of course, I cannot speak for the industry. No individual can speak for the steel industry; I don't care who he is, that cannot be done. In the case of my own company and in some other cases that have come to my observation, it seems to me that we can see the beginning of a catching up in the supply of steel to meet the requirements of the consumer. How far along that is, I do not know. It seems a straw in the wind to me, but it seems to me to be the beginning.

Stanley H. Ruttenberg, CIO

Mr. RUTTENBERG. To comment on your remark that we are now at maximum production and that it is a slow process to install new plant equipment to increase that production, I would like to say that we had that decision to make. Industry and government and all had that decision to make during the war, a decision of whether or not the steel industry's capacity should be expanded in order to meet the greater need, but temporarily reducing the use of steel in a very limited way, but in the long run accomplishing the objective which was vitally needed, and that was increased steel capacity for a war economy. I think that that same kind of psychology must now permeate throughout industry and the Government if we are to meet the kind of situations which are now being created. For example in the farm equipment industry there are many plants which have either to close down or work part time because they cannot get steel.

You are completely familiar with the automobile industry experience of last year, where they worked on the average of 3 to 4 days a week because they could not get sufficient sheet steel to keep the automobile industry operating. When you have these kinds of experiences occurring, it seems to me and to the CIO generally that it is in the best intrests of the Nation as a whole that these industries expand their capacity and make available the increased capacity which is needed by increasing demand; but unfortunately, again, it is this issue of faith in the future of America which I think plays a great part in keeping industry from expanding its capacity; for example, the steel industry from expanding to the point which it should.

Senator FLANDERS. Of course, the steel industry expansion must be slow; it cannot be done in anything short of a couple of years or so.

Mr. RUTTENBERG. But contemplated expansions today do not begin to meet the need.

Donald Montgomery, UAW-CIO

Mr. MONTGOMERY. The dim view of the future is more sharply pointed up, however, by the bottlenecks which persist in our basic industries and the manifest unwillingness of management to step up

to this fact. The American Iron and Steel Institute scorns the idea that we need a substantial increase in steel capacity, but the shortage of steel continues to cause difficulties in other vital industries—freight cars, mining machinery, pipe for oil and gas, power generators. Shortage of electric power is expected to cause brown-outs and lost production in many States this winter, and again next year. Yet the Electric Institute is reported to be considering a revision downward of its wholly inadequate expansion plans. Alcoa has just announced shut-down next February of its Niagara Falls smelter and the lay-off of 1,000 workers in Tennessee—not enough power.

Just let me quote the New York Times of December 8, this year. It quotes one prominent steel official who recently predicted that it—

> may not be long before the Government will be applauding the steel industry for keeping its feet on the ground against the hysteria for creating 10,000,000 tons of extra capacity overnight.

Since the end of the war, one large figure in the steel industry after another has been predicting that by the end of the year or by the end of next year we will be caught up and we will have all of the steel production we need, and that the future of American steel production calls for no more capacity for the next, 10, 20, or 50 years than we have right now. That is what I call a bottleneck.

Senator WATKINS. May I ask you for a comment on an argument made here yesterday by one of the steel executives that even though we had an increase in capacity we could not get an increase in production simply because of the lack of materials?

Mr. MONTGOMERY. I don't think it is true, and I have seen studies made by a good many competent people who do not think it is true either. Now, to be sure, there is a shortage of scrap, and it is going to mean a change in charging practice in the steel furnace, to be sure, if the scrap is not forthcoming. I think all of these things point up what I am saying, Senator, always finding reasons and telling you why it cannot be done, and that is what I am addressing myself to right now. I am not prepared to sell America short; that is what these people are doing.

Senator WATKINS. I did not hear any argument to that effect.

Mr. MONTGOMERY. Do you realize that in the next 10 years if we continue the growth in gross national product that we have had over the last 30 years, 2½ percent a year compounded, we will have to produce 40 percent more than we are producing right now, and right now we cannot meet all of our requirements? These things are short, chiefly the steel industry is short, and the steel industry does not come in here and tell you what it is doing to break these bottlenecks to overcome these difficulties. It writes articles telling why it is impossible and why we don't need more steel.

Senator WATKINS. I was interested in your opinion, and you said you don't believe it is true, but do you have any figures on the things that they claim we are short, the materials that are short, so that they cannot go ahead with more production even though they had more capacity?

Mr. MONTGOMERY. Coking coal and iron ore, and they are telling us iron ore is short.

Senator WATKINS. That is, quality iron ore.

Mr. MONTGOMERY. That is the kind they don't know how to use, and they are trying to use this magnetic ore and to beneficiate it so that they can charge it into the furnaces; they are working on that, but they tell us that there are vast quantities of ore now being opened up in Labrador and that can be brought right into the Cleveland and Pittsburgh mill areas, if, by your leave, the Congress will get busy on the St. Lawrence seaway projects so that we can get the boats up the river and bring it in at proper cost.

I have been through these hearings with the Small Business Committee, and I heard the steel men testify and I heard the basis of their saying we don't need more steel. You know what they did? They took the prosperous years of the twenties and they took the depression of the thirties and they averaged them together and said that is the average of the future of America.

Senator WATKINS. You have the advantage of me. I have not heard one of them say that they do not need any more steel, and, in fact, all I have heard, they told me that they do need more steel. They say, however, even if they had the capacity now, because of the lack of the essential materials they could not produce more steel. That is the thing I was addressing myself to. I have not heard anybody say that you do not need more steel. I think everybody knows that we do need more right now.

Mr. MONTGOMERY. Back in 1947—the American Iron and Steel Institute meetings in May—they were telling each other, "We don't need any more steel capacity," and, in fact, they had cut their capacity after the war, as you know, and they said, "We don't need any more." And the Senate Small Business Committee, Senator Martin, chairman, brought them down here and they said the same thing in the record—Wilford Sykes of Inland Steel Co.; Walter Tower, the American Iron and Steel Institute—it is all in that record; and they kept on saying it.

Then, they saw that was not quite popular, so now they say, "Yes; we do need some more, and we are providing more." What are they providing? About 1,000,000 tons a year, alleged capacity, but when you look into it, you will find that most of it is finishing capacity and very little of it is ingot capacity. We have given a great deal of attention to this, both the steel workers' union and ours, because we don't intend to run on into a blind alley with our eyes shut. If it is true we cannot produce more steel under present conditions, we intend to find conditions under which we can.

Prof. Seymour Harris, economist, Harvard University

Representative PATMAN. If the steel companies will not expand, and they say it is not in their interest to expand, I think the Government should consider either through Reconstruction Finance Corporation loans or through some method of expanding steel.

Dr. HARRIS. That seems to me to be a very sensible viewpoint and I would agree with that wholeheartedly. There is a tremendous social good involved there.

Representative PATMAN. You take these little fellows all over the country, they cannot get steel but the big fellows can. The little ones cannot obtain it because it is scarce and the larger ones have a little

stronger call than the smaller ones and in order to take care of the smaller ones in some way we have to increase our steel capacity.

Dr. HARRIS. You either have to do that or have allocations.

Representative PATMAN. You would still have an insufficient amount of steel if you had the allocations system.

Dr. HARRIS. You might get rid of some nonessential needs.

Representative PATMAN. Yes, like beer cans and things of that nature, but that would not solve the question by any means, I would not think.

Dr. HARRIS. I think you have a point there and it is a difficult point.

Representative PATMAN. I think consideration should be given and we must have more steel capacity.

APPENDIXES

APPENDIX A

GENERAL STATISTICS ON CORPORATION PROFITS

TABLE I.—*Corporate profits in the United States, 1926–48*

[In millions of dollars]

Year	Corporate profits before Federal and State income and excess-profits taxes	Tax liability	Corporate profits after Federal and State income and excess-profits taxes	Net corporate dividend payments	Undistributed corporate profits
1926	8,500	1,200	7,300	4,300	3,000
1927	7,500	1,100	6,400	4,500	1,900
1928	9,300	1,200	8,100	5,000	3,100
1929	9,818	1,398	8,420	5,823	2,597
1930	3,303	848	2,455	5,500	−3,045
1031	−783	500	−1,283	4,098	−5,381
1932	−3,042	3,382	−3,424	2,574	−5,998
1933	162	524	−362	2,066	−2,428
1934	1,723	746	977	2,596	−1,619
1935	3,224	965	2,259	2,872	−613
1936	5,684	1,411	4,273	4,557	−284
1937	6,197	1,512	4,685	4,693	−8
1938	3,329	1,040	2,289	3,195	−906
1939	6,467	1,462	5,005	3,796	1,209
1940	9,325	2,878	6,447	4,049	2,398
1941	17,232	7,846	9,386	4,465	4,921
1942	21,098	11,665	9,433	4,297	5,136
1943	24,516	14,153	10,363	4,477	5,886
1944	24,333	13,525	10,808	4,680	6,128
1945	20,389	11,641	8,748	4,720	4,028
1946	21,840	9,000	12,840	5,605	7,235
1947	29,784	11,709	18,075	6,880	11,195
1948 [1]	33,300	12,900	20,300	7,300	13,000

[1] Annual rate, based on first 9 months, preliminary estimate.

Sources: 1926–28: Labor's Monthly Survey (American Federation of Labor), September 1948, p. 3, based on reports of the Bureau of Internal Revenue, adjusted as nearly as possible to correspond with the 1929–1948 series.
1929–47: Survey of Current Business (Department of Commerce), July 1948.
1948: Economic Indicators, November 1948. Based on Department of Commerce data.

CHART 1

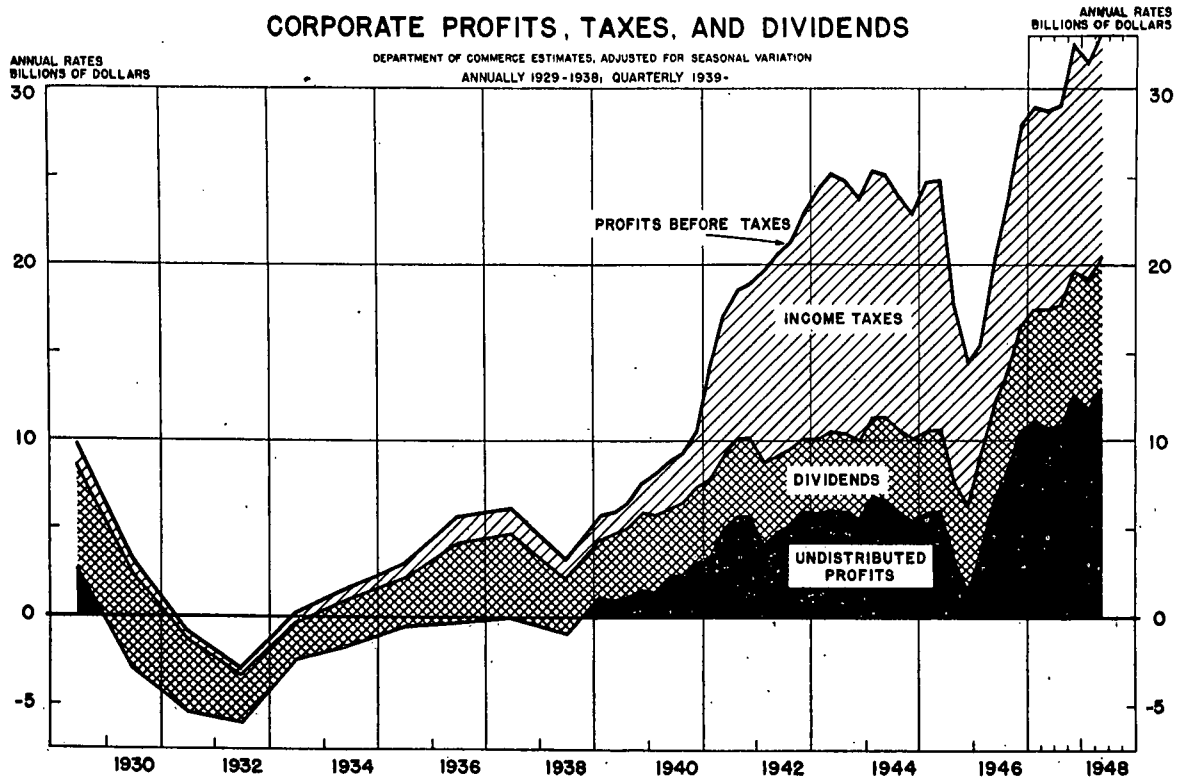


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TABLE II.—*Corporate profits after taxes of all private Corporations and of leading corporations,*[1] *1929–47*

[Dollar figures in millions]

Year	All private corporations net corporate profits	Leading corporations		Leading corporations as percentage of all private corporations	Year	All private corporations net corporate profits	Leading corporations		Leading corporations as percentage of all private corporations
		Number	Net corporate profits				Number	Net corporate profits	
1929	8,420	1,900	5,983	71	1939	5,005	2,590	3,565	71
1930	2,455	1,900	3,516	143	1940	6,447	2,540	4,367	68
1931	−1,283	1,810	1,275	----------	1941	9,386	2,560	4,969	53
1932	−3,424	1,925	151	----------	1942	9,433	2,625	4,776	51
1933	−362	1,935	1,314	----------	1943	10,363	2,665	5,266	51
1934	977	2,010	1,789	183	1944	10,808	2,806	5,160	48
1935	2,259	2,140	2,473	109	1945	8,748	2,958	5,241	60
1936	4,273	2,280	3,747	88	1946	12,840	3,102	6,750	53
1937	4,685	2,435	4,031	86	1947	18,075	3,102	9,228	51
1938	2,289	2,480	2,119	93					

[1] Companies are those listed annually by the National City Bank of New York in its Monthly Letter April issues.

Sources: Survey of Current Business, July 1948 and July 1947; National City Bank Monthly Letter, 1930–48 April issues.

TABLE III.—*Corporate profits after taxes of all private corporations, and of 629 large corporations, 1939–48* [1]

[In millions of dollars]

Year	All private corporations	629 large corporations	629 large corporations as percentage of all private corporations	Year	All private corporations	629 large corporations	629 large corporations as percentage of all private corporations
1939	5,005	1,465	29.3	1944	10,808	1,896	17.5
1940	6,447	1,818	28.2	1945	8,748	1,925	22.0
1941	9,386	2,163	23.0	1946	12,840	2,545	19.8
1942	9,433	1,769	18.8	1947	18,075	3,670	20.3
1943	10,363	1,800	17.4	1948 [2]	20,300	5,400	26.6

[1] There are approximately 450,000 private corporations (excluding nonprofit corporations) in the United States. Profits are after Federal and State income and excess profits taxes.
[2] Annual rate, based on data for first 6 months, preliminary estimate.

Sources: Survey of Current Business, July 1948; Midyear Economic Report of the President, July 1948 Economic Indicators, November 1948; Federal Reserve Bulletin, November 1948.

TABLE IV.—*Dividends and undistributed corporate profits as percentages of corporate profits after taxes, 1926–48*

Year	Dividend payments	Undistributed corporate profits	Year	Dividend payments	Undistributed corporate profits
	Percent	*Percent*		*Percent*	*Percent*
1926	58.9	41.1	1938	(1)	(1)
1927	70.3	29.7	1939	75.8	24.2
1928	61.7	38.3	1940	62.8	37.2
1929	69.2	30.8	1941	47.6	52.4
1930	(1)	(1)	1942	45.6	54.4
1931	(1)	(1)	1943	43.2	56.8
1932	(1)	(1)	1944	43.3	56.7
1933	(1)	(1)	1945	54.0	46.0
1934	(1)	(1)	1946	43.7	56.3
1935	(1)	(1)	1947	38.1	61.9
1936	(1)	(1)	1948 [2]	36.0	64.0
1937	(1)	(1)			

[1] Net corporate dividend payments were greater than corporate profits after taxes in each of these years
[2] Annual rate, based on first 9 months, preliminary estimate.

Source: Computed from data in table I.

TABLE V.—*National income by distributive shares, 1929–48*

[In billions of dollars]

Year	Total national income	Compensation of employees	Proprietors' and rental income	Corporate tax liability	Corporate profits after taxes	Corporate inventory valuation adjustment	Net interest
1929	87.4	50.8	19.7	1.4	8.4	0.5	6.5
1930	75.0	46.5	15.7	.8	2.5	3.3	6.2
1931	58.9	39.5	11.8	.5	−1.3	2.4	5.9
1932	41.7	30.8	7.4	.4	−3.4	1.0	5.4
1933	39.6	29.3	7.2	.5	−.4	−2.1	5.0
1934	48.6	34.1	8.7	.7	1.0	−.6	4.7
1935	56.8	37.1	12.1	1.0	2.3	−.2	4.5
1936	64.7	42.7	12.6	1.4	4.3	−.7	4.5
1937	73.6	47.7	15.4	1.5	4.7	(1)	4.4
1938	67.4	44.7	14.0	1.0	2.3	1.0	4.3
1939	72.5	47.8	14.7	1.5	5.0	−.7	4.2
1940	81.3	51.8	16.3	2.9	6.4	−.1	4.1
1941	103.8	64.3	20.8	7.8	9.4	−2.6	4.1
1942	136.5	84.7	28.1	11.7	9.4	−1.3	3.9
1943	168.3	109.1	32.1	14.2	10.4	−.8	3.4
1944	182.4	121.1	34.1	13.5	10.8	−.3	3.1
1945	181.7	122.9	36.0	11.6	8.7	−.6	3.0
1946	179.3	117.3	41.8	9.0	12.8	−5.0	3.4
1947	202.5	127.5	46.0	11.7	18.1	−5.1	4.3
1948 [2]	216.3	134.0	51.1	11.9	18.6	−3.9	4.6

[1] Less than $50,000,000.
[2] Annual rate, based on data for first 6 months, preliminary estimate.

Source: Midyear Economic Report of the President, July 1948, p. 79.

TABLE VI.—*Comparison of national income and corporation profits after taxes, 1939–48*

Year	Total national income	All private corporations		629 large corporations		Leading corporations		
		Net profits	Net profits as percentage of national income	Net profits	Net profits as percentage of national income	Number	Net profits	Net profits as percentage of national income
	Billions of dollars	*Billions of dollars*		*Billions of dollars*			*Billions of dollars*	
1939	72.5	5.0	6.9	1.5	2.1	2,590	3.6	5.0
1940	81.3	6.4	7.9	1.8	2.2	2,540	4.4	5.4
1941	103.8	9.4	9.1	2.2	2.1	2,560	5.0	4.8
1942	136.5	9.4	6.9	1.8	1.3	2,625	4.8	3.5
1943	168.3	10.4	6.2	1.8	1.1	2,665	5.3	3.1
1944	182.4	10.8	5.9	1.9	1.0	2,806	5.2	2.9
1945	181.7	8.7	4.8	1.9	1.0	2,958	5.2	2.9
1946	179.3	12.8	7.1	2.5	1.4	3,102	6.8	3.8
1947	202.5	18.1	8.9	3.7	1.8	3,102	9.2	4.5
1948 [1]	216.3	20.3	9.4	5.4	2.5	(2)	(2)	(2)

[1] Annual rate, based on data for first 6 months, preliminary estimate.
[2] Not available.

Sources: Survey of Current Business, July 1948; Midyear Economic Report of the President, July 1948; Economic Indicators, November 1948; Monthly Letter, 1940–1948 April issues, National City Bank of New York.

TABLE VII.—*Share of production paid to wages and salaries and to profits and interest in selected industries*

Industry and year	Value created by the industry	Paid to—		Industry and year	Value created by the industry	Paid to—	
		Wages and salaries	Profits and interest			Wages and salaries	Profits and interest
	Millions of dollars	*Percent*	*Percent*		*Millions of dollars*	*Percent*	*Percent*
Lumber:				Textiles:			
1939	507	84.9	15.1	1939	1,412	86.4	13.6
1946	1,481	76.4	23.6	1946	4,397	63.0	37.0
1947	2,152	69.9	30.1	1947	5,243	61.6	38.4
Iron and steel:				Paper:			
1939	2,273	83.7	16.3	1939	592	78.9	21.1
1946	6,116	78.0	22.0	1946	1,777	66.0	34.0
1947	8,645	68.1	31.9	1947	2,475	56.4	43.6
Utilities, electric and gas:				Automobiles:			
1939	1,718	46.1	53.9	1939	1,181	73.0	27.0
1946	2,671	46.5	53.5	1946	1,865	96.2	3.8
1947	3,029	49.3	40.7	1947	3,523	67.0	33.0
Railroads:				Retail trade:			
1939	2,740	81.6	18.4	1939	8,666	66.1	23.9
1946	5,692	90.2	9.8	1946	26,195	53.8	46.2
1947	6,366	85.0	15.0	1947	28,559	55.3	44.7

Notes on terminology, figures, sources: "Value created" is expressed in money value. Therefore, increases in "value created" are due both to the increased volume of goods produced, and to inflation of money value through price rises which do not increase the volume of goods available. Inventory valuation adjustment, where deducted by the Commerce Department, has been added back. Value created represents only the value created by the industry concerned and therefore excludes the cost of materials purchased from other businesses; this prevents duplication. Wages, salaries, profits, interest are before deducting income taxes. These 4 items add to 100 percent of value created. Wages and salaries include supplements such as social security payments, pensions, etc. Source: U. S. Department of Commerce National Income figures. See Survey of Current Business, National Income Supplement (July 1947), especially footnotes to table 13 for description of coverage; July 1948 for 1946 and 1947 figures.

Source: American Federation of Labor, Labor's Monthly Survey, October 1948, p. 7.

TABLE VIII.—*Sources and uses of corporate funds, 1946–48*

[Billions of dollars]

Use or source of funds	1946	1947	1948 [1]
Uses (where the money goes):			
Spending on plant and equipment	11.6	15.0	16.8
Additions to inventories (increase in book value)	7.5	7.2	5.6
Increase in customer financing	5.4	5.6	1.6
Other spending [2]	2.7	.1	1.4
Total uses of funds	27.2	27.9	25.4
Sources (where the money comes from):			
Internal sources:			
Retained net earnings and depletion allowances	6.3	10.6	[3] 12.0
Depreciation reserves	4.1	4.5	4.8
Reduction in cash, U. S. Government securities and other current assets	7.1	.4	.8
External sources:			
Increases in bank loans	3.3	2.9	0
Increase in mortgage loans	.6	.6	.8
Increase in trade debt	3.0	2.2	0
Increase in liability for Federal income tax	0	2.4	1.0
Net new security issues:			
Bonds	1.0	3.1	4.2
Stocks	1.3	1.3	1.0
Other net sources	0	.5	.6
Total sources of funds	26.7	28.5	25.2
Discrepancy (uses less sources)	.5	−.6	.2

[1] Annual rate, first half.
[2] Includes net repayments of trade debt, short term bank loans, and RFC loans and reduction in liability for Federal income tax.
[3] Estimate based on preliminary first quarter data.

Source: Department of Commerce estimate based on Securities and Exchange Commission and other financial data, in Midyear Economic Report of the President, July 1948, p. 106.

NOTE ON COMPARISON OF POSTWAR AND PREWAR FINANCING

"It appears that corporations by and large finance their expansion of fixed capital facilities in the immediate prewar period by funds generated through their current operations. This was not true of the twenties, when there was considerable recourse to the capital markets to supplement internal sources of funds. Part of this difference between the two periods is explainable in terms of the generally lower level of business activity and investment in the thirties.

"The amount of money raised through the capital markets in the twenties, however, was much more modest than is commonly thought. In the late twenties, including 1929, it is estimated, that net new issues, i. e., new domestic private security issues less retirements, were not much in excess of 2.5 billion dollars annually, exclusive of investment companies. This figure, of course, is far below the level of new issues in that period, and reflects the large volume of refinancing issues and outright retirements. For most of the years during the thirties and up until the end of the war, retirements of securities exceeded new issues. Even in 1936, the highest year for net new issues from the depression low to the postwar period, less than 1 billion dollars was raised on balance from the security markets." (Friend, Irwin; Business Financing in the Postwar Period, Survey of Current Business, March 1948, p. 12.)

TABLE IX.—*Expenditures on new plant and equipment by United States business,*[1] *1939–48* [2]

[Millions of dollars]

	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948 [3]	1948			
											January–March	April–June	July–September [3]	October–December [3]
Manufacturing	1,930	2,580	3,400	2,760	2,250	2,390	3,210	5,910	7,460	8,030	1,800	2,140	2,160	1,940
Mining	380	560	680	410	360	500	440	560	690	770	180	200	200	180
Railroad	280	440	560	540	460	580	550	570	910	1,320	270	300	360	380
Other transportation	280	390	340	260	190	280	320	660	800	680	180	190	170	150
Electric and gas utilities	480	550	710	680	540	490	630	1,040	1,900	2,540	500	640	690	700
Commercial and miscellaneous [4]	1,850	1,980	2,490	1,470	730	970	1,480	3,300	4,430	5,280	1,240	1,340	1,360	1,330
Total	5,200	6,490	8,190	6,110	4,530	5,210	6,630	12,040	16,180	18,630	4,170	4,810	4,950	4,690

[1] Excludes agriculture; figures represent estimates of actual expenditures except where indicated to be anticipated expenditures.

[2] Figures for 1939–44 are Federal Reserve Board estimates based on Securities and Exchange Commission and other data. These figures do not agree precisely with the totals included in the gross national product estimates of the Department of Commerce. The main difference lies in the inclusion in Commerce figures of certain outlays charged to current account.

[3] Estimates for the last 2 quarters of 1948 based on anticipated capital expenditures of business.

