# CORPORATE PROFITS

## HEARINGS

BEFORE THE

## JOINT COMMITTEE ON THE ECONOMIC REPORT
## CONGRESS OF THE UNITED STATES

EIGHTIETH CONGRESS

SECOND SESSION

PURSUANT TO

**SEC. 5 (A) OF PUBLIC LAW 304**
**79TH CONGRESS**

DECEMBER 6, 7, 8, 9, 10, 15, 16, 17, 20, 21, 1948

Printed for the use of the Joint Committee on the Economic Report

UNITED STATES
GOVERNMENT PRINTING OFFICE
82989 WASHINGTON : 1949

## JOINT COMMITTEE ON THE ECONOMIC REPORT

CONTENTS

# CORPORATE PROFITS

MONDAY, DECEMBER 6, 1948

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to call, at 1:30 p. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders, chairman of the subcommittee, presiding.

Present: Senators Flanders (presiding) and O'Mahoney, and Representatives Patman and Huber.

Also present: Senator Ferguson.

Senator FLANDERS. The hearing will come to order.

I am going to read a very brief opening statement.

The legislation which established this joint committee gave it a primary duty of considering the periodical economic reports of the President to the Congress, and reporting to the Congress its analysis and recommendations of the Chief Executive's information and proposals.

In addition to that, the enabling legislation charges the committee with a general responsibility for recommendations and proposals relating to the maintenance of employment and production and the improvement of the standard of living in a free society.

In fulfillment of the above responsibilities, this subcommittee is set up to consider the size, source and disposition of current business profits.

The President's report has directed attention to these profits which are, in the aggregate, of unprecedented size. The reports to stockholders of individual companies, analyses and tabulations of financial journals, and other business literature, likewise emphasize the unprecedented volume of business profits.

The assumption is generally made by organized labor, many financial writers and the general public, that business profits are large enough to warrant the diversion of a considerable part of them into lower prices, higher wages, or both.

It is the problem of this hearing to give particular attention to these suggestions for a more general distribution of large current returns to business.

We also have the more specific task of analyzing the profit situation from the standpoint of the major economic problem of our time, which is to find some way to halt inflation that does not involve considerable unemployment. No way has yet been found to do this and inflation can be ended easily enough if we are not concerned with the amount of resulting unemployment, but we are concerned. It is hoped that these hearings will expose to clear view and rational consideration some of the elements of this unsolved problem.

The undertaking which we have started this afternoon has an even deeper significance. It may turn out that in a free society the means of halting inflation without unemployment lies, to a considerable degree, outside the activity of government. Quite possibly it depends on statesmanlike decisions by business organizations and by groups of wage earners.

It would help if we could lay here such a ground work of objective information as will help business and labor to come to such statesmanlike conclusions. It is assumed that such conclusions will not run contrary to the long-range interests of business, of labor, of the consumer, or of the general public, but might have a temporary unfavorable effect on the short-range interests concerned.

We are only just beginning to realize the heavy economic burden which is imposed on us by the need for protecting ourselves and the western world from the rolling tide of oriental despotism which is pouring out of Russia. This economic burden is becoming so great that it can only be met by a nation which is not only united in determination but one which is likewise united in the maintenance of the economic strength which alone will make that determination effective.

Senator O'MAHONEY. Senator, may I add that it seems to me to be clear that the objective stated in the last paragraph of the chairman's opening statement is by all odds the most important objective before the country. Essentially what we have got to determine—and by "we" I mean the Congress—is to what extent the government may continue to get the revenue which is necessary to enable it to stem this rolling tide of oriental despotism of which the chairman speaks.

In all of the discussions which I have seen with respect to corporate profits on the part of those who are the apologists for the corporations which are making these profits, I see very little reference to the fact that a substantial portion of these profits are due to the business which these great corporations are receiving from the Government of the United States. The Government has to buy steel for the Navy, for the Army, and to some extent perhaps for the Air Forces. It has to buy aluminum. It has to buy high-octane gasoline. And when we consider the cost of high-octane gasoline to the Government, that is to say, to the taxpayers, we must bear in mind not only the tremendous implications for good of the airlift into Berlin, but we have to bear in mind the huge profits which apparently are being made by the petroleum companies which furnish to the taxpayers of the United States the gasoline by which this great enterprise is carried on.

I hope that as this hearing progresses it will become clear that statesmanship in business as well as in government will recognize the fact that we cannot cut industry off from this great enterprise in which the whole people of the United States are engaged, and expect business to be permitted to earn huge profits, by whatever standard they may be measured, and to evade taxation by which alone the Government of the United States can pay for this struggle to win the peace.

If we do not do it by taxation, it will be necessary to do it by deficit financing, and I am sure that before this hearing is over we shall find some spokesmen for industry saying that industry should bear a large share of the burden so as to prevent the Government from the necessity of selling more bonds to win the peace.

Senator FLANDERS. Thank you, Senator.

Now, our procedure in the calling of witnesses will be to have first, as we do today, two men discussing the economic phases of the question of profits; and we expect to have tomorrow witnesses giving us an idea of some of the accounting problems involved. We will then have representatives of organized labor, who will give us their point of view so that we may the more intelligently question industry from that standpoint. And then the remaining time will be for the most part taken up with various industries in the public eye, various industries, many of whose profits have been under specific criticism. And we will have then a series of case histories rather than of theoretical considerations on which to base our judgment as the question is raised.

We start in today with economists, and the first one is no stranger to those who have attended hearings for some years past here in the city of Washington, and before the House and the Senate, and I will ask Prof. Sumner Slichter of Harvard University to take the stand.

## STATEMENT OF PROF. SUMNER H. SLICHTER, LAMONT UNIVERSITY PROFESSOR, HARVARD UNIVERSITY

Senator FLANDERS. You may read your statement complete if you wish, or if you wish to shorten your manuscript at any time, you may do so, Professor Slichter.

Professor SLICHTER. Thank you.

During the last 3 years American corporations have overstated their profits by about $16,400,000,000. 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 12.0 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. Would it bother you if I interrupted you there, Professor?

Professor SLICHTER. Go right ahead.

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?

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 $14,900,000,000. 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 $16,000,000,000, but that reported profits will be between $20,000,000,000 and $21,000,000,000—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 $16,000,000,000 in comparison with $6,300,000,000. 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 pay stiff taxes on the amounts so reported.

In the year 1946, profits were overstated by $5,000,000,000 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 $5,100,000,000. For this reason, in the first two quarters of 1948, the overstatement has been running at the rate of about $3,900,000,000. For the year as a whole, because the corporations have counted the rise in the cost of replacing inventories as profits, the overstatement will be about $3,000,000,000.

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 than 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 prices 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, 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 distribution 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.

Corporate profits are also overstated, because the rise in the cost of replacing plant and equipment is treated as profit. 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.

Representative PATMAN. May I ask you a question there?

I do not understand about this 5-billion-dollar overpayment in taxes. Does that mean that the income was $5,000,000,000 that they paid taxes on and that they should not have paid taxes on?

Professor SLICHTER. They had their option; they elected to pay their taxes.

Representative PATMAN. What was the other option, the alternative?

Professor SLICHTER. They could have used the last-in and first-out method of computing inventory costs.

Representative PATMAN. Is this not a great indictment against the inefficiency of these officials?

Professor SLICHTER. You may interpret it as you see fit. I do not think that they keep their books in a very proper fashion. I think that they mislead their stockholders, their employees, and their customers, by overstating their profits.

Representative PATMAN. I thought that they had the best accountants and lawyers in the country. I cannot understand why they would let $5,000,000,000 slip through their fingers.

Professor SLICHTER. I cannot, either.

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; therefore, there has been only a moderate rise in output per man-hour. Certainly it is conservative to assume that the whole sale-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 dollars in 1946 and 4.6 billion dollars, as they were, in 1947.[1]

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 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.

Senator O'MAHONEY. Do you have any evidence that any corporations made this correction which should have been made?

Professor SLICHTER. Some of them are setting aside special reserves, and I think all of them should.

Senator O'MAHONEY. Can you give me any names?

Senator FLANDERS. The United States Steel Corp.

[1] Depreciation charges in American industry have been as follows:

| Year | Total business depreciation (billions) | Corporate depreciation (billions) |
|---|---|---|
| 1940 | $7.2 | $3.5 |
| 1945 | 10.7 | 5.9 |
| 1946 | 9.3 | 4.3 |
| 1947 | 10.3 | 4.6 |

Professor SLICHTER. I think the Du Pont corporation set aside reserves for excessive production cost, and I do not know the nature of those; but I think it will be in point.

Senator FLANDERS. I think that we will find that United States Steel set aside special reserves for depreciation, and we can inquire of them when they come forward.

Senator O'MAHONEY. May I interrupt there, in view of what the chairman has said? My purpose was to determine to what extent the witness has studied this overstatement of profit by the corporations, and if he knows which ones have done it and if he is willing or able to give us the names of the corporations which have done it.

Professor SLICHTER. I am afraid that I cannot give you a very long list on that, because I do not think that there are many. There are a few.

The present low depreciation charges of American corporations may be defended on the ground that increases in these charges to take account of the permanently higher costs of replacing plant and equipment are not an allowable cost for income-tax purposes. This defense may be a just criticism of present corporate-tax law, but it does not justify managements in counting increases in replacement costs as profits and thus in overstating the amount of income available to pay dividends, to increase plant, to raise wages, or to reduce prices. Some companies, rather than increase depreciation allowances, may prefer to set up special reserves to meet the rise of recent years in the cost of construction and equipment. A few companies have set aside such reserves, but the number appears to be small.

A correct statement of the profits of industry reveals important differences from the reported profits. In the first place, it reveals that real profits in 1946, the year of transition from war production, the year when millions of veterans were being absorbed into industry, and the worst year for strikes in the country's history, was not in reality a very profitable year. Actual profits were less than in 1945 and were scarcely any greater than in 1940, when the dollar volume of business was little more than half as large. In the second place, the corrected profit figures show that the increase in operating efficiency in the last 2 years has been considerably greater than is indicated by reported profits. This is particularly true of comparisons between 1947 and 1948. The reported figures on profits show little rise between 1947 and 1948. They seem to indicate that industry has thus far obtained little benefit from its large expenditures on plant and equipment in 1946 and in 1947. The corrected figures, however, show a large gain in profits between 1947 and 1948, indicating that the expenditures of last year and the year before on new equipment and plant are paying off. In the third place, the corrected figures on profits show that, even in 1948, real profits are substantially below the reported ones. In the fourth place, the corrected profit figures show that boards of directors have been wise in not raising dividends any faster. The corrected figures show that a high fraction of real profits was paid out in dividends—over 86 percent in 1946, 57.5 percent in 1947, and 40 percent in the first half of 1948. The usual year-end dividends this year are likely to raise total dividends up to half of real profits.

Why have American corporations so generally overstated their profits during the last few years? The principal reason probably is that accounting is a conservative and conventional art, and accountants are slow to adapt their methods to new conditions and new problems. Accountants are not used to taking account of permanent changes in the price level. An additional and important reason is the fact that business managements take a pardonable pride in showing large earnings. Especially when earnings in general are rising, no management likes to show less favorable results than other managements. Consequently, there is a strong temptation during periods of expansion for managements to overstate profits. Never has this been done, however, on a scale approaching that of the last 3 years.

Are profits excessive? Various yardsticks are used in an attempt to determine whether or not profits are excessive. One yardstick is the percentage of profits to sales; a second is the percentage of profits to the national income or to the gross national product; a third is the percentage of profits to owners' equity; a fourth is the percentage of profits to the original equity investment in the enterprise; a fifth is the percentage of profits to the cost of replacing the present capacity of the enterprise. None of these yardsticks is entirely satisfactory. In fact, most of them have little bearing on the crucial issue. Let us, however, briefly review the logic of these yardsticks and the present facts.

(*a*) Ratio of profits to corporate sales: It is reasonable to expect corporate profits to fluctuate more or less with the volume of corporate sales. For example, if there is a big drop in corporate sales, one would expect the total volume of profits to fall. The volume of profits can hardly be expected to fall with a drop in business unless it rises with an increase in business. Profits are a residual income—that is, they begin to accrue only after certain fixed expenses have been met. Consequently, one would expect the fluctuations in profits to be wider than the money fluctuations in volume of business—that is, one would expect profits to fall faster than sales during periods of contraction and to rise faster during periods of expansion. As a matter of fact, this is what usually happens. Indeed, during periods of contraction, profits often fall so fast that they disappear altogether. In periods of expansion, profits usually rise faster than the volume of business.

The present period of expansion is different from most preceding ones in that reported profits have risen only slightly faster than the volume of corporate sales, and correctly stated profits have risen only about as fast as the volume of sales. In 1940, reported profits were 4.7 percent of sales; in 1946, 5.1 percent; in 1947, 5.7 percent; and in the first half of 1948, 5.8 percent. Correct profits in 1940 were 4.7 percent of corporate sales; in 1946, 2.6 percent; in 1947, 3.8 percent; and in the first half of 1948, 4.4 percent.

Senator O'MAHONEY. Do I understand you, Professor, to say that according to your standard of measuring corporate profits there, the corporate profits in the first half of 1948 were 5 percent of corporate sales; whereas in 1940, reported profits were only 4.7 percent of corporate sales, which is the same figure that you apparently give for the corrected figure?

Professor SLICHTER. Reported profits for the first half of 1948 were 5.8 percent of corporate sales; corrected profits were 4.7 percent of sales.

Senator O'MAHONEY. So that the profits in 1948, according to your statement, are greater than they were in 1940 according to either the old standard or your standard.

Professor SLICHTER. Corrected corporate profits in the first half of 1948 were 4.4 percent of corporate sales in comparison with 4.7 percent in 1940.

The ratio of corporate profits to sales sheds no light on the question as to whether or not profits are "inadequate" or "excessive." The answer to this question depends upon how fast the community wishes industry to expand. If profits are causing industry to expand faster than the community would like to have it expand, they are excessive. If profits fail to bring about as rapid an expansion of productive capacity as the community would like to have, profits are inadequate.

(*b*) Ratio of profits to the gross national product: Since profits accrue only after certain fixed costs have been met, during periods of contraction they tend to drop faster than the gross national product and during periods of expansion to rise faster than the gross national product. The recent period of expansion, however, is unusual in that the ratio of reported profits to the gross national product has increased only moderately and the ratio of correct profits to the gross national product has scarcely increased at all. In fact, it is a little less than it was in 1940. In 1940, reported profits were 6.4 percent of the gross national product; in 1946, 6.1 percent; in 1947, 7.8 percent; and in the first half of 1948, 8.2 percent. In 1940, correct profits were 6.4 percent of the gross national product; in 1946, 3.1 percent; in 1947, 5.2 percent; and in the first half of 1948, 6.1 percent.

The ratio of profits to the gross national product has no bearing on the adequacy or inadequacy of profits because it does not show whether or not profits are bringing about the rate of industrial expansion desired by the community.

(*c*) Ratio of profits to owners' equity. One of the most widely used and most misleading measures of profits is the ratio of profits to owners' equity. It is difficult to see why this measure of profits is ever used. Owners' equity is only loosely related to the original equity investment. It is diminished by losses and by mark-downs and write-offs which represent recognition by management that investment mistakes have been made.

Between 1930 and 1933, losses and mark-downs reduced the net worth of American corporations by about $32 billion, or nearly one-fifth. A corporation may show a high return on the owners' equity for the simple reason that the concern lost money heavily for a number of years and the owners' equity in consequence has been greatly reduced. The recipients of this high rate of return on owners' equity would certainly not regard themselves as fortunate. The high rate of return would not measure business success so much as it would measure business failure. Furthermore, the return on owners' equity gives no indication as to whether or not profits are bringing about as fast an expansion of industrial capacity as the community needs or desires.

(*d*) Ratio of profits to original cost of the equity investment in business corporations. Original equity investment includes not only the investment made when the enterprise was established, but new investment from plowed-back earnings and proceeds of new security issues. This measure is superior to owners' equity because it is not distorted by business losses or write-downs. Nevertheless, it has no bearing on the adequacy of profits. The original cost of present plant and equipment may be far above or below present costs of plant and equipment. It is present costs of construction and equipment, not costs 20 or 30 years ago, which determine the profits necessary to attract new capital into industry.

(*e*) Replacement cost of plant and equipment: This measure of profits is superior to any of the others because it is based upon present costs of construction and equipment and, therefore, represents the rate of return which might be expected on new plant and equipment put into use today. By replacement cost, or course, is not meant the cost of replacing identical plant and equipment, but the cost of providing an equivalent amount of modern productive capacity. Allowance must, of course, be made for the fact that modern machines and equipment may require less labor to operate than older equipment. These considerations complicate the problem of measurement, but do not affect the essential principle. The principle is that prospective profits must induce the investment of capital at the present cost of construction and at the present prices of equipment. Hence, the comparison which comes closest to determining whether profits are inadequate or excessive is the return which profits yield on plants built at present costs of construction and present prices of equipment.

Senator O'MAHONEY. Do you state that as a hard and fast rule?

Professor SLICHTER. I think so. Why not?

Senator O'MAHONEY. Well, what I am thinking of is that the cost of replacement, to make it specific, may vary; it may vary up or it may vary down.

Professor SLICHTER. That is right.

Senator O'MAHONEY. If we do not take steps——

Professor SLICHTER. It is a poor rule which doesn't work both ways.

Senator O'MAHONEY. If we do not take steps to prevent inflation, replacement costs will probably go higher and higher. If steps are taken to prevent inflation, then perhaps replacement costs will go down or remain stationary.

Now, is it your contention that the Congress should view this subject of replacement costs solely upon the basis of the present inflationary price level?

Professor SLICHTER. I think that anyone, whether Congress or anyone else, has got to judge for himself whether or not he considers the long-run movement of prices most likely to be upward or downward. Over the last several hundred years, of course, the movement of prices has been upward. That may not be true of the next century.

I happen to think that the conditions making for an upward movement of prices are stronger today than they have been in the past. That is a long story, and while I should be glad to discuss it, I would prefer not to interrupt this particular discussion by it.

Senator O'MAHONEY. Of course not.

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 determine 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 in 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.

Another way of measuring the adequacy of profits is by making a direct analysis of the need of the community for more productive capacity. At the present time there is no doubt that the needs of industry for more capacity are very large. There are four principal reasons for this:

(*a*) During most of the last 20 years there has been an abnormally slow increase in the quantity of plant and equipment per worker. One reason has been the severe depression. During most of the depression, capital was not replaced as rapidly as it was being worn out. Another reason was the war, which also limited the rate at which capital could be replaced in most industries. During the 20 years 1909 to 1929, the increase in real estate improvements and capital per worker, expressed in dollars of constant purchasing power, was 21.9 percent.[1] During the last 18 years, the 18 years ending in 1947, plant and equipment per worker, expressed in dollars of constant purchasing power, was 9.1 percent less than at the end of 1929.

---

[1] This estimate is based upon figures of Kuznets in his *National Products Since 1869*, p. 228. Real-estate improvements and equipment, expressed in 1929 prices, were 109.1 billion dollars in 1909 and 175.2 billion dollars in 1929. During the same period the labor force increased from about 36.7 million to 48.2 million. Real-estate improvements and equipment per worker increased from $2,980 per worker in 1909 to $3,634 per worker in 1929.

(*b*) The need of industry for plant and equipment has been accentuated by the rapid increase in the labor force. The great demand for goods which has followed the war has caused the labor force to increase more rapidly than was expected. At the present time the labor force is as large as the census predicted that it would be in 1950. In order to permit the same increase in plant and equipment per worker during the 20-year period 1929 to 1949 as occurred in the preceding 20-year period, the plant and equipment of industry would need to be increased, at present prices, about $70,000,000,000.

Senator FLANDERS. And yet, Professor Slichter, this increased labor force does find enough plant and equipment ready to be completely employed.

Professor SLICHTER. That is true, and the reason is that there are more machines in place than there were in 1929, for example, or in 1940. But those machines represent less unused producing capacity. For example, we have today more automobiles on the road than ever before, but our actual supply of unused automobiles is considerably less than normal, because there are a great many cars on the road with a short life remaining. The average age of automobiles on the road is now up to about 8½ years, and the same thing has happened to the plant and equipment of industry. The machines are there, but many of them are high-cost machines; but it has been possible for industry to employ, I think, more people than most economists or businessmen would have guessed.

Senator FLANDERS. You think that they are, to a considerable measure, using machinery which should be obsoleted?

Professor SLICHTER. That is right.

(*c*) The rise of powerful labor unions means that the wage demands of organized labor will be greater than ever. These demands cannot be met without a rise in prices unless output per man-hour increases substantially as fast as wages. In the past, output per man-hour has increased a little less than 2 percent a year. It is unlikely that unions will be content with putting up money wages as little as 2 percent a year. In the 12 months October 1945 to October 1946, hourly earnings in manufacturing rose 14.3 percent; in the next 12 months 11.3 percent; and, in the next 12 months, 8.4 percent. If unions makes as stiff wage demands as they have been making during the last 3 years, productivity will have to rise about four times as fast as it has risen in the past in order to avoid a steady rise in prices.

Senator O'MAHONEY. How fast has it risen in the past?

Professor SLICHTER. It has risen about 2 percent a year.

Bear in mind that a price rise of only 2 percent a year would reduce the purchasing power of a life-insurance policy or of pensions or of Government bonds nearly one-half every generation and by considerably more than one-half during the span of an ordinary working life. The stiffer the wage demands of labor, therefore, the more rapid must be the increase in the productivity of industry. The increase in productivity requires more and better capital per worker. Hence, the stiffer the wage demands of unions, the greater become the capital needs of industry.

Senator O'MAHONEY. Have you made any computation of the output per unit of industry? I know this computation is on output per man-hour. Now, hours are reduced and productivity has very much increased, and it is my recollection that productivity per unit of industry has increased far more than the figures that you give here.

Professor SLICHTER. I am afraid the reverse is true, Senator. The capital per worker has also been going up around 2 percent a year. For example, between 1880 and 1940, capital per worker trebled; and naturally that is expressed in dollars of constant purchasing power. And so it follows that the increase in productivity per unit of capital was far less than the increase in productivity per unit of labor.

Senator O'MAHONEY. Are you contending that a disproportionate increase of compensation to the worker has been granted or has been gained, as compared with the increase of profit to capital?

Professor SLICHTER. No; I am not saying anything about the way in which income is distributed. I am simply saying that if we are to satisfy the greater demands of labor—and I think with an organized labor movement those demands are inevitable—industry must do a better job of raising output per man-hour than it has done up to now. And in order to do a better job, it must increase its capital per worker fully as rapidly as in the past, and probably more rapidly.

Senator O'MAHONEY. You are not contending, then, that wages have been increased disproportionately?

Professor SLICHTER. I am not saying anything about that one way or the other. Labor has done very well. I do not think that this is relevant to my point, but since you raise the question I am glad to comment on it.

Although capital per worker trebled between 1880 and 1940, the share of property in the national income went down between those years. I do not think that there is any complaint about that. That is the way it worked out in the markets.

Senator O'MAHONEY. Of course, we are holding this hearing under the so-called employment bill, and it seems to me that anything pertaining to that is important.

Professor SLICHTER. Practically all of the gains of technological progress in the last hundred years—and this also is irrelevant, but you have raised the question and I am glad to comment on it—but practically all of the gains of technological progress in the last 100 years have gone to people in their capacity as employees rather than to people in their capacity as consumers. You might have expected, in the 100 years between 1840 and 1940, with an increase of about sixfold in output per man-hour, you might have expected that the price level would go down in proportion, and the price level in 1940 would be no more than one-sixth as high as the price level in 1840. Well, the price level did not do that. The price level was just about the same in 1940 as it was in 1840. The index of prices in 1940 was about 10 percent above 1840.

I think there is an upward bias in that index, and I think the real price level was somewhat less, maybe 15 or 20 percent less. But that is the way the economy works. I am not saying that it is good or bad, but it is a fact that the gains of technological progress have gone to people as employees rather than as consumers.

Senator O'MAHONEY. What we are agreeing upon, I think, is that the workers, who constitute by far the greater proportion of the people, are receiving a larger share of the social product than are the holders of capital.

Professor SLICHTER. Yes. Their share, if you include all nonproperty forms of income, their share has gone up only moderately. But the striking fact is, and I do not think anyone would have predicted this, say, in 1860 or 1870—if you had said to an economist then, "What will be the share of capital, of property, in the national income, if in the next two generations capital per worker trebles?" I think the judgment of most economists back in 1870 or 1880 would have been, "Well, if capital is going to treble per worker, the share of the national income going to capital will probably go up." Well, it did not change very much, but the change was downward.

To get back to this analysis of capital needs, upon the rapidly growing private demand for goods is being superimposed a large and growing public demand for goods. To begin with, cities, counties, and States have huge accumulated needs for public works because they were forced during the war to curtail construction activities. In some parts of the country these needs have been greatly accentuated by large shifts of population. The steady increase in the number of automobiles and trucks is making the roads of the country obsolete. I do not think an 18-foot, two-lane highway is a modern highway for most parts of the country any more. Plans for public housing, for large irrigation works and public power projects, for a much larger postwar Military Establishment than anyone dreamed would be necessary, and international policies which the country has been compelled to develop, all of these require industry to furnish large quantities of goods and increase the need of industry for productive capacity. It is a striking fact that all of these demands for goods by the Government, especially the demands for the military and for foreign policy, run to far larger figures than anyone would have dreamed even as late as 1945. The fraction of the gross national product taken by the Government is rising, and will probably continue to rise. In 1929, it was 8.2 percent; in 1947, it was 12.1 percent; and in the third quarter of 1948, it was 14.7 percent.

Now, American industry can meet the huge demands which are being made on it provided the managers of industry raise their sights and provided the Government is willing to encourage industry to increase its capacity. I do not believe that the American people are willing to permit large quantities of goods to be diverted into increased armaments and into help for other countries if this diversion means either a drop in the American standard of living or a serious impediment to the rise in the American standard of living. Hence, new great demands of the Government for goods mean that the output of industry needs to grow faster than ever and that industry needs more than ever to increase and to improve its plant and equipment.

Have the present and recent prospects for profits been sufficiently favorable to permit industry to increase its plant and equipment at a reasonable rate? I think that the answer to this question is "Yes." Corporations which wished to expand their capacity have had to compete with a large number of demands for capital goods—there has been an enormous demand for capital goods because ordinary replacements were not made during the depression and the war. Expansion has had to compete with replacement there. There has been an enormous demand for capital goods by farmers and unincorporated enterprises and a large demand for goods for housing construction. There has been a great demand for goods by State and local governments and the National Government. The budget of the Federal Government has been running about 75 percent above the usual wartime estimates of postwar budgets. The great demand for durable consumer goods, such as automobiles, has limited the supply of steel for capital goods and has thus limited the output of capital goods. I do not know what share of the output of capital goods has gone into expanding the capacity of corporations or whether corporations have had enough money to obtain their share of the output of the capital-goods industries. I suspect that they have obtained their share but I cannot prove it. 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.

Senator O'MAHONEY. Have you seen any figures on the total investment in plant expansion since the end of the shooting? That is to say, in the conversion period?

Professor SLICHTER. Yes, I have.

Senator O'MAHONEY. What does it amount to?

Professor SLICHTER. I cannot give them to you offhand, but I have used them to compute these percentages; and it seems to me the more relevant figure, Senator, was the proportion of the total output going into those uses, and the proportion has been high, particularly in the first half of this year, up to 10 percent.

The plant and equipment figures are gross figures, and one needs to convert them into a net figure by eliminating the replacements, subtracting the capital consumption.

The figures were used in computing the percentages which I have just read you. The absolute figures in and of themselves would not be too instructive. The essential question is whether it is a large fraction of the net national product going into these uses; and the answer is that the fraction going into them is large by past standards. That is about all you can expect, because you must remember that the capital goods industries have only limited capacity to turn out capital goods, and the demand for replacements has been very large up to now. There has been a competition between the man who wanted to replace old machines and the man who wished to expand his plant or build a new plant.

Senator O'MAHONEY. A few moments ago, as I recall it, you testified that in your opinion about $70,000,000,000 ought to be added to increased capacity.

Professor SLICHTER. That is right.

Senator O'MAHONEY. It was not clear, from what you said, on what base or to what base you would add the $70,000,000,000 and therefore I was curious to know the figure which is actually——

Professor SLICHTER. That is a good question. Roughly, that is about 3 years' output at 1948 rates. I am not speaking of the gross figures for 1948, but the net domestic private investment for 1948. Roughly, it is about 3 years at the 1948 rate.

How has the expansion of industry been financed during the last several years? When one looks at the sources of the money which has paid for the recent expansion of industry, one has misgivings as to whether the prospect for profits in American industry is sufficiently bright. Three things stand out conspicuously: (1) Corporations have had only indifferent success in raising money from the outside and have had to rely to an abnormal extent upon plowing back profits; (2) the money raised from the outside has come mainly from the sale of bonds and notes rather than from the sale of equity securities; (3) the money from the outside has come in the main from institutional buyers rather than from individuals. Investments in American corporate industry seems to have very little attraction for the American public.

Let us look into these matters more closely. As a background for analyzing the recent sources of investment funds, I would like to direct your attention to an earlier period, 1910 to 1929, because this earlier period will show that present tendencies may be different in degree, but are not different in kind. In other words, the problem with which we are confronted is not an entirely new problem, although in degree it probably is.

(*a*) Between 1910 and 1929, therefore, the largest single source of investment funds was retained earnings. During 20 years, 1909 to 1929, retained earnings were 37.3 billion dollars, issues of stock 21.3 billion dollars, and bonds and notes 27.1 billion dollars.[1] This means that outside funds fell far short of meeting the capital needs of industry.

(*b*) Issues of stocks and bonds together were more important than retained earnings.

Senator FLANDERS. How does that measure with the present?

Professor SLICHTER. I will come to that in just a moment, if I may.

Senator FLANDERS. All right.

Professor SLICHTER. (*c*) Issues of bonds and notes were considerably more important than stocks—27.1 billion dollars between 1910 and 1929 in comparison with 21.3 billion dollars for stocks.

(*d*) Slightly more than half of profits were kept in the business. Between 1910 and 1929, retained earnings were 51.8 billion dollars, or 52.3 percent of total profits of 99.1 billion dollars.[2]

The 2½ years, 1946, 1947, and the first half of 1948, offer several important contrasts with the past.

(*a*) Retained earnings have been more important in relation to new issues of stocks and bonds as a source of new money than in the past. In other words, outside funds have been less adequate than ever. In this 2½-year period, corporations retained 34.9 billion dollars of reported profits and raised 11.2 billion dollars by the issue of new securities. But since the reported profits greatly overstate real profits, only part of the retained profits can be regarded as available for increasing the capacity of business concerns. This part was 10.1 billion dollars for the years 1946, 1947, and the first half of 1948. Although corporations raised 11.2 billion dollars of new capital by public issues,

[1] Slichter, S. H., Enterprise in Postwar America, p. 8, and TNEC, Profits, Productive Activities, and New Investments, Monograph No. 12, p. 45. The issues of stocks and bonds are exclusive of refunding issues.

[2] TNEC, Profits, Productive Activities, and new Investment, Monograph No. 12, p. 45.

retained earnings out of corrected profits were somewhat larger in relation to proceeds from new issues than in the period 1910 to 1929.

Senator O'MAHONEY. How much was distributed in dividends in the same period?

Professor SLICHTER. I think that I have that figure—15.9 billion dollars, in 1946, 1947, and the first half of 1948.

Senator O'MAHONEY. That makes a total of 50.8 billion dollars of profits, reported profits, retained and distributed?

Professor SLICHTER. That is right.

Now, you will note that retained earnings properly stated, although the largest single source of funds, were slightly less than money coming in from the outside.

(*b*) Issues of bonds and notes were considerably more important in relation to issues of stocks than between 1910 and 1929. In fact, stock issues represented only 30 percent of all domestic private issues exclusive of refunding issues in 1946, 1947, and the first half of 1948.

(*c*) There has been a tendency for the relative importance of stock issues to decline. They were less in absolute volume in 1947 than in 1946, alhough bond issues went up from 2.1 billion to 3.5 billion dollars. In the first half of 1948, stock issues were only 20.5 percent of private domestic issues exclusive of refunding issues. Last year they were about one-fourth.

(*d*) A negligible amount of outside money has been raised by corporations during the last several years by the direct sale of securities to individuals. In 1946, 1947, and the first half of 1948 individuals increased their net investment in corporate securities by only 2.5 billion dollars. This is only 22.2 percent of the private domestic security issues, exclusive of refunding issues, during this period.

(*e*) The failure of individuals to invest in the securities of corporations was not due to a lack of individual savings. Total liquid savings of individuals during 1946, 1947, and the first half of 1948 were 23.0 billion dollars, or more than nine times the amount which individuals put into corporate securities. Even when one deducts the large amounts which individuals put into Government and private insurance, which was 17.2 billion dollars during this period, individuals put less than half the residue of their liquid savings into corporate securities.

Total personal savings of individuals were, of course, larger than liquid savings—25.9 billion dollars for 1946, 1947, and the first half of 1948. Less than one-tenth of all personal savings went into corporate securities and less than one-third of all personal savings exclusive of the part devoted to insurance.

The most important questions which emerge from this analysis of recent profit experience is: How can American corporations induce individuals to buy large amounts of corporate securities and in particular how can corporations induce individuals to buy larger quantities of equity securities?

A widely offered suggestion is that corporations pay out a larger proportion of their profits as dividends. This suggestion comes in the main, I think, from persons who are misled by the profit reports of corporations. As I pointed out, the proportion of actual profits paid out in dividends has been fairly high—86 percent in 1946, 67.5 percent in 1947, and about 40 percent in the first half of 1948. As I have indicated, year-end dividend declarations in 1948 will undoubtedly raise corporate dividends to half or more of corrected profits.

A larger disbursement of corporate profits would not in my judgment, materially assist corporations in selling stock. In the first place, one must take account that corporations for the last six or more months have been under a special disadvantage in selling stock, because of the deterioration of the country's international relations and because of the widespread belief that there would be an early recession. In the fall of 1947, 75 out of 100 economists polled by the F. W. Dodge Corp. predicted a recession in 1948—most of them in the early spring. In the spring of 1948, the preponderant view of 100 economists polled by Montgomery Ward & Co. was that there would be a recession in the fall of 1948. More recently a second poll by the F. W. Dodge Corp. has produced the forecast for a recession sometime in 1949.

In the second place, even if these special conditions did not temporarily interfere with the sale of stock, I do not think that higher dividends in themselves would be particularly effective in making stock more salable. Most people have enough common sense to know that the value of a security depends in the main upon its future earnings—not the present rate of dividends. Higher dividends would not cause people to make materially more optimistic judgments of the future earnings.

The people who would be most affected by higher dividends are people in the middle- and upper-income groups. These people pay high personal-income taxes. Hence a large part of any increase in dividends would go to the Government in the form of higher taxes rather than to the stcokholders in the form of larger disposable income. Under these conditions a higher dividend rate has little effectiveness in inducing persons in the middle- or higher-income brackets to buy securities.

If the corporations of the United States wish to sell securities in large quantities to individuals, they will probably have to develop a market for them among persons whose incomes are low enough so that the income tax does not rob the security of a large fraction of its return. For the time being the corporations must plan to raise capital in the main by the sale of bonds and by plowing back earnings. The faster that they go into debt, in other words, the larger should be the proportion of earnings plowed back.

The willingness of corporate managements to plow back a substantial proportion of profits has had great advantages for the country. In the first place, it has enabled industry to make large expenditures on much needed increases in capacity, despite the inadequate supply of outside funds. In the second place, it has limited the extent to which industry has financed capital expenditures by methods which have brought about an expansion of credit, such as borrowing from commercial banks or insurance companies. The inflationary effect of larger dividend payments has frequently been overlooked. Larger dividend payments while not quite as inflationary as higher wage payments are almost so. Larger dividend payments would have meant that stockholders would have received some increase in income after taxes. Most of this increase would have been spent for consumer goods; since industry has been operating at capacity, the increase in the output of consumer goods would not have been large, and it would have been accomplished at the expense of output of capital goods. The prices of consumer goods would have been bid up still higher. Corporations would have been compelled to finance capital expenditures to a greater extent by borrowing, either from commercial banks or from life insurance companies.

Borrowing from commercial banks is inflationary, and borrowing from life-insurance companies is inflationary also when it has to be financed in part by the life-insurance companies' selling Government bonds to the reserve banks, as has been going on this year.

In the third place, 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.

Senator FLANDERS. That is the end, I take it, of your prepared statement. I would like to ask one or two questions which have come to mind as you have gone on.

You made a very strong point in the earlier part of your testimony and the difference between—I forgot the term that you used—reported profits and what you considered to be real profits. You called attention to the fact that the Government did allow an out, in that businesses were permitted to carry their inventories on the last-in and first-out basis, which does tend to prevent them from showing what you described as a loss as being a profit. Have you any idea as to the proportion of American business which is working on that last-in and first-out basis?

Professor SLICHTER. No; apparently it is not very large, although it is increasing.

Senator FLANDERS. The actual gross figures probably represent a comparatively small degree of that practice?

Professor SLICHTER. That is right.

I have used the Department of Commerce estimates which in the last several years, in 1947 and 1946, ran as high as $5,000,000,000 It is very curious that about four-fifths of the overstatement of profits could have been avoided under the present corporate-income tax law. Some managements, of course, will reason that over the course of a business cycle it evens out, and you get bigger profits during the upswing if you don't take the first-in and last-out method and bigger losses during the downswing. That would be all right if there were not a corporate-income tax or if there were an adequate loss carry-over under the corporate-income tax.

Senator FLANDERS. Now, so far as reserves for replacement are concerned, am I correct in saying that the Government does not offer any alternative on that?

Professor SLICHTER. That is correct.

Senator FLANDERS. That policy is definitely set by the Government?

Professor SLICHTER. It is still perfectly legal for a corporation to keep a wrong set of books for the Government and a right set of books for itself, but it has to pay taxes on the wrong set of books.

Senator FLANDERS. I wanted to get that point clear. Now, you dismissed the question of the ratio of profits to sales from the standpoint in which you were making your presentation. I would like to raise the question with you as to whether the ratio of profits to sales does not, however, have some validity in the popular mind at least as a measure of the contribution that a company might conceivably make to reducing the cost of consumer goods. That is if it is willing to forego all its profits, it could reduce its sales price so much by that amount, or, if we are willing to get along with half of the profits, it could reduce its prices by a corresponding amount. Do you see any validity to the point of view that the ratio of profits to sales does have some significance from that standpoint?

Professor SLICHTER. Well, if you ask that question, how much of a price reduction could be obtained if profits were wiped out, for example, or if profits were cut in half, the ratio of profits to sales would enable you to complete the answer. My point is that the adequacy of profits, whether profits are too large or too small, must be examined from the standpoint of whether or not the community wishes industry to expand faster or more slowly.

We might decide we did not want industry to expand as rapidly as it is expanding. If we reach that judgment, which I think would be a very unwise one, in view of the tremendous obligations which the country has taken on, but if we were to reach that judgment, then profits which would be inadequate in reference to a different desire for industrial expansion would become excessive.

Senator FLANDERS. That leads me into another question. You speak of the necessity for industry increasing its capacity. Is not the wise increase of capacity limited by the size of the working force available? Should not the principle under present conditions of practically full employment, should not the efforts of industry be directed rather to the increase in the productivity of their equipment, that is, based on the ability to make labor savings rather than simply expansion? Does not the rigidity of the labor force, or relative rigidity, going to the increase of the population, but the relative rigidity of the labor force, should it not focus attention on improved machinery rather than simply any expansion of capacity that is greater than the natural increase in the labor force?

Professor SLICHTER. Well, I would agree that the faster machinery can be improved, the better, and particularly in view of the tremendous shortage of investment-seeking funds.

There is a special case under present conditions for what the economists call capital-saving inventions. There are two kinds of inventions: the labor-saving invention, which is an invention that raises the productivity of capital faster than the productivity of labor, and the capital-saving invention which raises the productivity of labor faster than the productivity of capital.

The more capital-saving inventions we could get at the present time, the better, because we are desperately short of investment-seeking funds. The capital-saving invention is the kind of invention which produces the greatest additional increase in output for the smallest additional increase in capital. But inventions seem predominantly to be of the labor-saving type. There are some capital-saving inventions, but the type which is most easily made is the type which enables one man to run two machines instead of one, or a bigger machine, or for one man to run more production. That is a labor-saving invention; and, whether we like it or not, I am afraid that most of our inventions are going to be labor saving. But I certainly would agree that if we could get, in the next several years, a big flow of capital-saving inventions, it would be a godsend.

Senator FLANDERS. I have difficulty in visualizing a capital-saving invention. Could you give us an illustration?

Professor SLICHTER. The simplest illustration of a capital-saving invention is a speed-up. You don't do anything except invent a way of having men work the same machines at a faster rate. There you have got the extreme case of a capital-saving invention.

Senator FLANDERS. That does not require much in the way of an investment?

Professor SLICHTER. It does not require any. The more capital-saving an invention is, the less capital it requires, I am giving you an extreme to illustrate the point.

Senator FLANDERS. A capital-saving invention is just another term, then, for more skillful management?

Professor SLICHTER. No. You have two very different kinds of inventions. You are making me talk economic theory now.

Senator FLANDERS. Heaven forbid that we should do that. I was hoping that you could get something that we could understand out of it. I must confess that I do not clearly understand as yet.

Professor SLICHTER. Let me try once more, because I admit that I am not as good at making the point, perhaps, as I ought to be.

You make an invention, and it may have the effect of making it advantageous instead of using, let us say, $5,000 worth of capital per worker, to use $6,000 worth of capital per worker. If it is that kind of an invention, it is a labor-saving invention. Now, suppose the invention made it economical, instead of using $5,000 of capital per worker, to use $4,000.

Senator FLANDERS. That is the kind of a capital-saving invention I should like to see.

Professor SLICHTER. That is true, because it enables you to dispense with a great deal of capital. The crucial thing is that it changes the most economical ratio between labor and capital. Now, if we could get the same output with our existing labor force through changing technology, with half as much capital per worker, that would represent some capital-saving inventions.

Senator FLANDERS. I think that that is what every manufacturer of capital goods would be looking for.

Professor SLICHTER. But the kind of inventions we get and have been getting are the kind which give the locomotive engineer a bigger and faster locomotive, and which give the knitter in the hosiery mill a longer and faster machine, or which give the knitter in the woolen mill more looms because you put automatic stops on them. The typical invention is a labor-saving invention, and, incidentally, it is the capital-saving invention and not the labor-saving invention which creates temporarily uemployment problems in the greatest degree. Our transitional problems as a result of technological progress would be much greater than they have been if the inventions were predominantly capital saving rather than labor saving.

Senator O'MAHONEY. Why do you call the speed-up an invention? To me it has been a pretty old story.

Professor SLICHTER. Well, there are different ways of getting it, and some men may get a new idea. You have inventions in methods as well as in apparatus, do you not?

Senator O'MAHONEY. They used to use the bull whip to speed up production.

Professor SLICHTER. The invention, of course, might take the form of an inducement, of an attraction rather than a compulsion, and that might be a very productive capital-saving invention, to replace an attempt to drive, which men resist and defeat, with an invention which has a powerful attraction and pull to it. That would be a capital-saving invention, but you would be getting speed-up just the same.

Senator O'MAHONEY. You mean incentive to increase production rather than just speed-up?

Professor SLICHTER. That is right.

Senator FLANDERS. I was just going to say that I have asked all the questions that I wanted to, although I am still slightly foggy on the answer to this last one, but, Senator O'Mahoney, if you have further questions, you may proceed.

Senator O'MAHONEY. I would like to ask a question here.

I have the November issue of The Exchange, which, as you know, is the magazine of the financial community, as it defines itself. Unfortunately the pages do not appear to be numbered; but in an article entitled "Earnings of Listed Companies Surmount Rising Costs," I find this table.

(The table is as follows:)

*Net income of 376 companies having common stock listed on the New York Stock Exchange, first 9 months of 1948, by industrial group*

| Industry | Number reporting to date | Number showing net profit first 9 months of 1948 | Number showing improvement, 1948 versus 1947 | Estimated group net income first 9 months of 1948 (thousands) | Percent change, net income, 1948 versus 1947 |
|---|---|---|---|---|---|
| Petroleum | 24 | 24 | 23 | 805,716 | +74.3 |
| Railroad | 43 | 43 | 38 | 384,431 | +62.2 |
| Financial | 18 | 18 | 15 | 38,044 | +47.6 |
| Automotive | 26 | 25 | 19 | 464,245 | +41.8 |
| Building | 13 | 13 | 13 | 70,840 | +36.1 |
| Business and office equipment | 6 | 6 | 5 | 46,781 | +35.6 |
| Mining | 15 | 15 | 10 | 40,240 | +33.5 |
| Electrical equipment | 10 | 10 | 4 | 142,052 | +24.8 |
| Tobacco | 5 | 4 | 2 | 24,805 | +19.4 |
| Utilities | 17 | 17 | 10 | 275,076 | +15.5 |
| Steel, iron, and coke | 26 | 26 | 19 | 315,824 | +14.2 |
| Textile | 14 | 14 | 11 | 58,484 | +12.5 |
| Chemical | 31 | 31 | 18 | 308,413 | +12.2 |
| Machinery and metals | 49 | 48 | 30 | 117,975 | +10.7 |
| Amusement | 5 | 5 | 3 | 11,490 | +7.9 |
| Retail merchandising | 16 | 16 | 7 | 29,092 | +6.0 |
| Paper and publishing | 13 | 13 | 5 | 54,045 | +2.7 |
| Other | 23 | 22 | 15 | 48,392 | +2.7 |
| Food | 22 | 22 | 13 | 135,067 | −4.5 |
| Total | 376 | 372 | 260 | 3,371,012 | +33.2 |

This table shows that the percentage improvement for the amusement industry, 5 companies reporting, was 7.9, automotive industry, 26 companies reporting, was 41.8; building, 13 companies reporting, was 36.1; business and office equipment, 6 companies reporting, 35.6; chemical companies, 31 reporting, 12.2; electrical equipment, 10 companies reporting, 24.8; financial, 16 companies reporting, 47.6; food, 22 companies—and here for the first time we have a decrease—this is minus 4.5.

Machinery and metals, 49 companies reporting, was up 10.7; mining, 15 companies, 33.5; paper and publishing, 13 companies, 2.7; petroleum, 24 companies, 74.3; railroad, 43 companies reporting, 62.2; retail merchandising, 16 companies reporting, up 6 percent; steel, iron, and coke, 26 companies reporting, up 14.2; textiles, 14 companies reporting, 12.5; tobacco, 5 companies, 19.4; utilities, 17 companies, 15.7; other companies, 23, up 2.3. The total for 376 companies as shown and estimated in the group income for the first 9 months of 1948, $3,371,012,000, an increase for the entire group of 33.2.

Now, on the basis of that table, The Exchange says in the first paragraph:

The 376 companies reviewed comprise not many more than one-third of the full corporate listings. Nevertheless, they reveal the broad tendency of industrial and transportation income accounts during an interval of unusually active business in many lines, an interval accompanied by rising costs and also by a more gradual upward movement of prices.

Now, that represents the conclusion, I suspect, of the editors of the Stock Exchange Journal, that the profits of 376 companies—I should say the net income—has increased on the average 33.2 percent in a period of rising costs and upward prices. Is it your view that these companies reporting have all been mistaken in their accounting system and that although these figures seem to show a profit and they think that they have earned a profit, they, in fact, have not?

Professor SLICHTER. No; I have not said that. As a matter of fact, a correct statement of profits will show a greater increase between 1947 and 1948 than the incorrect statements published by corporations. The incorrect statements will show, I think, when the figures are all in, an increase between 1947 and 1948 of from 18.1 billion, the reported totals for last year, to somewhere between 20 and 21 billion dollars, which will be the reported figures for this year, up around 1.9 billion.

Now, the actual figures should be about 12 billion for 1947 and about 16 billion for this year, up about one-third; but we are still down, of course, considerably below the reported figures.

Senator O'MAHONEY. Then you want this committee to understand that these corporations listed on the New York Stock Exchange and reporting their earnings do not know their own weakness?

Professor SLICHTER. Well, you may draw whatever inference you wish from that, but I do wish the committee to understand that the corporations of the United States have been substantially overstating their profits and misleading employees, stockholders, and the public.

Senator FLANDERS. I would like to ask you a pertinent question. Are your bags at the station or at the hotel, or where are they? I got him here under the assurance that he could take a 4 o'clock train.

Professor SLICHTER. My bags are at the station, Mr. Chairman, and if you will allow me to go in about 5 minutes, I will appreciate it. I hate to run out on questions because I think that they are the most useful part.

Senator FLANDERS. I wonder if it might not be possible for us to call you back at a later period for an hour or two, if that seems advisable.

Senator O'MAHONEY. I will finish very quickly, Professor Slichter, and I would like to have you come back later on; but I noted that as you went through these papers, nowhere did you discuss working capital of corporations. What is the status of working capital? Has it been impaired during this period that you have been describing?

Professor SLICHTER. Well, the corporations have had to increase their working capital because of two things. They have been doing a much larger volume of business than they have ever done before in time of peace, and during the war, of course, the Government put up a substantial amount of the working capital. And they have also had to increase their working capital because of the fact that the price level is higher than it was before the war. Their new security issues have partly had the purpose of increasing working capital, and their bank loans have had that purpose, and, of course, their plowed-back earnings have partly had that purpose.

Senator O'MAHONEY. We are talking about 1946 and 1947 and 1948, the years taken in your paper?

Professor SLICHTER. That is right.

Senator O'MAHONEY. Now, the working-capital position of these corporations has not been impaired, has it?

Professor SLICHTER. No. They have not permitted it to be impaired; they have increased it substantially.

Senator O'MAHONEY. In spite of your description of the sad state in which they are with respect to profits, it remains true that their working capital has not been impaired?

Professor SLICHTER. I do not think that I used the expression "sad state of profits."

Senator O'MAHONEY. Oh, no. You did not. I withdraw the phrase, Professor; that was just my interpretation of the story that you are telling us.

Professor SLICHTER. When you measure their plowed-back earnings in terms of their reported profits, those plowed-back earnings were 24.9 billion dollars in 1946–47 and the first half of 1948; and when you measure their plowed-back earnings in terms of correct profits, their plowed-back earnings were around 10 billion dollars. That difference between the two, approximately 14.9 billion dollars, represented their attempt to make very necessary increases in their working capital.

Senator O'MAHONEY. Now then, when you were talking about their retained profits, were you talking about the correct measure of profits, or their reported measure?

Professor SLICHTER. I was talking about both, but when I compared their retained profits with the amount of capital obtained from the outside, I used the figure 10.1 billion dollars, which is based upon the correct statement of profits.

Senator O'MAHONEY. That 10.1 billion dollars represented what?

Professor SLICHTER. That represented the correct profits minus dividend disbursements for the period 1946–47 and the first half of 1948.

Senator O'MAHONEY. What were the correct dividends that were received by the stockholders of these companies?

Professor SLICHTER. There is only one dividend figure, namely, the dividend that they actually received. I had the figure here a moment ago.

Senator O'MAHONEY. Do you ask for reduction of taxes on corporations?

Professor SLICHTER. Let me answer your dividend question. I have it now. It was 15.9 billion dollars.

Senator O'MAHONEY. Now, do you ask for a reduction of taxes on corporations?

Professor SLICHTER. Do I ask for a reduction of taxes on corporate profits? I am not asking nor am I suggesting what the policy of the Government should be at this stage. I do not know what the budget for the Government is like to be, how rapidly these large, new public demands must be met. I am satisfied that sooner or later they will have to be met, and a larger proportion of the present output of industry will have to be diverted to meeting it. Therefore, the output of industry must go up if the standard of living of the country is not to go down, but I did not come here this afternoon for the purpose of discussing the budget of next year or the tax policies for next year. I should like to see the budget figures first before I undertake to discuss that problem. I came here to comment on some of the questions which your committee put in its outline, and I have allowed the outline to govern my remarks, the selection of topics.

Senator O'MAHONEY. You spoke of the increasing proportion of the gross national output which is taken by the Government. Was that statement intended to imply a criticism of the policy?

Professor SLICHTER. No; it was intended to be a statement of fact, and I expect the proportion to go up, but I do not think that the Government should take an increasing proportion of the output of industry without concerning itself very definitely with the question as to how much is left for the rest of the country. I think the Government must spend very heavily upon public works and public defense and many other things. I think people become increasingly impatient with these narrow roads, and particularly in view of the very large number of trucks which have gone on the roads in the last couple of years.

Senator O'MAHONEY. No implication is to be drawn that you advocate a decrease of Government activity which has been authorized by practically unanimous vote?

Professor SLICHTER. I am talking about the productive capacity of American industry.

Senator FLANDERS. Now, Professor Slichter, the House would like to talk with you for about 5 minutes, and there is a good taxi stand out in front here, and I think that you might be able to spend 5 minutes. We will take care of you and assure you that you will get to the station.

Representative HUBER. It is interesting to note that in the past the so-called long-hair boys, the college professors who engaged in Government service, have been frowned upon. Since industry now seems to be unable to properly evaluate and determine their profits, would it not be well for them to recruit some members from the various faculties, preferably Harvard, to help them straighten out?

Professor SLICHTER. We are terribly short of people at Harvard now, and I hope that they do not pick any of ours.

Representative HUBER. You referred to three of the polls. Do you have more confidence in those polls that you referred to than some of the other polls which we are familiar with lately?

Professor SLICHTER. Well, after each one of those polls came out, I went on record publicly to the effect that they were wrong, and it remains to be seen whether I am wrong the third time. On the first two times I was not. These are the polls of the economists predicting an early recession.

Representative HUBER. If industries have a bookkeeping system that does not show a correct picture, how can they be expected to sit down in negotiations with labor and arrive at a fair amount in the determination of wages and the basis of profits and the whole scheme?

Professor SLICHTER. I think industry is at a disadvantage in negotiating if its books overstate its profits. I have no doubt that that is true.

Representative PATMAN. I will not take his time.

Senator FLANDERS. We may call you back later, Mr. Slichter.

Professor SLICHTER. I am sorry to run out, but this was a previous engagement.

Senator FLANDER. Our next witness is Prof. Seymour Harris.

## STATEMENT OF DR. SEYMOUR E. HARRIS, HARVARD UNIVERSITY

Senator FLANDERS. Professor Harris, do you have a prepared statement?

Dr. HARRIS. Yes, sir, I have a prepared statement, and I would very much like to enter it later in the record, and perhaps try not to bore you reading it, but rather give you the main ideas, and perhaps amplify certain points and reemphasizing.

Senator FLANDERS. You may proceed as you please.

Dr. HARRIS. Senator Flanders, I should also like to say in the event that anyone feels that this is a conspiracy of two Harvard men, you will see that there are at least some differences between Professor Slichter and myself. I am going to emphasize the differences, but at the same time I wish to say that there is an awful lot that Professor Schlicter has said I heartily agree with.

I might say that I am proud of my 21 books.

Senator FLANDERS. May I inquire, sir, whether that is a case of speed-up? There is a folklore story to the effect that the motto of Harvard University is Publish or Perish, and I suppose that there is no danger of either you or Sumner Slichter perishing?

Dr. HARRIS. That is right, Senator Flanders.

I might say that I want to finish up giving a plug for my latest book, Saving American Capitalism, which will be published on January 11. Incidentally, you are on the list to get a copy.

Senator O'MAHONEY. How about the other members of the committee?

Dr. HARRIS. You are on the list, and so are Congressmen Patman and Huber.

Representative PATMAN. Do you discuss bigness in business to some extent?

Dr. HARRIS. I do.

Representative PATMAN. Do you see any alarming trend in bigness in business?

Dr. HARRIS. I do to some extent, although I think sometimes that is exaggerated.

Representative PATMAN. Do you believe in the decentralization of industry?

Dr. HARRIS. I advocate it on grounds of defense. I do develop that thesis because I am writing, also, a book on the economics of atomic energy.

Senator FLANDERS. That is the twenty-second book?

Dr. HARRIS. The twenty-second and twenty-third are in the press. May I then go on and say that I am going to deal primarily with the problem of profits, but in doing so, I am going to emphasize the general problem of prices, because I feel very strongly that in solving the problem of prices, you will very largely solve the problem of profits.

Now, I am not going to read this paper, as I just said, but I am going to read you one or two paragraphs. I do not believe in reading papers, because, unless you can read them as well as Professor Slichter, the whole effect is lost. [Reading:]

Inflation is a world-wide phenomena; in countries ravaged by war, and in those largely untouched; in countries blessed by overemployment and in those suffering from unemployment; in countries favored by an excess of imports and those injured by an excess of exports; in countries with a budgetary surplus and those with large deficits; in countries largely tethered to the principles of free enterprise and those relying on the planned economy and control.

War and its aftermath are, of course, the main causes of the current epidemic of inflation. For it is war that provided high levels of employment and activity in corresponding levels of income, without providing supplies of consumption goods and capital for nonmilitary purposes commensurate with the current flow of income. With the accumulation of cash and of liquid assets convertible into cash, the excess of purchasing power over the flow of wanted goods at the current price level tended to grow.

That is about all of the reading I shall do.

As you all know, there are pressures on the limited resources we have. We are doing all kinds of things, such as the investment program, ERP, our military program, and so forth and so on.

Obviously, we cannot have everything. In the last two and a half years the consumers of this country saved $29,000,000,000 and made that available to our economy. The Government also spent $14,000,000,000 less than it took in, and that made $43,000,000,000 available. These $43,000,000,000 were largely taken up, more than taken up, by business spending $30,000,000,000 more than its receipts, and by the country exporting $16,000,000,000 more than we imported.

So, the fact is that it is the spending of business for investment and the excess of exports that largely account for the using up of the savings of the rest of the economy. As a matter of fact, we have had a great deal of pressure on the whole economy, with the result, with limited resources, we have managed to raise prices and incomes until we now have a gross national product of about $240,000,000,000.

Not only have we had pressures on our resources but we have, of course, had this tremendous political pressure for higher wages, for higher farm incomes, and also, of course, for large rises in profits, and yet we have not had the monetary restraint that might have held in check this general demand for increased incomes. In other words, there was no attempt really made by the monetary authorities to restrain the total amount of money so that these pressures on the economy might have been held in check.

Now, a word about this monetary policy. Of course, the main explanation of the ineffectiveness of our monetary policy is the large national debt, because as soon as the Government tries to deal with the problem of excessive supplies of money and excessive lending, the net effect is that there is a tendency to dump Government securities on the market and the price of Government securities falls, for the demand for Government securities depends upon the total supply of money available to buy these securities. If you tend to cut down the amount of money, you tend to cut down the demand for these securities, and in days like the present, with war, with the threat of war, and all kinds of demands being made upon the Government, it is important that the most important asset the Government has should not depreciate in value substantially.

Of course, there are ways of dealing with the problem. You can cut down the supply of money if you are prepared to take unorthodox methods to protect the Government bond market. Mr. Eccles has made these general proposals quite well known, and the quite obvious one is to compel the banks to hold a certain quantity of Government securities as a means of preventing a depreciation when the total supply of money tends to decline.

Now, let us look at the history of the last 2½ years. In this period our price level rose 32 percent. Our production, according to the Federal Reserve Board Index, fell by 7½ percent. The total loans of the banking system rose by $15,000,000,000. The investment of the banking system fell by $26,000,000,000 and deposits by $12,000,000,000.

Now, what does all that mean? It simply means you have the unusual situation where the total supply of money has declined, and yet prices rose by 32 percent.

Let me point out to you how ineffective Federal Reserve policy has been during this period of 2½ years. In this period the total supply of gold coming into the country rose by $4,000,000,000. That means the banks get $4,000,000,000 more of reserves upon which they can expand their deposits. The total supply of money in circulation declined by about three-quarters of a billion dollars—this means also increases in the reserves of the banking system because the banks convert these notes into reserves with the Federal Reserve.

During a period of great inflation, what has happened is that the banks of the country have increased their total reserves by $4,000,000,000 and there would have been an increase of $5,000,000,000 had not the Federal Reserve sold securities to the extent of $1,000,000,000, thus depriving the banks of $1,000,000,000. So much for monetary policy.

How about fiscal policy? In a period like the present, I think we will all agree that what is required is as high taxes as is politically possible, and as little spending as is politically possible, because if the Government taxes more and spends less, it takes away a large proportion of the excess spending power of the public. Yet, what have we had? In the first place, according to the latest budget estimate, it seems that for the fiscal year 1949 the contribution in the fight against inflation by the Government is going to be $10,000,000,000 less than it was at an annual rate in the first half of 1948. That is due to $5,000,000,000 worth of more spending and $5,000,000,000 less of taxes. It is also true if you compound the 1945 and 1948 tax bills—both of which, in my estimate, were unfortunate bills—the net result is that Government is losing annually $10,000,000,000 of revenue. I think if the Government had received these $10,000,000,000 of revenue per year, the threat of inflation would have been substantially less.

It may well be as some economists have predicted, that the year of 1949 is going to be a year of balance or even a year of decline, with some pressure toward falling prices. Of course, the economists are not as good forecasters as the scientists who can tell you where the moon is going to be 1,000 years from now, and they probably are not as good as the meteorologist, who certainly makes his mistakes. But I am not putting much faith in these predictions. I simply say that the general view is that 1949 may be a year of balance or even a slight decline.

82989—49——3

Now, does that mean that we, therefore, should do nothing about the inflation problem? My answer would be no, for we certainly ought to do something. I agree with my distinguished colleague Professor Slichter, who has said very eloquently today that the general pressures these days toward inflation are greater than they were in the years before 1930. But the important thing is that I would strongly recommend that we use fiscal weapons as much as possible to deal with the problem of inflation. If we do not use fiscal tools to deal with the problem, then we either have to acquiesce to the inflation, or else we have to extend controls greatly.

The way to deal with the problem of controls is to start with allocation control, and if that does not carry far enough to go on to price control, and then finally the other controls that make price control work, e. g., all of the supply and demand controls, priorities, and ration, and so forth.

I might say, Senator Flanders, that my view of the chances of effective price control today is that they are not as good as they were in 1942, in part because there is not a war, and in part because there is too much purchasing power around, and with all this purchasing power around, you would have to implement price control with all kinds of controls or the system would not work.

Now, about profits. I might say that I am going to disagree with Professor Slichter on some points. I did not see his paper until just before this meeting.

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.

I should like to confirm or support a point that Senator O'Mahoney made, namely, that one must not, however, overestimate the significance of high profits today. When one looks at the picture, certainly the most important single factor is not only as he said, that the public is spending more money today, and the Government is spending more money, and therefore increasing profits, but it is perfectly true that it is the guaranteed markets that were provided by the Government from 1941 to 1945 that largely account for excess spending and purchasing power. This now hovers over the market, and I think more than anything else explains the tremendously high income of the country.

It is very important, therefore, to realize that the Government has made a very important contribution. I am not saying that it was desirable that we should have this inflation or expansion of monetary resource, but the point is that without the expansion we certainly would not have averaged over $200,000,000,000 in annual income. The Government certainly, by its power to create money, has contributed in an important way to this large rise in profits. I am perfectly willing to grant that profits incentive has played a large part in our system, but I think we should remember that our other factors, for example, widespread education, the technical genius of the average American, the large free trade areas, the absence of external pressures, wars, and so forth, have all contributed to this unusual situation under which the United States, on the average, has 9 times as high a per capita income as the rest of the world.

It is also true that there is a great danger of excess of profits. It would be too bad if our system should be jeopardized by profits being too high, and for various reasons. I will elaborate a little later on that, but I want to point out that high profits bring a tremendous amount of pressure on trade unions to ask for higher wages. And then there is the problem of equity, the problem of what seems to be justice to the average individual, should profits be so high, should they take an excessive part of the national income.

I am going to develop that particular point a little later and perhaps come to conclusions a little different from those of Professor Slichter.

Then of course there is the problem, and this is my major point, if we are going to stabilize the economy it is important that we keep the profits from being too high. That is probably because of the effect on wages and also because the high profits contribute to a high level of investment. I think the level of investment is too high and I am going to elaborate on that point presently.

Now, the question: Are profits too high? It is quite clear and I think Professor Slichter made this point, it depends partly on how you measure them. If you compare them with national income as Dr. Terborgh did, you might find, as he found, that profits were not too high. If you compare them to sales and net worth, as Nathan did, you might find that profits were very high. If you compare the profits with the year 1933, they seem tremendous. If you compare them with 1929, they do not seem to be so high.

Now, here is one of my crucial points, and I know that all economists will not agree with me, but I think that it is a point that this committee has to consider: What profits are you talking about? Professor Slichter wrote an article in the Atlantic Monthly on the subject, Are Profits Too High? in which he dealt with this same problem, and there again he did not reveal what profits he was talking about. Is he talking about profits before taxation or after taxation?

Now, you can see, for example, at the present time corporate profits are running at the rate of about $30,000,000,000 per year. After taxes those profits are only $18,000,000,000 a year. Obviously it makes a lot of difference what results you get, whether you talk about profits after taxes or profits before taxes.

I would like to point out that when we discuss incomes other than profits, we generally consider incomes before taxation, not after taxation. We talk about wages, farm income, and managerial incomes, before taxes, not after taxes.

I should like to point out that the estimates that seem to suggest that profits are low as compared to 1929 or less than they were in 1929, are all based on the theory that the appropriate profits to consider are not the profits before taxation, but the profits after taxation.

Senator O'MAHONEY. I would like to have you emphasize that particularly.

Dr. HARRIS. May I just develop this point theoretically just for 1 minute? I will tell you why I think myself that the relevant variable is not profits after taxes, but profits before taxes. I believe that because the whole theory of profit taxation is that you take something away from the businessmen when he has large profits, and partly because you believe that he is able to pay heavy taxes because the man who makes profits in general is a high-income man. If that is true, then obviously if the theory were that he could pass his taxes on, then of course the net effect would be that he would simply put on $10,000,000,000 worth more taxes, put $10,000,000,000 on the consumer and wage earners, and it would have no effect.

It is also true that we have fought a $400,000,000,000 war and somebody has to pay for it, and my view is that all groups ought to pay according to their capacity. If that is correct, then the profits we consider, the profits before taxes, are an indication of what the businessman gets out of distribution of products of industry, and what he pays as taxes simply reflects his contribution to taking care of the war and other obligations of the government. Now, that of course is terribly important because if you accept this particular theory, then you will find, as I shall point out to you presently, that profits in 1947 and so forth, are higher, on just about as high, as they were in 1929 and one should not use 1929 as a base of comparison, although I certainly would not take 1932 as a base. After all, 1929 was one of the great years of inflation in modern civilization.

Senator FLANDERS. Not in prices, however.

Dr. HARRIS. No, but a serious inflation.

Senator FLANDERS. Yes.

Dr. HARRIS. I do not want to get into an economic discussion.

Senator FLANDERS. No, keep away from that, by all means.

Senator O'MAHONEY. May I add just a statement of fact? Profits in 1929 were not only running very high, according to all previous standards, but they were running high after taxes in spite of a large debt remaining over from World War I, which had been reduced five times.

Dr. HARRIS. That is right.

Senator O'MAHONEY. Upon the theory, upon the argument, that to reduce taxes would increase the revenue of the Government. Of course, it never worked out that way.

Dr. HARRIS. Yes.

Senator O'MAHONEY. The revenue of the Government fell off while these taxes were being reduced, and the profits rose, and the result was that in 1933, after the depression, the Government had a national debt which was scarcely $2,000,000,000 less than that which it was at the change of the administration, may I say, between Wilson and Harding.

Dr. HARRIS. Senator, of course I do not want to get into politics, because I am merely an objective economist.

Senator O'MAHONEY. But you are a liberal who wants to be called a conservative sometimes.

Dr. HARRIS. Yes.

I once did write an article, and as a matter of fact I am sorry I ever wrote it. It was called "These Perverse Republicans," and the theory was exactly the one which you indicated, namely, that it was a great mistake in the middle twenties to cut taxes when you had these tremendous profits.

Senator O'MAHONEY. In view of your opening remarks, Professor, I want the record to show that I did not write your article.

Senator FLANDERS. I might inquire whether this expectation of yours that you will eventually be called a conservative is expected to take place under a Democratic administration?

Senator O'MAHONEY. It must take place under such an administration, although probably it will be many years.

Senator FLANDERS. The principle remains the same.

Dr. HARRIS. Well, Senator, I am only a middle-of-the-road Democrat, if you call me that.

Now, the question arises, and this, of course, is another fundamental point on which I may disagree with Professor Slichter.

Senator O'MAHONEY. You are still both members of the Harvard faculty?

Dr. HARRIS. Oh, yes, and we have honest disagreements frequently.

What are profits? Is it true that profits are being understated today? It is perfectly true that if you took your inventory at replacement instead of at cost, there is no doubt about it, your profits would be a good many billion dollars less, as Professor Slichter indicated. It is also probably true that if you replaced your capital at replacement values and counted depreciation accordingly, that your profits would be correspondingly lower, as Professor Slichter indicated. But it is important to point out the present accounting practice has been used for generations as far as I know, and now suddenly some businessmen find it more convenient to change this accounting method. As a matter of fact, I know, and probably you know, that there is pressure being put on the accountants to change that method of accounting of business profits so that these large inflationary profits during these periods will not seem as large as they are.

Now, Professor Slichter quite honestly pointed out this fact, that if the net effect of this particular change is that profits will be lower than they now seem to be, in periods of depression and falling prices, of course, they will be higher. So that what the businessman is now losing, you might say, by showing these high profits and having to pay higher taxes, and so forth, he gained during the depression period; and although I would agree with what Professor Slichter said, namely, that the chances are that we will have more inflation in the future than we had in the past, I am still a good enough historian to realize that over the last 150 years there was virtually no change in prices.

Senator O'MAHONEY. They were changing prices on the inflated level, but they would like to compute their profits on the deflated level.

Senator FLANDERS. Not on the last-in, first-out basis.

Senator O'MAHONEY. Oh, no.

Senator FLANDERS. It is on the current level, all transactions.

Senator O'MAHONEY. We are talking about replacement.

Senator FLANDERS. Oh, yes.

Dr. HARRIS. Now, as regards the level of profits. 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, but we have had an increase in the number of physicians of only 5 percent.

Representative PATMAN. In your statement I notice you referred to $50,000,000,000.

Dr. HARRIS. Yes.

Representative PATMAN. Which groups were they besides the professional?

Dr. HARRIS. I will give that in a minute, because that also is an important point.

Now, here are the figures that I get. If you take your profits before taxes and compare them to gross national product in 1929, they were 9.7 percent. In 1939, they were 7.3 percent. And this was before taxes, mind you. In 1947, they were 12.5 percent. In other words, in 1939, in relation to gross product, profits were up from 9.7 percent in 1929 to 12.5 percent. That would be the relevant figure in support of my interpretation of which are the relevant profits.

After taxes what do you get? You get, all corporate, 8.1 percent in 1929; 5.6 percent in 1939; and 7.9 percent in 1947. In other words, in 1947, you have even after taxes profits at virtually the record level of 1929.

Now, as to unincorporated profits, which of course correspond to corporate profits after taxes, because there is not a corporate tax, there is only an individual tax. The unincorporated profits were 7.8 percent in 1929, of gross product as compared to 10.5 percent in 1947. Now, if you compare that with corporate profits after taxes, you can see that unincorporated profits have gone up even more than corporate.

Senator O'MAHONEY. Now, what are these profits that you are talking about, of unincorporated firms?

Dr. HARRIS. Those are the profits of firms not incorporated.

Senator O'MAHONEY. You get these figures from what source?

Dr. HARRIS. They are published by the Department of Commerce.

Senator O'MAHONEY. Oh, yes.

Representative PATMAN. Partnerships, for instance, they will have profits this year aggregating $50,000,000,000.

Dr. HARRIS. Yes.

Representative PATMAN. You put the partners and professionals together in that group?

Dr. HARRIS. Yes. In my discussion of unincorporated profits, I am including business and not professional. I did in my statement point out that professional incomes had gone up a great deal. Of course, they are not all profits. You might say they are also wages or salaries, and nonincorporated business incomes as wages and salaries in part. But the rise is more largely in the profit element.

When you compare sales with corporate profits before taxation, it is 10.5 percent in 1929 and 14.0 percent in 1947. After taxes it is 9.1 percent and 8.4 percent.

Now, I would like to refer to a point made by Senator Flanders on this issue. After all, we are doing much more business now than we were in 1929. The national income is about two and a half times as high, although total output is less than 100 percent more. But the point is, why should business be getting 9.1 percent profits on sales after taxes even in 1929 and 8.4 percent in 1947, or 10.5 and 14.0 before taxes? I think Senator Flanders has a point when he says that the point ought to be considered whether when a great deal of business is being done the profits per unit of sale should not go down. It is supposed to be one of the great strengths of modern business enterprise, that as output and sales rise profits per unit should decline.

Senator FLANDERS. Of course I did not put my statement in exactly that way. I asked whether the investment should not be made in cost-saving equipment, rather than in mere expansion, if that was the point to which you were referring.

Dr. HARRIS. No; I thought earlier you had made the point and Professor Slichter showed that if you cut down profits, what would happen? I thought you suggested it as a possible question for him.

Senator FLANDERS. Yes.

Dr. HARRIS. I am not trying to reword your question, and I hope I have not done so.

Now, here is the point that Congressman Patman was asking about. Professor Slichter has presented some figures which seem to indicate that on the whole the property classes, the capitalist classes, and so forth, have a smaller proportion of the total national income. Now, I think part of the differences between Professor Slichter's figures and those which I have results from the fact that I consider corporate profits before taxation, but in any case I do point out that the total proportion of national income going to the proprietary classes, and that despite the fact that the proportion of interest to income has gone down by about 75 percent, that percentage has increased from 12.5 percent in the rather exciting year of 1929, to 23.7 percent in 1947.

I would like to point out, if I may, and I am not trying to be political, I would like to point out that despite all the anti-big-business, anti-business legislation, that we have had in the last 15 years, it does not seem to me that these figures reveal the administration in the last 15 years has been anti-business. Certainly the results do not seem to indicate that, because you are comparing two peak years, and in these two peak years you have doubled the proportion of income that goes to the proprietary classes. Now, perfectly true that taxes take a much larger part, but one must not forget that total direct taxes, today, including all kinds of direct taxes, State and Federal, and so forth, are only about $20,000,000,000 compared to about $2,000,000,000 in 1929 and those do not account for the difference between the 12.5 percent and the 23.7 percent.

Senator O'MAHONEY. What is the last percentage?

Dr. HARRIS. 12.5 percent in 1929 and 23.7 percent in 1947.

I should also like to make this point, that when you are talking about whether profits are too high, it depends on the industry you are talking about. For example, from 1929 to 1946—I was unable to get these figures for the late years—total income of all business went up 100 percent, total net income. In the case of manufacturing, the rise was 116. In the case of wholesale and retail trade, it was 150. In the case of finance, insurance, and real estate, it was 22.

Now, I think a great many people would agree that the profits in finance, insurance and real estate are very low now if you consider what has happened to the price level, and you also note that the profits in the wholesale and retail trade are up seven times as much as finance, insurance, and real estate, and up about one-third more than manufacturing. This is a phenomenon of inflationary periods, and it is a matter to which the committee might well give its attention.

I come to another point which Professor Slichter and I discussed independently, as you can see from my prepared statement. One of the points that is often made as regards the high profits is that you have to have high profits in order to satisfy the needs of capital. Well, I should like to point out first that the comparison is generally made with 1929. There is a considerable opinion that the amount of capital available in 1929 was excessive. In fact, the depression itself seemed to indicate that. So the comparison with 1929 is subject to some reservations.

I should also like to emphasize and italicize a point that Professor Slichter made, namely, that there is something in the general theory that $1 of capital is more effective today than it was 15 or 20 years ago. I should like to point out, for example, that in the thirties there was no net investment in this country. All of the investment was replacement. And yet we substantially raised our real national income in this period.

I should also like to point out that during the war we spent $20,000,000,000 on manufacturing equipment, and all that sort of thing, to carry on the war—virtually all of the investment done during that period. During this period we increased our national income from about $70,000,000,000 to $200,000,000,000. That also would seem to indicate that our capital is much more effective than it used to be.

Now, there is another point. In an advancing economic society, we tend to depend less on manufacturing and more on services, such as education, religion, travel, and so forth and so on. In general, these industries which the economists call the tertiary industries, are industries which on the whole tend to require less capital per laborer than the manufacturing industries. So from all of this I draw the conclusion that I am rather dubious that we need, say, 50 or 70 or 90 billion dollars worth of capital in order to make our capital plant as effective as it was in 1929.

Senator O'MAHONEY. May I interrupt you, Professor?

Dr. HARRIS. Yes.

Senator O'MAHONEY. I wanted to ask the chairman if he knows Mr. A. G. Bryant, who is the president of a concern.

Senator FLANDERS. Yes, of course.

Senator O'MAHONEY. He was quoted in the New York Times of April 9 as saying that industry could produce about 50 percent more output with the same manpower if it had the improved machine tools that the machine-tool industry can now furnish.

Senator FLANDERS. That would be true of those industries using machine tools.

Senator O'MAHONEY. Yes.

Representative PATMAN. Would that be true of steelmaking?

Senator FLANDERS. That would be true also in such cases, for instance, as sheet. If all of the old steel-sheet mills were replaced by continuous mills, that would be true. Now, I do not know how far you can go with that.

Representative PATMAN. How about making of pig iron?

Senator FLANDERS. I do not know of any similar great advances in pig iron. It would take someone better acquainted with that industry than I am. I am only speaking of these two that I know something about.

Senator O'MAHONEY. What is Mr. Bryant's company?

Senator FLANDERS. He has a small machine tool company. They are located in Green Bay, Wis.

Representative HUBER. Professor, you mentioned the profits per unit at some length. I am recalling that for instance in 1924, you could buy a new Ford car for $460 f. o. b. I am thinking of how much more these certain products are luxury items.

Dr. HARRIS. Yes.

Representative HUBER. Has that not made a difference in the cost per unit? In 1924 you could build a radio for just a very few dollars.

Dr. HARRIS. There is no doubt about it that in general the whole business of distribution, which is part of the servicing, is a larger part of our economy, and tends to be is an advancing economic society, and that means that you need less machinery per worker, and all that sort of thing.

Shall I go on, Senator?

Senator FLANDERS. Yes, sir; if you please.

Dr. HARRIS. Now, on the other hand, I do not mean to entirely disagree with what Professor Slichter said. I should certainly agree that in general there has been a revolution in the methods of financing business. Business on the whole, taking the last 50 years, has been tending to depend less on money; that is, on borrowing from the bank, and less on the capital market, and to be dependent more on its own resources, and to that extent there is certainly substance in the professor's point that you must not cut down profits too much if you want to maintain a reasonable economic plant.

I should like to point out that from 1927 to 1929 corporations raised 18 billion dollars' worth of new money. In the 1920's they raised 39 billion dollars. In the 1930's it was only 7 billion dollars. In 1941 to 1947 it was 10.5 billion dollars. That means that in the 1940's they raised three-eighths as much annually as in the twenties, and in relation to national income only one-eighth as much.

In other words, in the forties, business could depend upon the capital market in relation to national income only one-eighth as much as in the twenties. Now, that is, of course, exaggerated because the war to some extent interfered with the use of the capital market during this period. On the other hand, if you compare 1929 and 1948, the discrepancy is not nearly so large because in 1929 $8,000,000,000 was raised by corporations for new uses, new money, and in 1948 it looks as though it is going to be in excess of $5,000,000,000. The ratio in relation to national income is up to one-quarter.

In other words, business is beginning to use the capital market much more than in earlier years; that is, much more than in earlier recent years. It is also true that we have had a phenomenal raise in bank loans. Throughout the twenties and thirties it was more or less said that the bank loan was a dead institution. Now, as a matter of fact, from 1939 to 1945, the total amount of bank loans rose from $22,000,000,000 to $30,000,000,000, and by September 1948, to $47,000,000,000. That is a phenomenal rate of increase on any standard, and particularly on the theory that there is stagnation in bank lending. In other words, corporations and business generally seem to be able to use the banking resources of the country to a much greater extent than has been true for a generation, and to that extent are less dependent upon profits.

Now, the question is, is business short of funds? I have my doubts. For example, I would be inclined to argue that business is investing too much these days. In 1929 business invested $16,000,000,000. In 1946, $26,000,000,000. In 1937, it was $30,000,000,000, and in 1948, based on whatever evidence we have so far, $37,000,000,000.

Now, when you consider that $16,000,000,000 was a record in 1929, and when you consider the great effectiveness of a dollar of capital, even allowing for price changes, I think the 1948 figures are really quite phenomenal. It also is true that during the war period the total volume of liquid assets, cash, and Government securities, increased from $90,000,000,000 to $300,000,000,000 and that business captured a substantial portion of those. It is also true that in the year and a half ending June 1947, business liquidated only $7,000,000,000 of these liquid assets, and in the last year there was no liquidation at all.

I might also point out that from 1941 to 1945 business accumulated, as nearly as I could estimate, $80,000,000,000 of undistributed profits and depreciation funds and spent $29,000,000,000. Through 1948, they seem to have used up but $30,000,000,000 of the $51,000,000,000 saved.

Senator O'MAHONEY. Have you any figures on the amount of plant erected out of the Treasury which has been purchased by business for a fraction of its costs?

Dr. HARRIS. I think there were $15,000,000,000 put in by the Government during the war, and they were certainly sold for a small part of that.

Senator O'MAHONEY. The Geneva steel plant was purchased at 20 cents on the dollar by United States Steel. Kaiser-Frazer only last week bought the Willow Run plant for a fraction of what it cost the Government to build.

Dr. HARRIS. Well, of course, Senator, it is difficult to sell anything of that sort. There are few buyers, and obviously you are at a disadvantage.

Senator O'MAHONEY. In selling it, the Government is at a disadvantage with the only purchaser it has.

Dr. HARRIS. And you pay your Government experts $10,000 a year, and he deals with a $50,000-a-year man, who is about three times as smart.

Senator O'MAHONEY. I am not so sure. I have watched these experts, and they are pretty smart.

Dr. HARRIS. I was an expert for a year and a half during the war myself.

Representative PATMAN. You state profits for corporation and noncorporation.

Dr. HARRIS. They are estimates, $41,000,000,000 in 1941–45.

Representative PATMAN. 1941 to 1945?

Dr. HARRIS. Inclusive.

Representative PATMAN. That is about 5 years.

Dr. HARRIS. Yes. I will tell you about that in a moment.

The point I am making, there were depreciation funds and profits set aside which made $80,000,000,000 available to be spent for capital and they actually spent during these years only $29,000,000,000. So actually there were only $51,000,000,000 available for expenditures later on. Up to the present they have only spent in excess of what they really obtained of their own resources, $30,000,000,000. In other words, they have spent about $30,000,000,000 out of the $51,000,000,000 that were available, so they have still $21,000,000,000 available left from their wartime savings.