[4] Includes trade, service, finance, and communication.

NOTE.—Figures are rounded and will not necessarily add to totals.

TABLE X.—*Federal corporate income-tax returns—Numbers filed, active corporations only, 1929–45*

[In thousands]

Year	All active corporations	Returns with net income	Returns with no net income	Percent with no net income	Year	All active corporations	Returns with net income	Returns with no net income	Percent with no net income
1929	456.0	269.4	186.6	40.9	1938	471.0	169.9	301.1	63.9
1930	463.0	221.4	241.6	52.1	1939	469.6	199.5	270.1	57.5
1931	459.7	175.9	283.8	61.7	1940	473.1	221.0	252.1	53.2
1932	451.9	82.6	369.3	81.7	1941	468.9	264.6	204.3	43.5
1933	446.8	109.8	337.0	75.4	1942	442.6	269.9	172.7	39.0
1934	469.8	145.1	324.7	69.1	1943	420.5	283.7	136.8	32.5
1935	477.1	164.2	312.9	65.5	1944	412.5	288.9	123.6	29.9
1936	478.9	203.2	275.7	57.5	1945	421.1	303.0	118.1	28.0
1937	477.8	192.0	285.8	59.8					

Source: Bureau of Internal Revenue, Statistics of Income for 1945, pt. 2, p. 20, and similar earlier tables.

TABLE XI.—*Corporate sales and net corporate income after taxes for all industries excluding finance, insurance, and real estate, 1929–47*

Year	Sales (in billions of dollars)	Net corporate income after taxes (in billions of dollars)	Net income as percentage of sales	Year	Sales (in billions of dollars)	Net corporate income after taxes (in billions of dollars)	Net income as percentage of sales
1929	138.6	7.5	5.4	1939	120.8	4.8	4.0
1930	118.3	2.4	2.0	1940	135.2	6.2	4.6
1931	92.4	−.9	−1.0	1941	176.2	9.1	5.2
1932	69.2	−2.7	−3.9	1942	202.8	9.0	4.4
1933	73.0	.4	.5	1943	233.5	9.7	4.2
1934	89.6	1.6	1.8	1944	246.7	10.0	4.1
1935	102.0	2.7	2.6	1945	239.5	7.9	3.3
1936	119.5	4.4	3.7	1946	253.1	11.8	4.7
1937	128.9	4.6	3.6	1947	319.5	16.9	5.3
1938	108.6	2.1	1.9				

Source: Survey of Current Business, July 1947 and July 1948.

TABLE XII.—*Corporate sales and net corporate income after taxes for all manufacturing and trade corporations, 1929–47*

Year	Manufacturing corporations			Corporations in wholesale and retail trade		
	Sales	Net corporate income after taxes	Net income as percentage of sales	Sales	Net corporate income after taxes	Net income as percentage of sales
	In millions of dollars	*In millions of dollars*		*In millions of dollars*	*In millions of dollars*	
1929	70,305	4,403	6.3	43,108	651	1.5
1930	58,484	1,327	2.3	36,897	−92	−.2
1931	42,759	−480	−1.1	30,242	−473	−1.6
1932	30,995	−1,423	−4.6	22,903	−767	−3.3
1933	34,303	583	1.7	23,978	8	(1)
1934	40,131	1,056	2.6	32,813	291	.9
1935	46,782	1,742	3.7	37,417	407	1.1
1936	55,959	2,885	5.2	43,145	705	1.6
1937	61,459	2,936	4.8	45,383	615	1.4
1938	50,031	1,147	2.3	38,575	262	.7
1939	57,159	2,958	5.2	42,262	641	1.5
1940	65,755	3,840	5.8	46,638	785	1.7
1941	92,023	5,713	6.2	57,081	1,235	2.2
1942	116,278	5,209	4.5	55,184	1,160	2.1
1943	142,020	5,605	3.9	57,616	1,293	2.2
1944	150,960	5,985	4.0	61,023	1,376	2.3
1945	138,725	4,402	3.2	65,905	1,518	2.3
1946	129,090	6,558	5.1	85,920	2,849	3.3
1947	176,630	11,037	6.2	98,322	2,799	2.8

[1] Less than 0.05 percent.

Source: Survey of Current Business July 1947 and July 1948.

TABLE XIII.—*Corporate sales and net corporate income after taxes of leading corporations in manufacturing and trade, 1935–47*

Year	Manufacturing corporations				Trade corporations			
	Number of corporations	Sales [1]	Net income	Net income as percentage of sales	Number of corporations	Sales [1]	Net income	Net income as percentage of sales
		Mils. of dollar	*Mils. of dollar*			*Mils. of dollar*	*Mils. of dollar*	
1935	331	11,559	646	5.6	59	2,905	138	4.7
1936	577	16,062	1,219	7.6	93	4,080	197	4.8
1937	615	20,474	1,511	7.4	95	5,085	184	3.6
1938	680	16,890	667	4.0	100	4,118	146	3.5
1939	760	19,857	1,300	6.5	110	4,675	199	4.3
1940	900	24,251	1,831	7.5	110	5,007	194	3.9
1941	966	34,344	2,241	6.5	107	5,860	205	3.5
1942	910	43,805	1,885	4.3	109	7,147	203	2.8
1943	920	53,239	1,927	3.6	112	7,780	219	2.8
1944	941	59,799	1,994	3.3	116	8,665	233	2.7
1945	1,017	54,751	2,124	3.9	135	9,864	268	2.7
1946	1,155	53,400	3,200	6.0	145	12,400	562	4.5
1947	1,257	82,300	5,800	7.1	158	16,100	600	3.7

[1] Includes income from investments and other sources, as well as from sales.

Source: National City Bank of New York, Monthly Letter, April issues 1936–48.

TABLE XIV.—*Net worth and net income after taxes of leading corporations, 1928–47*

Year	Number	Net worth as of Jan. 1	Net income after taxes	Percentage return on net worth	Year	Number	Net worth as of Jan. 1	Net income after taxes	Percentage return on net worth
		Mil. dol.	*Mil. dol.*				*Mil. dol.*	*Mil. dol.*	
1928	1,520	30,378	3,549	11.7	1938	2,480	56,405	2,119	3.8
1929	1,900	56,055	5,983	10.6	1939	2,590	56,827	3,565	6.3
1930	1,900	61,581	3,516	5.7	1940	2,540	56,163	4,367	7.8
1931	1,810	52,524	1,275	2.4	1941	2,560	55,696	4,969	8.9
1932	1,925	53,452	151	0.3	1942	2,625	56,178	4,776	8.5
1933	1,935	49,774	1,314	2.6	1943	2,665	61,414	5,266	8.6
1934	2,010	50,660	1,789	3.5	1944	2,806	62,964	5,160	8.2
1935	2,140	49,291	2,473	5.0	1945	2,958	67,960	5,241	7.7
1936	2,280	51,447	3,747	7.3	1946	3,102	71,299	6,750	9.5
1937	2,435	55,998	4,031	7.2	1947	3,102	75,527	9,228	12.2

Source: National City Bank of New York, Monthly Letter, April issues, 1929–48.

TABLE XV.—*Net worth and net income after taxes of leading manufacturing and trade corporations, 1937–47*

Year	Manufacturing corporations				Trading corporations			
	Number	Net worth as of Jan. 1	Net income after taxes	Percentage return on net worth	Number	Net worth as of Jan. 1	Net income after taxes	Percentage return on net worth
		Mil. dol.	*Mil. dol.*			*Mil. dol.*		
1937	1,410	23,067	2,481	10.8	145	1,741	191	10.9
1938	1,440	23,210	1,068	4.6	149	1,789	155	8.6
1939	1,495	25,125	2,096	8.3	142	1,896	212	11.2
1940	1,420	25,297	2,665	10.5	133	1,934	201	10.4
1941	1,336	23,808	2,926	12.3	138	2,122	233	11.0
1942	1,321	24,225	2,388	9.9	143	2,287	226	9.9
1943	1,327	28,474	2,730	9.6	143	2,335	235	10.1
1944	1,406	28,771	2,776	9.6	164	2,550	264	10.4
1945	1,511	32,168	2,998	9.3	170	2,534	275	10.9
1946	1,571	34,005	4,112	12.1	177	2,850	624	21.9
1947	1,571	37,062	6,317	17.0	177	3,368	616	18.3

Source: National City Bank of New York, Monthly Letter, April issues, 1938–48.

TABLE XVI.—*Overstatement of corporate earnings, 1946–48*

[In billions of dollars]

Year	Overstatement due to failure to deduct the rise in the cost of replacing inventories	Overstatement due to failure to charge adequate depreciation	Total overstatement
1946	5.0	1.3	6.3
1947	5.1	1.0	6.1
1948	3.0	1.0	4.0
Total	13.1	3.3	16.4

Source: Sumner Slichter before Joint Committee on the Economic Report, Dec. 6, 1948.

APPENDIX B

TABLES AND CHARTS ON THE MEAT PACKING, PETROLEUM, STEEL, TEXTILE, AND AUTOMOBILE INDUSTRIES

TABLE I.—*Net earnings of the meat-packing industry* [1]

Year	Millions of dollars			Percent return		Earnings per 100 pounds	
	Net worth	Total sales	Net earnings	On net worth	Per dollar sales	Live weight	Dressed weight
22-year average, 1925–46	791	3,777	41	5.18	1.09	$0.15	$0.26
5-year average, 1925–29	835	3,575	39	4.67	1.09	.16	.30
5-year average, 1930–34	799	2,502	14	1.75	.56	.06	.10
5-year average, 1935–39	705	3,045	25	3.55	.82	.11	.19
5-year average, 1940–44	766	5,118	64	8.35	1.25	.19	.35
1940	721	3,158	42	5.85	1.34	.15	.27
1941	746	4,066	65	8.66	1.59	.22	.40
1942	779	5,781	67	8.64	1.16	.20	.37
1943	783	6,181	72	9.17	1.16	.20	.36
1944	802	6,404	72	8.93	1.12	.19	.35
1945	917	5,744	52	5.62	.90	.18	.29
1946	945	6,145	143	15.17	2.33	.48	.75
1947	940	9,439	149	15.85	1.58	.42	.67

[1] "The meat-packing industry," as used in this table, includes companies conducting commercial slaughtering operations under the jurisdiction of the Packers and Stockyards Act.

Source: Net worth, total sales, and net earnings reported by the Packers and Stockyards Division, U. S. Department of Agriculture. Earnings per 100 pounds live and dressed weight are approximations calculated by the American Meat Institute covering commercial meat production.

TABLE II.—*Total sales of meat-packing companies, 1929–47, reporting to the USDA, under the Packers and Stockyards Act*

Year	Four largest companies		Other federally inspected slaughterers			Slaughterers not federally inspected			Total slaughterers	
	Sales [1]	Percent of total	Sales [1]	Percent of total	Number of companies	Sales [1]	Percent of total	Number of companies	Sales [1]	Number of companies
	Mils. of dols.		*Mils. of dols.*			*Mils. of dols.*			*Mils. of dols.*	
1929	2,559	66.5	1,000	26.0	211	289	7.5	372	3,848	587
1930	2,262	62.3	1,066	29.4	216	300	8.3	466	3,628	686
1931	1,739	62.8	796	28.7	213	235	8.5	453	2,770	670
1932	1,258	64.1	541	27.6	207	162	8.3	415	1,961	626
1933	1,200	64.3	501	26.8	202	167	8.9	423	1,868	629
1934	1,515	66.3	579	25.4	202	191	8.3	402	2,285	608
1935	1,853	66.5	688	24.7	197	244	8.8	413	2,785	614
1936	2,004	66.3	748	24.8	191	269	8.9	394	3,021	589
1937	2,148	65.1	831	25.2	184	318	9.7	397	3,297	585
1938	1,944	63.8	792	26.0	184	309	10.2	407	3,045	595
1939	1,920	62.4	808	26.3	192	347	11.3	425	3,075	621
1940	1,968	62.3	833	26.4	185	357	11.3	415	3,158	604
1941	2,547	62.6	1,061	26.1	177	458	11.3	442	4,066	623
1942	3,559	61.6	1,784	30.8	[2] 231	438	7.6	[2] 381	5,781	616
1943	3,838	62.1	1,973	31.9	[2] 244	370	6.0	[2] 393	6,181	641
1944	3,972	62.0	2,082	32.5	[2] 263	350	5.5	[2] 378	6,404	645
1945	3,308	57.6	2,055	35.8	[2] 268	381	6.6	[2] 376	5,744	648
1946	3,256	53.0	2,332	37.9	240	558	9.1	399	6,146	643
1947	5,475	58.0	3,203	33.9	230	761	8.1	446	9,439	680

[1] Includes nonmeat items, which have been a significant and expanding proportion of total sales for the larger companies.

[2] There was a marked increase in the number of plants operating under Federal inspection during the war years.

Source: Annual report of the Livestock Branch, U. S. Department of Agriculture, summarizing financial results of meat-packing companies, subject to the Packers and Stockyards Act, who conduct slaughtering operations.

TABLE III.—*Financial summary, 14 major meat-packing companies combined, 1940, 1946, 1947*

[Thousand dollars]

Item	1947	1946	1940
Assets:			
Cash	$79,676	$94,457	$59,909
Marketable securities	46,309	95,505	14,848
Receivable	221,057	149,888	115,663
Inventories	463,452	351,220	240,270
Other current	701	5,082	816
Total current	811,195	696,152	431,505
Plant and equipment	376,215	338,183	353,132
Other noncurrent [1]	67,848	56,088	62,456
Total noncurrent	444,063	394,271	415,588
Total	1,255,258	1,090,423	847,092
Liabilities:			
Notes payable	66,169	7,469	28,459
Accounts payable	76,974	50,333	24,003
Taxes (Federal income)	84,262	82,591	15,942
Other current	62,918	71,126	29,288
Total current	290,323	211,519	97,690
Long-term liabilities	194,079	152,695	138,339
Total debt	484,402	364,214	236,029
Reserves	67,531	57,832	34,860
Net worth [1]	703,325	668,377	576,207
Total	1,255,258	1,090,423	847,094
Sales	6,687,624	3,995,233	2,348,371
Earnings before dividends	100,793	78,048	32,111
Working capital	520,871	484,633	333,815
Depreciation	23,482	20,311	19,102
Ratios:	*Percent*	*Percent*	*Percent*
Current	279.4	329.1	441.7
Earnings:			
Sales	1.5	2.0	1.4
Worth	14.3	11.7	5.6
Total assets	8.0	7.2	3.8
Worth:			
Total debt	145.2	183.5	244.1
Total noncurrent	158.4	169.5	138.6
Sales, worth	950.9	597.8	407.6

[1] Exclusive of Treasury stocks and tangible assets.

Source: Research Department, Federal Reserve Bank of Chicago.

TABLE IV.—*Financial and operating summary of 30 oil companies, years 1947 and 1946, and the average for 1941–45*

	1947	1946	Average, 1941–45
Total income.....million dollars	10,483	7,549	[1] 6,162
Total costs and other deductions.....do	9,264	6,786	[1] 5,625
Net income carried to surplus.....do	1,219	763	537
Net income in percent of total income.....percent	11.6	10.1	8.7
Preferred and common dividends paid in cash.....million dollars	425	331	259
Dividends in percent of net income.....percent	34.9	43.4	48.1
Net assets:			
United States.....million dollars	7,159	6,378	----------
Foreign countries.....do	1,365	1,145	----------
Total.....do	8,524	7,523	----------
Current assets.....do	4,325	3,687	3,135
Current liabilities.....do	1,690	1,227	1,046
Net working capital.....do	2,635	2,460	2,089
Ratio of current assets to current liabilities	2.6	3.0	3.0
Capital expenditures:			
Production.....million dollars	1,077	812	566
Transportation.....do	297	157	120
Refining.....do	402	201	192
Marketing.....do	277	185	59
Others.....do	23	22	9
Total.....do	2,076	1,377	946
Production in percent of total.....percent	51.9	59.0	59.8
Net investment in fixed assets:			
Production.....million dollars	3,548	3,136	2,484
Transportation.....do	979	777	706
Refining.....do	1,278	989	1,009
Marketing.....do	1,139	954	893
Others.....do	125	112	114
Total.....do	7,069	5,968	5,206
Production in percent of total.....percent	50.2	52.5	47.7
Borrowed capital.....million dollars	1,437	1,153	1,064
Invested capital [2].....do	9,054	8,002	6,838
Total.....do	10,491	9,155	7,902
Borrowed capital in percent of total.....percent	13.7	12.6	13.5
Average borrowed and invested capital [3].....million dollars	9,484	8,519	7,502
Net income [4].....do	1,252	793	569
Return on borrowed and invested capital.....percent	13.2	9.3	7.6
Crude oil production (net):			
United States.....thousand barrels per day	2,725	2,534	2,118
Foreign countries.....do	700	645	419
Total.....do	3,425	3,179	2,537
Crude runs to stills:			
United States.....do	4,165	3,873	3,319
Foreign countries.....do	604	569	436
Total.....do	4,769	4,442	3,755

[1] Gross operating income and costs have been adjusted to exclude sales and purchases under Government directives.
[2] Includes minority interests.
[3] Excludes minority interests.
[4] Before deducting interest charges.

Source: Pogue, Joseph E. and F. G. Coqueron, Financial Analysis of 30 Oil Companies for 1947, p. 2.

TABLE V.—*Summary of financial and operating data of 30 oil companies for the years 1934–47*

Year	Earnings					Preferred and common dividends paid in cash		Cash income		Working capital		Net assets common stock and surplus
	Total income	Operating costs and other charges	Capital extinguishments	Net income	Net income percent of total income	Total	Percent of net income	Total	Percent of total income	Total	Ratio of current assets to current liabilities	
	Million dollars	*Million dollars*	*Million dollars*	*Million dollars*		*Million dollars*		*Million dollars*		*Million dollars*		*Million dollars*
1934	3,527	2,938	432	157	4.5	128	81.5	616	17.5	1,443	3.9	5,037
1935	3,792	3,086	452	254	6.7	120	47.2	740	19.5	1,467	3.7	5,097
1936	4,257	3,378	467	412	9.7	233	56.6	922	21.7	1,413	3.5	5,299
1937	4,825	3,746	506	573	11.9	288	50.3	1,139	23.6	1,575	3.3	5,647
1938	4,439	3,623	516	300	6.8	199	66.3	857	19.3	1,741	4.1	5,687
1939	4,171	3,335	515	321	7.7	188	58.6	882	21.1	1,713	4.4	5,772
1940	4,071	3,160	534	377	9.3	209	55.4	953	23.4	1,709	4.2	5,742
1941	4,859	3,791	538	530	10.9	251	47.4	1,173	24.1	1,758	3.2	5,896
1942	5,230	4,285	542	403	7.7	221	54.8	1,014	19.4	1,920	3.2	6,050
1943	6,090	4,972	608	510	8.4	242	47.5	1,207	19.8	2,062	2.7	6,311
1944	7,308	5,892	776	640	8.8	288	45.0	1,507	20.6	2,222	2.7	6,639
1945	7,326	5,748	976	602	8.2	291	48.3	1,640	22.4	2,485	3.4	7,024
1946	7,549	6,023	763	763	10.1	331	43.4	1,545	20.5	2,460	3.0	7,523
1947	10,483	8,397	867	1,219	11.6	425	34.9	2,160	20.6	2,635	2.6	8,524

TABLE V.—*Summary of financial and operating data of 30 oil companies for the years 1934–47*—Continued

Year	Capital expenditures						Net investment					
	Production	Transportation	Refining	Marketing	Others	Combined	Production	Transportation	Refining	Marketing	Others	Combined
	Million dollars	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*
1934	290	25	64	81	1	461	1,729	646	773	928	128	4,204
1935	351	28	52	79	7	517	1,808	595	754	932	123	4,212
1936	401	73	74	80	5	633	1,929	613	754	939	122	4,357
1937	616	79	112	112	8	927	2,198	644	788	987	121	4,738
1938	406	56	109	92	5	668	2,226	636	807	1,000	125	4,794
1939	373	83	116	82	10	664	2,275	636	809	959	118	4,797
1940	370	88	103	90	5	656	2,272	617	814	935	120	4,758
1941	424	154	113	113	6	810	2,270	703	846	970	115	4,904
1942	341	144	243	45	12	785	2,285	689	994	937	112	5,017
1943	467	135	299	22	7	930	2,353	727	1,153	876	127	5,236
1944	764	93	183	42	12	1,094	2,640	704	1,171	840	118	5,473
1945	832	75	122	75	8	1,112	2,876	707	882	841	97	5,403
1946	812	157	201	185	22	1,377	3,136	777	989	954	112	5,968
1947	1,077	297	402	277	23	2,076	3,548	979	1,278	1,139	125	7,069

Year	Borrowed and invested capital				Return on capital		Operations					
							Net crude production			Crude runs to stills		
	Borrowed	Invested	Total	Borrowed percent of total	Borrowed and invested	Invested	Domestic	Foreign	Combined	Domestic	Foreign	Combined
	Million dollars	*Million dollars*	*Million dollars*		*Percent*	*Percent*	*Thousand barrels per day*	*Thousand barrels per day*	*Thousand barrels per day*	*Thousand barrels per day*	*Thousand barrels per day*	*Thousand barrels per day*
1934	767	5,667	6,434	11.9	3.2	2.9	1,141	340	1,481	2,047	332	2,379
1935	686	5,692	6,378	10.8	4.8	4.8	1,284	357	1,641	2,201	367	2,568
1936	672	5,818	6,490	10.4	7.2	7.6	1,400	366	1,766	2,443	398	2,841
1937	776	6,196	6,972	11.1	9.3	10.0	1,618	429	2,047	2,639	451	3,090
1938	983	6,203	7,186	13.7	4.9	5.1	1,491	381	1,872	2,537	437	2,974
1939	1,025	6,290	7,315	14.0	5.1	5.4	1,556	416	1,972	2,678	449	3,127
1940	1,035	6,234	7,269	14.2	5.9	6.3	1,694	389	2,083	2,810	377	3,187
1941	1,065	6,352	7,417	14.4	7.9	8.8	1,766	474	2,240	3,076	438	3,514
1942	1,110	6,494	7,604	14.6	6.0	6.6	1,787	285	2,072	2,875	331	3,206
1943	1,088	6,751	7,839	13.9	7.3	8.0	2,076	330	2,406	3,194	410	3,604
1944	1,032	7,106	8,138	12.7	8.7	9.6	2,433	464	2,897	3,682	487	4,169
1945	1,028	7,485	8,513	12.1	7.9	8.6	2,526	543	3,069	3,766	514	4,280
1946	1,153	8,002	9,155	12.6	9.3	10.3	2,534	645	3,179	3,873	569	4,442
1947	1,437	9,054	10,491	13.7	13.2	14.9	2,725	700	3,425	4,165	604	4,769

Source: Joseph E. Pogue and F. G. Coqueron, Financial Analysis of 30 oil companies for 1947, p. 29.

TABLE VI.—*Selected financial data of 30 oil companies adjusted for changes in value of dollar, years 1934–47*

Year	Indexes used in adjusting data (1935–39=100)				Net income			Preferred and common dividends paid in cash			
	Construction costs in 30 cities [1]	Cost of living [2]	Wholesale prices of all commodities [3]	Income retained after income taxes [3]	Reported	Adjusted to prewar dollars [4]	Amount (+) absorbed by decline in purchasing power	Actual	Retained after income taxes [5]	Retained adjusted for cost of living [6]	Absorbed by income taxes and rise in cost of living
				Percent	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*
1934	91	96	93	95.8	157	169	−12	128	123	128	0
1935	91	98	99	95.8	254	257	−3	120	115	117	3
1936	94	99	100	95.8	412	412	0	233	223	225	8
1937	105	103	107	95.8	573	536	+37	288	276	268	20
1938	105	101	98	95.8	300	306	−6	199	191	189	10
1939	106	99	96	95.8	321	334	−13	188	180	182	6
1940	118	100	98	94.7	377	385	−8	209	198	198	11
1941	126	105	108	87.4	530	491	+39	251	219	209	42
1942	139	117	123	76.5	403	328	+75	221	169	144	77
1943	146	124	128	76.5	510	398	+112	242	185	149	93
1944	151	126	129	74.1	640	496	+144	288	213	169	119
1945	157	128	131	74.1	602	460	+142	291	216	169	122
1946	186	139	150	77.9	763	509	+254	331	258	186	145
1947	247	159	188	77.9	1,219	648	+571	425	331	208	217

Year	Capital expenditures			Return on borrowed and invested capital		Capital extinguishment charges				
	Actual	Adjusted to prewar costs [7]	Amount absorbed by rise in construction costs	Actual	Adjusted to prewar dollars [8]	Actual	Adjusted to current dollars [9]	Deficiency (−) in charges	Net income before deducting minority interests' share	
									Actual	Adjusted for deficiency in charges
	Million dollars	*Million dollars*	*Million dollars*	*Percent*	*Percent*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*	*Million dollars*
1934	461	507	−46	3.2	3.5	432	402	+30	181	211
1935	517	568	−51	4.8	4.9	452	447	+5	280	285
1936	633	673	−40	7.2	7.3	467	467	0	444	444
1937	927	883	+44	9.3	8.8	506	541	−35	618	583
1938	668	636	+32	4.9	5.0	516	506	+10	335	345
1939	664	626	+38	5.1	5.3	515	494	+21	349	370
1940	656	556	+100	5.9	6.0	534	523	+11	402	413
1941	810	643	+167	7.9	7.4	538	581	−43	560	517
1942	785	565	+220	6.0	5.0	542	667	−125	426	301
1943	930	637	+293	7.3	5.8	608	778	−170	538	368
1944	1,094	725	+369	8.7	6.9	776	1,001	−225	678	453
1945	1,112	708	+404	7.9	6.2	976	1,279	−303	640	337
1946	1,377	740	+637	9.3	6.5	763	1,145	−382	800	418
1947	2,076	840	+1,236	13.2	7.7	867	1,630	−763	1,276	513

[1] American Appraisal Co.
[2] U. S. Bureau of Labor Statistics.
[3] U. S. Treasury Department: based on annual income of $10,000, married and 1 dependent.
[4] Reported net income divided by index of wholesale prices of all commodities.
[5] Actual dividend times percent of income retained after income taxes.
[6] Portion retained after income taxes divided by cost of living index.
[7] Actual capital expenditures divided by index of construction costs.
[8] Based on yearly change in capital employed and actual earnings expressed in terms of index of wholesale prices of all commodities.
[9] Actual capital extinguishments multiplied by index of wholesale prices of all commodities.