So much as regards the problem of whether business needs all this capital. I think the story is a mixed one. I think Professor Slichter has a point, but I think perhaps he exaggerates the extent of the needs and I certainly am inclined to argue that business can depend more on capital and the money market.

Now, the final question. What should be done? Senator Flanders, I am a little more inclined to put my neck out than did my distinguished colleague. I would say this. Of course we all know it is a question of what is going to happen to ERP, militray lend-lease, the military budget, but I think, and my general guess is, that the military budget plus ERP is going to be about $20,000,000,000. I will make my statement on that basis. I think it also may very well happen that even though we have a budgetary deficit, as I hope we will not in the next year, that we might still have falling prices because it is certainly clear that you can have a budgetary surplus and rising prices, you can also have a budget surplus and falling prices.

On the other hand, in view of the over-all situation, aside from 1949, I would be inclined to argue that we ought to have more taxes. I certainly think that if corporations could stand a 60-percent tax when they had incomes say of $15,000,000,000 to $20,000,000,000 during the war, that they could stand a 60-percent tax rather than the present 40 percent tax, or at least a 50-percent tax at the present time when their income is roughly around $30,000,000,000, and when we are living under a quasi-war situation.

Now, I think it is also important that we increase our social expenditures. I believe that the Federal Government ought to spend some money for Federal education; in fact, Senator Flanders, I wrote a book on this problem.

Senator FLANDERS. That makes four so far. How many are there altogether?

Dr. HARRIS. Twenty. I wrote a book entitled, "How Shall We Pay for Education?" And my general conclusion was that we cannot have a good educational system in the poor States unless they get Federal aid; that the poorer States spend a larger proportion of their income than do the richer States. I also believe we ought to spend some money on science. Compared to what the USSR spends, and compared to our income, we spend very little on science, and I think you all will agree that our science is very important, not only from the standpoint of war, but from the standpoint of industry.

Representative HUBER. Realizing you are an authority, otherwise you would not have written a book, how about the suggestion of former Secretary Ickes, that the Tidelands oil be held in reserve for the people?

Dr. HARRIS. That is my own opinion, but I do not consider I am an expert.

Representative PATMAN. Which people? There are people in the State as well as in the Nation.

Dr. HARRIS. I would say in the Nation.

Representative PATMAN. You take the States; they have always presumed that they have had 3 miles outside. Texas is in a little different position. We came into the Union by treaty, and we reserved three marine leagues, which is just about 10½ miles, and Texas people feel as though that belongs to them.

Dr. HARRIS. Yes.

Representative PATMAN. Now, the Continental Shelf goes out from 30 to over 100 miles. I can see where if you take the Tidelands proposal, the great controversy that it is, and let the States have 3 miles, and let the State of Texas have 10½, it would seem reasonable, because we feel that we are entitled to 10½ miles under the arrangement by which we came into the Union, and then let the Federal Government have it out to the Continental Shelf. Would that not be a fair settlement?

Dr. HARRIS. That is a subject which I have not looked into very carefully. It seemed to me that the controversy in the far West was whether the States would get these rights, and then pass them on to private companies, or whether these rights should go to the Nation. It seemed to me it should go to the Nation. In regard to some of the other effects, I do not know.

Representative HUBER. Excluding the Republic of Texas, do you think there might be some merit to the suggestion?

Dr. HARRIS. I should say my views should not carry much weight.

Representative PATMAN. Some of these companies are quitting this exploratory work that they have been doing, and we need oil and need it badly.

Senator FLANDERS. This discussion does have relation to the profits, there is no question about that.

Representative PATMAN. There is profit in oil.

Senator FLANDERS. But I do not know just how we can tie it into the matter under consideration in a satisfactory way, and I am glad we have to make some decision on that this coming session, but I think we had better have hearings directly on that subject.

Dr. HARRIS. I shall finish in 5 minutes, sir.

Senator FLANDERS. I am just remembering here, and have just been shown what I knew, that we are going to have the president of the Sun Oil Co. and the president of the Standard Oil Co.

Representative PATMAN. I know, but we have to ask these questions when we can, Mr. Chairman.

Senator FLANDERS. All right, sir.

Dr. HARRIS. Congressman Patman, I recommend a chapter in Saving American Capitalism that might throw light on the Tidelands problem.

Representative PATMAN. All right.

Dr. HARRIS. I am going to finish in 5 minutes, Senator Flanders.

I would like to say this, that to me the most important attack on the problem of profits is the attack on prices. If you can stabilize prices, a large part of your problem of excess profits would disappear, and that is quite clear from these figures. In 1939 to 1947, profits before taxes, all profits before taxes, were up four and one-third times. Prices were up two-thirds times, and output two-thirds times, and the national income, which represents both of them, one and three-fifths times. In other words, you had an increase in profit before taxes that was away beyond the increase of prices or prices corrected for output, and if you stabilize prices and even if you should have slightly declining prices, a large part of your profit problem would be solved.

I would like to reemphasize the point that unless we make more effective use of fiscal policy, the alternatives are inflation or control, and I think we ought to use fiscal policy as effectively as we can.

In conclusion let me say that there are great dangers in the present situation. Anybody who is an historian knows we have had depressions before, and we are going to have depressions in the future. Consider the capital market and the large rise of bank loans. Consider the rather unwise investments that are being made by business enterprises when they are investing at the rate of $37,000,000,000 a year, and have been going at the $30,000,000,000 rate for 3 years.

I think these economists who forecast a depression or recession in 1948 were not quite as foolish as some of the newspapers make them out to be. The fact is that there was a good deal in the situation that suggested we might have a recession, and my own view is that we would have had a depression quite awhile ago if it had not been for the fact that we have had $50,000,000,000 of Government spending. If it had not been for the unexpected lift of the ERP and the threat of Russia, those forecasts might have been a fact.

I am always impressed by the fact that the Russians keep on telling us that we are going to have an inevitable collapse and yet by their own actions they make us spend more and more money with the result that we put the evil day off.

But, when the evil day comes and with all these accumulated distortions, unless something is done to check the rise of prices then in my opinion we are going to have a very serious collapse. Government spending and Government guaranty of market puts off the day and increases the amount of malinvestment.

I think it is unfortunate that distinguished businessmen like Mr. Sloan announce publicly that we are going to have 2 years of prosperity. How does he know we are going to have 2 years of prosperity unless he knows we are going to have war with Russia or continue a large armament program or something like that? I think considering the long-run inflationary pressures and considering the general tendency of prices to rise and the bad investments we have made already, it is probably wiser if you are going to forecast that it would be better to discourage and you will have done a real service.

Senator FLANDERS. Thank you, Dr. Harris.

Dr. HARRIS. This, I believe, would be a good point for my prepared statement.

(The prepared statement follows below.)

*The causes of higher prices.*—Inflation is a world-wide phenomenon: in countries ravaged by war, and in those largely untouched; in countries blessed by overemployment and in those suffering from unemployment; in countries favored by an excess of imports and those "injured" by an excess of exports; in countries with a budgetary surplus and those with large deficits; in countries largely tethered to the principles of free enterprise and those relying on the planned economy and controls.

War and its aftermath are, of course, the main causes of the current epidemic of inflation. For it is war that provided high levels of employment and activity and corresponding levels of income, without providing supplies of consumption goods and capital for nonmilitary purposes commensurate with the current flow of income. With the accumulation of cash and of liquid assets convertible into cash, the excess of purchasing power over the flow of wanted goods at the current-prices level tended to grow.

*Pressure on resources.*—Obviously, we are doing too much with our limited resources. Hence the pressure on prices. We cannot achieve record levels of consumption, housing, investment, ERP, and disarmament and yet prevent inflation. We are still trying to make up for the deficiency of consumption, relative to income, of 1941–45 and of investment (again relative to income and demand) of the war years. On top of that, we are helping the outside world and we are rearming.

*The rise of wages, profits, etc.*—Under these conditions, our plant is under pressure; and so is our labor force, inclusive of farmers. All groups, although with varying success, seek and obtain higher incomes. Prices rise not only because of the pressure on our limited resources, but also because of the increased strength of labor and farmers who obtain higher monetary rewards, and particularly in boom periods.

On top of this, the businessman charges what the traffic will bear; and, in periods like the present, he can increase his prices and profits with little opposition. When the businessman shows some restraint (e. g., the automobile manufacturers), what he gives up is seized by others, the dealers make a killing by sending prices up to a level determined by supply and demand; and if the dealer should restrain himself, "consumers" would auction off their cars.

*Restraint through monetary policy.*—There seems to be little hope short of extreme measures, unless we pursue a strong monetary and fiscal policy. In the last few years we have had a resurgence of borrowing from the banks which is reminiscent of the twenties. And the Monetary Authority has done little about it, in part because of the fear of adverse effects on the Federal bond market, and in part because of the unwillingness of Congress to support unorthodox measures, that is, force the banks to hold a large volume of Government securities, and thus encourage anti-inflationary monetary policy without damaging effects on the Federal security market. The monetary impasse is suggested by a recent action of the Federal Reserve Board which increased reserve requirements by $2,000,000,000, and then proceeded to give the $2,000,000,000 right back to the market by buying Government securities.

*Restraint through fiscal policy.*—In periods like the present, it is imperative that the Government make the most effective use of monetary and fiscal policy. Particularly the latter might be used with great effectiveness. According to present estimates, the Government will contribute $10,000,000,000 less to fighting inflation in the fiscal year 1949 than in the first half of the calendar-year 1948, annual rate.

A loss of taxes of $5,000,000,000 associated with the unfortunate tax bill of 1948 and a rise of expenditures of $5,000,000,000 associated with rearmament, ERP, and so forth, account for the reduced contribution of the Federal Government. In periods of exuberance, what is required is an excess of Government receipts over outlays: An economy of expenditures consistent with broad objectives of national policy, and higher taxes.

This is probably correct policy even if the year 1949 should prove to be a year of balance. With strong institutional pressures tending to raise prices over the years and with the threat of war hanging over us, we should sharpen our anti-inflationary weapons.

*Controls.*—Should the Government not be prepared to mobilize its fiscal and monetary weapons, then the country will have to countenance a large inflation or else have recourse to direct curtailment of demand. The first step would be increased use of allocations and licensing; the second would be price control; and the third would be rationing and all the other minute controls of demand: That is, priorities. I should observe that price control alone will not do the job. In the present accumulation of liquid assets and excess demand, price control unsupported by supplementary controls would be a farce, and much more difficult to make effective than in 1942–45.

*Profits in our system.*—I have no criticism of businessmen for obtaining large profits. That is their objective in our system; the profit motive is the spark plug of our economic system. Certainly, the scramble for profits over the last 150 years has played a large, although far from exclusive, part in raising our national income by 400 times. This country now supports 27 times as many people at a standard of living 10 or more times as high as in 1820.

*Profits and prices.*—Profits are certainly a necessary condition for the smooth functioning of our system. But it is important that profits should not be higher than necessary to achieve the broad objectives of the economy, and not be so high as to raise the cry of injustice.

If profits are too high, their excess becomes a voluble excuse on the part of trade-union officials, who are always under pressure to obtain wage concessions, to demand further increases. If profits are too high, they in turn affect prices directly.

Whatever the long-run theory of the relation of profits and prices, in the short run, under postwar conditions, they contribute to higher prices as a factor influencing prices directly, and indirectly through the effects on demand.

*Are profits too high?*—Profits in comparison with what? This is not an easy question to answer, and the answer will depend upon the respondent. Here are a few of the pitfalls:

(1) It depends partly upon the base period chosen, and here one runs into the problem of what is the normal period. For example, from 1939 to 1946, one writer found a rise in wages and salaries of 138 percent, and of corporate profits before taxes of 288 percent; but a comparison of 1941 and 1940 yields respective rises of 81 and 45 percent.

(2) Then it is a question of comparison with what? Terborgh, representing the Machinery and Allied Products Institute, suggests that corporate profits after taxes of 9–10 percent of net national income is fair.

Nathan, on the other hand, compares profits with net worth and sales. Whereas the ratio of profits to net national income in prewar and postwar suggests moderate profits to Terborgh, the comparison with net worth or sales suggests very high profits to Nathan.

(3) A third problem is, what is relevant, profits after taxes as Terborgh suggests, or profits before taxes? My view is that the latter is relevant. Obviously, if the comparison were made with profits after taxation, then it would be assumed that it was proper for business to pass on taxes to consumers. This is not the theory of profits taxation, whatever the practice. And the Terborgh position would assume that business was not to pay its share of the 400-billion-dollar cost of the war.

*What are profits?*—Many difficult problems arise in this connection. Perhaps the most perplexing one relates to the valuation of assets. In a period of rising prices, inventories and capital generally rise in value.

Higher values for inventories mean higher profits. But should inventories be revalued at replacement costs, then profits would be substantially reduced, profits would have been $6,000,000,000 less in 1946, or about one-seventh of the profits of this year prior to taxes.

In this same year, business depreciation charges were 8.7 billion dollars. It is clear that, had depreciation been at replacement value, profits would have been less by several billion dollars additional. But the tax collector does not generally allow depreciation charges to cover replacement in periods of rising prices as against acquisition or book value.

I cannot enter into the merits of this debate. The accountants, under pressure from business, are reconsidering the whole problem. It is well to remember also that with depreciation based on replacement value and with inventories carried at replacement value, if profits would be lower in periods of rising prices, they would be higher in periods of depression and falling prices.

What business would gain now, they would lose in periods of depression. Over 150 years ending with the war, there was no net change in prices; they fell as much as they rose.

*The level of profits.*—It is well to be clear that, even in relation to national income, profits are very high, and even in comparison with 1929. What is especially disconcerting and is frequently lost sight of is the large gains of incomes in nonincorporated businesses inclusive of the professions. Note the following facts:

(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 bilion dollars and 5 billion dollars to 18.1 billion dollars and 18 billion dollars respectively, after taxes.

It should be observed that business and professional incomes (not subject to corporate tax) have increased almost three 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. I cannot go into this; but let me point out one interesting aspect.

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.

*Profits and capital needs.*—It is sometimes argued that profits are not excessive because high profits are required in order to finance the capital requirements of industry. This argument, however, leaves out of account issues of equity. If high profits are obtained at the expense of labor and consumers, then, it might be argued, businessmen obtain capital and corresponding property rights at the expense of the public.

Undoubtedly, a revolution has occurred in financing methods. In the twenties, business largely freed itself from the dependence on banks; and in the thirties and forties from substantial recourse to the capital market. Whatever funds were required were obtained primarily from retained profits and from Government.

It is also true that business now retains a larger part of profits than in the twenties. Thus, in 1929, corporations paid out as dividends 5.8 billion dollars, or 69 percent of the 8.4-billion-dollar profits after taxes; in 1945–47, they paid out only 17.2 billion dollars, or 43 percent of the profits of 39.7 billion dollars.

Yet, 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 in 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. That 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 one and one-half years they sold about 7 billion dollars' 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.

*What should be done?*—Obviously, much depends on the price movements of 1949 ,and these in turn depend upon the size of the budget and the budgetary deficit; and these in turn depend in no small part upon the international situation. There can be little doubt that a vigorous fiscal policy, supplemented by a monetary policy, would assure reasonable stability in the next year or two, on the assumption that ERP and military expenditures do not exceed $20,000,000,000 in fiscal 1950 or 1951.

The appropriate fiscal policy calls for a rise of taxes. Had the Government not reduced taxes in 1945 and 1948, annual revenue might well have been at least $10,000,000,000 additional. (Compare the yield of the average tax of 60 percent in 1945 on corporations with the 40-percent rate in vogue now, with a resulting annual loss of 5 to 6 billion dollars.)

Surely a substantial part of this increased bill should be put upon business; and I would like to see the tax based to some extent on excess-over-normal profits for the industry. Of course, I realize the difficulties. It would be helpful if the Executive could have some discretion to raise and lower rates in a manner determined by Congress.

I would support a heavier burden of taxes on business income, even though no clear-cut answer can be given to the question whether profits are too high. Even in relation to national income, profits now seem high when compared to earlier periods of prosperity. Even allowing for higher prices, the higher profits required in prosperity, the need for investment funds, and so forth, we still believe that moderate restraints on the accumulation of profits are now necessary, either on grounds of equity, with a relatively small part of the population receiving 50 to 60 billion dollars of business, and so forth, income—more than one quarter of the Nation's income—or from the viewpoint of stability, it would be better to stop the vertiginous rise of profits.

But aside from the tax program on profits, any general fiscal and monetary policy which keeps prices down will greatly reduce profits.

The most important attack on inflation and therefore on high profits lies in this direction. Profits rise much more than prices or even than prices and output. Total profits before taxes were four and one-third times as high in 1947 as in 1939, and prices were up but two-thirds and the rise of output expressed in prices (national income) by one and three-fifths times.

*Fiscal policy or controls?*—Unless adequate measures are taken in the fiscal and monetary field, we shall either have to acquiesce to inflation or else introduce serious controls. It is important for the Government to economize also. That does not mean that educational help, scientific expenditures, subsidies to housing, and the like, should be ruled out. But insofar as these measures are dictated on grounds of equity or political necessity, then they must be supplemented by other measures; that is, increased taxes, making every dollar go as far as possible, allocations.

We just cannot have more of everything, without inflation, when the country is overemployed and each pressure group is well organized to put the heat on Congress.

We have to give up something—either through more taxes or savings, or else through a system of allocations and priorities.

82989—49——4

I prefer to use fiscal and monetary policy to the annoying controls which the country is inclined to tolerate only in emergencies. The more we use the former, the less we shall need the latter. And the more Government has to spend for armaments, ERP, and to implement social legislation, the more use will have to be made of effective fiscal policy buttressed by an adequate monetary policy; and failing these, the more controls will be required—as the President's Economic Council has already warned the country.

Now, in summary, it is not easy to give a precise answer to the question as to whether profits are or are not too high. The answer depends in part upon what base period they are compared with; upon whether they are compared with sales, net worth, or national income; upon the manner of accounting used—they are, for example, much higher when capital assets are carried at book rather than replacement value; upon the industries studied—for example, from 1929 to a recent year all national income had risen by 100 percent, but the rise in finance, insurance, and real estate was but 22 percent, in manufacturing 116 percent, in wholesale and retail trade 150 percent or seven times that of finance, and so forth.

My considered judgment is that profits are too high. I do not base this primarily on an ethical judgment, although our system would stand a much better chance of survival if the incomes of business and professional groups, going to a relatively small part of the population, did not reach 50 to 60 billion dollars, or more than one-quarter of the total income (before taxes).

The main support for this position is, however, the need of stabilizing the economy. Excessive profits account for an unprecedented level of investment, an inflationary factor of great importance, and for an increase in the pressure on trade-unions to ask for higher wages; and they stimulate uneconomic expenditures which will be costly once the inflation ends.

Rising prices are not the result primarily of high profits. They are the result of a $400,000,000,000 war, with its expansion of money and incomes beyond the supply of goods available for purchase with the excess liquid resources.

The most important single attack on both inflation and excessive profits is to reduce demand relative to supply. Once the rise of prices is halted, profits will decline substantially.

It is well to note that profits rise much more than output, than prices, or even than the rise of output expressed in prices. From 1939 to 1947, prices rose by but two-thirds, output by about two-thirds, and national income (output expressed in prices) by one and three-fifths; but profits rose by four and one-third times. Hence, stabilize prices and there will be much less concern over profits.

In order to stop the inflation, it is necessary to use fiscal policy with effectiveness. Tax more and, insofar as broad national objectives allow, spend less.

In 1949–50, the Federal Government will contribute $10,000,000,000 less to fighting inflation than in the preceding 6 months (annual rate). For it is to raise less in taxes and to spend more. (Hence the public will have $10,000,000,000 more to spend.)

I am not arguing against effective expenditures for rearmament, ERP, and social legislation, greatly needed in my opinion. But I am contendoing that insofar as additional demands are made on the Government, the Government must economize on nonessentials, given the situation—e. g., roads—and the Government must counter additional spending with increased taxes insofar as practical.

Had the Government 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.

It is up to the Government to make effective use of fiscal and monetary policy; and if it does not, then, given the demands on the economy by Government, consumers, and business, there is no other way out but a galloping inflation or controls.

Even in the current situation, there is a case for some extension of controls. We just cannot have more of everything when the economy is already overemployed.

Senator FLANDERS. I must confess I find myself on the horns of a dilemma after listening to you. You suggest that fiscal policy is one of the best ways of handling an inflation, and with that I agree.

As a matter of fact, I think it is rather safer than monetary policy, which seems to me to lead more or less directly into immediate unemployment. I am allergic to curing inflation by unemployment; it can be done so easily and perhaps it is not so easy to control the extent of its operation.

But let me get back to my dilemma. Basing the policy for controlling inflation on the fiscal policy, that seems to require higher taxes and the higher taxes would seem to come largely from industry. The higher the profits, the higher the taxes.

Let us take the present scale of profits which seem to anyone, looking at it yourself, myself, the document just read by the Senator from Wyoming, the National City Bank News Letter and all the rest of it which seems to be so high.

There they are, the profits, and they look to be so high. They result in our present tax rate in a certain amount of insufficient income to government.

Now let us leave *X*-profits as they are and raise the tax rate on the corporations. That leaves less available profits and that brings us right back so far as I can see to the questions raised by Professor Slichter. Are those profits after taxes too large or too small?

The only source of increased revenue we have is from increased taxation of business profits and if the remaining profits are insufficient or just barely sufficient, or only a little more than sufficient, we certainly can see no excuse for reducing the total profits unless we are willing to reduce Government taxes, and on the basis of our analysis they should be raised; so I find myself in the dilemma of wondering whether we ought not to increase profits and increase taxation, or whether we ought to leave profits where they are and increase taxation and have as a net result a smaller remaining profit which will have to be examined closely in the same way, but perhaps with different results from what Professor Slichter examined them on the basis of the social adequacy of existing profits after taxation.

It comes back to Professor Slichter's thesis, in my mind, indubitably if you take the question of the need for Government tax revenue.

Dr. HARRIS. Senator, I am not sure that I get your question but, as I see it, is it your view that profits after taxes are not adequate?

Senator FLANDERS. No; my view is that that is the question to be considered in view of the fact that we have to have probably increased tax revenue.

Dr. HARRIS. Yes. I would say offhand, why not bring the taxes on corporations back to the 60 percent that they were at the end of the war and why not increase the personal income tax so you get some of the business noncorporate income and the corporate profits that are distributed? You might say that 1949 year is a bad year and does not look so promising, and I have talked with a number of people down here about it.

It is not as promising as 1948. I think perhaps it would be well to compromise and say let us have a 50-percent rate rather than the 60 percent. I agree and I think you agree that the attractive feature of the fiscal policy is a little more precise. You can better estimate what the effects are going to be than if you suddenly dump $10,000,000,000 of Government securities on the market.

Representative PATMAN. Or raising the discount rate.

Dr. HARRIS. Yes.

Representative PATMAN. That is having repercussions in the little banks throughout the county right now.

Dr. HARRIS. I think the economists now speak much more about fiscal policy because there is a feeling that the other weapon is not so precise and you do not know where you are going to go.

I do not say we should not use it at all, but it is difficult to use it because of the dangers to the Government bond market.

Senator FLANDERS. Well, the point I was trying to make is that we do have to consider whether the remaining profits after the necessarily increased taxation are adequate.

Dr. HARRIS. Yes.

Senator, I would like to say another thing. I do not believe that only profits ought to be taxed. I would not like to see the necessaries of life taxed, and if there is any gravy to be passed, I would like to see the masses get it.

But if you are afraid of inflation, it is important to tax the main body of consumers as well as profits. I think the 1948 tax bill tended to give too large a proportion to the well-to-do. I was amazed how much my own tax was cut by allowing the wives and husbands to handle their income on a split basis. That was something that was not publicized.

I am not saying that all additional tax should be put on profits.

Senator FLANDERS. So you definitely raise a difference of opinion between yourself and the previous witness on the question of whether or not there is too much current investment?

Dr. HARRIS. Yes; I do disagree with Professor Slichter on that.

Senator FLANDERS. Yes; that is a point that we have to consider in discussing among ourselves the questions raised by yourself and Professor Slichter.

Senator O'MAHONEY. When you speak of investment and say that there is too much investment, are you talking in terms of the runaway speculative investment in equity stocks which preceded the collapse of 1929 or are you talking about investment in the expansion of productive facilities?

Dr. HARRIS. Well, Senator, I am talking about the latter. I think the economist generally means that; that is, what he is talking about is the increased factories, school houses, even road building and all of that, anything that is being produced for future use.

Of course, you might even say that if you buy an automobile you are investing, you are buying 10 years' consumption and you are spending all your money today.

Senator FLANDERS. If you have it in mind that from your point of view it is unwise to encourage new investment too greatly, would you wish to apply that point of view, for instance, to the steel industry?

Dr. HARRIS. I had in mind the difficulty of the steel industry, Senator. That is a very difficult question to answer. I would say, for example, if Professor Slichter's suggestions were taken, I would hate to think of what would happen to business if they had $70,000,000,000 worth of more investment to bring them back to 1929.

There is a special case in steel. You probably know the whole British controversy is largely tied up with the same issue. The labor people claim they keep capacity down. I think it is awfully difficult to say. I would say in the case of steel you might put up a pretty good case for more investment, but you must not forget that if we are going to have a full employment economy in the next generation or more——

Senator FLANDERS. That is what this committee is for.

Dr. HARRIS. But can we achieve it? If we do not, we are going to have this tremendous problem of excess.

Senator O'MAHONEY. Are we to draw the conclusion that you are discouraging the thought of additional capacity for fear that the full employment economy cannot be maintained?

Dr. HARRIS. I would say as an historian that if I were an investor, for example, and could buy a stock that represented all corporations with the idea that we were going to full capacity, I doubt that I would invest. But as a witness or as a Senator I would certainly do my best to bring about this high-employment economy.

Senator O'MAHONEY. If you do not do that, the alternative is unemployment, is it not?

Dr. HARRIS. I would certainly say that whether you need $70,000,000,000 worth of investment depends in part on whether you are counting on full employment economy for the next 20 years. I would say even if you were, $70,000,000,000 is too much. I am now discussing the $70,000,000,000 deficiency mentioned by Professor Slitcher, not the $20,000,000,000 (say) needed additionally each year. I am perfectly willing to say that it might be worth while, not in the interest of the investors, but from the viewpoint of the Nation, it might be very well to subsidize added investment in steel and that is what the British Labor Party is doing in the iron and steel industry.

If the iron and steel people do not invest, say $100,000,000 because it is unprofitable in their point of view, you would be faced with the problem of subsidies.

Senator O'MAHONEY. Have you made any differentiation between plant expansion by large concentrated industry, plant expansion by local decentralized industry, and investment in productive enterprise and in investment in merely unnecessary enterprise?

Dr. HARRIS. That is one of the dangers, it seems to me, that there is a lot of investment going into industries where once we get into any kind of difficulties, these investments will be proven to be poor. It is difficult for an investor to come around and say where all this money should be invested. The Russians know where they want their money invested. They know how much military goods they want and how much they need for their civilian economy.

In our economy it is largely determined by what the people in private enterprise decide is going to be the demand for the kind of goods they produce. They may make very great mistakes since they depend on psychology and all that sort of thing.

Senator O'MAHONEY. Speaking for myself, I do not think it is necessary to reach the conclusion that we should not have an investment in productive plant capacity.

Dr. HARRIS. I did not say that. I said that $70,000,000,000 might be too much, and if I were a private investor that I would not invest my money in general on the assumption that we are going to have full employment for the next 25 years. I would say that on the basis of our experience despite the fact that we have now in the Senate people like Senator Flanders, who understand these problems much better than the average Senator and much better than the average businessman. I think that the Senate is fortunate in having him with us on this problem.

Senator O'MAHONEY. We are very fortunate to have him on this committee.

Representative PATMAN. Very.

Dr. HARRIS. I have gotten off the subject now. I am not sure, however, that the Senator approves of all my economics.

Senator O'MAHONEY. Whom are you addressing now?

Dr. HARRIS. Senator Flanders.

Senator O'MAHONEY. I think it boils down to this and the question that has been discussed here this afternoon, whether we expect the Government to support the people or the people to support the Government.

Now so far as the corporations are concerned it would seem to me that on the case made out here today by Professor Slichter, although he clearly sees the great expensive burden which the Government must carry if it is to win the peace, he nevertheless thinks that the profits of corporations should be reassessed so that they will not have to pay as much taxes as they ought to pay if we are going to have a surplus, a Government surplus, which is about the most effective anti-inflationary action that we could take.

Dr. HARRIS. I just want to make one comment there and this just struck me. If we have this war economy then I would say we certainly cannot afford the $70,000,000,000 worth of investment that the professor is talking about.

If we do not have the war economy, my guess is that we are going to have some trouble and therefore the $70,000,000,000 would be excessive. So either way you are going to have your difficulties.

Senator FLANDERS. I want to say in all seriousness to the witness that from my point of view, Professor Slichter's testimony alone would not have been complete and that the stimulation of your differences will enable us to reach sounder conclusions than would have been the case, with the presentation of one point of view.

Dr. HARRIS. Senator, I want to repeat that there are a great many points with which I agree on with Professor Slichter. We are not 100 percent apart. In fact I agree with you on fiscal policy. This fiscal attack, that is perhaps the most important point I have to make. It is a much better tool to use than regimentation.

Representative PATMAN. I want to ask a question or two, Mr. Chairman.

I think we do need new steel capacity. Many people are saying that we should have at least 10 million increase annually. I have an idea that the big steel companies have not been expanding for the same reason that you outlined awhile ago. As a businessman you probably would not recommend it as an investment.

Therefore, since steel is such an important item, basic commodity, I think it is probably time that the Government should give consideration to it.

We had several witnesses before our Committee on Small Business in some of the cities of the country recently and some of the business groups are advocating the Government's actually putting up the money to expand steel facilities because they are unable to get steel and something has to be done about it.

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.

Senator FLANDERS. It is now practically 5 o'clock and we will close this hearing today. We will resume tomorrow at 10 a. m. in this room.

We have two witnesses for tomorrow, William A. Paton, member of the committee on accounting procedures of the American Institute of Accountants and professor at the University of Michigan, and George D. Bailey, past president of the American Institute of Accountants of Detroit, Mich. They will address themselves to the question of whether profits as given out in the annual reports of businesses are real or imaginary.

We thank you, Professor.

(Thereupon, at 5 p. m., the committee recessed to reconvene at 10 a. m., the following day, December 7, 1948.)

# CORPORATE PROFITS

---

**TUESDAY, DECEMBER 7, 1948**

United States Senate,
Subcommittee on Profits of the
Joint Committee on the Economic Report,
*Washington, D. C.*

The subcommittee met, on the expiration of the recess, at 10 a. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders, chairman of the subcommittee, presiding.

Present: Senators Flanders (presiding) and O'Mahoney, and Representatives Patman and Huber.

Senator Flanders. The hearing will come to order.

This morning we are to listen to two leaders of the accounting profession on subjects raised in yesterday's testimony which, briefly stated, raises the question as to whether the profits of corporations, as they reckon them by their bookkeeping methods and as they publish them in their annual reports, are or are not real profits.

While the question is a special question in the accounting field, I think we may have hope that the two witnesses today may put it in such terms that we can understand it; that is the hope with which we start this hearing.

Senator O'Mahoney. It is good to have an optimist as a chairman.

Senator Flanders. This is the time to be an optimist. We will see how we are at the end of the day.

Our first witness is Prof. William A. Paton. He has had long experience in the accounting field and has published numerous books and is at the present moment a professor of economics at the University of Michigan.

Mr. Paton, will you take the chair?

## STATEMENT OF PROF. WILLIAM A. PATON, UNIVERSITY OF MICHIGAN

Senator Flanders. I believe you have been forewarned, Professor Paton, as to the particular question which we hope you will elucidate to us.

Dr. Paton. Mr. Chairman, I am very glad to have the opportunity to come down here and express my views on this subject of profits that you gentlemen are concerned with. I am taking the liberty in view of the joint appointment to which you referred, professor of economics and professor of accounting, to start off with a rather brief discussion of a couple of matters that perhaps might be thought of more properly in the field of economics, if you will bear with me.

Senator FLANDERS. You may proceed.

Dr. PATON. I will do that prior to dealing with the accounting as such.

I think in any discussion of the level of profits and proposals dealing with the taxation of profits, and so on, that a necessary preliminary step is recognition of the nature of corporate profits and their general significance in the economy.

Now this is rather elementary, but I feel that we, from time to time, need to be reminded of rather elementary considerations.

Senator O'MAHONEY. May I ask first, Professor, do you distinguish between corporate profits and any other kind of profits?

Dr. PATON. There may be differences, Senator, due to the fact that in the corporation, for example, practically all of the personal services are hired, whereas in unincorporated concerns what is called profit may include an element of wages. Aside from that I would say that the problem is somewhat the same, substantially the same, in both situations, although the tax situation in our institutional set-up is different as compared to partnerships and unincorporated concerns on the one hand and the corporations on the other. Therefore, I think there is a little something distinctive as a practical matter about this question of corporate profit.

In the first place, they are a dominant element in the economy and they are taxed in a different way from partnerships and sole proprietorships. Particularly for those reasons I would say it is a somewhat more distinctive subject—the part of profits that we are concerned about.

Senator O'MAHONEY. I note that you say they are a dominant element in the economy. I think that is significant.

Dr. PATON. I think with volume of business and number of employees that is clearly the case.

As I see it, corporate profits basically are the earnings—one might almost say "wages"—of the stockholders, the persons who provide the risk capital, which is the lifeblood of private-business enterprise. The corporation itself is nothing more than an institutional arrangement whereby a group of investors pool their savings for the purpose of carrying on some business activity.

Capital is one of the primary ingredients of business operation, one of the indispensable factors, and like other factors, capital commands a price that is a resultant of an array of demand-and-supply influences. In the case of funds furnished by bondholders and other groups of investors with a preferred position, the return to the investor is a contractual price, determined in much the same manner as prices of commodities and personal services.

The common-stock holder, on the other hand, occupies the residual or buffer position in the undertaking. He furnishes the essential layer of risk capital. He is not assured of a particular level of earnings, or of any earnings. He "holds the bag." The amount of his earnings, if any, depends upon the relation of varying revenues and varying costs arising from the sum total of transactions and conditions making up the operation of the business.

There is no cost-plus contract between the particular business and a definite body of responsible consumers; instead the capital invested is at the mercy of a complex of market forces, and earnings for the stockholders will appear only if the array of forces brings this about. If the undertaking is never successful the stockholder will never realize an income, and may lose a part or all of his investment. If the undertaking is highly successful he will make a high rate of return on his investment.

In most fields of industry a considerable range of results with respect to profits—the earnings of stockholders—is found. The particular concern in most fields of industry, moreover, has a fluctuating history in this respect. There may be periods of very profitable operation, periods of low earnings, and periods of no earnings and actual losses. As has sometimes been said, competitive private enterprise should be described not as a "profit system," but as a "profit and loss" institution.

Now, it seems to me, the important point for us all to bear in mind is that while the person who provides risk capital—the stockholder in corporate enterprise—is not assured of a particular level of earnings or of any earnings in our economy, the totality of economic and political conditions (including the tax structure) must offer a prospect of earnings if this type of investment is to be provided.

It is in this manner that risk capital is priced by the market, and earnings of such capital become a requirement of continuing business acivity. Without a prospect of earnings—and the prospect must not be too dim—it is obvious that there is no inducement to the person who is saving money to become a common-stock holder. And since the provision of a substantial layer of risk capital is the very essence of private corporate enterprise there must be an earning prospect—an earning potential—if such enterprise is to persist.

It follows that if interference with the competitive forces of the market through taxation, control of product prices, or other means should be carried to the point at which incentive to provide risk capital disappears, the final result would be the abandonment of private corporate enterprise and the substitution of governmental ownership and operation. The only alternative to risk capital, provided directly by the individual savers of the country to supply the funds needed for business development and expansion, is government money raised by government borrowing or taxation.

I would also like to say a few words about the tax structure as I see it in respect to the corporation before going more explicitly into accounting matters.

It seems to me that a second broad consideration that deserves attention preliminary to a discussion of the present level of stockholder earnings is this 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.

As I mentioned above, the corporation is simply an institutional arrangement which facilitates the pooling of the resources of a more or less considerable number of persons to carry on a business undertaking. The corporation is a vehicle of administration, corporate management is the steward of the stockholders. And taxation of the administrative vehicle—of the steward—as if it were a taxable person on its own account—is a highly unreasonable procedure—a procedure that would appear fantastic if we hadn't been doing it for many years.

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.

I would like to call attention to the fact, although this is ancient history, that this point of view was reflected in the early income tax legislation. In the statute of October 3, 1913, the list of deductions provided to individuals included—

> the amount received as dividends upon the stock or from the net earnings of any corporation * * * which is taxable upon its net income,

and with respect to corporations the act states—

> that the normal tax hereinbefore imposed upon individuals likewise shall be levied * * * upon the entire net income.

Similarly the act of 1916 provided for a tax on corporation net income restricted to the rate of the normal tax on personal income, and dividends received were treated as a "credit" for the purpose of the normal tax in the individual return.

The early statutes, in other words, 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.

I do think this, Senator, if I may add another word to avoid any misunderstanding, that the stimulation in one way or another of small corporate undertakings is extremely important. In other words, that is the kind of thing that made American business move along; John Jones starting up in the woodshed in a small way and getting in a little money, putting in a little money of his own and his father-in-law putting in $500 and so on, with the expectation of the thing rolling into a big business some day.

Senator O'MAHONEY. Would we not lose that completely if a small, new competitive enterprise is taxed in the corporate form at exactly the same rate as a gigantic enterprise which has been building up over a long period of years?

Dr. PATON. It is a very involved subject. I personally feel that we would have been better off years ago if we had gotten started off on the beam of a more moderate tax rate on all corporations as a corporate institution and more severe taxes on the distributive shares of the stockholders in accordance with their own financial positions.

Senator FLANDERS. There are of course complications involved in undistributed earnings which apply differently between the corporate form and the partnership form. It is not a simple subject.

Dr. PATON. It is a very complex subject, sir.

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 that 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.

Senator O'MAHONEY. Of course we cannot discuss the difference between small business and big business here this morning.

Dr. PATON. That is right.

Senator O'MAHONEY. May I ask you this question, Professor: Has there not been a very large increase in the number of corporate stockholders in the United States?

Dr. PATON. I would say yes.

Senator O'MAHONEY. Do you have that at your command, the numbers?

Dr. PATON. I do not know. My impression is that there are ten or twelve million people who own shares of stock of one kind or another.

Senator FLANDERS. That is the institutional shares as well?

Dr. PATON. Yes, and with the growing population there has been an increasing investment.

Senator O'MAHONEY. Is it not a matter of fact that until World War I corporate stock ownership was largely confined to individuals in the upper brackets? That is to say, confined to those of the comparatively large income but after the Government in financing World War I showed how much capital was available for $50 bonds and $5 bonds and $100 bonds, stock salesmen began to distribute corporate stocks to the little people and that there are millions of stockholders now holding almost infinitesimal numbers of shares in corporations—a much larger number than 20 years ago?

Dr. PATON. I could not say from my own knowledge just what the comparison for the two periods you indicate is, but there has been a substantial increase in the number of stockholders in certain types of corporations and that is perfectly clear. Of course, we ought to remember that of the 390,000 companies only two thousand or three thousand of these companies do we hear about as a result of being quoted on the Exchanges.

It is in the two or three thousand that the multiplication of stockholders has expanded more than in the small family corporations.

Senator O'MAHONEY. Those 3,000 corporations could roughly be designated as those which employ 500 or more individuals each or maybe more than 1,000. They are the dominant corporations, they are the ones that give the character to our modern corporate enterprise system.

Dr. PATON. They are in many fields and they do a large fraction of business, in fact, although the other fellows are not negligible.

The point on taxes which I want to bring out and I want to seize this opportunity to express my opinion is to the effect that the gradual development of the idea that the corporation was a sort of entity in its own right and the full-fledged taxation of corporate income and then the full-fledged taxation of anything that is left from that income that trickles through to the stockholder in his own right is, I think, a pressure type of taxation that is very unfortunate from the standpoint of long-run effects on the economy.

It was not in effect in the earlier tax structure and it has gradually grown up on us. I think we have absorbed rather too fully the idea that this steward of the stockholders is like a natural person and should be so treated.

Representative PATMAN. I would like to ask you a question on the smaller corporations. Do you believe that any of our corporations have reached the size to where they are less efficient than they would be if they were smaller?

Dr. PATON. Well, that is a tremendous subject also and my own opinion is somewhat mixed on that. I think that there is often an optimum point of size. I have never felt that, for instance, if the entire country were run as one corporation necessarily that we would get as much efficiency as with some decentralization.

I do not have a definitive opinion with respect to particular companies on that question, but I do have the feeling that we can see to it that monopolistic pressures are adequately restricted and full play for real competition in the various fields is assured; that young vigorous expending industries may at certain points prove to be more efficient than the larger, and in a sense, better established companies. I think that is an awfully difficult question to have anything but a broad opinion on.

But it seems to me that the presumption is always against too great a centralization. Even in an educational institution I think there comes to be an optimum point of size in which it is difficult to handle matters as effectively as if maybe some new schools are started to take up the increase.

Representative PATMAN. Of course we know that certain concerns must necessarily have to be large like those producing automobiles. I wonder if you have ever made a study to determine in certain industries were a point is reached that the corporation is most efficient.

Dr. PATON. No.

Representative PATMAN. Do you know of any study made by any group.

Dr. PATON. There has been a lot of discussion of the question but I do not know of any quantitative study that has any significance.

Representative PATMAN. You take some of these insurance companies, some of them have 5 or 6 billion dollars. And that seems like a great concentration of power. Have you even given thought to the concentration of insurance companies?

Dr. PATON. I have thought of it, but I have never made a statistical study of them. There are still a great many of them.

Representative PATMAN. There are a lot of insurance companies and in fact there are good ones.

Dr. PATON. I might say like any other citizen I tend to be a little suspicious of too much concentration of power even in the form of government.

Representative PATMAN. Is it not a trend toward socialism that if you get these industries into one package the Government could not take them over but if one concern engulfs all of them, all of the industries in that one package, would not the slogan or campaign to let the Government take over monopolies be almost irresistible by the people?

Dr. PATON. I am a great believer myself in competition and in the use of power of government in every possible way to restrict monopoly, and I do think that the concentration of the power in a limited number of hands might easily be the first stage toward Government ownership.

In other words, if the thing gets out of hand, the Government is going to step in. I think that is plain as day.

Representative PATMAN. That is all.

Dr. PATON. On the level of corporate earnings at the present time of course the immediate question is, what are the merits of charges being made to the effect that the earnings of American corporations are excessive, that our corporations are indulging in gouging, profiteering, exploitation, and that something must be done to curb these insatiable institutions if inflation is to be checked and the standards of living of the people preserved?

This is perhaps an unnecessary thing to say but I would like to point an aspect that I think is psychologically important that in any difficulty there is always the desire to divert attention from the real causes of our troubles to some imaginary culprit who can be safely scolded.

Organized business enterprise has occupied a whipping-post position in this country for some time. By a process of personifying business activity, using such expressions as capitalism, Wall Street, and so forth, as epithets, and forgetting that the people who provide business with capital and who supervise business operation are ordinary folks like the rest of us, as sort of mysticism is developed that tends to obscure the real issues. I hope that the members of our National Legislature, in pursuing their inquiries, will discount heavily all such loose talk and abuse.

I notice now that the accountant is getting to be a minor culprit in this situation although I think again this is largely a matter of diverting the mind from the real problem.

Senator O'MAHONEY. One of the real questions here, Professor, is not to seek out whipping posts but to seek out sources of tax revenue that will be sufficient to carry on the activities of the Government which the great majority of people want the Government to carry on.

I am sure so far as this committee is concerned that none of this talk of yours about culprits and the use of epithets and the rest of that has any application at all. We are here trying to carry on a constructive study to find out whether or not corporate earnings are, in fact, at unprecedented levels and if they are, whether they are properly and sufficiently taxed.

Dr. PATON. Let me make this perfectly clear, and this is absolutely sincere, that I have not the slightest intention of scolding this committee. I just wanted to express my opinion that all over the landscape, and it is a very important psychological matter, attention does frequently become misdirected.

Senator FLANDERS. Of course we may have, if I may say so, the problem of finding somebody or something to tax.

Dr. PATON. That is right; thank God you fellows have it on your hands, not me.

Senator O'MAHONEY. You are advising us, Professor?

Dr. PATON. I am going to.

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 was 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 stockholder, 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.

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.

Senator O'MAHONEY. Do you not think, Professor, that a possible explanation of that situation has been the growing concentration of economic power in the hands of a comparatively few corporate giants, these 3,000, of whom you spoke a short while ago out of some 400,000 plus corporations as a whole? So that, individuals hesitate to risk their capital in setting up small competitive enterprise in the same field?

Dr. PATON. Well, I do not feel that way, no, although I realize again that that is a very difficult question.

As I have said in my prepared statement 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 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.

Now to turn to the accounting for corporate earnings. 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. There are no serious complications in measuring the earnings of a corporate employee, for example, who is paid $4,000 in the year 1948, or the schoolteacher, for example. He receives 4,000 of the relatively cheap 1948 dollars and that is that. In the case of the stockholder, however, the situation is much more involved, although I am not saying that that is a whole lot either.

The earnings computed for the stockholder are the result of deduction from total revenues an array of applicable costs and other charges, and the final result is subject to all the limitations of an accounting system that endeavors to deal systematically with the complex questions concerned with recording costs as incurred, tracing the course of each cost factor through the stream of business operation, and allocating each type and item of cost to periodic revenue in a reasonable way. Judgments, analyses, valuations, come into play all along the line and the results are no better than the quality of the judgments exercised. It is safe to say that there is no statistical problem that the human being tackles more difficult than that of attempting to chop the stream of business activity represented by the affairs of a large corporation into annual segments and to state in black and white, in a definite number of dollars, what the company earned each year.

It is no wonder that generally speaking we do not understand the results of that very complex process. We do not understand how complex it is; very few people do.

Take for instance this distinction between disposable income and reported earnings. Quite aside from changes in the price level that is a basic distinction. The income statement is made up roughly at the top with a total stream of receipts from customers and then a large number of charges are deducted from that in getting at the earnings.

Well, all through the year money is being spent by the treasurer as it comes in to pay bills, expand inventories, if that is necessary, to buy equipment, to retire current debt if that is excessive, and there are a whole flock of ways for which that money is spent from day to day.

We come to the end of the year and we have accumulated computations which indicate that the earnings are, say, $10,000,000 and there may not be any money at that particular point that is disposable to the stockholder or anyone else. That is particularly true in expanding businesses where there is a need from day to day for larger working capital in the form of inventories and additional plant facilities.

That is also a puzzle to the stockholder and even the businessman. I would like to say that I do not think accountants have done as well as they might have to explain the situation, the distinction between computed earnings and any money that might be in the bank at that particular point available even to pay taxes as far as that is concerned. That is particularly important in an expanding situation.

Aside from the technical complexity of the process, conventional accounting has certain fundamental limitations. The most serious is found in the fact that the whole structure is predicated on the assumption of a stable measuring unit. The accountant assumes that the dollar he is using in his reckoning is the same yesterday, today, and forever. Unfortunately this assumption does not square with the facts. It would be grand if the economic significance of the monetary unit did not fluctuate, but that is not the case.

We are up against a real difficulty that the physicists are not up against because the units that they use stay put.

As every citizen knows, the only aspect of the dollar that remains unchanged from year to year is the name, and I sometimes get the notion that we would all think more rationally about our economic affairs if we changed the name every year or so as the economic content changed. Thus, we might call the 1948 unit the zollar, and this would encourage clear thinking when we were comparing the present value of money with, say the 1940 dollar

The accountant, in other words, 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 figure is not a large fraction of total expenses it may be an important figure when compared with net income.

Assume, for example, that a particular company shows net earnings for 1948 of $10,000,000 and that the depreciation included in expenses based on recorded plant costs is $4,000,000. Assume, further, that on the average the plant facilities of the company were acquired when the price level was only half as high as in 1948.

In this situation it can be urged that the expired plant cost shown as a deduction in the income statement is only half of what it should be, in terms of the 1948 prices applied to most other cost factors, and that the significant depreciation figure is therefore $8,000,000. With such a deduction the net earnings reported would be reduced from $10,000,000 to $6,000,000, a very substantial change.

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.

Senator FLANDERS. You have, of course, the problem of changing the accounting procedure as against changes in standards for reckoning profit that are set by the Internal Revenue Bureau?

Dr. PATON. That is right.

Senator FLANDERS. You will come to that, I presume?

Dr. PATON. Well, perhaps not directly, but one of the complications that we must remember when we criticize the accountant for this and that is that he is caught up in a highly institutionalized situation, in which the tax structure is a part, in which he cannot just throw his weight around as does a statistician who is not similarly restricted.

Senator O'MAHONEY. Professor, we read a good deal nowadays in the financial columns of the daily press and the financial press of the purchase of one corporation by another, of mergers of one kind or another. We find a good deal said about the acquisition of the assets of one corporation by another.

Now, in the case that you have cited here, would you say that the selling corporation would sell its plant at the inflated dollar or at the cost dollar?

Dr. PATON. The former, Senator, invariably, just as you or I or anybody else would; that is, if we own a piece of land that we are going to sell in terms of 1948 dollars we want to be paid the number of dollars that is appropriate in view of the present picture.

Senator O'MAHONEY. In other words, in such a circumstance there would be a large capital gain upon which there would be a tax.

Dr. PATON. That is right.

Senator O'MAHONEY. Well, does that not make it clear that every corporation has the capital gain advantage which is reflected in this instance; namely, plants and equipment owned by every corporation are today worth a good deal more in terms of dollars although the dollar may be cheaper than when originally purchased?

Dr. PATON. I think that it is worth more.

Senator O'MAHONEY. Would you take that into consideration in your advice to this committee that we should not figure that profit?

Dr. PATON. Well, I think that you are raising an entirely different question from the one that I am dealing with, if I may say so. How the earnings of corporations should be reported in view of very marked changes in the yardstick is one question and the question what should be done with any dollar gain which might be realized if those assets are transferred to another entity at the present cheap dollar calculation is another question.

I would say that, relatively speaking, the number of instances of those transfers at the present time is not a very significant factor in the situation.

Senator O'MAHONEY. My question is merely, Is it not a fact that inflation raises the dollar value of every piece of property that a corporation owns?

Dr. PATON. It should.

Senator O'MAHONEY. Surely it does?

Dr. PATON. The important point is that the accountant does not follow that change, as I will try to develop here.

Senator FLANDERS. Just to pursue that thought one step further. What happens is that while the present-day value of the facilities may be very much greater than at the time they were bought, both the accountant and the United States Government refuse to recognize that fact so far as the depreciation reserves are concerned?

Dr. PATON. That is right; which is a very important aspect of the situation.

Now the remedy, as I see it, is the 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 that procedure, but I believe they would all agree that earnings records are subject to serious limitations and should be read with due recognition of those shortcomings.

I would like to read a paragraph from a paper presented by an outstanding professional accountant, Mr. George D. Bailey, the immediate past president of the American Institute of Accountants and it is in the article presented in Financial Management Series No. 91, issued by the American Management Association.

Senator FLANDERS. I take it that this is the gentleman who will follow you?

Dr. PATON. I believe that he is to follow me; yes, sir.

This is the paragraph that I am anxious to get in the record of this committee:

> There are certain palliatives, believe it or not, that are available within the realm of generally accepted principles—

speaking of the problems of change of the value in money—

> It is still possible to set up on the books current values of facilities and take depreciation on such current values against current earnings. This, of course, requires objective evidence as to the propriety of the amounts written up and requires a continuation of the new position once started. It requires that the transaction be entered into in good faith in order to avoid the aura of impropriety that in the past has surrounded such write-ups, but it is a possible method.
>
> I think myself that it has more to recommend it than appears at first glance because if we are actually on a new and permanently high level of prices, the sooner we recognize the stake the stockholder has in that new level, and the responsibility which management has to earn upon that level, the better we will meet the transition period.

Now, I think that is a very sound recommendation although, as has been pointed out by the chairman, that does not correspond to the basis of reckoning if it is applied to the accounts of the company that is in the tax structure.

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.

Senator O'MAHONEY. My question is, How many corporations would actually build the same building? Is it not a fact that due to technological improvements of one kind or another factory replacements and particularly equipment replacement is far more productive than the outmoded building or equipment that has been depreciated and is being replaced? In other words, is it not a fact that in many cases, if not in most, a modern factory may be more productive than the old at a ratio of 2, 3, or even 4 to 1?

Dr. PATON. Well, I think that you are touching on a very important point and a good technical point for accountants and appraisers to consider.

Senator O'MAHONEY. Let us amend your statement and say a good technical point for an amateur.

Dr. PATON. A good technical point for a professional—I mean that very seriously. That is something that I think was not sufficiently regarded in many of the appraisals that were made in the twenties when we had perhaps a somewhat similar situation.

Senator FLANDERS. Can you not put that on the basis not of replacement of an individual building or an individual piece of equipment, but replacement of an equal productive capacity?

Dr. PATON. Mr. Chairman, I certainly would not want to argue that real expenses in this sense of the quantum of economic force expended should be measured literally by the replacement cost of particular facilities. I think the point that Senator O'Mahoney has made can be overstressed just like any other slant on these things. But I think that there are industries where it is quite important.

The thing that you and I are interested in is the maintenance of capacity in terms of capital goods and we are concerned with these dollars only because we have to be, in connection with making measurements in connection with these phenomena, and in any situation accounting wise that I were making recommendations on, I would say that that point ought to be taken carefully into consideration. I think that the way you have expressed it, Mr. Chairman, hits the nail very well on the head, namely, that in a very substantial sense the real cost is the cost of maintaining the productive capacity in that business. That is the thing that we are particularly interested in and that is the thing we hope that the revenues will do for us as well as making some return to the investors.

Representative HUBER. Professor, the contention, of course, is that a dollar is not a dollar anymore.

Dr. PATON. I think that is beyond a contention, sir.

Representative HUBER. This 1948 dollar—zollar—suppose the tax collector should say that you owe $1,000,000 in taxes but yet we do not want to accept the 1948 dollars. These dollars, the inflated dollars, well, they are worth only 50 cents and we would have to have $2,000,000. Would that not follow through?

Dr. PATON. No; I do not think so. I think the way to handle it in the tax technique there, is that for better or worse we have the 1948 dollar here and that is the measurement that you and I should think in terms of and that we simply want to be careful in making any calculation that it is made consistently in terms of these 1948 dollars.

When figuring the thing consistently across the board in terms of 1948 dollars instead of having a lot of figures such as those in income statements that are in 1948 dollars and some other figures that are in terms of an entirely different measuring unit, we should exercise care.

Now that creates a tremendous problem in equity. Of course, if the 1948 dollar stays with us, gradually that equity problem will be reduced.

Representative HUBER. We will still use the term "dollar" but we will do some bookkeeping to prove that it is not a dollar?

Dr. PATON. Yes; that is a practical thing.

I do think we need methods of more widespread recognition of the fact that the dollar has changed.

I am reminded of the story of the chap who came home to his wife and told his wife he had a $500 advance in salary. This actually happened, and he was feeling pretty good and Molly took a sour view of the case. She said, "Well, that $500 increase wouldn't make up the increase in our grocery bills," and some other bills that she mentioned during the past year. She took the wind out of his sails.

He said, "At least I am better off by having gotten the raise."

She agreed with that. More 1948 dollars are better than less 1948 dollars.

We have trouble adjusting ourselves to this situation and that partly because the accounts and statistics and so on tend to lag behind the procession.

If I might add another word here, and I realize I am perhaps doing too much talking, but I might add that a lot of folks are saying that the business of our Government and the rest of us is to get prices down. Now although I am a school teacher on a fixed income, I do not look at it that way at all.

I think our business is to 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 both private and public policy should be toward holding prices just where they are as long as we can. That should be our policy with the recognition of the desirability of minor fluctuations, to take care of the fluctuations in the demand and any particular factors.

I myself have no patience with this notion that we should be trying to get rid of the 1948 dollar. I think we should be adjusting ourselves to it.

Senator O'MAHONEY. May I ask this question? Let us assume that a corporation built its plant or acquired its equipment by the expenditure of borrowed money, let us say, in a 1939 or 1940 dollar and repaid that dollar substantially in 1940 or 1941 dollars, but still was depreciating the cost as a matter of accounting. Would such a corporation be entitled to get the tax deduction for which you contend in terms of 1948 dollars?

Dr. PATON. Well, on that I would like to say first that I have a sentence or two which I want to give you later on the question of what consideration I think we might give to this tax situation.

I would not want to contend literally without giving the matter still further attention that we should necessarily switch our tax structure.

I mean that is a very difficult question. I do think, however, in measuring the income for purposes of showing what a corporation is doing relative to other elements in the community and so on, that it would be highly desirable to adjust that deduction and I would not consider that the fact that the money was secured in part by borrowing had a bearing unless I were over in the utility field where we are specifically regulating rates and trying to assure the company of the narrow band of fluctuation.

I do not consider that the State or the public has gotten behind industry in general in that way and, therefore, that the risk situation is altogether different, but that is again a big subject.

I can see that you have picked up, Senator, some extremely interesting and technical aspects on this.

I am not saying this for the sake of talking at all because I consider this question of borrowed money in the utility field to be an important factor in deciding what the reasonable rates are.

Senator O'MAHONEY. Why would it not be an important factor in every field?

Dr. Paton. I do not think we have gotten to the point yet where the public is saying to industry that now we are going to restrict your rates to 5 or 6 percent, or whatever it may be, on the investment and then if you have a bad year we will raise prices for you so you will still make 5 or 6 percent. That is, we are still giving industry the opportunity to keep abreast of the market situation and I think that is an important distinction.

I want to mention the problem in connection with inventories, which has been dealt with somewhat here, I think, already. 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.

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. It is fair to say, however, 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 receipts from customers.

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.

As a final point that I would like to deal with, and then I will be through with my statement, I have been worried about the tendency to compute earning rates in terms of the present-day corporate statements. I think that in view of the limitations of accounting, more or less unavoidable limitations, that we have got to watch our step in this connection. As I have tried to indicate, corporate earnings are generally overstated nowadays in a significant sense because of the practice of basing certain expenses on recorded dollar costs that are out of line with current prices expressed in a new and cheaper monetary unit. This is bad enough. But the error becomes magnified when the overstated earnings are applied to an understated book value of stockholders' investment.

In many cases the dollar book values of corporate resources, particularly in the area of fixed assets, are very much less than the total number of dollars involved stated in terms of present-day prices. We were talking about that a minute ago. Accordingly, a rate of earnings, an earning power, computed in terms of these respectively overstated and understated figures is likely to be grossly improper and misleading. Suppose, for example, that the reported earnings of a particular company for 1948 amount to $10,000,000 and the total of resources employed less liabilities as reported in the statement of financial position is $50,000,000. Relating these figures it appears that the corporation had an earning rate of 20 percent, a very fine showing indeed. But suppose, further, that if all the costs deducted in arriving at the earnings of $10,000,000 had been converted to 1948 prices, so as to place them on the same basis as revenues received and other costs, the resulting net would be only $5,000,000. And suppose, still further, that if all recorded asset costs stated in terms of earlier price levels were converted to a current basis, so as to put them on the same footing as similar assets recently acquired, the total of the resources employed less liabilities would amount to $100,000,000. Evidently earnings of $5,000,000 give only a 5-percent yield on resources employed of $100,000,000—quite a change from the 20-percent rate computed on unadjusted book figures. This is an imaginary case but I don't believe it is farfetched. Moreover, I am convinced that in the case of some of our important companies that show an earning power of 5 to 6 percent on book figures, the actual return on risk capital calculated consistently in terms of 1948 dollars, both with respect to earnings data and assets involved, does not exceed 3 to 4 percent.

Senator O'MAHONEY. Professor, before you leave that, have you taken into consideration the fact that the Government in its expenditures cannot take advantage of the 1940 dollar but must spend its revenue in terms of the 1948 or the 1949 dollar; and when, therefore, the Government is purchasing petroleum from a petroleum corporation in terms of 1948 dollars, is it altogether equitable for that corporation to urge that it should pay its taxes not in the dollars which the Government has to spend, but in the old dollar of 1940?

Dr. PATON. I would not urge that at all.

Senator O'MAHONEY. Is that not what it amounts to?

Dr. PATON. It does not seem to me to be so, Senator.

Senator O'MAHONEY. If you depreciate the plant and equipment in terms of current dollars rather than in terms of cost?

Dr. PATON. It does not seem to me to be so. It seems to me that that is precisely the point.

Senator O'MAHONEY. I do not get it. Would you explain it to me? I will listen intently.

Dr. PATON. It seems to me that this is the fact: That we are in a 1948-dollar situation, as I said a few minutes ago.

Senator O'MAHONEY. And the Government is in that situation, too.

Dr. PATON. The Government is in that, and the Government is taking in 1948 dollars and spending 1948 dollars, or planning to spend 1949 dollars as you said.

All I am interested in is calculations that are consistent with that when we are trying to size up the basic economic position of any group in society, and I think that the result of our methods of reckoning at the present time tends to make it appear that the stockholder has earned more 1948 dollars than he has actually earned. That is what I am interested in. I am interested simply in the question of trying to calculate as accurately as we can what the earnings really are in terms of 1948 dollars.

Senator O'MAHONEY. I think that that is a very important factor in this discussion. How accurately can you calculate it and what measure would you take? Would you take an annual measure or would you take a measure that would last for 5 or 6 years? What measure would you take? Is it not necessarily a theoretical measure and not an actual measure?

Dr. PATON. Mr. H. W. Sweeney, a New York accountant, wrote a book on that subject one time, that is called Stabilized Accounting, and he suggested using the index that Carl Snyder computed or had computed for years, and used that in his illustrations. It was a book that he wrote in part as a result of his experiences with his observation of the ruinous inflationary situation in Germany.

Senator O'MAHONEY. What is the Snyder index?

Dr. PATON. It was the Second Reserve Bank of New York, the cost of living index, computed for many years, and has since been discontinued.

Now, I do not believe that we could get universal opinion among any group of accountants or any group of economists or statistical experts as to precisely what sort of an index is an appropriate one to use in the particular case.

Senator O'MAHONEY. If you cannot get an index, how can you get a new system?

Dr. PATON. I think the most important point for you gentlemen to realize is that there is a substantial question involved in these depreciation and inventory elements. As you pay current wages, you pay substantially in terms of 1948 dollars, and there is no question of the reckoning there. And as you receive dollars from your customers, you are receiving 1948 dollars; but there is a very important lag in the inventory situation, and in the plant a still more important lag.

I do not think that what I am saying there is anything novel or new. That has been pointed out for years. Mr. Sweeney in his book proposes a very systematic way of dealing with it, and he takes three illustrative companies and he goes over it. He shows precisely what to do.

I mentioned that simply to indicate that an illustrative procedure was very systematically and carefully worked out. There have been other suggestions. I, myself, like the suggestion that was made by the chairman, that we think in terms of productive capacity, that we are going to permit an adjustment of these deductions for tax purposes. And as I say, I think it would be well for us to give attention to it, further attention than we have.

Senator O'MAHONEY. Now, does that mean that you feel that a new plant which is four times as productive as the old plant should have a different rate of depreciation from one which was an exact duplication of the old plant?

Dr. PATON. In the case of the new plant built in terms of 1948 dollars, or approximately 1948 dollars, I would say we would depreciate in terms of its recorded cost, because its recorded cost would be right in line with the way in which other dollars were used.

Senator O'MAHONEY. That is not what I meant. I meant in figuring this depreciation, you would do it before the new plant is actually constructed or purchased, so that in figuring that depreciation are you going to figure it upon the basis of four times more productivity than the old, or on the same productivity as the old?

Dr. PATON. Well, the only suggestion that I would feel qualified to make at this point would be this: That if we have buildings and other facilities recorded in terms of 1938 dollars, on the average, of a particular company, the question of whether those are up to date and whether, as management sees the situation now, we would be replacing substantially in kind, would be a very important question in deciding what would be an appropriate adjusted deduction. I do not think that I can put it any more precisely than that at the present time.

Senator O'MAHONEY. It is rather indefinite in your mind?

Dr. PATON. I think the theory is perfectly plain, but the question is how you measure it in a given case.

Let me say one word further. Even conventional accounting is a very difficult, complex thing.

Senator O'MAHONEY. The theory is quite clear, but the practical application of it is rather vague?

Dr. PATON. The practical application, in part at least, is this: Let us at least recognize in general terms that the stockholder of this country—I make a plea for him here, he has been pushed around a lot—the stockholder is not as well off as is popularly supposed, by a long shot. He is not doing as well as he is popularly supposed to be doing. His take-home pay from most corporations is very modest, as compared with what it was earlier and as compared with others.

Senator O'MAHONEY. The number of stockholders who are actually dependent upon this take-home pay is a very small fraction of the total. I would venture to say that most of the stockholders, by far, in the United States Steel Corp., for example, have many other sources of revenue than the dividends they receive on that stock, when one considers that the average holding of stock in these large corporations which desire this new method of depreciation is comparatively small.

Dr. PATON. I wouldn't be so venturesome.

Senator O'MAHONEY. So venturesome as what?

Dr. PATON. As to say some of the things that have just been said.

Senator O'MAHONEY. Is it not a fact that the average holdings are comparatively small?

Dr. PATON. I believe that is true in many of the companies, but I have no information which would lead me to say that the dividends are not important in the personal budget of millions of stockholders.

Senator O'MAHONEY. I did not mean to say it was not important. I said that by far the larger number of corporate stockholders have other sources of revenue besides their dividends.

Dr. PATON. I hope that they have, Senator.

Senator O'MAHONEY. Surely.

Dr. PATON. I do not know very much about that, but I hope so.

There's another general feature of conventional accounting that tends to aggravate the showing of earning rates higher than true yields. I have in mind the long-cherished tradition of conservatism. For generations it has been second nature to the accountant to minimize recorded assets. This is reflected in various practices and procedures. Small items of capital expenditures may be included in maintenance on the ground of conservatism, and in time the resulting understatement of employed resources may be considerable. The treatment of doubtful items is resolved in favor of exclusion from recognized assets. Assets may have been fully depreciated in the accounts and still have some economic significance. Assets acquired by the process of accretion, such as the case of timber growth, may not be reflected in the accounts. Organization and development costs, and costs of raising capital, are often charged off although their contribution to the value of the going concern has not lapsed. Intangible assets of various types may have been written off as a gesture of conservatism. Marketing costs incurred, such as advertising, even when clearly applicable to the future are seldom included in acknowledged assets. Now, when this general and partially unavoidable tendency to understatement of corporate resources is coupled with the limitations of accounting resulting from the marked change in the level of prices in recent years, we have a situation in which reported earning rates are very generally overstated.

With respect to corporate accounting the conclusion I wish to emphasize is this: Under present conditions, and in the light of certain serious limitations of conventional accounting, corporate earnings as shown in current reports are generally overstated from the standpoint of effective, disposable income, and corporate earning rates computed by applying reported dollar earnings to reported dollar book values are generally much higher than true yield rates.

I will just mention one thing more, that I am very much interested, and I would like to impress upon you gentlemen the importance of this, proper computations of earning rates in connection with the discussion we are having nowadays in connection with corporate affairs. My feeling is that when you get into that computation there is a sort of a doubled-up error, because in so many cases we have not restated the stockholders' equity or the cost of these resources in terms of present-day prices.

Now that, in my opinion, magnifies somewhat the situation by the tendency toward conservatism that the accountant exhibits in always being a little more willing to write off than to restore and being a little more willing to reflect declining prices than advancing prices. That is a sort of a condition in accounting, to minimize the recorded assets.

If any of you gentlemen have every looked into the affairs of any considerable number of corporations at all closely in this regard, you will find that the accounts do not show certain assets that may have potency. If I might use a humble example, such a thing as the bookkeeping and accounting and recording system itself. I have never seen that recorded as an asset anywhere, but yet it is a part of the technical procedure, and there are other imponderable factors.

I want to mention that in calling your attention to the fact that what you and I would think of as the total worth of the corporation as a going concern may not be fully reflected in its accounts.

Senator O'Mahoney. What you are saying to us, Professor, is that the accountants are an asset to the corporations, but do not receive their credit?

Dr. Paton. I am not sure but what they get all that is coming to them.

That concludes the material that I intended to impose upon you folks, and I think that I have already talked too long, probably.

Senator FLANDERS. There was one question that I would like to ask you, if you will clear my mind on it, with regard to testimony given by Professor Slichter yesterday. He left me with the impression that the business firm was more or less helpless so far as correcting depreciation charges was concerned, due to the rules under which he must calculate depreciation for tax purposes; but that he had it within his power to correct the misstatements in different year dollars so far as inventory is concerned, by availing himself of the last-in and first-out device in inventories. I have since, in trying to remember my own business experience, or at least I think I recollect that he is helpless there. Also, since he has had to make his decision quite a number of years ago, he is not able to change at the present time; is that correct?

Dr. PATON. My understanding, Mr. Chairman, is that there may be a possibility of making a change with the consent of the Commissioner. The firm has a right to apply to make a change. I have not looked that up lately, but at any rate I believe within fairly recent years quite a number of companies have gone over to the "Lifo" basis, taxwise, with the consent of the Commissioner.

Mr. Bailey, the next witness, can perhaps check that more intimately than I, as I have not looked it up lately; but I would like to say about that proposition that it really does not do fully what some advocates imply, and it does base the cost of sales on the most recent acquisitions up to the amount applicable to sales. But, of course, it does not use literally replacement cost.

I think, however, Professor Slichter is right in this respect, that in a general way under the so-called elective method of handling inventory, provided by the Internal Revenue Code, beginning quite a few years ago, and after considerable discussion, there is available to the taxpayer a partial adjustment. There is a palliative to this problem in that tax rule. Basically there is a recognition of the change in the value of money aspect of our economic life.

I would say that is in that tax rule just as it is in the capital gains tax. The reason that the capital gains tax, I take it, is in the picture, is because we all know that where a considerable period of time elapses, economic conditions do change. Now, it is true that in the depreciation situation in this country, no such adjustment has yet been attempted.

I think that I would like to add this one more point in respect to the suggestion there, that I do feel that the tax return is only one of the products of accounting, and that there is no reason, even under accepted accounting principles, why a corporation should not endeavor in a report to stockholders, and to others, to make just as clear a picture as possible, as discriminating a picture as possible.

As was indicated in the quotation that I read from a paper by Mr. Bailey, he feels, and I feel, that within the accepted framework of accounting principles, if a management wants to do it, it does not violate any principle of accounting to make an orderly restatement of accounts that are no longer significant, having it properly authorized and properly formalized, and then going ahead on that basis. It should be done only if you intend to stick to it for an appreciable period of time.

That could not be reflected, however, at present in any special adjustment of the tax return, but I do not quite agree with those who seem to think that a tax rule controls all of the accounting that may be involved in making reports to stockholders and others. There is no requirement, as I see it, that prevents corporate accountants and corporate managements from trying to explain this situation that we are talking about here, just as carefully as can be. And if earnings are overstated from some points of view and that is not being properly explained, we in the accounting field and corporate management have ourselves to blame to a considerable extent. Because after all, people are going to go by our reports, and if their limitations are not properly brought out, folks are going to be misled at certain points.

So I would make a plea here for the idea that it would be a healthy development for corporations to take more pains in disclosing some of these weaknesses, from certain points of view, in the calculations that are being made. It would be helpful to the stockholders and helpful to management itself.

Senator FLANDERS. Do you have other questions, Senator?

Senator O'MAHONEY. I have just one, Senator.

Earlier in your testimony, Professor, you made some allusion to the dearth of risk capital, and the unwillingness of investors to go into common stocks. It is my understanding that the November Survey of Current Business, published by the Department of Commerce, shows that the present ratio of common stock to all issues is 25 percent, whereas in the late twenties, just before the crash, the ratio was 28 or 29 percent.

That would seem to indicate, would it not, that common stocks are standing up fairly well, if that is a fact, and I assume it is.

Dr. PATON. Senator, I have not checked into the November figure on that point, but taking a look at the SEC reports and other figures, I think that the case is perfectly clear that there has not been, and is not now a substantial flow of new common stock money into business.

Senator O'MAHONEY. That raises the other question, probably as a sort of a chicken and the egg question; is the emergence of the private placement by insurance companies and other large institutions, and financing out of accumulated capital, responsible for the dearth of risk capital, or is it the other way around?

Dr. PATON. I would say the other way around. In other words, the chap with money has become suspicious of the prospects of residual capital equities, and I think that that is literally true, and we do not need to speculate about it. The evidence is overwhelming and it has been true for some years, and even if you increase a trickle by 25 percent, it does not mean much.

Those percentage figures are not very reliable, and I am willing to say flatly that there has been only a trickle, hardly noticeable, of common-stock money, new money going into business.

Now, the reason some of these 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. I think the situation there, Senator, is not reassuring, whatever the explanation is. You have to bear in mind in a general way that, 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; the RFC is constantly under pressure to make loans to business and the RFC at one time announced a program of loans to little and local business provided the local banks would participate, but local banks have been rather hesitant to do so, probably because in turn the Government regulations frown on long-term loans, and the result is that insurance companies practice more private placement, and there is more financing out of cumulative reserves, and consequently a narrower field for real enterprise, new enterprise, to operate. That is only an opinion.

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.

Senator O'MAHONEY. Would you say that 25 percent is not a reasonable proportion?

Dr. PATON. Not at the present time, no, nowhere near where it should be. It should be substantially 100 percent new money right now, in view of this thinning equity, in the utility field. These men should be raising new common-stock money.

Senator O'MAHONEY. Utilities have historically financed through debt.

Dr. PATON. With a substantial equity of 40 to 50 percent of stock money, and that equity has been thinned.

Senator O'MAHONEY. And the story of utility stock in the twenties and thirties was not a very satisfactory one.

Representative PATMAN. I would like to ask a few questions, Mr. Chairman.

Professor, is not your theory predicated upon the assumption that we will return to a dollar comparable to the 1939–40 dollar?

Dr. PATON. No; just the reverse.

Representative PATMAN. Just the reverse?

Dr. PATON. Yes.

Representative PATMAN. Upon the assumption that we will not return?

Dr. PATON. Yes.

Representative PATMAN. And upon the assumption that we will retain at least a 1948 dollar?

Dr. PATON. That is the assumption I am going on.

Representative PATMAN. I do not understand your theory, then. I will read your testimony carefully and see if I cannot get it.

Dr. PATON. The point I have been trying to make is that one of the reasons I feel that adjustment with respect to these large elements of plant, and so on, that are on our books at figures that I think no longer are significant, is desirable, is because we are not going back to that basis. If very shortly we are going to go back to that basis, then I think the case for setting our house in order by stating everything in terms of 1948 dollars would be less strong.

In other words, the fact that it seems to me we are pretty well committed to the price level that at least roughly is as high as the present, would make me the more anxious to urge that the accounts of some of these companies be revised, where their recorded assets are not in line with the assets of other companies that have acquired their plant facilities more recently.

Representative PATMAN. You would not return to a 1939–40 dollar, if you could?

Dr. PATON. No, frankly I would not.

Representative PATMAN. It would upset the economy?

Dr. PATON. I see what you mean.

Representative PATMAN. In other words our high national debt of $260,000,000,000 can only be paid with good prices and good wages.

Dr. PATON. I think that a large debt, Congressman, has a great deal to do with it.

Representative PATMAN. If we were to return to the 1939 dollar, from a practical standpoint, we would increase our national debt 40 percent, would we not, in what the people have to pay with?

Dr. PATON. I believe that is roughly correct, and although none of us who hold the E bonds like to see the purchasing power diminishing, we realize that we have a tremendous problem there, and the administration of this enormous debt will call for all of the resourcefulness that you gentlemen have, and I think that to hope for or contemplate a revaluation of the dollar upward would be a mistake.

Representative PATMAN. But you would like to have it retained as it is now, in 1948.

Dr. PATON. At any given moment of time it is desirable for us to keep our monetary unit stable. In 1939 in a sense it was desirable for us to hold it at the level then, and our policy now should be directed not toward trying to undo the inflation we have gone through, but to try to avoid continual extremities of inflation.

Representative PATMAN. In order to keep the dollar somewhat as it is now, it is necessary to keep the high national income that we have, over $200,000,000,000; that is correct, too, is it not?

Dr. PATON. It seems reasonable to me, Mr. Patman.

Representative PATMAN. In other words, we can only repay the national debt conveniently with a high national income, and we can only have a high national income with good prices and good wages.

Dr. PATON. Another way of putting it, I think I agree with that, I would like to stress this aspect; a high level of productivity.

Representative PATMAN. That is the national product; that is a little bit in excess of the national income, is it not?

Dr. PATON. That is right, but I think that we see eye to eye on that point.

Representative HUBER. Professor, maybe you have covered this, but do you think present corporation profits are excessive?

Dr. PATON. No; I do not. I am speaking now of the general situation. I consider that a corporation is subject to the fat and the lean possibilities of our economy, and as far as my evidence goes, any opinions I have on it, I would say that I do not consider them excessive. I think that is an improper term to apply. I do not think that the total number of dollars reported can be compared with return to some of the other elements in the community, just as they stand, as I have tried to indicate. However, even if they were, and there was not this accounting problem, I would still be inclined to say that the rise in that share of the national product is not excessive, even if there was not this accounting problem, because we have had enormous increases in business, and why anyone should expect that a company should double its sales, for instance, dollarwise, and not have somewhat larger profits, I cannot understand.

Representative HUBER. It follows to some extent, then, I presume, that if, say, $40,000,000,000 does not represent $40,000,000,000 in corporate earnings, then, of course, $60,000,000,000 Government expenditures would not represent $60,000,000,000. It is not costing as much to operate the Government as it would appear from the figures.

Dr. PATON. I think it is best for all of us to think in terms of this present dollar, and say the Government is spending so many present dollars. Now, if for some statistical analysis we wanted to compare that expenditure with something the Government spent earlier, I think it is important for us to recognize that the increase in expenditures in a more objective sense is not as large as would appear on the surface.

Senator FLANDERS. Are there any further questions? If not, sir, we will excuse you, and we thank you.

This session will reconvene at 2 o'clock this afternoon.

(Thereupon, at 12 m., a recess was taken until 2 p. m., the same day.)

## AFTERNOON SESSION

The subcommittee reconvened at 2 p. m., upon the expiration of the recess.

Senator FLANDERS. The hearing will come to order.

This afternoon we have as our witness Mr. Bailey. Mr. Bailey is a partner of the firm Touche, Niven, Bailey & Smart, of Detroit, Mich., and is immediate past president of the American Institute of Accountants.

By chance we had two men from Boston yesterday and by similar chance, in looking for the best men, we have two men from Michigan today, although one comes from the cloistered atmosphere and the other the hurly-burly. It will be interesting to see to what extent and how they agree and disagree.

## STATEMENT OF GEORGE D. BAILEY, IMMEDIATE PAST PRESIDENT OF THE AMERICAN INSTITUTE OF ACCOUNTANTS AND PARTNER OF TOUCHE, NIVEN, BAILEY & SMART, DETROIT, MICH.

Mr. BAILEY. Mr. Chairman, thank you for the nice little compliment about Michigan.

I am here as an individual but, because of my official relationships with the American Institute of Accountants over the last several years, I think I can speak as well for the majority of the profession. We accountants appreciate the opportunity of appearing before your committee, as accounting and an understanding of accounting implications are fundamental to what we understand to be the purpose of this study.

Our profession incidentally is a profession that has to make these theories work so we are caught on both horns of the dilemma in the desire to follow these nice theories that are proposed but also with the necessity of making them work in corporate accounting.

I thought if I might I would summarize the four points that I propose to direct myself to in the first instance. And they are as follows:

I. Corporate profits reported in financial statements at the end of the year are not the same as dollars in the bank which corporation managements can dispose of as they see fit.

I think that point is often lost sight of.

II. The present tax structure accentuates the problem of retaining and reinvesting enough of corporate income to maintain the productive level of plants and facilities.

III. Any consideration of profits as a return on investment must recognize that profits are reported in current dollars whereas most investment was made in dollars of such greater purchasing power.

IV. Corporate financial statements prepared in accordance with generally accepted accounting principles should be interpreted in the light of prevailing economic conditions.

As a brief explanation of these points I might still further summarize.

I. 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 necesary 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.

II. 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 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.

III. The third point I wish to emphasize is the difficulty in dealing with profit statistics which compare prewar conditions with postwar conditions.

Most of the elements in corporate profits are determined on the basis of the current inflated monetary unit. Corporate invested capital in most manufacturing industries and in many other companies is, in an important part, determined on the basis of the prewar monetary unit.

Thus, any consideration of profits in relation to invested capital must appraise the effect of this inflation and recognize that the investment would be much greater if stated in terms of current dollars.

I will amplify each of these later.

IV. Accounting itself has made substantial strides in the last 7 or 8 years in refining and sharpening the concepts of income.

The American Institute of Accountants, through its committee on accounting procedure and the issuance of a number of bulletins, has done a great deal to reduce variety of practice in important areas and has, by and large, emphasized the importance of considering income for a given year against the back drop of the economic conditions for that year, rather than to have the impact of those economic conditions estimated, appraised individually and sporadically, in the determination of income for each company.

That again I will talk about later.

Further, the American Institute of Accountants has paid particular attention to the problem of depreciation as outlined above and as you heard about, today and yesterday, to determine whether accounting principles should be modified to permit or require depreciation to be determined on the basis of replacement cost.

For many reasons, it came to the conclusion that such a change in fundamental accounting principles was not desirable, but it did recognize the problem as I have already outlined it and has recommended that the condition be made known to stockholders and the public by each corporation.

An Institute survey indicated that businessmen preferred not to have the basic accounting principles changed. What the Institute has been accomplishing by its sharpening of accounting principles is to make it more frequently possible to compare the progress of one company against the progress of other companies and with its own progress over a period of years, all considered against the economic conditions of those years.

I will take up each one of those with a little more discussion. I will talk from a statement but I will try to make it as informal as I can by interpolating.

First as to the nature of accounting profits.

Now, your committee of necessity will be dealing with monetary profits reported by individual companies. These profits are reported in accordance with generally accepted accounting principles or, if you prefer, in accordance with accounting conventions, which have been developed over the years. To a certain extent these principles and conventions have been fluid and have been sharpened and changed over the years better to serve in the reporting of corporate income—but the results still are monetary profits determined in accordance with accounting conventions. That is an important thing for you also to keep in mind in considering these corporate profits that you will have before you.

These results are not necessarily the same as economic profits and they quite frequently differ from the ideas of various people as to what constitutes real profits, but they are determined in accordance with a reasonably standard measuring stick—standard in the sense that it is a measuring stick generally accepted.