Source: Joseph E. Pogue, and F. G. Coqueron, Financial Analysis of 30 Oil Companies for 1947, p. 30.

TABLE VII.—*Combined statement of source and disposition of working capital of 30 oil companies for year 1947*

	Millions of dollars
Source of funds:	
Provided by earnings	[1] 2,160
Long-term debt issued	476
Preferred and common stock issued	206
Sales of fixed assets and other transactions (net)	61
Total funds provided	2,903
Disposition of funds:	
Capital expenditures	2,076
Dividends paid to companies' shareholders	425
Dividends paid to minority interests	30
Long-term debt refunded	135
Long-term debt retired	62
Preferred stock redeemed	
Total funds disposed	2,728
Increase in working capital	175

[1] Represents net income of $1,219,000,000 plus capital charges of $867,000,000 and non-cash charges of $74,000,000.

Source: Pogue, Joseph E. and Coqueron, F. G., Financial Analysis of 30 Oil Companies for 1947, p. 20.

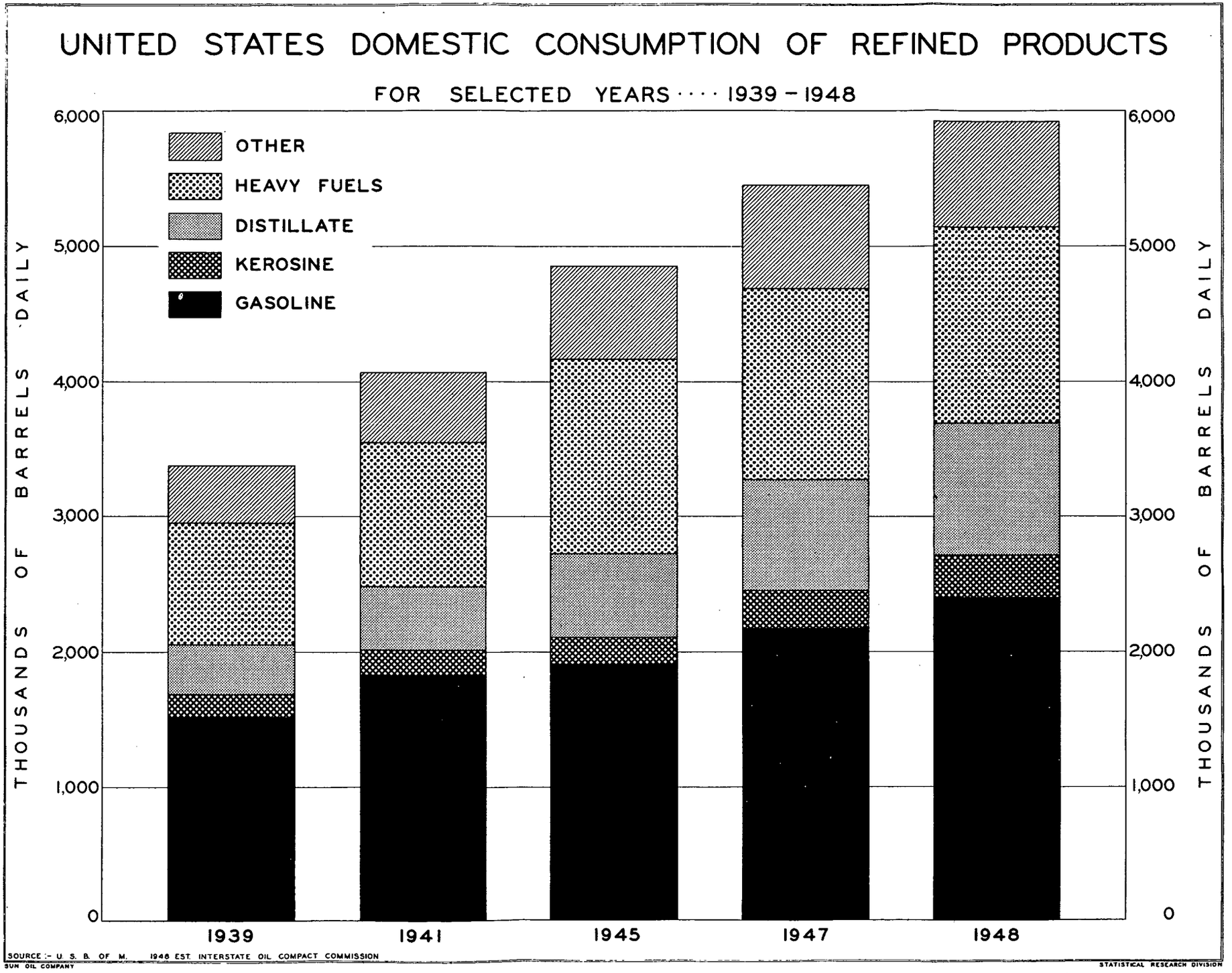
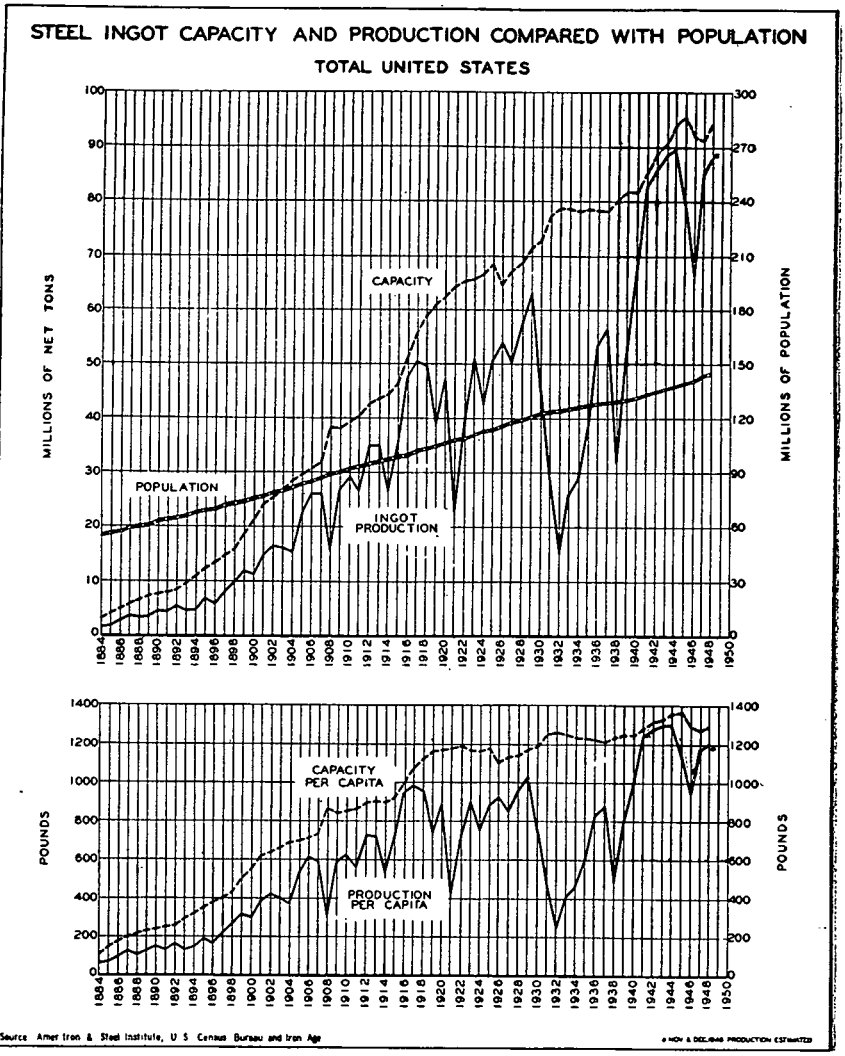

UNITED STATES DOMESTIC CONSUMPTION OF REFINED PRODUCTS
FOR SELECTED YEARS · · · · 1939 – 1948
OTHER
HEAVY FUELS
DISTILLATE
KEROSINE
GASOLINE
THOUSANDS OF BARRELS DAILY
6,000
5,000
4,000
3,000
2,000
1,000
0
1939
1941
1945
1947
1948
SOURCE :- U. S. B. OF M. 1948 EST. INTERSTATE OIL COMPACT COMMISSION
SUN OIL COMPANY
STATISTICAL RESEARCH DIVISION

CHART 2


STEEL INGOT CAPACITY AND PRODUCTION COMPARED WITH POPULATION
TOTAL UNITED STATES
MILLIONS OF NET TONS
MILLIONS OF POPULATION
CAPACITY
POPULATION
INGOT PRODUCTION
POUNDS
CAPACITY PER CAPITA
PRODUCTION PER CAPITA
Source: Amer Iron & Steel Institute, U S Census Bureau and Iron Age

Annual steel ingot capacity and production compared with population of United States

[000 omitted]

Year	Population, continental U. S. A.	Annual steel ingot capacity			Annual steel ingot production			
		Net tons	Capacity per capita		Net tons	Percent of capacity	Production per capita	
			Net tons	Pounds			Net tons	Pounds
1900	76,094	21,168	0.2782	556	11,411	53.9	0.1500	300
1901	77,585	24,039	.3098	620	15,090	62.8	.1945	389
1902	79,160	25,424	.3212	642	16,741	65.8	.2115	423
1903	80,632	26,768	.3320	664	16,279	60.8	.2019	404
1904	82,165	28,213	.3434	687	15,523	55.0	.1889	378
1905	83,820	29,456	.3514	703	22,427	76.1	.2676	535
1906	85,437	30,688	.3592	718	26,205	85.4	.3067	613
1907	87,000	31,920	.3669	734	26,166	82.0	.3008	602
1908	88,709	38,237	.4310	862	15,706	41.1	.1771	354
1909	90,492	38,080	.4208	842	26,830	70.5	.2965	593
1910	92,407	39,424	.4266	853	29,226	74.1	.3163	633
1911	93,868	40,320	.4295	859	26,517	65.8	.2825	565
1912	95,331	42,560	.4464	893	35,001	82.2	.3672	734
1913	97,227	43,680	.4493	899	35,057	80.3	.3606	721
1914	99,118	44,452	.4485	897	26,335	59.2	.2657	531
1915	100,549	46,249	.4600	920	36,009	77.9	.3581	716
1916	101,966	51,282	.5029	1,006	47,907	93.4	.4698	940
1917	103,414	55,568	.5373	1,075	50,468	90.8	.4880	976
1918	104,550	58,846	.5629	1,126	49,798	84.6	.4763	953
1919	105,063	61,021	.5808	1,162	38,832	63.6	.3696	739
1920	106,466	62,314	.5853	1,171	47,189	75.7	.4432	886
1921	108,541	64,262	.5921	1,184	22,158	34.5	.2041	408
1922	110,055	65,427	.5945	1,189	39,875	60.9	.3623	725
1923	111,950	65,682	.5867	1,173	50,337	76.6	.4496	899
1924	114,113	66,564	.5833	1,167	42,484	63.8	.3723	745
1925	115,832	68,473	.5911	1,182	50,841	74.2	.4389	878
1926	117,399	64,750	.5515	1,103	54,089	83.5	.4607	921
1927	119,038	67,236	.5648	1,130	50,327	74.9	.4228	846
1928	120,501	68,841	.5713	1,143	57,729	83.9	.4791	958
1929	121,770	71,439	.5867	1,173	63,205	88.5	.5191	1,038
1930	123,077	72,985	.5930	1,186	45,583	62.5	.3704	741
1931	124,040	77,258	.6228	1,246	29,059	37.6	.2343	469
1932	124,840	78,781	.6311	1,262	15,323	19.5	.1227	245
1933	125,579	78,614	.6260	1,252	26,020	33.1	.2072	414
1934	126,374	78,128	.6182	1,236	29,182	37.4	.2309	462
1935	127,250	78,452	.6165	1,233	38,184	48.7	.3001	600
1936	128,053	78,164	.6104	1,221	53,500	68.4	.4178	836
1937	128,825	78,148	.6066	1,213	56,637	72.5	.4396	879
1938	129,825	80,186	.6176	1,235	31,752	39.6	.2446	489
1939	130,880	81,829	.6252	1,250	52,799	64.5	.4034	807
1940	131,970	81,619	.6185	1,237	66,883	82.1	.5076	1,015
1941	133,203	85,158	.6393	1,279	82,839	97.3	.6219	1,244
1942	134,665	88,887	.6601	1,320	86,032	96.8	.6389	1,278
1943	136,497	90,589	.6637	1,327	88,837	98.1	.6508	1,302
1944	138,083	93,854	.6797	1,359	89,642	95.5	.6492	1,298
1945	139,586	95,505	.6842	1,368	79,702	83.5	.5710	1,142
1946	141,235	91,891	.6506	1,301	66,603	72.5	.4716	943
1947	[1] 144,034	91,241	.6335	1,267	84,894	93.0	.5894	1,179
1948	[1] 146,114	94,233	.6449	1,290				

[1] Preliminary.

TABLE VIII.—*Combined financial statements for the textile industry, 1939, 1946, and 1947 (units identical in each year)*

[000 omitted]

Items	Group I. Textile mills: American Woolen, Botany, Burlington, Cannon, Dan River, Pacific, United Merchants & Manufacturers, and West Point Manufacturing			Group II. Rayon producers: American Bemberg, Celanese Corp., Industrial Rayon, North American Rayon			Group III. Textile mills (2 years only): American Viscose, Goodall-Sanford, J. P. Stevens, Textron, Inc., Wm. Whitman	
	1939	1946	1947	1939	1946	1947	1946 [1]	1947 [2]
1. Cash	$12,370	$69,233	$85,523	$33,038	$57,455	$64,520	$66,223	$70,094
2. United States securities	0	20,059	19,602	786	39,134	24,237	49,815	47,176
3. Receivables	46,278	88,675	107,567	6,252	18,340	21,576	51,311	54,752
4. Inventories	89,735	189,976	231,700	8,564	19,359	27,740	99,460	116,507
5. Current assets	148,384	367,943	444,392	48,640	134,288	138,073	266,809	288,529
6. Fixed assets—net of depreciation (1)	100,866	132,104	168,498	65,408	110,335	141,931	134,094	161,723
7. Investments	5,210	11,651	22,687	1,779	4,846	7,590	772	614
8. Other assets and intangibles	6,051	12,990	15,222	2,202	12,954	9,677	8,676	10,603
9. Total assets	260,511	524,688	650,800	118,029	262,423	297,271	410,351	461,469
10. Accounts payable	10,255	38,782	47,989	2,064	7,201	8,669	42,633	42,177
11. Notes and loans payable	31,933	11,250	20,610	1,250	0	0	323	4,358
12. Accruals	4,914	22,486	28,247	1,216	4,622	7,025	14,283	19,338
13. Income tax items	3,824	49,139	60,089	2,912	11,296	20,610	34,987	36,071
14. Other current liabilities	2,908	6,072	6,419	679	0	1,975	3,947	3,484
15. Current liabilities	53,834	127,729	163,354	8,121	23,119	38,279	96,173	105,428
16. Funded debt	11,559	996	26,562	22,078	65,775	63,500	7,318	5,492
17. Reserves—contingencies	1,267	21,346	21,327	49	4,408	4,512	49,489	51,533
18. Reserve—retirement income plan	0	0	4,657	0	0	0	0	0
19. Common stock	69,075	93,941	119,114	14,051	6,627	6,627	91,501	91,562
20. Preferred stock	54,000	65,836	64,118	37,356	57,527	57,453	34,653	34,313
21. Surplus (2)	70,777	214,840	251,668	36,374	104,967	126,900	131,217	173,141
22. Total liabilities and capital	260,511	524,688	650,800	118,029	262,423	297,271	410,351	461,469
23. Net sales	293,613	858,537	1,089,078	66,439	206,324	266,921	388,727	658,122
24. Cost of goods sold (3)	263,476	636,346	835,315	47,617	142,665	182,020	303,804	519,003
25. Operating profit	14,977	176,547	194,169	14,108	48,865	68,111	62,592	109,237
26. Net profit before taxes	15,912	179,061	195,606	13,706	49,279	71,138	60,822	107,604
27. Net profit after taxes	12,175	104,240	115,659	10,962	29,325	43,375	34,823	59,850
28. Dividends:								
Cash	5,511	40,483	41,826	3,762	12,360	15,982	11,770	19,395
Stock	0	1,386	27,505	0	0	0	0	0
NOTES								
(1) Accumulated reserve, depreciation—fixed assets	$95,089	$143,992	$152,927	$29,245	$101,438	$107,394	$167,688	$181,460
(2) Including minority interest	323	2,793	851	0	0	0	6,552	6,739
(3) Including depreciation charges	7,335	8,071	10,553	5,019	8,475	9,544	9,528	17,619
Ratios—net profits after taxes:	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.
To net sales	4.1	12.1	10.6	16.5	14.2	16.3	9.0	9.1
To net worth	6.3	27.8	26.6	12.5	17.7	22.7	13.5	20.0
To invested capital	9.9	65.2	63.1	21.3	45.7	67.7	27.6	47.5
To reduction in funded debt	------	------	Increase	------	------	1,906.6	------	3,277.7
To increase in fixed assets	------	------	317.8	------	------	137.3	------	216.6
Dividends to net profits	45.3	40.2	59.9	34.3	42.1	36.8	33.8	32.4

[1] Includes 10-months statement, J. P. Stevens.
[2] Includes 11-months statement, Goodall-Sanford.

TABLE IX.—*Textile mill production*

Association cotton textile manufacturers data	1939	1946	1947
Cotton fabrics, woven goods:			
Average number active spindles (thousands)	22,317.5	21,933.6	22,113.8
Spindle hours run (thousands)	92,570,738	109,368,009	116,349,000
Hours run per average active spindle	4,148	4,986	5,261
Production in million square yards	9,045.0	10,171.2	11,077.2
United States Census, bleached, dyed, or printed goods data:			
Cottons, million linear yards	5,050.1	6,922.8	6,913.8
Rayon, million linear yards	1,252.7	1,725.5	1,757.5
Bulletin, year 1947, National Association Wool Manufacturers, woolen fabrics, woven goods (except felt):			
Average number active spindles (thousands)		3,291	3,121
Spindle hours run (thousands)	8,067,228	11,809,980	10,992,995
Hours run per average active spindle		3,588.6	3,522.3
Production, million linear yards, width 54-inch equivalents	371.8	603.7	500.5

TABLE X.—*The Studebaker Corp. and subsidiary companies—Percent of Studebaker factory sales from United States plants to total factory sales from all United States plants by years from 1935 through 1947 and first 9 months of 1948, all actual, and year 1948, projected*

Year	Total factory sales, all United States plants [1]	Studebaker factory sales	Percent of Studebaker factory sales to total factory sales	
			Each year	5 years, 1937 to 1941, inclusive
1935	3,946,934	54,649	1.38	
1936	4,454,115	91,999	2.07	
1937	4,808,974	91,475	1.90	
1938	2,489,085	52,605	2.11	
1939	3,577,292	114,196	3.19	
1940 [2]	4,410,176	119,509	2.71	
1941 [2]	4,634,401	129,197	2.79	
Total	19,919,928	506,982		2.55
1942 1943 1944 1945 War years.				
1946	3,089,550	119,275	3.86	
1947	4,797,820	191,531	3.99	
1948, Jan. 1 to Sept. 30	3,837,860	170,577	4.44	
1948, projected	5,117,147	230,000	4.50	

[1] Source: AMA Automobile Facts and Figures, 1948 edition, 1935 through 1947. 1948 from AMA bulletins.

[2] All military vehicles are excluded in the years 1940 and 1941.

APPENDIX C

SALES AND PROFIT DATA OF SELECTED AMERICAN CORPORATIONS, 1940, 1946, 1947, AND 1948

NOTE.—The corporations selected include the largest corporations as well as certain other representative corporations in important manufacturing industries.

Data include sales, net income, net worth, and earnings per share and dividends paid per share.

Net worth includes preferred and common stock (i. e., equity securities), earned surplus, capital surplus, and unsegregated surplus.

All years end December 31 unless otherwise noted.

Sources: Standard and Poor's Corporation Records, and Moody's Investor's Service.

Consolidated financial statements were used.

TABLE I.—*Automobile manufacturers*

	Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
Chrysler Corp.:					
1940	[1] $744,561,000	$37,802,000		[2] $8.69	$5.50
1946	870,000,000	26,889,000		[2] 6.18	3.00
1947	1,362,627,000	67,181,000	$325,074,000	7.27	[3] 1.75
First 9 months	989,400,000	[4] 47,873,000		5.50	
1948: First 9 months	1,069,902,000	[4] 59,888,000		6.88	3.00
General Motors Corp.:					
1940	1,794,937,000	195,715,000		[5] 4.32	3.75
1946	1,972,502,000	[6] 87,526,000		[5] 1.76	2.25
1947	3,815,159,000	287,991,000	1,570,576,000	6.25	3.00
First 9 months	2,688,155,000	213,217,000		4.62	
1948: First 9 months	3,436,332,000	327,155,000		7.22	2.50
Hudson Motor Car Co.:					
1940	60,631,000	[8] 1,508,000		[8] .95	
1946	120,715,000	[7] 2,748,000		1.51	.40
1947	159,514,000	5,763,000	45,925,000	3.17	.40
First 9 months	133,789,000	5,159,000		2.84	
1948: First 9 months	173,016,000	5,497,000		3.03	.50
The Studebaker Corp.:					
1940	84,164,000	2,124,000		.96	
1946	141,564,000	949,000		.40	.50
1947	267,999,000	9,127,000	47,991,000	3.87	.50
First 9 months	186,228,000	5,152,000		2.19	
1948: First 9 months	278,099,000	13,392,000		5.69	1.00

[1] Net sales.
[2] Adjusted earnings per share reflecting 2 for 1 split in July 1947 would have been $4.34 in 1940 and $3.09 in 1946.
[3] After 2 for 1 split; in addition to $2.25 declared on old stock before split.
[4] Includes dividends received from foreign subsidiaries of $1,009,614 in 1947; $7,318,918 in 1948.
[5] Common stock outstanding.
[6] Special income credit of $30,304,570 transfer from reserve for postwar reconversion and rehabilitation.
[7] Before deducting $365,466 or 20 cents per share nonrecurring loss on sale of vacant land net of tax reduction.
[8] Deficit.

TABLE II.—*Electrical equipment*

	Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
Cable Electric Products, Inc.:[1]					
1940	$1,565,000	$49,000	974,000	$0.19	
1947	2,435,000	240,000		.94	$0.10
1948	3,139,000	234,000		.92	
1947: First 3 months	592,000				
1948: First 3 months	546,000				.10
The Gamewell Co.:[2]					
1940	5,276,000	465,000	6,642,000	[3] 3.07	1.75
1947	10,043,000	875,000		2.44	1.00
1948	11,910,000	1,160,000		3.24	[3] 1.50
1947: First 3 months	2,628,000				
1948: First 3 months	2,978,000				.25
General Electric Co.:					
1940	[4] 411,938,000	56,241,000	412,926,000	1.95	1.85
1946	[4] 679,078,000	43,040,000		1.49	1.60
1947	[4] 1,186,346,000	88,332,000		3.06	1.60
First 9 months	[4] 921,221,000	62,467,000		2.17	
1948: First 9 months	[4] 1,137,935,000	83,893,000		2.91	1.20
Minneapolis Honeywell Regulator Co.:					
1940	15,934,000	2,528,000	32,396,000	[5] 3.87	3.00
1946	45,940,000	[6] 5,119,000		3.87	1.80
1947	60,596,000	6,694,000		5.10	2.00
First 9 months	43,303,000	4,603,000		3.49	
1948: First 9 months	38,524,000	2,932,000		2.14	2.00
Square D Co.:					
1940	13,613,000	2,023,000	14,707,000	[7] 4.56	2.80
1946	29,155,000	2,705,000		1.96	.60
1947	36,941,000	4,228,000		3.07	1.30
First 9 months	26,840,000	2,768,000		2.01	
1948: First 9 months	30,312,000	2,435,000		1.07	.75
Westinghouse Electric Corp.:					
1940	[4] 239,431,000	18,985,000	370,475,000	[8] 7.10	4.75
1946	[9] 301,692,000	8,824,000		.65	1.00
1947	[9] 703,154,000	[10] 48,806,000		3.59	1.25
First 9 months	[4] 583,342,000	34,515,000		2.53	
1948: First 9 months	[4] 711,276,000	33,546,000		2.45	.75

[1] Year ends Apr. 30.
[2] Year ends May 31.
[3] Adjusted earnings per share reflected in 3 for 1 split in November 1944 would have been $1.02 in 1940.
[4] Net sales billed.
[5] Adjusted earnings per share reflecting 2 for 1 split in March 1944 would have been $1.94.
[6] Before credit of $932,684 representing unused balance transferred from reserve for special contingencies, but after credit adjustment to property accounts and depreciation reserves of $276,773 arising from examination of prior years Federal taxes.
[7] Adjusted earning reflecting 3 for 1 split in 1946 would have been $1.52.
[8] Adjusted earnings per share reflecting 4 to 1 split in 1945 and recapitalization in 1946 would have been $1.78.
[9] Products and services sold—prior years not comparable to 1946 and 1947.
[10] After $8,101,000 provision for future inventory losses.

TABLE III.—*Foods except meats*

	Net Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
The Borden Co.:					
1940	$216,796,000	$7,583,000		$1.72	$1.40
1946	542,999,000	19,581,000		4.64	2.25
1947	602,959,000	19,793,000	$130,127,000	4.61	2.55
First 9 months	452,868,000	(1)			
1948: First 9 months	488,047,000	(1)			1.80
Continental Baking Co.: [2]					
1940	64,181,000	3,500,000		[3] .27	
1946	125,761,000	7,510,000		5.69	1.50
1947	150,285,000	5,552,000	34,101,000	3.87	
First 9 months	109,789,000	3,462,000		2.25	
1948: First 9 months	118,260,000	5,038,000		3.71	.75
General Foods Corp.:					
1940	152,188,000	15,244,000		2.77	2.00
1946	317,790,000	21,148,000		3.25	2.00
1947	407,267,000	18,304,000	131,530,000	3.19	2.00
First 9 months	285,212,000	[4] 12,599,000		2.22	
1948: First 9 months	336,850,000	[4] 20,432,000		3.55	1.50
General Mills, Inc.: [5]					
1940	125,574,000	5,639,000		[6] 2.20	3.12½
1947	[7] 370,932,000	9,236,000		3.91	1.50
1948	[7] 458,474,000	13,068,000	85,138,000	5.83	2.25
1947: First 6 months	(1)				
1948: First 6 months	(1)				
H. J. Heinz Co.: [8]					
1940	62,715,000	[9] 2,445,000		[10] 1.86	
1947	144,246,000	[11] 6,104,000		4.14	1.80
1948	169,455,000	[12] 5,033,000	77,072,000	3.32	1.80
1947: First 6 months	(1)				
1948: First 6 months	(1)				
National Biscuit Co.:					
1940	[13] 103,670,000	10,749,000		1.43	1.20
1946	220,195,000	17,162,000		2.45	1.20
1947	265,894,000	22,902,000	110,850,000	3.37	1.50
First 9 months	194,101,000	17,197,000		2.53	
1948: First 9 months	217,497,000	15,094,000		2.19	1.60
National Dairy Products Corp.:					
1940	347,410,000	11,094,000		1.66	.80
1946	742,409,000	[14] 25,444,000		4.06	1.65
1947	897,323,000	23,159,000	140,350,000	3.69	1.80
First 9 months	(1)				
1948: First 9 months	(1)				1.35
Standard Brands, Inc.:					
1940	[15] 98,875,000	9,516,000		.68	.50
1946	[15] 252,493,000	13,948,000		4.18	1.80
1947	[15] 276,131,000	8,119,000	101,562,000	2.32	2 00
First 9 months	[16] 202,703,000	5,379,000		1.51	
1948: First 9 months	[16] 214,035,000	5,807,000		1.65	1.50

[1] Not available.
[2] Year ends Dec. 27.
[3] Adjusted to reflect exchange of class A and B common stock for new common stock.
[4] Before $1,000,000 provision for contingencies in 1947 and $1,500,000 in 1948.
[5] Year ends May 31.
[6] Adjusted for 3 for 1 split in August 1945.
[7] Net sales and services.
[8] Year ends Apr. 30.
[9] After provision for contingencies of $500,000 in 1940.
[10] Adjusted to reflect recent 4 for 1 split.
[11] After provision for inventory price decline of $2,000,000 in 1947, and after provision for possible losses on foreign investments of $500,000 in 1947.
[12] After provision for inventory price decline and other contingencies in 1947 of $1,000,000.
[13] Gross sales.
[14] After provision for possible future inventory price decline of $5,000,000.
[15] Includes liquor taxes.
[16] Excludes sale of raw materials.

TABLE IV.—*Oil refining*

	Gross operating income	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
Gulf Oil Corp.:					
1940	$273,078,000	$22,150,000		$2.44	$1.25
1946	562,241,000	58,285,000		6.42	2.50
1947	797,211,000	95,540,000	$534,589,000	10.53	2.75
First 9 months	560,525,000	66,700,000		7.35	
1948: First 9 months	792,827,000	117,000,000		10.31	2.25
Shell Union Oil Co.:					
1940	254,104,000	15,655,000		1.05	.75
1946	444,828,000	[1] 32,880,000		2.44	1.50
1947	628,105,000	59,875,000	306,879,000	4.44	2.25
First 9 months	440,120,000	38,678,000		2.87	
1948: First 9 months	609,055,000	82,333,000		6.11	1.00
Socony-Vacuum Oil Co.:					
1940	[2] [3] 444,004,000	36,409,000		1.17	.50
1946	[2] 761,235,000	58,311,000		1.87	.75
1947	[3] 1,028,634,000	97,709,000	921,556,000	3.13	1.00
First 9 months	[3] [4] 730,658,000	66,000,000		2.12	
1948: First 9 months	[2] 977,982,000	103,000,000		3.30	.75
Standard Oil Co. of California:					
1940	[5] 176,145,000	22,488,000		1.73	1.00
1946	372,797,000	[6] 66,957,000		5.15	2.30
1947	530,132,000	[6] 107,269,000	709,546,000	8.25	3.20
First 9 months	372,543,000	66,545,000		5.12	
1948: First 9 months	535,585,000	117,073,000		9.00	3.00
Standard Oil Co. (Indiana):					
1940	358,849,000	33,579,000		2.20	1.50
1946	650,616,000	[7] 67,650,000		4.43	1.75
1947	910,746,000	[7] 94,881,000	924,870,000	6.21	2.00
1947: First 9 months	637,174,000	[8]			
1948: First 9 months	912,967,000	[8]			[9] 1.62½
Standard Oil Co. (New Jersey):					
1940	821,684,000	[10] 123,886,000		4.54	1.75
1946	1,622,339,000	[10] 177,610,000		6.50	3.00
1947	2,354,917,000	[10] 268,627,000	1,817,822,000	9.83	4.00
1947: First 9 months	[12] 1,571,629,000	203,000,000		7.43	
1948: First 9 months	[12] 2,428,958,000	290,000,000		10.25	[11] 1.00
Sun Oil Co.:					
1940	147,673,000	7,969,000		3.03	1.00
1946	306,644,000	14,727,000		4.17	1.00
1947	356,841,000	24,340,000	185,566,000	[13] 5.28	1.00
1947: First 9 months	[12] 253,832,000	[8]			
1948: First 9 months	[12] 332,744,000	[8]			[14] .75
The Texas Co.:					
1940	350,260,000	31,548,000		2.90	2.00
1946	586,537,000	71,089,000		6.32	3.00
1947	819,211,000	106,313,000	828,638,000	7.90	3.00
1947: First 9 months	568,403,000	78,396,000		6.97	
1948: First 9 months	783,248,000	[15] 113,617,000		8.44	2.25

[1] After $970,151 profit from sale of capital assets.
[2] Sales of products and services. In 1946–47 Federal excise taxes were eliminated from sales.
[3] In 1940 $29,075,402 was included in "sales" and in "Federal and other taxes."
[4] Includes $5,639,000 net income of foreign subsidiaries in Western Hemisphere for first 6 months of 1947 not previously reported.
[5] In addition State sales and motor fuel taxes and Federal gasoline and lubricating oil taxes are deducted from sales of products.
[6] After $10,400,000 in 1946 and $11,000,000 in 1947 provision for loss on exploration in foreign countries is deducted; less $5,400,000 in 1946 and $6,000,000 in 1947 credit for transfer from contingency reserve.
[7] After profit on sale of capital assets and investments of $7,571,191 in 1946 and $1,353,318 in 1947.
[8] Not available.
[9] 1 share Standard Oil Co. (New Jersey) for each 100 shares held in lieu of fractional share cash will be paid at rate of 80 cents.
[10] After deducting $3,247,172 unrealized foreign loss in 1940; after adding $2,890,671 credit for exchange profit in 1946; $616,900 in 1947. After deducting excess earnings from pipe-line operations of $884,355 in 1946; $174,435 in 1947. After deducting $8,426,636 provision for loss on investments in 1947. After credit for $15,500,000 for wartime contingencies in 1946 and $9,045,524 in 1947.
[11] Stock dividend 5 shares for each 200 shares held.
[12] Excludes excise taxes.
[13] Reflecting stock dividend of 10 percent (412,068 shares) paid Jan. 30, 1948.
[14] Stock dividend of 10 percent paid Jan. 30, 1948.
[15] After deducting $6,000,000 special inventory reserves.

TABLE V.—*Radio manufacturers*

	Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
Emerson Radio & Phonograph Corp.: [1]					
1940	$8,434,000	$304,000		$0.76	----------
1946	23,089,000	1,340,000		3.35	$1.10
1947	32,658,000	2,263,000	$6,417,000	5.66	1.90
1947: First 9 months	24,949,000	[2] [3] 1,585,000		[3] [4] 1.98	----------
1948: First 9 months	21,229,000	[2] 1,326,000		[3] [4] 1.66	[5] .65
Hoffman Radio Corp.:					
1940	122,000	[6] 12,000		[6] .09	----------
1946	3,437,000	118,000		[7] .45	----------
1947	3,452,000	[6] 54,000	833,000	[6] .21	.10
1947: First 9 months	[8]	[8]		[8]	[8]
1948: First 9 months	[8]	[8]		[8]	[8]
Philco Corp.:					
1940	52,311,000	2,249,000		1.64	1.05
1946	121,597,000	3,107,000		2.13	1.00
1947	226,508,000	[9] 9,631,000	42,965,000	6.19	[10] 2.00
1947: First 9 months	157,209,000	5,632,000		3.90	----------
1948: First 9 months	194,156,000	6,631,000		4.23	1.50
Radio Corp. of America:					
1940	[11] 120,687,000	9,113,000		.42	.20
1946	[11] 236,146,000	10,985,000		.56	.20
1947	[11] 312,678,000	18,770,000	107,895,000	1.13	.20
1947: First 9 months	[11] 223,925,000	12,234,000		.71	----------
1948: First 9 months	[11] 256,328,000	15,129,000		.92	.30
Zenith Radio Corp.: [12]					
1940	20,381,000	738,000		1.50	1.00
1947	57,363,000	594,000		1.21	1.00
1948	79,785,000	3,485,000	12,288,000	7.08	1.50
1947: First 9 months	[8]	[8]		[8]	[8]
1948: First 9 months	[8]	[8]		[8]	[8]

[1] Year ends Oct. 31.
[2] 39 weeks.
[3] After deducting $520,000 inventory reserve.
[4] Reflecting 100 percent stock dividend declared Mar. 2, 1948.
[5] A hundred percent stock dividend was declared payable Mar. 2, 1948.
[6] Deficit.
[7] After allowing for preferred dividends.
[8] Recent data not available.
[9] After provision for contingencies of $2,160,000.
[10] Plus 5 percent in stock.
[11] Total income from operations.
[12] Year ends Apr. 30.

TABLE VI.—*Steel*

	Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
Alan Wood Steel Co.:					
1940	$23,626,000	$1,210,000		$3.54	
1946	25,264,000	786,000		1.42	
1947	35,972,000	1,955,000	$17,209,000	7.26	
1947: First 9 months	26,607,000	1,433,000		[1] 2.39	
1948: First 9 months	33,523,000	2,384,000		[1] 4.38	$0.50
Bethlehem Steel Corp.:					
1940	[2] 602,203,000	48,678,000		[3] 14.04	5.00
1946	[2] 787,721,000	[4] 41,732,000		[3] 11.79	6.00
1947	[2] 1,032,338,000	[5] 51,088,000	565,423,000	[3] 4.98	[6] 2.00
1947: First 9 months	[2] 743,990,000	38,711,000		3.78	
1948: First 9 months	[2] 923,505,000	53,184,000		5.39	1.80
Crucible Steel Co. of America:					
1940	77,689,000	6,230,000		10.24	
1946	88,125,000	527,000		[7] 2.37	
1947	110,227,000	2,065,000	65,258,000	1.12	
1947: First 9 months	81,803,000	1,292,000		.26	
1948: First 9 months	92,148,000	2,191,000		2.08	
Jones & Laughlin Steel Corp.:					
1940	153,287,000	10,277,000		[8] 10.70	
1946	246,298,000	[9] 10,746,000		[8] 3.75	2.00
1947	350,132,000	22,384,000	228,225,000	8.45	2.00
1947: First 9 months	253,511,000	16,683,000		6.29	
1948: First 9 months	315,469,000	[10] 20,249,000		7.73	1.50
National Steel Corp.:					
1940	157,906,000	12,582,000		5.75	1.70
1946	239,764,000	[11] 25,170,000		9.17	3.25
1947	328,957,000	[12] 26,839,000	199,837,000	12.03	4.00
First 9 months	231,536,000	19,904,000		8.92	
1948: First 9 months	311,167,000	27,201,000		12.19	3.00
Republic Steel Corp.:					
1940	[13] 303,303,000	[14] 21,114,000		3.32	.40
1946	[13] 412,756,000	[15] 16,033,000		2.53	1.00
1947	[13] 645,329,000	31,018,000	293,115,000	5.17	2.00
First 9 months	[13] 473,202,000	23,112,000		3.85	
1948: First 9 months	[13] 553,872,000	29,813,000		5.03	1.25
United States Steel Corp.:					
1940	1,076,471,000	[16] 102,211,000		8.85	4.00
1946	1,496,064,000	[17] 88,622,000		7.28	4.00
1947	2,122,786,000	[17] 127,098,000	1,510,871,000	11.71	5.25
First 9 months	1,527,297,000	97,306,000		9.01	
1948: First 9 months	1,754,721,000	[18] 88,042,000		[18] 7.94	3.75
Allegheny-Ludlum Steel Corp.: [19]					
1940	54,703,000	3,823,000		2.87	1.50
1946	95,063,000	6,599,000		5.12	2.00
1947	106,606,000	6,002,000	39,738,000	4.66	2.00
First 9 months	78,368,000	4,554,000		3.53	
1948: First 9 months	89,668,000	4,424,000		[20] 3.26	1.20

[1] Reflecting complete exchange of shares under recapitalization in 1948.
[2] Net billings.
[3] Adjusted per common share earnings reflecting 3 for 1 split in 1947 would have been $4.68 for 1940 and $3.93 in 1946.
[4] After $11,000,000 credit for transfer from contingency reserve to offset extraordinary cost of strikes.
[5] Effective Jan. 1, 1947, last-in, first-out method was used in determining values of approximately 75 percent of consolidated inventories. As result of change, income before taxes for 1947 was approximately $17,500,000 less than it would have been under method of valuing inventories which was used in prior years.
[6] Adjusted for 3 for 1 split.
[7] Deficit.
[8] After dividend requirements on preferred stock outstanding at year end.
[9] After credit of $4,000,000 for transfer from contingency reserve.
[10] After $1,453,492 loss on sale of real estate.
[11] After $405,267 credit for profit on sale of securities and capital assets and $2,250,000 provision for contingencies.
[12] After $240,746 loss on disposal of capital assets.
[13] Includes operating revenue.
[14] After minority interest.
[15] After $3,100,000 credit for transfer from contingency reserve to cover strike costs.
[16] After deducting $6,413,186 premium and balance of unamortized debt discount and refinancing.
[17] After credit for war costs, provided for in prior years amounting to $29,212,714 in 1946 and $2,540,618 in 1947.
[18] Reflects additional charge for wear and exhaustion of facilities at rate of 60 percent whereas March and June 1948 quarters were based on 30-percent rate
[19] No blast-furnace facilities.
[20] After preferred dividend requirements.

TABLE VII.—*Textile fabrics*

	Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
American Woolen Co.:					
1940	$76,560,000	$3,154,000		$1.76	
1946	170,811,000	19,398,000		21.05	$12.00
1947	175,993,000	[1] 15,270,000	$79,071,000	15.37	10.00
1947: First 9 months	125,155,000	[1] 11,258,000		11.65	
1948: First 9 months	152,112,000	[2] 10,462,000		9.99	6.50
Burlington Mills Corp.: [3]					
1941	63,165,000	[4] 3,374,000		[5] 1.20	1.50
1946	141,544,000	12,921,000		3.47	1.60
1947	216,961,000	[6] 23,888,000	84,250,000	6.49	1.50
1946–47: First 9 months	163,592,000	18,230,000		5.01	
1947–48: First 9 months	206,777,000	[7] 21,108,000		5.81	1.12½
Cannon Mills Co.:					
1940	[8] 48,429,000	3,832,000		[9] 1.94	2.00
1946	[8] 116,666,000	19,060,000		[9] 9.19	2.00
1947	[8] 161,370,000	15,098,000	75,691,000	7.28	[10] 5.00
1947: First 9 months	96,284,000				
1948: First 9 months	119,357,000				2.50
Colonial Mills, Inc.:					
1940: Dec. 31, year end	8,098,000	257,000		.39	
1946: Nov. 30, year end	29,297,000	3,367,000		[11] 4.45	1.00
1947: Nov. 30, year end	34,801,000	7,134,000	15,679,000	[11] 8.97	[12] 1.00
1947: First 9 months	24,975,000	5,280,000		[11] 6.64	
1948: First 9 months	33,488,000	6,747,000		[11] 8.48	.75
Pacific Mills:					
1940	50,287,000	[13] 348,000		[13] [14] 44	
1946	78,304,000	9,503,000		11.99	[15] 2.75
1947	90,647,000	[16] 8,375,000	43,536,000	9.59	3.00
1947: First 9 months	65,666,000	[16] 5,645,000		6.79	
1948: First 9 months	83,077,000	7,818,000		8.54	[18] 2.50
United Merchants & Manufacturers, Inc.: [17]					
1940	42,459,000	2,022,000		[19] .56	.50
1947	180,087,000	21,132,000	67,872,000	5.36	1.60
1948	211,538,000	22,042,000		5.64	1.60

[1] After provision for contingencies of $1,000,000.
[2] After provision for contingencies of $3,000,000.
[3] Year ends Sept. 30.
[4] After provision for contingencies of $300,000.
[5] Adjusted to reflect 2 for 1 split in March 1945 and July 1946. Actual earnings per share amounted to $4.79.
[6] After provision for inventory contingencies for $1,000,000.
[7] After provision of inventory reserve of $3,000,000.
[8] Net sales including commissions.
[9] Adjusted to reflect 100 percent dividend in class B stock Nov. 10, 1947. Unadjusted earnings per share amounted to $3.88 in 1940; $18.38 in 1946.
[10] Plus stock dividend noted in footnote 9.
[11] Reflecting 2 for 1 stock split in 1947. Unadjusted earnings per share amounted to 78 cents in 1940 and $8.89 in 1946.
[12] Includes 25 cents paid on old $7.50 par stock prior to 2 for 1 split; also 5 percent in stock.
[13] Deficit.
[14] Adjusted to reflect 100-percent dividend paid Apr. 15, 1946. Actual earnings per share in 1940 amounted to deficit of 88 cents.
[15] Consists of 75 cents and $2 after 2 for 1 stock split on Apr. 15, 1946; 5 percent stock dividend was paid Dec. 30, 1946, on new stock.
[16] After provision for contingencies of $2,000,000 in 1946 and $3,000,000 in 1947.
[17] Year ends June 30.
[18] Also 5 percent stock dividend.
[19] Adjusted for 5 for 1 split in March 1945, and 3 for 1 split in July 1946. Actual earnings were $3.37.

TABLE VIII.—*Meat packing*

	Sales	Net income after taxes	Net worth	Common stock	
				Earnings per share	Dividends paid per share
Armour & Co.: [1]					
1940	$732,949,000	$4,561,000	$178,456,000	$0.28	
1946	1,183,538,000	[2] 18,526,000		3.71	
1947	1,956,490,000	[2] 22,950,000		4.85	
The Cudahy Packing Co.: [1]					
1940	211,925,000	2,116,000	46,864,000	[3] 1.00	
1946	349,902,000	[4] 6,721,000		[3] 4.06	[5] $2.20
1947	572,737,000	7,122,000		4.32	[6] .35
First 9 months	429,621,000	[14]		[14]	
1948: First 9 months	407,095,000	[14]		[14]	.45
Oscar Mayer & Co., Inc.: [1]					
1946	81,494,000	1,330,000	11,097,000	[7] 9.36	1.00
1947	136,247,000	1,440,000		[7] 9.76	1.00
The Rath Packing Co.: [1]					
1940	58,259,000	2,206,000	21,357,000	[8] 2.94	1.58
1946	100,300,000	2,066,000		2.30	1.40
1947	205,795,000	2,946,000		3.27	1.75
First 9 months	155,847,000				
1948: First 9 months	134,981,000				1.05
Swift & Co.: [1]					
1940	771,573,000	11,183,000	279,637,000	1.89	1.20
1946	1,308,364,000	16,395,000		2.77	1.90
1947	2,248,767,000	[9] 22,335,000		3.77	2.10
First 9 months	1,662,413,000	[14]		[14]	
1948: First 9 months	1,756,268,000	[14]		[14]	2.20
Wilson & Co., Inc.: [1]					
1940	[10] 280,000,000	3,619,000	78,982,000	.84	
1946	[10] 441,000,000	[11] 8,312,000		3.44	.60
1947	[10] 738,000,000	[11] 15,449,000		6.82	.90
1947: First 9 months	525,524,000	[14]		[14]	
1948: First 9 months	516,289,000	[14]		[14]	1.50
Kingan & Co., Inc.: [1]					
1940	[12] 52,691,000	[12] 21,000	15,304,000	[12] .26	[5]
1946	89,915,000	587,000		.52	
1947	192,608,000	333,000		.20	
1948	[14]	[14]		[14]	[14]

[1] Year ended approximately Oct. 31.
[2] After provision for inventory price decline of $9,500,000 in 1946 and $8,000,000 in 1947.
[3] Adjusted to reflect 10 percent common stock dividend paid in November 1946 and 3 for 1 split in September 1947. Before adjustments earnings amounted to $3.29 per share in 1940 and $12.19 in 1946.
[4] After provision for inventory price decline of $3,500,000.
[5] Plus 10 percent stock dividend.
[6] On new stock; in addition $1.40 paid on old stock before 3 for 1 split.
[7] After allowing for preferred dividends.
[8] Adjusted to reflect 40 percent stock dividend paid in 1942. Before adjustment earnings amounted to $4.11 per share.
[9] After provision for high cost additions to fixed assets of $12,000,000.
[10] Approximate sales.
[11] Before deducting $2,000,000 set aside out of surplus as a reserve against future price declines in 1946; $3,000,000 in 1947.
[12] Includes rental and other operating income.
[13] Deficit.
[14] Recent data not available.

APPENDIX D

FINANCIAL TABLES OF INDIVIDUAL COMPANIES

TABLE I.—*Allegheny-Ludlum Steel Corp. and Subsidiaries—Financial and statistical data*

	1940	1946	1947	1948 [1]
Sales	$54,703,000	$95,062,000	$106,606,000	$127,000,000
Net tons shipped	282,000	306,000	357,000	425,000
Net profit	$3,823,000	$6,599,000	$6,003,000	([2])
Dividends paid:				
Common	$1,882,000	$2,577,000	$2,577,000	$2,577,000
Preferred	$234,000			$340,000
Total	$2,116,000	$2,577,000	$2,577,000	$2,917,000
Retained earnings	$1,707,000	$4,023,000	$3,426,000	
Capital expenditures	$1,412,000	$4,007,000	$6,728,000	$7,025,000
Net capital expenditures [3]	$36,000	$2,632,000	$5,092,000	$4,785,000
Inventories (year end)	$13,757,000	$16,274,000	$18,681,000	$23,000,000
Net working capital (year end)	$12,842,000	$22,053,000	$20,846,000	$29,300,000
Net worth	$28,808,000	$36,294,000	$39,738,000	$54,000,000
Net plant and equipment	$16,378,000	$15,203,000	$20,019,000	$25,000,000
Average number of employees	10,204	12,639	12,459	12,800
Profit ratios:				
Percent to sales	7.01	6.94	5.63	5–5½
Percent to net worth	13.27	18.18	15.11	12–13
Dollars per net ton shipped	$13.56	$21.57	$16.82	
Dollars per employee	$375.00	$522.00	$482.00	

[1] Estimated.
[2] Profit for first 9 months, 1948 was $4,424,000.
[3] Net capital expenditures equal capital expenditures less depreciation, depletion and plant retirements for the year.