But accounting is by no means an exact science and there has been in the past and there is still, though to a lesser extent, a great deal of room for individual accounting judgment to be applied. We accountants have heard something about unreal profits and phantom profits, so I emphasize that corporate profits are stated in money in accordance with these accounting conventions.

Senator FLANDERS. In your first section here of your testimony you used in the middle of page 2:

> 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 the profits need to be withheld to provide for that additional investment.

Now in general, do the companies with which you are connected or with which you have particular knowledge, follow the Lifo principle which is the last-in, first-out method or do they follow the more conventional method?

Mr. BAILEY. By and large, the great majority of companies follow the more conventional method. There are several reasons for that I think, which I intended to touch on a little later, but I think perhaps I can deal with here.

One is that the Bureau of Internal Revenue established pretty rigid requirements that prevented or deterred, even prevented, a great many people, a great many companies, from following this Lifo method. The courts liberalized that interpretation so that today many more companies can follow the Lifo method than could have followed it before and have it accepted by the Bureau.

The only trouble is that after that liberalization by the courts, that price levels were already so high that the advantage accruing to a corporation from going on to a Lifo method seemed hardly worth the trouble for many people.

There is a specific angle about that that I think your committee would be interested in. There is a requirement that in order to have the advantage of this Lifo method the corporation must keep all of its accounts and render all of its statements on the Lifo basis and many corporations, having had the Lifo method disallowed by the Bureau of Internal Revenue, kept their books on the more conventional basis.

So that, when the point was liberalized by the court decision, that provision seemed to make it difficult for the corporations that had tried to get that allowed back in 1940–41 to go back to that period and get that allowance.

Senator FLANDERS. In so doing, would they have a retroactive right to excessive taxes they had paid if that basis were allowed?

Mr. BAILEY. Yes; they would. Some corporations were protected by claims for refund. Those that felt the Bureau's position was entirely wrong and felt strongly enough to continue their bookkeeping basis and to protect themselves by a claim for refund have an unquestioned right to get that recovered. Those who were convinced by the Bureau that it was hopeless to continue are in a little different category. But some of those who had it denied are in a little better position than those who did not even try.

Senator FLANDERS. That puts a premium on belligerence.

Mr. BAILEY. It does indeed, it is a gross penalty on those corporations that believed the Bureau knew what it was talking about or thought it was too difficult to argue with them with respect to it.

I have some figures here later on that may interest you in that connection.

Senator FLANDERS. I do not want to anticipate your talk.

Mr. BAILEY. Perhaps I can give that illustration later on as it comes in its place and it will fit in a little more accurately.

Before I leave this first part of accounting and accounting conventions I want to talk a minute on some of the accounting words that I think have gotten us into trouble.

We have grown up with the word "surplus" which implies to a great many people that something about that is not needed.

Surplus today even more than it has been in the past, is a balancing figure and is represented on the other side not so much by cash as by accounts receivable and inventories and plants all of which have a dollar mark on them much higher than they had before. This surplus.

we are beginning to call net earnings retained in the business because that is just what it is.

We have the problems of reserves. We very often find corporations with reserves for contingencies or reserves for future decline in inventory prices, but those reserves are seldom, if ever, represented by cash or funds.

By the same token the reserve for depreciation is usually not a cash reserve that is available for any other purpose, or any other cash reserve that is there at all. It is invested in plant to some extent or it has been put into working capital during this period when working capital has been so short.

Senator FLANDERS. Do you think it is proper to call that bad-business practice?

Mr. BAILEY. Well, I do not think it is, no; because it is pure terminology. If you say a reserve for depreciation or a reserve for future declines in prices, the latter is an earmarking of the stockholder's equity that has to be taken into consideration.

Senator FLANDERS. I am thinking of the New England railroads in the first 20 years of the century who carried their reserves as bookkeeping and paid off the funds, reserves to depreciation, and paid out the funds in dividends and their rolling stock and part of their right-of-way deteriorated to the point where they were practically useless and they had no money to buy the new with.

Mr. BAILEY. The railroads in the early part of the century were not using a reserve for depreciation very much. They were handling their problem by the theory that they were keeping up their current maintenance and charging their earnings with enough maintenance to keep the properties in order.

Actually what happened to a great many railroads in that period is that they let this maintenance fall way behind because the demand for earnings and for dividends was pretty great.

While I am not too familiar with the history of some of those New England railroads, I think that probably is as good a general characterization of what happened as any.

They had neither reserves for depreciation nor did they keep up their current maintenance problem. They got in trouble even with a reasonably stable price level. But if they had been faced with an increase in price level where it cost them twice as much to buy something to replace the old, they would have been in trouble long before they were.

Senator FLANDERS. Yes.

Mr. BAILEY. This whole business of profits in relation to distributable profits is an interesting thing. I read over briefly this morning Professor Slichter's testimony yesterday, speaking about the overstatement of profits and the conservatism of the accountants.

Economists, of course, would like to have the figures reported by corporations that approach what the economists regard as real income. The accountants have played around with that a great deal and they find a considerable disagreement between economists as to what constitutes real income.

But they have found extreme difficulty in any measuring stick that would be satisfactory to any more than one person. I come to that a little later.

Senator FLANDERS. You may proceed.

Mr. BAILEY. Now, a basic accounting convention is to match costs against revenues, with due regard for prudence. When an article is sold at a given price the problem in accounting is to gather the costs so that a profit can reasonably be determined. Accountants have to determine costs of the merchandise sold and the cost of the investment which is used up in the production and sale of product.

With a reasonably stable price level, that principle has not only measured profits in accordance with accounting conventions but has not been too far away from what the economists might consider profit.

There have been periods in there where the level has been substantial but on the whole the important price level changes have been temporary and so that difference has had a tendency to be lost sight of.

The use of cost has served most of the needs of our society, and I emphasize that because it has served the needs over a long time. Partly, this was, I think, because our society has not been interested in corporate profits in the past to the extent that it is today. There was no such need for a sharp determination of profits, nor was there a need for clear understanding of corporate profits as there is today. That has all come up, and the necessity has been sharpened over the last 10 years.

Senator O'MAHONEY. Why?

Mr. BAILEY. Well, I think there are several reasons for it, the increasing number of people that are interested in our corporations, the increased importance of corporations as a whole to our whole business economy. I think those are perhaps the two major things. There has been some activity over the last 10 years with respect to challenging the division of the fruits of the corporate enterprise among the various people or groups of our society that have been interested.

Senator O'MAHONEY. In other words, the corporation has become a more important segment of the economy, it does a larger proportion of the business than formerly, it gives character to the economy; is that right?

Mr. BAILEY. I think the corporation has become an increasingly important segment. I am not sure it does an increasing percentage of the business.

Senator O'MAHONEY. Well, it gives its character to the economy?

Mr. BAILEY. Right.

Senator O'MAHONEY. If we adopt a system which reduces the tax burden to be paid by the corporation, assuming that the Government has an obligation which can be met only out of revenue—an assumption which of course we have to make—then any revenue which may be lost by reason of more favorable treatment of the corporation, an adjustment of accounting methods, the depreciation which is argued for here, would mean that a larger proportion of the necessary revenue of the Government must be obtained from some other source?

Mr. BAILEY. Well, taking it strictly as you stated, Senator, it is a mathematical condition. If you need $45,000,000,000 and you are going to get X billion less from corporations, that X billion has to come from somewhere else.

Senator O'MAHONEY. That of course is what the taxing authority has to think of.

Mr. BAILEY. In a way but it also has a strong social implication beyond that. I think it is extremely necessary that the tax burden on corporations be a reasonable burden; that it be a fair burden; that there not be taxation of unreal income; that corporations not be asked to pay taxes out of profits or cash they do not have.

I think it is important that the tax structure be careful to get tax from corporations only on the profit that can be distributed or on the section on which money is available to be paid to the Government.

Senator O'MAHONEY. But as I pointed out this morning when Professor Paton was on the stand, when the Government for purposes of national defense, for purposes of its international obligations, for purposes of taking care of the veteran, and so forth, spends its funds, it spends the current dollar.

Mr. BAILEY. That is correct.

Senator O'MAHONEY. And if the corporation is allowed to pay its taxes or any portion of them in a different kind of dollar, if its profits are not figured in the inflated dollar which the Government must spend, does that not result in increasing the burden upon Government?

Mr. BAILEY. No; I think it might work the other way. If you expect a corporation to determine its profits on the basis in part at least by using up old value dollars because it is the only monetary unit that comes in, you may be asking the corporations to pay in a different kind of dollar than today's dollar.

Senator O'MAHONEY. Actually it does pay the taxes in today's dollar and must necessarily do so?

Mr. BAILEY. Of course that is true; that is what it pays it in. It pays that on profits that are determined in accordance with some scheme.

Now if those profits are determined entirely in terms of today's dollar, then everything marches along together.

Senator O'MAHONEY. The discussion is entirely theoretical up to this point because no witness has as yet described the scheme which you have just mentioned. Professor Paton spoke of some sort of index but he was indefinite as to what that index would be, whether it would be a firm index or a variable index or what sort of index it would be. Can you tell us what your standard would be?

Mr. BAILEY. Do you mind if I take that up after I get a little more background on this? It comes next and it is a basic part of our problem; it gets into the tax thing. I do want to discuss it with you and I do not want to run away from it.

We got to the place where I said that our society had not been as interested in corporate profits as it is today and that we had not needed as clear an understanding of corporate profits as we do now, nor as sharp a determination.

Today, however, after several years of rapidly increasing price levels, the use of the accounting conventions related to cost rather than to current values produce a figure of profits with respect to which there are certain economic restrictions.

Corporate profits determined by accounting conventions can no longer be regarded solely for the establishment of prudent reserves for protection against the variations in the business cycle, for reservations for expansion, or for dividends, or even, perhaps, as indicative of possible price changes for the product; they must be regarded first from the standpoint of some economic restrictions which make inexorable demands upon those points.

Accounting has had difficulty in measuring those demands and has believed, by and large, that it was preferable in reporting on the income of corporations to maintain the old measuring stick. The two major difficulties in the field I will discuss later, the depreciation and inventories that you heard so much about already.

Accounting, by and large, however, has made a great deal of progress in sharpening the presentation of corporate income year by year. In its essence, this his been the direction of reducing the arbitrary shifting of accounting income from one year to another, or from good years to bad.

I cannot overestimate the importance of the progress that has been made in that over the last 10 years. It has been in the nature of minimizing reserves designed to cushion the economic impacts of future years where those cannot be foreseen and where such cushioning is bound to be arbitrary, individual, and sporadic.

It has, again speaking generally, worked toward the disclosure of income for the single year, to be appraised against the backdrop of the economic conditions of that year rather than to have the appraisal of future impacts deducted or added in the determination of the figure reported as profit, without any generally accepted practice in that regard or any basis of measurement therefor. It has also worked in the direction of excluding from the determination of income items which have no relation to the operations of the year, are clearly related to earlier years, or are subject to the whim of the management, where such items are important.

Now this movement toward sharpening the principles of income for the year has proceeded very rapidly since the close of the war, but during the earlier of those years the conventions had not yet sharpened to the point that has now been reached.

Now I emphasize this particularly because in this study you are bound to be considering the reported profits of one company or another, or one group or another, and this continuous refinement of accounting principles and conventions over the last few years is something you should have in your mind.

The American Institute of Accountants has been in the forefront of this movement to sharpen concepts of income and its bulletins on accounting procedures have been the most important factors in reaching the positions I have stated above.

We will see that your committee has a file of these bulletins and, incidentally, I will leave a number of copies of an article I recently wrote in the same area entitled "The Increasing Significance of the Income Statement."

Senator FLANDERS. We would be glad to have that.

(The article was filed for the information of the committee and is available in the committee record.)

Mr. BAILEY. In spite of the fact that accounting progress over the recent years has pretty well eliminated any arbitrary reducing of income in good years and increasing it in bad, one still hears comment about the looseness of accounting principles. I recently heard a representative of one of the larger labor unions seriously criticize accounting and accountants for such fancied looseness.

But the plain fact with respect to that particular criticism was that the auditors had almost invariably pointed out that the procedures followed by the companies were not in accordance with generally accepted accounting principles and that fact was clearly available to anyone who read the statements.

I point that out strongly to you because you may hear the criticism of departures when in such cases accountants have clearly pointed out the departures and the companies have assisted in that disclosure.

Some companies, particularly with respect to depreciation, have felt that accounting principles were lagging behind realities and wanted to report income to the public on the basis of what they considered such realities, but in all cases that I recall the departure from generally accepted accounting principles has been clearly indicated and measured.

This may be a good point to insert parenthetically that in your consideration of the financial reports of individual companies, you note also the comments of the auditors with respect to those financial statements. The auditors may have given clear approval or they may not have done so.

Now accounting has not yet succeeded, and I hope it never will, in putting income reporting into a rigid mold, for this will conceal more than it reveals. Nor is it possible in most cases to compare one company with another on the basis of its percentage of earnings to its invested capital or to its sales. Businesses are seldom so alike that such comparison can be meaningful.

In addition to the variations in business methods and business product, there are the variations in costs of plants and facilities, in the good will built up in the past, in presence of patented products, for it is seldom indeed that such intangible values, no matter how valuable, are carried as a part of the invested capital.

Incidentally, that is one of the difficulties of comparing rates of return. So many have charged off so many good values, intangible and otherwise, that it now throws an added difficulty on comparable percentages of return.

Some companies will have spent tremendous sums over a long period of years for the establishing of trade names and trade brands and dealer organizations and distribution outlets, which sums have all been charged off, but which if they had been accumulated and carried on the books, they would have clearly increased the invested capital.

But we accountants do think, by sharpening the determination of income for each year by reducing the varieties of procedure in many important areas, that we will help to make it possible to appraise more accurately the progress of a company year by year in the light of the economic conditions of those years and to compare the progress of one company year by year with the progress of another company operating under the same broad economic conditions.

So, as an accountant, I ask you to remember that accounting presents certain facts and opinions, but that in considering corporate profits it is necessary to deal with and perhaps interpret the facts which are so presented.

If I may, I would like to pause a moment and talk to two particular points in Professor Slichter's paper yesterday and in Professor Harris' paper. You will remember that Professor Slichter in the early part of his talk said:

> Why are there such 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.

Now while the professor gets to a conclusion toward the end that is about the same conclusion as I have, that you have to segregate and pay attention to these particular economic demands, I ask you to remember that neither the cost of replacing inventories, the rise in the cost of replacing inventories, is a profit or is considered as such, nor is the rise of replacing plant and equipment considered a profit.

The mere rise in the price of a plant such as you mentioned this morning does not give rise to a corporation reporting a profit. The mere fact that an inventory costs more to replace than it did, does not in itself give rise to a profit.

I will come to that later but there is a fallacy that the increase in price level results in profits, reported profits.

Senator FLANDERS. Is not the point he was trying to make that the ordinary person in reading the company's annual report assumes that a larger part of the profit reported is available than the facts warrant?

Mr. BAILEY. That is right; that is why I said I thought we got to the same end result but part of our trouble with this whole problem is the concept of profits. The economist measures profits, I am told (there seems to be some disagreement), on whether you have as many real goods at the end of the period as you had in the beginning.

Anyway, it is a definition I have found useful.

Accounting determines profit by the profit of the transactions as the business goes along in its daily sales and purchases.

I think, as a matter of fact, and I will develop that later, what we have is not a profit resulting from the rise in prices, but having determined our profits under those conditions, we have at the end certain losses that we are stuck with, what I have called the economic restriction.

The other point, and I take it at this time, is what he called No. 6:

> Why have American corporations so generally overstated their profits during the last few years?

Again 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 adapt 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 to want to know where they are going before they give up the old conventions they had been using for many years.

Senator O'MAHONEY. We have three kinds of profits now, if I undersand you, the economists' definition of profit, the businessman's definition of profit, and the accountants' definition.

Mr. BAILEY. I meant to take the last two pretty much together, businessmen and accountants.

Senator O'MAHONEY. Do they agree?

Mr. BAILEY. Yes; by and large they do, and I will give you some figures.

Senator O'MAHONEY. But, at least, you warn us against the economists' definition of profits?

Mr. BAILEY. No; I just say that the economists' definition of profits is a different kind of thing. I do not want you to think that the businessman's profits and accountant's profits are wrong because they do not get to the economist's answer.

Senator O'MAHONEY. The question that the committee will have to express an opinion on eventually is whether the Government should derive its revenue on the economists' definition of profits or on the businessman's definition of profits.

Mr. BAILEY. Strangely enough I do not differ with the economist so much on that point, sir.

Senator O'MAHONEY. Anything that can reduce the taxes of the big fellow, that is O. K.?

Mr. BAILEY. No, sir; I do not take that position, sir. All of my talk on corporate taxes, I am talking about big and little corporations.

Senator FLANDERS. I think it might be inferred that perhaps that might not be the end result if the economists' definition is the right one for taxation, because the requirement for a given amount of Government income still remains and the expedient might well be to raise the general level of business taxation. All that you would do, if the economists' definition is accepted, would be to introduce a greater measure of equity in the collection of the taxes on that basis.

Mr. BAILEY. I think so. The point that is in my mind is that it is pretty hard to get taxes from something that has been invested in plants. I have not been talking on the total burden on corporations, sir. I am desirous of having a tax that keeps corporations healthy but I am not presuming to say where that point is.

I wanted merely to bring out the fact that the accounting determination of profit gives a figure which needs then an economic determination. There are economic claims and restrictions on that profit that Professor Slichter brought out and which I fully agree with, and I will touch on that later.

Dr. Harris' definition of what are profits I touch on here, "higher values for inventories means higher profits."

I disagree with that completely.

[Reading:]

Should inventories be revalued at replacement costs then profits would be substantially reduced.

That just is not true either. It is not important except that corporations report this profit in accordance with these accounting conventions and I want that point as to what their profits are, what those conventions do, to be as clear as possible.

Now we come to inventories. I spoke earlier of the economic restrictions which are placed upon profits, particularly in the two areas of inventories and plant replacements. First let me deal with the inventories.

With the exception of a small percentage of business concerns, inventories are kept on a cost basis, unless market has gone off, which assumes that the earliest or the average cost is that to be considered in determining the profit on a sale.

In a very large percentage of cases that is an exact reality because all business does not mark up its profits to recover what it will have to pay to replace its goods but more generally acts to try to recover what it has paid for its goods.

Senator O'MAHONEY. Would you repeat that please?

Mr. BAILEY. In a very large percentage of cases that is an exact reality because all business does not mark up its profits to recover what it will have to pay to replace its goods but more generally acts to try to recover what it has paid for its goods.

If a business buys an article for $1 and sells it for $1.25 and can repurchase a similar article for $1, it presumably has 25 cents profit.

Where a business buys that article for $1, sells it for $1.25, and has to pay $1.25 to buy a new article which it might then sell for $1.50, it has received a profit of 25 cents for sale, but the economic restriction upon that profit is such that it can be used for nothing at all except the replacement of the article which was sold.

What I am trying to bring out is this: You have had some good conversation that the increase in price level means increasing profits as if corporations in selling an article sold it on the basis of what would have to be paid to buy another article, rather than selling it on the basis of what it paid for that article. There is quite a difference there.

Senator O'MAHONEY. Which is the common practice?

Mr. BAILEY. I think by and large the common practice is to relate selling prices to cost rather than what it costs to replace that article.

Senator O'MAHONEY. If I understand your example it is this: An article is bought for a dollar; that is the cost to the corporation. It sells it to the consumer for a dollar and a quarter. The replacing of it may cost as much as $1.25. Now are we to understand that depreciation should be allowed on the first article on the basis of replacement cost so that the 25-cent differential disappears into the future? It is not an item of profit, it is not the basis of tax, but goes into the new basis upon which the new sale of the replacement item is made?

Mr. BAILEY. Senator, I had not gotten nearly that far. I was dealing now with the effect of the increased price level.

Senator FLANDERS. You are talking about inventory rather than replacement?

Senator O'MAHONEY. Let us go to the point.

Mr. BAILEY. This item that I had did not have the point of depreciation in it. You buy it for $1 and you sell it for $1.25 even when you know when you sell at $1.25 that what you have to pay for another one will not give you any margin for expenses or profits. So, you buy the new one and sell that for $1.50 and it is a continual relationship of selling price to cost. There are places where it is sold on the basis of replacement; and I suppose there are many cases where the influence of the higher replacement cost do have some bearing on a higher pricing situation, but it is hard to appraise.

Senator O'MAHONEY. Is it not a fact that you might have a situation of this kind. The depreciation is allowed, the inventory depreciation of this extra 25 cents, because it will cost that extra 25 cents to get a new article; but then when the time comes to sell that article, conditions have changed. For some reason or another the corporation desires to get a quick turn-over, and instead of selling the new article, which cost the $1.25, for $1.50, it sells it for 99 cents in order to get the money and thereby reports a loss. There is no profit at all, but a loss. So here you have the 25-cent profit wiped off the books by an accountant's legerdemain, and the new loss deprives the Government for the second time of any revenue with which to pay the expense of Government.

Mr. BAILEY. That just isn't right, but it is not to easy to lead you down the path on that one.

Senator FLANDERS. You pay the $1 and the $1.25, and you have spent $2.25, and you get $1.25 and 99 cents, and you have received $2.24, which is a bad bargain and no profit in the operations.

Mr. BAILEY. And you had to pay some expenses in the meantime. But Senator O'Mahoney has in his mind this "Lifo" method of inventory where there is some relationship of the replacement price to the cost level which is used in determining taxable profit.

In the first place, as I said before, the very, very great majority of all corporations do not have their books on that "Lifo" basis, large and small. In the second place, that cost, that drop from $1.25 to 99 cents is not a drop from $1.25 to 99 cents, because that same 25 cents that was saved out for "Lifo" on the first one gets applied on this one, and you are dealing with $1 inventory instead of $1.25; so that they do not get the saving of the taxable profit one way and a taxable loss on the other. They just offset each other.

This "Lifo" thing is about as complicated a calculation as there is, and it is subject, incidentally, to Treasury Department rules rather than to, let me say, logical rules. simply because there has to be machinery by which the Treasury Department can approve the taxable income under that method.

Senator O'MAHONEY. Do not forget, Mr. Bailey, that the Treasury acts on the advice of accountants, too.

Mr. BAILEY. Not as often as we would like, sir. We are getting to this business of arguing with the Treasury on this matter of depreciation, and I will get to that a little later.

While we are talking about profit and economic restrictions on profits, I would like to move over a moment to the 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 the Department 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 recover 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 businesses 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.

Now, 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 adopted 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 long in process, there is a comparatively small percentage of all 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 committee 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.

Now, as to plant facilities, the economic restrictions 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, the accumulation of funds to take care of the price rise that has already taken place in past years 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 such sums not only were not sufficient, but that they were forced into borrowing large sums of money to complete their replacement or to 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 for the 14 companies 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 account 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.

Senator FLANDERS. Just a little interruption there. You said that, in general, accounting profits and a businessman's idea of profits did not vary very much; but I take it that where they do vary, the accountant is duty-bound, in making his audit, to call attention to the variations.

Mr. BAILEY. That is right. When business reports its accounts on a basis that varies from generally accepted accounting principles, the auditor is duty bound to call his attention to that in his certificate, and does so with considerable frequency. It particularly happened last year where many business concerns thought that they wanted to take depreciation on this replacement basis. The accounting principles were against it, and there were quite a few exceptions by accountants in that field. You find it in other places, too, where the accountant had to say that this procedure is not in accordance with good accounting.

Representative HUBER. If 10 different accountants prepared a profit statement for a corporation, would there be a great deal of variance in the final report?

Mr. BAILEY. I do not think so, sir; not nearly as much today as there was 10 or 15 years ago. There are lots of places where judgment has to be applied as to the liability in connection with certain things or the pricing basis that represents cost, or things of that kind.

Representative HUBER. Basically, as to the reports of any 20 or 30 corporations, you would feel that they were all more or less similar in preparation in accordance with the standard accounting principles?

Mr. BAILEY. I think for your purpose, you can consider that is true; yes, sir. There is still considerable judgment on policies as affecting individual years, one year after another. Usually one policy works out for an income statement that would not be too different from the other, year after year.

Representative HUBER. Do present accounting methods give any advantage to the Government in the collection of taxes?

Mr. BAILEY. Well, the answer to that is "Yes," and they ought not to. I will get around to that in a little while. The Government has had some influence, particularly in this depreciation field and the inventory pricing field, but it has influenced corporate reporting a little more than it should have.

I was talking about a study of these 14 corporations, and I have that here if you would like to have it in the committee files.

Senator FLANDERS. We will accept that for the information of the committee.

(The study referred to was filed for the information of the committee and is available in the committee records.)

Mr. BAILEY. I made another study of a corporation, which reported to its stockholders last year that its facilities now in use had a cost amount of $210,000,000, but a replacement price at that time of $352,000,000. Its accumulated depreciation on cost was $130,000,000, but to maintain the same relation to replacement cost the accumulated amount perhaps should have been $218,000,000, or $88,000,000 more than the accumulated depreciation that they had taken. In other words, they had that kind of a financial problem staring them in the face.

I have had occasion to consider still another company, whose depreciation or replacement costs for this year would have been $4,400,000, as compared with $2,100,000, and the indicated shortage in accumulated earnings over the years would be about 13½ million dollars. In other words, their depreciation on cost just wasn't sufficient to take care of what the replacement problem seemed to be, by 13½ million dollars. There was an economic restriction on accumulated profits.

It is not possible to generalize and say that the depreciation should be increased 50 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; and that is exactly the thing that Professor Slichter was saying yesterday and Professor Paton said this morning—that same thing.

It is a fair question to ask why accounting has not reflected that difference in individual statements and why the profession in its official releases has stuck by cost. It is not because the profession has not recognized the problem, and I would like to file with you the last official release of the committee on accounting procedure on that subject. I will see that that is filed with the committee. The committee does say that the 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 position of the accounting profession may be well stated by an editorial in a recent issue of Business Week, which I would like to file with you and from which I quote as follows—it is not very long and I am not going to quote very much, but I would like to have it in the record, with your permission.

Senator O'Mahoney. As you have stated that, as I recall your language now, you should say that the accountants have stated as their opinion that business should be permitted to save, out of profits, a sufficient sum to continue in business. That is it, is it not?

Mr. Bailey. Well, not in quite those words, sir—we are talking taxwise—although it does come to that. Let me see if I can get the exact wording on that thing that the committee on accounting procedure did issue. They are talking about the maintenance of the continuance of the accounting procedure. There is the statement, dated October 14, 1948, and it is a white statement and I am reading on the back of it, and you will see that the second paragraph there on the back says:

> 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.

That is directed not to taxes, sir.

Senator O'Mahoney. The phrase is "to retain out of profits," so there is no dispute that we are talking now about the treatment of profits.

Mr. Bailey. That is right; that is correct, sir.

Senator O'MAHONEY. Suppose a new business is started with new capital. That new capital is somebody's profit remaining over after expenses and after taxes.

Mr. BAILEY. Yes, sir.

Senator O'MAHONEY. So the concept which we have here—and I want this to be clear on the record if I am right—is that once this profit after taxes has been invested in business, then the tax system should be so arranged as never again to tax that portion of profit which is necessary for reinvestment by the business to stay in business.

Mr. BAILEY. Well, it certainly should do that; yes, sir.

Senator O'MAHONEY. That is precisely what you are asking.

Mr. BAILEY. I have not gotten around to asking anything on taxes yet. I am talking about an understanding of profit. You see, there are two parts of this profit thing, corporate profit: Should it be distributed to the stockholders; is it available for various things? And I am trying to make out that it cannot—much of it cannot—be distributed to stockholders.

Senator O'MAHONEY. You can convince the stockholders that the profit should not be distributed, perhaps, if the corporation is to be in a position to replace its depreciating plant and fixtures; but the question that I raise is this next step: To what extent should this profit not be subject to support the necessary activities of Government merely because business wants to invest that profit in buying new plant?

Mr. BAILEY. Well, the new plant—I think maybe you are throwing a little different angle into it.

Senator FLANDERS. We are talking about replacement and not expenditure.

Mr. BAILEY. I am talking about maintaining the same productive capacity. When you get profits saved for expansion and new plant or additional plant, I never have heard anybody say that those oughtn't to be taxed as profits at the time they are earned. All we are getting at now——

Senator O'MAHONEY. But you do say that those profits which must be invested to maintain the same production capacity should not be taxed?

Mr. BAILEY. Well, I do not think that I went that far, sir.

Senator O'MAHONEY. I am only asking a question, Mr. Bailey.

Mr. BAILEY. I think that there is an evil in trying to tax that kind of profits.

Senator O'MAHONEY. You see, this is the difficulty that is in my mind when I am trying to comprehend the technicalities of this problem: The individual has a limited span of life, and the natural person is born, he lives fourscore years and ten, and he dies and he is through. But your artificial person, which is the corporation, may go on for years and years and years, and does.

Now, the individual person, during this terminable span of life, bears the cost of government and the cost of living, and he cannot get away from it.

Mr. BAILEY. Of course, you take the position that the corporation and an individual are different. The corporations are all owned by individuals.

Senator O'MAHONEY. That is right, of course.

Mr. BAILEY. So that it is a medium of conducting business.

Senator O'MAHONEY. Surely; it is an organized agency for conducting business.

Mr. BAILEY. I am like Professor Paton and many others; I think if it were possible to have our corporate tax structure so devised that the tax on corporations themselves would be small, and the bulk of it would be paid by the stockholder, that we would have a sounder structure. But I am not as optimistic as some about the fact that we can get away from all of the technical difficulties in developing such a law.

Senator O'MAHONEY. What it boils down to is this, Mr. Bailey, it seems to me: The corporation must pay its taxes in the current dollar just as the Government makes its expenditures in the current dollar and as the citizen pays for the cost of living in the current dollar. What we are asking here, it seems to me—when we contend for the depreciation of replacement facilities in terms of the old dollar, we are asking that the corporation, instead of computing its profits in the same dollar in which it fixes prices, may be permitted to compute its profits in a dollar capable of buying very much more than any existing dollar. The accountant wants us to say, "Let us allow the corporation to figure its profits in a technical nonexistent dollar, while the Government and everybody else has to struggle along with the existing current dollar."

Mr. BAILEY. Of course, Senator, I think it works just the other way. The corporation——

Senator O'MAHONEY. You are the witness. Now, tell me how it does work.

Mr. BAILEY. The fact that the corporation has to determine its profits on a basis of some of the old dollars means that its profits are higher than if they are determined on current dollars. Therefore, the taxable profit is higher and its tax is higher.

Senator O'MAHONEY. Perhaps I misstated it, but I am thinking of what Professor Slichter said yesterday—that the corporations are overstating their profits.

Mr. BAILEY. All right.

Senator O'MAHONEY. Now, are they?

Mr. BAILEY. I think Professor Slichter, speaking as an economist, says that they are overstating their real or economic profit; that when they report profits in accordance with these accounting conventions, in this inflationary period, those profits are higher than if it were possible to report them on the economic theory. And that is what he is driving at.

Senator O'MAHONEY. In the New York Times for Sunday, December 5, there was a long story published under the heading, "Industry's profits up all along the line." A table was given which is rather interesting. For example, it starts off with the steel leaders and shows that for 9 months to September 30, in 1948, nine steel companies, constituting the leaders, showed profits—and I am using the word that is in the headline—of $275,115,868; as against, in 1947 for the 9 months, $241,386,817.

Now, bearing in mind Professor Slichter said yesterday that the United States Steel Corp., which is certainly one of these nine, is using this new method of depreciation so far as its reports are concerned, we find that the next six steel companies, which are named small steel companies, had a profit of $18,698,206 in the first 9 months of 1948, as compared with $14,083,718.

Now, it is difficult for me to believe that the heads of all of these companies with the exception of United States Steel are making a perfectly stupid error in computing their profits in current dollars; and if United States Steel is computing its profits on the understatement which Professor Slichter illustrated yesterday, then obviously the disproportion of profit becomes even greater than it appears on this table. It says nine steel leaders were making $275,000,000, as against $18,000,000 for the six next in line. And all of the time we talk all around the subject, and when the accountant is asked to name the standard which is going to be used in order to adopt this new accounting procedure, why, then the accountant gets tongue-tied and does not give us the standard.

Mr. BAILEY. That is one reason why the accounting profession has not gone to that, sir. That is one reason why the auditors, in connection with United States Steel, had to say, "This is not in accordance with accepted accounting principles."

Senator O'MAHONEY. In other words, this argument asks for the adoption of a theoretical, arbitrary formula instead of a factual formula and we are all living with inflation.

Mr. BAILEY. That is right.

Incidentally, I am sure you realize that United States Steel, in taking that additional amount, does not deduct it for tax purposes.

Senator O'MAHONEY. Oh, yes; of course.

Mr. BAILEY. Well, that is part of our accountants' troubles; we cannot find any answer that is sufficiently accurate and definite to cause us to suggest a change from the old conventional methods.

I would like to read now the Business Week bulletin that I have here. The opening paragraph of this deals with more or less what Senator O'Mahoney said.

There's a more or less private argument going on between the accounting profession and some of its biggest customers—over extra depreciation allowances to cover today's inflated replacement costs. We don't mean to horn in on it. But both sides have declared that their main object is to keep the public from getting the wrong idea about corporate earnings. And so we think some public discussion would be a good thing all round.

Briefly, here is the sort of problem involved:

In its report for the first 9 months of 1948, United States Steel Corp. showed total sales of $1,755,000,000. To compute net income for the period, it subtracted various costs from this gross figure. Among other things, it deducted wages and salaries, products and services bought, and "wear and exhaustion of facilities, based on original cost." And under the "wear and exhaustion" entry it also deducted $39,700,000 "added to cover replacement cost."

On this basis, Big Steel came out with net income for the 9 months of $88,000,000. That is about $9,000,000 less than it showed for the first 9 months of 1947, when it deducted only $19,600,000 "to cover replacement cost."

According to the ideas of the committee on accounting procedure of the American Institute of Accountants, this is all wrong. Big Steel should have figured its income without subtracting anything for extra replacement costs. Then, if it wanted to, it could have earmarked part of the net income as a reserve to cover extra replacement.

Figured this way, Big Steel's income for the first 9 months would have been about $128,000,000 in 1948 and $117,000,000 in 1947. This year, in other words, would have shown up as some $11,000,000 bigger than last instead of $9,000,000 smaller.

Big Steel is sticking to its guns, however. Chairman Irving S. Olds says "adequate provision should be made currently for the replacement of assets which are constantly being worn out." Accountants retort that income is one thing and what you do with it is something else again. If Big Steel follows the same practice in its annual report, its auditors probably will take an exception.

IMPORTANCE OF THE ISSUE

At first glance, the whole thing may look like a pretty trivial issue—about on a level with the ancient argument over whether it's proper to put tomatoes in clam chowder. No matter how it sets up its books, United States Steel will get the same amount of cash out of its operations. And it will earmark the same amount for extra replacement costs. It won't even get a tax advantage by increasing its depreciation charge. The Treasury doesn't allow extra depreciation as a deduction from taxable income.

But the importance that people attach to the net-income figure these days gives a very practical flavor to the argument. Newspapers and financial services will pick up United States Steel's income figures, often without giving the break-down of cost items. It can make a lot of difference to the corporation if stockholders, investors, and labor unions get the idea that it earned more in 1948 than it did in 1947 when the company executives think it really earned less.

And, of course, United States Steel isn't by any means the only company that has been wrestling with this problem. All corporations with substantial investments in fixed plant and equipment face some variation of it. Many follow much the same practice that Big Steel does, in spite of the opposition of the accountants.

A majority of businessmen and financial analysts think corporate-income statements should explain the necessity for retaining part of the income to meet higher costs. That's what the American Institute of Accountants found out in a survey last summer. But, according to the survey, a majority also opposed making any basic changes in the income statement itself.

THINK IT OVER FIRST

Whatever a company does, obviously it should give a full explanation of what it is providing for replacement costs and why. It shouldn't count on a cryptic note in fine type to tip off the casual reader of its reports.

Then they close with the statement:

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.

And this is on your point, sir:

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.

Another thing that the institute did last summer was to send out a questionnaire to a selected list of businessmen, economists, lawyers, bankers, labor officials, Government representatives, and others, upon the subject of the desirability of a change in fundamental accounting principles to permit depreciation on replacement cost. That is not for any other basis but in a corporation reporting to its stockholders.

While some important minority of men who replied thought that the time had come when such change should be made, the great majority thought that the fundamental accounting principles should remain unchanged, but that this point was so important that information about it should be given by a corporation to its stockholders as supplemental data.

The statistics on that, I think, you will find interesting enough to have in your record, just by classes of businessmen that replied:

The economists, generally speaking, were the ones that had a majority vote in favor of a change in principles to bring it more nearly to what they considered economic or real income. But all other groups took the position that the time was not yet ripe for a change in those fundamental principles; that we are just getting acquainted with the concepts of accounting on costs for depreciation, and we had better not go to a basis which let each corporation do about what it wanted in this respect and to determine the effect all by itself. In other words, we found that business thought that this should be a restriction against earnings that could not be distributed, rather than trying to interfere with the traditional way of reporting income against the backdrop of the economic conditions of the time.

I have a paragraph here on taxation, Senator, because I think it has some connection with this. Perhaps the reading of it may help.

I have already mentioned the fact that the 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; that is the point.

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.

Senator FLANDERS. May I stop you there for a moment? You say it is not a good thing, and I think that you make an excellent case that it is not a good thing. At the same time, you have indicated that it is so difficult to set any standards for calculating what would be a good thing that it makes the problem of any legislation on that point pretty difficult.

Mr. BAILEY. That is correct, Senator. If I knew the answer of just how to do this, I would be glad to give it to you. We accountants have had the Bureau, the Treasury Department, the staff of the Joint Legislative Committee on Taxation—they have all been considering this to see what way can be developed to meet that problem. They have played with index figures a good deal, and admittedly there are weaknesses in index figures. I have thrown out a suggestion once or twice that sounds kind of complicated, but it is to expand the involuntary-conversion section of the law into this field, so that corporations save temporarily from taxes the money required for replacement.

Senator FLANDERS. At the time the replacement takes place?

Mr. BAILEY. No; at the time it is using up the facility, using up the tools. If it replaces that article, that machinery, let us say, within 10 years, or uses that money for replacement, the amount withheld is used to reduce the cost of the new facilities, so that the tax comes to the Government in this second generation. It does not quite cover this whole problem of not taxing the appreciation, but it spreads tax payment on it over two generations; and, if the money is not used for replacement within that period, it is taxed at the rates prevailing in the year the deduction was made.

That, again, has a good many technical difficulties, but it is not much more difficult than some of the other features in the law. But it is an extremely difficult problem, and I do not presume to have the answer. I do not know that I ever will.

There is another phase of it that comes into this which, while not operating in the same way, does give some relief at this period against taxing, in the old way, money that has to be turned around and reinvested willy-nilly. That method is to allow depreciation on substantially accelerated rates in the early years of life.

You asked me a moment ago about the effect of the tax legislation on corporate profits, and I think one of the places where that is most important, Mr. Huber, is the influence of the Treasury Department toward a straight-line depreciation over the full years of life of the facility, taking the same depreciation each year. That is an unrealistic thing, but it is easy to operate; and the Treasury advocacy of it has pretty nearly driven out, until the last 2 or 3 years, any other way of depreciation. We used to have a declining-balance method that took more depreciation in the early years of life than it did in the later years.

Representative HUBER. You feel, on the whole, the present taxes on industries are adequate, should be increased, decreased, or left the same?

Mr. BAILEY. You are asking me about rates, sir?

Representative HUBER. I mean the general tax scheme; let us take up the whole structure.

Mr. BAILEY. You are worse than Senator O'Mahoney. I would rather take it in two steps.

Senator O'MAHONEY. I take it that I am pretty bad.

Mr. BAILEY. I didn't mean it that way. You have posed a difficult problem.

Representative HUBER. Do you feel that corporation taxes are excessive at the present time?

Mr. BAILEY. Well, I have trouble with that one. I have got to go back to the position that you have got to raise money. I think that you are approaching, on your taxation of corporations, rates that can undermine and retard our business development. I do not pretend to know whether you have reached that place or not. Apparently you have not, because of the way things are going. At today's level of taxation, business is expanding from within itself.

So, I think that we have to say, based on what has been going on this year and last year and the year before, that the tax levels have not ruined our corporate-expansion program.

Representative HUBER. May I ask you how many corporations does your firm represent?

Mr. BAILEY. Well, hundreds.

Representative HUBER. Some of the larger ones?

Mr. BAILEY. Yes, sir.

Representative HUBER. Could you name several?

Mr. BAILEY. Well, yes; I will name several. Take some of those that I have known for a long time, like Chrysler, and Nash, and Murray Corp. of Detroit.

Representative HUBER. Have any of those corporations adopted your recommendations in their tax make-up?

Mr. BAILEY. It does not do them any good to do it unless the Government will allow them to do it; so that the answer to that is no.

Representative HUBER. I mean so far as they can under the Bureau of Internal Revenue.

Mr. BAILEY. Yes.

Senator FLANDERS. There is a difference between tax avoidance and tax evasion, is there not?

Mr. BAILEY. I have heard that said a great many times, sir; but I do not think that we are even talking about tax avoidance here.

Representative HUBER. I appreciate your sincerity and your willingness to assist the committee, but do you think that you could be entirely unbiased in this matter?

Mr. BAILEY. Well, sir, when you have a good many clients, you have got to go right down the middle of the road, because what pleases one doesn't please another; and you have to live with your own conscience all of the time.

Representative HUBER. That is all.

Senator O'MAHONEY. Now, your testimony and that of Professor Paton is that there is great difficulty in devising a formula by which to measure increasing cost of replacement.

Have you, or to your knowledge has any other accountant, endeavored to find a formula by which falling prices would be measured in the same way?

Mr. Bailey. Well, I think we are all pretty well in agreement that, once we have the formula that measures the up, it has got to measure the down as well. There is no disagreement on that. We have not one that is satisfactory on the way up. I think, while you were telephoning, I said there had been a good deal of activity on the part of the Treasury, the Bureau, and Mr. Stam's Joint Committee on Internal Revenue Taxation on that subject.

Senator O'Mahoney. I have never seen any intimation that any formula or any proposal for this new method of computing depreciation would allow the corporation to get the benefit of less than 100 percent of cost.

Mr. Bailey. Well, you have not seen it because you have not seen anything on the other side.

Senator O'Mahoney. Well, has there been such?

Mr. Bailey. The discussions that have been going on, on this whole theory of whether a formula can be devised for depreciation on the upswing of the cycle, pretty nearly always has with it the recognition that that same thing has got to operate on the downswing.

Senator O'Mahoney. I am very glad to hear that.

Mr. Bailey. In suggesting a rather complicated means of dealing with the problem. I think you may be interested in what I said in the record.

Senator O'Mahoney. Senator Flanders recommended that I read the record.

Mr. Bailey. I was just getting to this place of other ways of dealing with this depreciation, and I was talking about relating it more to the early years of life of the use of the facility.

Business seldom acquires a facility with the idea that it will be productive ratably over its entire life. A new facility is acquired or erected for a specific need, and ordinarily the economic usefulness of that facility over the next few years is the controlling factor. The profits to be returned during the next few years are the important thing. Depreciation, in my opinion, should be more nearly related to that economic usefulness or to the business realities under which management operates in deciding to acquire those properties. The 5-year amortization permitted during the war was an outstanding example of that particular point, and it did not particularly bother Congress that there would in many cases be a residual value at the end of the war period. So I urge that you consider a change in the emphasis in the allowances for depreciation which will permit higher depreciation in the early years of the use of a facility than in the later years of residual life, and that this be an important differential related to the current high prices, rather than merely a nominal one. For another 5 years, maybe, if we can have an emphasis on other than the straight-line basis, that will help in this period.

Senator Flanders. This subject, of course, of accelerated depreciation is one that has had a great deal of discussion, and it is still under discussion in the committees of Congress; and I wonder if you could give a fairly brief and simple explanation or imaginary example of just what it would do and how it would meet this particular situation.

Mr. BAILEY. Well, it meets this particular situation only kind of sideways; because, if you allow larger depreciation during this first few years of life, in this new expansion program, you get a higher depreciation charge right now, which, while still on cost, does have some way of offsetting what you are not getting now by the replacement method. So one or the other gives you a higher depreciation now. The accelerated depreciation gives you no more over the life of the property than your total cost. It just gives you more of it in the earlier years when the economic usefulness is higher.

I can give you a sample of one particular method that has been followed in more than one case, and it has its variations; but some companies have taken the position that in spending money for plant expansion at this time, at these high prices, they were taking a long-term risk that was quite different than if prices had not skyrocketed the way they have; and, therefore, because they had made that expenditure with the expectation of use during this period, that they had better get more depreciation out of the way during this period. So they have said, "We will take this excess cost we are paying for these facilities and write that off over a comparatively few years," and accelerate the depreciation to get the high cost behind them in the years when they are getting accelerated use of that facility.

That has not yet been recognized by the Bureau, but it is within the statute and within the possibilities. So that many of us think that the Bureau should and perhaps will recognize that to some extent. It needs some prodding from your committee, I might say.

Senator FLANDERS. In the long run, there would be no loss to the Treasury?

Mr. BAILEY. No loss at all; the total depreciation would be just the same.

I have a theory that the Government ought to pay more attention to its income taxation over the entire period than to be too much interested in the immediate year. They have to collect money year after year over a period; and if they collect it 3 years from now, on a system that taxes available profit, maybe it is just as good for the Government income, and it may be much healthier for the corporation from whom they are collecting it.

Senator FLANDERS. What, specifically, is the point of resistance of the Treasury officials to this idea?

Mr. BAILEY. Well, they have been accustomed to dealing with accelerated depreciation only on accelerated use, the number of pieces turned out, and the activity and the number of hours run. We will take a machine tool that is estimated to be able to produce 10,000 units; that depreciation can be accelerated as units are produced.

But in many cases people buy that machine tool because the demand for the product to be made from it for the next 3 years is going to be awfully big, and they are going to make more money out of the machine during the next 3 years. They do not know what is beyond that, because you are in a different economic period as to your product. So, this proposal is to relate that depreciation to the economic usefulness rather than to the piece usefulness, if I may use that term.

Senator FLANDERS. Even on the piece-usefulness basis, the Treasury does not recognize a period of overtime, two or three shifts as against a normal one of a single shift?

Mr. BAILEY. The Treasury would say that they do recognize it to a certain extent, and probably adequately. My own feeling is that, while they recognize the principle, they have not recognized it adequately.

Senator FLANDERS. All right.

Mr. BAILEY. I have got another point here that is not very much longer, sir.

Senator FLANDERS. You may continue.

Mr. BAILEY. The statistical dangers that I talked of a little while ago are involved here.

One of those things that has concerned many accountants, including myself, is the error that gets into over-all national statistics as a result of the present accounting conventions, which, by and large, cause the reporting of profits in the inflated dollar and the investment or so-called net worth of corporations, to a large extent, in prewar dollars. If it would be possible for all companies to adjust their investment to current price levels, then the relationship of current profit to current investment might be reasonably meaningful; it certainly would be much better for comparison with prewar years than are the present figures. The American Institute of Accountants, however, realized that it would be impossible under any conditions to have every corporation restate its position, and many felt that a partial correction would be of no statistical value. There is, however, another very interesting statistical study which has been made in this field. This latter deals with this problem of the percentage of invested capital and return for various years, comparing 1947 and 1945 to 1940. They have taken the 100 largest manufacturing companies and made an adjustment in their net worth for this index figure for change in value of plants; so that, on the basis of the conventional accounting as it is reported, on the items at cost, the 100 largest corporations report for 1947 a profit of 14.7 percent in relation to book value, as compared with a little over 10 percent for 1940. But, adjusted to the value of plant facilities by that index figure for the facilities, they added enough to the net worth of these companies so that their profits, as reported, were something under 10 percent in relation to net worth as compared to just under 15 percent in the orthodox way. It ought to be in your file.

Senator FLANDERS. I think that we have that for the information of the committee.

I would like to raise a question with regard to that. Obviously, with a new company starting in business, and with the same efficiency as an older company, their net worth would immediately reflect the current costs of their facilities. Does anyone raise the question as to whether the old company is entitled to that correction by any rule of justice or common sense or accounting, or what have you? Is that question raised?

Mr. BAILEY. I am sure it is raised plenty, sir. The feeling in many quarters is that the stockholder is entitled to a return on the present value of his investment because he is getting it in inflated dollars—against which he ought to have his investment figured.

Senator FLANDERS. Also in inflated dollars?

Mr. BAILEY. Yes. He is getting his return in inflated dollars.

Senator FLANDERS. That is the justification for the proposal, in brief, or for the tabulation that was made?

Mr. BAILEY. Yes; I think that that is so. I have not followed all of their reasoning, but I am sure that that is what they are trying to point out; what the effect of inflation has been on these customary comparisons. It looks as if corporations are earning 50 percent more in relation to invested capital than they were in 1940, on the basis of reported income. Actually, if you take your return in inflated dollars and relate it to investment in inflated dollars, they are earning 8.8 percent instead of the 14.3. It is an important thing to keep in mind in any study of what corporate profits in the United States are.

Senator FLANDERS. All right, sir; have you something more?

Mr. BAILEY. I have half a page of conclusion that may summarize it.

Senator FLANDERS. I will stay with you to the end.

Mr. BAILEY. May I conclude by emphasizing that 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.

There is as yet no magic formula to convert monetary accounting profit to economic profit, but the economic demands and restrictions on profits are demands which cannot be escaped and must be considered by each company in the determiation of its various financial policies.

Senator FLANDERS. I take it that your presentation, in part at least, could be summed up by saying that you do not disagree with Professor Slichter of yesterday or Mr. Paton of this morning as to what is going on, as to what the situation is. You are only suggesting that it should be reported, or taken care of, or made known or publicized as an addition or addendum to the company accounts rather than modifying the company accounts to take them into account?

Mr. BAILEY. That is basically correct. My suggestion is merely because the accountants have not found any other way of doing it. That is what we are doing now. And I am anxious that your committee, in considering these corporate profits with these accounting conventions, do realize that the profits are tied up just as Professor Slitchter said and just as Mr. Paton said.

Senator FLANDERS. Thank you, Mr. Bailey.

Mr. BAILEY. Thank you, sir.

Senator FLANDERS. The hearing is adjourned for today. It will reconvene tomorrow morning at 10 o'clock, and the panel tomorrow consists of Mr. Cruikshank, director of social insurance activities of the American Federation of Labor, and Mr. Stanley H. Ruttenburg, the director of the department of education and research of the CIO.

We have those two men for tomorrow. We are particularly interested in hearing from them to get a line on the questions we should be asking of the industry executives who will be appearing on the following days.

(Thereupon, at 4:20 p. m., a recess was taken until 10 a. m. Wednesday, December 8, 1948.)

# CORPORATE PROFITS

---

WEDNESDAY, DECEMBER 8, 1948

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders (chairman of the subcommittee) presiding.

Present: Senators Flanders (presiding) and O'Mahoney, and Representatives Patman and Huber.

Senator FLANDERS. The subcommittee will be in order.

We will open this session of the hearing this morning, and our first witness is Mr. Nelson Hale Cruikshank, labor economist. He is a graduate of Oberlin College, Ohio Wesleyan University, and I note that Mr. Cruikshank has been to the Union Theological Seminary and it does not say whether you graduated.

Mr. CRUIKSHANK. I did.

Senator FLANDERS. That is greatly to your credit. And you have had a great many relationships in educational and economic lines with labor organizations, and have done much publishing. You are appearing, as I understand it, as a representative in some capacity of the American Federation of Labor; is that correct?

Mr. CRUIKSHANK. That is correct, Senator.

Senator FLANDERS. You may proceed with your testimony.

## STATEMENTS OF NELSON H. CRUIKSHANK, DIRECTOR, SOCIAL INSURANCE ACTIVITIES, AMERICAN FEDERATION OF LABOR; AND MISS MARGARET SCATTERGOOD, MEMBER OF THE RESEARCH STAFF, AMERICAN FEDERATION OF LABOR

Mr. CRUIKSHANK. I would like to present to you and the members of the committee Miss Margaret Scattergood from the research department of the American Federation of Labor, and with your permission I will be calling on her very adequate resources from time to time.

Senator FLANDERS. Miss Scattergood's assistance is welcomed.

Mr. CRUIKSHANK. Thank you.

Mr. Chairman and members of the committee, as a representative of the American Federation of Labor I am very glad to have the opportunity to present our views on the very important subject with which your committee is dealing.

Labor is vitally concerned with the subject of business profits as it relates to the distribution of our national income. The economic system which we have developed in America and all the social and cultural byproducts of that system are at stake. This system which is now being attacked from all sides cannot endure unless fair and equitable distribution of the rewards of productive effort among workers and investors is developed and followed.

Next only to the immediate requirements of a good job at a wage sufficient to maintain his family in self-respecting decency, the first interest of the workingman is in an economy of continuing stability. This is because the savings of working people are in such things as life insurance, Government savings bonds, and in retirement programs, both private and government. The values in all of these are dollar values, and working people stand to lose more than any other group if continuing price increases are permitted to whittle away the purchasing power of these dollars.

It is not only the worker's future security but his present welfare that is dependent upon a stable economy. As I shall demonstrate, the last few years' experience shows that the lag in wage increases in relation to price rises undermines the living standards of working people.

For the last several years we of labor have missed hearing in the Halls of Congress the voices that were so insistent during the middle thirties on balancing the budget and reducing the national debt. We recall just 10 years ago when three out of nine million unemployed men and women were on the WPA how we were told that to borrow the necessary funds to provide them with relief employment would ruin the country. We were told that a national debt of $40,000,000,000 would wreck our economy. Now, with a debt of $259,000,000,000, these same voices are strangely silent on the question of retiring the national debt and devote their strident pleas to further reduction in income taxes, inheritance taxes, and taxes on corporation profits. It is labor that pleads for retirement of the national debt and the establishment of a stable economy.

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 techniques 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.

A policy of fairness to all groups is the only possible basis for a sound economy. Such a policy has not been in operation since the end of World War II.

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, the latest figure, living costs were up 34 percent, wages only 31 percent.

These comparisons are shown, Mr. Chairman, in graphic form on the chart appearing on the bottom of page 1 of the October issue of Labor's Monthly Survey. With your permission also, Mr. Chairman, I should like to introduce this attachment as a part of the record, with the omissions that are noted there. They refer to irrelevant material, and these are noted on the copies made available to the committee members and to the reporter.

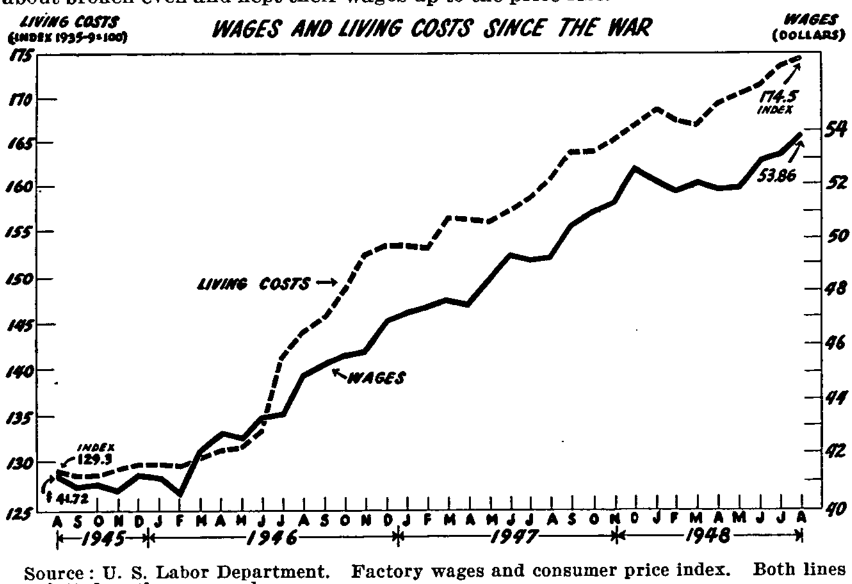
Senator FLANDERS. We will be glad to have it for the record.

(The document referred to is as follows:)

### WAGES AND PRICES

In the fall of 1948, more than 3 years after the war, American workers are still struggling to keep their wages abreast of price rises. Yet statements in the press, radio, and elsewhere repeatedly claim that large postwar wage increases have been the cause, not the result, of price rises. To clear up this confusion, therefore, the American Federation of Labor is releasing the following study on wages and prices, based on Government figures.

We note first the important fact shown in the chart below: that, except for a few months in the spring of 1946, wages have fallen steadily behind in the race with prices during the whole postwar period. The wage and living-cost lines on the chart are on the same scale, showing clearly how wages lag. Two years after the war (August 1947), living costs were up 24 percent, wages only 18 percent; in August 1948 (latest figure), living costs were up 35 percent, wages only 29 percent. These figures show what the worker has been up against in the postwar period. Union members have managed to preserve their living standards only by asking large wage increases; and, because their increases have been more than the average, shown in the chart, most of them have just about broken even and kept their wages up to the price rise.



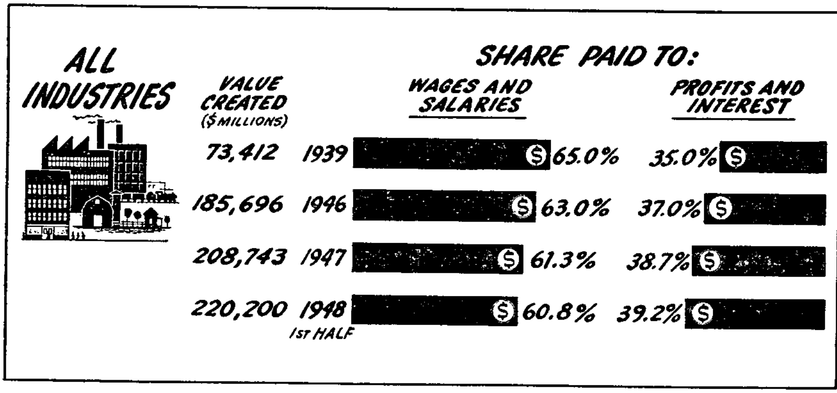

Source: U. S. Labor Department. Factory wages and consumer price index. Both lines are plotted on the same scale.

WAGE COSTS DECLINE PROPORTIONATELY TO VALUE PRODUCED, WHILE PROFITS RISE

The second important fact is as follows: In spite of all wage increases, the cost to industry[1] of its total wage and salary bill today takes a much smaller part of the market value of its products than before the war, and the proportion paid for labor cost has declined in each postwar year. There are two reasons for this: (1) Labor's productivity is higher today; the average worker produces about 32 percent more per year in 1948 than in 1939.[2] This rising productivity offsets part of the wage increase. (2) For the other part, industrial managements—who determine price policy—have, in general, set prices much higher than necessary to cover the cost of higher wages. Prices have been set so high in fact that profits in 1947 and 1948 reached all-time peaks[3]—and profits represent what is left of sales income (at market prices) after wages and all other costs have been paid. Due to this extra price increase, beyond what was needed to cover wage costs, profits have risen more than wages. Therefore, wage costs take a smaller part each year of the market value of industry's product, leaving a larger part each year to go to profits.[4] The chart below gives Commerce Department figures to illustrate this fact. "Value created," in this chart, represents the market value of all goods and services produced by industry less depreciation charges.[5]

The significant point is that the worker, as a consumer, pays the high prices that create today's peak profits. Because of this extra price rise above wage costs, the worker has been forced to ask further large wage increases to meet his living expenses.

The practice of raising prices more than enough to cover wage increases has characterized the postwar period, not only in one or two industries, but in nearly all industries. For at almost every step in the process of production, from raw materials to finished products, wage costs are a declining proportion of the market price of goods and services, and profits to owners and investors an increasing proportion. The charts below and table on page 110 illustrate this for basic industries, those on pages 111 and 113 for consumer goods industries.




Source: U. S. Department of Commerce National Income Studies. Inventory valuation adjustment, deducted in Commerce Department's totals, has been added back.

---

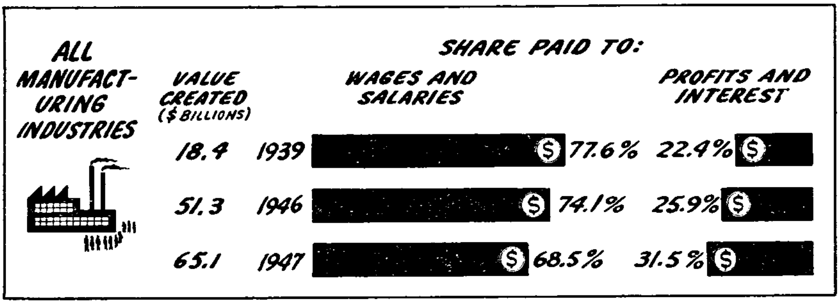
[1] The term "industry," as used in this study, includes farms, railroads, retail stores, etc.—every business (including Government) which produces and sells goods or services.

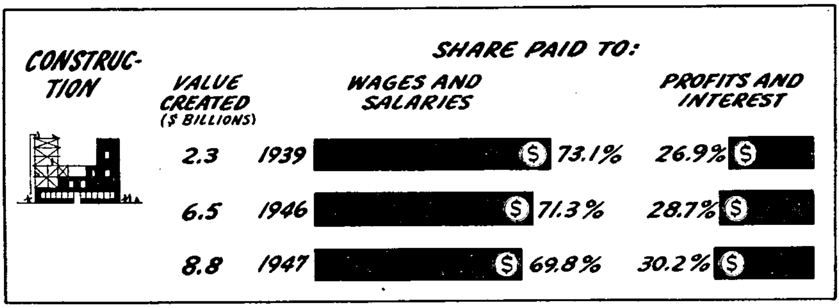
[2] Our estimate, based on figures in President's Midyear Economic Report and other estimates.

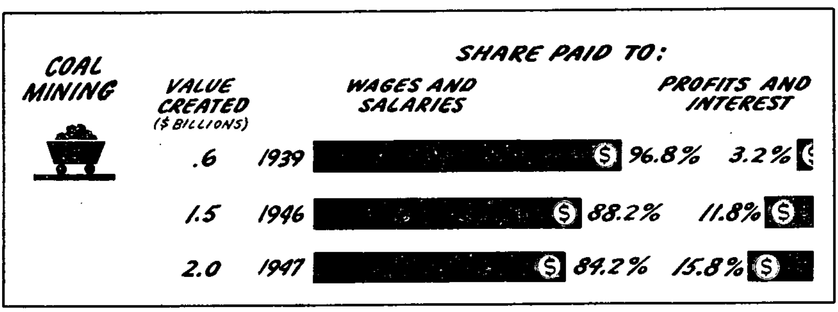
[3] See Labor's Monthly Survey, September 1948.

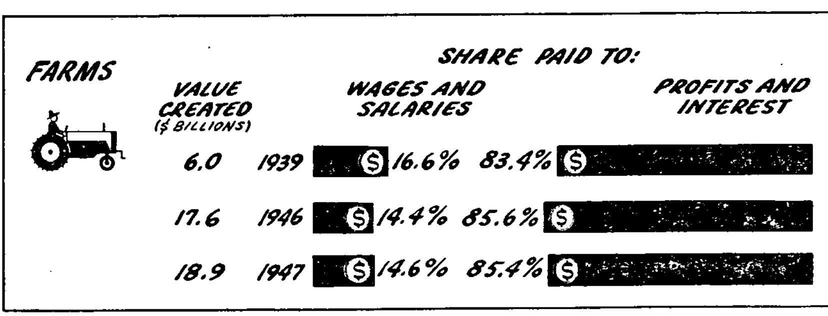
[4] The increase in the items "Profits and Interests", on the chart, is due to increase in profits. Interest payments declined sharply from 1939 to 1946 as industry paid off bonded debt; they rose very slightly in some industries from 1946 to 1947. Interest in 1947 formed less than 2 percent of value created in every industry except railroads (4.5 percent), utilities (14.6 percent), and real estate (20.5 percent). Interest was included with profit on charts to show the whole amount paid to owners and investors. This plus wages and salaries adds to 100 percent of value created.

[5] For exact description of items included in "value created," see Note on terminology, etc., page 7 and refer to sources noted therein. "Value created" is referred to by the Commerce Department as "income originating in the industry," and excludes business property taxes and a few other minor items, as well as depreciation. Figures for 1948 not yet available for separate industries.




"Value created," by each company in an industry, represents the value of goods produced by that company excluding the cost of materials or power bought from other companies. This prevents duplication. For instance, in the clothing industry the cost of power to run machines and cloth to make garments are excluded,[6] so that the "value created" represents only that resulting from the

[6] Because cloth is included in value created by the textile industry and power is included in utilities.

work of that one industry and the price mark-up on its products. The final price paid by the man who buys a pair of overalls, however, covers wages and profits in several industries—the retail store, the textile mill, the farm. For each industry the market value created is accurately shown, also the proportion of it paid to labor or to owners and investors. The figures for all industries are then added up, to give the totals shown in the chart on page 110 for all industries. Looking at a few of the industries we find:

*Construction.*—The high cost of new homes and other buildings is due in large part to increased profits in the construction industry, for wage and salary costs took a smaller proportion of value created in 1946, and smaller still in 1947, while the proportion going to profits increased (p. 111); also in lumber, high prices are due to a large extent to high profits, for the part of market value taken by profits has doubled, while the part required for labor costs declined (table, p. 114). The family who buys a new home pays for the increased profits in both these industries.

*Coal.*—We have heard much of wage increases and pensions for coal miners, but the price increase has been so great that profits have risen from 3.2 percent of market value in 1939 to 11.8 percent in 1946 and 15.8 percent in 1947—almost a fivefold increase, while wage costs have declined proportionately (p. 111).

*Clothing.*—High prices have raised textile profits from 13.6 percent to 38.4 percent of market value (1939–47); high prices have increased clothing profits from 9.6 percent to 26.3 percent of market value (1939–47); wage costs have declined proportionately in both industries. Workers and other consumers pay the cost of these high profits.

The story is similar for iron and steel, paper, leather and shoes, furniture, and the majority of all industries.

In the price of a rayon dress, wages have increased less than any other factor. The cost of materials in the dress have gone up most of all, the retail mark-up next; but figures on page 113 show that, in both the textile and retailing industries, consumers are paying chiefly the cost of increased profits, for in both industries wage costs have declined proportionately and profits risen since 1939.

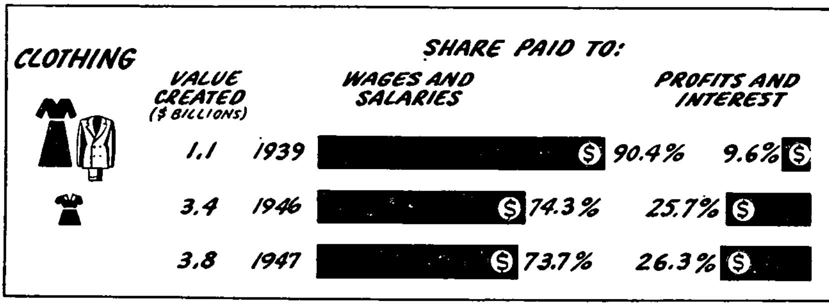
In a few industries, experience has been different; and we have included these, too, so as to show a representative picture. In automobiles, reconversion and strikes reduced profits in 1946, but 1947 showed wage costs down and profits up proportionately as compared to 1939. In retail trade, food processing and farming, high prices increased the proportion paid to profits from 1939 to 1946; but in 1947, prices were not so far above wage costs as in 1946, so that the proportion taken by profits decreased slightly in 1947 and that of labor increased, due probably to increased production and consumer resistance to high prices.

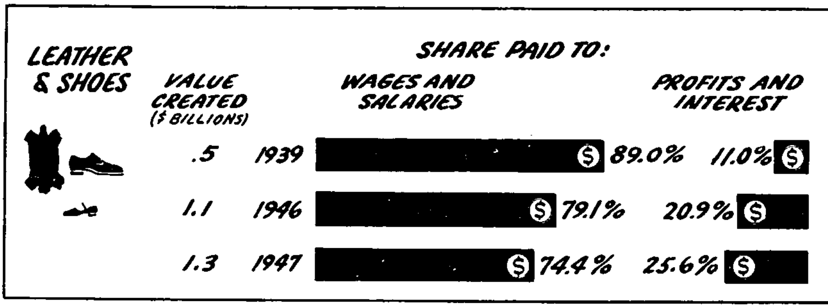
In railroads and utilities, where prices are controlled by Government commissions, the part paid to wages has increased, that to profits has decreased from 1939 to 1947. It has not been easy for either of these industries to increase profits by raising prices to the consumer. In fact, in electric utilities, the average price per kilowatt hour of electric current sold to homes has declined steadily since 1939, while wages have risen. Yet, because the industry has cut costs and improved efficiency by installing new machinery, profits are satisfactory. Output per man-hour has increased 36 percent since prewar.[7] This is an example of constructive progress: Increasing wages, costs lowered by improved efficiency, prices declining so that sales of electric current to American homes have increased 60 percent since 1939, resulting in greatly increased production and satisfactory profits. But this industry is the exception. Industry in general has followed a high-price policy, which has made serious inroads into the living standards of workers and other consumers since the war. We do not advocate Government control of prices for any other industry, but point to the utility industry because it proves that price increases can be avoided or kept to a minimum.

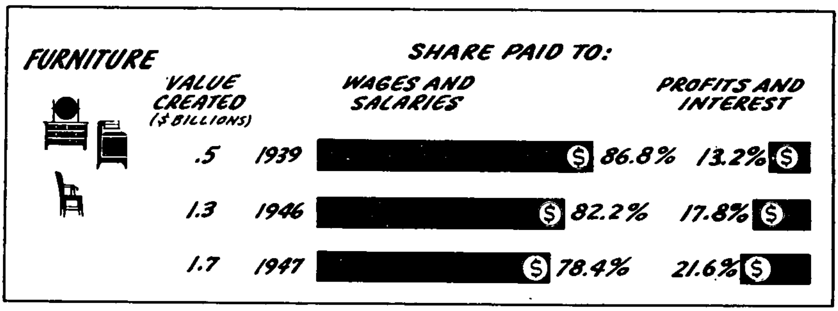
The charts and figures in this study show conclusively that increased wages have not been the major determining factor in the amount of the price rise. Prices have been set by management at a level substantially higher than necessary to pay the cost of wage increases. The result has been the highest profits in history. These profits were paid for by consumers—and that means all Americans—in the high prices they had to give for food, clothing, shoes, automobiles, gasoline, furniture, home appliances, and scores of other living necessities.

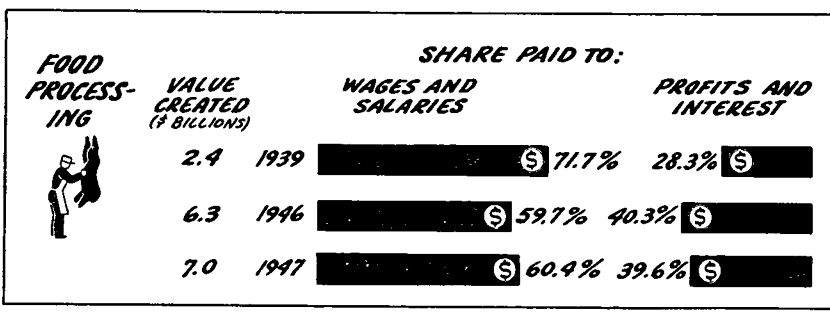
When confronted with the necessity of raising wages so workers can meet their living costs, industrial managements have three possible courses open to them: (1) To ask the cooperation of their unions in reducing costs so the price increase

[7] Standard and Poor, current analysis of the industry, August 1948.




may be kept to the lowest possible minimum. Thus far, not many managements have made full use of union-management cooperation, which has dynamic possibilities of benefit for workers as well as management in the present situation. (2) To raise prices somewhat more than necessary to cover wage costs, but keep prices below the maximum they could get in a time of shortage. Some managements have shown a commendable sense of responsibility for good public relations and have exercised restraint in their price policies, even though they have not worked jointly with their unions to cut costs. (3) To raise prices as much as the traffic would bear. Many managements have followed this policy, as is shown by the enormous profits reaped by industry generally. At a time when competition could not keep prices in check because of shortages and immense consumer demand, it is not surprising that so many followed this course.

It is sometimes claimed that if workers had not asked wage increases, prices would not have risen. Workers have never had any assurance that if they forego wage increases management will refrain from raising prices. On the contrary, if unions had not made every effort to keep wages up to living costs, in all probability the result would only have been disastrous losses for workers and more profits for owners and investors.

The Federation recognizes that businessmen want to raise their profits just as workers want to raise their wages. We recognize, too, that the profit motive is vital to a free-enterprise economy and is the mainspring of that business initiative which creates the income to pay higher wages. Also, profits furnish capital for plant expansion which benefits workers by increasing production.[8] But to continue the wage-price spiral, with wage increases followed by drastic price increases, is an economic absurdity which benefits no one.

Therefore, we say to American managements: Bring your unions into consultation. Ask their cooperation in cutting costs so that wage increases can be paid without continuing the price spiral. Agree to share equitably with them the returns of joint efforts to improve production, and open your books to them so they can understand the problems involved and see the results of their work. Make sure, beforehand of course, that you are dealing with loyal Americans and not with Communists. For every loyal American worker, it will be an immense gain to stop the price spiral, a gain worth wholehearted cooperation in any practical joint plan undertaken in good faith. For, as the chart on page 109 shows, the price spiral has prevented workers from making genuine progress since the war in spite of wage increases.

There is hope for next year if this course is followed. Farm and food prices (which are not set by farmers but by bidding on national exchanges) are declining at wholesale, as world-wide food shortages are overcome. This should be followed next year by declines of consumer prices for foods. If cooperation between managements and unions can cut costs and bring wage increases without continuing the price spiral, workers can recoup their postwar losses, and management will gain by better labor relations and a growing market for their products. Widespread acceptance of this policy would correct economic unbalance.

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 four 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.

| Industry and year | Value created by the industry | Paid to— Wages and salaries | Paid to— Profits and interest |
|---|---|---|---|
| | *Mil. of dol.* | *Percent* | *Percent* |
| Lumber: | | | |
| 1939 | 507 | 84.9 | 15.1 |
| 1946 | 1,481 | 76.4 | 23.6 |
| 1947 | 2,152 | 69.9 | 30.1 |
| Iron and steel: | | | |
| 1939 | 2,273 | 83.7 | 16.3 |
| 1946 | 6,116 | 78.0 | 22.0 |
| 1947 | 8,645 | 68.1 | 31.9 |

| Industry and year | Value created by the industry | Paid to— Wages and salaries | Paid to— Profits and interest |
|---|---|---|---|
| | *Mil. of dol.* | *Percent* | *Percent* |
| Utilities—electric and gas: | | | |
| 1939 | 1,718 | 46.1 | 53.9 |
| 1946 | 2,671 | 46.5 | 53.5 |
| 1947 | 3,029 | 49.3 | 40.7 |
| Railroads: | | | |
| 1939 | 2,740 | 81.6 | 18.4 |
| 1946 | 5,692 | 90.2 | 9.8 |
| 1947 | 6,366 | 85.0 | 15.0 |

Mr. CRUIKSHANK. Prices have been raised more than enough to cover any added cost due to wage increases, and the result has been

[8] See Labor's Monthly Survey for September 1948.

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.

Again referring to the attachment noted before, you will see this detailed at the bottom of page 110. However, that is not exactly identical with the break-down given here, because, in the chart referred to, profits and interests are grouped. The figures that I have given separate profits from interest, which show a more striking rise in the proportion of the returns of industrial enterprise going to profit than they would when they are grouped with interest.

It is common knowledge that profits, which reached an all-time peak in 1947, are exceeding that peak in 1948. The proper measurement of profits is the rate of earnings on net worth after taxes, which represents the income on stockholders' equity or investment—the National City Bank figures are generally used for current records. For manufacturing corporations, these figures show an average earnings rate of 17 percent on net worth after taxes in 1947, which exceeds by a considerable amount all previous records in the 22 years covered by these figures.

During the period from 1925 to 1946, in most peacetime prosperous years, the earnings rate varied between 8 and 11 percent, and in only four peacetime years did it exceed 11 percent: 1928, when it was 11.6 percent; 1929, at 12.8 percent; 1941, at 12.4 percent, and 1946, at 12.1 percent. And we could note that in 1941 the defense program was getting well under way, so that it is a question whether you could actually call that a peacetime year. During the war, excess-profits taxes reduced the earnings rate to between 9 and 10 percent. Yet, reports for the first three quarters of 1948, for a smaller number of corporations, show an increase of more than 2 percent on net worth above the corresponding period of last year. In 1948, thus far, these amazing profit rates are shown for individual industries: Automobiles, 26.1 percent; textiles and apparel, 22.5 percent; petroleum products, 21.3 percent; office equipment, 25.4 percent; pulp-and-paper products, 23.0 percent; cement, glass, stone, 20.8 percent. Thus, profits of leading corporations in many industries show more than double the rate of return on stockholders' equity that has been usual in prosperous peacetime years over the last two decades.

Those who would show profits as a percent return on sales ignore the fact that sales volume may double with little, if any, increase in stockholders' investment, and it is the income on investment which is significant.

The significant point about these profits is that they are created by the high prices paid by workers and other consumers.

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 billion dollars in 1946 to 2.8 billion dollar 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.

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. These acquisitions have been particularly marked in the textile industry where companies have been making profits of 20 to 36 percent on net worth in 1946 and 1947, in chemicals and drugs where profits were from 15 to 24 percent, and in foods and beverages where profits were from 10 to 42 percent. We do not have enough information to show the actual effect of this merger movement on competition, but these figures give cause for much concern. What could be more destructive to our economy than the use of high profits to eliminate or seriously lessen competition in a free market? A free-enterprise system depends on competition to check excesses, adjust prices and production to consumer needs, and stimulate efficiency and the invention of new techniques.

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.

There is attached a table later in my statement which shows the distribution of the gross national product, both in dollar amounts compared by various years, 1929 to 1948, and percentagewise.

(The table referred to is as follows:)

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

| Year | Total gross national product | Purchased by— Consumers | Business firms | Net exports (private accounts) | U. S. Government |
|---|---|---|---|---|---|
| | *Billions of dollars* | *Billions of dollars* | *Billions of dollars* | *Billions of dollars* | *Billions of dollars* |
| 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 (3 quarters) | 255.9 | 178.5 | 39.0 | .7 | 37.7 |
| | *Percent* | *Percent* | *Percent* | *Percent* | *Percent* |
| 1929 | 100.0 | 76.4 | 15.3 | 0.1 | 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 (3 quarters) | 100.0 | 69.8 | 15.2 | 3 | 14.7 |

Source: U. S. Commerce Department.

Mr. Cruikshank. 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.

When we take this back and compare it to the analysis of the purchase of our national product, and relating the importance of maintaining the purchasing power of wage earners as a large segment of the economy, we can see that what is actually happening is that the current wages are not enough to maintain their relative purchasing status; that they are having to spend their earnings which they saved in previous years, and spending anticipated wages in future years by installment buying, reminiscent of the period just preceding 1929.

In 1949, consumer buying must increase substantially if we are to maintain our economy at levels of maximum employment and production. To achieve this, a stable dollar is essential. The postwar price rise in living costs must be stopped.

Basic in checking inflation is a sound monetary policy on the part of the Federal Government. Efforts to maintain the prices of Government bonds should not be permitted to interfere with such a policy, for our entire economy depends on Government fiscal and monetary policies to check those excesses which may be disastrous in a boom period.

Government tax policy is also vital. The executive council of the American Federation of Labor has pointed out that the bulk of tax savings approved by the Eightieth Congress accrued to taxpayers in income groups over $3,000. The low incomes still bear a heavy tax burden, and this should be kept in mind in any new measures for taxation. Their buying power is vital to the Nation and must be increased.

In looking to 1949, 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.

I should like to add, Mr. Chairman, it is our very earnest hope that the President will call such a conference early in the year. The resources of our great voluntary groups were used to their maximum during the war, and in fact many people said that they constituted America's secret weapon; but they have not been adequately harnessed to the critical problems of the peacetime economy.

There should be, we feel, continuous give and take between the representatives of the great segments of our economy, and it is in this way that there can be put the responsibility on these groups that is commensurate with their power in our economic life.

This concludes, Mr. Chairman and members, my formal statement, and I should be glad to address myself to any questions that you may wish to ask.

Senator FLANDERS. Mr. Cruikshank, I have noted for a year past, and perhaps longer, the concern of your organization in finding a rational and proper solution to this question of rising prices; and I have been particularly interested, in reading from month to month your Monthly Survey, to see the editorials of Mr. Green on the subject. And I am glad to see this morning, in your last paragraph, recognition of what seems to me to be a vital part of the problem, which is that a large part of it lies within the responsibility of business and organized labor. That is, there is a large part of it which perhaps Government cannot do except in bringing the parties together along somewhat the lines that you suggest; and the inclusion of the farmer in it is, of course, essential. But the Government alone, without what we might call statesmanship on the part of the wage earners, the organized wage earners and industry, I believe cannot carry the whole responsibility for ending inflation; and I judge that you feel the same way.

Mr. CRUIKSHANK. Yes, indeed, sir.

Senator FLANDERS. And I have been very much interested in seeing that point stressed so often in your monthly survey.

Now, I find a number of detailed questions which came to my mind as you were reading. One of them is in the second full paragraph at the top of page 2 of your statement, in which you speak of the drastic price rise with reference to wages, or a considerable price rise with reference to wages, since VJ-day.

I note a tendency, a natural tendency, on the part of those who are seeking higher wages, to use as a base the last months of the war period. I have wondered whether that was justified, since you are making a comparison with a period in which prices were kept low by price controls and in which, as a matter of fact, there was a real scarcity of the goods whose prices were kept low. I have been wondering whether a fairer basis is not the last prewar year, say 1940, or something of that sort, when we were still living under a free economy, relatively free.

Mr. CRUIKSHANK. Well, Mr. Chairman, I think it depends on just what question or problem you are addressing your analysis to. We are endeavoring to show the way in which the worker, as a consumer, has been squeezed by the failure of his wages since that time to keep up with the rising prices.

I think that if you would take a prewar year, 1940, as your base, as well as 1946 where prices were artificial, as you indicate, I think that you would find the same squeeze as affecting the worker. He is up against the problem of balancing his family budget.

Now, the prices were kept down at the earlier period by free competition when there was plenty of goods on hand; and when that scarcity came in, created by the artificial condition of the war, then you had to bring in the artificial controls of price control, and so forth.

Senator FLANDERS. That leads to another point, which is not mentioned here, and that is that perhaps it is difficult in a time of statistically full employment, that it is more difficult to keep inflation under control than it is in periods when there is still a considerable number unemployed; because, among other things, if there are people unemployed and the demand is active, you can increase your output by employing more people. And that resource does not seem to be left to us now. Not that there are not people unemployed, but there is no great mass of unemployed people in any particular industry or any given area, on which we can draw.