TABLE II.—*American Woolen Co., Inc.*

	Sales	Yardage produced	Percent of looms run	Net profits before reserve for contingencies	Percent of net earnings to sales
1940	$76,560,111	38,987,385	93.3	$3,154,464	4.1
1946	170,810,787	65,531,626	158.1	23,098,178	13.5
1947	175,993,449	58,849,992	158.2	16,269,914	9.2
1948 [1]	152,112,364	45,147,093	163.0	13,461,626	8.8

	Net earnings per yard produced	Average selling price	Invested capital	Net earnings	Percent of net earnings to invested capital
1940	$0.081	$1.745	$79,076,750	$3,154,464	3.99
1946	.352	2.532	73,325,331	23,098,178	31.5
1947	.276	2.948	78,105,370	16,269,914	20.8
1948 [1]	.298	3.415	82,610,687	13,461,626	16.3

[1] To Sept. 30, inclusive.

TABLE III.—*Armour & Co. net profit ratios*

[Figures in millions in columns 2, 3, 4, 5, 8, 9, 10, 12, 13, 14, and 18]

Fiscal year	Profit or loss		Invested capital [2]	Net worth [3]	Percent profit or loss		Profit or loss, column 3		
	Before deducting interest [1]	After deducting interest			(2) to (4)	(3) to (5)	Domestic meat	Balance [4]	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1939	$10.00	$6.98	$295.6	$188.7	3.38	3.70	$1.34	$5.64	$6.98
1940	12.54	9.63	291.5	191.6	4.30	5.03	2.73	6.90	9.63
1941	16.89	14.12	310.0	199.0	5.45	7.10	1.93	12.19	14.12
1942	16.18	15.25	343.2	208.4	4.71	7.32	.14	15.11	15.25
1943	15.81	14.78	333.8	199.6	4.74	7.40	2.42	12.36	14.78
1944	10.71	9.77	312.8	172.4	3.42	5.67	2.97	6.80	9.77
1945	10.49	9.82	306.8	178.8	3.42	5.49	[5].24	10.06	9.82
1946	29.72	27.68	307.9	191.5	9.65	14.45	7.39	20.29	27.68
1947	33.22	30.91	339.2	204.6	9.79	15.11	8.09	22.82	30.91
1948	.87	[5] 1.97	413.7	204.0	.21	[5].97	[5] 12.63	10.66	[5] 1.97
Average	15.64	13.69	325.5	193.9	4.80	7.07	1.41	12.28	13.69

Fiscal year	Sales dollars			Percent profit or loss			Sales weight, domestic meat	Profit or loss (cents per pound (8) to (18))	Average number of employees	Profit (column 3) per employee
	Domestic meat	Balance [2]	Total	(8) to (12)	(9) to (13)	(10) to (14)				
(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
									Thous.	
1939	$481.8	$233.5	$715.3	0.28	2.42	0.98	3,542.7	0.038	66.5	$105
1940	503.1	230.8	733.9	.54	2.99	1.31	3,860.8	.071	69.6	138
1941	647.9	278.3	926.2	.30	4.38	1.52	4,180.4	.046	75.6	187
1942	918.4	381.6	1,300.0	.02	3.96	1.17	4,600.4	.003	84.8	180
1943	997.7	418.8	1,416.5	.24	2.95	1.04	4,408.8	.055	86.8	170
1944	1,053.0	425.0	1,478.0	.28	1.60	.66	5,012.5	.059	87.1	112
1945	801.1	411.8	1,212.9	[5].03	2.44	.81	3,709.0	[5].006	77.7	126
1946	721.8	461.7	1,183.5	1.02	4.39	2.34	2,855.6	.259	77.4	358
1947	1,362.3	594.2	1,956.5	.59	3.84	1.58	3,816.2	.212	84.6	365
1948	1,400.5	590.9	1,991.4	[5].90	1.80	[5].10	3,507.0	[5].360	[6]	[6]
Average	888.8	402.6	1,291.4	.16	3.05	1.06	3,949.3	.036	----------	----------

[1] Tax adjusted for elimination of interest.
[2] Average current and long-term debt, preferred stock, common stock, and surplus (including surplus reserves).
[3] Same as note 2 above, excluding debt.
[4] Represents shortening and oil, pharmaceutical, dairy and poultry, soap, glue, hair, sandpaper, ammonia, chemical, fertilizer, leather, and foreign operations.
[5] Red figures.
[6] Not available.

TABLE IV.—*Armour & Co.—Segregation of consolidated sales dollar*

MILLIONS OF DOLLARS

	Fiscal years									
	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948
Cost of material, livestock, etc	519.4	532.4	691.8	1,017.2	1,093.0	1,106.7	894.3	844.3	1,519.4	1,582.0
Cost of supplies	23.5	26.8	32.4	42.1	52.0	59.1	50.7	44.9	58.9	61.9
Combined	542.9	559.2	724.2	1,059.3	1,145.0	1,165.8	945.0	889.2	1,578.3	1,643.9
Paid to employees	82.7	87.9	99.6	123.4	143.3	168.5	151.4	150.3	199.1	208.8
Sales freight	26.7	24.5	27.3	29.3	26.1	28.5	21.7	22.7	37.0	41.2
Depreciation	6.4	6.5	6.7	6.9	6.8	7.1	8.0	6.9	7.5	8.6
Taxes	10.5	11.0	15.1	19.9	33.0	39.6	25.8	34.9	35.8	14.8
Interest	3.7	3.6	3.6	4.0	5.4	6.1	4.6	3.8	3.7	5.3
All other expenses—motive power and maintenance and repairs (excluding labor), insurance, rents, advertising, traveling expenses, communication expenses, etc	35.4	31.6	35.6	41.9	42.1	52.6	46.6	48.0	64.2	70.8
Net earnings	7.0	9.6	14.1	15.3	14.8	9.8	9.8	27.7	30.9	2.0
Total sales	715.3	733.9	926.2	1,300.0	1,416.5	1,478.0	1,212.9	1,183.5	1,956.5	1,991.4

CENTS PER DOLLAR OF SALES

Cost of material, livestock, etc	72.62	72.54	74.69	78.24	77.16	74.88	73.73	71.34	77.66	79.44
Cost of supplies	3.28	3.65	3.49	3.24	3.67	4.00	4.19	3.80	3.01	3.11
Combined	75.90	76.19	78.18	81.48	80.83	78.88	77.92	75.14	80.67	82.55
Paid to employees	11.56	11.98	10.75	9.50	10.12	11.40	12.48	12.70	10.18	10.49
Sales freight	3.74	3.33	2.95	2.26	1.84	1.93	1.79	1.91	1.89	2.07
Depreciation	.90	.89	.72	.53	.48	.48	.66	.58	.38	.43
Taxes	1.46	1.50	1.64	1.53	2.33	2.68	2.12	2.95	1.83	.74
Interest	.52	.49	.39	.31	.38	.41	.38	.32	.19	.26
All other expenses—motive power and maintenance and repairs (excluding labor), insurance, rents, advertising, traveling expenses, communication expenses, etc	4.95	4.31	3.85	3.22	2.98	3.56	3.84	4.06	3.28	3.56
Net earnings	.97	1.31	1.52	1.17	1.04	.66	.81	2.34	1.58	.10
Total sales	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

TABLE V.—*General Electric Co. financial statements*

[Amounts in thousands of dollars]

	Sales	Net income	Dividends	Money at risk in the business, end of period		
				Total assets	Total permanent capital	Equity capital only
1935	$232,715	$28,527	$20,191	$420,421	$316,965	$316,446
1936	299,076	45,550	43,266	390,467	329,184	319,952
1937	387,488	62,370	63,274	401,775	329,838	320,838
1938	292,622	27,288	25,899	394,087	332,436	322,739
1939	342,264	42,840	40,305	412,704	328,105	324,408
1940	456,492	56,570	53,295	464,628	330,712	326,056
1947	1,330,776	95,299	46,107	1,026,865	632,759	430,359
1948, 9 months	1,137,935	83,893	37,213	1,072,945	679,630	477,230
Annual rate for 9 months, 1948	1,517,247	111,857	56,800	1,072,945	679,630	477,230

	Number of employees	Total pay roll		Number of employees	Total pay roll
1935	63,048	$98,403,000	1939	71,485	$134,534,000
1936	70,199	119,815,000	1940	85,746	169,616,000
1937	85,947	163,130,000	1947	185,696	559,756,000
1938	68,809	116,645,000	Annual rate at Sept. 30, 1948	196,034	681,526,000

TABLE VI.—*Net profit relationships, General Foods Corp.*

[Figures in millions except last 2 columns]

Year	Profits	Invested capital		Net worth		Net sales		Number of employees	Profits per employee
		Amount	Net profits	Amount	Net profits	Amount	Net profits		
			Percent		*Percent*		*Percent*		
1938	$13.6	$261.0	5.2	$78.1	17.4	$125.9	10.8	10,578	$1,284
1939	15.1	261.8	5.8	80.6	18.8	135.5	11.2	11,103	1,362
1940	15.2	270.2	5.6	84.3	18.1	143.1	10.6	11,329	1,346
1941	15.7	275.2	5.7	88.8	17.6	169.2	9.3	12,062	1,298
1942	15.3	279.3	5.5	97.0	15.8	196.1	7.8	10,250	1,494
1943	15.7	284.8	5.5	111.7	14.0	243.4	6.4	11,777	1,328
1944	14.1	294.1	4.8	115.5	12.2	277.5	5.1	13,400	1,052
1945	13.1	292.9	4.5	104.4	12.6	280.2	4.7	13,200	996
1946	21.1	291.1	7.3	114.4	18.5	317.8	6.7	14,135	1,496
1947	18.3	300.8	6.1	141.6	12.9	407.2	4.5	15,437	1,186
1948 [1]	25.9	320.7	8.1	152.6	17.0	465.9	5.6	18,418	1,405
Total	183.1	3,131.9	5.8	1,169.0	15.7	2,761.8	6.6	141,689	1,292

[1] Estimated.

TABLE VII.—*General Motors Corp.—Record of sales, earnings, dividends, and income reinvested in business, 1928–48*

Years	Net sales	Net income available for dividends	Percent net income to net sales	Preferred dividends	Balance available for common stock
1928	$1,481,745,323	$276,468,108	18.7	$9,404,756	$267,063,352
1929	1,532,213,745	248,282,268	16.2	9,478,681	238,803,587
1930	1,005,327,903	151,098,992	15.0	9,538,660	141,560,332
1931	828,207,978	96,877,107	11.7	9,375,899	87,501,208
1932	440,899,312	164,979		9,206,387	[1] 9,041,408
1933	583,746,596	83,213,676	14.3	9,178,845	74,034,831
1934	862,672,670	94,769,131	11.0	9,178,220	85,590,911
1935	1,155,641,511	167,226,510	14.5	9,178,220	158,048,290
1936	1,439,289,940	238,482,425	16.6	9,178,220	229,304,205
1937	1,606,789,841	196,436,598	12.2	9,178,220	187,258,378
1938	1,066,973,000	102,190,007	9.6	9,178,220	93,011,787
1939	1,376,828,337	183,290,222	13.3	9,943,072	173,347,150
1940	1,794,936,642	195,621,721	10.9	9,178,220	186,443,501
1941	2,436,800,977	201,652,508	8.3	9,178,220	192,474,288
1942	2,250,548,859	163,651,588	7.3	9,178,220	154,473,368
1943	3,796,115,800	149,780,088	3.9	9,178,220	140,601,868
1944	4,262,249,472	170,995,865	4.0	9,178,220	161,817,645
1945	3,127,934,888	188,268,115	6.0	9,178,220	179,089,895
1946	1,962,502,289	87,526,311	4.5	9,782,407	77,743,904
1947	3,815,159,163	287,991,373	7.5	12,928,310	275,063,063
1948 [2]	4,563,335,808	401,929,119	8.8	12,928,313	389,000,806
Averages:					
1936–41	1,620,269,790	186,278,914	11.5	9,305,696	176,973,218
3 years ended Sept. 30, 1948	3,246,005,488	247,730,618	7.6	11,567,169	236,163,449

Years	Cash dividends paid on common stock	Percent income disbursed in cash dividends on preferred and common stocks	Income reinvested in the business	Per share of present $10 par value common stock	
				Earnings	Dividends paid
1928	$165,300,002	63.2	$101,763,350	$6.14	$3.80
1929	156,600,007	66.9	82,203,580	5.49	3.60
1930	130,500,002	92.7	11,060,330	3.25	3.00
1931	130,500,001	144.4	[1] 42,998,793	2.01	3.00
1932	53,993,330		[1] 63,034,738	[1] .21	1.25
1933	53,826,355	75.7	20,208,476	1.72	1.25
1934	64,443,490	77.7	21,147,421	1.99	1.50
1935	96,476,748	63.2	61,571,542	3.69	2.25
1936	192,903,299	84.7	36,400,906	5.35	4.50
1937	160,549,861	86.4	26,708,517	4.38	3.75
1938	64,386,421	72.0	28,625,366	2.17	1.50
1939	150,319,682	87.4	23,027,468	4.04	3.50
1940	161,864,924	87.4	24,578,577	4.32	3.75
1941	162,608,296	85.2	29,865,992	4.44	3.75
1942	86,992,295	58.8	67,481,073	3.55	2.00
1943	87,106,758	64.3	53,495,110	3.23	2.00
1944	132,063,371	82.6	29,754,274	3.68	3.00
1945	132,066,520	75.0	47,023,375	4.07	3.00
1946	99,158,674	124.5	[1] 21,414,770	1.76	2.25
1947	132,167,487	50.4	142,895,576	6.24	3.00
1948 [2]	142,975,458	38.8	246,025,348	8.84	3.25
Averages:					
1936–41	148,772,080	84.9	28,201,138	4.12	3.46
3 years ended Sept. 30, 1948	124,770,506	55.0	111,392,943	5.36	2.83

[1] Indicate red figures.
[2] 12 months to Sept. 30.

TABLE VIII.—*Kingan & Co., Inc.—Condensed income statements for selected years (consolidated to include domestic subsidiaries)*

	Fiscal year			
	1940	1946	1947	1948
Total amounts:				
Weight sold (thousand pounds)	[1] 384,605	345,202	539,529	521,988
Sales value	$52,691,375	$90,022,482	$192,607,983	$200,525,650
Raw material cost	40,329,088	71,862,459	166,144,719	168,779,845
Gross margin	12,362,287	18,160,023	26,463,264	31,745,805
Expenses	12,372,775	17,601,141	26,088,566	29,722,301
Profit before income taxes	[2] 10,488	558,882	374,698	2,023,504
Income taxes	[2] 167,362	[2] 28,200	42,000	850,000
Net profit	156,874	587,082	332,698	1,173,504
Average number of employees	4,500	4,165	5,260	5,600
Per hundredweight sold:				
Sales value	$13.70	$26.08	$35.69	$38.42
Raw material cost	10.49	20.82	30.79	32.34
Gross margin	3.21	5.26	4.90	6.08
Expenses	3.21	5.10	4.83	5.69
Profit before income taxes	----------	.16	.07	.39
Income taxes	[2].04	[2].01	.01	.17
Net profit	.04	.17	.06	.22
Per employee per week:				
Sales value	225.16	407.81	704.17	688.62
Raw material cost	172.34	325.55	607.42	579.60
Gross margin	52.82	82.26	96.75	109.02
Expenses	52.86	79.73	95.38	102.08
Profit before income taxes	[2].04	2.53	1.37	6.94
Income taxes	[2].71	[2].13	.16	2.90
Net profit	.67	2.66	1.21	4.04

[1] Not including weight of sales of domestic subsidiary.
[2] Denotes red figures.

TABLE IX.—*Financial data of Pacific Mills*

	1940		1946		1947		1948 (9 months)	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Net sales	$50,286,765	------	$78,303,654	------	$90,646,658	------	$83,077,575	------
Net profit before taxes	($348,310)	0.7	$19,154,241	24.5	$19,126,380	21.1	$16,928,563	20.4
Income taxes	(1)	------	$7,651,350	9.8	$7,751,000	8.6	$7,110,000	8.6
Net profit	($348,310)	------	$11,502,891	14.7	$11,375,380	12.5	$9,818,563	11.8
Invested capital	$21,694,932	------	$43,417,180	------	$52,573,333	------	----------	------
Earned before taxes	----------	(1.61)	----------	44.12	----------	36.38	----------	------
Earned after taxes	----------	(1.61)	----------	26.5	----------	21.6	----------	------
Distribution of net profit after taxes	($348,310)	------	$11,502,891	------	$11,375,380	------	----------	------
Dividends paid	(1)	------	$1,881,584	16.4	$2,495,578	21.9	----------	------
Reinvested in business	($348,310)	------	$9,621,307	83.6	$8,879,802	78.1	----------	------
Employees, end of year	12,873	------	10,436	------	10,420	------	11,676	------
Operating rate (capacity)	----------	60.0	----------	100.0	----------	100.0	----------	100.0
Inventories, end of year	$12,128,630	------	$15,574,650	------	$23,081,185	------	$29,000,000	------

[1] None.

TABLE X.—*Philco Corp. sales and earnings*

	1940	1941	1946	1947	1948 (9 months)
Sales	$52,311,131	$77,073,636	$121,596,622	$226,507,592	$194,155,516
Earnings before taxes	$3,595,790	$8,481,169	$5,741,150	$21,796,379	$16,368,592
Taxes	$1,347,222	$5,967,600	$2,817,750	$8,734,950	$7,051,500
Earnings after taxes [1]	$2,248,568	$2,513,569	$3,107,480	$9,630,699	$6,631,092
Earnings per dollar of sales (percent):					
Before taxes	6.87	11.00	4.72	9.62	8.43
After taxes	4.30	3.26	2.56	4.25	3.42
Return on net worth (percent)	14.19	15.48	8.85	22.42	19.12
Dividends:					
Preferred	$83,257		$187,500	$375,000	$281,250
Common	$1,355,149	$1,369,768	$1,372,143	$2,789,779	$2,248,505

[1] Earnings balance, as set forth in the consolidated earnings statements for the respective years, after nonrecurring items and transfers to reserve accounts.

CHART 1

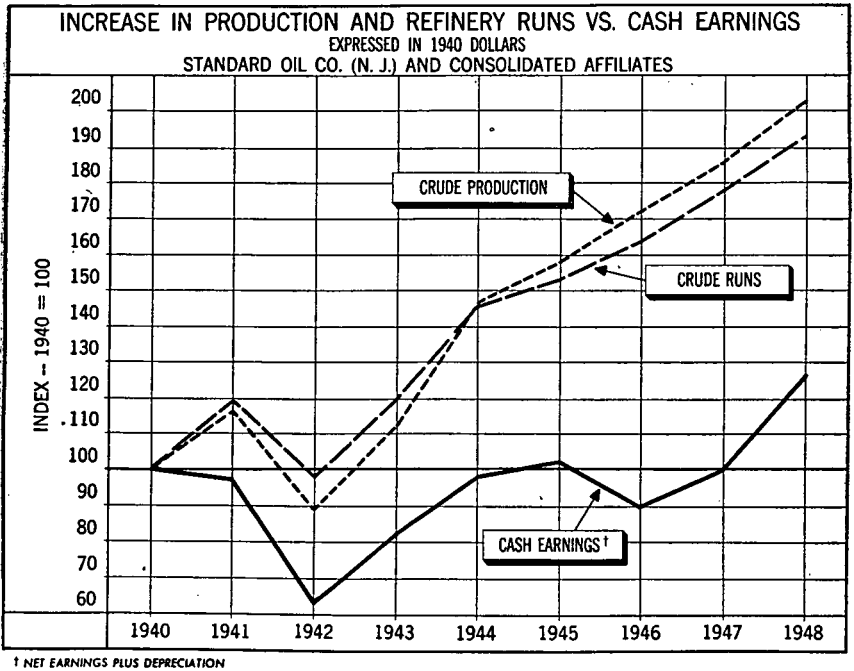


TABLE XI.—*The Studebaker Corp. and subsidiary companies—Comparison of net profits after taxes to dollar sales, total unit sales, unit sales above break-even point, number of employees, total pay roll, and invested capital (including funded debt) for the years 1940, 1946, 1947, and 1948 (projected based on 9 months 1948, actual)*

	1940	1946	1947	1948
Net profit after income taxes	$2,124,628	$948,808	$9,127,103	$18,000,000
Net sales	$84,164,224	$141,564,321	$267,998,838	$375,000,000
Percent of net profit to sales	2.5	0.7	3.4	4.8
Unit sales	119,509	119,275	191,531	230,000
Net profit per unit	$17.78	$7.95	$47.65	$78.26
Unit sales in excess of break-even point	25,497	(1)	81,375	135,150
Net profit per unit	$83.33		$112.16	$133.19
Number of employees	9,435	15,382	17,698	19,593
Net profit per employee	$225.19	$61.68	$515.71	$918.70
Total pay roll	$17,452,064	$43,734,365	$59,760,945	$80,000,000
Percent of net profit to pay roll	12.2	2.2	15.3	22.5
Invested capital (including funded debt)	$29,650,515	$55,629,641	$62,491,139	$78,368,000
Percent of net profit to invested capital	7.2	1.7	14.6	23.0

[1] Net loss before tax adjustment.

TABLE XII.—*Comparison of Sun Oil Co. net income*

	Gross revenue from sales and services	Net income	Sales dollar ratio		Gross revenue from sales and services	Net income	Sales dollar ratio
			Percent				*Percent*
1936	$105,447,000	$7,564,000	7.2	1943	$468,846,000	$13,354,000	2.8
1937	133,323,000	9,544,000	7.2	1944	600,823,000	13,350,000	2.2
1938	115,047,000	3,085,000	2.7	1945	438,975,000	15,667,000	3.6
1939	131,475,000	6,960,000	5.3	1946	306,644,000	14,727,000	4.8
1940	147,673,000	7,969,000	5.4	1947	356,841,000	24,340,000	6.8
1941	187,884,000	16,533,000	8.8	1948 to June 30	221,468,000	22,799,000	10.3
1942	310,660,000	8,671,000	2.8				

TABLE XIII.—*Comparative sales, cost and profits, 1940, 1946, 1947 and 9 months of 1948—United States Steel Corp., and subsidiaries (in millions)*

	In current dollars				In 9 months 1948 dollars [1]			
	1940	1946	1947	[2] 1948	1940	1946	1947	[2] 1948
Finished steel shipped (net tons)	15.0	15.2	20.2	15.1				
Products and services sold	$1,079.1	$1,496.1	$2,122.8	$1,754.7	$1,839.9	$1,834.2	$2,277.8	$1,754.7
Costs:								
Wages, salaries, social-security taxes, pensions	464.3	704.5	903.6	739.3	791.6	863.7	969.6	739.3
Products and services bought	358.3	589.6	841.9	705.8	610.9	722.9	903.4	705.8
Wear and exhaustion of facilities:								
Based on original cost	72.6	68.7	87.7	66.3	123.8	84.2	94.1	66.3
Added to cover replacement cost			26.3	39.7			28.2	39.7
Total wear and exhaustion	72.6	68.7	114.0	106.0	123.8	84.2	122.3	106.0
War costs included herein provided for in prior years, less associated Federal income-tax adjustment		[2] 29.2	[2] 2.5			[2] 35.8	[2] 2.7	
Interest and other costs on long-term debt	13.6	4.8	2.5	1.8	23.2	5.9	2.7	1.8
State, local, and miscellaneous taxes	41.8	37.1	45.2	37.6	71.3	45.5	48.5	37.6
Estimated Federal taxes on income	26.3	32.0	91.0	76.2	44.8	39.2	97.6	76.2
Total costs	976.9	1,407.5	1,995.7	1,666.7	1,665.6	1,725.6	2,141.4	1,666.7
Income	102.2	88.6	127.1	88.0	174.3	108.6	136.4	88.0
Dividends declared:								
Preferred stock	25.2	25.2	25.2	18.9	43.0	30.9	27.0	18.9
Common stock	34.8	34.8	45.7	32.6	59.3	42.6	49.1	32.6
Total dividends	60.0	60.0	70.9	51.5	102.3	73.5	76.1	51.5
Income reinvested in business	42.2	28.6	56.2	36.5	72.0	35.1	60.3	36.5

[1] Based on Bureau of Labor Statistics Consumers Price Index (cost of living): 1935-39=100, 1940=100.2, 1946=139.3, 1947=159.2, 1948 9 months=170.8.
[2] 9 months.
[3] Denotes red figures.

TABLE XIV.—*United States Steel's operating story, 1902–47*

[Net tons in thousands]

Year of operation	Total ores mined	Total fluxes produced	Total coal mined	Total coke produced	Total iron produced	Ingots and castings		Steel products shipped	Employment statistics			
						Total production	Percent capacity operated		Number of employees	Weekly hours	Hourly earnings	Weekly earnings
1902	17,991	1,471	13,813	9,522	8,933	10,920	97.2	8,913	168,127	68.4	$0.201	$13.75
1903	17,207	1,421	12,660	8,658	8,153	10,275	81.8	8,129	167,709	66.6	.207	13.79
1904	11,763	1,560	13,718	8,652	8,254	9,422	72.8	7,325	147,343	67.4	.192	12.94
1905	20,705	2,203	17,228	12,243	11,393	13,447	93.2	10,142	180,158	68.9	.198	13.64
1906	23,123	2,495	18,533	13,295	12,619	15,153	100.6	11,254	202,457	68.6	.204	14.00
1907	26,858	3,585	24,279	13,545	12,794	14,944	88.6	11,511	210,180	68.5	.214	14.67
1908	18,662	2,448	15,799	8,170	7,767	8,779	50.3	6,820	165,211	65.1	.214	13.92
1909	26,243	3,916	23,790	13,590	13,013	14,958	77.8	10,612	196,500	68.8	.216	14.85
1910	28,275	5,606	26,365	13,650	13,251	15,881	79.5	11,777	218,435	68.4	.224	15.33
1911	22,326	5,416	24,326	12,120	12,034	14,284	70.5	10,340	196,888	67.2	.234	15.73
1912	29,600	6,859	30,639	16,719	15,889	18,929	89.8	13,771	221,025	69.0	.238	16.41
1913	32,187	7,099	30,787	16,663	15,770	18,655	90.1	13,387	228,906	68.9	.252	17.35
1914	19,079	5,238	21,162	11,174	11,259	13,246	62.3	9,935	179,353	67.6	.257	17.38
1915	26,510	6,491	26,628	14,501	15,278	18,342	85.2	12,826	191,126	68.3	.260	17.76
1916	37,358	7,866	32,768	18,902	19,721	23,420	100.6	17,105	252,668	68.8	.290	19.94
1917	35,596	7,274	31,497	17,462	17,531	22,719	91.9	16,919	268,058	69.2	.359	24.85
1918	31,733	5,758	31,748	17,758	17,854	21,934	88.2	15,570	268,710	66.1	.489	32.33
1919	28,474	6,536	28,893	15,464	15,274	19,264	77.0	13,470	252,106	59.1	.617	36.48
1920	30,264	6,699	30,828	16,208	16,277	21,591	86.2	15,534	268,004	59.4	.699	41.55
1921	18,646	5,160	21,628	9,825	9,720	12,282	48.3	8,758	191,700	61.0	.546	33.30
1922	24,392	6,309	23,293	13,237	13,470	18,012	70.9	13,127	214,931	64.5	.446	28.78
1923	34,737	7,365	35,290	18,838	18,737	22,770	89.1	15,870	260,786	59.3	.583	34.54
1924	27,747	5,638	27,738	14,408	14,206	18,456	72.2	12,705	246,753	52.8	.650	34.29
1925	31,357	5,986	31,476	16,301	16,575	21,167	81.7	14,753	249,833	53.7	.653	35.04
1926	32,778	6,175	34,295	17,336	17,590	22,743	89.1	15,771	253,199	53.7	.660	35.42
1927	28,725	5,215	27,430	14,507	15,438	20,705	79.8	14,310	231,549	53.6	.666	35.68
1928	29,834	16,352	28,691	15,993	17,066	22,518	84.6	15,400	221,702	52.2	.684	35.70
1929	34,214	16,535	31,827	17,355	18,463	24,493	90.4	16,813	254,495	46.2	.685	31.67
1930	27,211	16,365	25,388	13,113	14,289	18,762	67.2	12,798	252,902	43.2	.686	29.66
1931	15,233	8,595	15,575	7,041	7,864	11,292	37.5	8,399	215,750	34.4	.690	23.74
1932	4,050	3,587	7,047	2,966	3,498	5,521	17.7	4,324	164,348	25.4	.614	15.58
1933	9,347	6,060	10,227	4,880	5,629	9,013	29.4	6,354	172,577	30.4	.596	18.14
1934	11,283	6,769	11,724	5,382	6,174	9,700	31.7	6,501	189,881	30.2	.705	21.26
1935	12,810	7,842	15,095	7,328	8,307	12,467	40.7	8,086	194,820	33.9	.731	24.77
1936	21,306	12,031	23,581	12,034	13,501	18,937	63.4	11,905	222,372	39.6	.737	29.16
1937	34,080	14,696	24,504	14,190	16,171	20,756	71.9	14,098	261,293	37.6	.864	32.51
1938	12,303	7,818	13,842	7,006	7,632	10,525	36.4	7,316	202,108	29.7	.902	26.80
1939	24,225	12,852	21,624	12,092	13,656	17,626	61.0	11,707	223,844	35.2	.897	31.59
1940	34,047	15,730	29,528	16,144	18,367	22,934	82.5	15,014	254,393	36.7	.898	32.97
1941	43,318	19,176	29,076	18,563	22,321	28,963	96.8	20,417	304,248	38.1	.994	37.91
1942	52,012	20,864	32,317	19,275	23,496	30,030	98.1	20,615	335,866	38.8	1.086	42.17
1943	51,649	19,478	29,046	19,028	23,660	30,540	97.8	20,148	340,498	42.2	1.159	48.94
1944	49,842	19,208	30,709	20,503	23,445	30,815	94.7	21,052	314,888	44.2	1.257	55.53
1945	47,655	19,030	27,622	18,341	19,648	26,479	82.0	18,410	279,274	42.0	1.287	54.03
1946	37,972	20,874	24,463	15,242	15,853	21,287	72.9	15,182	266,835	35.0	1.426	49.91
1947	47,434	24,827	29,639	20,806	21,511	28,570	96.7	20,242	286,316	38.5	1.550	59.64

Production data, which are grouped in broad product classifications, include all production of the materials by the operating subsidiaries and exclude all materials purchased. The average weekly hours and average weekly earnings shown are based on the average monthly number of employees receiving pay. Prior to 1929, the full-time equivalent rather than the actual number of employees is shown and, for those early years, the average weekly hours, hourly and weekly earnings have been partially estimated.

TABLE XIV.—*United States Steel's operating story, 1902–47*—Continued

[Dollars in millions]

Year of operation	Products and services sold	Employment costs	Yearly taxes accrued	Products and services bought	Wear and exhaustion	Interest and other costs on debt	Income or loss	Preferred stock dividend	Common stock dividend	Reinvested in the business	Percent income of investment	Percent income of sales
1902	423.1	120.5	2.4	160.8	27.8	21.3	90.3	35.7	20.3	34.3	7.6	21.3
1903	398.2	120.8	3.0	164.1	29.3	25.6	55.4	30.4	12.7	12.3	5.4	13.9
1904	324.9	101.0	3.1	142.3	18.2	30.1	30.2	25.2	-------	5.0	4.0	9.3
1905	409.2	128.1	3.6	151.1	28.0	29.8	68.6	25.2	-------	43.4	6.4	16.8
1906	484.0	147.8	4.4	168.7	35.6	29.4	98.1	25.2	10.2	62.7	8.2	20.3
1907	504.4	160.8	5.4	169.1	35.1	29.4	104.6	25.2	10.2	69.2	8.3	20.7
1908	331.6	120.5	5.4	104.9	23.8	31.3	45.7	25.2	10.2	10.3	4.8	13.8
1909	441.1	151.7	8.7	138.4	31.8	31.5	79.0	25.2	20.3	33.5	6.8	17.9
1910	491.8	175.0	9.2	157.1	32.5	30.6	87.4	25.2	25.4	36.8	7.1	17.8
1911	431.7	161.6	9.6	146.3	27.8	31.1	55.3	25.2	25.4	4.7	5.1	12.8
1912	533.9	189.6	9.8	214.3	33.4	32.6	54.2	25.2	25.4	3.6	5.1	10.2
1913	560.8	207.5	13.2	191.6	34.0	33.3	81.2	25.2	25.4	30.6	6.6	14.5
1914	412.2	162.7	12.6	153.7	26.6	33.2	23.4	25.2	15.2	[1] 17.0	3.2	5.7
1915	523.7	177.3	13.6	189.8	34.3	32.8	75.9	25.2	6.4	44.3	6.1	14.5
1916	902.3	263.9	26.6	265.3	43.0	32.0	271.5	25.2	44.5	201.8	15.3	30.1
1917	1,284.6	347.9	252.3	345.9	83.3	31.0	224.2	25.2	91.5	107.5	12.1	17.5
1918	1,344.6	453.0	297.6	339.2	98.8	30.7	125.3	25.2	71.2	28.9	7.2	9.3
1919	1,122.6	479.7	81.6	364.5	89.9	30.1	76.8	25.2	25.4	26.2	4.8	6.8
1920	1,290.6	581.8	76.2	413.6	80.0	29.3	109.7	25.2	25.4	59.1	6.1	8.5
1921	726.0	333.2	37.7	249.9	40.1	28.5	36.6	25.2	25.4	[1] 14.0	2.9	5.0
1922	809.0	323.4	35.8	334.7	47.1	28.4	39.6	25.2	25.4	[1] 11.0	3.0	4.9
1923	1,096.5	470.4	55.1	377.4	56.9	28.0	108.7	25.2	29.2	54.3	6.0	9.9
1924	921.4	443.6	45.3	266.9	53.2	27.3	85.1	25.2	35.6	24.3	4.9	9.2
1925	1,022.0	458.2	50.9	333.6	61.6	27.1	90.6	25.2	35.6	29.8	5.1	8.9
1926	1,082.3	469.3	52.4	346.7	70.4	26.8	116.7	25.2	35.6	55.9	6.2	10.8
1927	960.5	412.7	46.3	323.1	64.4	26.1	87.9	25.2	49.8	12.9	4.9	9.2
1928	1,005.3	402.9	51.0	338.4	73.2	25.7	114.1	25.2	49.8	39.1	6.0	11.4
1929	1,097.4	410.2	55.0	350.0	69.8	14.9	197.5	25.2	63.8	108.5	9.9	18.0
1930	828.4	371.7	48.1	234.8	63.8	5.6	104.4	25.2	60.4	18.8	4.8	12.6
1931	548.7	258.4	34.2	187.2	50.4	5.5	13.0	25.2	37.0	[1] 49.2	.8	2.4
1932	287.7	138.5	31.7	141.8	41.6	5.3	[1] 71.2	20.7	-------	[1] 91.9	[1] 3.1	[1] 24.7
1933	375.0	167.9	31.7	161.4	45.3	5.2	[1] 36.5	7.2	-------	[1] 43.7	[1] 1.5	[1] 9.7
1934	420.9	214.8	35.8	140.5	46.4	5.1	[1] 21.7	7.2	-------	[1] 28.9	[1] .8	[1] 5.1
1935	539.4	253.9	38.4	191.2	49.8	5.0	1.1	7.2	-------	[1] 6.1	.4	.2
1936	790.5	339.0	49.6	287.5	59.0	4.9	50.5	50.4	-------	.1	3.2	6.4
1937	1,028.4	447.1	74.6	342.6	64.1	5.1	94.9	58.5	8.7	27.7	5.6	9.2
1938	611.1	294.4	37.5	228.3	50.3	8.3	[1] 7.7	25.2	-------	[1] 32.9	.0	[1] 1.3
1939	846.0	386.5	52.2	293.5	63.4	9.3	41.1	25.2	-------	15.9	3.1	4.9
1940	1,079.1	464.3	68.1	358.3	72.6	13.6	102.2	25.2	34.8	42.2	7.0	9.5
1941	1,622.3	628.3	168.6	604.6	98.6	6.0	116.2	25.2	34.8	56.2	7.1	7.2
1942	1,863.0	782.7	201.3	673.4	128.2	6.2	71.2	25.2	34.8	11.2	4.5	3.8
1943	1,972.3	912.9	125.9	730.6	134.0	6.3	62.6	25.2	34.8	2.6	3.9	3.2
1944	2,082.2	957.2	105.8	814.4	139.0	5.0	60.8	25.2	34.8	.8	3.8	2.9
1945	1,747.3	825.5	66.8	670.1	123.4	3.5	58.0	25.2	34.8	[1] 2.0	3.6	3.3
1946	1,496.1	704.5	69.1	560.4	68.7	4.8	88.6	25.2	34.8	28.6	5.6	5.9
1947	2,122.8	903.6	136.2	839.4	114.0	2.5	127.1	25.2	45.7	56.2	7.4	6.0

The data are in some respects necessarily approximate, and are based on the yearly earnings reported annually to stockholders without adjustment for surplus charges and credits except that the years 1942 and 1943 reflect renegotiation settlements made in the succeeding years. For example, taxes are as accrued before adjustments. Income before interest, but after all other charges, was used to determine the percent income of investment.

[1] Denotes deficit.

APPENDIX E

TABLES AND CHARTS ON DISPOSITION OF EARNINGS OF INDIVIDUAL COMPANIES

TABLE I.—*American Woolen Co., Inc., disposition of profits—as to dividends; as to retained earnings*

	Net profits before reserve for contingencies	Dividends paid	Retained earnings	Disposition of retained earnings		
				Debt retirement	Capital expenditures	Working capital
1940	$3,154,464	$1,400,000	$1,754,464	----------	$970,727	$783,737
1946	23,098,178	23,602,666	[1] 504,488	----------	3,073,323	[1] 3,577,811
1947	16,269,914	10,133,477	6,136,437	----------	4,954,331	1,182,106
1948 (to Sept. 30, inclusive)	13,461,626	7,012,592	6,449,034	----------	3,197,086	3,251,948

[1] Red figure.

TABLE II.—*Armour & Co.—Disposition of profits*

[Figures in millions, except last column]

Fiscal year	Profit or loss	Dividends paid				Profits retained	Earnings per share, common [1]
		Amour & Co. of Delaware 7 percent preferred	Armour & Co., Illinois				
			$6 per share of preferred	7 percent Preferred	Common		
1939	$6.98	$3.75	----------	----------	----------	$3.23	[2] $0.05
1940	9.63	3.75	----------	----------	----------	5.88	.60
1941	14.12	3.75	$0.80	----------	----------	9.57	1.70
1942	15.25	3.69	2.40	----------	----------	9.16	2.00
1943	14.78	3.12	.80	----------	----------	10.86	2.02
1944	9.77	----------	2.40	----------	----------	7.37	1.56
1945	9.82	----------	3.20	----------	----------	6.62	1.57
1946	27.68	----------	[3] 5.86	----------	----------	21.82	5.96
1947	30.91	----------	[4] 15.52	[5] 2.30	----------	13.09	6.76
1948	[2] 1.97	----------	3.00	----------	$3.66	[2] 8.63	[2] 1.22
Average	13.69	1.81	3.40	.23	.36	7.89	2.09

[1] After allowing in each year, 1 year's annual preferred stock dividend requirement.
[2] Red figures.
[3] Includes payments on dividend arrearages of $1.87.
[4] Includes payments on dividend arrearages of $13.14.
[5] Includes payments on dividend arrearages of $2.06.

TABLE III.—*Armour & Co.—source of funds—credit, retained earnings; how applied; effect on working capital for the 10 years ended Oct. 30, 1948*

[Figures in thousands]

SOURCES OF FUNDS

		Amount	Items affecting working capital
Funds made available through credit sources:			
Notes payable were increased—			
From	$25,484		
To	51,654		
		$26,170	
Accounts and accruals payable were increased—			
From	15,303		
To	57,638		
		42,335	
Long-term debt was increased—			
From	77,557		
To	137,628		
		60,071	$60,071
Cash was increased—			
From	15,249		
To	31,972		
		[1] 16,723	
Total		111,853	
Funds made available through retained earnings:			
Earnings	$136,967		
Dividends paid	[1] 58,001		
Depreciation in excess of capital expenditures	8,760		
Reduction in deferred charges	3,213		
Surplus adjustments	[1] 11,404		
		79,535	79,535
Total funds made available		191,388	
Total items affecting working capital			139,606
Net increase in working capital			72,948

HOW APPLIED

Additional funds required to finance receivables and inventories at higher level of prices:			
Receivables went up—			
From	$36,491		
To	74,776		
		$38,285	
Inventories went up—			
From	89,196		
To	175,641		
		86,445	
Total		124,730	
Additional funds in investments		4,204	$4,204
Funds used in redemption of preferred stock:			
Preferred stock was reduced—			
From	$112,454		
To	50,000		
		62,454	62,454
Total funds applied		191,388	
Total items affecting working capital			66,658

[1] Red figures.

CHART 1. GENERAL FOODS CORP.

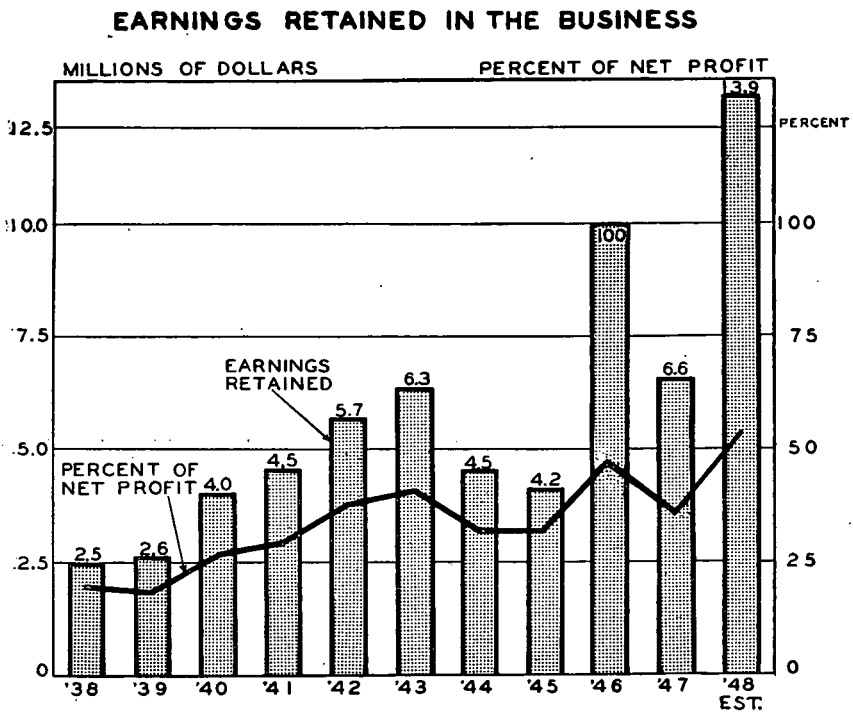


CHART 2. GENERAL FOODS CORP.

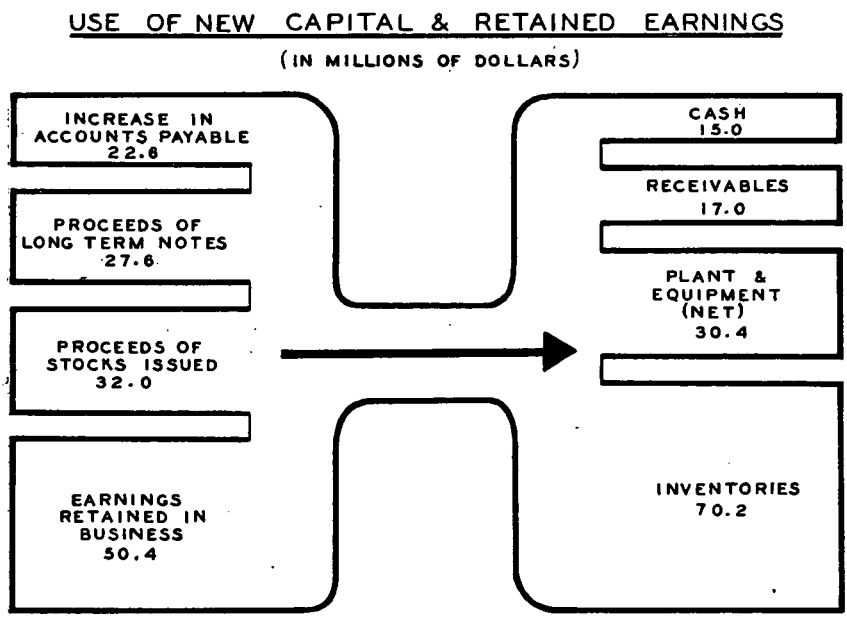


TABLE IV.—*Percentage of General Motors net income paid in dividends and retained in the business*

Year	Percent of net income		Year	Percent of net income	
	Paid in dividends	Retained in the business		Paid in dividends	Retained in the business
1928	63.2	36.8	1939	87.4	12.6
1929	66.9	33.1	1940	87.4	12.6
1930	92.7	7.3	1941	85.2	14.8
1931	144.4	[1] 44.4	1942	58.8	41.2
1932	[2]	[2]	1943	64.3	35.7
1933	75.7	24.3	1944	82.6	17.4
1934	77.7	22.3	1945	75.0	25.0
1935	63.2	36.8	1946	124.5	[1] 24.5
1936	84.7	15.3	1947	50.4	49.6
1937	86.4	13.6	1948 (12 months to Sept. 30)	38.8	61.2
1938	72.0	28.0			

[1] Red figures.
[2] 1932 earnings were $165,000 and dividends were $63,200,000.

TABLE V.—*Kingan & Co., Inc.—Statement of sources and disposition of funds for 8 years, 1941 to 1948, inclusive*

Sources		Disposition		Deficiency
Operations:				
Profits before taxes	$9,128,132	Income taxes	$4,393,942	
Depreciation allowances	4,267,784	Distributions to stockholders	1,911,653	
			6,305,595	
		Fixed asset replacements, improvements and additions	8,891,691	
Subtotal	13,395,916	Subtotal	15,197,286	$1,801,370
Investments:				
Profit from sale of subsidiary company	1,331,696	Increase in accounts receivable	3,798,914	
Realization from sale of nonoperating property	985,091	Increase in supplies, inventory and prepayments	626,384	
Liquidation of inventories	787,444	Increase in outside investments and miscellaneous	252,505	
Subtotal	3,104,231	Subtotal	4,677,803	1,573,572
Cumulative subtotal	16,500,147	Cumulative subtotal	19,875,089	3,374,942
Borrowings:				
Included in bank loans	1,800,000	Increase in cash	965,029	
Included in accounts payable and accruals	2,539,971			
Subtotal	4,339,971	Subtotal	965,029	[1] 3,374,942
Grand total	20,840,118	Grand total	20,840,118	

[1] Denotes red figures (surplus).

TABLE VI.—*How Philco earnings have been used*

	1940	1941	1946	1947	9 months 1948
Earnings	$2,248,568	$2,513,569	$3,107,480	$9,630,699	$6,631,091
Paid out as dividends	1,438,406	1,369,768	1,559,643	3,164,779	2,529,755
Retained in business	810,162	1,143,801	1,547,837	6,465,920	4,101,336

TABLE VII.—*Earnings and their disposition, Standard Oil Co. (New Jersey) and consolidated affiliates*

	1940		1946		1947		1948	
	Millions of dollars	Percent of total income	Millions of dollars	Percent of total income	Millions of dollars	Percent of total income	Millions of dollars	Percent of total income
Profits (Jersey plus minority interests)	145	16.8	212	12.9	321	13.4	474	14.8
Depreciation	96	11.3	120	7.3	143	6.0	159	5.0
Cash earnings	241	28.1	332	20.2	464	19.4	633	19.8
Dividends	67	7.8	102	6.2	138	5.8	91	2.8
Replacements and added facilities	125	14.6	279	17.0	426	17.8	551	17.3
Total	192	22.4	381	23.2	564	23.6	642	20.1
Over or (short)	49	5.7	(49)	(3.0)	(100)	(4.2)	(9)	(0.3)

TABLE VIII.—*The Studebaker Corp., and subsidiary companies—Statement of disposition of profit and new investment for the years 1940, 1946, 1947, and for the first 9 months of 1948*

	1940	1946	1947	Jan. 1 to Sept. 30, 1948
Net profit after taxes	$2,124,628	$948,808	$9,127,103	$13,392,724
Dividends		1,177,001	1,765,605	1,765,648
Retained earnings	2,124,628	(228,193)	7,361,498	11,627,076
Increase in equity capital	68,418			
Net increase in long-term borrowed capital		4,000,000		2,442,560
	2,193,046	3,771,807	7,361,498	14,069,636
Net reduction in long-term borrowed capital	704,302		500,000	
New investment	1,488,744	3,771,807	6,861,498	14,069,636
New investment distributed as follows:				
Net expansion of plant and equipment	2,188,065	8,211,357	1,046,694	6,041,988
Increase (or decrease) in working capital	*(531,989)	(4,485,436)	5,921,851	8,027,648
Other	(167,332)	45,886	(107,047)	
Total	1,488,744	3,771,807	6,861,498	14,069,636
*Includes increase in inventory—net	906,803	7,386,926	10,629,103	6,699,801

NOTE.—( ) indicate red figures.

TABLE IX.—*Disposition of net income of United States Steel Corp. and subsidiaries, 1940 to 1948*

	In millions				Percent on sales			
	1940	1946	1947	1948 [1]	1940	1946	1947	1948 [1]
Income	$102.2	$88.6	$127.1	$88.0	9.5	5.9	6.0	5.0
Dividends declared:								
Preferred stock	25.2	25.2	25.2	18.9	2.4	1.7	1.2	1.1
Common stock	34.8	34.8	45.7	32.6	3.2	2.3	2.1	1.9
Total dividends	60.0	60.0	70.9	51.5	5.6	4.0	3.3	3.0
Income reinvested in business	42.2	28.6	56.2	36.5	3.9	1.9	2.7	2.0

[1] 9 months.

APPENDIX F

STATEMENTS BY THE COMMITTEE ON ACCOUNTING PROCEDURE, AMERICAN INSTITUTE OF ACCOUNTANTS

[Accounting Research Bulletins, Issued by the Committee on Accounting Procedure, American Institute of Accountants, 13 East 41st Street, New York 17, N. Y., December, 1947, No. 33]

DEPRECIATION AND HIGH COSTS

The committee on accounting procedure recently authorized the issuance of a statement to members of the institute dealing with the propriety of charging to current income (*a*) amounts in excess of depreciation based on cost of plant facilities to provide for their replacement at higher prices, and (*b*) a portion of the cost of currently acquired new facilities representing part or all of the excess of current construction costs over an estimated "reasonable" cost. The committee now deems it appropriate to issue that statement as a research bulletin. The statement of the committee follows:

"1. The American Institute of Accountants committee on accounting procedure has given extensive consideration to the problem of making adequate provision for the replacement of plant facilities in view of recent sharp increases in the price level. The problem requires consideration of charges against current income for depreciation of facilities acquired at lower price levels.