So that raises the question as to whether we have not somewhere near reached the limits of our production with present equipment and present working hours, so that that resource of increased production which was available before the war is no longer available.

Mr. CRUIKSHANK. Well, in one sense we may have, and it is undeniable that full employment does bring certain problems regarding inflation that do not exist when there is some unemployment. But we have still great resources, I think, in management skill, in the development of new techniques, and the development of new equipment. We have great resources available to increase production of consumer goods and other goods.

Senator FLANDERS. Those, of course, particularly so far as new equipment is concerned, are comparatively slow; they do not make an immediate response as hiring new men would make.

Mr. CRUIKSHANK. That is right, of course.

Senator FLANDERS. And furthermore, that raises the question which we have been discussing from the economist's and accounting standpoint the last few days, as to whether there are profits enough for new labor-saving equipment. I will not go into that for the moment, but that is a part of the question.

Now, in the third paragraph from the bottom of page 2, you say:

> Those who would show profits as a percent return on sales ignore the fact that sales volume may double with little, if any, increase in stockholders' investment, and it is the income on investment which is significant.

I would like to suggest to you that a profit reckoned on sales does have significance of a sort, and I will ask you the question as to whether you think it does not have a certain significance in that it indicates the degree of take-out of the customer's dollar?

Now, if you have enormous aggregate profits and a very large investment, and if it is made by rapid turn-over on 2 cents out of the customer's dollar, that certainly sets a limit. If the profit is 2 cents and the sales price is $1, the businessman is getting 2 percent on sales. That certainly sets limits on what he can do in reducing prices. And if he is in a business which has an exceedingly rapid turn-over and involves low capital investment, that may show a very large return on his capital investment.

Mr. CRUIKSHANK. We do not maintain, Mr. Chairman, that the percent return on sales is without any significance, but we think that it does not have the significance that is often implied when those bases are used. When you think of the division of the return of the whole productive enterprise in the country, how the basic proportion is to be allocated, that is the question to which we are addressing ourselves. And when a business maintains that it is not making much profit, which is often implied, that it is not making much profit because it is operating on a 1 or 2 percent profit on sales turn-over, when it may be making 20 or 25 percent on the original investment, we are just saying that it does not have the significance that is often attributed to it.

Senator O'MAHONEY. Have you not already said, Mr. Cruikshank, that the record before us shows that by reason of rising prices the larger corporations, at least, have been able to obtain from the consumers, en masse, a sufficient amount of capital so that they can invest that profit in expanded facilities without going into the market and selling stock?

Mr. CRUIKSHANK. That is right.

Senator FLANDERS. That is the next point that I wish to raise, although just to go back for a moment, I imagine that when the packers appear before us they will point to 1 or 2 percent on the sales dollar, and a very low investment, comparatively speaking, as compared with heavy industries, for instance, and will raise the question as to whether that 1 or 2 cents on the dollar is not about as close as you might ask anybody to go. I am not surely predicting that, but after looking at their figures my guess is that they will bring up that point.

Now, on this matter at the foot of page 2 and the top of page 3, that the companies take their new capital from consumers, you raise there the hen and the egg question. Do they take it from consumers because they cannot get it from the capital market, which the testimony we have had previously would indicate, or is it lack of desire to go to the capital market since they can get it so easily out of their customers?

Now, that is a question. I hope that out of your testimony and the testimony this afternoon, we can get pertinent questions to ask the industry representatives, and that is one which we should be asking them.

The assumption has been that the capital market has dried up so that they have to get it out of profits, and the question is whether that is so or not.

Senator O'MAHONEY. As I pointed out a day or so ago, I think when Professor Paton was on the stand, the November issue of the Survey of Current Business published by the Department of Commerce shows that the ratio of common stocks to all issues is now about 25 percent, the same as it was in the early twenties, and perhaps 4 or 5 percent lower than it was in 1929 when there was a great speculative movement in common stocks preceding the collapse. So that actually, upon the statistical information before us, it would seem that percentagewise, at least, common stocks occupy relatively the same position that they did back in the early twenties.

Senator FLANDERS. That is a pertinent observation.

Senator O'MAHONEY. The question is whether or not they should be larger.

Now, one opinion was expressed that if common stocks should go up to 28 or 29 percent again, it would be an indication of unwise speculation in common stocks. Another opinion was expressed to the effect that a full-employment market, or the market created by full employment, warrants a larger investment in productive enterprise to produce the goods which a fully employed community would consume.

Senator FLANDERS. The facts pertinent to the discussion would seem to be what percentage, in the last 2 or 3 years, of new capital is being obtained from equities, and what from borrowing, and what from reinvestment inside the business.

Senator O'MAHONEY. To me, one of the great significant facts here is that big business is finding its necessary funds for expansion and capital investment of one kind and another, from accumulated earnings, and is made independent of the venture capital. And I might say that the testimony at least of Professor Slichter here the other day, and of Professor Paton, would indicate that some of the big corporate leaders, management leaders, want to take all of the risk out of risk capital by figuring profits upon a new basis so that they will not have to pay as much taxes to support the Government.

Senator FLANDERS. We will have an opportunity to investigate that practice, and the justification for it, as these representatives of big business appear before us.

Mr. CRUIKSHANK. I think it will be very constructive if you can get that out. It gets into the difficult area of motives, sometimes, just why they are going into that resource rather than going before the public with new issues. That is not exactly known. I think the record is clear that in the last few years they have not been going before the public in the same way that they have in previous years to sell securities.

Senator FLANDERS. At the top of page 4 of your statement, I would raise the question, without having the answer, as to whether a drop in consumer percentage of purchase of the Nation's production and the maintenance or expansion of the Government purchases—whether the consumers' drop may not be a recognition of the increased demands of Government rather than the Government having had to take this part of it owing to the inability of the consumers to buy it? In other words, is not the rise in prices in part due to the fact that the heavy Government purchases help to produce the scarcities which help to produce the increase in the prices?

Mr. CRUIKSHANK. May I ask Miss Scattergood to comment on that?

Miss SCATTERGOOD. In the first place, if you take the table that appears as page 5, the proportion that the Government bought of the entire product in 1939 is almost the same as it is in 1948, so that we have not exceeded the proportion the Government was taking in 1939. As you say, the fact that the Government is taking and using a large part of the product does increase the scarcity. But as we look ahead, the point seems to be that we must return to a dependence on consumers as we have in the past. We cannot go on increasing the dependence on the Government, and unless the consumer buying power expands considerably, business will have no justification for enlarging its plants and continuing to support the economy by enlarging its plants as it did in 1948.

The whole basis rests on the consumer, unless we expect to turn over to a Government-run economy.

Mr. CRUIKSHANK. I think that that is underscored, too, by the fact that the large portion of this Government expenditure as represented by the efforts to rehabilitate the economy of Europe, is not intended as all ever to be a continuing thing; that we hope to have Europe on its feet, and when Europe is on its feet it is going to start to export, and we are going to have to start to import, naturally, which again calls for the additional consumer buying power if our own economy, the economy of Europe and the whole stability of the world is to be maintained.

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 the 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, 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.

Senator FLANDERS. Does that express it clearly?

Mr. CRUIKSHANK. Well, yes; I think so. 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, and I do not know about anybody else in the room, 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.

Now, in the middle of page 4, you speak of the decline in savings. You may have the figures, and of course we can get them easily enough. You speak of the high rate of redemption of war bonds and savings bonds; and now, relating to savings bonds only, have you any figures handy for the net loss in savings bonds?

Miss SCATTERGOOD. I have the figures here, Mr. Chairman. I could look them up.

The savings bonds have recently been increasing in purchases because of a drive that has been going on, and there is no net loss. The recent drive has brought in enough new savings to offset the redemptions of bonds. But the bond redemption is still at an extraordinary high rate, as it was last year.

Senator FLANDERS. The turn-over is rapid.

Miss SCATTERGOOD. The point we wanted to bring out here was that the savings of low-income groups, as shown by these various factors, have declined. The net savings picture for the United States does not show a net decrease, because there has been probably a larger saving for the high-income groups.

Senator FLANDERS. It was my impression that there had not been any net loss, and I just wanted to make sure that that point was brought out; and your explanation will go on the record.

I was interested in your reference to Government monetary and fiscal policy. My own impression is that monetary policy is rather dangerous and may lead to unemployment, and fiscal policy is a safer way of handling the money-supply end of the inflation spiral. That is the third paragraph from the bottom on page 4 of your statement.

That brings my comments to an end except again, with reference to your last paragraph, I want to say that I believe that you and your organization and Mr. Green have put their fingers on an important fact; that is, that the Government cannot do everything in the way of controlling inflation except as they could end it by drastic monetary policies which would result in unemployment, and that is the wrong way to end inflation; but a large share of it lies in statesmanship by organized labor, business, and the farm groups. And it seems to me that your proposal for a conference on that subject is highly constructive.

Mr. Patman, do you have any questions?

Representative PATMAN. I would like to ask one or two questions.

On page 1 of your statement you make a very interesting observation down next to the last paragraph, about the 1920's and the 1930's when we heard so much about balancing the budget and paying off the national debt.

Of course, there was good reason then why they were doing that. They were trying to block the passage of the bill to pay the adjusted service certificates of the veterans of World War I. They claimed that the 1½-billion-dollar payment would absolutely ruin the country; do you recall that?

Mr. CRUIKSHANK. Yes.

Representative PATMAN. It would cause ruinous inflation.

Mr. CRUIKSHANK. Yes.

Representative PATMAN. Well, they blocked the passage of it until 1936, and when the money was paid it would have done this country a lot of good, but the Federal Reserve Board doubled the reserve requirements of banks and caused the deflation of 1937. They went too far.

That is the reason I would like to give very careful consideration to your statement on page 4 about sound monetary policy. That is right, we must have a sound monetary policy; and I think that we should have a balanced budget at all times, and pay off a sizable amount on the national debt each year. But we must watch these monetary policies. The Eightieth Congress, this Congress, gave the Federal Reserve Board more power on changing reserve requirements, and that is a very potent power. They have used that power. Those are dangerous dollars, the way they can arrange this monetary system.

We must keep in mind not to give any one group too much power along that line, which would permit them to put into effect the same policies that caused the unnecessary depression after the First World War. So I hope your group gives consideration to that.

Mr. CRUIKSHANK. We certainly agree with that, Mr. Congressman.

Representative PATMAN. That we must watch the powers offered to certain groups along that line, for fear that they might go too far and cause another depression, which should not be caused and will not be caused if the principles and policies of the maximum-employment bill are carried out. You are in accord with the policies of that bill, are you not?

Mr. CRUIKSHANK. Yes, indeed.

Representative PATMAN. You think if we carry out the policies expressed in that bill, now law, that is the proper thing?

Mr. CRUIKSHANK. It is providing in part some of the objectives that we have asked for here. Our group, as well as business groups, have been called into consultation with the economic advisers, and we have found them very willing and ready to consult with our representatives. However, we do not think that that quite fills the bill. When you get the representatives of these various groups together—they do not call them in together and consult and have a give and take, and make definite proposals to the economic advisers, but they call them in separately. And that, I think, is the way it is set up in the bill that they should do, or at least it is so interpreted, and I do not question that interpretation. But there is something beyond that that we are asking for, and that is to get these responsible leaders of these groups, that cannot act separately but which must act together in the public interest, just as we do in wartime, and lay on them the responsibility and say, "Now, bring it up, the public is waiting, the Congress is waiting, and the administration is waiting to see what these groups can offer as a way out of this serious problem." And if that kind of responsibility were put on them jointly, I think that we would see something come out of it.

Senator FLANDERS. It would be my hope that the nature of these proceedings, and the testimony brought by the two groups coming before it, might be of such a nature as to show the usefulness of the two groups getting together. And so far as it is possible to use this series of hearings to that end, I think that we should use them to that end.

Senator O'MAHONEY. I quite agree with the chairman in that respect. I feel that there is a good deal more agreement among all of the people who are thinking about this and talking about it, than there is disagreement. And I was very pleased to have you say here that the organization for which you speak, the American Federation of Labor, desires to promote and to strengthen a free-enterprise system.

It is customary, of course, to read statements in the press and in the magazines that labor wants to promote a police state. That is not your purpose, is it?

Mr. CRUIKSHANK. Definitely not.

Senator O'MAHONEY. In other words, you want to preserve a free economy in which risk capital may be attracted?

Mr. CRUIKSHANK. That is right.

Representative PATMAN. I had one or two other suggestions. I notice that you state that the executive council of the American Federation of Labor has called a joint conference of business, labor, and farmers to examine facts and propose a joint voluntary program. I understood you to say in your examination by the chairman, that you hoped the President would call such a conference.

Mr. CRUIKSHANK. Yes.

Representative PATMAN. Have you not already called one? I am referring to the last part of your testimony.

Mr. CRUIKSHANK. It says, "The executive council * * * has called for a joint conference."

Representative PATMAN. You mean that you are asking the President to do that?

Mr. CRUIKSHANK. I do not think any formal representations have gone to the President at this time, but in the report of the executive council to the convention, which was adopted, the executive council asked that such a conference be called.

Representative PATMAN. It occurs to me that it would be a very fine thing, and I hope it is called.

Mr. CRUIKSHANK. It is amazing, sometimes, I have had some experience with management and labor committees, and—well, it should not be amazing, it is just true—how the sense of responsibility develops among these people when they get together. We all make statements for the press, and we all make public speeches, and so forth, in which we say certain things, but when the responsible representatives of labor are sitting with responsible representatives of management across the table, and we both have a common objective before us, it is one of the most heartening experiences one can have to see how they buckle down and come to common agreements and brush aside a lot of the stuff that is just for public consumption, and understanding each other as they do, get right down to tackling a problem and come out with a workable solution.

That is the kind of thing that we think can meet this problem.

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.

Representative PATMAN. Has your organization made any study about the size of business, as to what particular point in the size a business is most efficient, of a particular type?

Mr. CRUIKSHANK. No, we have not. There are some recent studies out that I think are quite significant on that question.

Representative PATMAN. Who made the studies?

Mr. CRUIKSHANK. The study was made by the Committee for Economic Development. It is published in a book put out this year and it is by A. D. H. Kaplan, Small Business, Its Place and Problem.

Representative PATMAN. It would be interesting. I would like to see it.

Senator FLANDERS. I was on the committee that made the 20th Century Fund investigation, and that was quite a little time ago.

Representative PATMAN. I think that that is all.

Representative HUBER. I wish to compliment you on submitting a very excellent paper, not couched in the usual economic verbiage and double talk. It was right down to earth, and I enjoyed it.

Senator FLANDERS. You are excused, sir, and we thank you very much.

Mr. CRUIKSHANK. Thank you.

Senator FLANDERS. The next witness is Mr. Stanley H. Ruttenberg, economist with the CIO. Mr. Ruttenberg will take the stand.

Mr. Ruttenberg, you have a B. S. from the University of Pittsburgh and have been director of the department of education and research of the CIO since September of 1948. You came to the national office as associate director in 1939 and have been with the CIO since 1937 except for about 4 years, 1 of which was spent as assistant to the director of Hull House.

Mr. RUTTENBERG. And the other three in the Army.

Senator FLANDERS. That happened to a great many people.

You have written testimony, and you may proceed with it.

Mr. RUTTENBERG. Thank you very much.

## STATEMENT OF STANLEY H. RUTTENBERG, DIRECTOR OF THE DEPARTMENT OF EDUCATION AND RESEARCH, CONGRESS OF INDUSTRIAL ORGANIZATIONS

The Congress of Industrial Organizations welcomes the opportunity to testify before this joint congressional committee. Mr. Murray, president of the CIO, regrets that he could not accept the invitation to appear in person. I am appearing in his stead.

My name is Stanley H. Ruttenberg. I am the director of the department of education and research of the Congress of Industrial Organizations.

The CIO hopes that this investigation and hearing will throw some light upon the level of profits, which has been the subject of considerable discussion. Some groups say that profits are low and others that profits are high. We are hopeful that this series of committee hearings will get at the facts of the controversy. We are convinced that an impartial investigation into the profit picture of American industry will justify the position taken by the CIO over the period of years.

In this testimony we should like, first, to review the level of corporate profits of American industries, information which we are sure is quite familiar to the members of this committee. Secondly, we should like to discuss the reasons why we think profits are soaring to new all-time highs; and, thirdly, we should like to discuss the effect upon our economy of the present level of corporate profits. Fourthly, we should like to point our finger at some of the problems which have been raised by industry groups in an attempt to indicate that present profits are not as exorbitant as they actually are.

We should just briefly like to summarize the general profit picture as seen by organized labor. Reports for the third quarter of 1948 by the Wall Street Journal, which surveyed 155 major companies in 15 industries, showed third-quarter earnings to be—

> A sweeping 41.7 percent above the third-quarter earnings of 1947. Such a showing clearly points to record-high earnings for all of 1948.

The National City Bank reported third-quarter 1948 earnings of 400 leading corporations to be 38 percent above the similar period of 1947. The National City Bank's November 1948 letter showed that these 400 corporations had an annual return on net worth based on reports for the first 9 months of this year of 18.7 percent as compared to 16 percent for 1947. Return on net worth for previous years was considerably lower.

Individual corporations of 1948 have reported unusually high levels of profits after taxes. Bethlehem Steel Corp. showed an increase in the third quarter, 1948, of 40 percent over the same period in 1947. General Motors increased their profits from $213,000,000 for the first

9 months of 1947 to $327,000,000 in the similar period of 1948 for an increase of 53 percent. These are just two specific examples, but they are representative of two basic industries which have continued to increase their prices in 1948 because they say it is necessary to meet increased costs. As we shall point out later, these companies increased prices not just to cover increased costs, but far in excess of what was necessary to cover costs, with the resultant effect of the level of profits as indicated.

Looking at industry as a whole, 1948 profits, before taxes, of all corporations will be at least $34,000,000,000, and over $20,000,000,000 after taxes. This compares with the previous best year, 1947, when profits before taxes were almost $30,000,000,000 and $18,000,000,000 after taxes.

In the prewar years 1936–39, which, by the way, were the base years for the wartime excess-profits tax, the average corporate profits, after taxes, was 3.9 billion dollars. In other words, corporate profits, after taxes, in 1948 will be more than five times what they were during the excess-profits tax base period, 1936–39.

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-interested, shortsighted, depression-producing thinking of American industry that must be altered if we are to avoid serious economic dislocations.

This statement will briefly refer to each of these four factors.

First, in connection with the desire to make as much as possible while the making is good. It seems clear upon an examination of any series of facts or figures that American industry shows little regard for the general public, while it shows major concern for itself. One price increase after another has been made by the major industries since the elimination of OPA. Few attempts have been made to absorb increased costs or even to pass on to the American consumer a better product for a lower price. The only sight which industry envisions is its avidity to increase prices and reap more and more profit.

In addition corporations are engaged in protecting themselves against the depression which they feel is inevitable. This point of view is frankly set forth by Mr. Irving S. Olds, chairman of the board of the United States Steel Corp., in his annual report of 1946. He said:

> Operations are at an all-time high. Profits should be sufficient to enable a fair return to be paid to the owners of business in the form of dividends and *also to permit an adequate amount to be set aside for future needs since the day will come when steel operations are at a lower rate than at the present time.* [Italics added.]

It is clear from this quote that United States Steel Corp., at least, is safeguarding itself against the depression which it considers will inevitably come. Mr. Olds' remarks could be paraphrased this way:

> We must charge as high a price now as we can while business is good and production levels are at all-time peaks so that we can make sufficient profit to set aside for the rainy day when orders will fall off and production will decline.

This is an extremely dangerous attitude for American industry to take. Granted industry must protect itself against periods when production will not be at capacity levels, the question which we raise specifically in this connection is whether industry, in protecting itself against the future, is not adopting policies which will hasten "the day * * * when * * * operations are at a lower rate * * *."

By following the policy of raising prices and profits, in other words, industry is doing more toward bringing on the depression and bringing closer the day when they will need the reserves about which they speak. That is to say that the practice of industry to raise prices and thus its profits will do more bring on a depression and reduce production than any other single decision of industry. If, on the other hand, industry would moderate its avaricious appetite for profits by moderating its pricing policies, it would go a long way toward stabilizing our economy and thus postponing, maybe indefinitely, the inevitable depression which they seem desirous of protecting themselves against.

We would also like to comment briefly on the general attitude of business managers and industrialists that year in and year out, regardless of the effect it has upon our economy, profits must be ever increasing. It seems that the heads of our major corporations feel it incumbent upon themselves to maintain an enlarging profit picture for their organization. It is this attitude on the part of industrialists which is creating and adding to the serious economic distortions which are occurring. The atitude of having to do better than the last guy weights heavy upon the minds of American industrialists. It is this selfish attitude on the part of major segments of our American life which portends serious consequences for the future. It would be for the good of industry and for the good of our economy as a whole if this attitude could be moderated.

We further 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. 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 or 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.

As a result of these practices by American industry in the establishment of its price structure, higher and higher profits, quarter after quarter, are made. As profits soar to new all-time highs, (1) serious distortions in our national income occur; (2) serious maladjustments develop between prices and income levels; (3) the seed germs of the next depression are being sown; and (4) incentives to increase production and expand capacity are lessened.

As profits soar to new highs, they do so at the expense of other segments of our national income. Profits increase because prices increase and when prices increase faster than wages, serious distortions in our national income occur.

In comparing the year 1945 with the first half of 1948, we find that corporate profits before taxes took 11 percent of our national income in 1945, while taking almost 15 percent in the first half of 1948. On the other hand, compensation of employees took 67½ percent of our national income in 1945 and only 61 percent in 1948. Even compared to 1939 the same situation is true—a greater share of our national income going to corporate profits and a lesser share going to the compensation of employees. Instead of this occurring the compensation of employees component of our national income should be taking a larger proportion of an ever-increasing national income. For example, the Council of Economic Advisers, in discussing the long-range economic program specifically, said:

> In a future expanding economy, consumer income and expenditures will require a larger share in order to assure markets for everything that can be produced.

Here the Council of Economic Advisers clearly recognizes the need in an expanding economy for the compensation of employees to be ever-increasing rather than declining as has been the case in the past decade.

Since the war period prices have increased much more rapidly than have the incomes of the mass of American people. The cost of living, for example, as measured by the Consumers' Price Index of the Bureau of Labor Statistics has risen over 37 percent since early 1945 while income in terms of average weekly earnings of manufacturing workers has increased a little over 13 percent. This means that average weekly earnings as a result of rising prices and in spite of three rounds of wage increases purchase approximately 17 percent less today than they purchased in January 1945, when weekly earnings were at their wartime peak. This distortion between prices and income is in the process of leading to a situation where the products of American industry will not be absorbed by consumers because incomes are insufficient to purchase these products. We are witnessing this situation in the textile industry and the shoe industry where prices are already so high that many people are refusing to buy the products of these industries. The textile and shoe industries are attempting to remedy this situation by curtailing production instead of curtailing prices. Again we see an example of the self-interested thinking of American industry which is dangerous not only in this present inflationary period but which spells serious foreboding for the future.

It would be for the good of all concerned if prices were reduced so that demand would be bolstered and production maintained. The textile and shoe industries are doing just the opposite. They are attempting to bolster their present price structure by reducing production and eventually bringing demand and supply in balance at a point which will justify the present price structure.

This situation leads me to my third point.

Senator O'MAHONEY. May I ask you at this point if you could procure for the committee some statistical information or some announcements of the textile or the shoe industries, bearing out this conclusion? I have been seen the indications myself, but I think it would be well to have them in the record.

Mr. RUTTENBERG. Yes, Senator; I would be glad to secure them.

Senator FLANDERS. We will be glad to put them in the record.

(The materials submitted by Mr. Ruttenberg are included at the end of his testimony.)

Mr. RUTTENBERG. This practice combined with the general practices which we have discussed earlier will create the kind of situation wherein a depression will be inevitable if the economy is not receiving shots in the arm through the temporary props of an European recovery program, a defense and armament program, and so forth. Do not misunderstand our position; we feel that the European recovery program and the armament and defense programs are essential for American peace and security. Yet we simultaneously realize and sincerely hope that these are only temporary expenditures of our Federal Government, and as temporary expenditures they will not last forever. We must therefore consider the concomitant economic developments that are necessary to maintain a full-employment and full-production economy on an even keel when the temporary props are removed.

Therefore, it is with this thought in mind that we are calling to the attention of this committee the fallacious economic thinking of big business in America which we think will lead us into an inevitable collapse.

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.

This committee has a major responsibility in its investigation of the profit picture. It must get to the roots of the present situation which gives rise to the exorbitant unconscionable level of profits of American industry.

The claim is made by business and industry generally that profits today are not high and are not exorbitant and are not at unconscionable levels. Industry claims that present levels of profits are essential because of the increased costs of doing business and because venture capital is not available for use in sufficiently large quantities to replace, modernize, and expand facilities. Further, that large parts of today's profits are purely book profits resulting from increased evaluation of inventories. Industry claims that inventory profits cannot be considered actual profits and as such must be set aside to guard against inventory price declines. Industry also claims that profits do not take into consideration "inadequate" depreciation allowances. We should like to discuss with the committee these claims by American business.

First of all, the contention 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 difficult 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 new-business men.

Industry, however, counters with the claim 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 in 1936–39. 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.

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.

It is further 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 built such plants at current costs. However, if they built such plants at the cost of 5 to 10 years ago, it would be unfair 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.

There seems to be considerable disagreement between industry and its accounting representatives. Many accountants have recommended against the use of a fluctuating depreciation base.

Again we repeat in connection with both the inventory profits and the depreciation policy that industry has devised these two arguments currently only to explain away the currently high levels of profits. If profits today were low and not being attacked for being too high, industry would not be engaged in a propaganda campaign to up depreciation allowances and to deduct inventory profits.

There are many other problems in connection with the whole scope of the committee's investigation which could be taken up in greater detail in the course of this testimony. However, we have touched upon the major phases and I do sincerely hope that this committee's investigation will uncover the true facts in the light of the situation as it relates to profit figures in American industry.

In conclusion might we say that the CIO feels: (1) An all-out attack must be made upon the monopolistic and self-interest practices of American industry; and (2) an excess-profits tax and undistributed profits tax must be enacted in order that the present high levels of speculative profits can be taxed away. We sincerely hope that the results of this committee's investigation will lead among other things to such recommendations to the incoming Eighty-first Congress.

Senator FLANDERS. Thank you, Mr. Ruttenberg. I have marked some points here on which I should like to ask you further questions. I think that we may well ask the steel industry representatives with reference to the quotations on page 3 as to the purpose of setting aside, as Mr. Olds said, an adequate amount for future needs, "since the day will come when steel operations are at a lower rate than at the present time." Do you assume that it is wrong to make any provision for a possible period of lower operations?

Mr. RUTTENBERG. No, sir; I do not assume that at all. But the point which we make in connection with this quote from Mr. Olds is that it is the policy of raising prices to get the profits to set aside in reserves which, in effect, will create the serious economic situation that might result in a depression. In other words, if the steel corporation would retain earnings out of profits not derived through excessive pricing, then the process of retaining reserves for the future is good.

Senator FLANDERS. You are criticizing the quantity of the reserves as being self-defeating rather than the principle of setting aside some reserves for fluctuation in business? I want to get that clear.

Mr. RUTTENBERG. I think that that is a fair restatement of the problem, but I would say we would have less need to set aside large reserves for the future fluctuating business trends if a more sound pricing policy were adopted by industry, including the steel industry.

Senator FLANDERS. I may say, whether rightly or wrongly, I raised that question in a letter to Mr. Olds a year or so ago, as to whether there was not an element of self-defeat in the size of the provisions made. I cannot, however, criticize him for setting aside reserves for fluctuations in business.

Mr. RUTTENBERG. I think that we are in agreement there, I think, if you agree with me in regard to the pricing policies from which they have derived the excessive reserves for the future.

Senator FLANDERS. We have to examine long-range business judgment on that matter as distinguished from short-range judgment. Now, you say there:

> 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.

You have criticized two industries specifically with relation to that, namely, the textile industry, and the shoe manufacturers. It is not true that most other industries, with some exceptions, are running at maximum production at the same time, so that there is no possibility at the present time of increasing that maximum production?

Mr. RUTTENBERG. Yes; that is perfectly right, Senator, but the point which I am making in the testimony is that they are setting their price to make a profit not at maximum production but at moderate levels of production, so that as production increases and the price is set to make a profit at costs of moderate production, their profits soar to even [unusually] higher levels.

In other words, over the long run, if they are going to operate at maximum levels of production, as they are operating now, then they ought to set their price to make a profit at maximum levels of production and not set their price to make a profit at moderate levels of production.

Do I make myself clear on that point?

Senator FLANDERS. Yes; although as an ex-businessman I would feel a bit cautious about setting my prices on the basis of a moderate profit at maximum production, and I think that that caution has been ground into the ordinary businessman from the experience from 1929 on. I think it is a perfectly natural thing and has to be reckoned with.

Mr. RUTTENBERG. As it is a perfectly natural thing, it has implications, if all industry adopts it as they are currently doing, of creating serious economic dislocations because it is that policy of wanting to make a higher profit now to protect themselves against the future which creates the kind of economic distortions which we are going to have to become worried about when we stop spending money for armaments and European recovery program and such items, when we are going to get to the point of stabilizing a full-production economy. We cannot do it with business psychology setting prices at moderate levels of production; it has got to be set at maximum levels of production, in the hope we can sustain an economy instead of having a boom-and-bust psychology or a depression in business cycles.

Senator FLANDERS. Again, the quantitative question is involved to some extent?

Mr. RUTTENBERG. That is right.

Senator FLANDERS. You speak, at the top of page 6, of the incentive to increase production and expand capacity being lessened by these practices. I believe that there is, as I suggested in Mr. Cruikshank's testimony, the fact that we have a ceiling on production which we seldom reach in peacetime. In other words, except for a few industries here and there, we are at maximum production, and there is no possibility of increasing it except by slow means, "slow means" in general being the purchase, installation and use of more productive equipment, the improvement in management techniques and also a possible improvement, which I suggest only diffidently, of increased labor hours; that is, the worker has a right to say whether he prefers more goods if they can be obtained by increased labor hours at reasonable prices or more leisure, that is, he makes a judgment as between leisure and goods, and I think that he has a right to make that judgment himself.

Mr. RUTTENBERG. I should like to comment on your remarks, starting from the last one and going back. In terms of hours, there is nothing to prevent any corporation or any company or any industry in America today from working their workers as many hours as they so choose; as long as they abide by the provisions of Federal laws, Federal Fair Labor Standards Act, in terms of overtime and collective-bargaining agreements, there is nothing to prevent them.

Senator FLANDERS. I would suggest that conditions are different enough in different industries so that in some of them at least there is something to prevent that. That is, depending on the ratio of fixed charges in a given industry to current production costs of labor and material. There are different industries in very different positions as to their ability to pay overtime.

Mr. RUTTENBERG. Well, it is relative; if you work 8 hours of extra time at time and a half, in that 8 hours you produce a product that actually the cost of the overtime is compensated for by the increased number of units turned out which are sold by that industry, so that actually in most cases—and there are certainly exceptions, as you indicate—but in most cases they produce enough during that extra overtime period to compensate for the increased costs resulting from the payment of overtime.

Senator FLANDERS. I am just bringing out the suggestion that that does vary in different types of industries, depending on the proportion of fixed expense and current expense to the production.

Mr. RUTTENBERG. Of course, I think what we are going to have to be considering, not this year and not next, but in the next 4 or 5 or 6 years, is not working longer hours, but working fewer hours to absorb the total number of workers in the products which can be produced.

Senator FLANDERS. But also remembering that in default of improvements in machinery and in default of improvements in management technique, that will result in a smaller amount of goods to distribute.

Mr. RUTTENBERG. Of course; 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 to either close down or work part time because they cannot get steel.

Now, 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. Now, when you have these kinds of experiences occurring, it seems to me and to the CIO generally that it is in the best interests 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.

Senator FLANDERS. That is one of the points that we will be interested in taking up with the steel industry.

Now, again, as in the case of Mr. Cruikshank, and as is the case I think uniformly in presenting the organized labor point of view, you go back to 1945 for comparisons instead of going back to prewar years. It seems to me that in going back to prewar years a pretty good case can be made for an improvement in the conditions of the wage earner, while it is not so clear in going back to 1945 where conditions are artificial.

The elements that went into the cost of living were kept down by OPA, and as a matter of fact, we could not buy all we wanted of the things we wanted in 1945, so that the basis of prosperity indicated there would seem to me to be in large measure a fallacious basis, and we have to remember that during that period in which 1945 was the last year, enough of the income of the workers was available for savings due to the rationing and the small production and the small consumption resulting therefrom so that during that period they had relatively very high savings. I question the whole basis of reference to the year 1945.

Mr. RUTTENBERG. Let me just explain that, if I may, Senator. The position which the organized labor movement takes, and particularly the CIO, is that that year the living standards in terms of money available to purchase products were at the highest level they had ever attained. The basic objective of the trade-union movement is on a long-run scale, the ever-improving standard of living of the American people; and the Council of Economic Advisers, as I indicated, agree generally with the concept of an aver-expanding consumer income.

Senator FLANDERS. Let us be sure when we say "income" whether we mean in terms of goods and services, or in terms of dollars.

Mr. RUTTENBERG. Well, let me first talk about the real income.

Senator FLANDERS. That is what we want.

Mr. RUTTENBERG. It is the purchasing power of the income, not as it relates to the availability of the product but as it relates to the availability of the real income. The availability of the product is another problem which comes into the whole area of availability through expanded capacity and through increased output and so on.

Now, if you take 1945, as we do, and compare it to the present day, you begin to show a decline in the real earning ability. The purchasing power of that dollar has declined since 1945. Now, you have raised the question, Why don't we go back to 1939? Now, from 1939 to date, wages have increased approximately 105 to 107 percent. Prices have increased, according to the Consumer Price Index about 75 to 77 percent. There has been an increase in real earnings of the American worker of 30 percent since 1939 to date. With that fact we have no question.

However, we do raise this question, that in 1939, which is used as the base period, we had 8,000,000 to 10,000,000 unemployed workers, and production facilities in America were inadequately used.

Senator FLANDERS. I would like to interject there a firm conviction of mine which is that the New Deal did not solve the problem of unemployment, at any time.

Mr. RUTTENBERG. I dare say the Democratic members of the committee would disagree with that.

Representative PATMAN. Well, we have had the New Deal and we do not now have unemployment.

Senator FLANDERS. It took a war to take us out of it. It is a mighty poor method, but it worked.

Mr. RUTTENBERG. Well, the Republican administration in 1929 took us in so deep it has taken us a long time to get out of it.

Senator O'MAHONEY. And I might say to the chairman that I think he underestimates the obstructionist tactics of the Republicans during that period.

Senator FLANDERS. The Republicans were hog-tied during all of that period.

Representative PATMAN. I do not know of any law that the gentleman proposes to repeal that was offered by the New Deal.

Senator FLANDERS. I offered that criticism of the New Deal, which stands. I would also say that it set up social objectives which are permanent. Now, there is the credit and debit balance of the New Deal so far as I am personally concerned.

Representative HUBER. And labor did not exist as any factor up until 1933, is that right? I mean we had reached a low ebb when labor was not a dominant factor in this country, so that it could not be blamed upon labor.

Mr. RUTTENBERG. In 1933 there were about 3½ million organized workers in America. Today we have over 16 million organized in the A. F. of L., the CIO, the railroad brotherhoods, and independent groups. And whether or not they are a dominant factor I shall leave to your judgment in terms of November 2.

Senator O'MAHONEY. Since the chairman has brought the subject up and made it a part of the record, perhaps I might say that the New Deal was successful enough at least to induce the Republican National Convention in writing its platform to adopt a very large proportion of its objectives and its methods. Of course, it is true that during the campaign, the Republican candidates did not have the courage of their platform makers and they withdrew from their pledges, and the result, of course, was perfectly apparent.

I sympathize with the position of the so-called liberal Republicans who are now trying to reorganize their party upon a liberal basis with this very broad segment of, I shall not say "reaction" but I shall say obstructionists, who really constitute the backbone of that party.

Senator FLANDERS. Now, let me pursue this conversation for a few minutes more.

Senator O'MAHONEY. Are we studying economics or are we talking politics, Mr. Chairman?

Senator FLANDERS. We are not talking theoretical economics, we are not talking politics, but we are talking mechanics. The failure of the New Deal——

Senator O'MAHONEY. It depends upon how you define "failure," sir.

Senator FLANDERS. From the standpoint of overcoming unemployment to my mind lies in a faulty understanding of our mechanism of production and distribution, and if that understanding had been there and had been put into execution, we might have had unemployment disappearing to a much greater extent while the social objectives were likewise kept alive and served. I consider it to be at least my personal duty, and to that extent I hope all Republicans will feel the same thing, to see to it that the means we provide for controlling, to the extent that government should control, or to provide incentives to the extent that government can provide them, should be along the line of policies that will work.

I went into the machine shop as an apprentice on January 14, 1897, now almost 52 years ago, and I became a mechanic. Now I am in the Senate and I am a mechanic and I am concerned with policies, with laws and with practices that will work, and that I think is a responsibility of the Republican Party.

Senator O'MAHONEY. Well, Mr. Chairman, now let me say that I recognize the very high grade of the chairman's mechanical abilities, both in terms of machine tools and in the operations of this committee. It ought to be pointed out that the New Deal sought to overcome this problem of unemployment by the passage of the legislation under which this committee is operating.

Senator FLANDERS. It is a good act.

Senator O'MAHONEY. Thank you. That act called for the creation not only of this committee but also of the Council of Economic Advisers. I am sure the chairman will not object if I express the opinion that during the Eightieth Congress under which for the first time this act was brought into operation, there was a much less degree of intent to use it than the chairman is now exhibiting since November 2. I welcome his interest in the mechanics of the Maximum Employment Act.

Senator FLANDERS. It is not a new interest.

Senator O'MAHONEY. I know it is not.

Representative PATMAN. Mr. Chairman, since you have evidenced so much interest in this act of which I happened to be the House author, and of which I am very proud, I do want to ask you one question, and of course it is considered to be a New Deal law, too. There are twenty-five major New Deal laws, and I cannot understand why the Republicans continue to talk about the New Deal laws and how bad they are, and never propose to amend or repeal a single one of them.

Mr. RUTTENBERG. They tried to amend one, the Wagner Act, and look what happened.

Representative PATMAN. They tried to amend it, but of these 25 laws, I do not know of a single proposal from an influential Republican to repeal or substantially amend one of them, so they must be pretty good laws.

Senator FLANDERS. They were quite largely concerned with social objectives which objectives I think are a part of the American general policy, and I think credit is due to the New Deal for setting up the objectives. I want to do all within my power to reach them.

Mr. RUTTENBERG. I wonder if I could interject just one comment.

Senator FLANDERS. It is your turn now.

Mr. RUTTENBERG. I mentioned that there were 8,000,000 or 10,000,000 unemployed in 1939, and then you interrupted with the discussion which ensued. I think that we ought to remember that in 1932 and 1933 the unemployment figures were about 14,000,000 to 15,000,000, and that by 1937 they were down to about 6,500,000 to 7,000,000. It was in 1937 and 1938 through what I would call in my own judgment the obstructionism on the part of the Republicans in Congress who reduced some of the appropriations for PWA and WPA work which the New Deal was intending to carry on, which resulted in an increase in 1937 and 1938 and early 1939 of unemployment from the low level which had been attained by 1936 and 1937.

Senator O'MAHONEY. I think it is only proper to say that from the activities and the disposition of our present chairman, I have great hopes for cooperation in the future, cooperation in the Congress and cooperation in the country. May I ask you if as a representative of the CIO, you do not see evidence of great possibilities of labor and management cooperation?

Mr. RUTTENBERG. Generally speaking, sir, there are areas of considerable cooperation between management and labor. I think collective-bargaining experiences of the past 2 or 3 years, in spite of the Taft-Hartley Act, bear that out, and in spite of the postwar experience. I think we can look forward to much improved collective-bargaining relationships in mass-producing industries, in which the CIO is represented in the coming year.

Senator O'MAHONEY. These conferences between labor and management, have they not been improving in their results?

Mr. RUTTENBERG. Well, of course, Senator, as yet there have been no major collective-bargaining negotiations entered into since the election, or even since July and August of last year. There will not be any major ones in steel or autos or electrical or the rubber industry or the petroleum or meat-packing industries for another 3 or 4 months.

Senator O'MAHONEY. What is your feeling with respect to the labor and management conference that was suggested by the previous witness?

Mr. RUTTENBERG. Might I say, as I am sure that you realize, Senator O'Mahoney, that that suggestion has been made over a period of years by Mr. Murray, the president of the CIO, and as a matter of fact a conference which resulted just 7 years ago, right after Pearl Harbor, called by President Roosevelt and called the Joint Labor-Management Conference, was originally the suggestion of the president of the CIO at that time. We feel that a considerable amount of good could be had from a joint labor, management, and farm conference and other consumer groups.

I would not subscribe, however, to Mr. Cruikshank's statement or the statement which emanates from the executive council of the American Federation of Labor that such a conference should be called for the purpose of attempting to arrive at voluntary solutions to the inflation problem. I think voluntarily we are not going to solve much. The voluntary allocations program in steel has been a miserable failure under the Taft-Wolcott Act passed at the end of 1947; but I think from the standpoint of a Joint Labor-Management Conference to work out long-range economic objectives, a lot could come of it if the right people were called into the conference.

Senator O'MAHONEY. That is the important answer, which I felt sure you would give. In other words, on the part of labor, whether it be through AFL or CIO, there is no objection to a settlement of these basic issues by conference and agreement?

Mr. RUTTENBERG. You see, at the last such conference called in 1945, right after VJ-day, Mr. Murray, the president of the CIO, injected into it a discussion of the wage problem which was then going to be the beginning of the first round of wage increases. The conference ruled that out of order and did not discuss the first round of wage increases which everybody at that time knew was going to be forthcoming, and as a result the conference was a failure. If they would really get down to brass tacks and permit discussion of the basic issues, a great deal could be accomplished; and we, in September, right before the election, proposed such a thing to the Council of Economic Advisers.

Now, to go back to where I was interrupted, at the point of 1939, 10 million were unemployed and production facilities at that time, of course, were only being inadequately used. Diets were tragically inadequate, and income was $23.86 a week on the average for workers in manufacturing industries, so that it would be unfair to compare what has happened to labor since 1939, because in 1939 living standards were low, and production facilities were not being completely utilized, and there was considerable unemployment. It is, therefore, for that reason that we choose 1945 as the day when living standards were at a point which was the highest they had ever attained. If you want to compare 1939, wages have gone up 100 percent. But how much have profits gone up in that same period? Let us forget about the price structure, and we see that wages have gone up about 100 percent and profits about 500 percent, so that you get another comparison which ought to be brought into the picture.

Senator FLANDERS. In my mind the result of this is to cast a little doubt on both 1939 and 1945.

Mr. RUTTENBERG. I would say that we could cast doubt on both of those base periods if we could ever get serious consideration of what would be an equitable distribution of our total gross national product and our national income, but having no group that is willing to, as yet, determine what is an adequate decision of total national income, the best thing that can be done, in our judgment, is to pick the period in which living standards were the highest that they had ever been, and that was 1945.

Representative HUBER. Do you feel, Mr. Ruttenberg, with this seller's market that exists, that manufacturers have made available to the public their best product, that they have given the public the advantage of improvements in various products that they are manufacturing?

Mr. RUTTENBERG. In the textile and shoe industry in which you have a very difficult situation of production declining and prices remaining stationary, quality has not improved to the extent that it should, and I think that I made that point in one part of my statement, that industry is not making available better quality products at lower prices.

Representative HUBER. Haven't they been able to avoid the expense of retooling that would have been necessary to bring out a newer product? I am thinking, for instance, about automobiles. Most of the cars on the market today are not, in reality, 1948 cars. They are revamped 1942 cars, and there is not 10 cents difference between some of them and the 1942 automobile.

Senator FLANDERS. I hope, Mr. Huber, that they do not put any more gadgets on them. I have enough on my present automobile.

Representative HUBER. They might take a few gadgets off, and they might put on some of the improvements that are available.

Mr. RUTTENBERG. They could certainly reduce costs if they put in some of the improvements which have been developed which are not yet in the automobile.

Senator FLANDERS. Now, to return to your manuscript, Mr. Ruttenberg, on page 8. I wonder if you were interpreting, in the middle of that paragraph, whether "Further, that large parts of today's profits are purely book profits, resulting from increased evaluation of inventories."

The testimony we had was the increased costs of carrying those inventories, it was an increased cost rather than simply a book evaluation, and that increased cost required the diversion of profits to inventory, making it unavailable for distribution in any way.

Mr. RUTTENBERG. I have not had the opportunity to go over carefully the testimony on Monday and Tuesday of the witnesses before the committee, but as I understand it, I think Professor Slichter said that the profits derived from inventories are needed for the sole purpose of replacing the same quantity of inventories which existed at lower prices.

Senator FLANDERS. And are, therefore, unavailable for use in any other way.

Mr. RUTTENBERG. That would generally be true if the assumptions were right, but actually in terms of the LIFO method of accounting which many corporations have adopted, and they are continuing to adopt, day in and day out, 1941 is used as a base for inventory calculations; and you will never get inventory change until you return to the price level of 1941. As long as you have increased prices of inventory products, they are accounted for by using 1941 as the base period.

Senator FLANDERS. The LIFO scheme applies to a comparatively small percentage of business, and that is one which in essence, keeps the inventory valuation current with current prices and automatically assigns to the inventory the increased cost of maintaining it, whereas the last witness yesterday, Mr. Bailey, said that he thought that conventional methods were the ones that were proper. He did not object to the LIFO method except that it is very difficult to get it accepted by the Treasury, but he felt that the conventional inventory methods were a better solution, provided one introduced footnotes or explanations to the effect that a given amount of capital had had to be used in maintaining the same inventory at the higher prices. He was favorable to stating that definitely in the company's annual statements to its stockholders and employees. But it seems to me that this is not clearly stated as you have done it here, as though they were book profits, purely book profits, resulting from increased evaluation.

The testimony so far, and we will get more definite testimony from the industries as they are called, seems to be that profits have to be diverted into carrying that higher cost inventory and are not available for any other purpose.

Mr. RUTTENBERG. Except, of course, as has been pointed out, where LIFO exists they make the kind of adjustments in their profit picture which enables them to carry the higher inventory without taking anything out of reported net profits to do so.

Now, I should like to make one further point which I make in the statement further along in that line, and that is, those companies that do not use LIFO use for tax purposes cost or market, or whichever is lower, as a method of determining inventory. I would like to read a brief statement here which I think clearly sets forth this point:

> In practice, the numerous adjustments that are made on cost or market enables the corporation to have tremendous leeway. There are always adjustments for style changes, spoilage, wastage, speculative drops, and so on. Anyone talking to accountants these days knows that there is a very large number of firms that are protecting themselves against possible price drops by writing down their inventories far below either cost or market.

Even though they are not using LIFO as a method of accounting. In other words, there is a sufficient leeway within the tax laws and within the inspection procedures of the Bureau of Internal Revenue so that many, many corporations are able to adjust their inventory costs in such a way as to guard against inventory profits which must be used to supplant inventories. In other words, they do exactly the same thing as LIFO without admitting to the Treasury Department that they are using LIFO.

Senator FLANDERS. I would say that that was the opposite to the effect of LIFO; and does it prevent them from the necessity of diverting a part of their book profits? They would not be book profits in that case. You would still have to have the note. But is it not a fact that you still have to use profits which appear on the books as profits to maintain your inventory with present high prices? That is the question.

Mr. RUTTENBERG. You do, sir, where LIFO is not used or where corporations do not exercise their own judgment in so adjusting inventory costs through these procedures of spoilage and style changes.

Senator FLANDERS. I think that you must use the term "inventory prices" rather than "inventory costs."

Mr. RUTTENBERG. Inventory costs.

Senator FLANDERS. Because the inventory costs is the essential thing whichever method is used. Under the LIFO method the profits are reduced by the necessary amount of carrying the inventory, the necessary cost of carrying the inventory, whereas under the other methods that has to be indicted by the footnote.

Mr. RUTTENBERG. But what I am saying, sir, is that while in many instances where LIFO is not used, but where cost or market is used, without making notations, and without indicating in any way they so adjust inventory costs as to guard against or to protect themselves in precisely the same way which LIFO does.

Now, I will grant you where corporations stick strictly to the letter of cost or market, or whichever is lower, they then must note after net profits after taxes a certain reserve set aside for inventory adjustments, and that is done in most financial statements where they want to set aside such reserves, but the point I am making is that even those corporations that use cost or market, whichever is lower, do, before they ever compute the net profits after taxes, make the necessary kind of adjustments because of leeways which permit them to accomplish the same thing which LIFO does.

Senator FLANDERS. It would appear that the practice you are describing results in an underpricing of inventories, which would show a larger net profit, which, it would seem to me, the company, for its own protection, should explain by a footnote, and if they do not explain it by a footnote, they are laying themselves open to criticism which they should not have to receive.

Mr. RUTTENBERG. No. The method which I am describing tends to understate profits and not overstate them.

Senator FLANDERS. If they understate inventories for future protection, you overstate profits.

Mr. RUTTENBERG. Yes, but the point I am making is that they so make the adjustment in their inventory costs, as to reduce their net profit, and that is the adjustment which is made.

Senator FLANDERS. Then, do they write the inventories up or write them down?

Mr. RUTTENBERG. They would do precisely the same thing which LIFO does, write them up.

Senator FLANDERS. The Bureau of Internal Revenue will not allow that.

Mr. RUTTENBERG. That is exactly right, but yet there is sufficient leeway in terms of the interpretation for items such as style changes, spoilage, wastage, speculative drops and so forth, that can be used as techniques by accountants to accomplish just this objective without running into violation of the Bureau of Internal Revenue regulations.

Senator FLANDERS. I rather doubt whether you can manipulate the pricing of inventories in that way under the rules of the Internal Revenue Department.

Mr. RUTTENBERG. It would be something that might well be looked into. We are now in the process of discussing the item with the Department of Commerce in relation to their calculations of profits and national income figures.

Senator FLANDERS. I wanted to make the point, which seems clear to me, but which does not seem clear from your testimony, that the purely book profits, if they are justly assessed and put into the annual statement, do not result from increased evaluation so much as they result from increased cost of maintaining inventories at high prices.

Mr. RUTTENBERG. It is another way of stating the same problem.

Senator FLANDERS. It is a little different. I think it is pertinent; and you bring up the question as to the present disparity of stock-market prices, if you reckon them 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 at the foot of page 9 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 at that point 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 not interested in getting venture capital.

Senator FLANDERS. I imagine that you would agree with me that the long-range interests of business and the long-range interests of labor do not differ?

Mr. RUTTENBERG. That is right.

Senator FLANDERS. I think that that is an important point.

Mr. RUTTENBERG. There is no question about that.

Senator FLANDERS. And it seems to me that that again leads to the desirability of such a conference on long-range interests as has been suggested and as you suggest was called in 1945 with very poor results. It seems to me that there is a need for a conference between organized labor and organized business and likewise the agricultural interests on the long-range interests of all of the parties involved. It seems to me that something ought to come out of such a conference.

Well, I could also have a similar discussion with you with regard to the question of depreciation allowances.. It would be much the same sort as we have had with regard to inventories, and the time comes when equipment has to be replaced. At one point here you suggested that perhaps when the time did come, that the cost of replacement might be appreciably lower than it would be today. Mr. Bailey yesterday expressed his personal opinion that it was not desirable either to go to a higher price level than we have at the present or to a lower price level, that in the interest of stabilization what we should be doing is to try to maintain the present price level.

That would indicate, if we succeed in doing that, and it seems to me the sensible thing to try to do, that the present price level had some validity as a basis for depreciation allowances.

Mr. RUTTENBERG. The present price base has validity for depreciation allowances on equipment and property in plant which is built with present-day costs. But I think it is unreasonable to assume that a corporation ought to be permitted larger depreciation allowances now because prices are now higher, and the price is higher on a plant which was not built at present-day prices.

Senator FLANDERS. The question is when they come to replacements, what will the prices be?

Mr. RUTTENBERG. At that point, if the prices are higher than they were at the original point of construction, some 15 or 20 years prior, they then proceed to get their capital through the procedures or methods they have normally used, either equity capital or retained earnings or bonds and notes, and proceed to build, and from that point on depreciate the property at the current-day costs.

Senator O'MAHONEY. May I add at that point that all history indicates that the efficiency of the new plant is always greater than that of the old.

Senator FLANDERS. We disposed of that point yesterday in words which we have not used this morning and should always use, which is replacement of present productive capacity, rather than present productive units. That was the formula which Mr. Bailey very directly presented, and he also mentioned another point which is pertinent to Mr. Ruttenberg's discussion, and that was this, that any provision made for adjusting inventory profits so-called, or depreciation allowances, should work both ways. It should work going down as well as going up.

Senator O'MAHONEY. He made that statement in response to one of my questions, but Professor Slichter made no such allusion, nor did Professor Paton; and it was clear both from Professor Paton and from Mr. Bailey that the accountants themselves have worked out no formula by which this theoretical depreciation method could be established.

Mr. RUTTENBERG. As a matter of fact, the committee on accountants of the American Institute of Accountants has recommended against this very procedure that Mr. Bailey was advocating.

Senator FLANDERS. I do raise some question about both the inventory position you have taken and the replacement position, because it seems to me that so far as replacement is concerned, if you have not allowed sufficient depreciation, even though it has to be reckoned as profit and you are taxed on it, that you correct the thing too late when you wait until you have installed the new equipment; and that in waiting until that time before you take your new depreciation, the Government taxes on a larger amount for depreciation than the Government allows, have been in the nature of a capital levy to that extent, because it requires you to go out for new capital.

Mr. RUTTENBERG. From the standpoint of the American worker, he cannot set aside depreciation allowances, and he cannot take into account inventory rises or falls in prices. He has to come into the market with a limited income at the time he is required to buy.

Senator FLANDERS. He does things currently, and the various proposals that have been made—and as has been indicated, no satisfactory formula has been found—are an attempt to solve the problem for the manufacturer on the current basis as it occurs, but it was admitted no satisfactory formula has been found.

I have no further questions to ask the witness; have you, Senator?

Senator O'MAHONEY. You recommended 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. I think one factor which you, I think, just omitted from mentioning, which I think that 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 is why 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.

Senator FLANDERS. Have you any methods to suggest, or any base to suggest, for an excess-profits tax?

Mr. RUTTENBERG. Yes, we have; and I should be glad to submit to you, sir, and the committee, a pamphlet which is just coming off the printing press in the course of the next 2 or 3 days, called CIO's Tax Program for Full Employment.

Senator FLANDERS. Will you send us each a copy of that?

Mr. RUTTENBERG. I will send that to you.

Senator O'MAHONEY. Now, are we entitled to draw the inference from what you have said about distributing profits in order to create a new reserve of risk capital and thereby stimulate competitive industry, that the CIO, like the A. F. of L., is for the preservation of a free economy?

Mr. RUTTENBERG. Yes, unquestionably.

Senator O'MAHONEY. And you are not advocating these policies with the desire of obtaining the development of a police state?

Mr. RUTTENBERG. Not at all, and I am mighty glad you brought that out.

In the course of my statement I referred, for example, to the problem of making a reasonable level of prices through low prices and maximum production. We recognize the fact that the economy in America requires that a profit be made. We object to the level of prices and the procedures through which they are——

Representative PATMAN. You mentioned about your program, an all-out attack must be made on the monopolistic and self-interest practices of American industry. I presume a large part of that program is in your discussion with Senator O'Mahoney just now, concerning keeping these larger corporations from retaining earnings to the extent that they could continue to buy up their competitors, and at the same time not have to go into the market for venture capital, thereby discouraging smaller enterprises.

Mr. RUTTENBERG. That is right.

Representative PATMAN. I mean you mentioned the steel industry a while ago.

Mr. RUTTENBERG. Yes.

Representative PATMAN. What about the expansion program of the steel industry, and how does their capacity now conform to their capacity, say, 10 years ago?

Mr. RUTTENBERG. They are now producing more than they did prewar, I think 10 to 12 or 15 million tons.

Representative PATMAN. I mean their capacity. Has the capacity increased?

Mr. RUTTENBERG. The steel industry is operating at about 98 to 99 percent of rated capacity.

Representative PATMAN. I know they are now, but I mean, say, 10 years ago, did they have the capacity to produce as much as they do now?

Mr. RUTTENBERG. They did not have the capacity. During the war, there was expansion both by the industry and by the Government.

Representative PATMAN. During the war?

Mr. RUTTENBERG. Yes.

Representative PATMAN. Now, in the cement industry, we have I believe, about 175 cement plants in the country, and they have not expanded much in recent years, have they?

Mr. RUTTENBERG. I am not familiar with the cement industry.

Representative PATMAN. My information is that we have only had 2 plants in 20 years, one in Pennsylvania and one in California, and they have not expanded their facilities adequately, I am sure. So I will agree with you that they should, to furnish those needed and vital products.

Now, in your study of the profits of these large concerns, have you given consideration to the basing-point as related to profits?

Mr. RUTTENBERG. The basing-point practice is one which, as far as the CIO unions are concerned, affects our steel industry and our steel union, the United Steel Workers of America, and they are in the process of making a survey and study of the whole problem, and as yet have not publicly made their position clear on the basing-point system. It is the only industry which we have organized that it affects.

Representative PATMAN. You do not have organizations in the cement industry?

Mr. RUTTENBERG. We have very little; very little, sir.

Senator FLANDERS. We will excuse you, Mr. Ruttenberg, and thank you for your testimony and your attendance.

I will now make an announcement as to the course of the proceedings. Mr. Walter Reuther, who was to have testified this afternoon, has asked to be postponed until December 17. We will hear him on that day.

Mr. John Ballantyne, who was to appear tomorrow, has had to go to the hospital for a minor job, and expects to be with us on December 16.

Tomorrow we will have a hearing at 2 o'clock, at which time we will hear from Mr. Joseph Pogue of the Chase National Bank, and he will tell us about an analysis he has made about the profits of 30 oil companies.

Senator O'MAHONEY. May I request that there be inserted in the record at this point an article from the New York Times of Sunday, December 5, appearing in the financial section, under the heading "Industry's profits up all along line."

Senator FLANDERS. Did you not put that in yesterday?

Senator O'MAHONEY. No; I just quoted from it.

Senator FLANDERS. I can assure you that we will put it in the record in full.

(The news article appearing on p. 1, sec. 3 of the New York Times for December 5, 1948, entitled "Industry's Profits Up All Along Line," is as follows:)

INDUSTRY'S PROFITS UP ALL ALONG LINE—STRONG UNITED STATES ECONOMY REFLECTED IN EARNINGS RECORDED IN THE YEAR'S FIRST 9 MONTHS—HEAVY PROBLEMS SOLVED—GAINS NOTED DESPITE HIGHER WAGES, UNSETTLED STATE OF WORLD, AND THE LIKE

By C. M. Reckert

Earnings of the Nation's manufacturing industries for the third quarter of this year outstripped the previous two quarters, lifting the combined earnings in the first 9 months of 1948 to a peacetime high for the period.

A compilation of 291 industrial enterprises, representing virtually every field of manufacture, shows total net profits of $3,073,042,922 for the 9 months ended with September, this year. This represents an increase of 33 percent over their returns of $2,312,826,730 in the first three quarters of 1947.

The notable result was achieved despite the cumulative effects of bigger pay rolls, high agricultural prices, consumer price resistance, shortages and increased costs of raw materials, shrinking exports, a shift to f. o. b. pricing for some essential materials, and an unsettled international situation.

On the other side of the ledger were such significant advantages as a peak peacetime production, a strong position of the national economy, completion or added facilities of plant-expansion programs, product price advances, and record employment levels.

As in the earlier part of the year, steel, motor, construction, mining, and other basic industries showed the best gains in earnings. Deterioration in the consumer goods fields continued as diminishing demand or cautious buying induced promotional campaigns in markets becoming more competitive. Profit margins of many companies have been narrowing under the pressure of high cost of operations.

WILL EXTEND TO DURABLE GOODS

With the easing of material scarcities, similar competitive influences will extend to the durable goods lines. However, this is not likely to occur for some time in view of the vast requirements for national defense and European relief programs now speeding up. The export of basic materials will work some hardship on many of our domestic manufacturers, but may create a healthier economy in the long run, according to some company officials. A gradual leveling off of business to the more normal peacetime rate, rather than a sudden drying up is the more preferable objective.

It is, therefore, expected that many industrial manufacturers next year will probably place more emphasis on greater improvement of operating efficiency rather than on the extension of large costly expansion.

Any enactment of greater taxation, price and labor policies, and other legislative restrictions will be major factors in the trend of operations and earnings in the ensuing year.

Reviewing the effects of the record peacetime industrial production during the 9 months of this year, the most prominent advances in earnings over last year of the 37 different manufacturing classifications, were achieved by the aviation, coal and coke, petroleum, automobile, electrical manufacturing, and the smaller steel companies.

MODERATE GAIN IN STEEL

Although operating at capacity levels, the 9 leading steel producers showed the moderate gain of 14 percent in total net earnings of $275,115,868 over the 1947 9 months' income of $241,386,817. A more favorable improvement—32 percent—was made by six smaller concerns whose combined net of $18,698,206 compared with $14,083,718. With steel production currently reaching record proportions, the peak peacetime output of ingot and steel for castings established for the first 9 months of 1948, may not only be maintained for the year, but break all-time records.

Huge defense orders were primarily responsible for the 104 percent rise for five aviation manufacturers whose net profits aggregating $16,812,144 for the three quarters, contrasted with $8,235,102 a year before. The industry is enjoying its greatest peacetime boom and is destined to be operated in the black next year on the basis of the sizable backlogs for military aircraft.

Despite suppliers' strikes and shortages of various materials, mainly steel, the output of automobile production set a new postwar peak in October. This was 27 percent higher than September production and indications are that for the second time in automotive history, more than 5,000,000 vehicles will be turned out in 1 year. The total for the 10 months of 1948 was 4,329,611 motor vehicles, of which 3,166,336 were passenger cars. The high volume of sales enabled eight automotive producers to show total net income of $419,426,041 which exceeded the 1947 figure of $277,746,869 by 51 percent.

VAST DEMAND FOR OIL PRODUCTS

Spurred by the vast demand for oil products, crude production climbed steadily throughout the year, reaching new high levels in recent weeks. Translated into operating results, sales and earnings of several companies were the best for any 9 months peacetime period on record. The combined net profit of 20 reporting corporations came to $1,026,689,389 this year in contrast to $628,367,950 for the 1947 period, up 57 percent.

The supply of food products has begun to overtake demand and the cost-price squeeze has had a telling impact on companies in this field. Five concerns reporting a total net income of $21,669,347, showed a decline of 34 percent from the previous year's earnings of $32,686,423.

Limited space prevents comment on the other industries included in the tabulation below which shows the results for the 9 months of this year and last. Figures in parentheses indicate the number of firms in each classification:

| | 9 months to Sept. 30— | |
|---|---|---|
| | 1948 | 1947 |
| Steel leaders (9) | $275,115,868 | $241,386,817 |
| Steel, small (6) | 18,698,206 | 14,083,718 |
| Iron and steel fabrication (16) | 34,664,442 | 31,596,853 |
| Coal and coke (8) | 29,609,600 | 18,525,956 |
| Metal products (6) | 12,153,808 | 15,574,125 |
| Outdoor machinery (7) | 23,660,837 | 18,465,244 |
| Factory machinery (8) | 15,284,833 | 13,519,012 |
| Machine tools (5) | 4,587,942 | 5,495,945 |
| Railroad equipment (10) | 29,870,467 | 24,479,529 |
| Total (75) | 443,646,003 | 383,127,199 |
| Automobile (8) | 419,426,041 | 277,746,869 |
| Automotive equipment (25) | 96,165,645 | 79,489,825 |
| Aviation (5) | 16,812,144 | 8,235,102 |
| Total (38) | 532,403,830 | 365,471,796 |
| Petroleum (20) | 1,026,689,389 | 628,367,950 |
| Mining (10) | 97,369,245 | 83,424,099 |
| Total (30) | 1,124,058,634 | 711,792, 49 |
| Chemical (17) | 252,842,355 | 218,944,473 |
| Paper and pulp (10) | 34,887,764 | 33,451,199 |
| Containers and seals (6) | 28,548,468 | 25,748,713 |
| Newsprint (4) | 59,422,667 | 55,464,537 |
| Total (37) | 375,701,254 | 333,608,922 |
| Electrical manufacturing (8) | 142,708,003 | 105,027,174 |
| Electrical appliances (7) | 30,832,009 | 27,845,720 |
| Heating and plumbing (8) | 31,915,520 | 25,292,306 |
| Furniture (3) | 2,812,338 | 2,222,210 |
| Floor coverings (5) | 9,064,883 | 5,949,553 |
| Paint and varnish (2) | 4,281,313 | 4,006,776 |
| Hardware (3) | 4,117,823 | 3,889,005 |
| Building materials (11) | 62,239,947 | 47,445,702 |
| Cement (2) | 5,695,315 | 4,528,387 |
| Office equipment (7) | 48,786,866 | 36,190,493 |
| Total (56) | 342,454,017 | 262,398,326 |

| | 9 months to Sept. 30— | |
|---|---|---|
| | 1948 | 1947 |
| Food (5) | $21,669,347 | $32,686,423 |
| Dairy products (3) | 3,589,964 | 4,084,940 |
| Soft drink (3) | 31,243,039 | 27,803,732 |
| Liquor (1) | 15,653,758 | 23,100,712 |
| Baking (8) | 37,573,693 | 34,549,204 |
| Candy (6) | 22,925,152 | 21,586,327 |
| Textile (7) | 60,936,286 | 48,082,257 |
| Apparel (6) | 5,891,954 | 4,513,675 |
| Cigars (4) | 3,605,159 | 4,251,747 |
| Drugs (12) | 51,690,832 | 55,769,421 |
| Total (55) | 254,779,184 | 256,428,438 |
| Grand total (291) | 3,073,042,922 | 2,312,826,730 |

The previous record of peacetime earnings for the first 9 months was made last year when the grand total of 247 companies was $1,807,372,339. This was 89 percent above the $956,056,350 net for the 1946 period, a year when strikes caused a widespread shutdown of plants and factories.

Senator FLANDERS. We will recess at this time until 2 o'clock tomorrow afternoon.

(Thereupon, at 1 p. m., a recess was taken until 2 p. m., Thursday, December 9, 1948.)

(Materials submitted by Mr. Ruttenberg in response to a request from Senator O'Mahoney.)

### INTERNATIONAL CUTS MEN'S SHOE OUTPUT

#### CURTAILS SCHEDULE BECAUSE OF DROP IN DEMAND

ST. LOUIS, September 28 (AP).—International Shoe Co. announced today it is reducing production of men's shoes temporarily because of lower production requirements. The company, one of the largest manufacturers in its field, has curtailed operations at 10 of its factories in Missouri and Illinois to 4 days a week, effective this week.

"Production requirements can be met on that basis," a company spokesman said. He said the company was not sure how long the curtailed work schedule would remain in effect but that it probably would be "only for a few weeks."

#### LAG IN RETAIL SALES NOTED

Men's shoe sales in retail stores have been lagging recently, industry sources said here yesterday. One retail spokesman summarized the current footwear situation this way: "Children's shoes are the only ones in which sales are really good, women's sales are quite satisfactory, and men's are difficult."

Most sources here said they have heard of no other curtailments in men's shoe output other than the International Shoe Co. cut. Some, however, were of the opinion that smaller manufacturers may have reduced their workweek or may plan to do so.

Source: New York Herald Tribune, September 29, 1948.

---

### INCREASES SHOE PRICES

#### INTERNATIONAL CO. ANNOUNCES 10-CENT AVERAGE RISE AT WHOLESALE

ST. LOUIS, July 29 (AP).—International Shoe Co., one of the largest manufacturers in its field, announced tonight it will increase its wholesale shoe prices an average of about 10 cents a pair effective Monday.

The company said that although some of its prices will remain unchanged, most of its shoes will be affected by price increases ranging from 5 to 25 cents a pair.

A spokesman for the company said the price hikes were made necessary by increased costs of materials and labor.

Source: Evening Star, Washington, D. C., July 29, 1948.

---

### Textile Production Is Heading Downward

Mills are cutting hours. Stocks are high, and new orders are not coming in at the rate expected. Buyers seem to be reluctant to buy * * * seem to think prices may come down. Exports do not amount to much * * * Marshall plan has no money for textiles. Mills are not cutting prices much. They cut production, keep prices up. Thus textiles are probably drifting toward some sort of forced recession.

Shoes, pretty much the same story, and same future consequences.

Source: The Kiplinger Washington Letter, Washington, Saturday, August 28, 1948.

---

### Workers Protest Textile Cut-Backs

#### 60 PERCENT OF NORTHERN MILLS RUNNING ON 4-DAY WEEK TO AVOID BUILDING UP OF INVENTORIES

(By Herbert Koshetz)

Protest by the textile workers union that major cotton goods producers were cutting output to maintain "exoribtant prices and extortionate profits" highlighted the whole pricing problem of the industry last week.

While there are serious doubts as to the efficacy of following an "economy of scarcity," textile men voiced the opinion that for the balance of the year mills would continue to cut output to prevent building up of inventories.

Figures gathered by the TWU show that in the northern mill areas close to 60 percent of the mills are operating on a 4-day week. In the Fall River area widespread lay-offs were reported as mills cut out their third shifts or placed them under skeleton crew operation. Berkshire Fine Spinning Associates, which operates in this area, had all units on 4 days.

In Rhode Island the 4-day week has become widespread, it was reported. In Maine two divisions of Bates Fabrics are on a 4-day shift. Two mills in Connecticut laid off 200 workers.

In New Hampshire the Amoskeag mills were reported to be operating on a 3-day week and other mills had cut down to 4 days.

The reduced operation, it was estimated, will cut production in the northern area by 20 percent. Southern mills, which have also curtailed third-shift operations and overtime, will show a lighter output this year than last, it was predicted.

Reductions in prices made thus far by cotton mills, according to Emil Rieve, president of the TWU, have not been large enough to induce buying on a wider scale. He held that all increases in wages have not in any way affected mill profits, and that the reduction in the cost of cotton has not been passed on to the public.

Millmen, however, countered that prices have been cut deeply, citing the reductions in print cloth, which has come down 28 percent since the peak of last year, and reductions of 20 percent in fine goods and corresponding decreases on sheetings.

By and large, they held, these cuts have not induced any great amount of buying, not because they were not drastic enough but because the market has shrunk owing to full pipe lines of distribution and sharply curtailed export sales.

Heavy cuts in textile prices, millmen said, are highly dangerous in their secondary reactions. The whole experience of the industry in the 1930's, it was pointed out, showed that repeated price cuts were not a factor in bringing in more business but rather contributed to the detrimental deflationary trend that all but ruined it.

The era of prosperity in the cotton textile industry starting about 1941, and in which labor shared to a large extent by wage increases of more than 170 percent, had its roots in stabilized prices at higher levels, according to the millmen.

Advocating of stepped-up production and cut prices is not an exclusively new idea, they said, as it had been put forward repeatedly by Walter Reuther of the United Auto Workers Union (CIO).

In a sense, they added, they were following the lead of the automobile industry, which had rejected the idea, even though in textiles the situation is not exactly analagous.

Source: New York Times, August 29, 1948, page 4F.

---

## Cotton Prices Assailed

### LEO C. SAFIR WARNS OF PERIL IN KEEPING LEVEL HIGH

Lack of response by the cotton mills to his advertised request for 500,000 yards of white terry cloth and 750,000 yards of seersucker indicates that the "cotton mills and the Worth Street monopoly are determined to keep prices up despite the largest cotton carry-over in our recent history," Leo C. Safir, president of the Safir Plan, Inc., robe manufacturer, said yesterday.

Reporting the response by the mills as "nil, but just what I expected," Mr. Safir said the ultimate result of this attitude and the Government subsidy of cotton at parity would be that all the cotton eventually would be in Government warehouses. He pointed out that formerly the mills would keep running and build up their inventory, and warned that the situation would lead to unemployment and closings in plants such as his, which employs 500 persons.

"We will go back to the situation that we had in 1932," Mr. Safir commented.

Source: New York Times, September 2, 1948.

# CORPORATE PROFITS

THURSDAY, DECEMBER 9, 1948

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 2 p. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders, chairman of the subcommittee, presiding.

Present: Senators Flanders (presiding), Watkins, and O'Mahoney, and Representatives Herter, Patman, and Huber.

Senator FLANDERS. The hearing will open, and our witness this afternoon is Mr. Joseph E. Pogue, a vice president of the Chase National Bank.

Mr. Pogue, will you take your seat at the table?

Mr. Pogue has specialized in the petroleum industry and is, as I understand it, the authority on the petroleum industry for the bank of which he is vice president.

I note, Mr. Pogue, that you ask to have as a part of the record this pamphlet of September 1948, Financial Analysis of Thirty Oil Companies, and I would like to ask whether it would be fairly inclusive or stand alone by itself if we end it on page 15. There are still a great many tables which I imagine are interesting, but there is some doubt as to the extent to which they will be read, while I am sure your comment will be; or, are those tables referred to too often in the text?

## STATEMENT OF JOSEPH E. POGUE, A VICE PRESIDENT OF THE CHASE NATIONAL BANK, NEW YORK, N. Y.

Mr. POGUE. There is only one table that would be essential to the story, and that would be table No. 21, which is the last table.

Senator FLANDERS. The reporter will note the inclusion of table 21.

Mr. POGUE. And possibly tables 18, 19, and 20. I think if those four were included, the rest could be omitted.

Senator FLANDERS. We will include tables 18, 19, 20, and 21 with the report.

(The report is as follows:)

### FINANCIAL ANALYSIS OF 30 OIL COMPANIES FOR 1947

(By Joseph E. Pogue, vice president, the Chase National Bank; and Frederick G. Coqueron, petroleum department, the Chase National Bank)

Companies included in study: Amerada Petroleum Corp., Atlantic Refining Co., Barnsdall Oil Co., Continental Oil Co., Gulf Oil Corp., Houston Oil Company of

Texas, Lion Oil Co., Louisiana Land & Exploration Co., Mid-Continent Petroleum Corp., Ohio Oil Co., Pacific Western Oil Corp., Phillips Petroleum Co., Plymouth Oil Co., Pure Oil Co., Richfield Oil Corp., Seaboard Oil Co. of Delaware, Shell Union Oil Corp., Sinclair Oil Corp., Skelly Oil Co., Socony-Vacuum Oil Co., Standard Oil Co. of California, Standard Oil Co. (Indiana), Standard Oil Co. (New Jersey), Standard Oil Co. (Ohio), Sun Oil Co., Texas Co., Texas Gulf Producing Co., Texas Pacific Coal & Oil Co., Tide Water Associated Oil Co., Union Oil Co. of California.

*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 ... millions of 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 ... millions of dollars | 425 | 331 | 259 |
| Dividends in percent of net income ... percent | 34. 9 | 43. 4 | 48. 1 |
| Net assets: | | | |
| United States ... millions of 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 ... millions of 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 | 51. 9 | 59. 0 | 59. 8 |
| Net investment in fixed assets: | | | |
| Production ... millions of 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 | 12 | 114 |
| Total ... do | 7, 069 | 5, 968 | 5, 206 |
| Production in percent of total | 50. 2 | 52. 5 | 47. 7 |
| Borrowed capital ... millions of 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 | 13. 7 | 12. 6 | 13. 5 |
| Average borrowed and invested capital [3] ... millions of 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 ... thousands of 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.

## INTRODUCTION

The purpose of this report is to present the financial trend of the operations of the American petroleum industry, as indicated by a large segment comprising 30 oil companies, which represent about two-thirds of the aggregate investment of the industry. This review supplements previous reports published by the petroleum department of the Chase National Bank and provides a continuous and homogeneous series of data for the 14-year period, 1934–47. The study is based upon data derived from the annual reports of the companies to their stockholders and to the Securities and Exchange Commission, supported by special information obtained from other sources.

The petroleum industry in 1947 enjoyed the second year of peacetime operations, which were characterized by a remarkable rise in the demand for oil products, representing an increment of 569,000 barrels per day or approximately 11 percent over 1946. This extraordinary increase in demand is related to the prevailing world-wide condition of postwar inflation and is the key to proper interpretation of financial developments in the petroleum industry. It impelled the companies to approach capacity operations, exceeding those of the wartime peak; it stimulated an advance in petroleum prices, resulting in sharply increased gross and net income; and it accelerated the development of a vast expansion program, requiring unprecedented capital expenditures at inflated costs.

At the same time, the decline in purchasing power of the dollar introduces a theory of relativity into the interpretation of financial statements and renders conventional accounting practices unrealistic in reflecting the true facts. Thus, the customary interpretation of financial results is misleading; and yet, the concept of the dollar as a consistent yardstick is so ingrained that it is difficult for the observer to realize that year-to-year comparisons cannot be accurately presented if no allowance is made for the shrinkage in the unit of measurement. Under these circumstances, the dollar income soared but so did the capital requirements. The matching of these two items was so closely achieved that the industry was able to bring about an approximate balance between supply and demand for petroleum products during 1947 and to prepare for a still better position in 1948. The achievement of these results, in the presence of war-depleted inventories, constitutes striking testimony to the effectiveness of the petroleum industry in the process of capital formation.

The manner in which capital is formed has not received the attention it deserves in interpreting the functioning of private industry. This oversight is particularly manifest in public discussions and official investigations of trends in prices and earnings. The subject assumes special importance in periods of inflation, which are marked by sharply rising costs and by corresponding declines in the purchasing value of the dollar. Under such circumstances, the need for accelerated capital formation is paramount and constitutes a prime cause of price advances, without which demand cannot be met. The petroleum industry is a good example of the essential character of capital formation, and this study provides a quantitative measure of this important mechanism.

## FINANCIAL RESULTS FOR 1947

*General summary.*—The principal features of the financial and operating results of the 30 oil companies for 1947 in contrast with 1946 and the yearly average for 1941–45 are presented on page 160. This table reveals that practically every item for 1947 shows a substantial increase over 1946 and a larger advance over the 5-year base period. For example, in 1947 as compared with 1946, total income increased $2,934,000,000 or 39 percent; total costs and other deductions, $2,478,000,000 or 37 percent; and net income, $456,000,000 or 60 percent. Cash dividends in 1947 increased only $94,000,000 or 28 percent because of the reinvestment in the business of $794,000,000 or 65 percent of the earnings. This relatively large retention was necessitated by a rise of $699,000,000 or 51 percent in capital expenditures to $2,076,000,000 in 1947, thus illustrating the contribution of the stockholders to the process of capital formation.

*Income statement.*—An analysis of the combined earnings of the 30 oil companies is given in table 1. The special feature of this exhibit is the sharp disparity between those items expressed in 1947 dollars, such as gross income, operating costs, and taxes; and the item of capital extinguishments, which is largely based on original, prewar costs. The former show increases over 1946 ranging from 25 to 77 percent, whereas the latter represents an increase of only

14 percent. Standard accounting principles have no means of reconciling this disparity between original and current replacement costs, which vitiates the validity of the "reported" net income.

The combined earned surplus of the group increased from $3,136,000,000 at the close of 1946 to $3,937,000,000 at the end of 1947, as analyzed in table 2.

In 1947, for each dollar of total income received by the 30 oil companies, 72.6 cents were absorbed by operating costs and expenses; 8.8 cents by depreciation, depletion, and other charges; and 6.5 cents by income and other taxes. Of the remaining 12.1 cents, 4.0 cents were paid to stockholders as dividends, 0.5 cent was applicable to minority interests, and 7.6 cents were reinvested in the business. The distribution of the average sales dollar for 1947 compared with other periods is shown in table 3. The decline in the item for depreciation, depletion, and other charges from 12.6 cents in the 1941–45 period to 8.8 cents in 1947 should be particularly noted.

*Balance sheet.*—The total assets of the 30 oil companies amounted to $12,641,000,000 at the close of 1947, an increase of $1,791,000,000 over 1946. (See table 4.) The three main components of these assets at December 31, 1947, were: Property, plant, and equipment, 56 percent; current and working assets, 34 percent; and investments and other assets, 10 percent. The liabilities and net worth of the group were distributed as follows: Current liabilities, 13 percent; funded and other long-term debt, 11 percent; deferred credits, other reserves, and minority interests, 7 percent; and net worth, 69 percent.

The net assets of the 30 oil companies at the close of 1947 amounted to $8,524,000,000, of which 84 percent was represented by investments in the United States and 16 percent was located in foreign countries, as detailed in table 5.

*Working capital.*—The combined net working capital of the 30 oil companies increased $175,000,000 in 1947, or from $2,460,000,000 at the beginning of the period to $2,635,000,000 at the year-end. This increase, however, was accompanied by a decline in the ratio of current assets to current liabilities from 3.0 to 2.6, the lowest figure reached in the 14-year period, 1934–47, during which the high was 4.4. An analysis of the working capital of the group is presented in table 6.

The net current assets of the 30 oil companies suffered further diminution in liquidity during 1947, as measured by the reduction in the ratio of cash and marketable securities to total current assets from 45 to 39 percent. Inventories of crude oil and refined products increased $135,000,000 during 1947, largely the result of higher prices. The ratio of these inventories to gross income, however, was small, amounting to 10 percent.

*Source and disposition of funds.*—The cash flow of the 30 oil companies during 1947 is traced in table 7. The total funds provided were $2,903,000,000, of which 74 percent was derived from earnings, 24 percent from the issuance of long-term debt and stock, and 2 percent from sales of assets and other transactions. Of the portion disposed, amounting to $2,728,000,000, 76 percent went for capital expenditures, 17 percent for dividends to stockholders and minority interests, and 7 percent for the refunding and retirement of long-term debt. The excess of funds provided over those disposed, amounting to $175,000,000, was added to working capital.

*Capital expenditures.*—The expenditures for property, plant, and equipment by the 30 oil companies reached an all-time high in 1947, amounting to $2,076,000,000 compared with $1,377,000,000 in 1946 and a yearly average of $946,000,000 in the 1941–45 period. Capital extinguishment charges in 1947 totaled only $867,000,000, leaving $1,209,000,000 to be provided for out of net income and other funds, as follows: From reinvested earnings, $821,000,000; from outside financing, $310,000,000; and from other sources, $78,000,000.

The combined expenditures for the group aggregated $12,710,000,000 for the 14-year period, 1934–47. The trend thereof by years is presented by departments in figure 1.

Of the total capital expenditures made by the group in 1947 for domestic and foreign facilities, $1,077,000,000 or 52 percent went into the production department. (See table 8.) The balance of $999,000,000 was invested in other departments as follows: Transportation, $297,000,000; refining, $402,000,000; marketing, $277,000,000; and others, $23,000,000. An analysis of the total capital expenditures of the 30 oil companies for 1947 is given in table 9 by facilities and areas. These figures do not include substantial expenditures of a fixed capital nature represented by security investments in and advances to nonconsolidated subsidiaries and associated companies, which operate principally in foreign countries.