"2. The committee recognizes that business management has the responsibility of providing for replacement of plant and machinery. It also recognizes that, in reporting profits today, the cost of material and labor is reflected in terms of 'inflated' dollars while the cost of productive facilities in which capital was invested at a lower price level is reflected in terms of dollars whose purchasing power was much greater. There is no doubt that in considering depreciation in connection with product costs, prices, and business policies, management must take into consideration the probability that plant and machinery will have to be replaced at costs much greater than those of the facilities now in use.

"3. When there are gross discrepancies between the cost and current values of productive facilities, the committee believes that it is entirely proper for management to make annual appropriations of net income or surplus in contemplation of replacement of such facilities at higher price levels.

"4. It has been suggested in some quarters that the problem be met by increasing depreciation charges against current income. The committee does not believe that this is a satisfactory solution at this time. It believes that accounting and financial reporting for general use will best serve their purposes by adhering to the generally accepted concept of depreciation on cost, at least until the dollar is stabilized at some level. An attempt to recognize current prices in providing depreciation, to be consistent, would require the serious step of formally recording appraised current values for all properties, and continuous and consistent depreciation charges based on the new values. Without such formal steps, there would be no objective standard by which to judge the propriety of the amounts of depreciation charges against current income, and the significance of recorded amounts of profit might be seriously impaired.

"5. It would not increase the usefulness of reported corporate income figures if some companies charged depreciation on appraised values while others adhered to cost. The committee believes, therefore, that consideration of radical changes in accepted accounting procedure should not be undertaken, at least until a stable price level would make it practicable for business as a whole to make the change at the same time.

"6. The committee disapproves immediate write-downs of plant cost by charges against current income in amounts believed to represent excessive or abnormal costs occasioned by current price levels. However, the committee calls attention to the fact that plants expected to have less than normal useful life can properly be depreciated on a systematic basis related to economic usefulness."

The statement entitled "Depreciation and High Costs" was adopted by the assenting votes of 20 members of the committee, of whom one, Mr. Wellington, assented with qualification. Mr. Paton did not vote.

Mr. Wellington assents to the bulletin but does not approve the statement that changes in accounting and financial reporting should be postponed until the dollar is stabilized at some level. He believes that the depreciation of the dollar is already so great as to call for recognition thereof in the accounts expressed in dollars. In his opinion the price level is rarely believed to be stable, and waiting for stability may again and again be advanced as a reason for no recognition of changes that have already taken place.

NOTES

1. Accounting Research bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, p. 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, p. 3.)

Committee on Accounting Procedure (1946–1947): George D. Bailey, *Chairman*, William H. Bell, Samuel J. Broad, Henry T. Chamberlain, M. C. Conick, James L. Dohr, Fred J. Duncombe, Anson Herrick, David Himmelblau, John B. Inglis, Paul K. Knight, Edward J. McDevitt, Jr., Warren W. Nissley, William A. Paton, Maurice E. Peloubet, Charles S. Rockey, Walter L. Schaffer, Maurice H. Stans, Virgil S. Tilly, Edwin H. Wagner, Jr., C. Oliver Wellington, Carman G. Blough, *Director of Research.*

AMERICAN INSTITUTE OF ACCOUNTANTS

COMMITTEE ON ACCOUNTING PROCEDURE

Samuel J. Broad, Chairman	Anson Herrick	Maurice E. Peloubet
John N. Aitken	Thomas G. Higgins	Walter L. Schaffer
William H. Bell	David Himmelblau	Maurice H. Stans
Homer L. Dalton	John B. Inglis	Virgil S. Tilly
Thomas M. Dickerson	Paul K. Knight	C. Oliver Wellington
James L. Dohr	John A. Lindquist	Carman G. Blough, director of research
Fred J. Duncombe	Edward J. McDevitt	
J. P. Friedman	William A. Paton	

13 EAST FORTY-FIRST STREET, NEW YORK 17, N. Y.,
October 14, 1948.

To the Members of the American Institute of Accountants:

GENTLEMEN: The committee on accounting procedure has reached the conclusion that no basic change in the accounting treatment of depreciation of plant and equipment is practicable or desirable under present conditions to meet the problem created by the decline in the purchasing power of the dollar.

The committee has given intensive study to this problem and has examined and discussed various suggestions which have been made to meet it. It has solicited and considered hundreds of opinions on this subject expressed by businessmen, bankers, economists, labor leaders, and others. While there are differences of opinion, the prevailing sentiment in these groups is against any basic change in present accounting procedures. The committee believes that such a change would confuse readers of financial statements and nullify many of the gains that have been made toward clearer presentation of corporate finances.

Should inflation proceed so far that original dollar costs lose their practical significance, it might become necessary to restate all assets in terms of the depreciated currency, as has been done in some countries. But it does not seem to the committee that such action should be recommended now if financial statements are to have maximum usefulness to the greatest number of users.

The committee, therefore, reaffirms the opinion it expressed in Accounting Research Bulletin No. 33, December 1947.

Any basic change in the accounting treatment of depreciation should await further study of the nature and concept of business income.

AMERICAN INSTITUTE OF ACCOUNTANTS

The immediate problem can and should be met by financial management. The committee recognizes that the common forms of financial statements may permit misunderstanding as to the amount which a corporation has available for distribution in the form of dividends, higher wages, or lower prices for the company's products. When prices have risen appreciably since original investments in

plant and facilities were made, a substantial proportion of net income as currently reported must be reinvested in the business in order to maintain assets at the same level of productivity at the end of a year as at the beginning.

Stockholders, employees, and the general public should be informed that a business must be able to retain out of profits amounts sufficient to replace productive facilities at current prices if it is to stay in business. The committee therefore gives its full support to the use of supplementary financial schedules, explanations, or footnotes by which management may explain the need for retention of earnings.

Four of the 21 members of the committee, Messrs. Broad, Paton, Peloubet, and Wellington, dissented from the conclusion that no basic change in the accounting treatment of depreciation of plant and equipment is practicable or desirable under present conditions. They believe further that inflation has proceeded to a point where original dollar costs have already lost their practical significance and that where depreciation is an important element of cost the advantages which would result from a basic change in accounting treatment outweigh the possible disadvantages which have been advanced against it.

For the

COMMITTEE ON ACCOUNTING PROCEDURE,
By SAMUEL J. BROAD, *Chairman.*

APPENDIX G

SUGGESTED LIST OF TOPICS AND QUESTIONS FOR DISCUSSION BY WITNESSES BEFORE SUBCOMMITTEE ON PROFITS, JOINT COMMITTEE ON THE ECONOMIC REPORT

TABULATION OF COMPANY DATA

Furnish and be prepared to discuss comparative sales, cost and profits data for 1940, 1946, 1947, and 1948 to latest available date:

(*a*) Relate profits to units of output, number of employees, net worth, invested capital, sales, and other reference points which you deem of significance.

(*b*) The disposition of profits as between dividends and retained earnings.

(*c*) The disposition of retained earnings as between debt retirement and new investment.

(*d*) For new investment give types of asset—working capital, inventories, cost-reducing plant and equipment, and net expansion of plant and equipment.

LEVEL OF PROFITS

It is often charged that profits are "too high" and at other times and by other people that they are "too low."

(*a*) What criteria would you suggest to this committee as a fair approach for determining a proper and equitable level of profits in your company? For other industries?

(*b*) Would you agree that profits are ever too high? If so, where or when? Should anything be done about such profits?

(*c*) Some industries made relatively large profits in 1947 operating at or near capacity; yet their profits increased sharply in 1948. What is the justification for such increased profits?

SPECIAL RESERVES

(*a*) Have you set aside any special allowances (over and above those permitted as costs by the Internal Revenue Bureau) to offset higher plant and equipment costs than allowed by the Bureau? If so, how much and how was the amount arrived at?

(*b*) Are any such items (nondeductible for tax purposes) taken into the costs as distributed through your cost accounting system?

(*c*) What do you intend to do with these special reserves if prices adjust permanently to lower levels? Will these higher depreciation allowances be used as a cost on which prices are fixed in all future accounting by your firm?

PRICING POLICIES

(*a*) In the light of 1947 record profits what pricing policy did you follow for 1948? Reduce, raise, or hold them unchanged? Why?

(*b*) How are prices fixed; what factors are taken into account; what officer or officers have specific responsibility for saying, "This will be the price"?

(c) Discuss the factors outside your control which have influenced the profits in your company, e. g., money supply.

(d) To what degree do you consider your own costs in fixing prices to meet competitive conditions?

(e) What profit level do you expect to achieve when prices are determined?

(f) Could you have charged more for your product and thereby realized greater total profits? If so, amplify.

(g) To what extent are your profit expectations responsible for increased prices?

SOURCES OF CAPITAL

(a) Why have you not paid out a larger portion of earnings and raised equity funds by sales of stocks? Would not equity funds be made more attractive and presumably more salable if investors received a larger portion of earnings?

(b) Is the small proportion of profits paid out as dividends itself a deterrent to obtaining equity capital through the capital markets?

(c) Have you made an effort to raise equity capital in the postwar period? If so, with what result?

APPENDIX H

CORPORATE PROFITS AND THEIR MEASUREMENT [1]

(By William H. Moore, staff economist)

In matters of economics and the weather, new records always make impressive reading. It is not surprising, therefore, that considerable interest should attach to statements in recent economic reports of the President that "Profits during 1947 reached a new peak" and that "Profits for the first half of 1948 were at levels above the average of 1947 * * *." [2] From such statements, statistically correct in themselves, it, of course, need not follow that even record profits were "excessive" or "above the levels necessary to furnish incentives." Though inferences to that effect recur in much discussion of the current inflationary situation, the validity of such arguments must rest upon theoretical evidence beyond the mere record of new "highs."

The special purpose of the present study is to examine the facts concerning these reported record levels. The profits with which statisticians, economists, critics, and defenders of current levels are dealing, are the corporate profits reported under a set of accounting conventions and a given structure of finance. Any consideration of current profit levels accordingly involves a brief examination of these accounting practices which determine the amount of "profits" reported. Since there is no simple norm by which profits or their level may be judged, the alternative yardsticks available for their measurement will also be considered.

ACCOUNTING PROFITS IN A PERIOD OF PRICE CHANGES

Generally speaking, accountants and bookkeepers, in arriving at the profits of a corporation, disregard fluctuations in the value of the domestic currency. A consequence of this practice is that in periods of significantly rising prices (such as 1947 and other recent years) reported profits tend to show extraordinary dollar gains, giving thereby the illusion of extraordinary corporate prosperity. At such times, costs, calculated on the book values of yesterday, fall short of the amounts needed to provide the physical replacement of inventory and plant used up in current production. Conversely, in periods of rapidly falling prices, as the early 1930's, profits expressed in dollars tend to be understated, and operating losses, not uncommon at such times, tend to be magnified.

Like all problems arising from fluctuations in the value of money, realization of what is taking place comes slowly to everyone affected. Though wholesale prices in the United States had more than doubled in the preceding 7 years, spokesmen for the accounting profession continue to advise adherence to the practice of basing depreciation on cost, "at least until the dollar is stabilized." [3] Not

[1] This report was prepared for the committee's review and information in connection with the hearings. It does not necessarily represent the views of the committee either individually or as a committee.

[2] Economic Report of the President, January 1948, p. 40; Midyear Report, July 1948, p. 12.

[3] Committee on accounting procedure, American Institute of Accountants, Bull. No. 33, Depreciation and High Costs, December 1947.

until January 1948 did the Bureau of Internal Revenue reluctantly permit department stores to adopt inventory valuation methods ("Lifo"), which give partial recognition to effects of fluctuating prices on inventories and profits. Income tax laws still limit allowable depreciation to the cost basis. The effect is to overstate current "profits" in such a way that current tax revenues actually arise in part from taxation of something that is economically not profit at all.

Through "last-in-first-out" valuation of inventories or through special reserves, a few of the larger corporations have undertaken to make accounting provision for some of the profit distortions which result from monetary fluctuations. Sporadically applied these methods fall far short of solving the problem of, or materially affecting, the profit statistics. Less than 10 percent of the corporations covered in a special study of profits by the Federal Trade Commission in 1947 had set aside from income substantial reserves to cover possible future price declines in inventories, excessive current construction costs, or higher replacement value of fixed assets.[4] It is, of course, highly probable that the companies which did establish special reserves were among the larger and more profitable of the entire group.

Since efforts to show the effect of price changes on profits have not attained the status of "generally accepted accounting principles" the general economic situation in respect to stated profits must be interpreted carefully. The United States Department of Commerce estimates the profit distortion resulting from changes in inventory valuation at upward of $5,000,000,000 in each of the years 1946 and 1947.[5] That is to say, had the corporations charged the same sales prices that they did charge in 1947, but had they universally followed the practice of charging to expense the amounts needed to replace the physical volume of inventory used up, corporate "profits" would have been 5.1 billion dollars less than they were. With inventory thus maintained aggregate corporate profits would have been some $13,000,000,000 instead of the indicated book figure of over $18,000,000,000 after taxes.

An axiom of economics states that without maintenance of capital there can be no income. Long established accounting conventions, involving individual firms and individual managerial judgments, may countenance some disregard for this axiom when recording the financial results of an individual enterprise. The nonrecurring and phantom character of the profits which arise from failure to conform to it, suggest, however, that such "profit" insofar as practicable be excluded from discussion of aggregate profits.

The overstatement of profits which results from basing depreciation of plant and equipment on cost, rather than on the amount necessary to replace the physical property, is less satisfactorily estimated. One widely quoted estimate indicates that, under established accounting principles, depreciation provisions in 1947 fell some $2,000,000,000 short of the amount required to cover depreciation on current replacement costs.[6] Since, according to Department of Commerce data, 1947 depreciation on the cost basis for all corporations aggregated nearly $5,000,000,000, estimates of 1½ to 2 billion dollar replacement deficiency do not appear unreasonable.

From study of construction cost index numbers and other data available to them, individual companies which undertook to estimate the deficiency placed 1947 allowable depreciation at some 30 to 40 percent under depreciation based on replacement values. Absence of tax law or other accepted accounting standard gave rise to several bases of computation as between various companies. United States Steel, representative of one view, increased its provision for wear and exhaustion of machinery, plants, and mines by 30 percent, saying, "This was a step toward stating wear and exhaustion in an amount which will recover in current dollars of diminished buying power the same purchasing power as the original expenditure."[7] The Chrysler Corp. in explanation of a 60-percent increase in depreciation charges emphasized the new construction aspect. Representative of concerns following the "acceleration" view, Chrysler pointed out: "Because of the disturbed price levels, it has been decided to modify at this time the corporation's depreciation policies by accelerating the charges for the early years of productive use of facilities acquired since the war, amortizing on a short-time basis the excess cost of such acquisitions over prewar price levels."[8] Though

[4] Federal Trade Commission, report on rates of return (after taxes) in selected industries for the years 1940 and 1947, August 16, 1948.
[5] Survey of Current Business, July 1948, national income section, table 1
[6] Mr. George O. May, in Certified Public Accountant, January 1948.
[7] United States Steel Corp., annual report, year ended December 31, 1947.
[8] Chrysler Corp. annual report, year ended December 31, 1947.

varied rationale gave rise to varied methods of computation these reserves were all prompted by a common concern over the adequacy of depreciation charges in times of rising prices and costs.

Should the effects of monetary depreciation continue, accountants and tax authorities in the United States may be forced to recognize this extraordinary depreciation as has been done at various times in countries experiencing more extreme inflation. Such recognition may take the form of allowing depreciation on estimated replacement costs. Another device that has been used would authorize multiplication of the normal depreciation deduction by a factor, 1½, 2, or other appropriate number, depending upon changes in cost levels subsequent to the time when the plant facilities were acquired.

In the Department of Commerce data on profits used in the accompanying tables the Department's estimate of "inventory valuation adjustment" has been accepted. This is done as a recognizable and necessary step bringing accounting profit more nearly in line with the economic requirement that capital depletion is not income. In the absence of a definitive estimate no such general adjustment, placing depreciation on a reproductive cost basis, has been made either by the Department in its aggregate series on the national income or in other profits data employed in this report. Basic data on aggregate corporate profits (1929–47) as reported by the Department and used in various of the subsequent tables of this report are summarized in table I.

PROFIT RECORDS DIFFER BETWEEN CORPORATIONS

The task of analyzing profits of any considerable number of corporations individually, together with the ready availability of aggregates through the national income data, sometimes obscure the fact that not all corporations make profits even in good years.

That profit experience varies widely between companies is illustrated by results reported for 1947 by the 1,250 leading manufacturing companies included in a compilation by the National City Bank of New York. Despite a sharp rise in composite earnings for the group, about 23 percent of the individual companies reported decreased profits in 1947. While the over-all average profit margin (cf. table V) was 7.1 cents per sales dollar, 5 percent of the companies had net deficits; 27 percent had margins under 5 cents; 43 percent had margins of 5.1 to 10.0 cents; and 25 percent had margins over 10 cents per sales dollar.[9]

TABLE I.—*Corporate profits as a distributive share of national income, 1929–47*

[Billions of dollars]

Year	Profits before tax [1]	Tax liability [1]	Profits after tax [1]	Inventory valuation adjustment	Profits after tax and inventory valuation adjustment
1929	9.8	1.4	8.4	0.5	8.9
1930	3.3	.8	2.5	3.3	5.8
1931	−.8	.5	−1.3	2.4	1.1
1932	−3.0	.4	−3.4	1.0	−2.4
1933	.2	.5	−.4	−2.1	−2.5
1934	1.7	.7	1.0	−.6	.4
1935	3.2	1.0	2.3	−.2	2.1
1936	5.7	1.4	4.3	−.7	3.6
1937	6.2	1.5	4.7		4.7
1938	3.3	1.0	2.3	1.0	3.3
1939	6.5	1.5	5.0	−.7	4.3
1940	9.3	2.9	6.4	−.1	6.3
1941	17.2	7.8	9.4	−2.6	6.8
1942	21.1	11.7	9.4	−1.3	8.1
1943	24.5	14.2	10.4	−.8	9.6
1944	24.3	13.5	10.8	−.3	10.5
1945	20.4	11.6	8.7	−.6	8.1
1946	21.8	9.0	12.8	−5.0	7.8
1947	29.8	11.7	18.1	−5.1	13.0

[1] Federal and State income and excess-profits taxes.

Source: Revised series of national income and product of the Department of Commerce. Survey of Current Business, July 1947, July 1948. See also Midyear Economic Report of the President, July 1948, appendix C, table 3.

[9] National City Bank Monthly Letter, March 1948, April 1948.

General statements about profit "levels" such as those quoted in an earlier paragraph from the economic report of the President, like much of the statistical data elsewhere in this report, conceal these differences between industries and between companies. In 1945, the last year for which data have been published, 118,000 out of 421,000 active corporations reported deficits on their corporate tax returns (table II). For 11 years, from 1930 to 1941, the number of active corporations reporting no net income on Federal tax returns exceeded those reporting income. Comparability of the historical data over the years is, of course, affected by changes in the statutory definition of net income, though not by changes in rates and exemptions which influence the number of individual returns so markedly.

While giving full recognition to this fact, the data on table II are nevertheless suggestive of one very important aspect of the profit-level question. As profit levels rise, large numbers of companies move out of the deficit category into the profit group. The significance of an improved status for these marginal companies to the aggregate of corporate profits is doubtless considerable. The significance to employment trends is even greater, for the job-giving capacities of a company which begins to make money after loss years are undoubtedly above those of the type of corporation already expanded under the impetus of an established profit record. "Record" profit levels do not necessarily mean that profitable companies are "profiteering"; they mean as well that large numbers of marginal companies have managed to get their "heads above water."

Caution respecting use of aggregates and averages because they obscure differences is not to deny the obvious fact that some individual corporations did make large, even "handsome," 1947 profits. Doubtless some companies do every year, and "record" years are no exception.

TABLE II.—*Federal corporate income-tax returns, numbers filed, active corporations only, 1929–45*

[In thousands]

Year	All active corporations	Returns with net income	Returns with no net income	Percent with no net income
1929	456.0	269.4	186.6	40.9
1930	463.0	221.4	241.6	52.1
1931	459.7	175.9	283.8	61.7
1932	451.9	82.6	369.3	81.7
1933	446.8	109.8	337.0	75.4
1934	469.8	145.1	324.7	69.1
1935	477.1	164.2	312.9	65.5
1936	478.9	203.2	275.7	57.5
1937	477.8	192.0	285.8	59.8
1938	471.0	169.9	301.1	63.9
1939	469.6	199.5	270.1	57.5
1940	473.1	221.0	252.1	53.2
1941	468.9	264.6	204.3	43.5
1942	442.6	269.9	172.7	39.0
1943	420.5	283.7	136.8	32.5
1944	412.5	288.9	123.6	29.9
1945	421.1	303.0	118.1	28.0

Source: Bureau of Internal Revenue, Statistics of Income for 1945, pt. 2, p. 20, and similar earlier tables.

THE CONCEPT OF "REAL PROFITS"

In a dynamic and progressive economy such as this country has had (and hopes to continue), new economic records, in order to have significance, must always be judged in relation to other dynamic criteria. Turning from the accounting difficulties of measuring profits, it is statistically correct, but of limited significance, to point out that 1947 profits of some $30,000,000,000 before taxes were higher than in any previous year, including 1929, the prewar years, or the previous record of 1944. Since 1929 population of the country has increased nearly 20 percent; many indices of prices are double prewar levels; and the employed civilian labor force has increased some 10 percent since 1943. The altered perspective which some of these changes give to the aggregate of corporate profits is given in table III.

The most obvious adjustment called for involves the changing monetary standard. Curiously enough the concept and reporting of "real profits" lags far behind the understanding and use of the "real wage" concept. This is partly because the choice of an index by which to measure changes in purchasing power

of the profit-dollar is still debated. On the theory that profits represent income to individuals, as owners of the corporation, the consumers' price index has been used in the table to estimate "real profits." This is the same index that is ordinarily used in calculating "real wages." Whether distributed in dividends or retained as additions to stockholders' equity, profits represent pay for the things which the people who receive them do for the corporation and for the economy. For these people the "cost of living" has risen as it has for other groups who furnish the limited resources employed in the productive process.

TABLE III.—*Corporate real profits after taxes, national and per capita totals adjusted for changes in buying power,*[1] *1929–47*

Year	Consumer's price index 1935–39=100	Corporate profits after taxes [2]		Per capita disposable personal income	Per capita corporate profits after taxes	Ratio profits to disposable personal income in 1935–39 dollars
		In current dollars	In 1935–39 dollars			
		Billions of dol.	*Billions of dol.*	*1935–39 dol.*	*1935–39 dol.*	*Percent*
1929	122.5	8.9	7.3	551	59	10.7
1930	119.4	5.8	4.9	503	39	7.7
1931	108.7	1.1	1.0	466	8	1.7
1932	97.6	−2.4	−2.4	392	−19	----------
1933	92.4	−2.5	2.7	391	−21	----------
1934	95.7	.4	.4	426	3	.7
1935	98.1	2.0	2.0	464	16	3.4
1936	99.1	3.5	3.5	520	27	5.1
1937	102.7	4.7	4.6	536	35	6.5
1938	100.8	3.3	3.3	500	25	5.0
1939	99.4	4.3	4.3	541	33	6.0
1940	100.2	6.3	6.3	574	48	8.3
1941	105.2	6.8	6.5	658	48	7.2
1942	116.5	8.1	6.9	741	51	6.8
1943	123.6	9.5	7.7	780	56	7.1
1944	125.5	10.5	8.3	840	61	7.2
1945	128.4	8.2	6.4	835	46	5.5
1946	139.4	7.8	5.6	808	40	4.9
1947	159.2	13.0	8.2	757	57	7.5

[1] Current dollars divided by consumer's price index 1935–39=100 to give a rough measure of changes in buying power.

[2] After elimination of Department of Commerce estimate of value of the change in volume of business inventories.

Source: Department of Commerce, Survey of Current Business, July 1947, Supplement July 1948, data reproduced in Midyear Economic Report of the President, July 1948.

Another view of profits is to treat them as a form of ultimate income when received by the corporation. If this view be followed, a different index may be chosen as evidence of the decline in purchasing power of the profit dollar. The precise index used is likely to make little difference, however, either in direction or order of magnitude. All price indexes have gone up—some more than others. In general, prices of things which corporations buy have gone up in recent years as much as or more than those which consumers buy. In December 1947 the Department of Labor consumers' price index stood at 167.0 on a prewar base. Selected price indexes constructed by the National Bureau of Economic Research on a similar base [1939=100] and covering items which corporations are likely to purchase were, in December 1947, as follows: [10]

Producer goods, raw	203.1
Producer goods, processed	158.6
Durable goods, producer	170.9
Goods destined for use in capital equipment	146.8
Building materials	186.5
Capital equipment and building materials	164.6
Producer fuels	165.6
Producer goods, raw—foods	229.3
Producer goods, raw—nonfoods	185.5

[10] Frederick C. Mills, the Structure of Postwar Prices, National Bureau of Economic Research Occasional Paper 27, July 1948.

Adjustment of corporate profits for changes in the consumers' price index, correct in theory, clearly does not overstate the impact of recent high prices on profit dollars, should one prefer as a matter of approach to think of the corporation rather than its owners.

The record 1947 profits of $13,000,000,000 (after taxes and elimination of the direct inventory aspects of the price changes) were barely equivalent in purchasing power to the other record year of 1944. In current dollars, aggregate profits were 25 percent higher but measured in constant dollars were substantially unchanged from that year. That profits were relatively high even in dollars of unchanging purchasing power is, of course, indisputable.