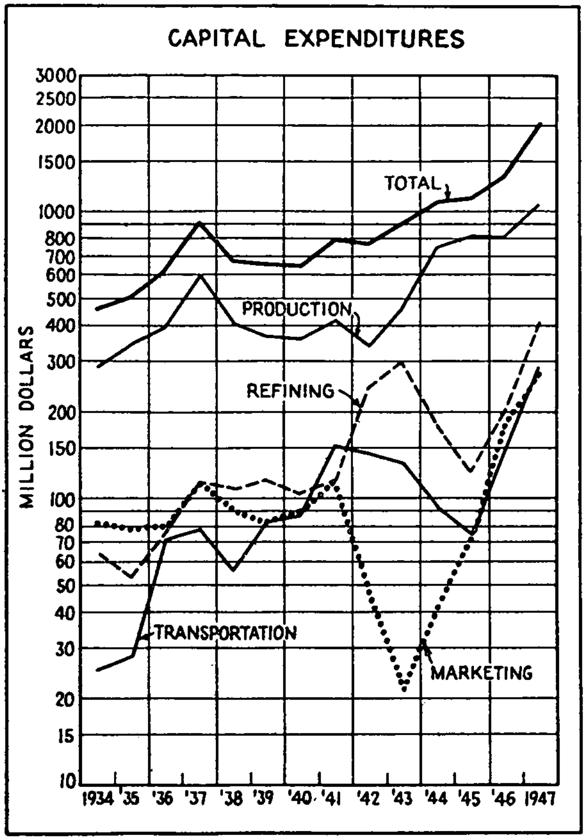



FIGURE 1.—Trend of expenditures for property, plant, and equipment of the 30 oil companies, classified by departments of the business, by years, 1934–37. Semilogarithmic scale. (See table 20 for data.)

In addition to the outlay of $831,000,000 made by the group in 1947 for domestic crue oil-producing facilities, disbursements of $47,000,000 for undeveloped lease rentals and of $131,000,000 for exploratory expenses were made and charged directly to earnings. Thus, a total of $1,009,000,000 represents expenditures for the exploration, development, and acquisition of crude oil reserves. The results obtained from this outlay cannot be determined from present information, but this expenditure amounted to $1.01 for each net barrel produced in the United States by the group in 1947, the corresponding figure for 1946 being 87 cents per barrel.

*Fixed assets.*—The combined gross investment of the 30 oil companies in property, plant, and equipment amounted to $14,776,000,000 at December 31, 1947. After deducting accumulated reserves for depreciation, depletion, and amortization of $7,707,000,000, the net book value was $7,069,000,000, as analyzed by departments in table 10. The net investment at the close of 1947 represents 48 percent of the gross investment, compared with a ratio of 45 percent at the end of 1946.

The gross and net investment of the group in fixed assets at December 31, 1947, segregated between domestic and foreign facilities, are presented in table 11. These investments exclude $934,000,000 of related fixed capital assets, as indicated by security investments in and advances to nonconsolidated subsidiary and associated companies operating mainly in foreign countries.

*Borrowed and invested capital.*—The combined borrowed and invested capital of the 30 oil companies amounted to $10,491,000,000 at December 31, 1947, compared with $9,155,000,000 at the close of 1946. The increase of $1,336,000,000, during the year is principally due to additional borrowings from banks and insurance companies and to a gain in surplus, the latter reflecting the reinvestment of earnings after dividend payments and other charges. An analysis of the changes in borrowed and invested capital during the year is shown in table 12. The working capital of the group was 1.8 times long-term debt at December 31, 1947, compared with 2.1 times at the close of 1946.

*Financing transactions.*—In 1947, the 30 oil companies obtained funds aggregating $682,000,000 from banks, insurance companies, and public investors, compared with $608,000,000 in 1946. The transactions are detailed as to source, disposition, and nature in table 13. Of the total amount raised, 28 percent was obtained from public investors, 44 percent from banks, 24 percent from insurance companies, and 4 percent from other sources. The proceeds were applied as follows: for capital expenditures and additional working capital, 80 percent; and for retirement of existing obligations, 20 percent.

*Return on capital.*—The productivity of the capital employed by the 30 oil companies may be measured by the ratio of earnings to borrowed and invested capital, or to invested capital (net worth). The return of $1,252,000,000 on the average borrowed and invested capital, aggregating $9,484,000,000, was 13.2 percent in 1947, compared with 9.3 percent in 1946. The return of $1,219,000,000 on the average invested capital, totaling $8,189,000,000, was 14.9 percent in 1947 compared with 10.3 percent in 1946. The earnings in 1947 for a large group of manufacturing companies represented a return of 17.0 percent on their invested capital.

## OPERATING RESULTS FOR 1947

*Crude production.*—The combined world-wide crude oil production of the 30 oil companies averaged 3,425,000 net barrels per day in 1947, an increase of 8 percent over 1946. For the fifth consecutive year, this segment of the industry attained a new high level of production. The domestic operations of the group contributed 2,725,000 net barrels per day in 1947, an increase of 8 percent over 1946. This volume represented approximately 54 percent of the total production for the United States. The output of the companies' consolidated subsidiaries operating in foreign countries averaged 700,000 net barrels per day in 1947, or 9 percent more than in 1946. An analysis of the domestic and foreign net crude oil production of the 30 oil companies for 1946 and 1947 is given in table 14. In addition to the consolidated operations detailed above, several associated companies of the group produced 360,000 gross barrels per day in 1947, of which about 87 percent was derived from countries in the Middle East.

*Crude runs to stills.*—The volume of crude oil processed by the domestic and foreign refineries of the 30 oil companies averaged 4,769,000 barrels per day in 1947, an increase of 7 percent over the quantity handled in 1946. For the fifth consecutive year, this segment of the business also reached a new high operating level. The domestic refineries of the group ran to stills 4,165,000 barrels of crude per day in 1947, an increase of 8 percent over 1946. This volume represented approximately 82 percent of the total throughout all refineries operating in the United States. The crude oil processed by consolidated subsidiaries of the group operating in foreign countries average 604,000 barrels per day in 1947, or 6 percent more than in 1946. An analysis of the domestic and foreign refining operations of the 30 oil companies for 1946 and 1947 is shown in table 15. In addition to the consolidated figures cited above; several associated companies of the group processed 320,000 barrels per day in 1947, of which 79 percent was run at refineries located in the Middle East.

*Wells drilled*—The petroleum industry drilled 31,389 wells in the United States during 1947, of which 31 percent were dry holes. In comparison, the 30 oil companies completed 9,211 wells, of which 20 percent were dry. The drilling results of the industry and the group are presented in table 16.

## CAPITAL FORMATION

One of the most important mechanisms in any economy is the medium through which the capital needed for maintenance, replacement, and expansion of plant facilities is obtained. All production utilizes capital. Expanding industries require more capital than static ones, and highly technological industries employ more capital than those in which limited equipment and techniques are engaged. The petroleum industry is a large and rapidly growing enterprise, utilizing a wide range of specialized technologies. Its capital requirements are prodigious, amounting last year to about one-seventh of those for all American business, excluding agriculture. During the past 14 years, 1934–47, the 30 oil companies made capital expenditures amounting to $12,710,000,000 for domestic and foreign facilities. The net assets employed per worker were $17,048 at December 31, 1947, and the capital expenditures per employee were $4,151 during the year.

The petroleum industry generates most of the required capital from its own operations, the funds being supplied from charges made against earnings for depreciation, depletion, and amortization, and from retention of a large portion of net income. Figure 2 shows the relationship of these features for 1947. Over the years, the combination of these two items has come close to providing the capital expended for property, plant, and equipment—the industrial tools. During the 1934–47 period, the 30 oil companies generated internally $12,605,000,000, while capital expenditures amounted to $12,710,000,000, practically a balance.

In the case of a growing industry, however, more capital is needed than the amount represented by capital expenditures. Investments in and advances to nonconsolidated subsidiary and associated companies require substantial additional funds and also working capital must expand in keeping with the growth of the business in order to finance receivables and inventories. The petroleum industry has not been able to finance itself entirely from its own savings, but has had recourse to the savings of others, through the capital markets, for a small portion of its funds.

During the 14-year period 1934–47, the 30 oil companies issued 4,111 million dollars of long-term debt, 239 million dollars of preferred stock, and 393 million dollars of common stock. These transactions, aggregating 4,743 million dollars, represent gross proceeds which were applied as follows: 2,479 million dollars for the refunding and redemption of existing securities, and 326 million dollars for the acquisition of assets, leaving a balance of 1,938 million dollars for working capital and other purposes. With the spread of inflation, despite rising income,

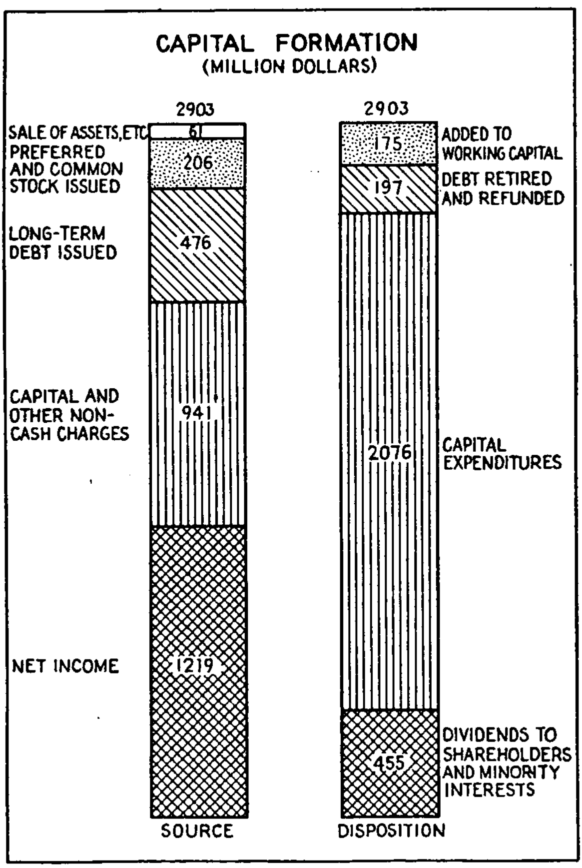



FIGURE 2.—Analysis of source of funds and disposition thereof by the 30 oil companies for year 1947. (See table 7 for data.)

the group found it necessary in 1947 to make heavier drafts on the capital markets than in former years. An analysis of these financial transactions as to source and disposition of proceeds is presented in table 17. The trend indicates marked variability from year to year and particularly from cycle to cycle.

The processes of internal and external capital formation in the petroleum industry are illustrated in table 18 by means of the combined operations of the 30 oil companies. This summary shows that the group during the 1934–47 period had funds aggregating 17,652 million dollars available from the following sources: cash earnings after payment of dividends, 12,605 million dollars; proceeds from borrowings and sales of equity securities, 4,743 million dollars; and proceeds from sales of assets and other transactions, 304 million dollars. These funds were utilized by the 30 oil companies as follows: for capital expenditures, 12,710 million dollars; for retirement and refunding of existing obligations, 3,848 million dollars; and for additional working capital, 1,094 million dollars. This table reveals a conspicuous pattern indicating that the amounts of outside capital obtained rise with rising prices and fall with falling prices. This correlation supports the thesis that capital requirements constitute an important price determinant, because in periods of expanding or high-level business activity the industry must increase both its internally generated capital and the funds sought from capital markets. Thus, in the postwar period of rapidly expanding oil demand, not only have petroleum prices advanced but the capital markets have been drawn upon in greater degree, a necessary combination in enabling supply to overtake demand.

At the close of 1947, the 30 oil companies employed 10,491 million dollars of capital, 14 percent of which represented borrowed capital and 86 percent, invested capital. Accordingly, about one-seventh of the total capital employed by the petroleum industry is in the form of debt, a low ratio conducive to economic stability. Of the total borrowings outstanding at December 31, 1947, 35 percent was from the public, 35 percent from banks, 25 percent from insurance companies, and 5 percent from other sources. The trend in each of these categories in comparison with the items of invested capital is given in table 19 for the years 1933–47.

### ADJUSTMENTS FOR CHANGES IN THE PURCHASING POWER OF THE DOLLAR

*General.*—A financial record is consistent and homogeneous as long as the purchasing power of the dollar is reasonably stable. However, in times of inflation, marked by rapidly rising prices and costs, the accounting figures, being subject to the limitations of standardized procedures, become distorted by the shifting value of the dollar. For example, the charges for depreciation, depletion, and amortization of fixed assets, as well as the valuation of investments, are calculated on the basis of original (historical) costs and therefore are expressed in past dollars; whereas gross and net income, dividends, and most of the other financial items are measured in current dollars, which not only have altered in value but also differ in each of the categories. Thus, the dividend dollar is affected by income taxes and the cost of living; the operator's dollar is determined by the costs of doing business; and the capital investment dollar is influenced by construction costs—all different in value. With the dollar yardstick varying both in time and space, it is obvious that something akin to the physical theory of relativity must find application to economics in time of inflation.

Table 20 summarizes the principal financial and operating results of the 30 oil companies for the period 1934–47. The financial data are expressed in dollars, but this common denominator has fluctuated from year to year—only slightly in the prewar period, more significantly during the war years, and sharply in the postwar period, particularly in 1947. A review of this table reveals a sharp upswing in the figures for that year. In order to facilitate more accurate comparisons, table 21 has been prepared in which some of the key data have been expressed in terms of a stable dollar. Four factors have been selected for this purpose: (1) The American Appraisal Company's Index of Construction Costs in 30 American cities, (2) the Bureau of Labor Statistics Index of Living Costs, (3) the Bureau of Labor Statistics Index of Wholesale Prices of All Commodities, and (4) an index of income taxes based on taxable income of $10,000 per annum. The first three indexes have been recomputed on a base of 1935–39=100. The adjusted figures cannot have precise accuracy, but it is felt that they do reflect in a practical manner a close approach to the actual facts and, therefore, will prove useful in indiating what has actually transpired—more so, at least, than the unadjusted figures.

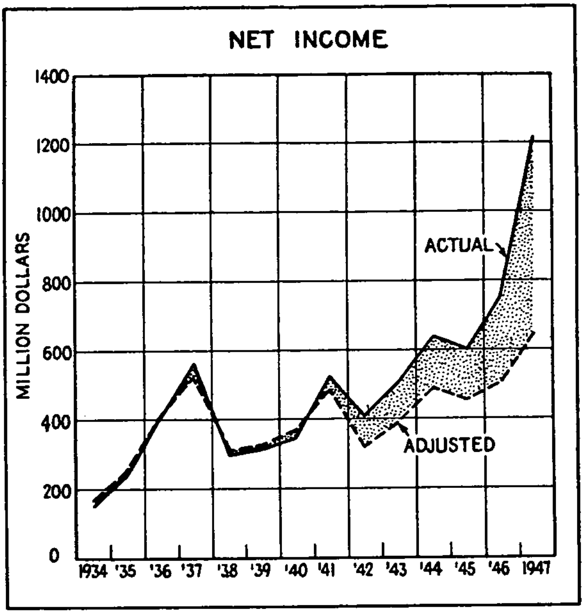



FIGURE 3.—Trend of reported net income of the 30 oil companies compared with adjusted results expressed in prewar dollars, by years, 1934–47. (See table 21 for data.)

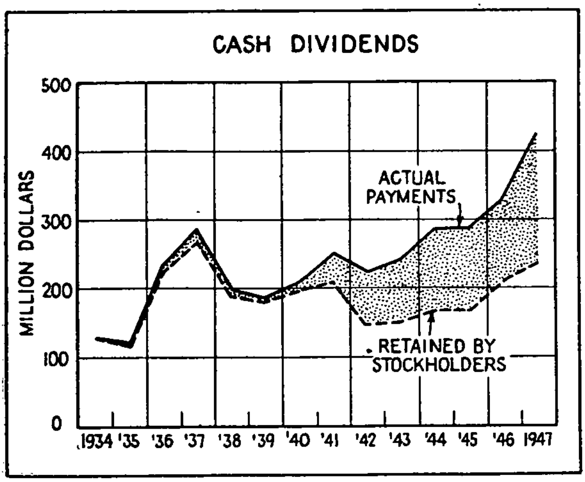



FIGURE 4.—Trend of actual cash dividends of the 30 oil companies compared with indicated amount retained by stockholders after deducting personal-income taxes and adjusting for cost of living, by years, 1934–47. (See table 21 for data.)

*Net income.*—The reported net income of the 30 oil companies in 1947 was 1,219 million dollars, an increase of 456 mililon dollars or 60 percent over 1946. Expressed in prewar dollars, these earnings would be 648 million dollars, an increase of 139 million dollars or 27 percent over the correspondingly adjusted figure for 1946. Thus, the reported net income for 1947 contained a component amounting to 571 million dollars which represented the extent that the purchasing power of the dollar has declined since the 1935–39 base period. Figure 3 shows the actual net income of the group for the years 1934–47 compared with indicated results expressed in prewar dollars. The adjusted earnings in 1947 were 21 percent larger than in the previous peak year, 1937, while the physical volume increased 54 percent during the interval. The adjusted net income per barrel of crude oil processed, therefore, shows a decline from 48 cents per barrel in 1937 to 37 cents per barrel in 1947.

*Cash dividends.*—The stockholder, the recipient of dividends, has suffered from an increase in personal income taxes and from a loss in the purchasing power of the dollar during the period under review. (See figure 4.) The actual cash dividends paid in 1947 by the 30 oil companies aggregated 425 million dollars, an increase of 28 percent over 1946. If this sum is adjusted for personal income taxes and also expressed in cost-of-living dollars prevailing during the 1935–39 base period, it would amount to 208 million dollars or an increase of only 12 percent over 1946.

*Capital expenditures.*—The actual capital expenditures of the 30 oil companies amounted to 2,076 million dollars in 1947, an increase of 699 million dollars or 51 percent over 1946. However, expressed in prewar construction dollars, this outlay would be 840 million dollars, leaving 1,236 million dollars or 60 percent of the total as an indication of the amount absorbed by rising costs. (See figure 5.) The 840 million dollars is actually less than the correspondingly adjusted

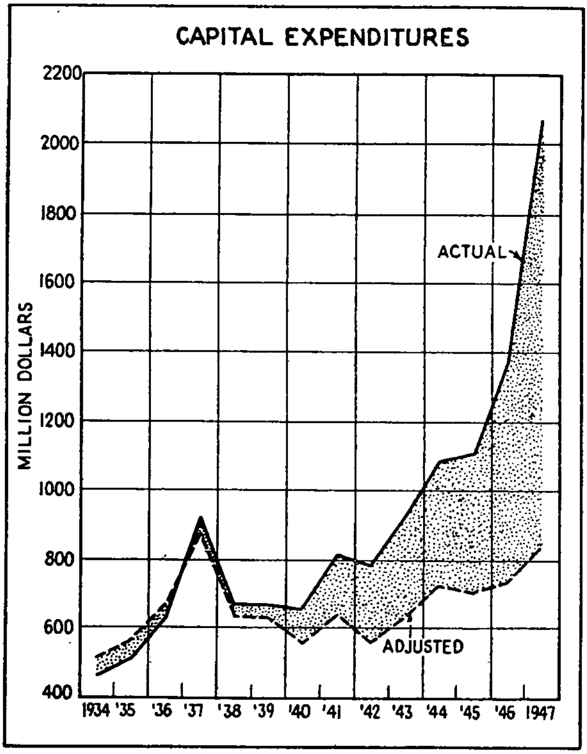



FIGURE 5.—Trend of actual expenditures for property, plant, and equipment of the 30 oil companies compared with adjusted figures expressed in prewar costs, by years, 1934–47. (See table 21 for data.)

expenditures for 1937. If allowance is made for the growth in volume during the interim, it is found that the adjusted expenditures per barrel of crude oil processed dropped from 78 cents in 1937 to 48 cents in 1947. In comparison, the actual expenditures per barrel of crude runs increased from 82 cents in 1937 to $1.19 in 1947, emphasizing how necessary it was to increase income in terms of dollars of lessened purchasing power.

*Return on capital.*—The actual return on borrowed and invested capital for the 30 oil companies indicated a rate of 13.2 percent in 1947 compared with 9.3

percent in 1946. This ratio is derived by dividing assets partially valued in prewar dollars into earnings expressed in inflated dollars, and therefore its validity is vitiated. However, if the reported net income is expressed in prewar dollars, the adjusted rate presents a more accurate result. (See figure 6.) On this basis, the return would be 7.7 percent in 1947 compared with 6.5 percent in 1946 and 8.8 percent in 1937.

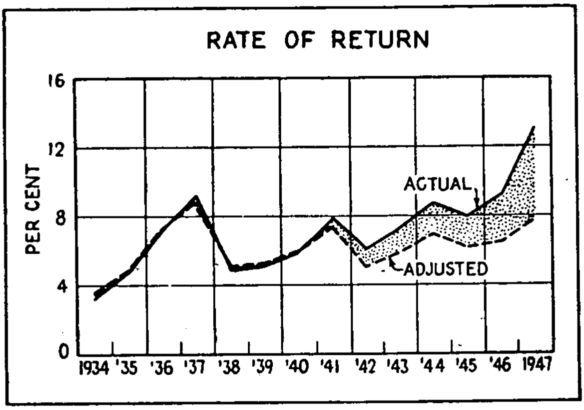



FIGURE 6.—Trend of actual return on borrowed and invested capital employed by the 30 oil companies compared with adjusted results expressed in prewar dollars, by years, 1934–47. (See table 21 for data.)

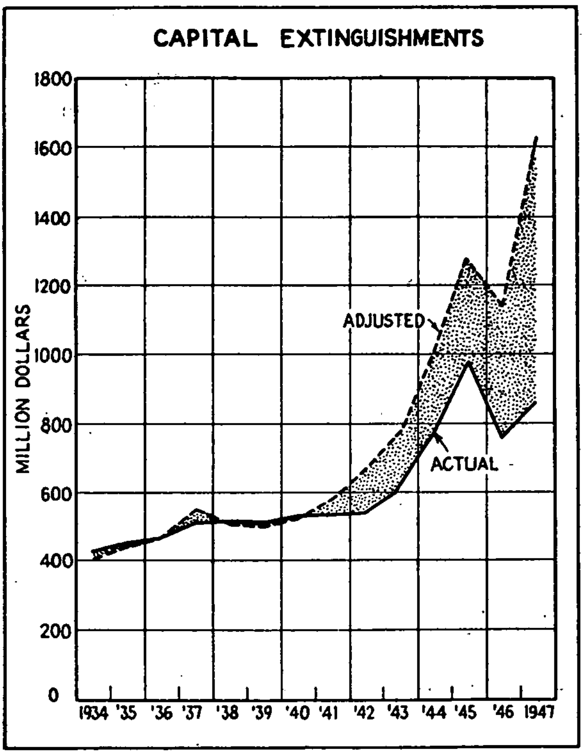



FIGURE 7.—Trend of actual charges for capital extinguishments of the 30 oil companies compared with figures adjusted to value of current dollars, by years, 1934–47. (See table 21 for data.)

*Capital charges.*—Charges for depreciation, depletion, amortization, and retirements are designed theoretically to provide the funds to maintain the productive enterprise intact, though not to expand it. If capital costs rise, this provision falls behind in the performance of its function, because it is calculated on the basis of original (historical) costs. Capital extinguishments for the 30 oil companies amounted to 867 million dollars in 1947 and 506 million dollars in 1937, the difference being due primarily to expanded volume. If these charges are computed in terms of the current purchasing power of the dollar, the 1947 figure would amount to 1,630 million dollars, or 763 million dollars greater than the actual provision per books. Figure 7 illustrates the indicated spread between the actual and the adjusted provision for capital extinguishments of the group for the years 1934–47. The differential in 1947 is almost identical with the 794 million dollars of actual earnings retained that year, which supports the thesis that the margin of net income over dividends in periods of inflation must compensate for the inadequacy of capital extinguishment charges. In fact, retained net income should be larger than this differential as long as expenditures must be made for the expansion and replacement of facilities at rising costs. The deficiency in capital extinguishments is indicative of the essential nature of the depletion allowance as a contributor to capital formation.

## CONCLUSIONS

Analysis of the combined statements of the 30 oil companies provides the basis for the following résumé:

1. The rise in operating and capital costs, characteristic of recent years, accelerated in 1947 and further distorted the reported financial figures, which are of necessity measured by a changing dollar yardstick. New highs were reached in practically every aspect of the business, but the 1947 dollar figures are no longer strictly comparable with the prior record and call for special interpretation by means of relativity calculations.
2. The total dollar income of the group registered a new high in 1947, amounting to 10,483 million dollars, an increase of 39 percent over 1946, and 70 percent over the 1941–45 average. This attainment was the result of higher prices and increased volume and was barely adequate to generate the capital needed for replacement and expansion of facilities.
3. The reported net income of the group amounted to 1,219 million dollars in 1947, an increase of 60 percent over 1946 and of 127 percent over the 1941–45 average. This result, expressed in dollars of sharply lower purchasing power, is equivalent to earnings of only 648 million dollars based on 1935–39 purchasing power.
4. The actual cash dividends paid by the group to its stockholders in 1947 amounted to 425 million dollars, an increase of 28 percent over 1946 and of 64 percent over the 1941–45 average. After adjusting for personal income taxes and for the rise in living costs, the 1947 dividends are equivalent to 208 million prewar dollars.
5. The capital expenditures of the group in 1947 totaled 2,076 million dollars, an increase of 51 percent over 1946 and of 119 percent over the 1941–45 average. Of these expenditures, 1,236 million dollars or 60 percent were absorbed by the rise in construction costs from the prewar base of 1935–39. The funds expended were derived from capital extinguishments, 867 million dollars; reinvested earnings, 821 million dollars; and outside financing and other sources, 388 million dollars. It is noteworthy that in the presence of enormous capital requirements and inflated construction costs, the industry was able to continue its record of high-degree capital formation.
6. The group increased its working capital in 1947 to 2,635 million dollars from 2,460 million dollars at the close of 1946. Its ratio of current assets to current liabilities, however, dropped to 2.6 from 3.0 at December 31, 1946. Working capital at the close of 1947 was 2 times long-term debt and 25 percent of the total income for 1947.
7. The borrowed and invested (equity) capital employed by the group at the close of 1947 amounted to 10,491 million dollars, of which 1,437 million dollars or 13.7 percent were in the form of long-term debt. This represents a rise from the 12.6 percent prevailing on December 31, 1946, but still remains a favorable debt ratio.

8. The productivity of the group's capital can no longer be measured satisfactorily by the conventionally calculated rate of return on borrowed and invested capital, because this ratio is based upon two factors measured in different kinds of dollars. If the actual return for 1947 is adjusted to homogeneous dollars, the ratio is reduced from 13.2 percent to 7.7 percent.

9. The capital extinguishments for the group amounted to 867 million dollars in 1947 compared with 763 million dollars in 1946. These charges were inadequate to finance the necessary replacements at current costs. In 1947, the actual charges for capital extinguishments fell short of indicated requirements by 763 million dollars, almost the counterpart of the 794 million dollars of net income reinvested in the business. Thus, the rise in earnings was absorbed in compensation for the deficiency of capital extinguishments, and the percentage of net income paid to stockholders dropped to 35 percent.

10. The gross investment of the group in property, plant, and equipment at the close of 1947 was 14,776 million dollars, against which reserves of 7,707 million dollars have been set up; leaving an indicated net value of 7,069 million dollars. The latter figure, however, is not realistic as it is stated on the basis of higher dollar purchasing power than that now prevailing. The replacement cost of these facilities is some multiple of the stated carrying value.

11. The net crude-oil production and runs to stills of the group in 1947 increased respectively 8 percent and 7 percent over 1946. The ratio of net crude-oil production to runs to stills for domestic operations was 65 percent in 1947, the same as in 1946.

12. On the whole, this study reveals that the petroleum industry completed the second year of increasing postwar inflation with considerable competence and continued to make effective use of its mechanism of capital formation so essential to expansion. Its financial results, while showing marked upward changes from 1946, are revealed to be temperate in the light of vastly increased capital requirements and with due regard to the reduced purchasing power of the dollar. The industry is supplying additional testimony of its vigorous and dynamic characteristics.

TABLE 18.—*Combined statement of source and disposition of funds and change in working capital of 30 oil companies, years 1934–47*

[Thousands of dollars]

| Year | Net income retained in business [1] | Capital extinguishments and other non-cash charges | Funds available from operations | Proceeds from borrowings and sales of equity securities [2] | Proceeds from sales of assets and from other transactions | Funds available for capital expenditures and other purposes | Capital expenditures [4] | Long-term debt refunded and retired and preferred stock redeemed [5] | Net change in working capital |
|---|---|---|---|---|---|---|---|---|---|
| 1934 | 29,151 | 434,716 | 463,867 | 82,088 | −5,942 | 540,013 | 460,952 | 177,434 | −98,373 |
| 1935 | 131,618 | 460,124 | 591,742 | 346,032 | 48,977 | 986,751 | 517,168 | [3] 445,644 | +23,939 |
| 1936 | 179,863 | 478,630 | 658,493 | 388,711 | −43,996 | 1,003,208 | 632,667 | [3] 423,999 | −53,458 |
| 1937 | 296,034 | 521,706 | 817,740 | 474,969 | 53,398 | 1,346,107 | 927,010 | 257,178 | +161,919 |
| 1938 | 103,563 | 521,515 | 625,078 | 356,017 | 20,340 | 1,001,435 | 668,064 | 167,184 | +166,187 |
| 1939 | 135,164 | 532,742 | 667,906 | 261,386 | −73,987 | 855,305 | 663,661 | 220,012 | −28,368 |
| 1940 | 173,443 | 550,906 | 724,349 | 259,262 | −76,334 | 907,277 | 655,964 | 254,786 | −3,473 |
| 1941 | 291,043 | 612,556 | 903,599 | 197,190 | −47,556 | 1,053,233 | 809,796 | 195,091 | +48,346 |
| 1942 | 188,341 | 588,074 | 776,415 | 257,355 | 124,745 | 1,158,515 | 785,104 | 210,745 | +162,666 |
| 1943 | 279,337 | 668,937 | 948,274 | 201,847 | 90,325 | 1,240,446 | 930,528 | 168,782 | +141,136 |
| 1944 | 369,700 | 829,228 | 1,198,928 | 139,461 | 92,797 | 1,431,186 | 1,093,978 | 177,161 | +160,047 |
| 1945 | 328,691 | 1,000,793 | 1,329,484 | 488,722 | 40,596 | 1,858,802 | 1,112,460 | 483,277 | +263,065 |
| 1946 | 449,173 | 744,779 | 1,193,952 | 607,657 | 20,342 | 1,821,951 | 1,377,211 | 469,866 | −25,126 |
| 1947 | 821,494 | 883,416 | 1,704,910 | [3] 682,365 | 60,869 | 2,448,144 | 2,075,536 | 197,179 | +175,429 |
| Total | 3,776,615 | 8,828,122 | 12,604,737 | 4,743,062 | 304,574 | 17,652,373 | 12,710,099 | 3,848,338 | +1,093,936 |

[1] Represents net income accruing to stockholders and to minority interests, less cash dividends paid to stockholders and to minority interests.
[2] Represents proceeds at par or stated value, before deducting underwriting commissions and discounts and expenses incurred by companies, and includes common stock issued in conversion of funded debt.
[3] Includes preferred stock of consolidated subsidiary company.
[4] Includes additions to fixed asset accounts, intangible development cost of producing wells, and dry holes charged to income account, and undeveloped and developed lease purchases charged to income account.
[5] Includes long-term debt transferred to current liabilities.

TABLE 19.—*Borrowed and invested capital employed by 30 oil companies, December 31, 1933–47*

[Thousands of dollars]

| Year | Funded and long-term debt | | | | | | Preferred stock | Common stock | Earned and capital surplus | Minority interests | Grand total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Public | Banks | Insurance companies | U. S. Government agencies | Others | Total | | | | | |
| 1933 | 683, 760 | 800 | | | 186, 290 | 870, 850 | 239, 348 | 3, 609, 264 | 1, 792, 310 | 332, 842 | 6, 844, 614 |
| 1934 | 558, 115 | 8, 500 | 26, 500 | | 173, 749 | 766, 864 | 236, 704 | 3, 247, 599 | 1, 789, 378 | 393, 497 | 6, 434, 042 |
| 1935 | 335, 971 | 130, 414 | 60, 232 | | 159, 490 | 686, 107 | 232, 591 | 3, 192, 931 | 1, 904, 064 | 362, 371 | 6, 378, 064 |
| 1936 | 362, 939 | 90, 813 | 57, 964 | | 160, 742 | 672, 458 | 245, 779 | 3, 343, 749 | 1, 954, 904 | 273, 333 | 6, 490, 223 |
| 1937 | 386, 220 | 44, 067 | 145, 000 | | 201, 048 | 776, 335 | 268, 838 | 3, 430, 869 | 2, 216, 130 | 280, 296 | 6, 972, 468 |
| 1938 | 540, 844 | 50, 635 | 235, 500 | | 156, 359 | 983, 338 | 243, 904 | 3, 440, 968 | 2, 245, 710 | 271, 782 | 7, 185, 702 |
| 1939 | 621, 708 | 47, 965 | 202, 416 | | 152, 532 | 1, 024, 621 | 243, 808 | 3, 457, 920 | 2, 314, 629 | 273, 817 | 7, 314, 795 |
| 1940 | 548, 305 | 182, 885 | 154, 633 | 2, 725 | 146, 452 | 1, 035, 000 | 235, 352 | 3, 425, 819 | 2, 315, 818 | 257, 438 | 7, 269, 427 |
| 1941 | 581, 429 | 186, 119 | 148, 750 | 3, 860 | 144, 821 | 1, 064, 979 | 188, 934 | 3, 439, 933 | 2, 456, 001 | 267, 119 | 7, 416, 966 |
| 1942 | 575, 156 | 158, 008 | 215, 650 | 41, 400 | 119, 517 | 1, 109, 731 | 173, 316 | 3, 440, 297 | 2, 609, 741 | 271, 095 | 7, 604, 180 |
| 1943 | 540, 113 | 156, 752 | 196, 275 | 79, 948 | 115, 363 | 1, 088, 451 | 168, 309 | 3, 473, 774 | 2, 836, 872 | 271, 988 | 7, 839, 394 |
| 1944 | 565, 221 | 145, 407 | 153, 113 | 61, 466 | 107, 074 | 1, 032, 281 | 177, 750 | 3, 483, 961 | 3, 154, 767 | 289, 683 | 8, 138, 442 |
| 1945 | 463, 090 | 330, 564 | 117, 675 | 19, 322 | 97, 079 | 1, 027, 730 | 154, 467 | 3, 501, 256 | 3, 522, 892 | 306, 676 | 8, 513, 021 |
| 1946 | 513, 730 | 350, 771 | 203, 850 | 7, 034 | 77, 646 | 1, 153, 031 | 155, 191 | 3, 531, 293 | 3, 991, 405 | 323, 876 | 9, 154, 796 |
| 1947 | 509, 345 | 497, 932 | 362, 325 | 6, 192 | 61, 445 | 1, 437, 239 | 175, 904 | 3, 665, 368 | 4, 858, 655 | 354, 144 | 10, 491, 310 |
| Change, 1947 from 1933 | −174, 415 | +497, 132 | +362, 325 | +6, 192 | −124, 845 | +566, 389 | −63, 444 | +56, 104 | +3, 066, 345 | +21, 302 | +3, 646, 696 |
| | Percent distribution | | | | | | | | | | |
| 1933 | 10.0 | 0.0 | 0.0 | 0.0 | 2.7 | 12.7 | 3.5 | 52.7 | 26.2 | 4.9 | 100.0 |
| 1947 | 4.9 | 4.7 | 3.4 | 0.1 | .6 | 13.7 | 1.7 | 34.9 | 46.3 | 3.4 | 100.0 |

TABLE 20.—*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 | |
| | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Percent* | *Mil. dol.* | *Percent* | *Mil. dol* | *Percent* | *Mil. dol.* | | *Mil. dol.* |
| 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 | 0, 483 | 8, 397 | 867 | 1, 219 | 11. 6 | 425 | 34. 9 | 2, 160 | 20. 6 | 2, 635 | 2. 6 | 8, 524 |

82989—49——12

TABLE 20.—*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 |
| | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* |
| 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 |
| | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Percent* | *Percent* | *Percent* | *Thous. bbl. per day* | *Thous. bbl. per day* | *Thous. bbl. per day* | *Thous. bbl. per day* | *Thous. bbl. per day* | *Thous. bbl. 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 |

TABLE 21.—*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 [2] | Income detained 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* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* |
| 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 |

[1] American Appraisal Company.
[2] U. S. Bureau of Labor Statistics.
[3] U. S. Treasury Department: Based on annual income of $10,000, married and one 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.

TABLE 21.—*Selected financial data of 30 oil companies adjusted for changes in value of dollar, years 1934–47*—Continued

| 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 | Net income before deducting minority interests' share: Adjusted for deficiency in charges |
| | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Percent* | *Percent* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* | *Mil. dol.* |
| 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 | 7.0 | 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 |

[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.

Senator FLANDERS. You may proceed now, Mr. Pogue, with your statement.

Mr. POGUE. Mr. Chairman and gentlemen, my name is Joseph E. Pogue, and I am a vice president of the Chase National Bank, in charge of its petroleum department. I appear before this committee, however, in my individual capacity as a petroleum economist. For the past 10 years my associate, Mr. Frederick G. Coqueron, and I have conducted a continuous study of the combined financial and operating results of a group of 30 representative oil companies which comprises a sufficiently large sample of the entire petroleum industry to be indicative of the whole. The results of this study have been brought together and presented in detail in a report, to which the Senator referred, entitled "Financial Analysis of Thirty Oil Companies for 1947," which was published by the Chase National Bank in September 1948.

I hope the committee will have this report before them, because I will have occasion to refer to it from time to time in this statement. This report provides an accurate and homogeneous record of the operations of this large segment of the petroleum industry for a period of 14 years; and I know of no other industry study which gives a comparable X-ray for anyone to read of the actual manner in which the industry financed itself and formed the necessary capital for its progress and operations.

Now, my first question is, What are profits? Few business terms are less understood than "profits," and throughout this statement I have used the term always in quotation marks for reasons that I hope will appear as we proceed. 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." That is what the accountants call it. 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 from this balance an estimate I repeat, 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, are themselves not an absolute figure.

Next is the fundamental principles affecting profits.

There are four basic conditions which should be clearly held in mind by anyone seeking to analyze the size and significance of profits. I shall try to define these four principles and then briefly illustrate each point by data taken from our study of 30 oil companies.

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, I repeat, to maintain and expand. As capital costs rise, profits are called upon to supply increasing amounts of these funds.

Reported "profits" are overstated in periods of inflation. The reported net income of 30 oil companies, a large sample of the industry, was \$763,000,000 in 1946 and \$1,219,000,000 in 1947, an increase of \$456,000,000, or 60 percent. On the face of it, this increase appears large. But the charges for capital extinguishments (depreciation, depletion, and so forth), designed to recover the capital fund 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 standard 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. 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.

In normal times profits and net income are synonymous; with the changing value of the dollar, they diverge. In other words, inflation throws a monkey wrench into the machinery of accounting and you do not get out a realistic figure.

The absorption of part of the reported net income by the higher costs of replacements—and understand now I am speaking about replacement and leaving expansion for further consideration—is indicated by a 1947 rise in capital expenditures of \$699,000,000. Thus the industry expended \$699,000,000 more than the previous year for the capital account. This is reflected also by a decline in the percentage of net income paid to stockholders from 43.4 percent in 1946 to 34.9 percent in 1947. Later I will indicate that this figure drops to 24 percent in 1948. By way of comparison, this ratio was 66.3 percent in 1938 at a time when the job of replacement and expansion was not so great.

Now, this is a complicated, subtle, and involved concept. Perhaps I can illustrate it by an overdrawn simplification. If a shoe merchant orders a consignment of shoes at $4 a pair and sells these shoes at $6 a pair, forgetting overhead, it is apparent that he makes $2. If his next consignment of shoes are brought at $6 and sold at $8, he makes another $2. If his third consignment of shoes is bought at $8 and owing to change in market conditions he has to sell that consignment at $8, he breaks even on his third transaction. After he has made his third transaction, and the year comes to an end, his accountant tells him that on his transactions he has made $4. His income-tax counsel calls on him and makes out his returns and he pays taxes on the $4, but he is a little worried because he finds that he has not made any money. He has in reality broken even on the three transactions. What became of his accounting profits?

The point is that the change in the value of the dollar reflecting itself in this exaggerated rising price has simply rendered the accounting unsuitable in reflecting the facts. He has made, in reality, no money. His net income is $4.

Senator FLANDERS. I may say, Mr. Pogue, that previous witnesses, both the economists and the accountants who have been before us, have presented these ideas both with relation to inventory and to replacement costs for business as a whole. Of course, I would assume that they would have somewhat the same application to the petroleum industry, although probably the inventory of raw materials, goods in process, and so forth, does not have quite the same incidence in the rapid flow of fluid through a petroleum refinery and so on as it does in some other industries.

Mr. POGUE. You are quite right, Senator. It does have a bearing on what might be termed the "underground inventory."

Senator FLANDERS. On the other hand, probably the replacement factor has a larger incidence than it does in many other industries.

Mr. POGUE. I think it does. If I had similar data for other industries, we could make some very interesting comparisons there. I feel sure that you are right, however.

Senator FLANDERS. The theory of the thing has been presented to us.

Mr. POGUE. I understand so. I have read it with much interest. I apologize for presenting this simple illustration, but it occurred to me that it might be opportune. That is the only extraneous illustration that I plan to bring in.

My second point is that reported profits cannot be compared properly with previous years; and these points, I think, have been brought out by previous witnesses. I was not sure to the extent to which these matters would be brought out by others, but, nevertheless, it is of interest to emphasize them because they have been overlooked in the past and a little repetition may not be out of order.

All financial transaction 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. It is proper to say, however, that these profits increased from $763,000,000 1946 dollars in 1946 to $1,219,000,000 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.

Once you say that, it occurs to you to adjust these figures to the same dollar value? We have done this in table 21 of our report. These computations are not precise in the sense that accounting computations are exact, but they give a clearer picture of the actual facts than do the accounting figures. The accountant is somewhat helpless in the matter. His procedures are forced away from reality by inflation, on the changing value of the dollar. So if we make this adjustment, which is done in table 21, you will see the actual net income for a 14-year period, compared with the difference between the two representing the impact of inflation.

Expressed in another way, it is shown 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.

If this correction is not made in the reported figures, one finds himself comparing two different kinds of aggregates and falling into the same type of error as if he concluded that 2 bushels are twice as much as 1 ton. You can say twice is twice as much as one, but 2 bushels are not twice as much as 1 ton. You have different things there.

Now, No. 3, the rate of return on invested capital is an erroneous yardstick to employ in times of inflation. The rate of return is commonly used, and we all are accustomed to it, and it gives a true picture only so long as the dollar is relatively constant.

One of the ways of computing it is simply to establish the ratio of current net income to accumulated borrowed and invested capital, or invested capital alone. Since investments are made in the past and income is derived in the present, this ratio is obviously the relation of present dollars to past dollars. If the two sets of dollars are approximately the same in value, all well and good. But if the two sets of dollars differ substantially, as they do when inflation intervenes, then the ratio is not only false but one commits a mathematical error even in computing it. It is not permissive to strike a ratio between unlike things; for example, no one would undertake to say that profits of $1,000,000 made by an enterprise which had a net investment of £10,000,000 represented a rate of return of 10 percent. He would first convert the dollars to pounds or else the pounds to dollars and then compute the ratio.

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 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.

Now, I come to the fourth point, which I regard as far more significant than these accounting points, as important as they are. This is the relation of profits to capital formation. The term "capital formation" may not be familiar to everyone; although doubtless it is to the members of this committee. It is the heart of our production system. It is the method whereby the capital is generated or obtained for the purposes of production. It is essential under any system and it is complicated a bit by the dual meaning of the word "capital," and that causes endless confusion in a lot of thinking. "Capital" is, at the same time, a financial or monetary term, and it has a physical counterpart in tangible things, in plants and inventories to some extent. Therefore, when we speak of the capital formation, we speak of the formation of the funds and their translation into things, productive things, and it is complicated a little bit by the time lag that must intervene, and it is complicated further by the various ways in which the capital funds are formed.

If we bear that in mind when we say capital that we mean either or both capital funds and physical capital, our thinking, I believe, will be clarified. Now, the funds must come before the things. 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, future savings can be transferred to the present.

Now, as I said, 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. Again we use the record of 30 oil companies for the illustrative figures. I will ask you in this connection to refer to the chart on page 8 of our report, which shows in graphic form for the year 1947 the source and disposition of the capital funds. In examining this chart please use your imagination to think of the disposition of the capital funds as converted where appropriate into tangible things, because certain items of great size there go through that process.

Now, our 30 oil companies, representing about two-thirds of the industry, generated cash out of its own operations to the extent of \$2,160,000,000. That is a huge sum. It is a huge industry and does a huge job. 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 we call capital extinguishments. This amount repreesnts 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. \$61,00,000. 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 [1]; $197,000,000 to the retirement and refunding of debt; and $455,000,000 to stockholders and minority interests.

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 to cover its conversion into physical replacement of the capital worn out and used up.

Now, if you refer again to the chart on page 165, you will see some rather striking relationships. The sum of capital extinguishments and net income is $2,160,000,000. Capital expenditures are $2,076,000,000. They match very closely. Dividends to stockholders have a minority interest, $455,000,000, and borrowings $476,000,000. They match pretty closely. So one might ask, Where did the industry get any money to pay dividends? It looks on the face of it that it spent all of its cash on capital accounts, and that they borrowed to pay dividends. The accountant would not let you say that, because you cannot pay dividends except out of surplus, and you can pay capital expenditures out of any form of funds, so it is perhaps incorrect to say that, but it is still striking to note that the dividend account matched the borrowings, and the capital expenditure account matched the net income plus the capital extinguishments.

Anyhow, it is fair to say that without borrowings there would have been scant funds for dividends unless capital expenditures had been reduced, and if capital expenditures had been reduced, the oil shortage of the winter of 1946–47 would still be with us. Under those circumstances, it is difficult to speak of the earnings of the oil industry in 1947 as being too great, because they played a very essential role in the process of capital formation.

It can also be said that too much capital was not formed by the oil industry in either 1947 or 1948 because I can assure you that if the magnitude of capital formation in 1947 had been less, there would have been no means for doing what was done, namely, the conversion of an oil economy from one of scarcity to one approaching abundance. I do not know of anything that is of more importance from the public standpoint than for that transition to have taken place.

Those of you who attended hearings on the so-called oil shortage last winter can appreciate what would have happened this winter if a similar shortage had intervened or should intervene. Of course, the winter is not here yet, but the evidence is that the shortage trouble is over.

It may be shown, and this is another way in which inflation works, that the cost of our capital expenditures has been vastly inflated by the change in the value of the dollar. If you refer to page 168, you will find a chart which shows the actual capital expenditures expressed in current dollars and adjusted to prewar dollars. You

---

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

will see that the actual figures for 1947, which are over $2,000,000,000, come down to slightly over $840,000,000 in terms of prewar dollars. The prewar equivalent of the expenditures in 1947 were actually less than the adjusted or actual expenditures in 1937, which was a previous peak year of oil developments.

If it is clear that oil profits play an important role in the essential process of capital formation, then we might look at the item of cash dividends to stockholders, for this amount passes out of the stream of corporate savings and into the hands of the public. It plays no part in capital formation except to the extent that individuals may reinvest these funds. 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.

Now, as the year 1947 drew to a close, it became evident that we would witness great difficulty in supplying the demands that lay ahead, and the process of capital formation would have to speed up to get over this further rising demand. And bear in mind that in 1947 the consumption of oil increased 11 percent over the consumption of oil in 1946 or approximately in 1 year the increase was equivalent to the 1947 production of oil in Russia.

During the 2 years 1947 and 1948 the consumption of oil in the United States increased about 800,000 barrels a day. The average consumption of oil in the United States during World War I, which many of us remember, was about 900,000 barrels a day; so, in thinking of the magnitude of income, think of the size of the job to be done. Here, in 2 years, this industry was called upon to meet an increment in demand approximately the size of the whole works with respect to oil in the period of World War I, and we regarded the oil industry as pretty big in those days.

Representative HERTER. I would like to ask one question. You have the raised the question there of the increase in the volume carried by these 30 oil companies. Have you anywhere in your tables figures indicating the unit increase in profit over the same period?

Mr. POGUE. You mean the unit per barrel?

Representative HERTER. If that is the convenient unit to use.

Mr. POGUE. Well, such a calculation would be complicated by the fact that while we know the crude oil production of these 30 companies, they buy a lot of crude oil, and we know the crude oil processed, but they likewise buy products.

Senator FLANDERS. You could probably insert it into the record, a division of the thousand barrels a year processed and the profits for the year, for different years.

Representative HERTER. I think that that would be an interesting figure two ways, one an absolute figure in cents per barrel, whatever it might be, and the other in percentage of the outlay per barrel.

Mr. POGUE. We have explored many ratios, such as the expenditures per barrel, but they have not been too significant, because of the incompleteness of the data or the lack of a common denominator. The earnings of a group of companies comprising crude oil producers, oil refiners, and integrated companies, cannot be expressed in terms of crude oil produced, or crude oil refined, because neither unit is common to the entire group and therefore the result would be meaningless. The sales dollar, however, is an ascertainable common denominator; the net profit per dollar of sales, for the group, was 10.1 cents in 1946, and 11.6 cents in 1947, an increase of 15 percent.

Now, my next point, on which some confusion of thought exists, is that in the oil industry the extinguishment of capital proceeds in two ways, through depreciation and depletion. Resource industries suffer a diminution of capital in two ways. The plant above ground wears out bit by bit, sometimes accelerated by obsolescence, and the oil under ground is gradually exhausted. When you take out a barrel, there is one barrel less, and any oil company, to be a going concern, has got to wildcat and discover a new barrel for each barrel it takes out; otherwise, it is on the toboggan as an enterprise. Therefore, we have to consider the replacement of our capital just to keep the status quo physically.

Then, if you happen to be in a rapidly growing industry or in a phase of the economy where expansion is called for, you have to expand. Of course, in the postwar period, so far as oil is concerned, that expansion need was magnified in two ways. In the first place, the inflationary forces of monetary origin stimulated demand, while the war period itself had resulted in a lag in the supply factors. Thus there was a great deal of accumulated physical underage to be made up. So for a while the industry not only had to expand forward, but also had to fill in the gap left by the conditions of the war period when the effective emphasis was on consumption rather than on production. Therefore, the industry faced the triple task of catching up, replacing its wear out, and expanding to larger size.

In addition, there are several circumstances that make the capital needs of the petroleum industry unusually large, and this is a fundamental of the industry for which there is no help. This is also aside from the effect of the inflationary forces.

In the first place, the industry is highly technological. That means that it has to have a great deal of plant and equipment per unit of output. For example, the net investment per worker in 30 oil companies was $17,000 at the end of 1947 and during that year capital expenditures per worker was approximately $4,150. Every time you expand the demand by a barrel a day, it takes several thousand dollars to do it. The growth of 800,000 barrels a day over the past 2 years probably cost in the neighborhood of $3,000 per daily barrel, or 2.4 billion dollars.

It has been estimated for the economy as a whole that about two-thirds of capital formation is for replacement, and about one-third for expansion. I don't know what the division is in the oil industry. I suspect that for the past 2 years, when expansion has been very rapid, it was about 50–50.

Now, whatever the proportion, the capital needed for expansion is going to vary more from year to year than the capital required for replacement, aside from the effect of the fluctuating dollar; and we know that expansion was very substantial in the last 2 years when demand grew 15 percent.

As for the future, the need for capital funds for expansion may decline to some extent, because we do not need to expand at the recent rate. The rate of growth in demand is already beginning to show some deceleration, and the magnitudes are too big, anyhow, to sustain large percentage rates. Trees don't grow to heaven. The compound-interest curve defeats itself. The funds required for replacement, however, will increase as the industry gets larger. On balance, the net outcome will probably be some drop in the total volume of capital formation in the year ahead; and if that happens, profits will adjust themselves to a lower level of capital requirements.

Now, so far, I have confined this presentation to a statement for 1947 and previous years. I have done that because we have a complete record for those years. For 1948 I can only give you more sketchy figures, because the year is not completed, and we can estimate only some of the items. It is recognized, of course, that oil earnings went up another substantial percentage in 1948. Our 30 oil companies for the first 9 months of 1948 will show somewhat larger earnings than for the full year of 1947. In the first 9 months of 1948, the estimated reported net income increased $563,000,000, or 67 percent, in comparison with the corresponding period of last year. For the full year, however, the rate of increase will be less because the rate of change decelerated in the second and third quarters, and also the price structures for certain oil products has weakened in recent months.

All the qualifications relating to 1947 earnings apply to the 1948 figures as well. Of greater significance, however, is that the increase in capital requirements for plant account and for inventory build-up will amount to 600 to 700 million dollars, which is just about the same amount that reported net income is expected to increase.

In 1948 a new factor comes in that did not appear materially in 1947. Last year the physical inventories of the industry remained about unchanged. As I recall, the total stocks of oil were reduced 5,000,000 barrels in 1947, but obviously in view of the increased demand, the inventory position in oil became subnormal, and that was the prime reason why spot shortages developed in the winter of 1947–48. In 1948, when we get through the year, we will find that inventories of oil will have increased about 89,000,000 barrels, and have again become ample. That is one reason for the belief that the supply-demand situation will be comfortable over the coming winter, and that, barring acts of God, we will not suffer any difficulties in the way of meeting demands.

This drop in the rate of payment is an interesting indication of the extent to which net income as reported was diverted to capital formation, and I believe it is very fortunate that this took place, because this is the means by which the shortage of oil was licked. A year ago, at this time, we faced the prospect of a tight, if not a short, oil supply. Today our tanks are full of oil and supply is beginning to run ahead of demand. And if this trend continues the need for capital formation will become less insistent and the mechanism of the market will reduce profit margins and bring about a lower level of profits. In this cycle we have almost a perfect case history of the function of profits in converting a scarcity into an ample supply.

I think profits can be likened to the motive power on a transcontinental train. Out on the plains where the slopes are gentle, one locomotive is sufficient. As you enter the mountains and go into the steep upgrades a second locomotive is attached. It is kept on until the divide is reached, and as you go over the divide, the second locomotive becomes unnecessary and is dropped.

Now, supply and demand correspond to the terrain that is traversed by the train. When supply and demand are in balance, the gradient is moderate. Inflation throws supply and demand badly out of kilter and creates a difficult country to be traversed. In the case of oil, inflation created a mountain range. Profits were the means by which it could be surmounted. In propelling the oil industry up the steep upgrade, profits, the motive power, were called upon to do an almost impossible job. I doubt if there is a man in the oil industry, who a year ago thought that this job could be completed in 9 months, that the shortage could be broken. It has been. The divide in oil has been reached, and it is now being passed. I don't know whether beyond lies a plateau or downward slope and, if the latter, whether that slope will be gentle or steep or how soon it will turn up again; but if it is true that we have reached the divide, less motive power will be needed. Only a renewal of the inflationary forces can interpose a new mountain range.

That is the end, Mr. Chairman.

Senator FLANDERS. I have two or three questions that I want to ask you. One of them is this: 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 some oil products in 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.

Senator FLANDERS. Your testimony is very comforting to that extent.

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, in your table of figure 2 on page 8—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 it would result in lower prices, per se.

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 sufficiently 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 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 economic 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. They all 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.

Representative HUBER. In connection with that, you mentioned the possibility that you are on the down-grade in the petroleum business now, and being able to supply the demand. If we should provide a 70-group Air Force, will the petroleum companies not find themselves hard put to supply the amount of petroleum needed, and will it also not be necessary to have rationing immediately?

Mr. POGUE. I am not familiar, offhand, with the volumes involved in that, as it relates to special products. There might be bottlenecks in respect to that. Naturally, you can set up objectives that would create bottlenecks for the time being.

I know that from my own experience in World War II. The quantities of aviation gasoline that were required were apparently out of all reason, and in due course they were provided. The volume of production went up to five or six hundred thousand barrels a day.

Representative HUBER. An article in today's paper mentions the possibility. You say that there wil be certain types of fuel of which there will probably be a shortage?

Mr. POGUE. There are committees working on all of those points, and it is a question of alternatives and how you adjust all of those things. Naturally, one type of strategy may have to change for another if the material supply factor interposes too much difficulty or too much of a time gradient to get it broken. And it is very easy to figure emergency demands that could not possibly be met for the moment by the present equipment and capacity of the industry.

Senator FLANDERS. The last question that I wanted to ask you, Mr. Pogue, was brought to my mind by your brief, and your practice there of expressing profits in terms of a dollar of a past time, saying that in comparing profits one should also take into account the purchasing power of the dollar.

Now, what should the investor demand in that respect? The man who buys an evidence of debt like a bond does not expect to be repaid in any other terms than the dollar which he invested. There is no provision made for upping the return on that bond due to the change in the cost of living.

Mr. POGUE. That is correct.

Senator FLANDERS. Now, should a man who has invested his dollars in equity in the same concern properly expect that his returns should be on any other basis than the particular dollar originally invested when the stock was issued? Do you see any difference between those two things? If there is a difference, you tend perhaps to make a case for your conclusion that profits should be reckoned in terms of an older dollar for comparison. If there is no basis of equity in the two things, it seems to me that you would use the current dollar right along straight through.

Mr. POGUE. Well, Senator, I do not see that.

Senator FLANDERS. Why should we say that profits should be great enough to make the same basis of comparison with a previous period in which the dollar was worth more? That is the question.

Mr. POGUE. Well, I hope that I have not fallen into the lapse of passing judgment on profits or dividends in the sense of saying what they ought to be. I have observed what they have been, and I have attempted to explain them in terms of capital formation, the job that they did, and I have pointed out certain fallacies in comparisons. You cannot properly compare one year to the next if the unit is changed. You may insist on doing it, but it is not proper to do it.

Senator FLANDERS. Looking at it this way, with regard to the uses of profits, there is no need for upping your profits to a depreciated value of the dollar for your servicing of the debt. That can be done in the old dollar. There is need for upping your profits for capital replacement, because that has to be in the new dollars.

Mr. POGUE. That is right.

Senator FLANDERS. Now, where does the need for dividends on common stock lie? We know where the needs of the holder of common stock are. He has got to pay more. Is the company whose stock he holds bound to recognize that need of the stockholder for more money to live on?

Mr. POGUE. No; I would not think it would have to.

Senator FLANDERS. That really reduces the need for reckoning profits in the new dollar, it would seem to me, to that area of capital replacement, where very evidently it is needed.

Mr. POGUE. Well, I do not know that I have made my point clear. When we get to examining these economic developments, prices and profits, and so forth, and deal with them collectively as we do when we speak in large large totals, it is so easy to shift our point of view from the competitive one, from the fact that these are developments, to one of thinking to some extent of the question of right and wrong and fairness and unfairness. There is no evil in the world, short of war, greater than the evil of inflation, and I think if my testimony has shown anything, it has shown the distortions that are brought about by this force that we call inflation, which has manifold origins, and which we perhaps do not understand too well and which we are all seeking to correct in a painless manner.

Now, inflation does strange things to the profits figures. It does strange things to the dividends figures, and it does strange things to the bondholders' return.

Insofar as the bearing of a low interest rate and cheap money on borrowings is concerned, you would think offhand that these industries would have gone into debt far more than they have. The facts are that they have not.

Now, having something to do, myself, practically with some phases of debt, I know the difficulties and limitations and the ways in which these things are done. A given company will go as far as it deems prudent along the debt route, and there is no way to make it go further or less far. That is a state of individual decision, and over the long run it has worked out pretty well. I do not think it is fair to say because the bondholder gets a lessened real wage, the stockholder should be forced into the same mold. There has got to be some flexibility in the economy, and the more it is regulated in certain directions the more the repercussions are concentrated in others.

I am not sure yet that I have satisfactorily answered your question.

Senator FLANDERS. It is quite possible that you cannot or that no one can.

Mr. POGUE. I was going to lead up to the fact that perhaps this hearing is not long enough this afternoon to explore that question. That opens many other questions.

Senator FLANDERS. Mr. Patman?

Representative PATMAN. I will pass for the present.

Representative HUBER. Mr. Pogue, I will ask you specifically, and I anticipate your answer, do you feel the present petroleum company profits are excessive?

Mr. POGUE. Excessive in relation to what, sir?

Representative HUBER. In just plain words, are they making too much money?

Mr. POGUE. It looks to me, in the first place, that if they are making too much money, that condition will not continue.

Representative HUBER. In 1948 dollars, or what?

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, that 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 have another mountain range.

Representative HUBER. Well, if the profit figure for corporations, limiting this to petroleum, do not present a true picture in 1948, does the financial statement there then present a true picture in years of depression? Are they worse off or better off, using the same criteria?

Mr. POGUE. Well, if you reduce them to the same terms, then of course the up and down would be true. But if the price level in general came down, with each notch at decline the distortion created by the price level would be less; and if prices came down to prewar levels, then the disparity between profits and net income would disappear.

You see, the trouble is that in normal times with a standard dollar, net income and profits, as we popularly look at it, are identical. As you turn on more and more inflationary steam, those two concepts diverge.

Now, we are so accustomed to conventional terms that it is terribly hard to think of the relativities in this thing. In the physical sciences years ago there was an atomic bomb, so to speak, exploded in the theory of relativity which is no more nor no less than the discovery that yardsticks which were thought to be immutable were subject to change; that the speed of light varied from place to place, and time was not constant. So the whole theory of physical science was revolutionized.

Now, we face in finance and accounting a problem in relativity brought about by the impact of inflation. There may be need for the development of a theory of relativity in accounting, because these things that we thought were constant as the laws of the Medes and Persians, are not. Now, our ordinary yardsticks have just been upset.

Senator O'MAHONEY. May I interrupt to say, Mr. Pogue, that I doubt whether Congress can wait for the development of this theory of relativity by the accountants before passing upon the appropriations and the taxes that will balance the budget for the next fiscal year. That is our problem. Do you agree with me?

Mr. POGUE. I do not think the accountants can throw much light on that. The accounting procedures do not make the tangible wealth.

Senator O'MAHONEY. Do you not think that all of these public statements regarding the alleged overstatement of profits have an effect, upon some persons, of convincing them that if the Government should increase corporate taxes in any form in order to help balance the Government budget, it would be doing an injustice to corporate business? Do you think that that could be by any possibility the purpose of these various theories of relativity and otherwise?

Mr. POGUE. Well, Senator O'Mahoney, you raise the point, in effect, whether testimony of this kind is designed to influence tax action. I was invited to appear before this committee to give my analysis of profits because I had devoted some time to a study of the oil industry; and coming here, I had to give the interpretation that seemed to me to be correct.

Senator O'MAHONEY. I do not object to that.

Mr. POGUE. No matter where the chips would fall.

I do not think that it matters too much as to the various accounting interpretations, other than it should be understood that those are essential to the understanding of the problem.

The supreme problem is what is best for the economy. Now, as a matter of fact, the essence of this problem, as I see it, is to get capital formed to carry this industry into balance and maintain balance with demand. You understand the oil industry, and you come from a great oil State, and I had the pleasure last June of flying over most of the oil territory in Wyoming, and there is a great deal of oil there and it is very much on the upgrade. You understand thoroughly the importance of those developments.

Senator O'MAHONEY. I would like to amend that by saying that I try to understand it.

Mr. POGUE. Oil is such a unique and pivotal element in our economy that I believe that if we could understand and appreciate the mechanism which keeps it going forward and meeting this miraculous growth in consumption, we would find that we would have to weigh that mechanism against these other factors that you mentioned.

Now, fortunately, it is not my job and it may be someone else's job to do that.

Senator O'MAHONEY. I had hoped that your answer might be that it was not your purpose, in discussing this technical problem of accounting and its effect upon the statement of profits, to induce the committee to be more generous than it might otherwise be in recommending a tax structure to meet the well-known needs of Government.

Mr. POGUE. Well, to be perfectly frank with you, Senator O'Mahoney, I did not realize it was the function of this subcommittee to recommended on taxes. So that the preparation of my report was done in ignorance of that fact, if it is a fact, and therefore I was not influenced by it.

Senator O'MAHONEY. This committee has the whole economic world as its orbit, and it can look wherever it sees fit. As a matter of fact, a subcommittee of this committee last year, appointed as the result of the introduction of a resolution by Senator Baldwin, of Connecticut, to investigate the rising cost of living, made a survey of the whole country. The western subcommittee, which studied conditions throughout the West—and of which Senator Watkins was the chairman—came back and filed a formal recommendation for the reinstitution of an excess-profits tax. That recommendation, as I recall it, was afterward eliminated or modified by the full committee. But it was not a partisan recommendation by any manner of means.

It is true it was not accepted by the Finance Committee of the Senate, nor by the Ways and Means Committee of the House, but evidently it was the view of all of the members of the committee, without regard to party, that the profit situation was such that there ought to be an excess-profits tax.

Now, I listened to all of the testimony that has been presented here except yours, and I am awfully sorry that I was compelled to miss that because I know how valuable your testimony is and how thorough your studies are. You have testified before committees on which I have sat before this. I openly confess to a great admiration for your abilities.

But as I glance over the first few pages of your testimony, I find there the same lack of a definite measuring by which a change of depreciation could be satisfactorily figured. I suspect that that is what you had in mind when you referred to the accountants' theory of relativity.

Now, may I ask you; what, in your opinion, are normal profits? I ask you that question because I think it is a statistical fact that prices have been increasing over a large number of years, and it has been sort of characteristic of a modern development. Therefore, if we were to make some sort of a computation of depreciation costs in inflationary dollars, I would like to know what dollar you would regard as the base which should be used as the expression of normal profits?

Mr. POGUE. I do not see how you can get an expression of normal profits. In fact, I do not know what is meant by normal profits.

Senator O'MAHONEY. You used the phrase yourself. That is why I asked the question.

Mr. POGUE. Did I use the phrase "normal profits"?

Senator O'MAHONEY. Yes.

Mr. POGUE. If I did, I do not know what is meant by that. My thinking was to the effect that the profits that were indicated by the reports of the oil companies, expressed as they are in the changing units, were apparently needed, so far as I could judge, to do this job of getting us over the hump. And therefore, they were abnormal in terms of prewar reported profits.

Much of that abnormality would disappear if you would express them in the same units; but whether so or not, the pivotal thing, from the point of view of anyone interested in the public interest and the welfare of the country, was whether they accomplished a useful purpose or whether they were just a windfall for the owners of the companies.

Senator O'MAHONEY. But you see, Mr. Pogue, when the Appropriations Committee makes an appropriation to enable the Air Forces to buy high-octane gasoline, or the Navy to buy motor fuel, it cannot deal in any fictional dollar. It cannot apply the theory of relativity. It must make appropriations of the current dollars, and it will pay to the corporation which produces the fuel the price which that corporation fixes in current dollars.

Mr. POGUE. That is correct.

Senator O'MAHONEY. Therefore, it seems to me to be clear that when the Government undertakes by taxation to raise the current dollars to pay the current prices, it must do it in current dollars and not in this mental abstraction about which the accountants talk.

Mr. POGUE. There is one more step in that. If the measures they take should result in a further inflation of current dollars, then it all would have to be gone over again. In contrast, if the steps they would refrain from would result in lower prices and less inflation, then, of course, less funds would be needed for expenditures and we would approach a better balance.

The only point I make is not the academic one of trying to decide a thing that cannot be decided, whether something is too big or too little. The practical problem is to decide what gives the best results.

Now, the record showed that these profits, which are large in current dollars, serve a very useful purpose. Now, there may have been some other way of achieving that purpose, but the facts are that 1 year ago we faced a very serious oil situation, of people being cold, and certainly the Congress of the United States regarded it as serious.

Senator O'MAHONEY. I agree, there can be no doubt about it; but I must add that the expenditure of current dollars by the Air Forces to provide the gasoline that carries on the Berlin airlift is also a very constructive expenditure, and a very necessary one, according to the policy which the Government has adopted.

In other words, what I am trying to do is to find out whether you, in appearing before this committee, from the point of view of our problem of adopting a policy which the Government must follow, are recommending that we take one standard with respect to the dollars that the Government spends, and another standard with respect to the dollars that the Government must collect in taxes?

Mr. POGUE. No; certainly not. But what I am trying to do, and what I think will throw light on the problem that you mentioned, and what must precede that problem, is to analyze the nature and the function of the profits that you are considering.

Senator O'MAHONEY. Of course, that is perfectly true, and I quite agree with you.

Mr. POGUE. That is what I have attempted to do. And now you raise another problem.

Senator O'MAHONEY. But your answer is quite a satisfactory one to me, so far as the issues which are presented at this hearing are concerned. It is clear to me, therefore, that you agree that this abstract, technical dollar which the accountants talk about and which the economists talk about, is not the practical dollar with which the Government and business must do business.

Mr. POGUE. I think that you are oversimplifying it. The dollar that has to do with capital formation is a current dollar, and it is not an abstraction, and it is not a relativity dollar; that is the type of dollar that bears on capital formation. It is very vital in the decision that you face.

Now, these other things are important, and they relate to arriving at the true view of the situation. But the point there that I was making was simply that there were certain fallacies in popular thinking which needed to be corrected. But the overwhelmingly important thing is not the divergence between the accountant's dollar and the real dollar. That is important from the attitude of people toward these things; but the important thing is the cash produced by an enterprise and the cash that is obtained from the flow of savings outside the enterprise, and what comes of it; and furthermore, what would be the effect—and this is your problem—on that flow and the results thereof, of diversion of those dollars.

Senator O'MAHONEY. When this committee was called together to hear this testimony, it was told that the purpose was on consider profits in relation to prices and taxes and dividends and uses.

Now, I found a very interesting statement in your definition of what are profits, and one with which I quite agree, but one which I would like to amplify. It was the example on page 177:

> According to accounting practice, it (profit) 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.

Now, the difficulty arises in determining how to make that estimate.

Mr. POGUE. That is the difficulty relating to one's attitude or measurement of the profits.

Now, the facts are quite different. The realistic thing is the cash produced by the enterprise. The rest of it is theory. You can forget it all. And if you deal with cash and what it does, if you divert some of that cash you want to be very sure that what is left and what is available from other sources will do the job that society needs to have done. That is the real issue.

Now, you raise a question of taxation. I am not a tax expert. I have not gone into that angle in this report. That is another matter. I think that I have contributed some bases for considering that.

Senator O'MAHONEY. I have no doubt. And may I ask you this additional question. This is on pages 177–178 of your statement again. This is 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.

Now, 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. But the theory or procedure have 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 the accounting theory or come out of profits, you are then living on capital.

I surmise that much of that sort of thing is going on in Great Britain. I suspect 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, 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 that you did it. It would not change any of the facts and it would simply change the names.

Now, and 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.

I always have found in my own analyses for investment purposes that far more significant than the income account and the balance sheet of the corporation is what we termed cash flow or cash production. In drawing up analyses on which actual extensions of credits are made, that we always in our shop, before making a loan to an oil company, prepare what we call a cash-production forecast, and such figures are regarded as much more realistic and useful than net incomes. Cash is the tangible thing, and that is what you are concerned with in your problems rather than accounting concepts. 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 statemen 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 O'Mahoney, 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—unless he was awfully dumb—hitting upon this relationship of capital formation to replacement.

Senator O'MAHONEY. I am not objecting to your stating it. I am talking about the implications.

Mr. POGUE. That is very easily explained. This paper would never have been written, so far as my opinions are concerned, they never would have been formulated had I not been invited by your committee to appear here. So that disposes of the coincidence.

Senator O'MAHONEY. I make no personal allusion at all, Mr. Pogue, and I assure you of it, nor do I attribute this to the committee; this hearing is being held because this precise subject has been discussed. You did not initiate it and we did not initiate it.

Mr. POGUE. I am trying to explain the coincidence.

In the first place, several witnesses mentioned this, and you can have 20 more, and you cannot escape it.

Senator O'MAHONEY. Of course. And may I say that I am very grateful to you personally for having come here, and I am going to read your paper with the greatest of care, and I know that I will profit by it.

Mr. POGUE. Thank you, sir.

Representative HUBER. I have one question, sir. What percentage of the petroleum production is sold to the United States Government?

Mr. POGUE. I ought to know that. I have the figures.

Representative HUBER. Perhaps you can make that available for the record at this point.

Mr. POGUE. I think it is around 5 percent, or maybe 8 percent, or somewhere in that neighborhood.

Senator FLANDERS. You can put that in the record when you get the figures.

Mr. POGUE. I think some of the companies testifying next week will give you that figure, but I will be glad to look it up and send it to you.

(The figure showing the percentage of the United States supply sold to the United States Government during the second half of 1948 is approximately 4 percent.)

Mr. POGUE. Mr. Chairman, I would like to insert into the record at this point a table of the growth of 30 oil companies classified by size groups, December 31, 1940, to December 31, 1947.

Senator FLANDERS. That will be made a part of the record at this point.

(The table is as follows:)

*Growth of 30 oil companies, classified by size groups, Dec. 31, 1940, to Dec. 31, 1947* [1]

| | Grouping based on net worth at Dec. 31, 1947 | | | |
|---|---|---|---|---|
| | Less than $100,000,000 each | $100,000,000 to $500,000,000 each | More than $500,000,000 each | Combined |
| Number of oil companies | 13 | 11 | 6 | 30 |
| Net worth: [2] | | | | |
| Dec. 31, 1940 ........ millions of dollars | 323 | 1,671 | 3,983 | 5,977 |
| Dec. 31, 1947 ........ do | 526 | 2,437 | 5,737 | 8,700 |
| Change 1947 from 1940 ........ percent | +62.8 | +45.9 | +44.0 | +45.6 |
| Borrowed and invested capital: [3] | | | | |
| Dec. 31, 1940 ........ millions of dollars | 377 | 2,018 | 4,874 | 7,269 |
| Dec. 31, 1947 ........ do | 569 | 2,911 | 7,011 | 10,491 |
| Change 1947 from 1940 ........ percent | +51.0 | +44.2 | +43.9 | +44.3 |
| Total assets: | | | | |
| Dec. 31, 1940 ........ millions of dollars | 404 | 2,238 | 5,590 | 8,232 |
| Dec. 31, 1947 ........ do | 670 | 3,491 | 8,480 | 12,641 |
| Change 1947 from 1940 ........ percent | +65.5 | +56.0 | +51.7 | +53.6 |
| Gross operating income: | | | | |
| 1940 ........ millions of dollars | 177 | 1,395 | 2,395 | 3,967 |
| 1947 ........ do | 525 | 3,368 | 6,441 | 10,334 |
| Change 1947 from 1940 ........ percent | +196.6 | +141.4 | +168.9 | +160.5 |
| Net income: | | | | |
| 1940 ........ millions of dollars | 20 | 87 | 270 | 377 |
| 1947 ........ do | 112 | 337 | 770 | 1,219 |
| Change 1947 from 1940 ........ percent | +463.2 | +285.9 | +185.3 | +223.2 |
| Preferred and common dividends: | | | | |
| 1940 ........ millions of dollars | 13 | 64 | 132 | 209 |
| 1947 ........ do | 35 | 119 | 271 | 425 |
| Change 1947 from 1940 ........ percent | +175.0 | +86.0 | +105.1 | +103.5 |
| Domestic net crude production: | | | | |
| 1940 ........ millions of barrels | 60 | 231 | 329 | 620 |
| 1947 ........ do | 100 | 358 | 537 | 995 |
| Change 1947 from 1940 ........ percent | +67.1 | +54.6 | +63.2 | +60.4 |

[1] By Joseph E. Pogue and Frederick G. Coqueron, the Chase National Bank, petroleum department, Nov. 18, 1948.
[2] Net worth includes preferred stock, common stock, and surplus.
[3] Borrowed and invested capital includes long-term debt, minority interests, and net worth.

Senator FLANDERS. Is that the end of the questioning? If so, I will make an announcement as to tomorrow's hearing.

We will convene here at 10 o'clock in the morning, and our witness will be Mr. Clarence Francis, president of the General Foods Corp., New York City.

Mr. POGUE. Mr. Chairman, may I express my appreciation to the committee.

Senator FLANDERS. I should also, sir, have expressed my appreciation to you, which I feel deeply.

Mr. POGUE. Thank you.

Senator FLANDERS. We will now recess until 10 o'clock tomorrow morning.

(Thereupon, at 4 p. m., a recess was taken until 10 a. m., Friday, December 10, 1948.)

# CORPORATE PROFITS

FRIDAY, DECEMBER 10, 1948

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the Caucus Room, Senate Office Building, Senator Ralph E. Flanders (chairman of the subcommittee) presiding.

Present: Senators Flanders and Watkins, and Representatives Herter, Patman, and Huber.

Senator FLANDERS. The committee will come to order.

This morning our only witness is Mr. Clarence Francis. Are you at present chairman or president of General Foods?

## STATEMENT OF CLARENCE FRANCIS, CHAIRMAN OF THE BOARD, GENERAL FOODS CORP. (ACCOMPANIED BY WAYNE C. MARKS, CONTROLLER OF THE GENERAL FOODS CORP.)

Mr. FRANCIS. Chairman, Mr. Chairman. A man without a future.

Senator FLANDERS. As chairman of the board, how do you spell the word "board"?

Representative PATMAN. He is like an ex-president, a man without a future.

Senator FLANDERS. That is right.

You may proceed, sir, with your testimony.

Mr. FRANCIS. The business of General Foods is to process and distribute food products to the consuming public. Our sources of supply are the four corners of the earth. Our principal customer is the American housewife. It will be our pleasure, upon request, to provide each of you with more detailed information about the operations and our branded products.

It is an honor as a citizen, and a responsibility as a businessman, to appear before you. Your inquiry into the nature, extent, and human consequences of an industrial system based on profit can be a monument for the world to see. It can be a token of the fact that democratic capitalism has the strength and vitality to turn its analytical facilities critically upon itself.

To the degree that you gentlemen demonstrate anew the interdependency of the forces at work in the American system of individuals and groups producing, bargaining, distributing, and above all sticking together, you will be carrying the flag for a system of human values against the reaction wherever it exists.

To the degree that General Foods, representing a small proportion of a great American industry, can contribute to your important deliberations, believe me we shall endeavor to do so. Let me say at the outset that we have nothing to conceal, nothing to withhold from you. In the event that any of your questions on the technical side of the business which I am about to discuss with you might lead to revelation of information which for purely competitive reasons we keep confidential, I shall ask in advance for the privilege of giving such information to you in private. As for our operating policies, it will be a pleasure to discuss them freely.

May I compliment the committee for providing us with a topical list of the categories in which you seek information. These remarks, which represent the point of view of General Foods, will fall into five major categories: I. Tabulation of company data; II. Special reserves; III. General Foods pricing policies; IV. Level of profits; V. Sources of capital.

The first question was: Relate profits to units of output, number of employees, net worth, invested capital, sales, and other reference points which you deem of significance.

May I suggest now, gentlemen, that at the back of those pamphlets, you will find 10 charts, which I am about to comment on. I think that it may be easy if you separate them and look at the charts as I go, rather than to check back and forth at them; but, of course, you can suit your own convenience.

You have before you schedule No. 1 on which we have shown the net profits of General Foods for the years 1938 through 1948. In order that we may be as cooperative as possible, we have for the first time in our business history publicly projected profits for a calendar year before that year is finished.

May I say parenthetically that a great deal can happen between now and the end of the year to disturb it, but this is our best guess of the close of the year. Figures shown for 1948 are actual for the first 9 months, but they do "guesstimate" for the final quarter of this year. Schedule No. 1 also shows the other items referred to in the question with the exception of relationship of profits to units of output. The percentage which each of these items bears to net profit appears on schedule 1. We would like to comment on the relative significance of each of these items.

1. Units of output: We were frankly unable to comply to your request to relate profits to units of output. There is no common standard whereby we may add up the unit output of all of our factories and use such a figure as basis for comparison with earnings. You can understand readily what I mean when I say that oysters are sold in either gallons or barrels, feed by the ton, our canned goods by the case in varying weights and sizes, our maple sirup by the bottle, and our other products in almost every imaginable kind of unit, in varying weights and sizes, some in retail sizes, some in wholesale and bulk. We trust that the committee will be tolerant of our inability to add all these things together so as to relate the unit to the profit.

2. Invested capital: We have included in schedule 1 the invested capital by years and have computed the ratio of profits to such invested capital. For your information the invested capital base has been determined under the provisions of the Internal Revenue Code

for consolidated excess profits tax purposes. On this basis our invested capital is $324,000,000.

On this Revenue Code basis we earned, as you will note from the chart, 5.6 percent on invested capital in 1940, 6.1 percent in 1947, and estimate our earnings to be 8.1 percent in 1948.

3. Net worth: Your committee has requested the relationship of profits to net worth. 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. Even so if you will refer to schedule 1 again you will find that the net-worth figures rise 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 in 1947, and on the basis of the current profit, estimates 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.

The figures for invested capital and net worth have been charted on schedule 2.

4. Sales: In the years 1938 to 1948, General Foods sales have grown from $126,000,000 to an estimated $466,000,000 in 1948. You will find this on exhibit 3. In the first 3 years of this decade, 1938, 1939, 1940, we earned 10 to 11 percent on net sales. But as you will note from exhibit 1 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 three prewar years.

5. Employees: On exhibit 1 we have also shown the computation of profit per employee. In the past 10 years this has varied between a high of about $1,500 in 1946 and a low of about $1,000 in 1945. I offer these figures with some misgivings, however, as our number of employees includes seasonal workers who vary greatly in number and I hesitate to compute an average wage in profit per employee on that basis.

It might be interesting for you, however, to look at page 1, the increase in the number of employees, and that may be significant.

Senator FLANDERS. What did you do, Mr. Francis, actually, with your seasonal employees in this total column? Did you include them on some basis or leave them out?

Mr. FRANCIS. Our comptroller is here, and he tells me that we left them out.

Senator FLANDERS. So that actually the figures should be lower, if you could find some way of taking those seasonal employees into account?

Mr. FRANCIS. That is correct; yes; and our seasonal employees would number approximately 5,000 to 7,000 or 8,000 for the seasonal operations.

In this same 10-year period the salaries and wages paid by General Foods have risen from $18,600,000 in 1938 to an estimated $56,700,000 in 1948. If you will refer to exhibit 4, you will see that for the years 1938 to 1948 salaries and wages have retained their historical relation to sales, while other items, such as profits and dividends, have been declining greatly.

Now, the next question was on the disposition of profit. If you will turn now to exhibit 5, you will see the chart which we have prepared showing the earnings retained in the business and the percentage which they represent of the net profit. In this chart the vertical columns represent the earnings retained in millions of dollars. The million graph is shown on the left-hand side. In 1938, those retained earnings were 2.5 million dollars, measuring the figures from the left-hand side of the scale. This represents about 20 percent of the total amount of earnings that year; percents may be read from the black line and in the right-hand scale. In 1946 General Foods had its biggest retention, 10 million dollars, except for the 1948 estimate, or about 48 percent of all net profits.

Senator FLANDERS. Your estimate for 1948 is higher yet, of course, and are you going to return at a later time to describe the reasons for these large retentions?

Mr. FRANCIS. Yes, sir.

Senator FLANDERS. That is good. I will not question you, now, then.

Mr. FRANCIS. Chart No. 6 shows the payments per common share over the 10-year period and what part of the profit was paid out in dividends. 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.

You will note that the payment at the end of 1947, or the current payment for 1948 is $2 a share, exactly the same as it was in 1938, and I have made no comment on the buying power of the dollar, but on that basis it would be about $1.16 on the 1930 to 1939 comparison.

Next, the disposition of retained earnings as between debt retirement and new investment.

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.

Fourth, for new investments give types of assets—working capital, inventories, cost-reducing plant and equipment, and net expansion of plants and equipment.

1. You see, gentlemen, we have taken you at your word. If you will turn to exhibit 7, you will see what funds were taken into the business during the past 10 years and what use was made of these funds. Our principal source of funds as you will note from exhibit 7 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; $70,000,000, by far the largest share of this new money, has gone into inventories.

That is on the right-hand side of the chart. 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 that figure has been increased by over $70,000,000 until on September 1, 1948, it represented $115,800,000. The increase has been fairly uniform, and for the years requested by the committee the figures are: 1940, 48.2 million; 1946, 94.7 million; 1947, 111 million; 1948, 115.8 million.

Senator FLANDERS. By the way, you may refer to it later, and if not, we will make a mental note, to see whether it is possible to divide up that increased use of capital and inventories as between expanded operations and increased prices.

Mr. FRANCIS. Well, we will try. I do not know whether we cover that or not.

Senator FLANDERS. By the way, your comptroller is entitled to sit there at your left hand or your right hand if you wish, so that you can refer to them quickly.

Mr. FRANCIS. To be perfectly frank, Senator, he is here to answer any questions which you may propound which we have not got here, and if we have not got them with us, he can get them for you. Thank you just the same, but I will yell for help if I have to have it.

Exhibit 8 shows the increase in inventories over these same years. You will note the 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. I could give many illustrations of that, I feel sure, but whether I can give them accurately or not is another question, that is, right to the penny.

Exhibit 9 shows 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 payments 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 expending volume. We think ours is only typical.

Exhibit 10 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. They are:

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.
And there are many minor items, of course.

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

Representative PATMAN. What was the approximate cost of these acquisitions?

Mr. FRANCIS. The sum total would came in our fixed assets primarily in this $30,000,000 that we are talking about.

Representative PATMAN. Is that on this chart 7 about plant equipment?

Mr. FRANCIS. I am told that it is $50,000,000. I had previously said that—that we have invested $50,000,000 since.

Representative PATMAN. In new plants?

Mr. FRANCIS. Yes.

Representative PATMAN. How long?

Mr. FRANCIS. In the past 4 years.

Representative PATMAN. In the past 4 years?

Mr. FRANCIS. Yes, having been unable to do anything before that.

Representative PATMAN. Could you have acquired those plants without retaining the earnings that you did?

Mr. FRANCIS. I do not know how.

Representative PATMAN. You could not have, could you?

Senator FLANDERS. Could you have gotten money in the capital markets?

Mr. FRANCIS. That is what I am hesitating about. I do not know that. I would not want to rely on that.

Representative PATMAN. But you did use the retained earnings for the purpose of acquiring these plants?

Mr. FRANCIS. By all means. That is where it went.

Representative HERTER. Not entirely. You issued that preferred stock; did you not?

Mr. FRANCIS. Yes.

Representative HERTER. And you likewise borrowed some money?

Mr. FRANCIS. Yes; but I thought that the Congressman's—Congressman Patman's—query was, What did we do with the retained earnings? We needed more than the retained earnings, as indicated in my previous testimony.

Representative PATMAN. The earnings, $50,000,000; they were retained over what period of time?

Mr. FRANCIS. Ten years, I would say. I have stated that.

Representative PATMAN. You have stated that in your written testimony, and the last 4 years only you have acquired plants because obviously you could not acquire them very well during war years, and the value of the acquired plants, the value is approximately $50,-

000,000, almost exactly the amount of your retained earnings for 10 years.

Mr. MARKS. In addition to the plants listed in the exhibit here, we have added much equipment and other facilities. These are just typical and represent some of the larger investments. The $50,000,000 figure does happen fairly to coincide, but I do not think anything can be drawn from that.

Representative PATMAN. You state it is a coincidence, but the amount of retained earnings is approximately the same amount as the value of the new plants that you have acquired.

Mr. FRANCIS. That is a mathematical thing, if those figures jibe, but I am not sure of your point.

Representative PATMAN. Well, my point is, Mr. Francis, that you have retained $50,000,000 in earnings that you did not pay out to stockholders.

Mr. FRANCIS. That is right.

Representative PATMAN. Over a period of 10 years.

Mr. FRANCIS. That is right.

Representative PATMAN. And during this period and just within the past 4 years of the 10 years, you have acquired $50,000,000 in new plants.

Mr. FRANCIS. That is right.

Representative PATMAN. That is right; is it not?

Mr. FRANCIS. That is approximately the figure; it happens to come that way.

Representative PATMAN. That is the information that I want. Thank you very kindly.

Mr. FRANCIS. Of course, you are quite conscious of the fact that if you get those plants you are going to require more money to operate them, for inventories and receivables and so on.

Representative PATMAN. That is the reason that you went into the market and obtained about $32,000,000 that way, and you issued preferred stock, and you obtained some of the money that way.

Mr. FRANCIS. That is right. Some of the moneys which are spent in plants are needed for operations.

Representative PATMAN. But you did retain $50,000,000 in earnings and you spent $50,000,000 for new plants?

Mr. FRANCIS. Yes, sir; but whether we spent the money for earnings in new plants or the money which we borrowed, I would not know.

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.

We have taken the liberty at this point of moving directly from the category entitled "Tabulation of Company Data" to the category of questions which you have entitled "Special Reserves."

II. Special reserves: Your first question follows: "Have you set aside any special allowances, over and above those permitted as cost 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?"

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 profit are the normal and approved reserves such as of depreciation, bad debt, and so forth.

This answers your second question, "Are any such items—nondeductible for tax purposes—taken into the cost as distributed through your cost accounting system?"

Since we have no such reserves, we have no answer to your third question in this category, "What do you intend to do with these special reserves if prices adjust permanently to lower levels?"

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.

III. Pricing policies: Your question is: "In the light of 1947 record profits, what pricing policy did you follow for 1948? Reduce, change, or hold them unchanged? Why?"

Our 1947 profits were by no means record profits. In fact they were $3,000,000 less than in 1946, despite larger sales in 1947 and the reduced income-tax liability during that same year.

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 in pricing has always been 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 in your questionnaire. Some 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.

Your committee asks: "How are prices fixed; what factors are taken into account; what officer or officers has specific responsibility for saying, 'This will be the price'?"

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.

Senator FLANDERS. By general managers, you mean by the heads of these specific product manufacturing groups?

Mr. FRANCIS. Our business is pretty well decentralized in different units with fairly complete authority to each of them to operate within the policies outlined.

Volume estimates are vitally important. An incorrect guess on volume has serious results. Pricing is not child's play. Let me assure you that an upward change in price is a serious matter to us and represents concentrated consideration of all the costs of doing business. Even after all this consideration is taken, we have got another boss who finally reviews the price policy and approves or disapproves it. That boss is your wife and mine, buying in a highly competitive market where pennies count.

In summary on this section, our pricing policy rests on building and sustaining a franchise and not merely on the profit which a given price is designed to produce in any given period.

Your next question was: "Discuss the factors outside your control which have influenced the profits in your company; e. g., 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 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 have 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.

Your next question is: "To what degree do you consider your own costs in fixing prices to meet competitive conditions?"

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.

I list these factors to give you a mild insight into the hullabaloo inside our own company upon increasing prices even though every index may point to such a need.

On the other side we have made some pretty serious mistakes in underestimating costs. We almost lost our shirts in one of our major items during 1947 when we misread the commodity market and offered our customers a major price reduction on the basis of an anticipated decline in the commodity price. Confession may be good for the soul, but I and all my associates wince a bit when we remember that one.

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.

Your next question is: "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 rate 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.

You will notice how I have been answering these questions on pricing policies in terms of our individual products or product lines. I do this because there is no general answer. I only wish I could take you gentlemen through one of our budget sessions in which you could get a glimpse of the complexity of this question of pricing.

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.

The most realistic answer I can give you to your question is, "I wish I knew."

Your next question: "Could you have charged more for your product and thereby realized greater total profit? If so, amplify."

We certainly could have charged more for some of our products and realized greater total profits. We could not 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.

Your next question was: "To what extent are your profit expectations responsible for increased profits?"

I am sorry, gentlemen, but none of us know the answer to that question because we do not know what the question means. I have tried to indicate that we price for a stable franchise, not for quarter-by-quarter or year-by-year profit. For instance, if we hope to maintain a modest per pound net profit on coffee and all of a sudden freight rates go up or green coffee beans rise a cent or there is another wage increase, we are likely sooner or later to react to those cost developments by raising the price of coffee.

Maybe our price rise will compensate for the higher costs, maybe not. Conditions will decide.

Again I can only say it is impossible to generalize.

IV. Level of profit: Your own introductory statement to this section illustrates the complexity of the problem you are attempting to analyze. "It is often charged," you say, "that profits are 'too high' and at other times and by other people that they are 'too low.'" 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.

First. 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 have got to furnish the same incentives as we must furnish to attract high caliber employees. We have 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.

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 have been built out of that share of the residual known as profit which has been retained in our business. We think that is an important function of profit.

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 is 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.

We think that the criteria just mentioned are what we would suggest to your committee as a fair approach for determining a proper and equitable level of profit. There is no formula we know of which can justifiably express adequacy of profit in static percentage figures.

In your second question, you ask if we would agree that profits are ever too high. If so, where or when should anything be done about such profits?

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." During one year cereals may be our best ball carrier doing especially well in profits. In another, coffee; in another year 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 this 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, Government, 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 sellers' 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 problems 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.

This is an attempt to answer a very thorny question. We think that the nation can be gratified at President Truman's evident intention to restrain Government expenditure within the limits of national safety. We are gratified at this policy because the welfare of the average American citizen can best be served by careful retreat from current high levels of Government expenditure.

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 or profits in any of our lines.

I have, almost with a blush, 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.

The next question is on the sources of capital. You ask the question, "Why have you not paid out a larger portion of earnings and raised equity funds by sales of stock? Would not equity funds be made more attractive and presumably more saleable if investors received a larger portion of earnings?"

The simplest answer, I suppose, is that capital raised by reinvesting earnings in the business is costless capital. 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 $25,000,00 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 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.

B. Your next question is: "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 do not 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.

C. 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 from 1948 has been between 96 and 87¾.

Conclusion: You have been extremely patient in listening to this complicated story. Our problems in one sense are only multiplied versions of identical problems which are faced by the small-business man, the farmer, the cattle rancher and the whole working population of America. In another sense it is a smaller version of the problems of companies which are many times larger than we are. Our conviction which we leave in your hands is this: our common cause is the vitality of all economic and social groups and of all the men and women who make them up. We in our business feel most keenly the need for balance in administering our three-way responsibility to the American consumer, to our associates in this business, and to the 68,000 men and women whose faith has been shown by their investment in General Foods.

We who are charged with administering this company would serve its interests badly by shifting the fruits of the enterprise too heavily towards any one of these groups. Similarly, in the larger area all of us as American citizens have a responsibility to avoid any possible punitive approach toward any single group and to work cooperatively for the good of the whole.

Please call on us whenever and wherever we can contribute toward your efforts in that direction.

I would like to have these charts to which I have referred made a part of the record.

Senator FLANDERS. That will be done.

(The charts are as follows:)

CHART 1

*Net profit relationships, General Foods Corp.*

| Year | Profits (millions of dollars) | Invested capital: Millions of dollars | Invested capital: Net profits | Net worth: Millions of dollars | Net worth: Net profits | Net sales: Millions of dollars | Net sales: Net profits | Number of employees | Profits per employee |
|---|---|---|---|---|---|---|---|---|---|
| | | | *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.

CHART 2

PROFIT RATIOS

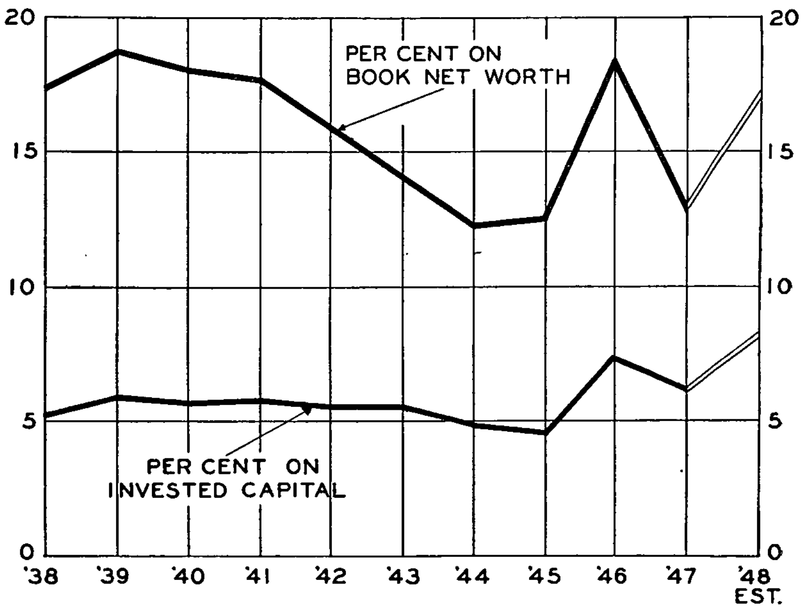


Chart 3

SALES GROWTH

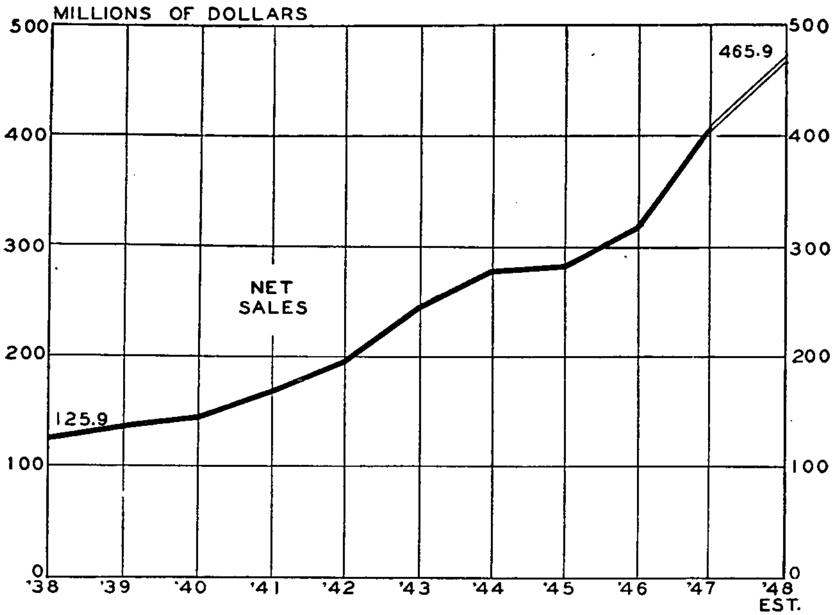



Chart 4

SALARIES & WAGES

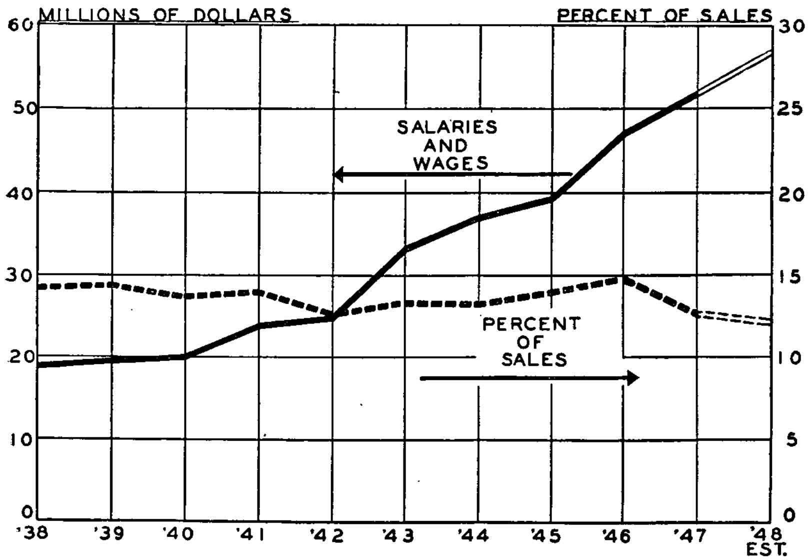


CHART 5

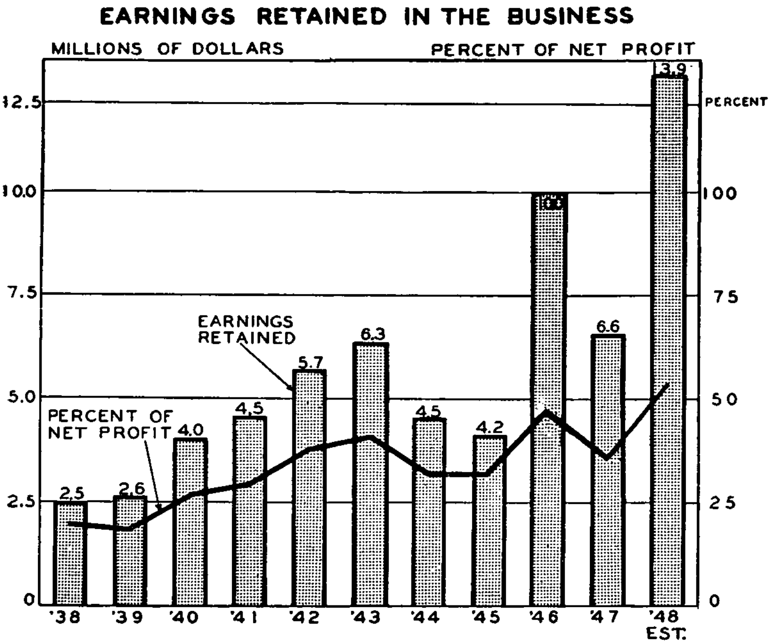



CHART 6

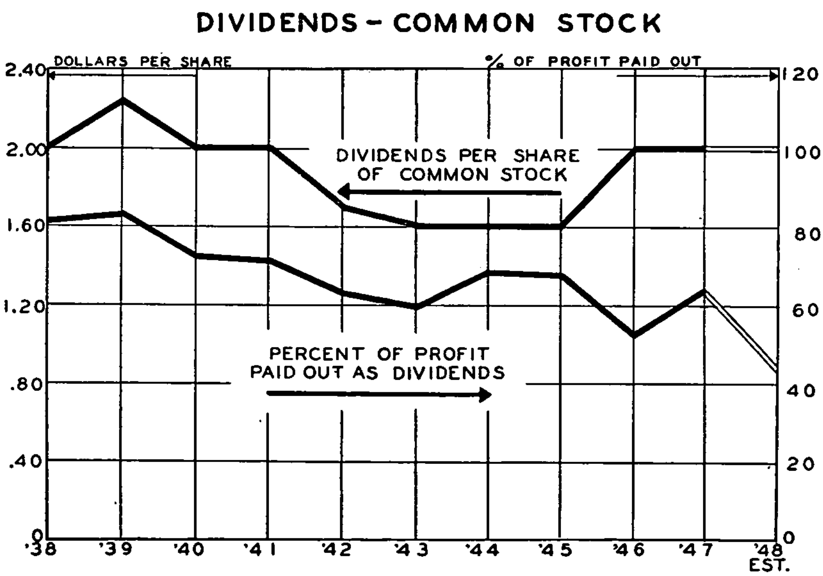


CHART 7

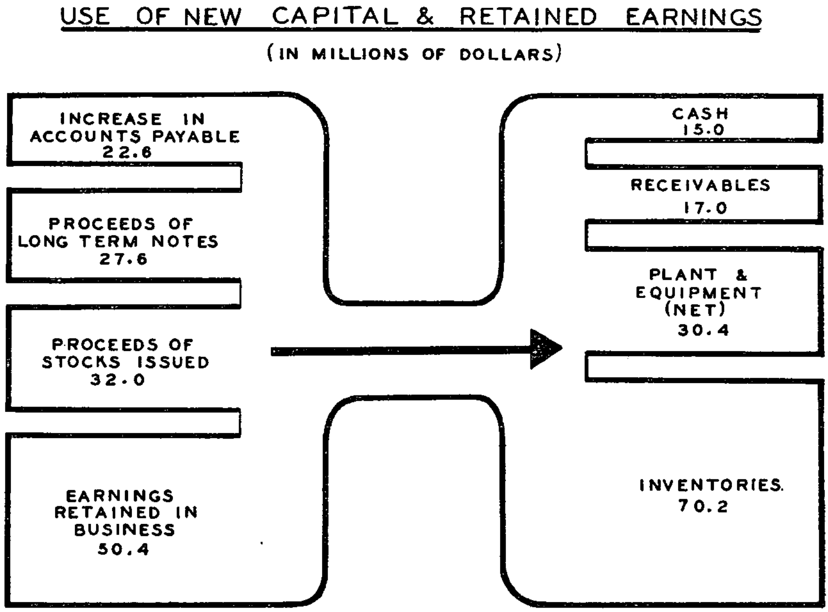



CHART 8

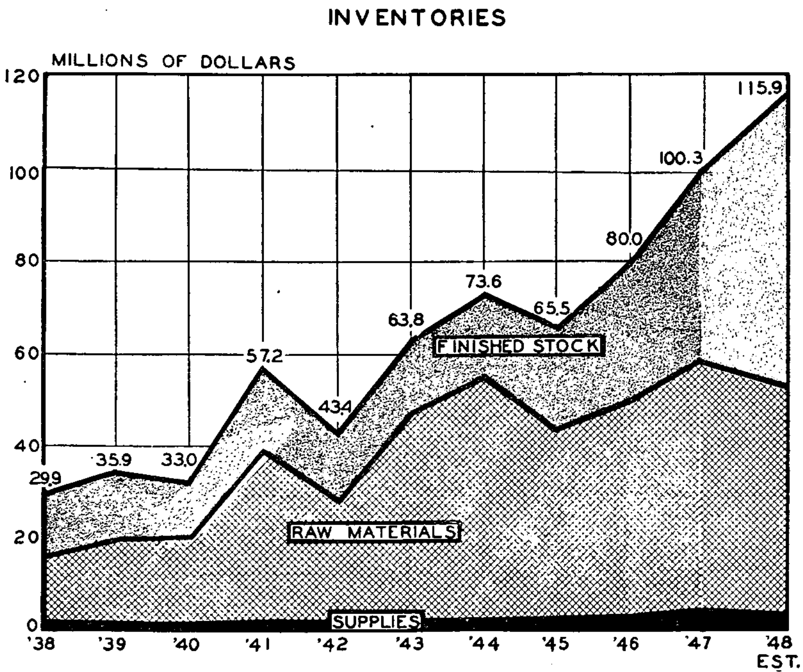


CHART 9

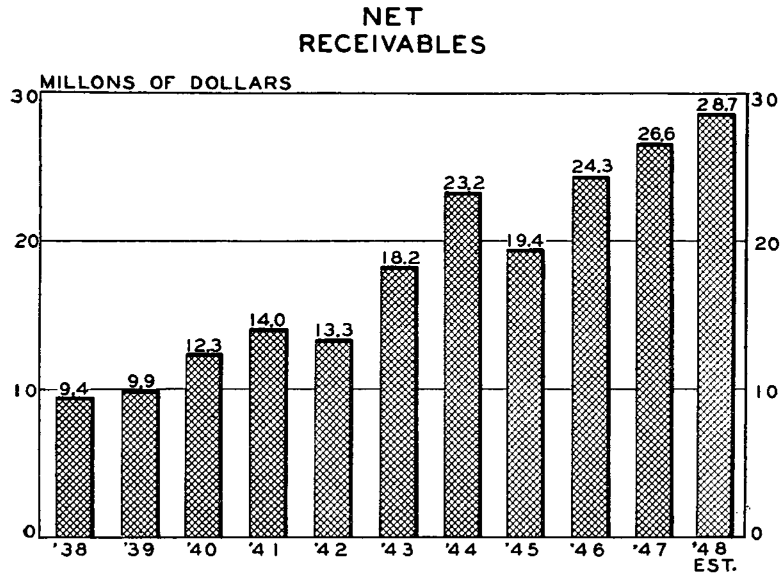
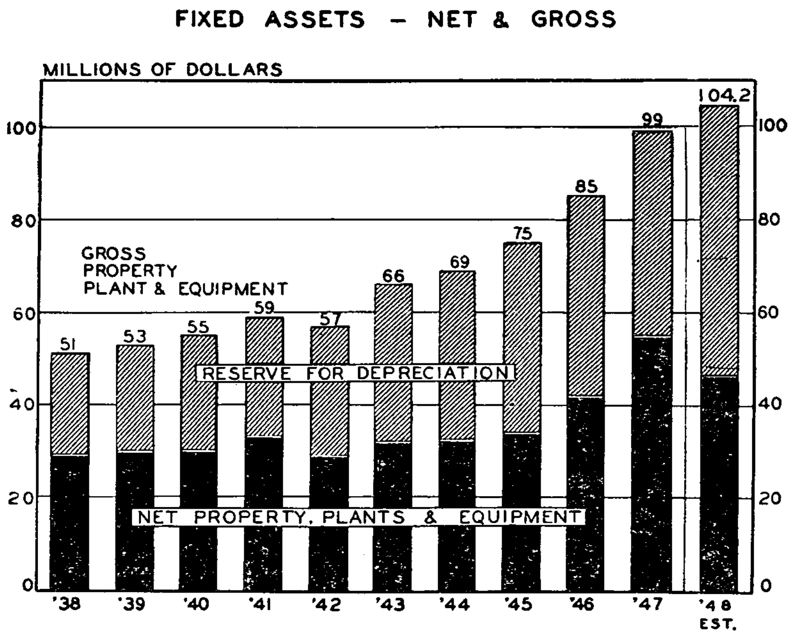



CHART 10



Senator FLANDERS. Thank you, Mr. Francis. Now we will ask you some questions.

One question which interested me, and which I was prepared to ask, you have in a measure answered. It is a question that has been in the minds, I think, of all of the members of this committee—that is the desirability of expanding from retained earnings versus the sale of equities on the market.

As I understand you, what you say about that is that the market is such that equity money is obtained at too high a cost.

The suggestion has been made by some of the witnesses who have appeared before us that if a larger proportion of earnings by industry as a whole had been paid out in dividends, the whole structure of the stock market would have been more healthy and equity money could have been obtained at a less cost.

Have you any thoughts to offer us on that general situation; and will you also, if you can, in answering that, give your own view as to what it is that makes the equity market so expensive a means of obtaining capital as the present stock prices indicate?

Mr. FRANCIS. Let me say at the start that my opinion of the procedure which you outline, of paying out all dividends to stockholders and relying on the equity market to finance operations, is quite different from the favorable one given by others.

Senator FLANDERS. The fact is that equity money comes high, and that is a fact, 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. The question which I am asking perhaps relates to the general health of the equity market, which perhaps results from this tendency to plow in capital rather than seeking new.

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 sidestepping 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.

But I do not know, really. Maybe we should have a poll, if we haven't completely lost faith in them.

Senator FLANDERS. You have no general observations to offer on the bad state of the equity market?

Mr. FRANCIS. No, sir; I just hope we do not have to go into it at this time.

Senator FLANDERS. You see it clearly from the standpoint of your own business, but general observations are, you feel, a little bit outside your line?

Mr. FRANCIS. I should prefer not to speculate, because it would be speculation, and I am afraid my opinion would not be worth much.

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 think that we are sir, but go ahead.

Senator FLANDERS. I think perhaps I have stated the point.

Mr. FRANCIS. I think that I get the point, Mr. Senator. 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. Our operations here are two companies, each with a certain amount of assets and stock, and the stock was 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.

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. 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." Please do not ask me to particularize on it.

Senator FLANDERS. There have been some distress acquisitions from your standpoint?

Mr. FRANCIS. Yes, sir.

Senator FLANDERS. All right. Can you give us any idea as to what proportion of the food industry your company represents?

Mr. FRANCIS. I indicated 2 percent of the food processing industry.

Senator FLANDERS. About 2 percent of the food processing industry?

Mr. FRANCIS. That is the best estimate that we can give.

Senator FLANDERS. You do not think, 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. That is 2 percent of the food processing industry, and that is a portion of the total.

Senator FLANDERS. But you do reckon that 2 percent on the sales of the food processing industry?

Mr. FRANCIS. Yes, sir.

Senator FLANDERS. One of the points which has been made by the economists and the accountants who have appeared before us has been that something ought to be done, either in the way of changed practices in accounting as indicated by some of our witnesses, or from the standpoint of footnotes in annual statements, to indicate that a part of the earnings are unavailable for distribution in any way, whether in lower prices, higher wages or in any other form, or to stockholders or otherwise.

I note in your testimony you seem to take inventory price increases and the provision of funds for replacement more or less in your stride. You do not seem to have expressed any concern over the necessity that you are under for sterilizing, in a sense, certain of your profits to meet these two considerations.

Do you make any note of that fact in your annual reports, or do you feel that you need to?

Mr. FRANCIS. We make definite notes. I believe that we reveal every action of that sort in our annual reports; and of course, I would be glad to submit reports to you. We have, over the past 4 or 5 years, indicated the necessity for reserves against possible risks of inventory, to the amount of $10,000,000.

Mr. MARKS. That is for about 7 years.

Mr. FRANCIS. The $10,000,000 has been indicated and clearly earmarked as reserves for that particular purpose. But that is really adding it to surplus. It is merely saying to the stockholders, "Listen, we think that we had better conserve this in your own welfare."

Senator FLANDERS. Do you have any criticism of the Department of Internal Revenue for taxing those funds that you have to put into that reserve? You probably would accept any reduction in taxes with pleasure.

Mr. FRANCIS. We would welcome a consideration of it, of course.

Senator FLANDERS. Now, on the bottom of page 22, you apparently gave some indication 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—about 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 that because of the great supply that we have had of grains, that 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. Well, we got the picture yesterday of at least a stabilization and possibly a slight lowering of prices in petroleum products. Here today, 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.

Senator FLANDERS. Thank you.

Senator Watkins, do you have any questions?

Senator WATKINS. I am interested in your statement on dividends. Would you mind pointing out just what the situation is with respect to dividends in your company?

Mr. FRANCIS. May I ask you in just what regard, sir?

Senator WATKINS. I wanted to see if I understand this chart. I am looking at the exhibits attached, on the table.

Mr. FRANCIS. This chart indicates that in 1938 our earnings per share were $2; that is the dividends per share, rather. It indicates that in 1943 and 1944 we dropped to $1.60, and we are today back to $2.

Senator WATKINS. Now, what rate is that on the value of the stock, the market value of the stock at the time the dividend was declared?

Mr. FRANCIS. I do not know. The price today is about $40, so that would be relatively 5 percent on the basis of today's market.

Senator FLANDERS. What is the par value of the stock?

Mr. FRANCIS. It is no-par-value stock.

Senator FLANDERS. It is a no-par stock?

Mr. FRANCIS. Yes. I am having my comptroller check me on these figures.

Senator WATKINS. I note the statements have been made from time to time that the stockholders only get a small part of the profits in dividends; that the balance of the profit made by the corporation or the business is plowed back into the business.

Well, now, what happens to the value of the stock of these stockholders when you plow back 60 percent of your profits in any one year into the business? Does it go up or down?

Mr. FRANCIS. The value goes up.

Senator WATKINS. How much? Take it on your stock, for instance.

Mr. FRANCIS. Are you asking me for a reflection in the stock market? I am sorry, sir, I know nothing whatever about it. I have never seen a figure, and I hope we never get one.

Senator FLANDERS. Your only interest in the price of your stock lies——

Mr. FRANCIS. I am interested only in a sound merchandising procedure, and the cards will have to fall where they may in that regard.

Senator WATKINS. We are trying to get some information about the dividends paid to stockholders, and I am interested in that question. And you say that you pay $2 per year, and you are back to the point where you were in 1938, and I am trying to find out if the plowing back of 60 percent of your profits made by your corporation in 1947, for instance, has increased the value of the stockholders' stock and, if so, how much, in your judgment.

Mr. FRANCIS. Well, generally speaking, it has increased the value of their security. It has given a safety factor to them.

Senator WATKINS. More than a safety factor, has it not actually made an increase in the marketable factor?

Mr. FRANCIS. I like to think so.

Putting it another way, if our stock is selling at $40, I cannot conceive, if we had added nothing to it back then, it would today be selling at $40 a share. Now, where it would be selling, I do not know.

Senator WATKINS. As a matter of fact, you built some new plants and expanded your business, and that expansion increased the value of the stock because that was taken out of the profits?

Mr. FRANCIS. It increased the value.

Now, I differentiate between that and a stock-market price. It increased the value.

Senator WATKINS. Let us talk about the value, and forget the stock market for a while. But it would be reflected to some extent in the stock market; as a businessman you would know that. If you put in, perhaps, $50,000,000 into new plants for the company, it certainly would be worth more money after that.

Mr. FRANCIS. That is increased value.

Senator WATKINS. And the stockholder would be getting that increased value of the stock which in effect, if not in the legal definition, would be a dividend.

Mr. FRANCIS. Getting it how, sir?

Senator WATKINS. The stock that he owned would be increasing in value, every share would be worth more money.

Mr. FRANCIS. The value would be back of the stock, that is true.

Senator WATKINS. For instance, if your corporation was dissolved at that particular moment, he would share in whatever it owned at that time, and his share would be much larger than it was before you made any profit.

Mr. FRANCIS. That is true.

Senator WATKINS. That is what I am trying to bring out, that what is paid to the stockholders by way of dividends, a formal dividend, is not the only value that he gets out of the profits. He actually gets the increase in value of the stock or what is represented by the stock, the holdings of the corporation itself.

Mr. FRANCIS. The stock which the person holds may have more value. Whether he gets it or not, and the form in which he gets it at all, are points on which I am not so sure.

Senator WATKINS. It would be exactly the same on a farm. The farmer makes $10,000 profit, and he goes out and puts up a new dairy barn, and his farm is worth $10,000 more than it was before; and if you put $50,000,000 back, of your profits, into the business, you have increased the worth of that property $50,000,000, if you have not wasted your money in doing it.

Mr. FRANCIS. I am not so sure.

Senator FLANDERS. That is an interesting subject, because it is my impression that in 1929 the present equity and the hope for future equities in stock were reflected or overreflected in the price of stock. At the present time there is some question as to whether these increased values that Senator Watkins is referring to are reflected in the price of stock on the market, and the reason why they are not is something that is of interest to me. But I take it from what you have been saying that you have no particular light to throw on that particular subject.

Mr. FRANCIS. Not on stock-market values, sir.

Senator FLANDERS. The price probably is at least adequately supported by the value of the equities in your company.

Mr. FRANCIS. I should think so.

Senator WATKINS. I would like to pursue this subject just a little further. How much money have you put into new plants out of profits this year?

Mr. FRANCIS. I gave that specifically.

Senator WATKINS. I will take 1947, where you have your figures complete, probably.

Mr. FRANCIS. $9,000,000 this year, and it would be about $18,000,000 last year. We have given them for the 10 years, but by years it would be just about that figure.

Senator WATKINS. That has come out of earnings?

Mr. FRANCIS. No; a combination of earnings and equity capital acquired.

Senator WATKINS. Have you had any equity capital or have you gotten into your business any equity capital in this year?

Mr. FRANCIS. In 1947.

Senator WATKINS. Well take this year, and get free and clear of the equity capital.

Mr. FRANCIS. We did some last year, but I think we put a little in the sock.

Senator WATKINS. How much have you put into new plants this years out of earnings?

Mr. FRANCIS. I would say the whole business.

Senator WATKINS. Was that $9,000,000?

Mr. FRANCIS. Yes.

Senator WATKINS. $9,000,000 this year?

Mr. FRANCIS. Yes.

Senator WATKINS. Your property is worth $9,000,000 more than it was before you turned those profits into plant extensions?

Mr. FRANCIS. That is right.

Senator WATKINS. I am interested also in how you figure your profits. I have read in the newspapers—I apologize for not being present, Senator and Mr. Chairman—as I came across the country, about the difference in the way they figure profits.

Your profits, as I understand you, are figured on the sales dollar. You say you made 6 percent for 1947.

Mr. FRANCIS. We have given every method right in these charts. If you will look at chart 1, we have the profits on invested capital, on net worth, on net sales, and profits per employee.

Senator WATKINS. I note that the one on the sales dollars, you say 6 percent; you take 6 cents out of every dollar of sales as a profit.

Mr. FRANCIS. That is right.

Senator WATKINS. And of course, if you turn that same money, that you had invested in the business, over, say, 25 or 30 times in a month, that profit on the sales dollar would be whatever the number of times multiplied times the percent.

Mr. FRANCIS. Is that right mathematically?

Senator WATKINS. If your turned it over, let us say, 10 times, 10 times 6 would be 60 cents.

Mr. FRANCIS. On the basis of an inventory turn-over of three times a year, it runs into this 5.6.

Senator WATKINS. It does not occur on every sale that you make?

Mr. FRANCIS. On the over-all business. In other words, if you take $465,000,000 worth of business we did this year, and divide it by the $26,000,000 net profit, you will find that we made 5.6 percent.

Senator WATKINS. On the total sales; and the money you actually have in the business making those sales was not the total of the sales, but was a far smaller sum, much smaller sum?

Mr. FRANCIS. On the net worth of the business, which I think is what you mean—do you want the invested capital?

Senator WATKINS. The amount of capital you actually use in the making of that amount of sales.

Mr. FRANCIS. Yes; I think that that is right. Are you talking money or are you talking net worth?

Senator WATKINS. I am not talking net worth. I am talking about the money you actually use in your business, whether it is net worth or borrowed money.

Mr. FRANCIS. I do not know whether that is more than a partial answer, but we have $115,000,000 in inventory, and you have to have a lot of working capital.

Senator WATKINS. Maybe I can explain what I am trying to get at. It has been said that actually in the operation of a food business, the money is turned over so many times that you need but very little capital to operate it, and you could make a good showing on the sales dollar profits, say 6 percent in your case, but actually on the money that they use it is many times larger than the 6 cents.

Mr. FRANCIS. Senator, we have tried to give all of the answers to it from all angles here. We have given it on invested capital, net worth, net sales, right in that chart there.

Senator WATKINS. I apologize. I have not been through your charts.

Mr. FRANCIS. Regardless of how we are doing it, this is the result.

Senator WATKINS. What is your explanation, is that true or is it not true that the money is turned over and you figure it on the total amount of sales for the year, but the actual money used in making that sale is only a fraction of the total sales that are handled during the year; so that your figure is on sales, but actually on the amount of cash used it would be much larger?

Mr. FRANCIS. I do not think that there is any question about it. It has to be larger. But that is not giving the whole picture.

Senator FLANDERS. I wonder if at this point we might get a definition of the distinction in these first two columns, the second and third column, of the difference between invested capital and net worth?

Senator WATKINS. I am not so much interested in that at the moment. I tried to illustrate what I have in mind. I talked to a groceryman who said in his business he only had about $5,000 on his counters, and that was all he actually used in the operation of that business, but his sales ran to many, many times the amount of cash that he actually had there. And his earnings were on the total sales that he made and not on the amount of cash that he had invested. And he paid himself a salary and he paid all of the expenses, and yet he had a net. So on the mony actually being used, instead of it being 6 percent it was probably more like 40 or 50 percent.

Senator FLANDERS. I would expect in one or the other of these two columns, we would find the equivalent of that grocer's $5,000 of money used in the business.

Mr. FRANCIS. You are talking about a distributor and not a processor.

Senator WATKINS. You are not a distributor?

Mr. FRANCIS. No, we are processors.

Senator WATKINS. You said the housewives were your customers, and I thought that you must be a distributor.

Mr. FRANCIS. They are.

Senator WATKINS. Somebody else does the distributing?

Mr. FRANCIS. We sell only to wholesale grocers or chains.

Seantor WATKINS. As I read your statement in a hurry, you counted the housewife as your customer, and I naturally concluded you were in the retail business.

Mr. FRANCIS. No, sir. I am sorry.

Senator WATKINS. What I have been saying, then, would apply to a retail business.

Mr. FRANCIS. And if they don't get a turn-over of 12 or 13 or 14 times a year, I think that they would have great difficulty in this competitive field.

Senator WATKINS. I happen to know that groceryman, who made about 18 turn-overs in a year on $5,000.

Mr. FRANCIS. Those figures are published for the corporately owned chains, and the actual turn-over is a matter of record.

Senator WATKINS. We never could get from the chain itself how much it made on the money it used.

Mr. FRANCIS. They have got it.

Senator WATKINS. They did not want to report to the committee that was investigating this very problem, and they said that they were in court and did not want to report.

I can understand now, if you are only a processor, that is probably true. But still, you turn over your money rather frequently there.

Mr. FRANCIS. We turn our inventory over three times a year.

Senator WATKINS. That is different from some grocerymen. One admitted that he turned it over 30 times in a month, and I thought it was pretty fast, but he said that is what he did.

Mr. FRANCIS. We have got much more money involved in the business other than just the inventory.

Senator WATKINS. He did not seem to have, and he gave us the total assets and everything that he invested, and he started from nothing, and in a few years he was worth $300,000, but he only made 6 percent during all of that time.

The average person who has to buy over the grocer's counter and the meat counter is interested in what they have to pay, and if what this groceryman told me is the case, somebody is making extraordinary profits on the actual money that he is using in the business. If you turn it over that many times and make 6 cents on it every time you turn it over, that is a large profit.

Mr. FRANCIS. If there is anything in this country more competitive than the food distribution business I wish that you would tell me what it is—and you have got to be alert to make a living.

Senator WATKINS. On a seller's market that does not make a lot of difference, because no matter what you have and how many competitors you have, it all goes.

Mr. FRANCIS. That is a different thing.

Senator WATKINS. You admit that that is different?

Mr. FRANCIS. That is right.

Senator WATKINS. That is the market that we have had, and that is the market that we are talking about now, is it not, and that is the one that we are trying to correct, if possible, for the benefit of the consumer?

Mr. FRANCIS. That is right.

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 maintain 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, 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 financiang be a very serious problem at the present moment?

Mr. FRANCIS. I think we would be in a very serious position, not only domestically but in our world position.

Representative HERTER. If artificially, 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.

Representative HERTER. You have not by any chance given any thought to the effect on our tax revenues of the distribution of a larger part of your retained profits to stockholders or to labor, through the increased taxes that would come from individual income taxes?

Mr. FRANCIS. I have not made any such computation.

Representative HERTER. That is all.

Representative HUBER. Mr. Francis, do you sell foods directly to the Government?

Mr. FRANCIS. Yes; we do.

Representative HUBER. What percentage of your output is sold to Government agencies?

Mr. FRANCIS. I would say it would be a small fraction of 1 percent.

Representative HUBER. Will you put the definite fraction in the record at this point, whatever it may be?

Mr. FRANCIS. We will have to get it.

Representative HUBER. That is what I mean. Can you obtain that?

Mr. FRANCIS. We will be glad to.

The figure referred to is as follows: In 1947 approximately six-tenths of one per cent of our total sales were made to the Government.

Representative HUBER. You state on page 5 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 three prewar years."

Now, you also state on page 4 that "we earned 5.6 percent on invested capital in 1940, 6.1 percent in 1947, and estimate our earnings to be 8.1 percent in 1948."

In other words, although profits as a percent of sales decline, yet profits as a return on invested capital have increased?

Mr. FRANCIS. Yes.

Representative HUBER. Now, my question is: Do you think the above figures show a more favorable or a less favorable profit position?

Mr. FRANCIS. You are asking me whether I think our profit position in 1948 is more favorable than it was in 1947?

Representative HUBER. That is right.

Mr. FRANCIS. I do, yes, sir.

Representative HUBER. And you do not feel that there is any excessive profit being earned by your company?

Mr. FRANCIS. No, sir.

Representative HUBER. That is all.

Senator FLANDERS. If there are no other questions, Mr. Francis, we will excuse you. We thank you for the very frank presentation you have made, and personally I take some comfort from your expectation that food prices will not rise further, in view of the conditions at present discernible.

Mr. FRANCIS. You probably know as much about the demand on the food, or more than I do, and I am saying what I know about it at the present.

Thank you very much, gentlemen.

Senator FLANDERS. Our next hearing will not be until Wednesday, December 15, in this room. We expect to have appear before us at that time Mr. Vance, chairman of the board and president of the Studebaker Corp.; and Mr. Dunlop, president of the Sun Oil Co.; and Mr. Holman, president of the Standard Oil Co. of New Jersey.

(Thereupon, at 11:45 a. m., a recess was taken until 10 a. m., Wednesday, December 15, 1948.)

# CORPORATE PROFITS

**WEDNESDAY, DECEMBER 15, 1948**

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders, chairman of the subcommittee, presiding.

Present: Senators Flanders (presiding), Watkins, and O'Mahoney, and Representatives Wolcott and Herter.

Senator FLANDERS. We are a little past the hour, and while I am the only member of the committee here, the record will be available to all of the members, and I think that we had better open the hearing.

I wish first to have put into the record a staff memorandum of the Joint Committee on the Economic Report on the subject of corporate profits and their measurement. On this manuscript is a sticker, which I will read:

This report has been prepared for the committee's review and information. It does not necessarily represent the views of the committee either individually or as a committee.

This document will be available at the office of the committee.

(The staff memorandum referred to is as follows:)

## 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.

[1] This report has been prepared for the committee's review and information. 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.

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 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.

---

[3] Committee on accounting procedure, American Institute of Accountants, Bull. No. 33, Depreciation and High Costs, December 1947.

[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.

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 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]

---

[7] United States Steel Corp., annual report, year ended December 31, 1947.
[8] Chrysler Corp. annual report, year ended December 31, 1947.
[9] National City Bank Monthly Letter, March 1948; April 1948.

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.

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 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] In current dollars | Corporate profits after taxes[2] In 1935–39 dollars | Per capita disposable personal income | Per capita corporate profits after taxes | Ratio profits to disposable personal income 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 indices 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 indices 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 |

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 suc-

[10] Frederick C. Mills, the Structure of Postwar Prices, National Bureau of Economic Research Occasional Paper 27, July 1948.

ceeding 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.

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.

[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.

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.

(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.

[12] Federal Trade Commission, Report on Rates of Return (After Taxes) in Selected Industries, for the years 1940 and 1947, August 16, 1948.

"Net worth, as recorded on 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:

"* * * 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 books 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 exhorbitant 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.

[13] Investigation of Concentration of Economic Power, Monograph No. 12, Profits, Productive Activities, and New Investment, pp. 17 and 25.

[14] Hardy, Charles O., Wages, Profits, and the American Standard of Living. The Chicago Association of Commerce and Industry, April 1947.

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; idem, July 1948.
2 Securities and Exchange Commission, survey of American listed corporations.
3 National City Bank letter, April 1948.
4 Not available.

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.

15 Psychological Corporation Survey, reported in Commercial and Financial Chronicle, July 8, 1948

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: Amount | Corporate profits: Before taxes: Ratio to national income | Corporate profits: After taxes: Amount | Corporate profits: After taxes: 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 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 3 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.

Senator FLANDERS. Mr. Huber, one of the members of our committee, has asked to have put into the record an editorial from the Christian Science Monitor of Monday, December 13. It is entitled, "Toward an Excess Profits Tax," and without reading it we will ask to have that put into the record.

(The editorial referred to is as follows:)

TOWARD AN EXCESS PROFITS TAX

One of the keener struggles in the new session of Congress is going to center on proposals for an excess profits tax. Two major impulsions are putting steam behind the demand for such a tax. One is the general complaint over high prices. The other is an acute need for revenue.

The first kind of pressure is most actively expressed in the hearings of the Flanders subcommittee of the Joint Committee on Economic Report.

Stanley H. Ruttenberg, speaking for the CIO, told the committee that many industries are inviting a depression by "making as much as they can while the making is good." This is notably similar to a statement made by Senator Taft a few months ago:

"If extra funds are available, it is far better from an economic standpoint for corporations to reduce prices rather than increase wages or dividends further."

This is a sound argument. Some companies are consciously "putting on fat" so they can withstand lean times. Whole industries are cutting production rather than prices. In certain cases special circumstances may seem to leave no other recourse. But as a rule this is the way to bring on the very depression which they seek to guard against. Insofar as excess profits taxes discouraged such practices, they would have much justification.

But is this a fair picture of American business as a whole? One witness before the Flanders committee contended that the common stockholder is so far from getting too large a share of present prosperity that he might be called the forgotten man of the era. Figures on profits, wages, and dividends appear to bear out this view. Profits for American corporations are running today at a rate of more than $20,000,000,000 a year. This is three times the 1940 level. Wages and salaries are currently piling up at roughly $130,000,000,000 a year, three times the 1940 amount. Dividends are estimated at only $7,000,000,000, or less than double 1940.

But there is disagreement even as to the figures on profits. Sumner Slichter, respected Harvard economist, told the committee that corporations are mistakenly figuring as profits the increased costs of inventory. He cuts the figures nearly in half. Others have pointed out that 1948 dollars will buy only 50 to 60 percent as much in raw materials or labor or equipment as 1940 dollars, so that comparisons are deceiving. Spokesmen for business also argue that one reason more dividends are not paid is that companies are having trouble getting investment capital, and have to sow profits back into plant.

This last argument is particularly pertinent for small firms. But the need for maintaining a flow of investment capital for all business is a crucial factor in this whole question. The surest road to socialism is through creating conditions in which citizens will not risk their money in new enterprises.

Some thoughtful observers believe the United States has come dangerously close to such a situation. Certainly those who would impose an excess-profits tax should look twice at this danger in any attempt to say what prices are too high. Yet, really excessive profits are themselves destructive of the capitalist system, and reasonable tests can be applied.

Many businessmen will prefer this form of tax to a straight increase in the levy on corporations. An excess-profits tax, by its very name, appears fairer. In any case we are likely to see continuing public interest in and scrutiny of profits. Along with such information as the Flanders committee is digging out we need more knowledge of probable effects of an excess-profits tax. Experience indicates that it is more apt to succeed in producing revenue than in markedly restraining prices. The wartime tax brought in $11,000,000,000 in 1945. But where experts disagree so sharply wise men will not rush in.

Senator FLANDERS. Our first witness this morning is Mr. Harold S. Vance, chairman of the Studebaker Corp. He has been with the Studebaker Corp. since 1911, and should have some experience with the vicissitudes of automobile manufacture. In fact, we are particularly pleased that he is here, because we will be able to get, I am sure, from Mr. Vance, a clear picture of the problems of the so-called independents to lay alongside later testimony with regard to one of the very large operators in the automotive industry.

Mr. Vance, you can, in regular form, identify yourself for the record, and then proceed with your testimony. May I ask if you have written testimony?

Mr. VANCE. Yes, sir; I have a statement which I would like to read.

Senator FLANDERS. You may proceed.

## STATEMENT OF H. S. VANCE, CHAIRMAN AND PRESIDENT, THE STUDEBAKER CORP., SOUTH BEND, IND.

Mr. VANCE. Gentlemen, for the record, my name is H. S. Vance. I am chairman of the board and president of the Studebaker Corp. I have been invited by your committee to present the viewpoint of Studebaker on the subject of business profits. I propose to confine myself to that. Your committee has heard expert testimony from economists on the question of whether corporate profits generally are too high. I am not prepared to testify on this broad question any more than I am on the needs of the Government for additional revenue through corporation taxes. I am prepared to answer questions regarding Studebaker's profits. I should like first, however, with the committee's permission, to read a statement on the subject.

First, I should like to point out that Studebaker is a small company in a big industry. I need only to mention the names of our three principal competitors—General Motors, Ford, and Chrysler—to give you a proper perspective of the quality of our competition and of the reason why I say that ours is a small company in its field.

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.

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.

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 in the business. As our business expanded, however, our working capital needs increased. Consequently we borrowed a total of approximately $18,000,000.

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 postwar period would have been greatly curtailed, if not made impossible, under either of these excess-profits-tax plans.

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 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.

Now, I should like to discuss profits. In 1940, on sales of $84,164,000, we made a net profit after taxes of $2,125,000. The ratio of net profit to sales in that year was 2.5 percent. In the first 9 months of 1948, 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 sacrificed 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 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, amost 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 | 7,788 | 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.

Now I should like to talk about prices. 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.

In conclusion let me say that 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.

Senator FLANDERS. Mr. Vance, you have this accounting data. Do you want to go over it and point out what seem to be to you the specific points of interest in it? Or perhaps you have already covered them in your text.

Mr. VANCE. I have to some extent. Perhaps there are some questions that you would like to have me answer.

(The accounting data referred to are as follows:)

*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 | . 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 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.

*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 |
| Total | 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 | 1 (531, 989) | 1 (4, 485, 436) | 1 5, 921, 851 | 1 8, 027, 648 |
| Other | (167, 332) | 45, 886 | (107, 047) | |
| Total | 1, 488, 744 | 3, 771, 807 | 6. 861, 498 | 14, 069, 636 |

1 Includes increase in inventory—net: 1940, $906,803; 1946, $7,386,926; 1947, $10,629,103; Jan. 1 to Sept. 30, 1948, $6,699,801.

NOTE.—() indicate red figures.

*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 | Studebaker factory sales | Percent of Studebaker factory sales to total factory sales: Each year | Percent of Studebaker factory sales to total factory sales: 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 [1] | 4,410,176 | 119,509 | 2.71 | |
| 1941 [1] | 4,634,401 | 129,197 | 2.79 | |
| | 19,919,928 | 506,982 | | 2.55 |
| 1942 [2] | | | | |
| 1943 [2] | | | | |
| 1944 [2] | | | | |
| 1945 [2] | | | | |
| 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] All military vehicles are excluded in the years 1940 and 1941.
[2] War years.

Source: AMA Automobile Facts and Figures, 1948 ed., 1935 through 1947. 1948 from AMA bulletins.

Senator FLANDERS. I have accumulated one or two questions as you were reading.

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.

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. That answers the question I was about to ask as to why you resorted to borrowing instead of equity financing.

Are you just simply accepting as one of the facts of life the difficulty of getting equity financing, or 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. has?

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 dividend 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.

Senator FLANDERS. You do not know just what it is that is keeping them awake nights?

Mr. VANCE. No, sir; I do not.

Senator FLANDERS. I have another question that I wanted to ask. On page 5 of your statement you speak of your price policy. You say your prices average 110 percent more than in 1940, and your costs for material, labor, and factory overhead, exclusive of fixed charges, average 111 percent more than in 1940, and so it is quite obvious that although your prices are up substantially, the rate of increase has not exceeded that of your costs. "Our pricing policy since the war has been that prices should be increased only in proportion to the increase in actual costs." That is your statement.

Now, that leaves out of consideration, if that if your policy, any reference to the competitive price position as between your cars and other cars. Does that mean that during this period there have been no competitive influences which would have affected your pricing?

Mr. VANCE. No, sir. 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, Senator, 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. I think well of the Studebaker car, by the way, but that is neither here nor there. I first drove one out in California for a few days last June, and I was on the overdrive and did not realize it and did not think that it had much power on the hills; but when I was informed of my mistake, I discovered that the car was all right after all.

Mr. VANCE. I think this may be a little bit off the subject——

Senator FLANDERS. So was mine.

Mr. VANCE. But on this matter of being conscious of competition, the most significant thing that has happened to us since the war is not the money we have made, but the fact that we have added over 500,000 to our road population since we resumed production. That means doubling our road population. It is 1,000,000 today, whereas it was a half a million when we resumed production.

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. How much reduction, Mr. Vance?

Mr. VANCE. I should say that today we could sustain a 55 to 60 percent reduction.

Senator O'MAHONEY. And before the war you could sustain only 20 percent?

Mr. VANCE. That is right, only 20.

Senator O'MAHONEY. Does that not mean that your profit position is such that you are at least twice as well off now as before the war?

Mr. VANCE. Yes, sir; we are, from a security standpoint.

Senator FLANDERS. This, Mr. Vance, is a question which we should have been prepared on, and I have not questioned the staff, and perhaps we are prepared on it. But, do you know of any current publicly available tabulation of the major items in the accounting of the automotive industry that we can use for an examination of the industry as a whole?

Mr. VANCE. For the industry as a whole?

Senator FLANDERS. Of course, the Ford Co. is the only one not publicly reported, and we only get certain information from their reports to the Massachusetts authorities.

Mr. VANCE. That is only a balance sheet, and you cannot tell what their margin of profit is, for example.

Senator FLANDERS. But is there any public tabulation available for the other companies in the automotive industry?

Mr. VANCE. Not that I know of, sir. We have to depend upon the annual reports and the quarterly reports which they issue for our information.

Senator FLANDERS. We have an efficient staff, and it may be that we have got it. We have the important items tabulated here of sales, net incomes after taxes, net worth, earnings per share and dividends paid per share, so that the staff has been at work, and I have not been sufficiently enterprising to keep up with it.

Senator O'Mahoney, have you other questions to ask Mr. Vance?

Senator O'MAHONEY. I should like to ask one or two questions. Unfortunately, Mr. Vance, I was not able to be here at the beginning of your paper, and I have been scanning through what you said before my arrival. I have noted with interest that the percentage of the industry done by Studebaker has been increasing steadily.

Mr. VANCE. Substantially it is double what it was in 1940.

Senator O'MAHONEY. You have up from 2½ percent of the industry's total to 4½ percent now.

Mr. VANCE. That is correct.

Senator O'MAHONEY. You say, then, on page 2 of your statement, that expenditures for plant and property have been particularly heavy since the war. What do you have to say to the committee about the productivity of the new plant and the new equipment as compared with that which you had before the war?

Mr. VANCE. It is substantially greater as proven by the figures of our increased production, which we could not have accomplished without these additions; and I should like to add, also, that these plant improvements have increased efficiency and decreased costs.

Senator O'MAHONEY. So that the expenditures for new plant and new equipment have increased the productivity of the plant—increased its efficiency and reduced the cost?

Mr. VANCE. Yes, sir.

Senator O'MAHONEY. Now, what do you have to say to the committee with respect to the effect upon depreciation of that fact, or those facts, which you have just announced? You see, 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, and 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. When you say the West, Mr. Vance, I am very sympathetic.

Mr. VANCE. Perhaps it would be presumptious of me to argue this question from a different point of view than some of the eminent economists who have appeared before you.

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 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.

Senator FLANDERS. You lost some buttons in going through the wringer?

Mr. VANCE. That is right, in the old company.

Senator O'MAHONEY. And they put on some bows.

Mr. VANCE. 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, for the benefit of your chairman, who I know at one time at least was in the machine-tool business——

Senator FLANDERS. I am no longer.

Mr. VANCE. 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 made 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.

Now, 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. Do you see what I mean?

Senator O'MAHONEY. Yes.

Mr. VANCE. 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 year, 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 the 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.

Senator O'MAHONEY. And is it not a fact that practically every manufacturing industry follows substantially the same procedure?

Mr. VANCE. I think so, sir; yes.

Senator O'MAHONEY. Now, there are one or two other questions that I should like to ask you. I made note of your statement that your greater margin of profit in 1948 was principally the result of increased volume. I take that to mean that you can make more profit, or you can increase your profit by increasing your volume, without increasing your price.

Mr. VANCE. Yes, sir.

Senator O'MAHONEY. If you increase both volume and price, then profit is increased to a much greater degree?

Mr. VANCE. That is correct, sir.

Senator O'MAHONEY. Until you get your price to such a point that it causes the customer to withhold buying.

Mr. VANCE. That is right, sir.

Senator O'MAHONEY. I have not noticed anywhere in your statement here any information with respect to whether or not Studebaker has increased prices since the war. Your price is greater than it was before the war, of course?

Mr. VANCE. That is right.

Senator O'MAHONEY. But how many times since 1945 has Studebaker increased its price?

Mr. VANCE. Three or four times. I don't know the exact number, Senator.

Senator O'MAHONEY. Do you know what the percentage of increase is?

Mr. VANCE. Since 1945?

Senator O'MAHONEY. Yes.

Mr. VANCE. No, sir, I do not. We have made this comparison between 1940 and 1948, which, of course, includes the increases in the period from 1945 to 1948.

Senator O'MAHONEY. Can you obtain and furnish the committee a statement showing the percentage of increase of volume and the percentage of increase of price during this period?

Mr. VANCE. Certainly. I can say to you this, that I know that in the year of 1948 we have had one increase in our passenger-car prices; that was in June of this year, the increase amounting to approximately 5 percent.

*The Studebaker Corp., and subsidiary companies—Statement of percent of increase in sales in units and average selling price per unit from 1946 to 1948*

| | 1946 | 1947 | 1948 |
|---|---|---|---|
| Number of units sold | [1] 119,275 | 191,531 | 230,000 |
| Increase over 1946: | | | |
| Quantity | | 72,256 | 110,725 |
| Percent | | 60.6 | 92.8 |
| Average selling price per unit | [2] 975.14 | 1,207.66 | 1,316.43 |
| Increase over 1946: | | | |
| Amount | | 232.52 | 341.29 |
| Percent | | 23.8 | 35.0 |

[1] 1948 estimated.
[2] 1948 actual for the period Jan. 1 to Sept. 30.

Senator O'MAHONEY. So far as the passenger car is concerned, there has been only one increase of price?

Mr. VANCE. In 1948.

Senator O'MAHONEY. In 1948?

Mr. VANCE. Yes; and that was about 5 percent. That was made in June, 6 months ago, and it was made, I should say, following the last general wage increase that we made at that time.

Senator O'MAHONEY. Now, 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 the level of prices less than what the market will bear which you try to state?

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. That is what we tell them.

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.

Senator O'MAHONEY. Now then, I noted—and this will be the last subject that I will deal with—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—and I am talking now about industry and not other lines of business—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 results 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 improve 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 businessman 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.

Senator FLANDERS. I would like to ask another question which has been brought to mind.

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 others, 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 turn-over of inventory has not lengthened materially from what it was prewar.

Representative WOLCOTT. Mr. Chairman, I do not know as we want to leave this question of pricing just where it is.

You made the statement that you had increased your inventories materially, and, of course, we understand by that that you do not mean inventories of completed cars and trucks.

One of the main differences between pricing by the Government and pricing by industry is, is it not, that if there was pricing by the Government you would hesitate to build up your inventories; is that right? Do I make myself clear?

Mr. VANCE. In our particular case, it would not have made any difference, because as I said a moment ago, in response to Senator Flanders' question, our inventory turn-over is so rapid—we turn it once in 6 weeks—that the thing that determines our inventory is what we have to have to prevent interruptions to production, and that is what determines it and the size of it, and it is nothing in relation to price or cost.

Representative WOLCOTT. Now, if we reinstituted price controls on basic industries—steel, for example—what would be your attitude toward purchasing large inventories of steel in anticipation, perhaps, of the Government cutting back the price of steel after delivery?

Mr. VANCE. Well—you will pardon me, I am not trying to be facetious—even under those conditions we would take all of the steel we could get.

Representative WOLCOTT. You would under present circumstances.

Mr. VANCE. Because steel is so difficult. But the serious answer to your question is that, of course, it would make us more cautious in buying ahead.

Representative WOLCOTT. To put it this way, if the Government made the mistake, as we might expect that it would, of putting a price ceiling on your finished product and not putting a price ceiling on the raw material which you buy, that would materially slow up your production?

Mr. VANCE. It would, of course.

Representative WOLCOTT. And it would materially affect your profits?

Mr. VANCE. It would.

Representative WOLCOTT. And it would materially affect your employment?

Mr. VANCE. That is correct.

Representative WOLCOTT. And it would materially affect national income?

Mr. VANCE. Our contribution to it; yes, sir.

Representative WOLCOTT. And that of your employees?

Mr. VANCE. That is right.

Representative WOLCOTT. There seems to be an affiliation between excess-profits taxes and price controls by the Federal Government, because it is possible to exercise to a certain degree price controls through excess profits taxes, and I think that that is conceivable.

Is not the main difference between price controls by the Government and the pricing arrangements which you have with your dealers, fundamentally the fact that the Government manages to a large measure your business, and thereby destroys the free enterprise?

Mr. VANCE. Well, I think that I would like to answer your question in this way: I believe the difference between the control that we might exercise on prices and what the Government might exercise on prices, if I understand correctly that is your question, I think the main difference is this: That the controls that we exercise over our prices contemplate all of the variables within our situation which we can take into consideration and weigh one against the other; whereas if Government controls our prices, there must be certain rules and regulations set forth, some of which do not apply to our individual situation. That is precisely what happened during the period of price control in the wartime.

Representative WOLCOTT. How long has the traditional retailer mark-up been in existence in the automotive field?

Mr. VANCE. What is that question?

Representative WOLCOTT. How long has this traditional retailer mark-up been in existence? It has been the same over a period of how many years?

Mr. VANCE. With little change over the last 20 years.

Representative WOLCOTT. Then the only price fixing in respect to your industry is more traditional than it is obligatory?

Mr. VANCE. That is correct.

Representative WOLCOTT. So that if you have to raise the price of your product to the dealer because of increased production costs, then it is to be expected and you expect that he will raise the retail price to include his traditional mark-up on the new price to him?

Mr. VANCE. The actual mechanics of it, Mr. Wolcott, are that we set what we call a list price, and then give the dealer a discount from that list price; and it is the list price minus the discount which is our price to him.

Representative WOLCOTT. That traditional mark-up has been, with the exception of the price-control days when we compelled the retailer to absorb about 67 percent of the production costs, it has been traditionally 24 percent, has it not, for many years?

Mr. VANCE. That is correct.

Representative WOLCOTT. But it did get down as low as 17½ or 18 percent?

Mr. VANCE. I do not think it got that low, but it did come down for a period. But you are right, 24 percent is the average.

Representative WOLCOTT. The only price fixing that you are engaging in now is in compliance with this tradition which has existed in the industry throughout all of these years?

Mr. VANCE. That is correct, sir.

Representative WOLCOTT. And that price fluctuates according to your production costs, so that you have freedom of action in respect to increasing the list price of your cars to offset the cost of production?

Mr. VANCE. That is correct.

Representative WOLCOTT. Is that not the fundamental difference between pricing by Government and pricing by industry?

Mr. VANCE. That is correct; sir.

Representative WOLCOTT. That is all.

Senator WATKINS. To what extent do you participate in export trade that might be a part of this so-called "cold war"?

Mr. VANCE. Well, sir, our position in the export field has always been a little bit better than our position in the domestic field. By that I mean that we have over the years sold a slightly higher percentage of our total output abroad than has the industry as a whole.

The reason for that is that many years ago we established ourselves in some of the important foreign markets, and that early establishment still helps us, in that we get larger shares of the total business in some other countries than we do here.

Senator WATKINS. That is sold to private purchasers in those countries?

Mr. VANCE. Oh, yes, exept in one instance. We have our own and have had for many years our own subsidiary company in Canada. We have a plant in Canada, and we produce cars in Canada. But that is the only foreign operation that we own.

Senator WATKINS. To get directly to what I have in mind, how much is the ECA buying from you to help out in the "cold war"?

Mr. VANCE. So far as I know, nothing.

Senator WATKINS. Then you have not a comparable situation at all to the time when the United States was buying all of your product during the "hot war"?

Mr. VANCE. Oh, no.

Senator WATKINS. So that the question the Senator from Wyoming asked you had no real relationship as between the "hot" and "cold" war?

Mr. VANCE. No, sir.

Senator WATKINS. No basis is really there for comparison?

Mr. VANCE. No, sir.

Senator WATKINS. Now, with respect to excess profits, you said that your books were checked occasionally during the war, when you were producing entirely for the United States, by Army officers, to see whether or not you were getting beyond the point, and I did not understand just what point that was. You said it was some point, to see that you were not getting beyond that.

Mr. VANCE. Their idea of what would constitute a reasonable profit.

Senator WATKINS. Did it have anything to do with renegotiation?

Mr. VANCE. Yes, sir, that is exactly what it was.

Senator WATKINS. What was the figure? What was the percentage they allowed you to get so that you would be up to the renegotiation point and you would not be beyond it? What was the percentage, or could you figure it in percentages?

Mr. VANCE. They did not increase our profits. They merely said that they thought that we were making less than they would have considered to be a reasonable profit.

Senator WATKINS. What did they do if you were making more than they thought was a reasonable profit?

Mr. VANCE. If we had been making more, they would have required us to return the excess, as they did many companies.

Senator WATKINS. Independent of an excess-profits tax?

Mr. VANCE. That is right, yes, sir.

Senator WATKINS. You had both the taking away under renegotiation, and also the taking away under the excess-profits tax?

Mr. VANCE. Many corporations did have to return part of the profit that they made, as a result of renegotiation. But I am merely saying that we did not.

Senator WATKINS. I am trying to find out why you could justify an excess-profits tax during wartime and cannot justify it now. In other words, did they permit you to make so much money, and there is a real difference between that period and now?

Mr. VANCE. No, I think the difference between what we will call the war period and this period, assuming that we are now in a "cold war," is this: That in the previous war period, all of the forces of competition were frozen.

Senator WATKINS. There was not any competition; the Government was the only buyer, and they took it all, all you could produce?

Mr. VANCE. Yes. And in the present situation, even though we denominate it as a cold-war situation, the forces of competition are now active.

Senator WATKINS. As a matter of fact, as you have just said, they are not buying any of your product to take part in this cold war.

Mr. VANCE. Not so far. They may.

Senator WATKINS. Do you know whether or not they are buying to any considerable extent in the automobile industry?

Mr. VANCE. They have not up to date, so far as I know.

Senator WATKINS. It is not one of the weapons they are using; the automobile is not one of the weapons that they are using in the cold war?

Mr. VANCE. No, sir.

Senator WATKINS. Like we used it in the hot war?

Mr. VANCE. No, sir.

Senator WATKINS. So that the situation is entirely different?

Mr. VANCE. Entirely different, yes, sir.

Senator WATKINS. That is what I wanted to see, if I had the right understanding.

I think that is all.

Senator FLANDERS. If there are no other questions, we will excuse you, Mr. Vance, and we thank you for your very frank answers to all questions.

Mr. VANCE. If there is any further information the staff requires of us, we will be very glad to furnish it.

Senator FLANDERS. Thank you.

Mr. VANCE. Thank you, Mr. Chairman.

Senator FLANDERS. The next witness is Mr. Dunlop, who is president of the Sun Oil Co.

Mr. Dunlop, will you identify yourself in regular form for the record?

## STATEMENT OF ROBERT G. DUNLOP, PRESIDENT, SUN OIL CO., PHILADELPHIA, PA.

Mr. Dunlop. My name is Robert G. Dunlop, president of the Sun Oil Co., Philadelphia, Pa.

I have prepared a statement here, Mr. Chairman, which, with your permission, I would like to read at this time.

Senator Flanders. You may proceed that way.

Mr. Dunlop. I am pleased at your request to appear before this committee to express my views on business profits. After I present this statement which I have prepared, I shall be happy to try to answer any questions you might care to ask me.

In preparing this statement I have been mindful of the suggested list of topics and questions that you sent to me. Accordingly, I have organized my remarks into three parts: first, a review of the governing philosophy of Sun Oil Co. with respect to the economic principles relating to profits; second, a general outline of the oil industry's economic situation during recent years, with particular emphasis on the roles played by price and profits; and, third, an account of my company's price-production-profit story.

By way of preface to my remarks, I want to call your attention to the fact that the size of corporate profits appears to present a problem chiefly because—as competent witnesses before me have testified—the true size of profits is not accurately revealed by customary accounting procedures. Monetary inflation has clouded the accountant's mirror, distorting the true image of profits. This inflation stems directly from an overexpanded money supply resulting from loose monetary policies and the Federal Government's deficit financing practices during the war and before.

We have a chart here, gentlemen, which is indicative of the increase in the money supply. As shown by this chart (chart No. 1), we have today, including both money in circulation and deposits in commercial and savings banks, 2½ times as much money as in 1939. As a result of record-breaking industrial achievement, the production of goods increased 79 percent in the 1939–48 period. This increase in the physical output of our factories and mines, coupled with that of our farms, has, no doubt, helped to make the manifestations of inflation less acute than they otherwise would have been.

However, increased production is but part of the solution to the problem of inflation. It should be clear to every American that increased production alone cannot erase the fact that the root cause of this inflation is precisely the injection of increased quantities of money into circulation by a process which has been but one step short of an outright printing-press operation. It should be equally clear that the surest way to bring on more inflation is to resume deficit financing practices by the Federal Government through increasing the money supply.

In speaking of profits we must be careful to give due recognition to the complexity of the profit concept. Otherwise, we are liable to make the same type of mistake as that made by the six blind men of Indostan, who, if you recall the poem, could not agree on what an elephant was like. One of them, feeling of its tusks, thought an elephant was like a spear. Others said a rope, a wall, a tree, a snake, or a fan, depending upon the part of the animal each happened to touch.

Some Americans are equally blind in appraising the true nature and purpose of profits. They look at just one limited aspect of profits and, failing to consider any other factors, form concepts which are wholly erroneous. One of the most dangerous of these erroneous 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 demands 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.

I shall not spend more time discussing fundamental economic theory; I know you are quite familiar with it. But I think it is worth while to review this theory because the story of the petroleum industry so forcibly bears out its essential correctness. As I continue my statement, I hope you will note how clear the evidence is that the petroleum industry does in fact function in conformity to these principles of a free, competitive enterprise system.

The paramount reality facing the oil industry since the beginning of World War II has been the urgent necessity of meeting a vastly increased demand for petroleum products. 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.

The chart (chart No. 1) which has been set up there, gentlemen, gives an indication of the rise in petroleum demand over the prewar period into the year 1948, showing how the demand has risen from 3,400,000 barrels a day to just shy of 6,000,000 barrels a day. This chart, showing domestic consumption of finished petroleum products gives you an idea of how great that increase has been since 1939. Perhaps you wonder what is behind the tremendous postwar jump in demand.

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 characteristics 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 airliners, more Diesel locomotives, and, as shown by this chart (chart No. 3), there has been a striking increase in the number of oil burners installed. You will note that as of the close of this year, 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.

You will note in the 1946–47 period, the number of installations of oil burners (the broken line) shows an unusual peak of almost 900,000 units arising in the middle of last year.

As was to be expected and desired, the lifting of OPA controls permitted such corrective price adjustments as have since been taking place.

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 No. 4, which is before you gentlemen, sets forth the historical trend of well drilling as following the pattern of crude prices. You will note the lower line is the line of average crude oil prices by years. The upper, 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. Chart No. 5 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 chart No. 6, which demonstrates the statements that I have just made.

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.

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.

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.

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.

Let me give you more details about the operations of Sun Oil Co.

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 oil 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.

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 over-statement of profits arising from the inadequacy of charges for capital extinguishment, such as depreciation and depletion. We have set forth here a comparative table, going back to 1936, which indicates the profits of our company in each year in question. I would just like to mention those in which the committee initially indicated an interest.

(The table is as follows:)

*Comparison of Sun Oil Co. net income*

| | Gross revenue from sales and services | Net income | Sales dollar ratio |
|---|---|---|---|
| | | | *Percent* |
| 1936 | $105, 447, 000 | $7, 564, 000 | 7. 2 |
| 1937 | 133, 323, 000 | 9, 544, 000 | 7. 2 |
| 1938 | 115, 047, 000 | 3, 085, 000 | 2. 7 |
| 1939 | 131, 475, 000 | 6, 960, 000 | 5. 3 |
| 1940 | 147, 673, 000 | 7, 969, 000 | 5. 4 |
| 1941 | 187, 884, 000 | 16, 533, 000 | 8. 8 |
| 1942 | 310, 660, 000 | 8, 671, 000 | 2. 8 |
| 1943 | 468, 846, 000 | 13, 354, 000 | 2. 8 |
| 1944 | 600, 823, 000 | 13, 350, 000 | 2. 2 |
| 1945 | 438, 975, 000 | 15, 667, 000 | 3. 6 |
| 1946 | 306, 644, 000 | 14, 727, 000 | 4. 8 |
| 1947 | 356, 841, 000 | 24, 340, 000 | 6. 8 |
| 1948 to June 30 | 221, 468, 000 | 22, 799, 000 | 10. 3 |

Mr. DUNLOP. In 1940 we had a gross revenue from sales and services of $147,000,000, realizing a profit of $7,969,000 or 5.4 percent on the sales dollar. In 1941, the gross revenue was $187,884,000, realizing a net income of $16,533,000, which was 8.8 percent.

In 1947 our gross volume of business was $356,841,000 and our net income was $24,340,000 or a profit of 6.8 percent. For the first 6 months of this year, which is the last period for which we have had an official public closing of our records, we did $221,468,000 worth of business, from which we realized a profit of $22,799,000, or 10.3 percent.

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.

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.

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.

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 indices. 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.

To me, as I imagine to every executive of a competitive American business, the economic principles that I have attempted to elucidate are in fact nothing less than workaday laws we are forced to observe as surely as we observe the law of gravity. Efforts to dismiss these principles as mere schoolboy prattle or as being no longer appropriate to present business conditions are, to say the very least, extremely unwise.

The oil industry is a monument to the workability of the doctrine of the free, competitive market and the American individual private enterprise system. One does not have to be a very keen student of this industry to comprehend that market forces are effective in bringing about economic adjustments that result in an ever-increasing flow of petroleum products to the American consumer. I hope my testimony today has helped make that point clear.

It is because my association with the oil industry has convinced me of the truth of these assertions that I take an unqualified stand against restrictive control and regulation of this and other competitive industries.

Let petroleum remain free and unfettered, subject to the laws of economics and the corrective forces of the market place, and the oil industry will continue to serve the best interests of the American people, helping to raise their standard of living and to insure their national security.

(The charts referred to by Mr. Dunlop are herewith inserted.)

Senator FLANDERS. Thank you, Mr. Dunlop.

There are two or three questions that I would like to ask you. 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.

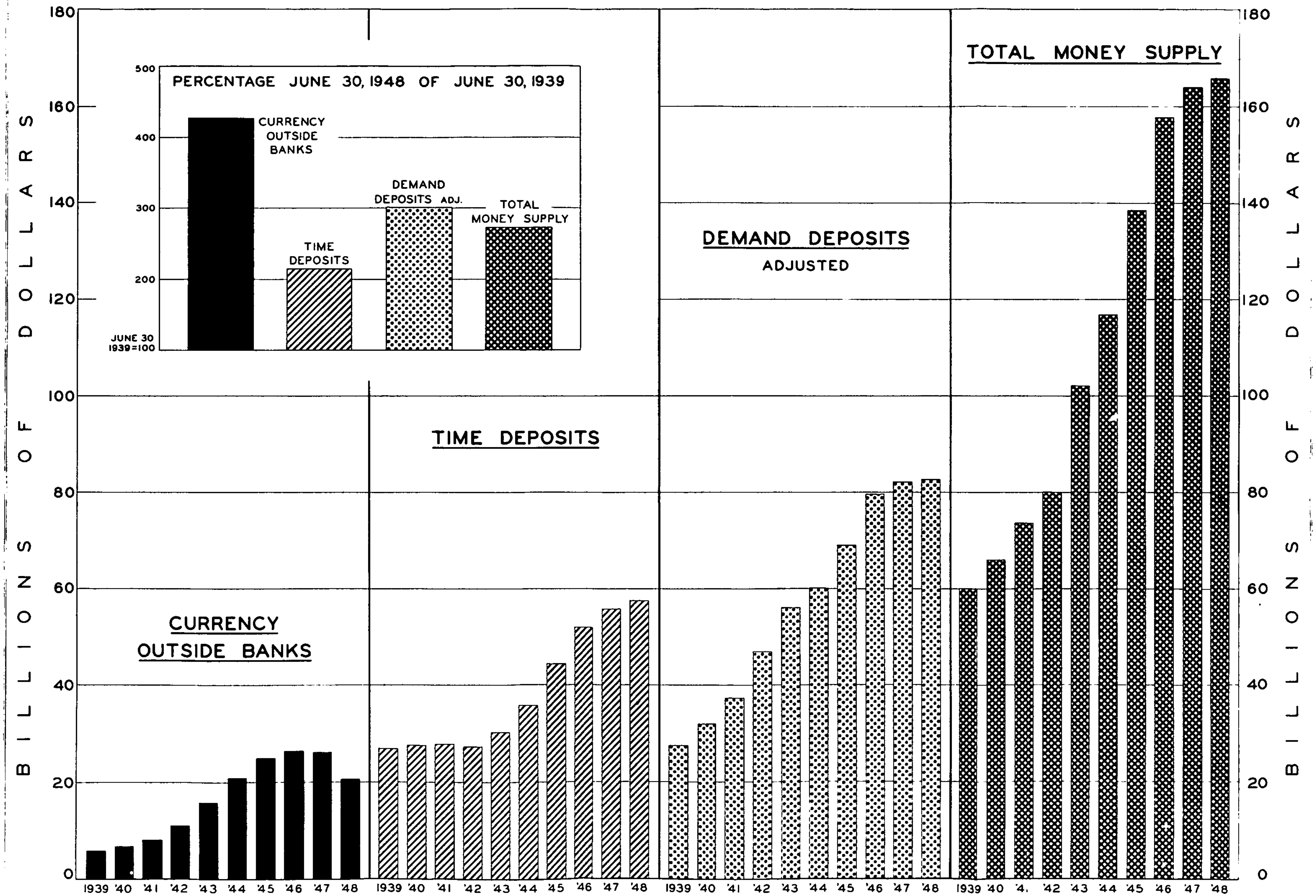
Senator FLANDERS. Do you want to make any observations of personal opinion as to the cause of the present weakness of the public market for equities?

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 equity capital, the return on that 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.