The still considerable variability of profit aggregates even with the variability of the monetary standard removed, is noteworthy. On the face of things, one might suppose that with the effect of the variable monetary factor removed profits would show appreciable stability. The data on profits in 1935–39 dollars in the accompanying table disclose, however, that between a given year and the succeeding one profits declined in 7 out of the 18 years; were either up or down by over 100 percent in 3 of the years; were either up or down by more than 20 percent in 12 of the years; and changed less than 10 percent from the preceding year in only 3 out of the 18 years. Year-to-year change in the absolute amount of profits are indeed abrupt and clearly subject to a variety of influences apart from simple price changes.

Since the growth in population is likewise a factor contributing to new economic records, profits after taxes and disposable income per capita are also given in table III. Per capita figures in general have little other meaning than that of removing the influence of the population growth factor. The per capita data in the table suggests, however, that had the record profits of 1947 been distributed uniformly among the population, per capita income would have been increased by about $90 in current dollars (or $57 in 1935–39 purchasing power). On a similar basis, a per capita contribution of about $20 each year would have been necessary to cover the corporate deficits in 1932 and 1933.

RATIO OF PROFITS TO NET WORTH

The rate of return on the stockholder's investment—the ratio of profits to net worth—is frequently used as a standard by which to measure differences in, and especially the reasonableness of, corporate profits. The two statistical series most often cited on the ratio, one governmental and one privately computed, are given in table IV. Though somewhat different lists of companies are used, each of the series is based upon the reported statements of over 1,000 leading manufacturing corporations. Considering some of the problems of computation, the data are in quite close agreement, both as to individual years and trend. Because the data cover a longer period and are more promptly available, reference is made particularly to the National City Bank compilations.

For companies included in the bank's data, 1947 income after taxes (but before inventory valuation adjustment) represented an average return of 17 percent on net worth. This compares with previous peak rates of 12.1 percent in 1946, 12.4 percent in 1941, and 12.8 percent in 1929.[11]

While these figures are ordinarily given as rate/percent, it is helpful to think of them as dollars return per $100 of net worth. In 1940 the "return" was thus $10.30 per $100 compared with an estimated $17 per $100 in 1947, representing an increase of 65 percent. During the same interval average hourly earnings in manufacture increased 85 percent; and wholesale prices of other than farm products, a rough measure of the things which corporations buy, increased 80 percent. What appears as a substantial increase from prewar average "rates of profit" on net worth is simply another manifestation of the change in value of the monetary standard reflected in every index where dollars are involved. Though depreciation of the dollar had gone on all through the war years the "wages" of net worth were actually falling in dollar terms from $12.40 per $100 in 1941 to $9.30 in 1945. The sizable increase in rates of return during 1946–47 did little more than help profits catch up in purchasing power.

[11] For 1946–47 detail by industrial groups see National City Bank Letter, April 1948, and table reprinted in Joint Economic Report, 1948, pp. 67–68.

TABLE IV.—*Net income after taxes, as a percent of net worth; average annual rate leading manufacturing corporations, 1925–47 (percent)*

Year	Registrants, Securities and Exchange Commission [1]	Corporations publishing financial statements [2]	Year	Registrants, Securities and Exchange Commission [1]	Corporations publishing financial statements [2]
1925		10.7	1937	11.1	10.8
1926		10.8	1938	5.1	4.8
1927		9.7	1939	8.3	8.5
1928		11.6	1940	10.1	10.3
1929		12.8	1941	12.0	12.4
1930		6.4	1942	9.6	10.1
1931		2.3	1943	9.7	9.9
1932		−.5	1944	10.1	9.8
1933		2.5	1945	9.6	9.3
1934		4.3	1946	11.8	12.1
1935		6.7	1947	(3)	17.0
1936	10.1	10.4			

[1] Securities and Exchange Commission: Survey of American Listed Corporations.
[2] National City Bank, 1925–46, inclusive; Economic Almanac for 1948, p. 133; 1947 data from bank letter, April 1948.
[3] Not available.

Viewed another way, the sharp increase in the rate of return in 1947 on top of an increase in 1946 fell somewhat short of restoring capital in the form of net worth to the relative earning capacity which it enjoyed in prewar years. At prevailing rates of profit, it took, in 1947, $16,440 of net worth to return an amount equivalent to the average annual earnings of a manufacturing employee compared to $12,050 in 1929 and $13,330 in 1941.

A special study of the rates of return has also been made by the Federal Trade Commission.[12] This careful study, intended primarily as a large-company, concentrated-industry survey, covers 508 identical manufacturing corporations, comparing rates of return after taxes in prewar 1940 and 1947, the last year for which statistics are available. For the particular group of companies as a whole the rate of return (after taxes) to stockholder's investment was 15.2 percent in 1947, compared with 9.8 percent in 1940.

While rates of return varied among the 25 industries covered by the study, the over-all results strikingly emphasize a not unexpected relationship. In 1940, when the rate of return was 9.8, the consumers' price index was 100; in 1947, when the rate of return had reached 15.2, the consumers' price index had reached 159. Translated into percentage changes this means that the dollar return on a given amount invested in net worth increased 55 percent between 1940 and 1947 while prices of consumers' goods increased 59 percent. Returns just about kept up with dollar depreciation that took place in the interval. Other measure of price changes such as wholesale, farm product, and raw material prices nearly doubled, or in many cases more than doubled between the same years.

At first blush the rate of return on stockholders equity does seem to offer a useful and proper index of profit levels. Despite its wide usage the rate of return on net worth is open to several serious, if not fatal, reservations as a significant measure of corporate profits.

(1) There is no objective standard or bench mark as to what a proper or fair rate of return on net worth is or ought to be. There are doubtless subjective standards in the minds of many which undertake to relate it to some accepted rate of interest; for example, to a conventional 6-percent standard. Economically and statistically a sharp distinction in thinking must be preserved between interest and profits. Measurement of profits by any interest-rate yardstick (as rate of return may suggest) is not only irrelevant but dangerous, for profits are uncertain, variable, and play an entirely different economic role. The ratio of profits to net worth may at times be useful in pointing out that profits were higher or lower in one year than in another, or appear to be higher or lower in one industry or company than in others. It is nevertheless true that, unless supplemented by predilections or interests, net-worth comparisons tell nothing as to whether profits are high or low in relation to other economic shares or in relation to normal.

[12] Federal Trade Commission, Report on Rates of Return (After Taxes) in Selected Industries, for the years 1940 and 1947, August 16, 1948.

(2) The net worth of a company is, of course, in no sense a measure of the total assets used in the business. As the combined total of carrying figures for capital stock and surplus it is dependent on the method of financing employed by a company. The larger the proportion of a company's total capital obtained through borrowing, the smaller the net worth and the higher a given profit will appear when stated as a rate of return on that net worth. Risks of trading on the equity are by the same token enhanced with the result that profits fluctuate more widely and are more likely to be converted at times into losses. Since methods of financing differ between industries and between firms, use of the net worth ratio for comparisons must be viewed cautiously.

(3) A further serious objection to the ratio of profits to net worth as a standard of reasonableness is that neither factor entering into the ratio is a precise, uniform, or certain quantity in itself. Some of the problems of profit determination have been discussed earlier. In periods of changing price levels the kind of dollars in which net worth is recorded invariably lags behind the dollars in which current profits tend to be expressed. Profits, the numerator of the ratio, tend to be written in current dollars while net worth, the denominator, is inevitably reckoned in dollars more or less historical.

A monograph of the Temporary National Economic Committee points out the general unreliability of rate of return as a measure of profitability. In the long run there is a tendency for asset values to follow earning power up and down; in the short run the significance of rate of return is nullified by the stickiness of the net-worth figure. Language of the monograph commenting on the character of book values of the equity is particularly applicable to the current inflationary period.

"Net worth, as recorded in corporate books, bears very little, if any, consistent relation, as one might expect, to cost, whether cost be defined as actual cost to the current owner, original cost, or replacement cost. In other words, net-worth figures taken from corporate books bear no consistent relation to what a corporation actually received from investors (including retained profits) or to what a predecessor company received from investors or to what a new corporation would have to receive to duplicate the existing corporation. In addition, the book values are based to an unknown extent upon money values set in exchanges between nonindependent bargaining agents.

"A book net worth figure is, by and large, what a corporation (or rather the particular individual or group of individuals controlling policy in this regard) finds it necessary, convenient, or desirable to have as a net-worth figure. While small deviations from the desirable figure may be tolerated, large ones usually are not. For this reason, surplus adjustments, reorganizations, intercorporate trading of assets leading to changed valuations, inconsistencies in classifying expenditures as capital or expense items, changes in depreciation charges, etc., are constantly occurring.

"* * * Furthermore, revaluations of major magnitude are generally not made in terms of the short-run environment of a corporation, but rather after a fairly long history of operations inconsistent with book values. Custom appears to endow figures once put on the books with a large amount of sanctity. Consequently, a backlog of contradictions between the entrenched book figures and the operating results must be built up before revaluations occur * * *.

"* * * Conditions conducive to revaluations in one direction must exist for a relatively long period before the cumulated revaluations begin to have a significant effect upon corporate profit rates. Sharp price changes, for example, would not lead to revaluations until after a new level had been maintained for some time or prices continued to move in the same direction as the original movement for some time." [13]

There has as yet been no such mass revaluation of corporate assets either during or since the war through the sale of assets or through the write-up procedure. The Federal Trade Commission reports that out of 508 cases studied, not more than 3 had made any adjustment for appreciation in the years 1940–47. This means that any statement of 1947 profits related to net worth is, generally speaking, a rate of return on prewar property values. Insofar as this is true, it means not only that depreciation allowances used in figuring profits are understated on the basis of reproduction cost, but that rate of return on net worth is overstated both absolutely and relatively.

The problem and its correlaries have been summarized elsewhere as follows:

[13] Investigation of Concentration of Economic Power, Monograph No. 12, Profits, Productive Activities, and New Investment, pp. 17 and 25.

"* * * Under ordinary conditions no objection need be made to the use of book values, but in a period when the price level has recently changed such computations are as misleading as wage comparisons would be if they were made without allowance for changes in the cost of living. A large fraction of present-day corporate assets were owned by the same corporations before the war, and are still valued at the prewar cost or other basis. Insofar as this is true, the real rate of return on reproduction cost is overstated by one-third to one-half. Moreover, the depreciation allowances used in figuring profits are largely based on these book values and consequently too low to provide for replacement. Thus the profits are overstated in absolute amount and still more in their ratio to net worth." [14]

PROFIT MARGIN ON SALES

Another yardstick often used in appraising the level of corporate earnings is the ratio which net profits bear to sales—the net profit margin. As a single measure, the profit-margin ratio is sometimes objected to on the ground that it tells nothing about total profits and may even be misleading. The contention is that even a small margin per dollar may yield exorbitant aggregates. On the other hand, the profit-to-sale ratio does have merit over the profits-to-net-worth ratio in that the two factors which it relates are much more nearly contemporary. The sluggish elements which go to make up accounting profits are, of course, the same in either case.

Average margins for all corporate industry, together with the portions of industry which the Department of Commerce classifies as "Manufacturing" and as "Wholesale and retail," are given in table V. Available data on margins for the groups of so-called leading companies referred to in the "Net worth" section of this report are also given in the table. Each of these latter series, it will be remembered, cover some 1,000 leading manufacturing companies.

TABLE V.—*Net profit margins, in cents per sales dollar, all corporations and leading manufacturing corporations, average annual rates, 1929–47*

Year	All corporations [1]			Leading manufacturing corporations	
	Total all industries	Manufacturing	Wholesale and retail trade	Registrants SEC [2]	Publishing financial statements [3]
1929	6.1	6.3	1.5	----	----
1930	2.1	2.2	−.2	----	----
1931	−1.4	−1.1	−1.6	----	----
1932	−4.9	−4.5	−3.3	----	----
1933	−.5	1.7	.03	----	0.9
1934	1.1	2.6	.89	----	3.1
1935	2.2	3.7	1.1	----	5.6
1936	3.6	5.2	1.6	9.2	7.6
1937	3.6	4.8	1.4	8.9	7.4
1938	2.1	2.3	.7	5.3	4.0
1939	4.1	5.1	1.5	7.7	6.5
1940	4.8	5.8	1.7	8.4	7.5
1941	5.3	6.2	2.2	7.3	6.5
1942	4.6	4.5	2.1	4.8	4.8
1943	4.4	3.9	2.2	3.9	3.6
1944	4.1	3.9	2.3	3.8	3.3
1945	3.7	3.2	2.3	4.2	3.9
1946	5.1	5.1	3.3	6.4	6.0
1947	5.7	6.2	2.8	(4)	7.1

[1] Computed from data, United States Department of Commerce, Survey of Current Business, July 1947 supplement, tables 19 and 29; id. July 1948.
[2] Securities and Exchange Commission, survey of American listed corporations.
[3] National City Bank letter, April 1948.
[4] Not available.

[14] Hardy, Charles O., Wages, Profits, and the American Standard of Living. The Chicago Association of Commerce and Industry, April 1947.

From the standpoint of the margins realized on sales, the increase in profits of all industries in 1947 over 1946 is not as striking as that suggested by the change in aggregate corporate profits. For the wholesale and retail portions of industry, sales margin was indeed lower in 1947 than in 1946, though it was higher than in the earlier years for which data are available. For manufacturing industry, the profit margin in cents per dollar in 1947 was the same as in 1941 and 1929. During the 10 years, 1938–47, which excludes the loss years of the early 1930's, the net margin of profit to all industry sales averaged about 4.4 cents per dollar compared with 5.7 in 1947.

In view of the rate of profit margin shown by the table for all company and for leading company groups, a recently reported survey of public beliefs in regard to profit levels is of incidental interest.[15] Conducted in 148 cities from coast to coast, the survey indicated that only one-fourth of the public believed that profits averaged under 10 cents on the dollar, as they have in year after year for which data are available. It is reported that 66 percent of those interviewed believed that profit margins were 10 cents and over, and that 29 percent believed them to be 30 cents and over per sales dollar. In response to a further question, 62 percent of those interviewed said that they thought companies should keep as a fair profit anywhere from 10 cents to 60 cents profit on every dollar of sales. Granted that many of the answers may have been given by persons unexperienced in business and percentage reckoning, the study does suggest a startling general misconception of the facts about corporate profits.

TABLE VI.—*Relation of corporate profits before and after taxes to national income, 1929–47*

[Amounts in billions of dollars]

Year	National income amount	Corporate profits			
		Before taxes		After taxes	
		Amount	Ratio to national income	Amount	Ratio to national income
1929	87.4	10.3	11.8	8.9	10.2
1930	75.0	6.6	8.8	5.8	7.7
1931	58.9	1.6	2.7	1.1	1.9
1932	41.7	−2.0	−4.8	−2.4	−5.8
1933	39.6	−2.0	−5.0	−2.5	−6.3
1934	48.6	1.1	2.3	.4	.8
1935	56.8	3.0	5.3	2.0	3.5
1936	64.7	4.9	7.6	3.5	5.4
1937	73.6	6.2	8.4	4.7	6.4
1938	67.4	4.3	6.4	3.3	4.9
1939	72.5	5.8	8.0	4.3	5.9
1940	81.3	9.2	11.3	6.3	7.7
1941	103.8	14.6	14.1	6.8	6.5
1942	136.5	19.8	14.5	8.1	5.9
1943	168.3	23.7	14.1	9.5	5.6
1944	182.4	24.0	13.2	10.5	5.7
1945	181.7	19.8	10.9	8.2	4.5
1946	179.3	16.8	9.4	7.8	4.4
1947	202.5	24.7	12.2	13.0	6.4

Source: Department of Commerce, Survey of Current Business, July 1947 supplement, July 1948, reproduced in Midyear Economic Report of the President, July 1948.

PROFITS IN RELATION TO THE NATIONAL INCOME

In the figures which the Department of Commerce reports for national income, corporate profits, like all other shares—salaries, wages, rentals, etc.—are included before deduction of income taxes. The relationship which profits as a distributive share bear to national income ought thus to be based on the amount of profits before deduction of taxes. Data on this relationship since 1929 are given in table VI. From the standpoint of the owners and managers of a corporation much greater significance attaches to the amount and the trend over the years of profits after corporate income-tax deduction. The percentage of what

[15] Psychological Corporation Survey, reported in Commercial and Financial Chronicle, July 8, 1948.

may be called disposable profits, that is, profits after taxes, to national income is accordingly also given, with the warning that the share-after-taxes thus computed is not directly comparable with other contemporary shares. This latter series of profits after taxes (shown in the right-hand column, table VI) is, of course, of the utmost significance in answer to the fears of some persons and the charge on the part of others that profits are taking an increasing slice of national income.

Both computations deal with profits after the inventory adjustment which the Department of Commerce introduces into national income figures to bring national income into line with national production. This adjustment eliminates from profits (and from national income) the value of the change in volume of business inventories.

Corporate profits after taxes were 6.4 percent of the national income in 1947 (table VI). In that year when profits were at record amounts in dollars, the proportion of national income going to profit was below that of 1929, 1930, and 1940, the same as in 1937 and 1941, and only fractionally greater than in 1939 or the three war years, 1942–44. Stated another way, profits for 1947, though high in absolute amounts, represented about the same or a lesser percentage of national income as they did in 9 out of the preceding 18 years.

In the years 1931–35 and 1938, generally conceded to have been poor years for nearly everyone, the percentage of national income going to profits was, it is true, significantly lower. With the exception of these generally bad years, profits on this basis were the lowest in 1946 of any year for which the Department of Commerce has published detailed national income figures. Myopically viewed from the relatively low base of 1946, the year 1947 did, indeed, show a significantly larger share of national income ascribable to profits. It is only fair to say that by this national income standard profits for 1947 were but little above the average of the preceding decade. The relation of profits to national income would not be fully appreciated or understood without special attention to the negative profits of the depression years. During 1932–33 corporations in the aggregate not only received no distributive share of the national income but paid out more than they took in.

CONCLUSION

Corporate profits during recent months as reported in dollars have been reaching new peaks only to surpass themselves in later reporting periods. This has been widely noted and commented on but like all peaks can only be comprehended when viewed in perspective and preferably from a sufficient distance. With proper weight given (1) to the rigidity of accounting conventions and (2) to the monetary aftermath of a war, which itself surpassed all records, examination of available data discloses that these record profit levels of the postwar period are far less conspicuous than they at first appear.

Concerning the reported aggregate corporate profits for 1947 of over $18,000,000,000 after taxes, three serious reservations are important.

1. Aggregates, essential as they may be to economic analysis, must not be allowed to obscure the fact that wide differences exist between industries and between individual firms.

2. Since accounting practices fail in periods of rising prices to provide for the maintenance of physical inventory and plant (without which there can be no economic income), profits for 1947 must be adjusted for the resulting overstatements. In the aggregate, these "phantom" profits are estimated at upward of $5,000,000,000 from the inventory valuation factor, and some $2,000,000,000 from deficiencies in the provision made for exhaustion of plant facilities.

3. While the concept of "real wages" is frequently used and generally understood, the parallel concept of "real profits" is rarely reported or used; the fact of course, is that profit dollars, like other dollars, during recent years have suffered greatly reduced purchasing power.

Two common indexes for the measurement of profits and profit levels relate them (*a*) to net worth, or (*b*) to the sales dollar. The ratio of profits to net worth is open to objection as a yardstick because:

1. There is no bench mark or scale as to what profit percentage is, or is not, fair and adequate.

2. The "net worth" of a company does not represent the total assets employed, but depends upon the method of financing.

3. One factor in the ratio (profits) is arrived at in more or less current dollars the other factor of the ratio (net worth) is inevitably historical.

When the ratio of profits to net worth is used, however, the data indicate that, while the over-all ratio increased between 1940 and 1947 by some 60 percent, prices in general were increasing by about the same percentage. If purchasing power of a dollar received as profit was not to decline out of proportion to income dollars received from other sources, such a rise in the rate of profit was necessary and expected.

From the standpoint of the second popular index—profit margin realized on sales—wholesale and retail portions of corporate industry reported lower profit results in 1947 than in 1946. For manufacturing industry the profit margin in cents per dollar in 1947 was the same as in 1941 and 1929.

Implicit in much of the discussion of current profit levels is a concern on the part of some that profits are taking an increasing slice of the national income. In 1947, when profits were at record amounts in dollars (after inventory adjustment), the proportion of national income going to profit was below that of 1929, 1930, and 1940; the same as in 1937 and 1941; and only fractionally greater than in 1939 or the three war years, 1942, 1943, and 1944.

Data on annual profits over a period of years emphasize the variability inherent in the residual, uncertain character of profits. The realization of profits is always in the future and uncertain when the decisions are made which result in ultimate gain or loss. Since it is the *prospect* of profit which "moves men's wills," levels of profit are significant principally for the influence they have upon business anticipations.

Dated: October 1948.

APPENDIX I

TABLE I.—*Total sales of meat-packing companies, 1929–47, reporting to the USDA under the Packers and Stockyards Act*

Year	4 largest companies		Other federally inspected slaughterers			Slaughterers not federally inspected			Total slaughterers	
	Sales [1]	Percent of total	Sales [1]	Percent of total	Number of companies	Sales [1]	Percent of total	Number of companies	Sales [1]	Number of companies
	Mil.dol.		*Mil.dol.*			*Mil.dol.*			*Mil.dol.*	
1929	2,559	66.5	1,000	26.0	211	289	7.5	372	3,848	587
1930	2,262	62.3	1,066	29.4	216	300	8.3	466	3,628	686
1931	1,739	62.8	796	28.7	213	235	8.5	453	2,770	670
1932	1,258	64.1	541	27.6	207	162	8.3	415	1,961	626
1933	1,200	64.3	501	26.8	202	167	8.9	423	1,868	629
1934	1,515	66.3	579	25.4	202	191	8.3	402	2,285	608
1935	1,853	66.5	688	24.7	197	244	8.8	413	2,785	614
1936	2,004	66.3	748	24.8	191	269	8.9	394	3,021	589
1937	2,148	65.1	831	25.2	184	318	9.7	397	3,297	585
1938	1,944	63.8	792	26.0	184	309	10.2	407	3,045	595
1939	1,920	62.4	808	26.3	192	347	11.3	425	3,075	621
1940	1,968	62.3	833	26.4	185	357	11.3	415	3,158	604
1941	2,547	62.6	1,061	26.1	177	458	11.3	442	4,066	623
1942	3,559	61.6	1,784	30.8	[2] 231	438	7.6	[2] 381	5,781	616
1943	3,838	62.1	1,973	31.9	[2] 244	370	6.0	[2] 393	6,181	641
1944	3,972	62.0	2,082	32.5	[2] 263	350	5.5	[2] 378	6,404	645
1945	3,308	57.6	2,055	35.8	[2] 268	381	6.6	[2] 376	5,744	648
1946	3,256	53.0	2,332	37.9	240	558	9.1	399	6,146	643
1947	5,475	58.0	3,203	33.9	230	761	8.1	446	9,439	680

[1] Includes nonmeat items, which have been a significant and expanding proportion of total sales for the larger companies.

[2] There was a marked increase in the number of plants operating under Federal inspection during the war years.

Source: Annual report of the Livestock Branch, U. S. Department of Agriculture, summarizing financial results of meat-packing companies, subject to the Packers and Stockyards Act, who conduct slaughtering operations.

TABLE II.—*Contract prices of cotton textile fabrics and yarns, 1946–48*

	October 1946 OPA controls	Highest price since OPA	Dec. 7, 1948
Print cloths—Class A:	*Cents per yard*	*Cents per yard*	*Cents per yard*
38½ inches—60 by 48—6.25	12.48	21.00	12¾–13
38½ inches—64 by 60—5.35	14.58	24.70	15½
39 inches—68 by 72—4.75	16.57	27.71	16⅞
39 inches—80 by 80—4.00	19.67	32.85	20 –20½
Carded broadcloths:			
36½ inches—80 by 60—4.85	15.60	26.43	16¾–17
37 inches—100 by 60—4.10	19.03	34.50	19¾
Narrow sheetings:			
40 inches—48 by 48—2.85	24.06	28.00	21¼
37 inches—48 by 48—4.00	17.49	22.25	17
36 inches—56 by 60—4.00	18.01	24.50	17
36 inches—40 by 40—6.15	11.72	17.00	11
Denim—28 inches 8 ounces, Sanforized	39.78	40.00	40
Chambray—3.60, Sanforized	26.56	32.00	29
Covert—3.60, Sanforized	27.72	33.25	30¼
Combed broadcloth: 37 inches—136 by 60—4.00–4.10	31.93	46.00	31
Combed lawn: 40 inches—76 by 72—9.00	21.01	38.82	23
Combed voile: 39 inches—60 by 52—9.00, S. T	17.03	32.93	19¾
	Cents per pound	*Cents per pound*	*Cents per pound*
Carded yarns:			
10/1 cones	64.49	67.00	55
30/1 cones	76.98	90.15	73 –74
20/2 warps	75.93	85.50	67 –69
30/2 warps	85.38	99.00	78 –80
Combed yarns:			
30/1 cones	85.06	102.00	83 –85
40/1 cones	95.08	130.00	98
30/2 warps	92.29	127.00	97½
40/2 warps	103.64	130.50	112

Source: The Cotton Textile Institute, Inc., New York, N. Y., submitted by Pacific Mills.