I might say as far as my own company is concerned, we have always felt, as I have expressed herein, we should grow as we provided the

# TOTAL U. S. MONEY SUPPLY — EXCL. U. S. GOV'T. DEPOSITS

FEDERAL RESERVE BOARD — END OF JUNE — ANNUALLY FROM 1939

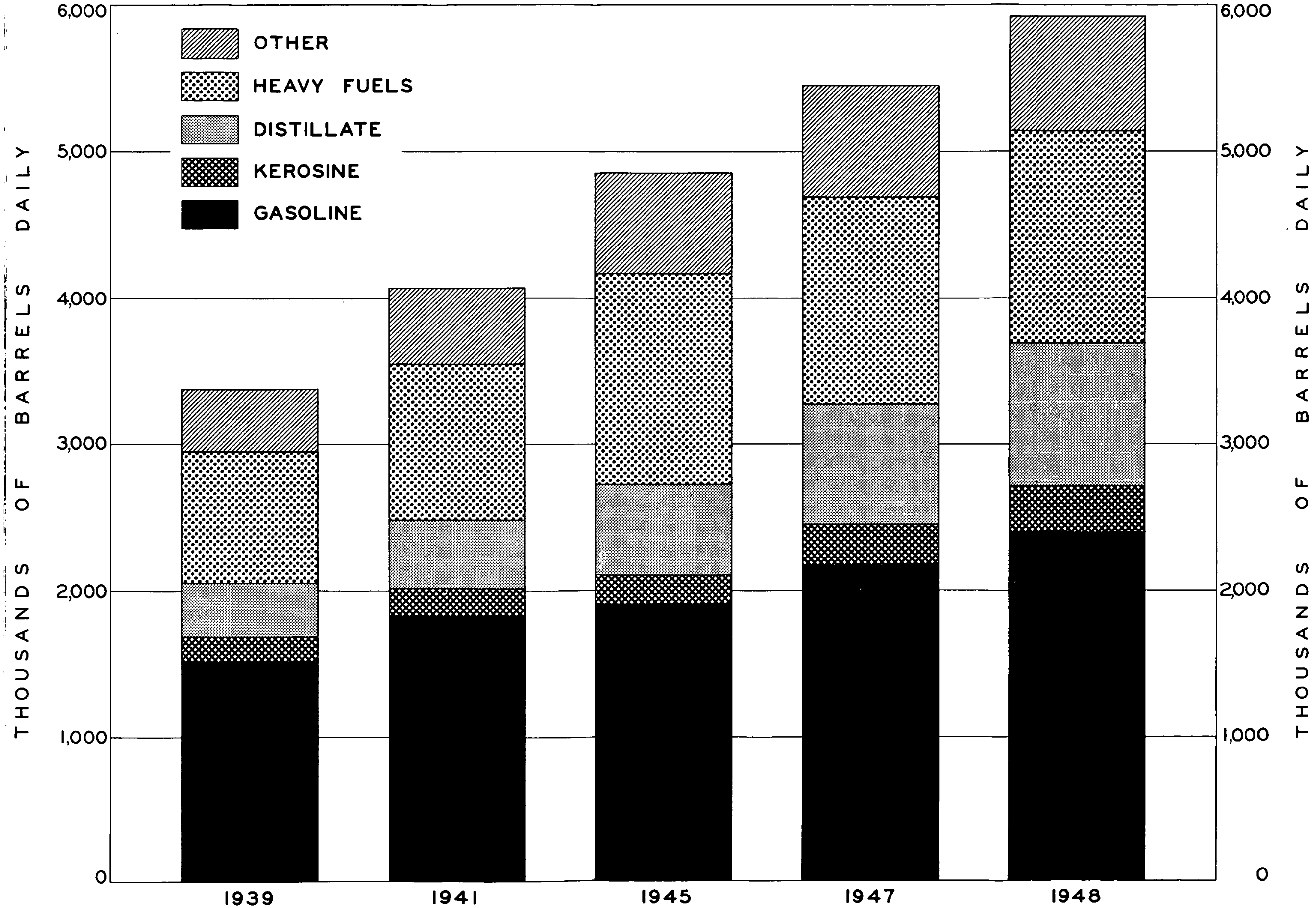



SUN OIL COMPANY

STATISTICAL RESEARCH DIVISION

# UNITED STATES DOMESTIC CONSUMPTION OF REFINED PRODUCTS

FOR SELECTED YEARS ···· 1939 – 1948



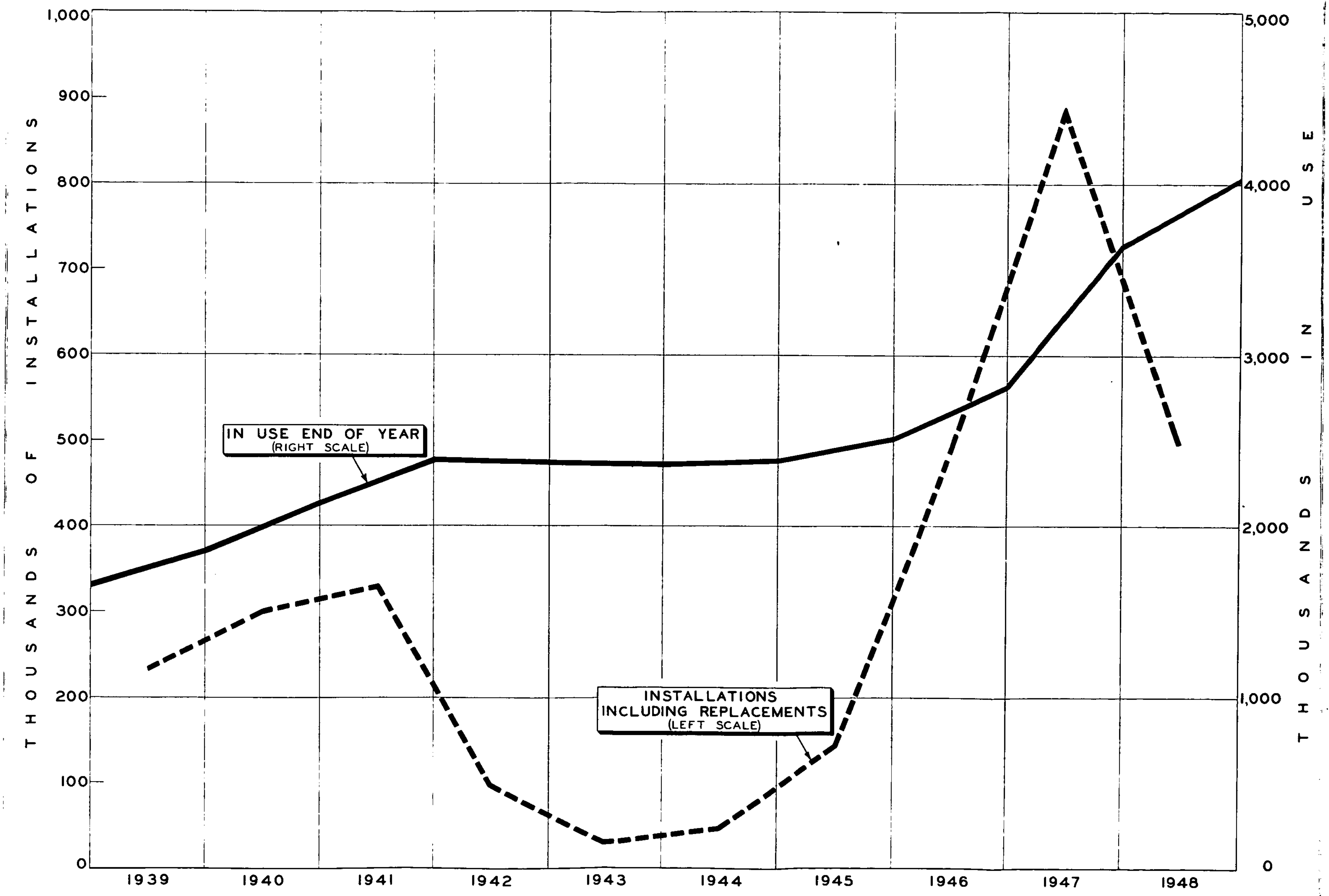

SOURCE – U. S. B. OF M. 1948 EST. INTERSTATE OIL COMPACT COMMISSION
SUN OIL COMPANY

STATISTICAL RESEARCH DIVISION

FIGURE 3

# TOTAL CENTRAL PLANT DOMESTIC OIL BURNER INSTALLATIONS AND NUMBER OF BURNERS IN USE

ANNUALLY FROM 1939 TO 1948




SOURCE – FUELOIL AND OIL HEAT
SUN OIL COMPANY

STATISTICAL RESEARCH DIVISION

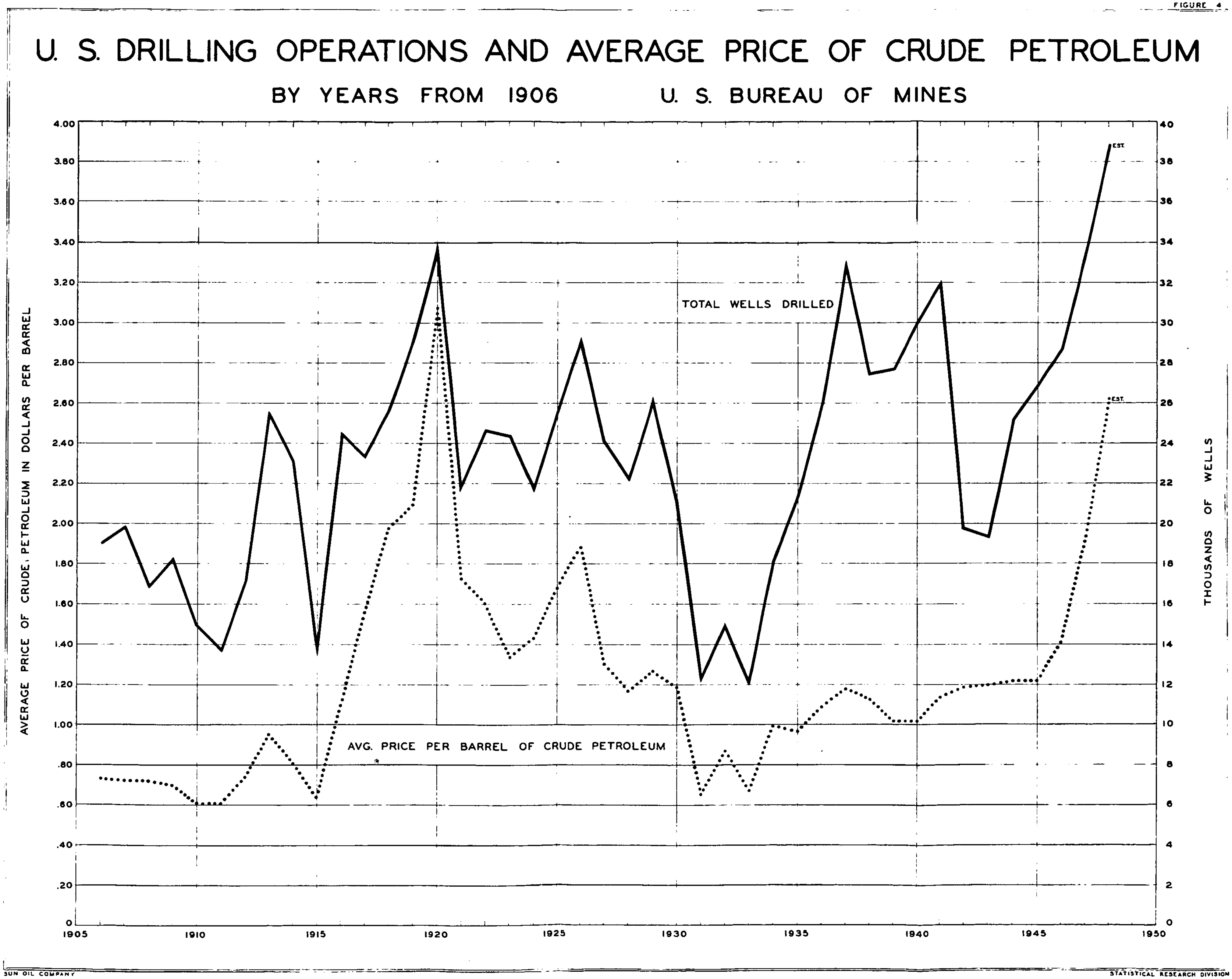
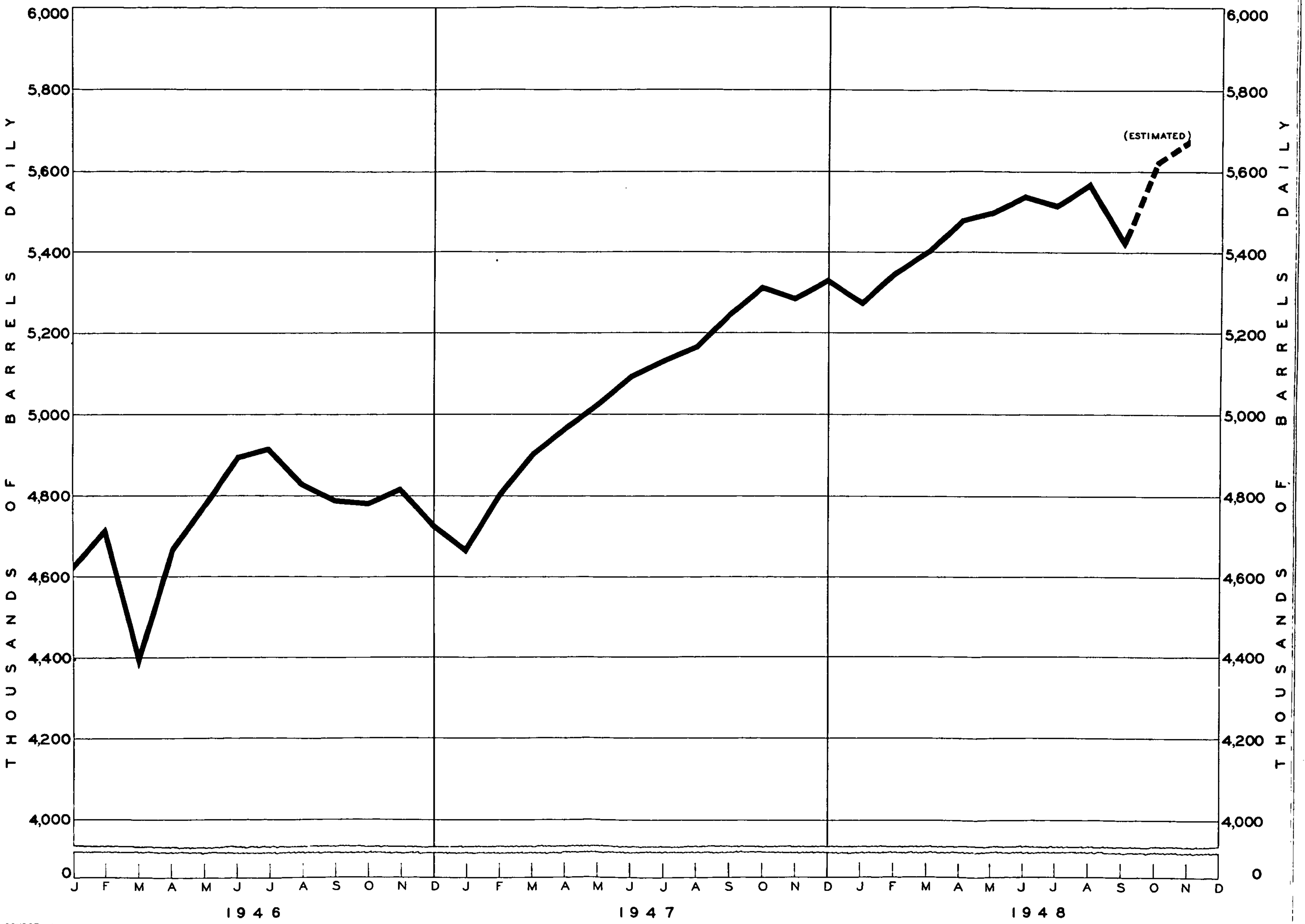

U. S. DRILLING OPERATIONS AND AVERAGE PRICE OF CRUDE PETROLEUM
BY YEARS FROM 1906
U. S. BUREAU OF MINES
AVERAGE PRICE OF CRUDE PETROLEUM IN DOLLARS PER BARREL
THOUSANDS OF WELLS
TOTAL WELLS DRILLED
AVG. PRICE PER BARREL OF CRUDE PETROLEUM
EST.
EST.
4.00
3.80
3.60
3.40
3.20
3.00
2.80
2.60
2.40
2.20
2.00
1.80
1.60
1.40
1.20
1.00
.80
.60
.40
.20
0
40
38
36
34
32
30
28
26
24
22
20
18
16
14
12
10
8
6
4
2
0
1905
1910
1915
1920
1925
1930
1935
1940
1945
1950
SUN OIL COMPANY
STATISTICAL RESEARCH DIVISION

FIGURE 5

# UNITED STATES CRUDE OIL PRODUCTION

## BY MONTHS 1946 - 1948



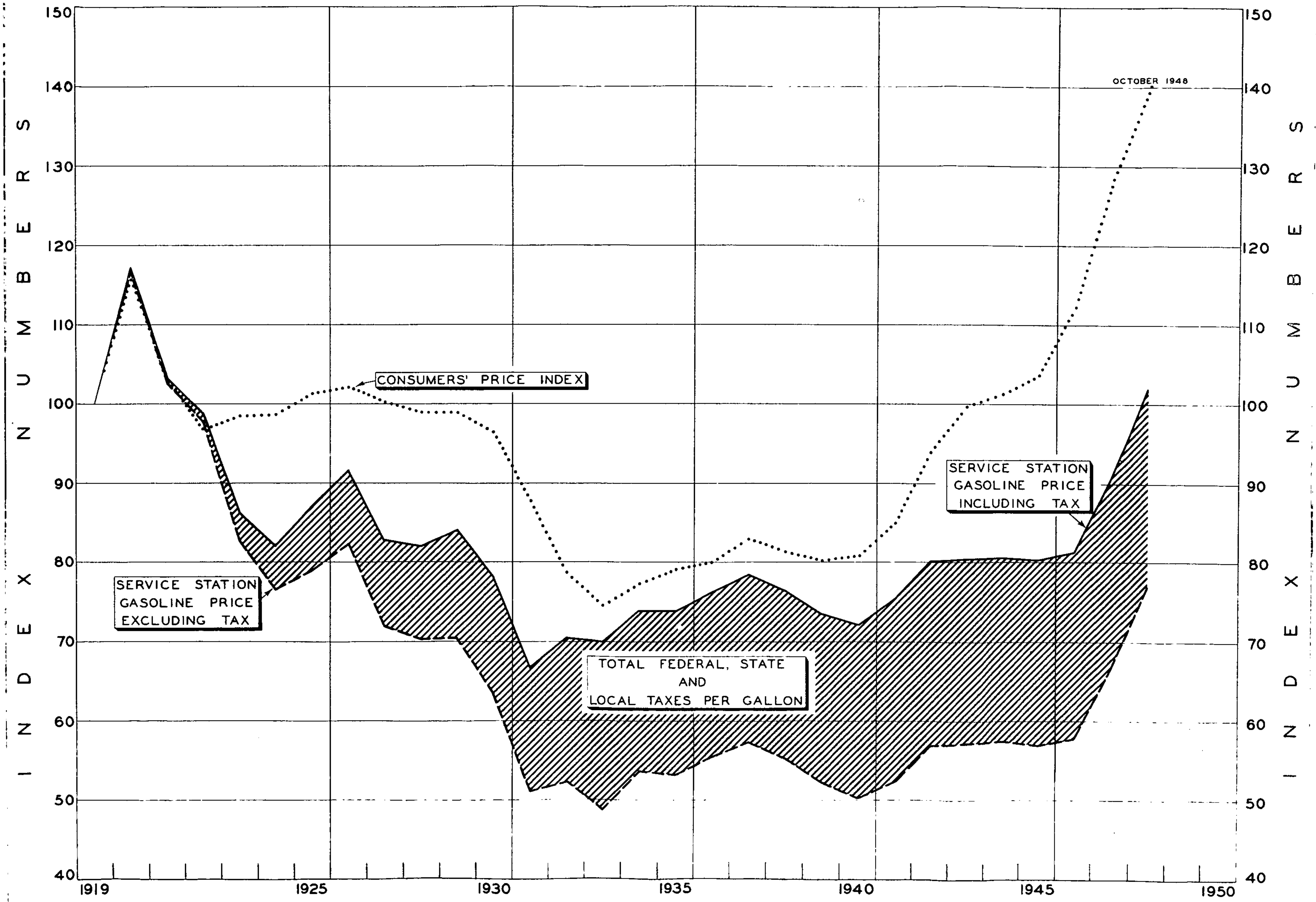

SOURCE - U. S. B. OF M. AND A. P. I.
SUN OIL COMPANY

STATISTICAL RESEARCH DIVISION

FIGURE 3

# 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

internal means to grow. We wanted to grow soundly, and our ability to continue in business over a succession of years and to meet the competitive forces that play over a long period of time, dictated the policy of our growing on a basis of what we believed to be financially sound, namely, to grow as we had the funds necessary to grow.

Senator FLANDERS. Later in your statement, you noted an increase in your inventory of 72,000,000 barrels, and then you later made reference to a recent decrease in your prices.

Is that inventory largely finished products, or is it largely of crude?

Mr. DUNLOP. The figures that are set forth there are industry figures. Those are the figures currently obtaining in the industry. The 72,000,000 barrels is the increase in finished stocks, the finished stocks of the four principal producrs. The four principal products in the petroleum industry are gasoline, kerosene, heating oils, and heavy fuel oils. Those inventories in the last year have risen 72,000,000 barrels.

In like manner, the inventory of refinable crude has risen 11,000,000 barrels, and I believe in accordance with the operations of the basic law of supply and demand, that the pressure of those inventories has been of significance in connection with these lower prices which are currently being established.

Senator FLANDERS. The testimony we have had earlier in these hearings indicated two points at which so-called profits could be considered as fallacious. One of them was with respect to inventories, and the other was with respect to depreciation charges.

I note that you make a reference to depreciation charges. So far as the inventory situation is concerned, the industry would seem to be in the position of getting that inventory profit in reverse. That is, apparently you would be inventorying the 72,000,000 excess at a lower price now than before the drop in price, or how is that? Is it inventoried on cost? How do you price your inventories?

Mr. DUNLOP. Speaking to the question which you raise, there are several answers. First of all, these are industry figures, and as to just what the practices or what the composite practice of the industry might be with respect to the handling and costing of inventories, I would not be in a position to say.

The general observation that you make could be true; that is, these inventories, if held at higher prices and then subsequently liquidated al lower prices, could result in a loss. That, however, is just a statement of conjecture, because I am not sure of the situation in the industry.

As far as our own company is concerned, it is true that there are two general areas in which this impact of inflation strikes with greatest consequence. One is in the matter of inventories, and the other is in the matter of capital assets. With respect to inventories, we have sought to nullify the effect, to the fullest extent of our ability to do so, by the inventory method which we use. We use the last-in first-out method, which does give some beneficial effect or some advantages in conditions such as at present. And while there is some adverse effect, we have not felt that it was of near the consequence that the impact of inflation has been on the matter of replacement costs of capital assers.

Senator O'MAHONEY. How often do you turn over your inventory?

Mr. DUNLOP. We are turning our inventory over, Senator O'Mahoney, as far as our finished inventory is concerned, about once every month, in that general neighborhood. We are running approximately 5,000,000 barrels of crude oil a month, and while I do not have the exact figure, it would be my impression that we have between 5 and 6 millions barrels of refined products inventory.

Senator O'MAHONEY. With a rapid turn-over like that, you are pretty current in your price situation, are you not?

Mr. DUNLOP. Yes.

Senator FLANDERS. In that 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.

Senator FLANDERS. I have one other question. In your statement you spoke about debt retirement. To what extent have you, over the period we have been studying, found it necessary to go to the banks or insurance companies or other sources for borrowing money?

Mr. DUNLOP. I would like to break that question down in a twofold way. As you know, we are engaged in the shipbuilding business, through a wholly owned subsidiary which builds ships. The shipyard we can dispose of rather briefly. During the war, bceause of the tremendous program involved, we went to the banks for a

V-loan; and through the operation of the Government contracts, that was automatically paid off.

As far as the oil company has been concerned, in order to finance our very substantial program undertaken during the war, that is, the extension of facilities, we borrowed money under Government contracts from the Reconstruction Finance Corporation, which were repaid out of the revenues which we received from the sale of the products under those contracts. Accordingly they were liquidating borrowings.

Since that period of time we have only borrowed, I think—and that was just a temporary borrowing—$2,400,000 from the banks, which was paid back within 6 to 8 months of the initial borrowing. It was to tide us over a temporary deficiency of cash.

Senator FLANDERS. So that your policy of making all of your expansion out of profits remains intact, so far as your peacetime operations are concerned?

Mr. DUNLOP. It has been a fundamental policy with our company to seek to rely upon our internal ability to generate funds, and that is the policy which we have sought to follow consistently, with one or two modifications.

Senator O'MAHONEY. You referred to a Toledo plant investment. As I recall your statement, the original estimated cost of this refinery was $16,000,000, and then rising prices forced you to boost the estimate to $18,000,000, and then rising prices caused you to elevate it again now to $20,000,000; and is it likely to go higher?

Mr. DUNLOP. I do not know. Frankly, I certainly hope not.

If I may just comment on that point Senator, we have been subject to tremendously increased prices throughout this postwar period.

Senator O'MAHONEY. So have we all.

Mr. DUNLOP. Industry is no different than the Government or the consumer in that regard, and we recognize that we all have dollars which have identical purchasing power, as far as that is concerned.

We undertook to build a plant; and, when we economically justified that plant a little better than a year and a half ago, we were pretty sure it was going to cost us 5 million dollars. I might say we are one of the smaller integrated companies, and that is a substantial amount of money in our thinking. The plant is about being completed, and it looks like it is going to cost pretty close to 8 million dollars; which is approximately a 60 percent increase in cost.

I think the same pattern, in effect, Senator O'Mahoney, has occurred in this Toledo situation, but I certainly am very hopeful that the pattern won't run the full course that it ran on this other facility that I mentioned.

Senator O'MAHONEY. Do you think that Government, through the Congress, should adopt any policies designed to hold rising prices in check?

Mr. DUNLOP. Along what particular line?

Senator O'MAHONEY. Any policy.

Mr. DUNLOP. I think——

Senator O'MAHONEY. I might have one idea, and you might have another.

Mr. DUNLOP. As far as Government's responsibility in this is concerned, I think that Government could be exceedingly helpful in connection with the money supply. After all money supply, under the Constitution, is a matter of congressional jurisdiction. I think whatever Government can do in decreasing the money supply will be of substantial benefit. The first chart which we set forth indicated that the money supply has gone up something like two and a half times, whereas production is up but 80 percent.

Senator O'MAHONEY. There is no question about that.

Mr. DUNLOP. I think any steps the Congress can take in that regard would be very desirable.

Senator O'MAHONEY. There is no doubt that the distortion of money supply is one of the major factors involved in inflation.

Now, precisely what would you recommend the Government do with respect to monetary policy to control the supply?

Mr. DUNLOP. I think that, as far as monetary policy is concerned—and I must say that I am not an expert in that particular field—I would like to qualify my statement: I am a business man, down here on invitation to express a point of view particularly with regard to the petroleum industry.

Senator O'MAHONEY. You do not regard yourself as qualified to speak about monetary policies?

Mr. DUNLOP. Well, I consider that I have observations as a businessman, but I would not consider myself a monetary expert.

Senator O'MAHONEY. I observed at the beginning of your statement you said:

> Monetary inflation has clouded the accountant's mirror, distorting the true image of profits. This inflation stems directly from an overexpended money supply resulting from loose monetary policies and the Federal Government's deficit-financing practices during the war and before.

Now, if you had undertaken to reach a judgment that the monetary policies of the Government have been loose, certainly you must be in position to tell us in what respects those policies were loose.

Mr. DUNLOP. I shall seek to do that. What I meant when I said I was not an expert was the fact that the subject, as all of us appreciate, is a very broad one; and I would not for one moment presume to know all of the answers.

Senator O'MAHONEY. I think that we will all join you in that statement.

Representative WOLCOTT. Would you yield for an observation? I think perhaps Mr. Dunlop and you will find the answer to that in the report filed by the House Banking and Currency Committee on the last anti-inflation bill.

Senator O'MAHONEY. There is a question about that, Mr. Wolcott. Let us try to make a new survey of the situation. That report did not turn out so happily.

Mr. DUNLOP. I think there are two factors involved there: Two observations that bring me to that conclusion, Senator O'Mahoney. One is the fact that when we inject a substantial quantity of money into our system, without any increase or any appreciable increase in the supply of goods and services which the people want, there is only one way prices can go. In other words, if we have these two containers, one representing money supply and the other the available goods and services, they are in balance. Now if we inject another container into the picture, which is increased money supply, I think it is rather apparent that prices have just one direction that they can go, and that is up.

Senator O'MAHONEY. You will not get any debate from any member of this committee on that point, of course.

Mr. DUNLOP. And I think in effect the same thing takes place wherein the Federal Government has financed its operations through deficits.

I am of the opinion, as I am sure the members of this committee are, that a return to a deficit-financing basis would be economically unsound and prejudicial to all of the various interests that make up the American people. By that, I mean the Government itself, the consumer, the wage earner, the stockholder, and all other segments.

Senator O'MAHONEY. Then you advise this committee against deficit financing?

Mr. DUNLOP. I make the observation very definitely that I think it would be unsound.

Senator O'MAHONEY. How shall we avoid deficit financing, by what Federal monetary policy can we do that? By decreasing the money supply?

Mr. DUNLOP. Personally, I entertain some misgivings as to whether we can appreciably reduce the money supply, frankly.

Senator O'MAHONEY. What would you think of taxation as a method of reducing the money supply?

Mr. DUNLOP. To the extent that the Federal Government operates at a surplus, to that extent, you can reduce the money supply by applying that surplus toward the retirement of the Federal debt.

Senator O'MAHONEY. So it is desirable that the Government should operate at a surplus; and it is also desirable, in your opinion, that the Government should, to the maximum degree possible, apply that surplus on the reduction of the national debt.

Now, do you think that the Government should tax away in any degree at all the money supply, and thereby keep the price of the Toledo plant down?

Mr. DUNLOP. I don't follow you specifically as to what you mean by "tax away the mohey supply."

Senator O'MAHONEY. Is it not a fact that the best antidote for a large money supply is taxation?

Mr. DUNLOP. In part, yes; but aren't there also other factors involved: namely, taking a look at how the money supply increased and seeing what corrective steps can be taken in that regard? I have in mind at that particular point, the efforts of the Treasury Department to sell bonds to people with consumer purchasing power and then using the funds so acquired toward the reduction of Government securities in the hands of the commercial banks. That would be one of the other observations as being a step in the right direction.

Senator O'MAHONEY. That would be desirable?

Mr. DUNLOP. Yes.

Senator O'MAHONEY. Do you want to say to this committee that we should use every monetary policy to reduce the money supply except the policy of taxation.

Mr. DUNLOP. I would say that we would have to integrate the various methods that are available, and use them—as I am sure the Congress will do—with discretion and wisdom; so that, in so using them, it would not result in an unbalanced situation on any one segment of the economy.

Senator O'MAHONEY. You do not want to be understood as arguing here against taxation as one cure for price inflation?

Mr. DUNLOP. No, definitely not; but I would like to make one other comment on that. I do think, Senator, that that should be just one of the approaches that the Government would take in recognition of the problem involved.

Senator FLANDERS. You would probably wish to be assured that the tax policies involved did not decrease production.

Mr. DUNLOP. I think that that is very important. In our own industry, if I may use our own industry as an example, if we look back at last winter, all of you gentlemen here, as a result of some pressure from your constituents, were vitally concerned about the needs of the American people for petroleum products. Now those needs are being met, and it is my personal opinion, maybe with some prejudice, that the industry performed unusually well. The reason we were able to perform unusually well in having turned a shortage into a surplus, which seems to be the case at the moment, was because we were operating under a free competitive system wherein price and profit were permitted to perform their normal economic roles.

Senator O'MAHONEY. And, also, you have been operating under this same Federal Government whose monetary policies you have characterized as loose.

Mr. DUNLOP. Yes, sir.

Senator O'MAHONEY. Now then, turning to another portion of your testimony having to do with the expansion of plant facilities and the cost of new construction, you have testified that the industry as a whole, in the last 2 years, has made capital expenditures averaging more than $2,000,000,000 annually.

Mr. DUNLOP. Yes, sir; I did.

Senator O'MAHONEY. That is at a rate twice the average for the war period, and approximately three times the average for the 5 years immediately preceding the war.

Then there has been a considerable investment of profits by the oil industry in the expansion of new facilities?

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

Senator O'MAHONEY. And that has happened within the last 2 or 3 years?

Mr. DUNLOP. Yes.

Senator O'MAHONEY. Now, do you feel that the cost of that expansion in this inflationary period should be depreciated not at cost but at some other figure, some other dollar value antedating the date of the expenditure?

Mr. DUNLOP. Well, the costs of these replacement and expansion facilities which have gone in, Senator, will be depreciated over their useful life on an original-cost basis.

Senator O'MAHONEY. That is the inflationary cost that you have put in there.

Mr. DUNLOP. And the problem is, of course, the maintenance of a price level to do that.

Senator O'MAHONEY. You see, what is going through my mind is that Professor Slichter testified here that industry as a whole is overstating its profits, and he argued that replacement costs or replacement depreciation should not be figured in the current inflationary dollar, but should be figured in some imaginary dollar which nobody can describe. It is a dollar of some previous period.

Now, what I am trying to determine is whether or not Mr. Dunlop, of the Sun Oil Co., is coming before this committee in his argument about depreciation and replacement, and asking that you have some more favorable method of depreciation than the actual cost in inflationary dollars. Do you want to use a noninflationary dollar?

Mr. DUNLOP. For the cost of these new facilities, insofar as their depreciation is concerned; no, sir.

Senator O'MAHONEY. If anybody understood that from your testimony, that is not what you meant?

Mr. DUNLOP. I hope I did not give the impression. The point I sought to make clear, Senator, was this: today industry is required to replace existing facilities at costs which are substantially in excess of the cost of the original facilities, and that is a recognized fact.

Senator O'MAHONEY. But you are talking about the facilities that you have now, and not the ones before the war.

Mr. DUNLOP. We are also depreciating the facilities that we had before the war.

Senator O'MAHONEY. Are you not depreciating the new facilities, too?

Mr. DUNLOP. We are depreciating those to the extent that they are in operation and to the same extent the facilities we have in operation which were constructed before the war.

If I may just broaden out my statement a little bit, our problem is that, in the determination of our profits, we take a depreciation charge based upon original cost of these latter facilities.

Senator O'MAHONEY. You reminded me of your testimony before the TNEC, in which it was clearly proven that the advance of technology in the petroleum industry is very rapid, and that the productive capacity of the plant is rapidly expanding in the petroleum industry.

Mr. DUNLOP. I am sure that you would also like the observation that we would not want the effect of inflation to nullify, insofar as the American people are concerned, the benefits which should accrue to them through that technological advance.

Senator O'MAHONEY. Certainly not.

Mr. DUNLOP. By that, I mean if you have a unit, let us say, that cost you 10 million dollars, and you now find that the replacement unit is going to cost you 20 million dollars, the first one having fully depreciated, theoretically you have 10 million dollars of funds to go against the second. If that second one will do twice as good a job, in effect inflation has wiped out the technological benefits which characteristically, in our industry, have been passed on to the consumer.

Senator O'MAHONEY. If it does twice as good a job, the 20-million-dollar plant, as the 10-million-dollar plant, then your productive capacity is exactly the same.

Mr. DUNLOP. That is right; you are in statu quo. But the point I am making there is that we——

Senator O'MAHONEY. If it should be three times more productive you would be ahead of the game.

Mr. DUNLOP. We are getting into pretty big figures, as far as productivity is concerned.

Senator O'MAHONEY. If it went the other way, you would be at a disadvantage. And now I ask you, as we have asked every other witness, do you have any formula to suggest to the committee by which this depreciation should be measured, except the formula of actual cost?

Mr. DUNLOP. May I elaborate on what we are doing ourselves, which we feel to be dictated by prudent management. We recognize that it is costing us at least double to replace the facilities that are being worn out, so in the last 2 years—we have done it for the years 1947 and the first 6 months of 1948—we determined the difference between our original cost and our replacement cost of certain facilities. For example, we left out ships, because a unique problem attaches to the ship situation, and we left out certain of our production facilities because there again a different type of problem is involved. But, in regard to all of the rest of our facilities, we sought to determine what was the difference between the original cost of those facilities and what it would cost us to replace them at that particular time.

Senator FLANDERS. Just a moment—to replace the facilities themselves or equivalent productive capacity?

Mr. DUNLOP. Equivalent productive capacity insofar as we were able to determine.

Bear in mind it was impossible for us to go down every facility. We had to make some general, average assumptions.

Senator FLANDERS. Was this calculation and this application made principally to facilities which were approaching the period at which they would have to be replaced, or did you start with the brand new facilities?

Mr. DUNLOP. We took an average of all of our facilities for ease of mechanics, and having determined that figure we then applied our regular depreciation rates. The difference between our regular depreciation rates applied against that figure, and our regular depreciation, was the amount of the fund which we have set aside out of income in order to take care of the replacement of these facilities.

Senator FLANDERS. And the Government taxes you on those funds? It does not recognize that these reserves are any different from any other segregated reserves?

Mr. DUNLOP. That is correct; those reserves were not deductible for Federal income tax purposes.

Senator FLANDERS. I see.

Representative WOLCOTT. Perhaps this question may answer itself. Maybe I have been wrong all of these years, but I had assumed that the primary object of taxes was to meet the legitimate expenses of government. Do you understand that we should use our taxing authority to manipulate prices and manipulate the value of the dollar?

Mr. DUNLOP. No, sir; if I gave that impression, that certainly was not my intent. I think basically and soundly, the device of taxes—and I use the word "device" on an advised basis—is for the purpose of raising the Government's revenues. That is the purpose of taxes. If in that operation a Government surplus arises, it is my personal opinion that that Government surplus should be directed to the reduction of Federal debt.

Senator FLANDERS. Would you think of that Government surplus as being merely a happy chance arrived at by inscrutable operations which are beyond analysis, or do you think the Congress should direct itself, in both its appropriations and its tax policy, to the hope of having a surplus?

Mr. DUNLOP. I think that the Government certainly should, as all prudent business or as prudent individuals do, seek by every means possible to operate on a self-sufficient basis; and if in such an operation a surplus occurs, then I think that that surplus should be directed toward the reduction of the debt.

If I may go back to the statement that was made in response to Senator O'Mahoney's question, I think a surplus is desirable provided, Senator Flanders, it is integrated with whatever else is involved in the economy. I would not want you gentlemen to say that we had indicated in our testimony that we believed that the Government should set as an objective a surplus, without regard to what influence that may have on other phases of the economy. The point that I would like to make, that is of particular importance to us, is the necessity of business being provided with the means to maintain its productive capacity. That is all-important, because it is on productive capacity that jobs depend and the standard of living of the American people depends. If we do not maintain our productive capacity, we are in effect living off our fat, and we are liquidating our business enterprise.

Senator O'MAHONEY. You do not want the Government to confiscate your profits, but you no doubt believe that business, like everybody else, must bear its proper part of the burden which the Government has to bear.

Mr. DUNLOP. Very definitely. I might just say that corporate management, Senator, today has a variety of responsibilities, and one of those responsibilities is a responsibility to Government; and when I say "Government," I mean the Government and the people generally of the United States. The corporation has to bear its proper share of the burden in that regard.

Senator O'MAHONEY. We will all agree with you on that, I am sure.

Mr. Chairman, before you adjourn, I would like to ask that there be inserted in the record an interesting letter which I have found in the Wall Street Journal. It is a letter to the editor by Mr. E. Arnold Sunstrom of Knoxville, Tenn., published under the heading "Counting Profits," and it is an analysis and response to the testimony of Dr. Slichter before this committee.

Senator FLANDERS. We will have that inserted in the record.

(The letter referred to is as follows:)

### COUNTING PROFITS

*Editor, the Wall Street Journal:*

As an accountant, I wish to take exception to the newspaper heading and discussion of Dr. Sumner H. Slichter's recent testimony before the House-Senate economic subcommittee investigating corporate profits, which was published in your paper under date of December 7.

I dislike to think that Dr. Slichter could testify in the manner reported and even feel generously enough toward him to think that the newspaper account was poor reporting.

In the first place, Dr. Slichter in talking about "real profits" is speaking in economic terms and not those customarily used in the business world, at least by accountants. Net profit is not the balance after deducting amounts "available to pay dividends, expand plant, raise wages, or reduce prices." Accountants record historical facts and not imaginary amounts to reflect some possible happening in the future, except provisions for measureable reserves to cover anticipated losses.

Dr. Slichter is reported to have said that "most corporations still insist on counting a rise in the cost of replacing inventories as profits, and most corporations count the rise in the cost of replacing plant and equipment as profits." This is the most weasel-worded, deceptive explanation of the present problem that I have heard and sounds like the testimony of an advocate and not that of an objective witness. My reasons for this statement are as follows:

1. He ignores entirely the fact that many corporations follow the "lifo" (last-in, first-out) method of accounting for inventories, many use the base-stock method, and many set up estimated reserves for probable losses.
2. He ignores the fact that inventories turn over in many cases time after time and that any balance sheet losses as of a given date would be for only one inventory, which can be adequately and properly provided for under present accounting rules.
3. He ignores the fact that much property having higher replacement costs will not be replaced for many years in the future and possibly at dates when the price levels will be lower.
4. He ignores the fact that when property is replaced, in most cases, a business does not replace the same piece of equipment but one often much more modern and efficient, with latest labor-saving features; also, that money borrowed today is at interest rates much lower than those available when the replaced equipment was installed.

As an accountant, I would like to assign the task to Dr. Slichter of valuing property and inventories from time to time under his principles, in the fluctuating amounts that occur, any of which valuations would be subject to dispute, and to give him the task, particularly, of handling the accounting problem when price levels are below those of today. When that time comes he would undoubtedly change his tune to the expediency of the time.

E. Arnold Sunstrom,
*Knoxville, Tenn.*

Senator Flanders. Owing to the lateness of the hour, I think that we will set the time for the hearing this afternoon at 2:15.

Senator O'Mahoney. Mr. Chairman, I am very sorry that I am leaving for New York at 1 o'clock, and I cannot be with you, much as I would like to be, at your very stimulating and instructive hearings.

Senator Flanders. We regret your absence, and we will try to perform diligently and properly while you are away.

The witness this afternoon will be Mr. Eugene Holman, president of the Standard Oil Co. of New Jersey.

The hearing is adjourned, and thank you very much, Mr. Dunlop, for your very intelligent testimony.

(Thereupon, at 12:40 p. m., a recess was taken until 2:15 p. m., of the same day.)

## AFTERNOON SESSION

(The subcommittee reconvened at 2:30 p. m., upon the expiration of the recess.)

Senator Flanders. The hearing will come to order.

Our witness this afternoon is Mr. Holman, president of the Standard Oil Co. of New Jersey.

## STATEMENT OF EUGENE HOLMAN, PRESIDENT, STANDARD OIL CO. (NEW JERSEY)

Senator FLANDERS. Mr. Holman, for the record, will you give your name and connections and personal history and so on?

Mr. HOLMAN. Thank you, Mr. Chairman.

My name is Eugene Holman and I am president of the Standard Oil Co. (New Jersey).

Senator FLANDERS. If you have written testimony you may proceed with it.

Mr. HOLMAN. Thank you, sir.

Mr. Chairman and gentlemen, the subject under consideration by your subcommittee is of major importance to the continued strength of our Nation and to the welfare of its people, and I appreciate your invitation to discuss this topic with you. You wish to obtain facts and analyses of corporate profits. To aid your study I will outline the Standard Oil Co. (New Jersey) position. After finishing this prepared statement, I will be glad to answer any questions I can. In doing so I might, with your permission, call upon some of my associates who may be more fully informed on specific details.

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.

This is an expensive undertaking, involving great risks. Many who assume these risks go broke. As you gentlemen have no doubt heard before, four out of every five wildcat wells drilled in the United States turn out to be dry holes. Outside the United States as well, millions of dollars have been spent without finding a barrel of oil. Also, in many parts of the world, political risks are added to what may be called the geological risks.

In a dynamic industry such as oil, therefore, very large sums of new capital must be poured into the business regularly. The situation is quite different from more static businesses where, after the initial investment, operations can be kept going with relatively small amounts spent for replacement.

In this country the demand for oil has risen more than 60 percent since 1940, and it is still on the uptrend. In meeting people's demands for its products, the oil industry has measured up, particularly when one considers the magnitude of the problems it has faced in the postwar period.

It is a highly competitive industry and, I believe, one of the most progressive and efficient. Its success in providing an abundance of petroleum products has been a vitally important factor in raising our standard of living.

As striking examples of expenditures required by the oil industry to meet people's needs, I should like to cite some calculations we recently made. Each additional automobile on the road requires an oil company expenditure of $530; each new home oil burner $670; each transport plane $221,000.

This is what must be spent by the oil industry to provide the new capacity to fuel and lubricate this equipment. It costs more than twice as much now to do these jobs as it did before the war.

Before dealing with our company's earnings, let me give a few general facts concerning Standard Oil Co. (New Jersey). The company is owned by nearly 200,000 shareholders, with 99 percent of the stock being held in this country. No single individual owns as much as 3 percent of our shares. The employees total approximately 130,000—substantially fewer, in other words, than the number of owners of the business. About half of our employees are in the United States and about half abroad. A little over half of our profit comes from foreign operations.

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 cost. 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.

Under Jersey's form of organization, operations are carried on by a number of affiliated companies, in some of which there are minority shareholders. The figures which I am about to give are on a consolidated basis and include minority interest.

It should be recognized that this results in profit figures considerably higher than the amounts actually accruing to the interest of Jersey's stockholders, which in 1940 were $124,000,000 and which we estimate will be $390,000,000 this year. On the basis of including minority interest, the consolidated accounting profit was $145,000,000 in 1940 and will be about $474,000,000 this year.

But 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.

In exhibit I, cash earnings and their uses are shown both in dollars and as a percent of total income. It can be seen that accounting profit in the postwar years, while higher in numbers of dollars, is a smaller proportion of total income than in 1940. This, in spite of the fact that profit is overstated because depreciation is based on original cost. If depreciation were figured on the basis of today's replacement cost, the percentage of profit would have declined more.

Depreciation, it will be noted, has declined sharply from 11 percent of total income in 1940 to 5 percent in 1948, even though there have been substantial additions to our capacity.

One of the points of principal significance in this exhibit is that while cash earnings have increased considerably since 1940, they have gone down as a percent of total income. In each postwar year cash earnings—that is, accounting profit plus depreciation—have represented only about 20 percent of total income compared with 28 percent in 1940. In other words, out of every dollar we take in, less is available for replacements, expansion, and dividends than before the war.

Cash dividends, in percent of total income, have declined from almost 8 percent in 1940 to less than 3 percent in 1948.

The committee may be interested in what some of these figures mean in cents per gallon. 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 exhibit I 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.

The next line in exhibit I shows that expenditures required for replacements and added facilities have increased from $125,000,000 in 1940 to $551,000,000 in 1948. They have also increased as a percent of total income. This shows both the tremendous job which had to be done to meet rapidly expanding needs for oil and the higher cost of material and wages.

During the postwar years, in enlarging our productive capacity to meet the increased needs of our customers, we have not done so by buying out other companies. On the contrary, we have narrowed the field of our business by selling our interest in several concerns.

The proceeds have been used for our primary job, which is supplying liquid energy.

This exhibit also gives a picture of the influences on our cash position. 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.

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.

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. Exhibit II shows the increase in our actual physical output compared with cash earnings expressed in 1940 dollars. You will notice that, 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. 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 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.

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 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. This is shown in exhibit III, a very simple chart which I think requires no elaboration.

I might mention before I go to the rest of the testimony that there are a few more charts here. While you are looking over in this direction there is a chart entitled, "Gross Investment in Property, Plant, and Equipment Per Employee."

The main significance of this particular chart, I think as far as this hearing is concerned, is to illustrate the tremendous amount of money that goes into tools or plant. For example, you see the comparison there between motors, steel, railroads, and our company.

You will notice it required about $3,281 for motors, $9,000 for steel, $15,000 for railroads, and $24,000 for our company per employee.

Representative HERTER. Where you used the word "property" there, does that include oil-bearing property?

Mr. HOLMAN. That includes cost of the property, Congressman. Of course we think that what is under the ground is probably worth more than the cost of that property in most cases.

Representative HERTER. I was wondering if that was included in that $24,000 unit figure?

Mr. HOLMAN. Yes.

Now on the other side here there are a few simple charts. Annual Rate of Return on Average Net Worth is a chart to the left there and this other chart, Wages, Salaries, and Benefits Versus Cash Dividends,[1] which I think are self-explanatory and require no further elaboration.

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.

This is the way we have tried to operate in Jersey Standard during the period of inflationary pressure. We have passed up many opportunities for investment which would have paid high rates of return, and have concentrated on expenditures which would add to oil supply, even though the prospective return on these latter was not so attractive.

I feel that no time is better than the present to stop inflation. But it cannot be done by one company, one industry, labor, the farmer, or any one group. It will take courageous budget paring by the Government as well as restraint and teamwork from all segments of our economy. The Jersey company has been doing what it can in this direction and will continue to do so.

[1] The charts referred to appear on p. 675.

Thank you very much, Mr. Chairman.

Senator FLANDERS. Thank you, sir. I have only one or two questions which I wish to ask.

One of the questions is whether you are a net purchaser or net seller of crude?

Mr. HOLMAN. World-wide we are a net purchaser.

In the United States we are considerably—I do not recall the exact figures—we are substantial purchasers of crude oil, while in the foreign field we are probably about in balance. Over-all we are pretty substantially net purchasers, I would say on the order of four hundred to four hundred and fifty thousand barrels a day.

Senator FLANDERS. Do you participate in the Arabian oil?

Mr. HOLMAN. Yes, sir.

Senator FLANDERS. Are the profits from that crude in your consolidated return?

Mr. HOLMAN. Yes, sir; they would come through the dividends from Aramco.

Senator FLANDERS. They come in as dividends but the net earnings from that company do not appear in the net earnings of your company?

Mr. HOLMAN. That is right.

Actually Senator, we just secured that interest at the end of this year so there is nothing from Aramco in any of the financial statements that we have issued so far, but next year to the extent that we receive any dividends they will be in.

Senator FLANDERS. I have been unable to see that your testimony differs in any respect from the smaller oil company which we heard from this morning? Were you present?

Mr. HOLMAN. Yes; I heard that testimony. No, sir; I do not think there is any substantial difference as far as the oil business is concerned; that is, the oil economy.

Senator FLANDERS. You would feel that the two firms together do not give an unfairly balanced picture of the profit situation or the method of using profits, the method of distributing for industry as a whole? In other words, have we taken a good sample in asking you two gentlemen to come?

Mr. HOLMAN. Well, I think you have taken a good sample.

As to whether our balance sheets, or what we have done with our profits and so on is typical, I am not sure of that. I would be inclined to think it was.

I think without question that everyone in the industry would say over the past 3 or 4 years that the main job has been to develop more petroleum products to meet this expanding demand. And I am confident that everyone in the industry has put his shoulder to the wheel on that and has devoted his time and energy to that.

Now to say that our situation is exactly typical from a balance sheet standpoint, I do not know about that.

Senator FLANDERS. That might not be but so far as your practice, say, in the use of profits and so on, your general policy, as I remember Mr. Dunlop's testimony, neither of your two firms is out of line with the industry practice?

Mr. HOLMAN. I think that is generally true, Senator. The main point I wanted to make was that we do not want our balance sheet to speak for other people's balance sheets.

As far as the general procedure and the actions taken by industry people as a whole, I think probably that you have a pretty good cross-section.

Senator FLANDERS. Mr. Pogue diffidently made certain prognostications. One of them was that he felt that enough addition had been made to productive capacity so that it would not be at as high a rate in the next year or two as it had been in the past 2 or 3 years. Would you agree with that from your company standpoint?

Mr. HOLMAN. As I pointed out in my statement, we are inclined to believe that the postwar demand is tapering off a bit. If that should be true, I suppose that industry in general would not have to put forth such an effort to bring forth additional products, which probably would not require as much capital expenditures.

Senator FLANDERS. Mr. Pogue, also as an outsider looking in, has a guess that there will not be that insistent demand for reinvestment on account of their expectation that the consumer demand would not rise so rapidly; he thought there might be a faint hope for some drop in the price of petroleum products. Do you see anything like that in prospect?

Mr. HOLMAN. I do not like to prognosticate price trends. It is a highly competitive industry, of course, and I suppose if supply exceeds demand that would be the natural thing to expect.

Senator FLANDERS. You would not be surprised, in other words, if that happened?

Mr. HOLMAN. Well, this guessing as to consumption and demand, we think we are pretty good at that but we find that we are frequently wrong.

Senator FLANDERS. I am not going to ask you to go on record with a prophesy.

Mr. HOLMAN. I think that assuming that supplies become abundant that that naturally could be assumed.

Senator FLANDERS. You have a certain productive capacity now that you did not have 2 or 3 years ago; that is definite?

Mr. HOLMAN. That is right.

Senator FLANDERS. Both in your developed oil-producing areas and in your refining capacity?

Mr. HOLMAN. Yes.

Of course we continue to have an increasing demand even though the rate of increase is tapering off. It will keep industry busy. You might not have to do it at the rate we are doing but our experience right along, Senator, has been that we continually have to keep going to do two things and one is to enlarge our facilities.

Senator FLANDERS. Stay where you are?

Mr. HOLMAN. That is right. We have the question of expanding industry and replacing equipment and so on. I know that in our own company as our business has grown, as the industry has grown, we have found that our capital expenditures continue to mount and I think that is a natural thing.

Senator FLANDERS. Senator Watkins?

Senator WATKINS. You stated that you had been compelled to sell some assets in order to get capital?

Mr. HOLMAN. Yes, sir.

Senator WATKINS. What is the nature of the assets that were sold?

Mr. HOLMAN. Over the period of years; of course, our company has been in business a long time, Senator. For example, at one time we were retailers of gas and as a result of that we had gas lines. Some time ago the retailing gas business was distributed to the stockholders and we were left with these gas lines. They had no particular connection with the oil business and consequently, although they were reasonably good investments, we have sold them over the past 2 years. There were several interests in gas lines.

Another example: We had a coke company that was also related to the retail gas business many years ago. During the war period there was more demand for coke and we sold that company.

Then we had some allied specialty businesses as we call them. For example, we had Daggett & Ramsdell and we disposed of that.

There are others. I have probably forgotten all of them, but in the aggregate the amount was pretty substantial and we realized 60 or 70 million dollars from the sale of these various assets. The money was put back into the oil business during this expansion program.

Senator WATKINS. None of them had to do with the production of oil, did they?

Mr. HOLMAN. No, sir.

Senator WATKINS. What part of your output is sold to the European Cooperation Administration?

Mr. HOLMAN. The ECA?

Senator WATKINS. Yes, the ECA.

Mr. HOLMAN. I am under the impression that it is around 10 percent; about 10 percent I would say.

Senator WATKINS. Where is that shipped?

Mr. HOLMAN. That is shipped to all of the European countries—places like Italy, France, and England. Practically all of those countries in western Europe are involved.

Senator WATKINS. Is it actually shipped from this country or delivered from some of your foreign holdings?

Mr. HOLMAN. By far the greater part of it comes from South America, from the Caribbean area; Aruba, originating in Venezuela.

Senator WATKINS. How is that purchased, on what conditions?

Mr. HOLMAN. Well, actually the mechanics of it, Senator, it is sold to our companies in those European countries. You see, we have been working in those countries for many, many years and our companies there have always received their supplies from our affiliates in other places. They are selling companies while these other companies may be producing and refining companies. They currently order supplies through them.

Now the only place that ECA comes into it is that we have always insisted, from the time we have done business in Europe, that we wanted dollars for the sale of our products. Being an American company, naturally we had to convert the currency of those countries into American currency to be of any use to our stockholders.

So, those particular companies over there go to their governments, for example, our company in Holland would go to the Holland Government and say they needed a certain amount of oil and had it on order with one of our companies and in order to get delivery they had to have dollars. That Government then, I suppose, has gone to ECA if they did not have dollars of their own.

Senator WATKINS. There would not be a direct sale?

Mr. HOLMAN. No, sir.

Senator WATKINS. There would be money advanced?

Mr. HOLMAN. To the extent that that particular Government needed dollars and if they did not have dollars they would have to go to ECA, I suppose, and get it that way.

Senator WATKINS. In other words, ECA does not buy directly?

Mr. HOLMAN. No, sir.

Senator WATKINS. You have of course a private business interest in any sale to Government under the European recovery program?

Mr. HOLMAN. Yes. Well, these sales are not to Government. The oil is actually sold to our company in that particular area, Senator. Say in Holland, using that as an example, our Holland company would buy from the Creole Petroleum Co. in Venezuela.

Creole Petroleum Co. would say, "We want a certain number of dollars per barrel, for this crude."

The Holland company would have to go to their Government because they have exchange restrictions over there to get the dollars. Then the Holland Government would have to go to ECA in case they did not have dollars to give to our company over there.

There may be minor sales to some French Government departments or Holland Government departments but the amount is very small. If there are any I know they would be practically nothing.

Senator WATKINS. The 10 percent you mentioned then is sold to your companies?

Mr. HOLMAN. That is right.

Senator WATKINS. You have companies in nearly all of these countries participating in the European recovery program?

Mr. HOLMAN. Yes; I think without exception in all of them, Senator.

Senator WATKINS. These foreign companies, are they incorporated under the laws of the country where they are operated?

Mr. HOLMAN. Practically I think without exception.

Senator WATKINS. They are not American corporations simply operating in foreign lands.

Mr. HOLMAN. No.

Senator WATKINS. In the previous testimony we had here this morning, mention was made of shipping in connection with the oil business. Do you have that in your general set-up or do you have shipping in an independent set-up?

Mr. HOLMAN. No; our ships are owned. We have ships owned both by our American company and we have a good many ships owned by the foreign companies. But the ships are all 100-percent owned by the company in one form or another. Some of them are owned by foreign affiliates and some by domestic affiliates.

Senator WATKINS. Wherever profits arise from operating the ships they of course are shown in the consolidated statement?

Mr. HOLMAN. Yes, Sir.

Senator FLANDERS. Mr. Herter?

Representative HERTER. I notice in your testimony you referred to the fact that a little over one-half of your profit comes from foreign operations.

Mr. HOLMAN. That is right, sir.

Representative HERTER. I am wondering, in all of your calculations from the point of view of inflation, and so on, and the inflationary value of replacement costs, it must be pretty difficult to adjust those to that part of your foreign operations.

Mr. HOLMAN. That is true, sir, but that, in turn, has been adjusted in dollars to the best of our ability in the exhibits. Our balance sheet the stockholders currently receive has not been adjusted to 1940 dollars.

Representative HERTER. Is not the greater part of your foreign operation from which you make profits, the production of oil in Venezuela?

Mr. HOLMAN. That is one of the more profitable operations, and of course, that is all a dollar operation. We are dollar sellers down there, so the exchange does not enter into the problem there.

Representative HERTER. The greater part of your replacement cost comes in refineries in this country, would that be true?

Mr. HOLMAN. I wouldn't say that, Mr. Congressman. Our business and our refining capacity is roughly half-and-half.

Representative HERTER. Your refining capacity?

Mr. HOLMAN. Yes.

Representative HERTER. It is as great elsewhere in the world as it is in the United States?

Mr. HOLMAN. Yes.

Representative HERTER. Most of the material that goes into the replacing of your refineries has to originate in this country, does it not?

Mr. HOLMAN. A very large part of it. We are in hopes, of course, that we can get more of that material from European sources as Europe gets back on its feet. In normal times we got quite a bit of material in Europe. We were building a refinery in France, for example. If we do that, we would buy as much material locally there as we could. Even in normal times you are quite right that some of the more delicate pieces or in some cases the more highly designed pieces would have to come from this country.

Representative HERTER. In your chart, when you speak of the purchasing power of the dollar, in considering replacement cost, is that averaged out for all of the countries in which you operate, or is it only for the United States?

Mr. HOLMAN. It is averaged out, that is right.

Representative HERTER. Is that figure substantially the same as that in the United States? It seems to run pretty parallel to those who operate only in the United States. You have the same inflationary tendencies in these other countries?

Mr. HOLMAN. Actually, our consolidated balance sheets for the 1940 period on, are largely the Western Hemisphere.

Mr. J. C. ANDERSON (Comptroller, Standard Oil Co. of New Jersey). The financial statements and the charts presented furnish the financial results on a consolidated basis for all of our Western Hemisphere companies, and in addition, any divdiends that we may have received from our affiliates in Europe and other areas.

Mr. HOLMAN. I think that those figures are the consolidated balance sheet insofar as the Western Hemisphere operations are concerned, and the income other than from the Western Hemisphere is in the form of dividends from the Eastern Hemisphere.

Representative HERTER. In your statement you gave some rough figures using the gallon as a unit. When Mr. Pogue was testifying, we asked him if he had any figures of the same kind, broken down to a unit basis, whether it be a barrel or gallon, for the 30 companies the analysis of which he had made, and he said that he did not have any unit cost of any kind.

Do you figure that your per-unit cost is approximately the same as the average in the industry?

Mr. HOLMAN. I do not think that I would hazard a guess on that, Mr. Congressman.

Representative HERTER. I am interested in that figure in relation to your taxes, both the sales tax that is paid on the gasoline and the refined product, and in connection with the balance of your taxes, whether it be corporate profit or real-estate taxes, in the rest of your business.

Mr. HOLMAN. The margin of profit per unit is pretty small in the oil industry.

Representative HERTER. The margin of profit is very much smaller than the tax that you bear per unit, certainly in the gasoline field.

Mr. HOLMAN. That is true.

Representative HERTER. How does that average now, in the areas in which you sell your gasoline?

Mr. HOLMAN. I do not know right today, but I saw some figures sometime ago that it was 6 or 7 cents a gallon, but the consumer pays that tax.

Senator FLANDERS. You suggested that Mr. Holman's company bore that tax, and I suspect that you and I do.

Representative HERTER. I am quite sure that we do, but it has a relation to the sensitiveness of the consumer to the price of the product, and that is a part of our study here.

In the face of increasing taxes and increasing costs, the demand for your product has gone up steadily, has it not?

Mr. HOLMAN. That is right.

Representative HERTER. You have not the problem before you now of consumer resistance as a result of price?

Mr. HOLMAN. In some parts of our business we actually have, Congressman. As a matter of fact, one reason why we resisted price increases was that we did not want to price ourselves out of business in some petroleum products. Actually in some of our products—take residual fuel oil today—we have lost customers because we were just charging too much money for our residual fuel oil.

Representative HERTER. You mean a competitive form of energy?

Mr. HOLMAN. A situation had developed where the price of fuel oil had gone up to where some customers converted back to coal.

Representative HERTER. In the case of fuel oil, have you got that same consumer tax? It is not as large, is it?

Mr. HOLMAN. No; I do not believe there is any consumption tax on residual fuel oil.

Representative HERTER. That was a reflection of ordinary cost?

Mr. HOLMAN. Yes.

Representative HERTER. How do your other taxes compare with this 1½ cents per gallon, your corporate taxes, and what you pay on your real estate?

Mr. HOLMAN. I do not have any figures on that. I would be very glad to compile it for you and furnish it to you, Mr. Congressman.

Representative HERTER. As I recall, Mr. Pogue's study showed that the taxes being paid actually represented a considerably larger amount than the profit realized, even on the basis of accredited accounting practices.

Mr. HOLMAN. We could very well convert this and furnish you with that figure, if you would like to have it.

Senator FLANDERS. You might do that, if you will.

Mr. HOLMAN. May I permit Mr. Page, my assistant, to give that figure?

Mr. HOWARD W. PAGE (executive assistant to the president, Standard Oil Co. (New Jersey). It is 1.33 cents per gallon this year.

Representative HERTER. That is the tax?

Mr. PAGE. Those are the direct taxes on the company.

Representative HERTER. Just slightly less than your per-gallon profit as you have made it clear here?

Mr. PAGE. That is right.

Senator FLANDERS. Mr. Holman, I would like to ask you one more question. On this chart showing gross investment in plant and equipment, and so forth, is that investment calculated on original cost or depreciated value, or on what basis?

Mr. HOLMAN. Gross investment in property and plant, that is on original cost, sir.

Senator FLANDERS. The only one on which I would have any basis, Mr. Holman, for a personal judgment, would be on that of General Motors, since it is a type of industry with which I have been connected. That looks a little low to me.

Mr. HOLMAN. I think that they are based on the same figures. I do not mean to say that they are illustrative of anything other than the fact that to me, they mean that the oil industry has to put in a lot of money in capital investment as compared with other industries.

Now, I would not for a moment say that General Motors or any other company wasn't just as efficient as we were.

Senator FLANDERS. It is a difference in the business?

Mr. HOLMAN. Yes.

Senator FLANDERS. I suppose your men spend most of their time turning valves.

Mr. HOLMAN. That is right. As an example, Senator, you take one of our big "cat" plants, which I suppose—I hesitate to say what it would cost today, but they are very expensive plants, 20 million or 30 million dollars.

Senator FLANDERS. I suppose a "cat" plant is a catalyzing plant.

Mr. HOLMAN. That is right. Eight or nine men on a shift run one of those plants, although it takes a lot of money to build the tools to keep those nine fellows busy.

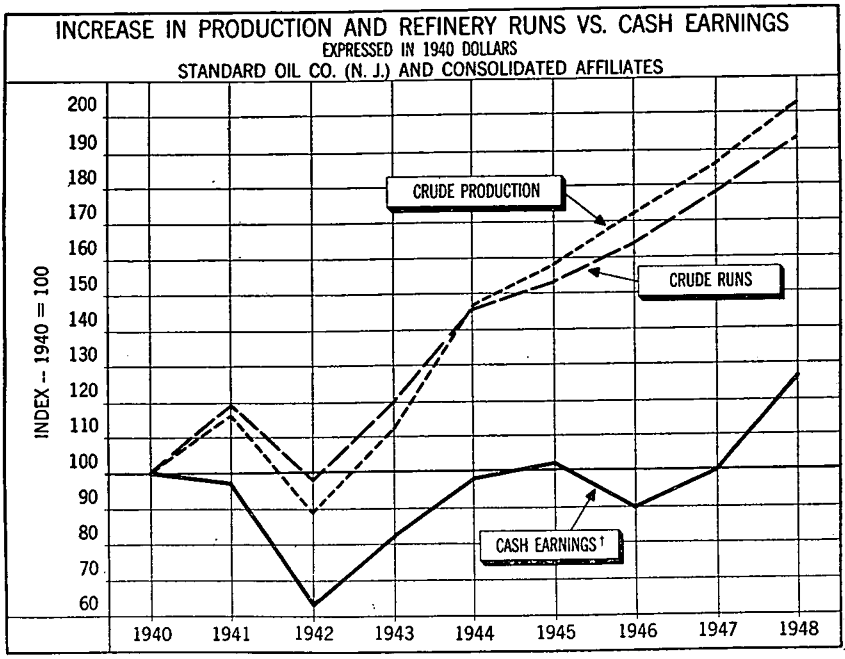
Actually, most of the work is reading charts, and so on. It is mostly done with mechanical tools. They don't even have to turn a valve, really. They have to read charts to see that the pressures are right.

Senator FLANDERS. Well, it is an unusual business.

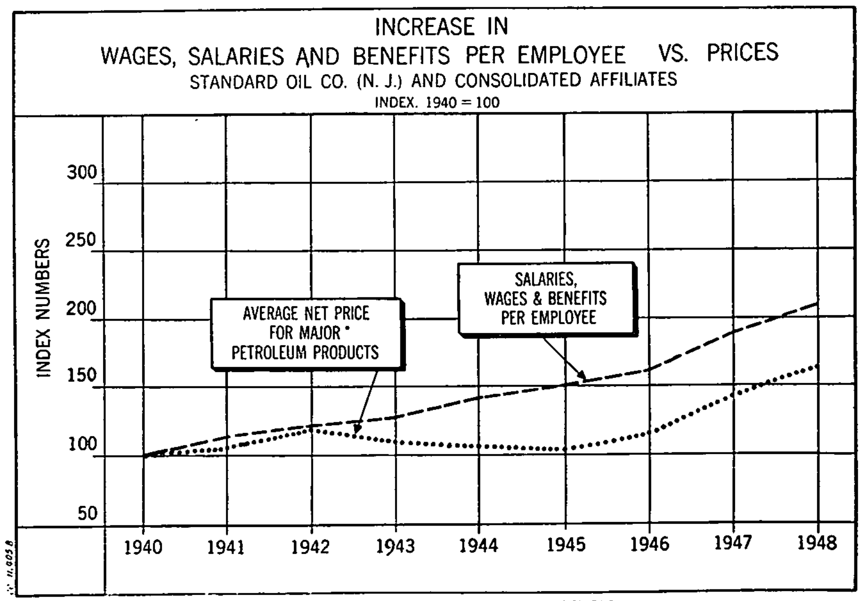
Are there any further questions? If not, sir, we thank you for your testimony and for the frank way in which you have presented it and answered the questions. You may be excused at this point.

Mr. HOLMAN. Thank you very much.

(The charts referred to in Mr. Holman's testimony are as follows:)




† NET EARNINGS PLUS DEPRECIATION




* NAPHTHAS AND GASOLINES, REFINED OILS, DISTILLATE OILS, LUBE OILS AND RESIDUAL FUEL OILS.

*Earnings and their disposition, Standard Oil Co. (N. J.) 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) |

Senator FLANDERS. The hearings tomorrow will be held in the caucus room on the third floor of the Old House Office Building, and those who are expected to appear are Mr. Moses Pendleton of the American Woolen Mills, of Boston; Mr. J. E. Bradley, vice president of the Pacific Mills, a cotton manufacturing company; Mr. Hiland G. Batcheller, president of the Allegheny-Ludlum Steel Corp.; and Mr. John Ballantyne, president of the Philco Corp., of Philadelphia.

This hearing is adjourned.

(Thereupon, at 3:25 p. m., a recess was taken until 10 a. m., Thursday, December 16, 1948.)

# CORPORATE PROFITS

THURSDAY, DECEMBER 16, 1948

United States Senate,
Subcommittee on Profits of the
Joint Committee on the Economic Report,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the caucus room, Old House Office Building, Senator Ralph E. Flanders (chairman of the subcommittee) presiding.

Present: Senators Flanders (presiding) and Watkins, and Representatives Wolcott and Herter.

Also present: Fred E. Berquist, assistant staff director.

Senator Flanders. The hearing will come to order.

Following the plan of having representatives in each industry, both from those of great size and those of more modest dimensions, appear before us for any given industry, we are greatly privileged this morning to have as our first witness Mr. Hiland Batcheller, who is the president of the Allegheny-Ludlum Steel Corp., and I will ask Mr. Batcheller to take the stand as a representative of one of the smaller and nonintegrated steel industries.

Mr. Batcheller, you may proceed, sir.

## STATEMENT OF HILAND G. BATCHELLER, PRESIDENT, ALLEGHENY-LUDLUM STEEL CORP., PITTSBURGH, PA.

Senator Flanders. First, you had better give your name and position to the reporter.

Mr. Batcheller. Hiland G. Batcheller, president of the Allegheny-Ludlum Steel Corp., Pittsburgh.

Last March I appeared before the Joint Committee on the Economic Report to discuss our company's pricing policies, a subject closely related to that of corporation profits now under discussion. I am glad to appear again before this committee, if by explaining to you the policies and experience of Allegheny-Ludlum Steel Corp., I can help to clear up any misconceptions, now so widespread, as to the role of corporation profits in our national economy. In my opinion, it is extremely important to the national welfare that this committee, all policy-making Government officials, and the entire public obtain a fair picture of corporation profits in order to judge them fairly and without prejudice.

Last March I outlined for you certain background information concerning the nature of this company's business and its cost and earnings position in order that you might be in a better position to understand the business problems of a company that is neither large nor small and may, therefore, be typical of American business. I think it would be well, briefly, to review that report.

Allegheny-Ludlum, like many other companies, is in transition between the old and the new. While we are classified as a steel company, almost all of our research and much of our production is centered on the manufacture of what might be called synthetic metals resulting from the skillful combination of various metallic elements to form new alloys. The constantly expanding use for these new alloys arises either from the need to conserve diminishing supplies of the base metals or to meet the requirements of new end products which scientists are continuously developing. As an illustration of our contribution to conservation, I cite a series of alloys of iron combined with nickel and chromium having the incorrodible characteristics of the noble metals and popularly referred to as stainless steels. To the march of science we have contributed a series of alloys to the electrical industry having characteristics not possessed by any one metal. These alloys are used in electric motors, generators, and transformers and all types of radio, radar, television, and other electrical equipment. Illustrative of a continuing effort in research, I might mention a program to find a practical way to transform titanium oxide, so plentiful in the earth's crust, into a useful metallic form. In recent years we have been only incidentally in the carbon steel business but we are now reentering this field on a more substantial basis through the undertaking of a major expansion program designed to meet the needs of several companies which are seriously handicapped by the present acute shortage of carbon steel.

My explanation of last March on the cost, pricing and profit problems of Allegheny-Ludlum is quite pertinent to your present study of corporate profits. At that time I pointed out that, 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. I concluded my remarks of last March with the statement that a company which had refrained from raising its prices in spite of drastically increased costs to the extent that Allegheny-Ludlum had done, could not reasonably be expected to absorb further cost increases and that price increases might be necessary to assure it a fair and a reasonable profit.

I should now like to bring this story up to date.

Senator FLANDERS. May I just stop to inquire whether your holding the line on prices brought you below the prices of competitors?

Mr. BATCHELLER. In some cases, yes; although I think that the "hold the line" price policy on the products that I am speaking of was pretty generally prevalent, as I point out, I think, later in this statement.

Senator FLANDERS. It is especially a line of specialties, I take it.

Mr. BATCHELLER. We do not call it that, but that is perhaps as good a word as any. It is steels that are not commonly made, yes.

Senator FLANDERS. You may proceed.

Mr. BATCHELLER. Cost increases have continued throughout 1948. 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.

I submit this evidence in contradiction to that of various experts who do not have to meet a pay roll and who labor under the delusion, I feel, that there is some mysterious way by which business can continually absorb cost increases while prices continue unchanged. Even now a campaign is under way for a fourth round of wage increases. If experience is any criterion, further price increases will follow.

This recital of our 1948 experience goes far, I think, to explain the pricing policies of Allegheny-Ludlum and emphasizes the extent to which costs must be taken into account. Major pricing policy decisions of the type referred to 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.

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.

With regard to your question concerning special reserves, Allegheny-Ludlum does not use the so-called "Lifo" method of handling inventory. In retrospect it appears it would have been of at least some temporary advantage to our company to have adopted this accounting device in 1939. At that time, however, no such increase in the cost level as has since occurred was foreseen, and so the traditional policy of pricing inventory at "cost or market whichever is lower" was not changed. There are, of course, many problems with the "Lifo" method, as other witnesses have pointed out. Among other things, it is complicated to administer, and if prices should drop below those that are current at the time it is adopted, there are decided disadvantages to it.

Nor has Allegheny-Ludlum set aside any reserves, in addition to normal depreciation, to cover present-day replacement costs. The company has so increased its investment in plant since the end of the war that depreciation charges already partially reflect current construction costs. Normal depreciation charged by the company in 1940 was only about $1,400,000, while for 1949 it will probably exceed $2,600,000.

As one means of judging the fairness of present-day profits, your committee has suggested a comparison of profits of the prewar year 1940 with those of the years 1946 to 1948. Profits of Allegheny-Ludlum are now undeniable 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, presented herewith, and are also set forth graphically on charts A through E, 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. I think that these figures present some interesting comparisons. I think, Senator, that table I, which I have presented, will give you this in the most abbreviated form, if you care to glance at it.

Consider, for example, our profit margins as measured by percent of profit to sales. That is shown on chart A. 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 at 100 percent of theoretical capacity, as is now the case, for any extended period 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. May I interrupt there? 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.

Senator FLANDERS. All right, sir, you may proceed.

Mr. BATCHELLER. 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.

Senator WATKINS. I would like to ask a question, if I may, at this point, because I may forget it.

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 at close to 100 percent its steel-making facilities, 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 still be 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 in a deterioration of 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 the steel industry is running at almost an unprecedented high percentage of capacity?

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.

Senator FLANDERS. Is it not true that the scrap situation is easing up, as compared with a year ago?

Mr. BATCHELLER. This winter, or the next 4 or 5 months, will answer that question, Senator. There has been a great, intensive drive put on to bring in all of the scrap possible during the summer months, and that was particularly effective during the fall, and produced splendid results. But during the war years we conducted so many of these drives that I fear that the country is like Mother Hubbard's cupboard; we are getting to the bottom of the barrel on the accumulation of scrap on the farm and here and there.

Senator WATKINS. What about getting scrap from foreign sources, particularly from Europe? We certainly sent enough steel over there. We ought to be able to get some back.

Senator FLANDERS. Is there not a prospective improvement in returns from Germany? Is that not under way at the present time?

Mr. BATCHELLER. A number of expert committees, Senator, have visited Germany and tried to devise ways and means of getting back to our country some of the 10,000,000 tons I believe is estimated to be available over there. All of these measures, so far as I know, and I believe I am correct in this, have been pretty puny up to the present time. If I recall correctly, some 500,000 tons of scrap has been authorized to come back from Germany, but I believe only 250,000 or 300,000 tons has really materialized. It is a drop in the bucket.

Senator WATKINS. What is the difficulty? Why can we not get it?

Mr. BATCHELLER. I have not the answer to that, Senator.

Senator WATKINS. It is not the lack of shipping, is it?

Mr. BATCHELLER. There is great competition for all of this scrap between all of the western European nations. I presume that there are political difficulties. I do not know the answer to that, sir. It has been studied. General Clay has issued reports on it, and so on, but I do not have that answer.

Mr. BERQUIST. Mr. Batcheller, you referred to the diminishing reserves particularly in Minnesota. Is it not true that at the current rate of production, it is based upon the largest shipments of ores from the Upper Lake region ever in history?

Mr. BATCHELLER. Yes, that is true. We are dragging ore out of Mesabi, I believe it is about 80,000,000 tons a year still, and the total consumption of ore must be running close to 100,000,000 tons or more. That is correct.

With the beginning of the war, we started to make history in the extraction of iron ore from old mother earth, and we are continuing to do that.

If you would like a voluntary observation, sir, I think that we are making a great mistake in lack of concentration on the possibilities of a conservation of iron ore, and by that I mean stimulated research and exploration into ways and means of making a ton of iron ore do a better job, to do the work that 2 tons or 3 tons of iron ore did in the old days, rather than continuing to put all of the pressure and all of the spotlight on the increased mining and dissipation.

Senator FLANDERS. Do you mean by that, Mr. Batcheller, that there is a wastage, a present wastage of the iron content of the ore?

Mr. BATCHELLER. So far as I know—and I do not know whether anyone could approve of this—I have seen figures all of the way from $5,000,000,000 a year to $16,000,000,000 a year by various skilled economists. You take iron ore, which is iron oxide, out of the ground, and we are taking it out in these perfectly stupendous quantities, and we transform it into metallic iron; and mother nature starts to work at this very minute, endeavoring as best she can to transform that metallic iron right back to the iron oxide from which it was made.

Now, iron oxide likes to stay in the oxide state, and we call it rust, but rust is exactly what we started with, an iron oxide. And I think that in this country we have been woefully short in our effort and ingenuity to find and adopt more and better ways to protect that iron when it is made so that it will last longer and make it stronger so that one ton will do the work of two tons.

Senator FLANDERS. You are making a good sales talk for stainless steel.

Mr. BATCHELLER. I beg your pardon, sir; stainless steel is the best way to do that, but it has not yet reached the economic state where it can be done on any tremendous scale. I am talking, for instance, of better ways or better protective coatings for steel, such as galvanizing and tin-plating. These tin-plated milk cans that the farmer has are pathetic to me. He has to have them retinned two or three times a year, and then they are no good. The process of tin-plating leaves so many microscopic openings in that plated covering that the atmosphere gets in under there like the decay in a tooth, and goes to work. You have seen them banging around the farms. They are not economic, in my opinion. They could be improved on. That milk can could last 10 years instead of 2 years.

Senator WATKINS. As I understand you, then, from your point of view there is very slight possibility of getting an increased supply of steel by simply increasing capacity of plants?

Mr. BATCHELLER. Well, that is a dangerous thing to say, because American ingenuity knows no bounds. I do not know how, and I do not think any expert knows how we can produce very much more steel, regardless of capacity, with the known supplies of the materials available. But to say that it cannot be done, I would not go that far, because we have done miracles before and we will do them again some way.

Senator WATKINS. I understood that it was your opinion that we would not get much more capacity.

Mr. BATCHELLER. It would be my opinion that we would have great difficulty in continuing to operate the steel industry at its present capacity in view of the known methods of utilizing raw materials available, and in some cases their diminishing supply.

Senator FLANDERS. You may proceed.

Mr. BATCHELLER. The ratio of our earnings to invested capital, as you will see from chart B, is expected to be about the same in 1948 as in 1940, notwithstanding our present higher operating level, and is expected to be considerably lower than in either 1946 or 1947. In interpreting this trend you should realize that we have more than doubled our investment in plant since the end of the war, all of this new investment being made at high prices. This is a graphic illustration of the effect of replacing equipment bought with old dollars with equipment bought with new dollars, and it suggests that the present price level for steel is possible only because of the tremendous investment in plant built at low costs in past years, and it suggests conversely that a steel company starting from scratch on the basis of today's construction costs might have a very difficult time showing a return that would interest investors with steel products selling at today's prices.

It seems to me that these two factors by themselves—namely, the probable profit at a normal operating level and the prospective earnings of new high-cost facilities—may have a very strong bearing on the fact that present earnings of steel companies are held in such low esteem in the security markets. They probably have something to do, also, with the fact that expansion in steel-producing facilities has not proceeded more rapidly.

An appraisal of profits of Allegheny Ludlum is not complete unless one considers the needs of the company for additional funds and the uses to which it is putting its current income, and I would like to stress that point particularly. To understand this you should first know a little more about the peculiar type of business we are in.

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 super alloys, and, as science progressed, into high-temperature metals for jet planes and gas turbines.

May I digress there for just a brief moment. My understanding is that the engineers and designers of the jet motor would like to operate at 2,000 degrees Fahrenheit. There is not any metal and we have never known any such metal that could operate at that high temperature with the strength required to keep it from falling apart.

Through science and research and the cooperative effort of groups of scientists, which I think first appeared during the war, scientists working together for a common end, we are up to about 1,600 degrees Fahrenheit now; and the jet planes that you see flying around are operating at something near that temperature. The gas turbines are beginning to come off the drawing boards, and in another year or two, if we can continue we will be up to 1,800, perhaps, and then to 1,900, and eventually to 2,000.

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 F, presented herewith, 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. 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.

Senator FLANDERS. May I ask a question there? Is not carbon steel an old-time, old-line basic product?

Mr. BATCHELLER. Yes, sir.

Senator FLANDERS. Why do you feel the necessity for increasing that, you being so much in the special field?

Mr. BATCHELLER. Well, tonnagewise, we are quite a producer of carbon steel also, Senator, and we are adding to that because certain industries need it and they cannot get it anywhere else, and they are old friends and customers of ours and we are going to supply them with what they need.

May I give you a specific example of that. The petroleum industry has been sorely in need of steel. One of our customers in that industry in a very close, friendly commercial relationship, came to us, and after weeks and I guess months of engineering and so on, we arrived at a method by which we could make some more carbon steel for them. We were signing the final contracts one morning under which we will make 5,000 tons a month, 60,000 tons a year, for this particular petroleum company in the form of blooms for casing pipe which will enable them to go on with their drilling for oil, which they had to curtail.

Senator FLANDERS. You have no pipe mill yourself?

Mr. BATCHELLER. No, sir; we do not.

On the day this was all being concluded in the normal course of trade I was late in reading my mail. I was somewhat amused later that day when my secretary brought in my mail and I received a letter from a very distinguished gentleman here in Washington, abusing me for not doing anything about the need of the petroleum industry for steel. It was somewhat bitterly accusing me of selling my steel for frivolous purposes. That does not make any difference; he just didn't know what he was talking about, that is all. But the point I want to make is that in the normal course of trade, these things get worked out somehow.

We are doing this by new methods, and we are going to make 400,000 ingot-tons of steel a year, beginning about April, in a new type of furnace—four furnaces; and in four furnaces having an area which will be half of this room we are going to release 74,000 electrical horsepower, and that has never been done before, and we think that that is going to make history.

An important part of this new output will be used to relieve the intense shortage of pipe in the oil indusrty. 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.

Chart E, 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.

Senator WATKINS. May I interrupt here to say that you probably have given them an increase in the value of their stock which is not counted as a dividend.

Mr. BATCHELLAR. That is what we think that they are looking for, rather than current dividends.

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 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 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 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.

Senator WATKINS. Do you think that they 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 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. That is what I want to do, I want 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 WATKINS. You know, the contention is being made that in view of the high profits of these companies, these industries, they can stand another wage round without a price increase.

Mr. BATCHELLER. I know that, sir.

Senator WATKINS. That is the reason I am asking this question.

Mr. BATCHELLER. I am not a statistician, but a statistician can do funny things. They can take base-period years when earnings were at a low ebb, and the years 1936 to 1939 in the steel industry were terrible years; they contrast those with earnings this year and make an increase that looks like the pathway to the moon. You can take a base year on wages, and take 1945, and show a relatively small increase.

But what happened between 1940 and 1945? I got curious about that, and I think it is interesting. I will tell you what it is. In 1940 in our company, our average hourly wage rate was about 84 cents per hour. Our average hourly wage rate at the present time is $1.73 an hour. During that time our earnings have not done anything like that, and they should not. But with a 5-percent profit margin in our present selling prices and our present costs and our present volume, which is 100 percent, practically, I do not see how I can absorb any other great increase in cost, whether it is excess-profits tax or wage rates or increase in cost of materials.

Senator FLANDERS. What about a normal increase, an increase in the normal corporate tax, as suggested by Professor Harris, running the present 40 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.

May I just give you one quick one, sir, that I did not put in here because I was only told this the day before yesterday as I was leaving Pittsburgh. But after 2 years of combined research with a medical-supply manufacturer, we have found a metal which permits the introduction of anesthetics by spraying through the pores of the skin. For 2 years this patient, exhaustive effort has been under way, to find something that would do that; and they tell me that there are about 5,000,000 diabetic patients in this country, and many of them are children, and to squirt them with hypodermic needles is not good, and the children particularly, they get all excited and hysterical about this. And a way has been found with a little gun arrangement to force that insulin, or whatever it is, insulin compound through the pores of the skin without sticking holes in that skin at all.

I do not want to give up that sort of thing, but that costs money, and we will not make a nickel out of that for I don't know how many years.

Mr. Chairman, I should like to offer this table I and charts A through F for the record.

Senator FLANDERS. They may be made a part of the record.

(The table and charts referred to are as follows:)

TABLE I.—*Allegheny Ludlum Steel Corp. and subsidiaries—Financial and statistical data*

| | 1940 | 1946 | 1947 | 1948 (estimated) |
|---|---|---|---|---|
| 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 | (1) |
| 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 [2] | $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 |
| Per net ton shipped | $13.56 | $21.57 | $16.82 | |
| Per employee | $375.00 | $522.00 | $482.00 | |

[1] Profit for first 9 months, 1948, was $4,424,000.
[2] Net capital expenditures equals capital expenditures less depreciation, depletion and plant retirements for the year.

Senator WATKINS. I noted early in your statement you said that you had gone on without increasing your prices, and you still made profits notwithstanding you had not increased your prices.

Mr. BATCHELLER. I said, sir, in July when we did not increase prices, after the last round of wage increases, we dropped to 2 percent profit, and that wage increase was only effective 2 weeks in that month; and if it had been effective applicable to the whole month, together with the other cost increases that closely followed, we would have been in the red. If we get a major cost increase we will try to do something about it; we will try to absorb all of it that we can, but if we get to the point where we cannot meet the pay roll, then we cannot absorb it.

I do not mean that literally, but we have to give up expansion, better building, or the payment of any returns to our stockholders. And then there is only one thing we can do—put the price up. But we will fight that to the last ditch, as we did last time, because we are only interested in one thing—increasing the volume of our business.

Any time during the past 2 years I could have made a barrelful of money by turning all of my product into funny operations; and we are not interested in that at all. We want to hold down to the last ditch the cost of our product, to expand its use, to make it available to everybody in the country at a reasonable profit to us. We are not a charitable institution.

Senator FLANDERS. The suggestion has been made before this committee that if the dividend rate had been higher 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?

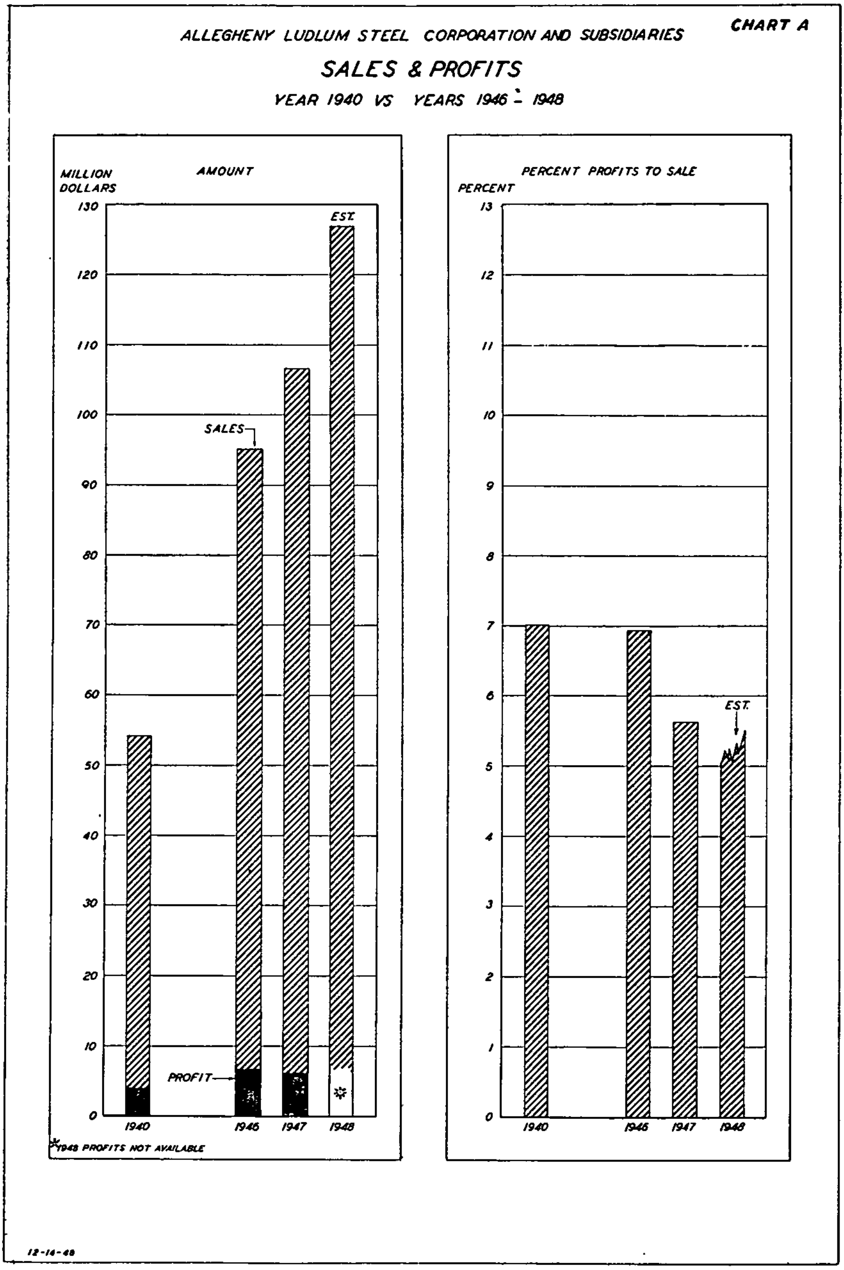


CHART A
ALLEGHENY LUDLUM STEEL CORPORATION AND SUBSIDIARIES
SALES & PROFITS
YEAR 1940 VS YEARS 1946 - 1948
AMOUNT
MILLION DOLLARS
SALES
PROFIT
EST.
*1948 PROFITS NOT AVAILABLE
PERCENT PROFITS TO SALE
PERCENT
EST.
1940
1946
1947
1948
12-14-48

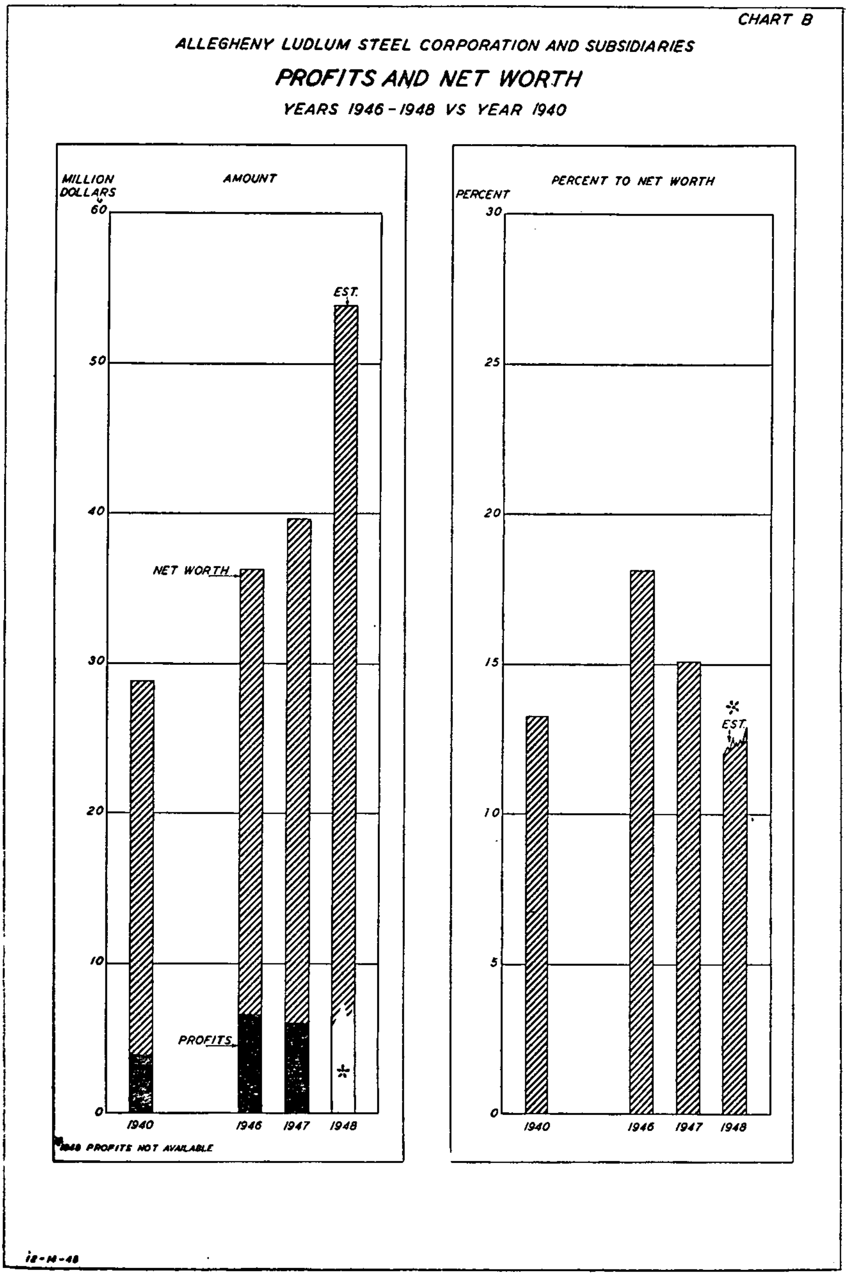


CHART B
ALLEGHENY LUDLUM STEEL CORPORATION AND SUBSIDIARIES
PROFITS AND NET WORTH
YEARS 1946-1948 VS YEAR 1940
MILLION DOLLARS
AMOUNT
60
50
40
30
20
10
0
NET WORTH
PROFITS
EST.
*
1940
1946
1947
1948
*1948 PROFITS NOT AVAILABLE
PERCENT TO NET WORTH
PERCENT
30
25
20
15
10
5
0
*
EST.
1940
1946
1947
1948
12-14-48

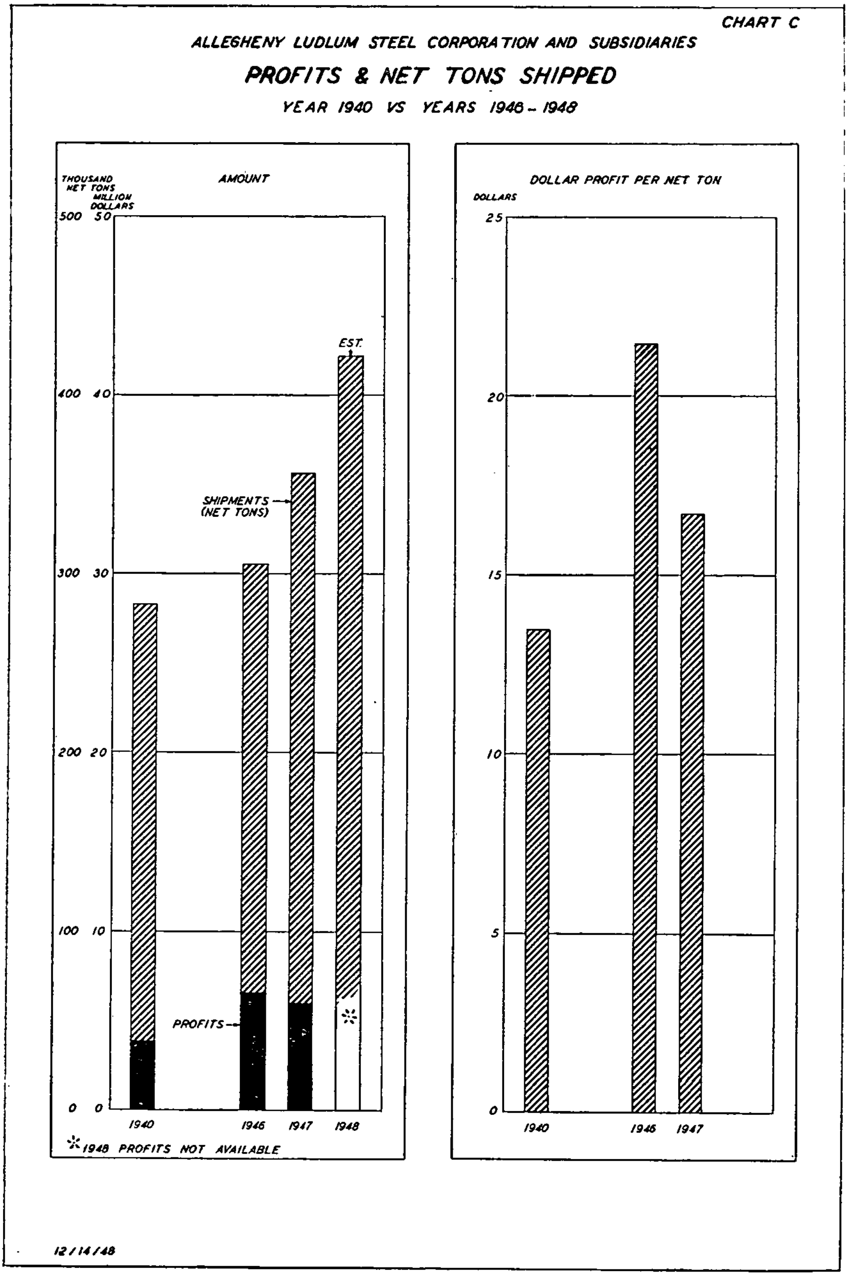


CHART C
ALLEGHENY LUDLUM STEEL CORPORATION AND SUBSIDIARIES
PROFITS & NET TONS SHIPPED
YEAR 1940 VS YEARS 1946 - 1948
AMOUNT
THOUSAND NET TONS
MILLION DOLLARS
500 50
400 40
300 30
200 20
100 10
0 0
EST.
SHIPMENTS (NET TONS)
PROFITS
1940
1946
1947
1948
* 1948 PROFITS NOT AVAILABLE
DOLLAR PROFIT PER NET TON
DOLLARS
25
20
15
10
5
0
1940
1946
1947
12/14/48

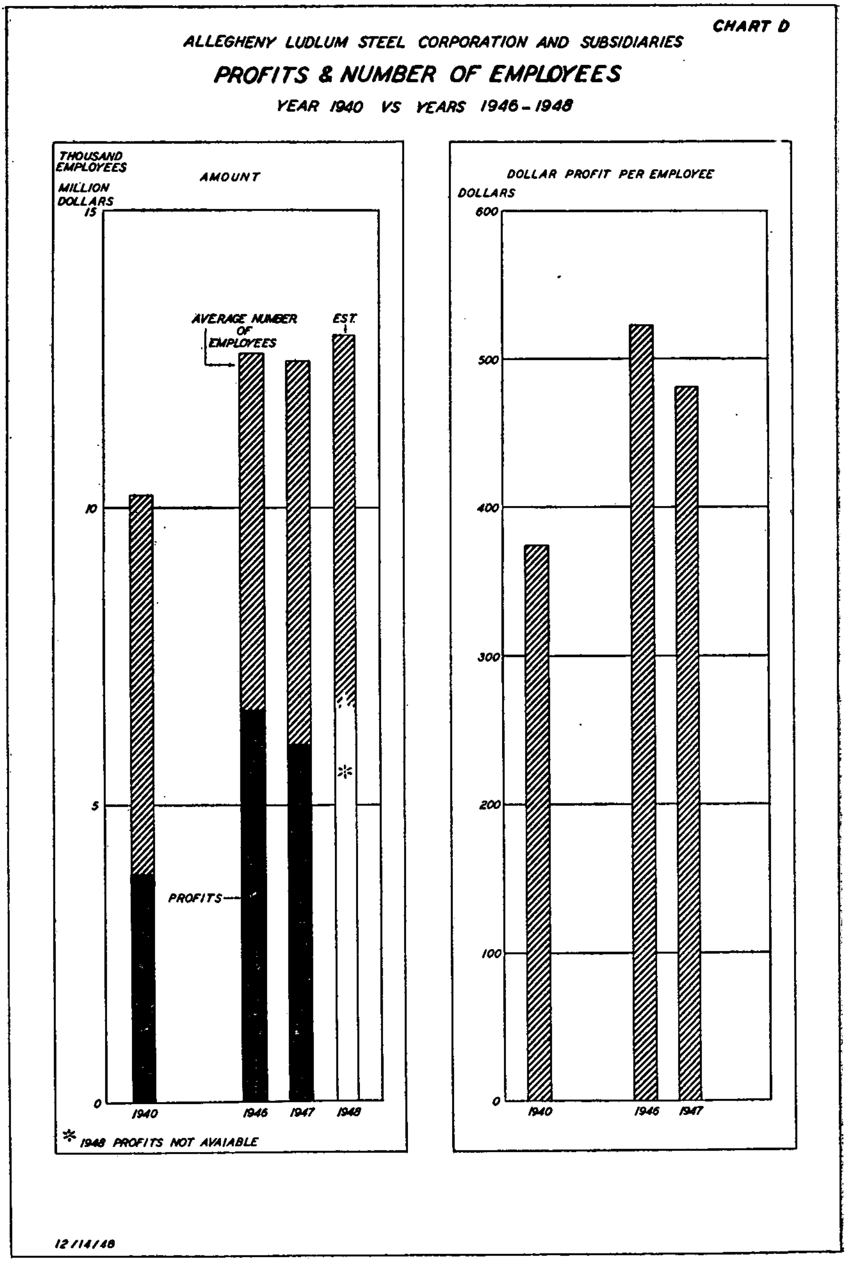


CHART D
ALLEGHENY LUDLUM STEEL CORPORATION AND SUBSIDIARIES
PROFITS & NUMBER OF EMPLOYEES
YEAR 1940 VS YEARS 1946-1948
THOUSAND EMPLOYEES
MILLION DOLLARS
AMOUNT
AVERAGE NUMBER OF EMPLOYEES
EST.
PROFITS
15
10
5
0
1940
1946
1947
1948
* 1948 PROFITS NOT AVAIABLE
DOLLAR PROFIT PER EMPLOYEE
DOLLARS
600
500
400
300
200
100
0
1940
1946
1947
12/14/48

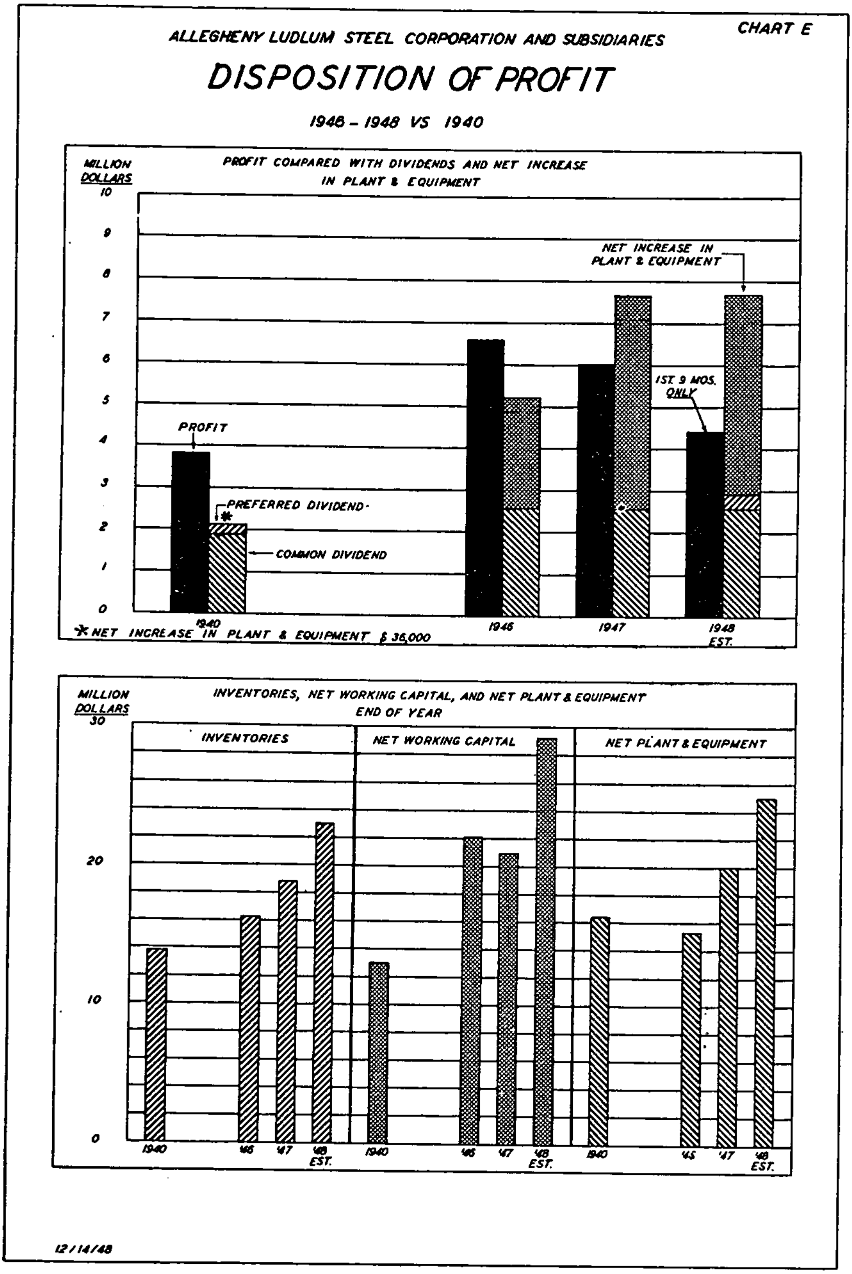
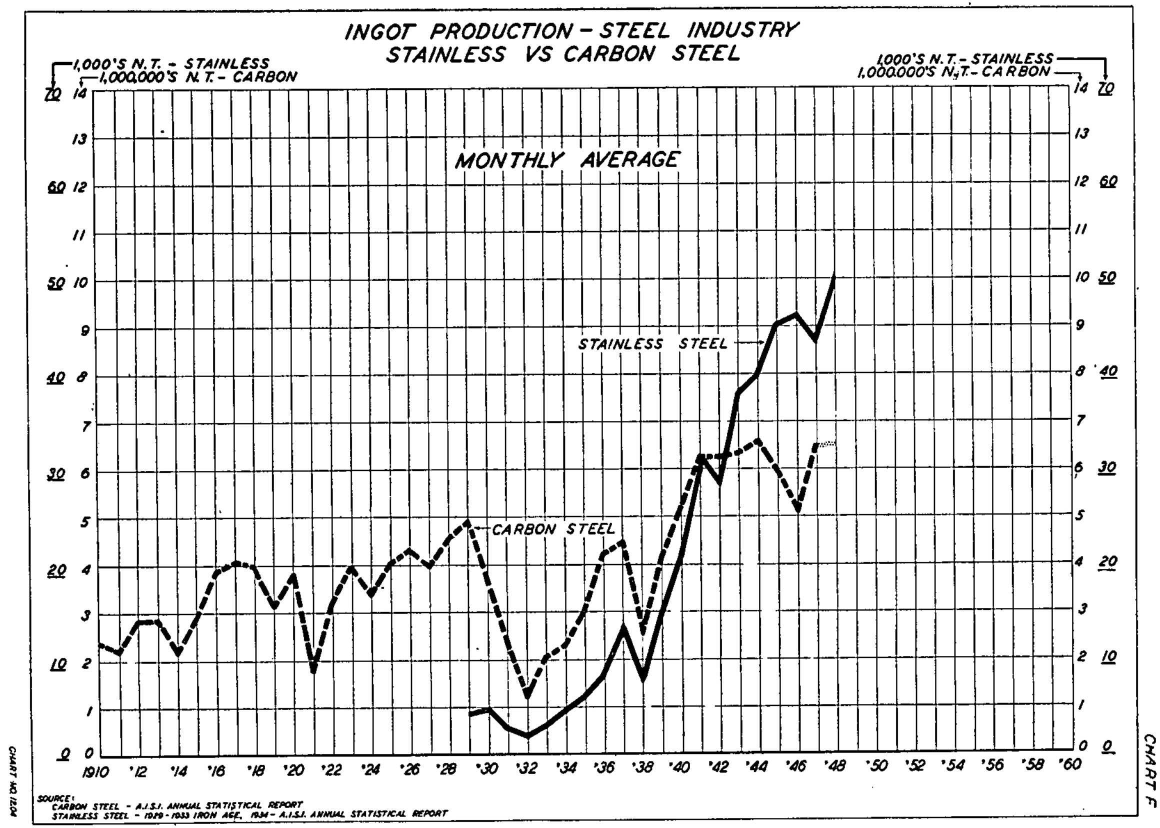


CHART E
ALLEGHENY LUDLUM STEEL CORPORATION AND SUBSIDIARIES
DISPOSITION OF PROFIT
1946 - 1948 VS 1940
PROFIT COMPARED WITH DIVIDENDS AND NET INCREASE IN PLANT & EQUIPMENT
MILLION DOLLARS
NET INCREASE IN PLANT & EQUIPMENT
1ST 9 MOS. ONLY
PROFIT
PREFERRED DIVIDEND
COMMON DIVIDEND
1940
1946
1947
1948 EST.
* NET INCREASE IN PLANT & EQUIPMENT $ 36,000
INVENTORIES, NET WORKING CAPITAL, AND NET PLANT & EQUIPMENT END OF YEAR
MILLION DOLLARS
INVENTORIES
NET WORKING CAPITAL
NET PLANT & EQUIPMENT
'48 EST.
12/14/48


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
CHART NO. 1204
CHART F
SOURCE:
CARBON STEEL - A.I.S.I. ANNUAL STATISTICAL REPORT
STAINLESS STEEL - 1929-1933 IRON AGE, 1934 - A.I.S.I. ANNUAL STATISTICAL REPORT

Mr. BATCHELLER. My point of view is from the practical viewpoint, Senator. I am not an economist, and maybe they know things that I do not know, but I just do not see any sense in it. 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 I can see is the cost of the financing is lost to both the company and the stockholder, and the Internal Revenue Department takes a bigger bite out of the amount he receives of that extra dividend. I do not think it does any good, because I do not think investors 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, compiling or 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. Food products are 16.8, and so on, and so forth. And I think that that is the principal thing. 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, 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 plentiful, and 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.

Senator FLANDERS. Do you operate blast furnaces at all?

Mr. BATCHELLER. No, sir, we do not; not at the present time.

Senator FLANDERS. I have no more questions.

We thank you, Mr. Batcheller.

Mr. BATCHELLER. I am sorry that I have this cold.

Senator FLANDERS. Your statement has been most interesting.

Mr. BATCHELLER. Thank you, Senator.

Senator FLANDERS. Our next witness is Mr. Robert Montgomery, of the American Woolen Co.

Mr. Montgomery, will you take the witness chair, please. Will you identify yourself for the reporter, please?

## STATEMENT OF ROBERT MONTGOMERY, A DIRECTOR AND SECRETARY OF THE AMERICAN WOOLEN CO.

Mr. MONTGOMERY. My name is Robert H. Montgomery. I am a director and secretary of the American Woolen Co., and in Massachusetts we call it clerk. I trust that you will forgive me for also being a lawyer when I assure you that my association has been more on the management side than the legal side during the past 15 years, and I think that I am reasonably familiar with the subjects that we are to discuss today.

I wish to convey to you Mr. Pendleton's regret that he has found it impossible to come in person. He remembers very pleasantly his appearance at your hearing a year ago and would like very much to have joined you.

Our company feels complimented in being asked to participate in this symposium about profits because predominantly in the past our experience has been on the other side of the ledger.

I have a statement here which I would like to present. This statement is made on behalf of the American Woolen Co. which is engaged in the manufacture of woolen and worsted fabrics, blankets, and knitting yarns. It operates 25 mills, 22 located in New England, 2 in New York and 1 in Kentucky, and is a complete manufacturing unit, taking wool in the grease through all processes to the finished fabric, and only occasionally does it purchase partly processed materials, such as tops and yarns. The industry to which it belongs is the wool-textile industry in which it is the largest single unit, although it represents only 15 percent of the production.

Your committee has asked for a tabluation of company data and for information about special reserves, pricing policies, sources of capital, and the level of profits. The tabulation is annexed to this statement.

Two groups of questions, those relating to special reserves and to the sources of capital are not applicable to this company because we have not set aside any specific allowances, over and above those permitted as costs by the Internal Revenue Bureau, to offset higher plant and equipment costs and because, as our tabulation shows, we have paid out a very large portion of earnings during the past 3 years, and have not made any effort to raise equity capital since 1923.

This leaves for discussion two groups of questions—pricing policies and level of profits.

Our marketing practices and price policies are the same as before the war. Ours is a mass production industry and our customers are mass producers and mass distributors of clothing. Our profits and the profits of our customers depend upon sales in great volume, which means sales by us and by them at the lowest possible price.

With insignificant exceptions, the company's fabrics and yarns are used by other manufacturers to make clothing and other products. The company's sales are to clothing manufacturers and, in small part, to jobbers who in turn resell to clothing manufacturers. This company could not and it never has made any attempt to control resale prices of any of its products.

The fabrics of this company and of its many competitors, both in the wool textile industry and in other fabric producing industries, are for the most part marketed in a single domestic market in New York.

Woolen and worsted fabrics are marketed in two seasons—spring and fall. Before a season is opened our designers and stylers prepare a line of samples and our cost department estimates the cost of producing each fabric and determines the prices which include a manufacturing profit. Our customers are then invited to place orders and it is our practice to manufacture against definite orders only.

The type of fabrics manufactured is determined by the popular demand. During and since the war there has been a decided trend toward better-quality fabrics, both woolens and worsteds, and many of the cheaper grades have found no market. Better quality increases costs because we must use better wool. Changing styles are also a factor in determining the price of fabrics. For example, when fabrics in pastel shades are popular, a very high type of wool is required and this increases the cost over an equally durable fabric made of a less expensive wool.

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.

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.

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 and 15 percent, so as to permit profits after taxes of 8 percent to 10 percent; but 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 |

Coming now to your specific questions about 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?

Our pricing policy for 1948 was unchanged, but we had to deal with a new set of costs. 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.

(*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"?

What we have already said answers this question except the last part of it.

The final responsibility for prices is with the president who confers with department heads—cost, sales, manufacturing—before decision is made.

(*c*) Discuss the factors outside your control which have influenced the profits in your company, e. g., money supply.

We know of no factors other than those already enumerated that have influences over profits.

(*d*) To what degree do you consider your own costs in fixing prices to meet competitive conditions?

When there is a buyers' market, fabrics are sold at best available prices, regardless of costs, in order to obtain business.

(*e*) What profit level do you expect to achieve when prices are determined?

This has already been answered.

(*f*) Could you have charged more for your product and thereby realized greater total profits? If so, amplify.

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.

(*g*) To what extent are your profit expectations responsible for increased prices?

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.

We come to the second subject, the level of profits. Your first question was:

(*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?

First, let us state why we believe that certain criteria that have been suggested cannot be used for this purpose in the case of this company.

No. 1, 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. 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, 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.

Second, 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. 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.

Third, it is submitted that 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 1 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 divided 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.

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 reimvestment 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.

Equity capital will then be required. There are two sources, 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.

(b) Would you agree that profits are ever too high? If so, where and when? Should anything be done about such profits?

This is a question for the economist or the philosopher. 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.

(c) Some industries made relatively large profits in 1947 operating at or near capacity; and yet their profits increased sharply in 1948. What is the justification for such increased profits?

This was not true in our company. As you will see from the tabulation annexed, the trend of our profits was downward in 1948 and this downward trend will, in our opinion, continue into 1949.

In our company we are sure that our problem is to maintain a high level of profits if we are to survive. If depression comes, we shall need the cushion of a surplus; if inflation continues, we shall need new equity capital. Our problem will be aggravated by any increase in the taxation of the company or its stockholders.

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 are 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.

To carry the illustration to still greater heights, we find that a dividend of $100 added to the income of a stockholder with other income of $200,000 is worth $17.87 in 1948; in 1923 it would have been worth $50; and in 1939, $38.

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. Depreciation and replacement reserves set up on the basis of costs of a decade or more ago must be supplemented by additional dollar earnings because the cost of replacement has increased along with everything else.

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.

I have some tabulations here that I would like to have put in the record.

Senator FLANDERS. They will be made a part of the record.

(The tables are as follows:)

*American Woolen Co., Inc.*

| | Sales | Yardage produced | Percent of looms run | Net profits before reserve for contingencies | Percent of net earnings to sales | Net earnings per yard produced | Average selling price |
|---|---|---|---|---|---|---|---|
| 1940 | $76, 560, 111 | 38, 987, 385 | 93. 3 | $3, 154, 464 | 4. 1 | 0. 081 | $1. 745 |
| 1946 | 170, 810, 787 | 65, 531, 626 | 158. 1 | 23, 098, 178 | 13. 5 | . 352 | 2. 532 |
| 1947 | 175, 993, 449 | 58, 849, 992 | 158. 2 | 16, 269, 914 | 9. 2 | . 276 | 2. 948 |
| 1948 (to Sept. 30, inclusive) | 152, 112, 364 | 45, 147, 093 | 163. 0 | 13, 461, 626 | 8. 8 | . 298 | 3. 415 |

*American Woolen Co., Inc., percent of net earnings to invested capital*

| Year | Invested capital | Net earnings | Percent |
|---|---|---|---|
| 1940 | $79, 076, 750 | $3, 154, 464 | 3. 99 |
| 1946 | 73, 325, 331 | 23, 098, 178 | 31. 5 |
| 1947 | 78, 105, 370 | 16, 269, 914 | 20. 8 |
| 1948 (to Sept. 30, inclusive) | 82, 610, 687 | 13, 461, 626 | 16. 3 |

*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.

Senator FLANDERS. Will you briefly comment on these tables?

Mr. MONTGOMERY. I will. The first one has in the first column the amount of our sales for the years 1940, 1946, 1947, and the first 9 months of 1948. The 1940 sales were approximately $76,000,000, and the sales in 1947 had gone up to $175,000,000. In 1948 we will have sales, if we annualize the 9 months' results, of about $200,000,000. The yardage produced in 1940 was 38 million. It went up to a high point in 1946 of 65 million, and it will reach about 60 million, we think, in 1948.

Senator WATKINS. What is the reason for the decrease? Is it because of lack of demand?

Mr. MONTGOMERY. You mean in 1947? Those figures are, of course gross, and in a sense they may be somewhat misleading, and yet we did not know upon what basis to put them. It depends upon the quality of the fabric you produce a great deal as to how many yards you produce, and that depends, of course, upon the public demand.

Senator WATKINS. You cannot produce as many of a high quality?

Mr. MONTGOMERY. As you could of something else, that is true. Now, I should say that demand in 1946, 1947, and up to this time in 1948 has been equal to what we could produce.

Senator WATKINS. It is still a seller's market?

Mr. MONTGOMERY. Well, up until September, I should say it was a seller's market. It is now a buyer's market in men's wear and to a lesser extent in women's wear. We have a very good trade in women's wear which has made up for the decline in the men's wear.

Senator WATKINS. I noted you said in your general statement that you could have increased the prices and your customers would have stood for higher prices.

Mr. MONTGOMERY. That is true up until the fall of this year; I think that we could have increased our prices.

Senator WATKINS. You have not had much time since you say it turned to be a buyer's market to determine just what is going to happen, have you?

Mr. MONTGOMERY. Oh, yes. We have been taking orders, and we know our orders are off. I think that there was a report the other day showing that unfilled orders in the industry are off about 29 percent over a year ago.

Senator FLANDERS. At this point I would like to call attention to the testimony of Mr. Ruttenberg of the CIO before us the other day, in which he said:

> It would be for the good of all concerned if prices were reduced so that demand would be bolstered and production maintained. The textile and shoe industries are doing just the opposite. They are attempting to bolster their present price structure by reducing production and eventually bringing supply and demand in balance at a point which will justify the present price structure.

Will you make some comment on that?

Mr. MONTGOMERY. As far as the American Woolen Co. is concerned, and so far as I can speak for the wool-textile industry, there is no effort being made to reduce production.

Senator FLANDERS. Are prices actually coming down as a result of that?

Mr. MONTGOMERY. Prices are not coming down, but they are not going up at the same rate that they were going up and they are not going up in proportion to the increase in the price of wool or the price of labor.

Senator FLANDERS. If the buyer's market develops, will you still maintain, if it becomes more severe, your present price structure?

Mr. MONTGOMERY. We cannot. We will have to meet competition, and that will mean that we will have to absorb some of the increased costs.

Senator FLANDERS. That, of course, is a rather serious charge.

Mr. MONTGOMERY. There is nothing in it so far as this company is concerned. There is no effort of any kind to reduce our production. We are trying to sell as many goods as we can and to produce as many as we can.

Senator WATKINS. May I call your attention to this: In the percent of looms run in 1948, for instance, you have it up to 163 percent.

Mr. MONTGOMERY. That is correct.

Senator WATKINS. Does that indicate an increased production?

Mr. MONTGOMERY. Oh, yes.

Senator FLANDERS. Is that the influence of overtime when you say you are running to capacity?

Mr. MONGTOMERY. One hundred percent equals running all of your looms an average of 40 hours a week, so that in 1940 we were running all of our looms at less than 100 percent, and then we have now been running them a double shift.

Senator FLANDERS. That accounts for the 158 percentage?

Mr. MONTGOMERY. During one year in the war we actually did get over 200 percent average, but this is pretty high for us, 163 percent.

Senator WATKINS. Does your actual production increase in proportion to the time that you work?

Mr. MONTGOMERY. That is right; yes.

Senator WATKINS. Have you had difficulty, as some other industries have had, with lesser production, with lower production even though you worked longer?

Mr. MONTGOMERY. Oh, no. We don't think that there is much difference, if you are speaking of the efficiency of our labor, we do not think that there is much difference from year to year in that.

Senator WATKINS. You would account for the difference in production there, probably, due to the fact that you are manufacturing goods of a higher quality?

Mr. MONTGOMERY. That is one of the things, yes; you have to take that into account, and that, of course, has a direct effect on the dollar volume, too, when you sell. So far, the American market apparently wants fine clothing, worsted clothing. We have not been able to sell so many of the rough tweeds and so on that we formerly did, and those are higher priced and higher cost wool goes into them, and more labor, and the result is your sales volume is higher.

Senator FLANDERS. Are you still, in this fourth period, running at a high level of capacity?

Mr. MONTGOMERY. Yes, sir; and I think that we will probably for the first 2 or 3 months of 1949.

Senator FLANDERS. So your answer to Mr. Ruttenberg's charge is, you are not currently reducing production?

Mr. MONTGOMERY. If he means that we are turning away business, that is absolutely untrue. We are trying to fill the mills. 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. The only thing that reduces our production is when we cannot get enough orders.

Senator FLANDERS. Still pursuing, if you do not mind, this charge of Mr. Ruttenberg, if the buyer's market continues, would you go on to a smaller profit margin for the sake of maintaining your production?

Mr. MONTGOMERY. 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.

Senator FLANDERS. And you would do it again?

Mr. MONTGOMERY. We would have to do it again. We feel it is probably better to lose money running our machinery than to lose it shutting it down.

Senator WATKINS. Well, may I inquire about the way you fix these prices to the trade. When they come in twice a year to place the orders, that is the only time that you fix prices.

Mr. MONTGOMERY. Sometimes we have to refix them; if we don't get enough orders at the price that we fix at the opening of the season, we may have to cut our prices.

Senator WATKINS. What do you do with the trade that has already bought? Do you cut that?

Mr. MONTGOMERY. No. I don't know what the policy is. I imagine that we do not guarantee a price level.

Senator WATKINS. If some customers buy later in the season at lower prices, you would protect those who had bought already?

Mr. MONTGLMERY. I don't think so.

Senator WATKINS. You do not think that you do?

Mr. MONTGOMERY. I don't think so.

Senator WATKINS. That is 6 months in advance of what the selling period for the retailer is?

Mr. MONTGOMERY. That is right.

Senator WATKINS. You wait for orders before you manufacture?

Mr. MONTGOMERY. We don't wait for orders before we buy wool. We have a large wool pile of what we call free wool at all times, because it takes so long to get it to us from Australia and South America and so forth, so we have to buy wool in advance of orders, but we do not start the actual manufacturing until we have orders.

Senator WATKINS. Your business is largely controlled by what the distributors determine they are going to do?

Mr. MONTGOMERY. That is right.

Senator WATKINS. Do you attempt to work up sales or promote sales?

Mr. MONTGOMERY. Oh, yes.

Senator WATKINS. And you get them to buy more?

Mr. MONTGOMERY. We try to get the consumer to buy more, also. You may have seen some of our shows of fabrics on Fifth Avenue, in New York, where some of the department stores have shown our fabrics and also shown the methods of manufacture. Mostly that is women's wear, of course.

Senator WATKINS. If there is any effort to curtail production, it would come through the dealers who manufacture clothing? Take your raw material, your product, and work it up into clothes, ready-made clothes and what-not?

Mr. MONTGOMERY. That is right. We have no evidence of that. What happens is that the retailer stops buying because the consumer stops buying from him, and that backs up to us.

Senator WATKINS. If these manufacturers of the ready-made clothing and the tailors and so on should determine that they can't keep prices up, they could do that, could they not, by placing less orders?

Mr. MONTGOMERY. As far as we are concerned, they can do anything they want. We have no way of controlling their price. A great many of our sales are made to these chain-store people, who sell—I am thinking of men's wear now—who sell suits in large quantities to the consumer. Now, those prices are fixed at a certain amount, $39.50 or $29.95 or something of that kind. Those people either make their own clothing or they buy from clothing manufacturers who buy the fabric from us. Well, if the consumer does not want to buy enough of those clothing at the price, then the retailer has the inventory, and he won't buy any more from the clothing manufacturer, and the clothing manufacturer won't buy fabrics from us until those inventories are out of the way.

Senator WATKINS. Can you give us an idea of how many hands your product passes through from the time it leaves your mills until it gets to the consumer?

Mr. MONTGOMERY. Well, ordinarily it would go from us to the clothing manufacturer.

Senator WATKINS. Or a broker?

Mr. MONTGOMERY. There is a small amount sold to jobbers, and the jobber has a clientele of small clothing manufacturers who find that they would prefer to buy from a jobber, and they don't buy in large volume, and they prefer to have the quick service of the jobber, but that is a very small part of the business, perhaps 5 to 10 percent or less. Most of it is sold directly to clothing manufacturers. Now, the clothing manufacturer may either resell to a retailer or he may be his own outlet, and he may make the clothes and sell them both.

Senator WATKINS. You have both types?

Mr. MONTGOMERY. Yes.

Senator WATKINS. The majority of your product, or the big portion of your product, is sold direct to the manufacturer and the manufacturer makes the clothing?

Mr. MONTGOMERY. That is right.

Did you wish more comment on this, Mr. Chairman?

Senator FLANDERS. The other tables, I think, as I look them over, are more or less self-explanatory until we get to the one on the disposition of profits. You show in 1946 a red figure in your retained earnings. What accounted for that?

Mr. MONTGOMERY. That was the year that we paid up a lot of back dividends on the preferred stock. We recapitalized that year, and there were back dividends paid up, and we found when the whole thing was over that we had paid out all of our earnings for that year and a small amount of our surplus, a half million of our surplus. We would not expect ordinarily to pay 100 percent of our earnings in any year, but that year we did.

Senator FLANDERS. In these retained earnings figures for 1947 and 1948 you show figures of over $6,000,000 for the 2 years. What are the uses to which those retained earnings are applied?

Mr. MONTGOMERY. Well, in the year 1947 we spent $4,954,000 for capital expenditures. That is largely new machinery.

Senator FLANDERS. Is that replacement or expansion?

Mr. MONTGOMERY. That, I think, is replacement for the most part. We are replacing older types of machinery with newer types of machinery as we can.

Senator FLANDERS. You get a higher productive capacity out of the newer types?

Mr. MONTGOMERY. Oh, yes.

Senator FLANDERS. Did you say that that was $4,000,000?

Mr. MONTGOMERY. Yes; it was the capital expenditure and the rest of it was added to working capital.

Senator FLANDERS. And in 1948 to date you have had somewhere near the same rate of capital expenditure but a higher rate of retained earnings?

Mr. MONTGOMERY. Yes; that is the way it turned out for the 9 months.

Senator FLANDERS. You are putting those higher rates of retained earnings into the cushion which you mentioned in your testimony—the cushion to carry you over bad times?

Mr. MONTGOMERY. The part of it that goes into working capital, of course, is a part of the cushion, and what goes into the capital expenditures improves our plant and it is beneficial from that point of view.

Senator FLANDERS. There is no indication then that you have added to a surplus for carrying you over hard times in those figures, unless your working capital describes that process?

Mr. MONTGOMERY. It becomes a part of our surplus for the hard times. We have, in addition to that, set aside a reserve for contingency, but that reserve we have not considered in these figures. I mean we have regarded that as part of earnings. That is designed to protect us against inventory losses rather than anything else.

Senator FLANDERS. Can you give us your total reserve for contingencies as it is at the present moment?

Mr. MONTGOMERY. It is either $5,000,000 or $6,000,000. I would not be sure which it is.

Senator FLANDERS. Now, I have a few questions to ask on your testimony, some of which you have answered in the last few moments. You have answered that question of the inventory risk which has been a subject of discussion between the economists and others. You have a special problem apparently in that with regard to the necessity for purchasing your wool a long time in advance. I questioned you on the buyer's market. You have indicated that in dividends you felt that the stockholders were entitled to an increase which took into account the change in the value of the dollar. Have you actually increased your dividends on the common stock in a way which implements that principle?

Mr. MONTGOMERY. We paid $12 in 1946, and we paid $10 in 1947, and we are going to pay $8 in 1948.

Senator FLANDERS. Will you repeat those figures again?

Mr. MONTGOMERY. It was $12, $10, and $8. We felt that we should distribute as much 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.

Senator FLANDERS. So that you expressed that as a matter of principle, but you do not seem to have been able to live, to pay, according to the principle, so far as the common-stock holders are concerned.

Mr. MONTGOMERY. Not under present conditions, we have not.

Senator FLANDERS. Will you submit for the record—and I presume that you may not have them here—the same figures that you have given us for the period from 1929 on, because that would give a picture of the ups and downs of your industry in the way in which the years we called for did not. You spoke in general terms of that, but I think it might be useful to have in the record the figures from 1929 on.

Mr. MONTGOMERY. I am not sure that I can give you that with respect to invested capital, because the invested capital we have used here is what the Government actually allowed us in 1940 for purposes of our taxes, and I don't know just whether we could put it on the same basis, but I can give you the sales figures of course, and the profits.

(The matter referred to is as follows:)

*American Woolen Co., Inc.*

| | Sales | Yardage produced | Percent of looms run | Net profit before reserve for contingencies | Percent of net earnings to sales | Net earnings per yard produced | Average selling price |
|---|---|---|---|---|---|---|---|
| 1929 | $98,617,558 | 43,970,844 | 53.2 | [1] $4,228,191 | [1] 4.3 | [1] $0.096 | $2.009 |
| 1930 | 60,472,815 | 29,344,347 | 33.3 | [1] 4,897,584 | [1] 8.1 | [1] .167 | 1.757 |
| 1931 | 51,898,379 | 31,278,323 | 43.6 | [1] 2,836,826 | [1] 5.5 | [1] .091 | 1.535 |
| 1932 | 33,925,048 | 25,663,318 | 36.4 | [1] 7,269,822 | [1] 21.4 | [1] .283 | 1.129 |
| 1933 | 49,561,419 | 36,187,605 | 59.8 | 7,053,088 | 14.2 | .195 | 1.328 |
| 1934 | 48,711,188 | 28,501,126 | 50.7 | [1] 5,458,495 | [1] 11.2 | [1] .192 | 1.407 |
| 1935 | 70,317,233 | 46,379,953 | 92.0 | 2,740,599 | 3.9 | .059 | 1.368 |
| 1936 | 71,022,579 | 41,443,517 | 81.0 | 1,929,983 | 2.7 | .047 | 1.50 |
| 1937 | 75,061,505 | 40,161,958 | 87.2 | [1] 1,854,902 | [1] 2.5 | [1] .046 | 1.775 |
| 1938 | 42,038,076 | 24,920,697 | 51.8 | [1] 4,911,502 | [1] 11.7 | [1] .197 | 1.404 |
| 1939 | 64,935,976 | 43,126,693 | 101.7 | 2,311,887 | 3.6 | .054 | 1.412 |
| 1940 | 76,560,111 | 38,987,385 | 93.3 | 3,154,464 | 4.1 | .081 | 1.745 |
| 1946 | 170,810,787 | 65,531,626 | 158.1 | 23,098,178 | 13.5 | .352 | 2.532 |
| 1947 | 175,993,449 | 58,849,992 | 158.2 | 16,269,914 | 9.2 | .276 | 2.948 |
| 1948 (to Sept. 30, inclusive) | 152,112,364 | 45,147,093 | 163.0 | 13,461,626 | 8.8 | .298 | 3.415 |

[1] Red figures.

*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 | |
|---|---|---|---|---|---|
| | | | | Capital expenditures | Working capital |
| 1929 | [1] $4,228,191 | | [1] $4,228,191 | $578,235 | [1] $4,806,426 |
| 1930 | [1] 4,897,584 | | [1] 4,897,584 | 444,886 | [1] 5,342,470 |
| 1931 | [1] 2,836,826 | | [1] 2,836,826 | 1,861,273 | [1] 4,698,099 |
| 1932 | [1] 7,269,822 | | [1] 7,269,822 | 1,238,934 | [1] 8,508,756 |
| 1933 | 7,053,088 | | 7,053,088 | 1,066,446 | 5,986,642 |
| 1934 | [1] 5,458,495 | $999,538 | [1] 6,458,033 | 532,319 | [1] 6,990,352 |
| 1935 | 2,740,599 | | 2,740,599 | 1,730,946 | 1,009,653 |
| 1936 | 1,929,983 | 1,532,860 | 397,123 | 3,536,860 | [1] 3,139,737 |
| 1937 | [1] 1,854,902 | 1,149,645 | [1] 3,004,547 | 2,624,647 | [1] 5,629,194 |
| 1938 | [1] 4,911,502 | | [1] 4,911,502 | 431,567 | [1] 5,343,069 |
| 1939 | 2,311,887 | 1,050,000 | 1,261,887 | 564,601 | 697,286 |
| 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 figures.

Senator FLANDERS. That is the list of questions that I wished to ask.

Mr. Wolcott, have you any that you would like to ask?

Representative WOLCOTT. I think all of mine have been covered.

Representative HERTER. I had just one question in connection with the items of expenditures that you had for the purchase of wool. In 1946, there were considerable stock piles of fine-grade wools available in the world; were there not—accumulated in Australia?

Mr. MONTGOMERY. That is correct.

Representative HERTER. Have not those been pretty generally liquidated now?

Mr. MONTGOMERY. I think so.

Representative HERTER. How is that affecting your raw-material costs, your woolen costs; and how does that prospect look from the point of view of your own supply factors?

Mr. MONTGOMERY. I don't know whether it is the effect or the cause or what, but I can say that prices of wool seemed to hesitate a little in August of this year; and then, in September when the Australian auctions opened, the world competition was such that they started on the upward course; and they are now at the all-time high, and apparently there is no top in sight—no peak in sight. It is a price fixed by the world market rather than anything else. Our domestic market is only a small fraction of the world market.

Representative HERTER. During the last 3 years, there has been a constantly rising price in that field?

Mr. MONTGOMERY. That is correct.

Representative HERTER. How much of your earnings, then, are a part of inventory increases in value, and how much from operating?

Mr. MONTGOMERY. I cannot give you that in percentage; and, of course, they are quite a large part.

Representative HERTER. It must be a fairly substantial part.

Mr. MONTGOMERY. Yes, sir.

Representative HERTER. Something which you could not control in any way whatsoever?

Mr. MONTGOMERY. No. As you buy on a rising market and sell on a rising market, you will pick up some profit on the disposition of your inventory that you have purchased at lower prices, and you will lose as you go down the scale.

Representative HERTER. And, against that loss, you set aside that reserve?

Mr. MONTGOMERY. That is what we hope will cover our loss when it goes down.

Representative HERTER. Does the Government make any allowance for the setting aside of those reserves when you have as hazardous a factor as that?

Mr. MONTGOMERY. It is only a way of earmarking a part of our surplus. It is not a part of our costs, and it is not a deduction for our taxes.

Representative HERTER. In your pricing, when you say in the spring and fall you ask customers to place orders with you, do you stick to a firm price; or do you make allowances, when your deliveries are 6 or 8 months later, for increase in labor cost or charges in your inventory costs?

Mr. MONTGOMERY. As far as the labor is concerned, we have a contract which permits opening of the wage question twice a year; and it was done that way so that we would know what our labor costs were in advance. So, we don't take very much of a chance on labor. Wool, we already have in the pile for the most part; so that we can make prices on that. One of the risks, of course, is that there would be such a change in the economic situation that our customers could not take the goods that they had ordered, and then we would have the choice either of forcing them to pay and forcing them into bankruptcy or accepting cancellations; and, either way, it is not very good business.

Senator FLANDERS. Do you have any practice in your industry not merely of accepting cancellation, but being forced to take goods back?

Mr. MONTGOMERY. Well, legally, we have a right to insist upon the contract. In times past, there have been many cases where cancellations have been accepted, because we had the choice either of accepting the cancellation or proving our claim in bankruptcy and forcing our customer into liquidation.

Senator FLANDERS. Do you ever accept the return of goods?

Mr. MONTGOMERY. Not unless we have to.

Senator FLANDERS. I was wondering whether you ever had to.

Mr. MONTGOMERY. When the buyer's market comes around, we find that we try to make delivery and they find a great many defects in the cloth which they had not noticed when the seller's market was in operation.

Senator FLANDERS. I have one other question that I would like to ask. In the line of goods to which you apparently devote yourself, which is the mass production of men's and women's suiting, do you feel any competition from English woolens?

Mr. MONTGOMERY. Not at the present time. Before the war started—I think it was about the middle of 1939—there had been a change in the tariff rate under the Tariff Pact, and we were beginning to feel some competition at that time. And then, of course, during the war there was none; and I don't think that it is a material factor yet.

Senator FLANDERS. Do the English woolens, for the most part, go into the tailor-made industry?

Mr. MONTGOMERY. Most of those imported here are very high quality and go to the merchant tailor; yes.

Senator FLANDERS. When you said you sold a certain small percentage through jobbers, does that go to the merchant tailor?

Mr. MONTGOMERY. Some of it; most of it.

Senator FLANDERS. But some of it does go into the large suiting industry?

Mr. MONTGOMERY. Most people who buy from the jobbers are small manufacturers or merchant tailors.

Senator FLANDERS. Are there any further questions?

We will excuse you; and thank you, Mr. Montgomery, for appearing before us.

Now, the hearing this afternoon will be held at 2:15 in this same room, and our witnesses will be Mr. Dwight Billings, controller of the Pacific Mills, and Mr. John Ballantyne, president of the Philco Corp. With the Pacific Mills witness, we will have a chance to look at the cotton goods as distinguished from the woolen goods we have been looking at this morning.

The committee will now recess.

(Whereupon, at 12:30 p. m. the subcommittee recessed, to reconvene at 2:15 p. m.)

AFTERNOON SESSION

The subcommittee reconvened at 2:45 p. m., upon the expiration of the recess.

Senator FLANDERS. We will come to order.

We have, as our witness, Mr. Dwight B. Billings, controller and assistant treasurer of Pacific Mills.

## STATEMENT OF DWIGHT B. BILLINGS, CONTROLLER AND ASSISTANT TREASURER, AND J. E. BRADLEY, VICE PRESIDENT OF PACIFIC MILLS

Senator FLANDERS. Mr. Billings, will you identify yourself for the record; and also, since you have an associate who will play an active part in the proceedings, you may identify that gentleman also.

Mr. BILLINGS. I will be very glad to do so, Mr. Chairman.

I am Dwight B. Billings, controller and assistant treasurer of the Pacific Mills. Our plants are located both in New England and in the South.

I have with me Mr. J. E. Bradley, vice president of Pacific Mills.

I would like to do the best I can to answer the financial and accounting questions, and Mr. Bradley will take on anything along a merchandising line.

Senator FLANDERS. You may divide the answers between you as seems best to you.

Mr. BILLINGS. Thank you.

Senator FLANDERS. If you have a prepared statement which you wish to read, you may do so.

Mr. BILLINGS. In making a statement to your committee, I would like, if agreeable to you, to preface my remarks by a brief summary of what happened to Pacific Mills from 1928 through 1940.

During these 12 years, overproduction by the industry resulted in severe competition, which in our case drove selling prices below the cost of production. During this period, we lost $10,828,599. In addition to this loss, large charge-offs of assets of doubtful value further reduced the net worth of the company from $44,185,517 at the start of 1929 to $21,694,931 at the close of 1940.

Because of these severe losses, and being heavily in debt, the company did not have the money to replace more than a small part of its worn-out and obsolete machinery. This resulted, of course, in higher production costs and less efficient work. These deteriorating conditions meant loss of earning power to personnel and a $22,490,586 loss of capital to stockholders.

Early in 1941, the company's difficulties brought about a change of management. Because of the lack of capital, the obsolete plants and overcapacity, it was necessary, if the company were to continue in operation, to abandon the three most obsolete and unprofitable plants, and to concentrate production on the better equipment. Unfortunately this meant that approximately 3,000 of our personnel found it necessary to seek other employment.

After a careful study of the physical assets of the company, the new management decided that, in an industry where competition is normally very severe and the business highly speculative, survival required ownership of the best, the fastest, and the most modern equipment; for, with anything less, personnel could not perform efficiently, nor could the company become a low-cost producer. To this aim, the present management has continued to be fully committed.

Following are certain data on the years of operation as requested by your committee.

Would you like to look these over?

Senator FLANDERS. I think, perhaps, you might pick out some of the high spots, if you will.

Mr. BILLINGS. I have done so, sir, by commenting on each year.

Senator FLANDERS. Very good.

The table will appear in the record at this point.

(The table is as follows:)

| | 1940 | 1946 | 1947 | 1948 (9 months) |
|---|---|---|---|---|
| Net sales | $50,286,765 | $78,303,654 | $90,646,668 | $83,077,575 |
| Net profit before taxes | $348,310 | $19,154,241 | $19,126,380 | $16,928,563 |
| Percent | 0.7 | 24.5 | 21.1 | 20.4 |
| Income taxes | None | $7,651,350 | $7,751,000 | $7,110,000 |
| Percent | | 9.8 | 8.6 | 8.6 |
| Net profit | $348,310 | $11,502,891 | $11,375,380 | $9,818,563 |
| Percent | | 14.7 | 12.5 | 11.8 |
| Invested capital | $21,694,932 | $43,417,180 | $52,573,333 | |
| Earned before taxes (percent) | 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 | |
| Dividend paid | None | $1,881,584 | $2,495,578 | |
| Percent | | 16.4 | 21.9 | |
| Reinvested in business | $348,310 | $9,621,307 | $8,879,802 | |
| Percent | | 83.6 | 78.1 | |
| Employees, end of year | 12,873 | 10,436 | 10,420 | 11,676 |
| Operating rate (percent of capacity) | 60 | 100 | 100 | 100 |
| Inventories, end of year | $12,128,630 | $15,574,650 | $23,081,185 | $29,000,000 |

Senator FLANDERS. You may proceed with the reading.

Mr. BILLINGS. Year 1940: These results represented operations of the company just prior to its reorganization early in 1941. During this year, the company was operating in a very competitive market with much old equipment and three obsolete plants. I would estimate that operations were about 60 percent of capacity. The company in this year made a start on its rehabilitation program by spending $2,044,436 for new equipment. No dividends were paid.

Interim period 1941 through 1945: In this interim period, with the demand for goods exceeding supply, and with steady operations at capacity, the company had profitable years. Pacific, throughout this war period, allocated a large percentage of its production to orders for the Army and the Navy. Normal dividends were paid, and all remaining earnings were used to pay off the large indebtedness, to purchase new equipment, and to increase working capital as prices had started their upward movement.

Year 1946: Operations were again at capacity levels, and the benefits of the large machinery investment were increasingly being felt.

Representative HERTER. When you speak of capacity level, do you speak of three shifts?

Mr. BILLINGS. It is three-shift in most of the plants. In the finishing plants it happens to be two shifts.

Selling prices over which we have no control, as pointed out later, were on the whole in a rising trend.

During this year we paid cash dividends of $1,881,584, or 16.38 percent of net profit after taxes; $9,621,307 was reinvested in the business, and of this amount $5,677,343 was spend for new machinery and plants while the balance was held in working capital.

Year 1947: The increase in sales volume over the previous year was due both to rising selling prices and to more productivity from the new machinery.

This year showed a reversal of the upward profit trend. During the year, cash dividends were increased to $2,495,578, 21.9 percent of net profit, and the profits retained in the business were $8,879,802.

Continuing the plant modernization program, the company spent $4,809,618 for fixed assets and the balance of profits were invested in working capital. While units of inventory were somewhat higher than in the preceding year, rising prices of raw materials accounted for most of the difference.

Year 1948: For this year I can only give estimated and unaudited figures for the first 9 months. While the figures indicate only a further slight reduction in the percentage of profit, there has been a drastic price reduction throughout most lines of cotton goods, and this reduction in profits will be reflected in the first quarter of 1949.

An outstanding development this year has been the sharp rise in the cost of wool. Prices of this raw material have increased substantially since January and have accounted for all of the increase in the current inventory values.

Senator FLANDERS. May I ask you, your mills work both with cotton and with wool?

Mr. BILLINGS. Our mills manufacture cotton goods, rayon goods, and also worsteds.

Senator FLANDERS. Worsteds?

Can you give us some idea of the distribution between those as to volume of product, roughly, I mean.

Mr. BILLINGS. We are diversified with those three types of fabrics. In some years there will be more of one and less of the other. Let me say that probably our worsted operations would run between say, 40 and 55 percent, the total.

Senator FLANDERS. The rayon is the smallest?

Mr. BILLINGS. The rayon is the smallest; yes.

We expect this year to spend about $6,000,000 more on our plant rehabilitation program. In connection with the program, I wish to stress that it is a move toward modernization rather than expansion. The $27,000,000 which has been spent since 1939 has been for the sole purpose of increasing efficiency and thereby lowering costs.

Level of profits: It may be alleged that profits in any 1 year or over a few years are too high. My personal opinion is that only by taking a number of yeers 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.

High profits and the capital necessary to do business, in my opinion, are closely tied to inflation, just as low profits are related to deflation.

Cotton from January 1940 has advanced in price from 11.54 cents per pound to 32.78 cents. Wool during this same period has gone up from $1.06 per pound to $2.05. Cotton machinery has registered an average increase of 84 percent. It should be obvious that the replacement of these items requires much more capital than in 1940.

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.

Although the replacement of plant extends over a long period, the effect of inflation is exactly the same. 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.

I think perhaps the hue and cry about the huge corporation profits arises both 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 a personal opinion that a company over a business cycle should earn enough profits to—

(1) Pay fair wages and salaries to its personnel;

(2) Put enough aside to replace its equipment and to provide extra working capital when necessary;

(3) Pay a reasonable dividend to the owners who put up the money; and

(4) 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.

Special reserves: Watching with alarm increasing raw material prices, the company, who 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.

Pricing policies: 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 surrounedd 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 percent 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 in the pockets of the average American consumer.

When this was coupled with scarcities of 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.

Based, however, on our 1948 experience on new orders taken, it would appear that a larger money supply by itself does not necessarily have a beneficial effect upon profits. At present the national gross product is the largest in the history of any country. The same applies to national income, consumer income and employment.

People have more money to spend than ever before, and yet sales on many of our lines are sharply down. The reason appears to lie in the fact that when there is a lot of money and few goods, pressure is exerted on prices, and hence everybody's profits are high. Remove the shortages, however, and leave only the high money supply, and this pressure disappears as both sales and profits begin to decline.

Cost is one of the most important though by far not the only determinent 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.

In looking at the future, it will be our hope to continue the profit of the company by selling our fabrics at competitive levels and keeping our costs from efficient operation at the lowest possible point, consistent with paying fair wages to our employees and receiving in return from them efficient productive services.

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.

Sources of capital: In order to provide the funds to finance higher inventories and to carry out our program of modernization, additional capital had to come from some source. We have consistently believed that the sound way to acquire this additional capital when possible was through the reinvestment of profits.

This, I firmly believe, is the way by which the United States has prospered and grown strong.

It might be possible to have raised this capital either through borrowing, which would eventually have to be paid out of profit, or by the sale of capital stock. Whether either of these would have been possible and desirable in our case is a question for the investment bankers. We believe that even though small dividends have been paid out, the increase in invested capital has built up the stockholders' equity and has made their holdings more valuable.

In conclusion may I say that I do not feel that the profits earned by the company are extraordinary under these unusual circumstances. Our selling prices are determined in the market place, our costs have continually been under pressure for reduction. Much of this profit is illusory in that it has had to be used to finance high-valued inventories and machinery.

We believe that our policy of providing the best and most efficient tools for our employees will redound to the benefit both of stockholders and employees and in the very near future to the benefit of the general public in the form of better goods at lower prices.

Senator FLANDERS. Mr. Billings, there are two or three questions which I want to ask you. You spoke about having shut down three of your mills. Where were these mills located?

Mr. BILLINGS. The mills were located in Lawrence, Mass., two of them in Lawrence, and one in Dover, N. H.

Senator FLANDERS. Where are the mills that are at present running located?

Mr. BILLINGS. In South Carolina, North Carolina, and Virginia. Also in Lawrence.

Senator FLANDERS. And Lawrence?

Mr. BILLINGS. Yes; excuse me.

Senator FLANDERS. You have one mill remaining in Lawrence?

Mr. BILLINGS. Yes; one large mill.

Senator FLANDERS. The cotton, rayon and worsted equipment, are they in any sense interchangeable? Is any part of it interchangeable?

Mr. BILLINGS. You mean worsted machinery being useful on cotton goods?

Senator FLANDERS. Yes.

Mr. BILLINGS. No.

Senator FLANDERS. Is that also true on the interchangeability between cotton and rayon?

Mr. BILLINGS. Some, but not much. Of course on the loom you can weave anything.

Senator FLANDERS. When you spoke of proportions of your business which were respectively worsted, cotton, and rayon, it would mean that as one of those reduced in proportion, you have to reduce operations in a mill. You cannot transfer your products from one to the other?

Mr. BILLINGS. Unfortunately not.

Senator FLANDERS. Your profits are given on your table here in terms of your percentage on invested capital, is that right?

Mr. BILLINGS. They are given, I believe, two ways, as a percentage of sales and also as a percentage on invested capital.

Senator FLANDERS. Referring to the table, it says "Earned before taxes" and "Earned after taxes" giving a percentage. Which is that?

Mr. BILLINGS. I have it invested capital. I should have put in there "Earned on invested capital before taxes."

Senator FLANDERS. That is, net profit before taxes in the second line is on sales?

Mr. BILLINGS. In the second line is on sales.

Senator FLANDERS. Yes.

And the percentage as given below on the sixth and seventh lines are on invested capital?

Mr. BILLINGS. That is right.

Senator FLANDERS. Of course those profits on sales and the profits on invested capital look pretty high for those of us who have been engaged in other lines of business. You feel that they are clearly justified, I take it?

Mr. BILLINGS. May I make this observation with respect to invested capital? I was just looking at the cost of replacing our investment and I found that machinery which is used in the company and is at the original cost of $25,000,000, you would have to spend $17,000,000 more in order to bring that to replacement. Consequently, when you use your balance sheet figure of invested capital it is low at least by the $17,000,000 so that your invested capital percentage figure, I believe, is too high. I would prefer in looking at competitor statements to look at the net profit on sales.

Senator FLANDERS. Well, even that looks quite high just to a casual observer.

Mr. BILLINGS. It is, there is no question about it, but look at the 12 years that I cited when we lost $10,000,000.

Senator FLANDERS. Does this consideration hold: You have been through a period in which you have replaced obsolete equipment with new equipment. You have abandoned three plants completely and retained only plants which had reasonably new equipment. Is the time approaching when the heavy investments which you are making out of profits will taper off so that you will have more of these profits available for distribution either in dividends or wages or in lower prices than you have at the present time?

How near are you to being through with your reinvestment program?

Mr. BILLINGS. With respect to the modernization part of the program we expect to have that finished by April so that that $27,000,000, a little bit more than that, will represent the modernization. From that point on we will probable have to be replacing some old machinery which is running perfectly all right, but there will probably be something in addition to depreciation.

In fact, it will have to be more than depreciation because of the price level and the taxes.

Senator FLANDERS. Do you see then the prospect from April on for a better profit position which can be reflected in the different ways I have indicated?

Mr. BILLINGS. I have a profit 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. BILLINGS. What was that?

Senator FLANDERS. You 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.

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. Will you put that into the record?

Mr. BRADLEY. I would like very much to put that into the record.

(The information is as follows:)

*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.

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.

It is rather interesting to look at the figures as furnished by the Bureau of the Census for the quarters in the year 1946, 1947, and the first three quarters of 1948.

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 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. Will you enter those figures?

Mr. BRADLEY. I will be glad to.

(The information is as follows:)

*Quarterly production of cotton goods as compiled by U. S. Bureau of Census*

| Year | 1948 | | | 1947 | | | | 1946 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Quarter | 3 | 2 | 1 | 4 | 3 | 2 | 1 | 4 | 3 | 2 | 1 |
| | Millions of yards | | | | | | | | | | |
| Broad woven goods: | | | | | | | | | | | |
| Duck | 54 | 57 | 57 | 45 | 41 | 56 | 70 | 60 | 54 | 60 | 62 |
| Sheetings and allied fabrics | 445 | 533 | 571 | 581 | 544 | 578 | 583 | 545 | 520 | 548 | 535 |
| Birdseye diaper cloth | 5 | 10 | 16 | 21 | 20 | 19 | 12 | 10 | 10 | 10 | 10 |
| Print cloth yarn fabrics | 838 | 903 | 869 | 863 | 783 | 818 | 786 | 736 | 681 | 727 | 737 |
| Colored yarn fabrics | 180 | 201 | 197 | 195 | 174 | 177 | 180 | 161 | 152 | 154 | 148 |
| Wide fabrics | 156 | 161 | 165 | 166 | 156 | 160 | 164 | 150 | 133 | 144 | 135 |
| Fine goods | 299 | 341 | 364 | 357 | 294 | 332 | 340 | 334 | 303 | 320 | 317 |
| Napped fabrics | 119 | 132 | 131 | 136 | 123 | 127 | 128 | 121 | 115 | 109 | 112 |
| Towels and towelings | 80 | 99 | 113 | 107 | 89 | 101 | 112 | 107 | 101 | 106 | 100 |
| Specialties | 94 | 103 | 104 | 97 | 85 | 94 | 108 | 131 | 121 | 138 | 119 |
| Total | 2,270 | 2,540 | 2,587 | 2,568 | 2,309 | 2,462 | 2,483 | 2,355 | 2,190 | 2,316 | 2,275 |
| | Millions of pounds | | | | | | | | | | |
| Tire fabrics: | | | | | | | | | | | |
| Cotton | 76 | 79 | 88 | 84 | 74 | 94 | 93 | 85 | 75 | 78 | 72 |
| Rayon | 64 | 60 | 61 | 62 | 58 | 53 | 57 | 56 | 52 | 53 | 51 |
| Total | 140 | 139 | 149 | 146 | 132 | 147 | 150 | 141 | 127 | 131 | 123 |

Source: The Cotton Textile Institute, Inc., New York, N. Y.

Production of cotton goods followed usual seasonal decline in third quarter but dropped 10 percent from second quarter while the decline was only 6 percent in the same period of 1947 and 5 percent in 1946.

Most marked drops were in: Sheetings and allied fabrics, 16 percent as against 6 percent in 1946 and 5 percent in 1945; Fine goods, 12 percent contrasted with 11 percent in 1946 and 6 percent in 1945; Towels and towelings, 19 percent compared to 13 percent in 1946 and 6 percent in 1945.

A much reduced production of birdseye is recorded, after the exceptional demand during the last several years.

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 difficult to express in percent. 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 sellers' market to a buyers' 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 not arouse suspicion that there is a collapsing market in prices.

I presume that you are keeping those points in mind. I hope that all of industry is and I hope that the Lord will give us the wisdom to walk that straight and narrow path that does not lead downward.

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 quite 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.

Senator FLANDERS. You make some goods which go directly to retailers or through jobbers to retailers—I suppose your pillow cases, sheets, and towels?

Mr. BRADLEY. Those go direct.

Senator FLANDERS. Have you reduced prices on those which go directly into consumption?

Mr. BRADLEY. On our towels we have made some substantial reductions. On our sheets we have not primarily, due to the fact that we have been right under the market for most of this year and a small part of last year. The market advanced and we did not advance.

Senator FLANDERS. I may say that I was in the swankiest hotel in New York a few days ago, you can name it yourself if you want to, and found the sheets and pillowcases repaired to beat the band. It looked to me like a puzzle and I do not know whether that is a sellers' or a buyers' market, I am sure.

Mr. BRADLEY. There has been a terrific demand by hotels and hospitals for sheets and pillowcases; that has taken up a great deal of production in the last 12 months and yet even there, there is a trend toward less buying.

I think only partly on account of price feeling. More substantially that pipe line is beginning to be filled, I believe.

One other point that I would like to point out is that in 1947 on cotton textiles, 1,470,146,000 square yards were exported. In 1948 that has dropped off quite sharply. Of course, I do not know what the year will do but if you figured it on the annual rate as of September it would be at the rate of 543,000,000. Now it is going to be more than that because it was running more than that during the forepart of the year.

That difference in export is pretty close to the drop in production on the figures I have quoted on the over-all production.

Senator FLANDERS. So that, that moving into the domestic consumption has not yet decreased material, does that follow?

Mr. BRADLEY. No, it has not. The merchants of the country can always change their minds much more rapidly than the consumer can.

Senator FLANDERS. There are one or two other things that I have. Well, you spoke of the increase in cotton machinery but you indicated that your improvement program was nearly finished?

Mr. BILLINGS. That is correct.

Senator FLANDERS. I was wondering if you would give specific examples and the times at which you had made the price decreases? I find some reference to this, however, you might expand it a little bit if you are able to. For example, on page 8, 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?

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.

Representative HERTER. 92½ percent.

Mr. BRADLEY. 92½ percent; is that not right, Congressman?

Representative HERTER. Yes.

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.

Mr. BERQUIST. It is about support level now; is it not?

Mr. BRADLEY. About support level now; yes.

Senator FLANDERS. I would like to ask you, as I asked Mr. Montgomery, to bring in corresponding figures back to 1929 so that we can get a better cyclical picture of the industry.

Mr. BILLINGS. We will be very glad to do so.

*Pacific Mills—Comparative profits statistics as requested by the Joint Committee on the Economic Report*

| | 1929 | 1930 | 1931 | 1932 | 1933 |
|---|---|---|---|---|---|
| Net sales | $47,603,674 | $36,843,573 | $33,808,023 | $21,268,126 | $32,311,264 |
| Net profit before taxes | $1,106,168 | [1] $2,417,887 | [1] $3,801,678 | [1] $3,044,952 | $1,225,208 |
| Percent | 2.32 | [1] 6.56 | [1] 11.24 | [1] 14.32 | 3.79 |
| Income taxes | $75,000 | | | | $220,000 |
| Net profit | $1,031,168 | [1] $2,417,887 | [1] $3,801,678 | [1] $3,044,952 | $1,005,208 |
| Percent | 2.17 | [1] 6.56 | [1] 11.24 | [1] 14.32 | 3.11 |
| Invested capital | $45,148,042 | $36,350,967 | $39,071,955 | $36,028,404 | $37,033,611 |
| Earned on invested capital before taxes (percent) | 2.45 | [1] 6.65 | [1] 9.73 | [1] 8.45 | 3.31 |
| Earned on invested capital after taxes (percent) | 2.28 | [1] 6.65 | [1] 9.73 | [1] 8.45 | 2.71 |

| | 1934 | 1935 | 1936 | 1937 | 1938 |
|---|---|---|---|---|---|
| Net sales | $40,732,302 | $51,035,089 | $55,950,032 | $47,881,648 | $35,434,096 |
| Net profit before taxes | [1] $521,091 | [1] $457,771 | $1,088,191 | [1] $2,073,763 | [1] $2,531,215 |
| Percent | [1] 1.28 | [1] 0.90 | 1.94 | [1] 4.33 | [1] 7.14 |
| Income taxes | | | $132,000 | | |
| Net profit | [1] $521,091 | [1] $457,771 | $956,191 | [1] $2,073,763 | [1] $2,531,245 |
| Percent | [1] 1.28 | [1] 0.90 | 1.71 | [1] 4.33 | [1] 7.14 |
| Invested capital | $24,363,180 | $24,071,466 | $24,652,842 | $22,030,132 | $19,505,254 |
| Earned on invested capital before taxes (percent) | [1] 2.14 | [1] 1.90 | 4.41 | [1] 9.41 | [1] 12.98 |
| Earned on invested capital after taxes (percent) | [1] 2.14 | [1] 1.90 | 3.88 | [1] 9.41 | [1] 12.98 |

| | 1939 | 1940 | 1941 | 1942 | 1943 |
|---|---|---|---|---|---|
| Net sales | $46,411,224 | $50,286,764 | $69,604,070 | $84,154,760 | $85,610,823 |
| Net profit before taxes | $948,532 | [1] $348,310 | $6,426,500 | $11,997,195 | $14,243,267 |
| Percent | 2.04 | [1] 0.69 | 9.23 | 14.26 | 16.64 |
| Income taxes | $157,700 | | $1,229,750 | $8,796,200 | $10,425,000 |
| Net profit | $790,832 | [1] $348,310 | $5,196,750 | $2,200,995 | $3,818,267 |
| Percent | 1.70 | [1] 0.69 | 7.47 | 2.62 | 4.46 |
| Invested capital | $21,891,500 | $21,694,932 | $27,562,027 | $29,849,489 | $32,398,116 |
| Earned on invested capital before taxes (percent) | 4.33 | [1] 1.61 | 23.32 | 40.19 | 43.96 |
| Earned on invested capital after taxes (percent) | 3.61 | [1] 1.61 | 18.85 | 7.37 | 11.79 |

| | 1944 | 1945 | 1946 | 1947 | 1948 (9 months) |
|---|---|---|---|---|---|
| Net sales | $74,259,371 | $64,023,405 | $78,303,654 | $90,646,658 | $83,077,575 |
| Net profit before taxes | $12,196,609 | $10,136,070 | $19,154,241 | $19,126,380 | $16,928,563 |
| Percent | 16.42 | 15.83 | 24.46 | 21.10 | 20.38 |
| Income taxes | $8,825,000 | $7,390,000 | $7,651,350 | $7,751,000 | $7,110,000 |
| Net profit | $3,371,609 | $2,746,070 | $11,502,891 | $11,375,380 | $9,818,563 |
| Percent | 4.54 | 4.29 | 14.69 | 12.55 | 11.82 |
| Invested capital | $34,318,713 | $35,634,915 | $43,417,180 | $52,573,333 | |
| Earned on invested capital before taxes (percent) | 35.54 | 28.44 | 44.12 | 36.38 | |
| Earned on invested capital after taxes (percent) | 9.82 | 7.71 | 26.49 | 21.64 | |

[1] Red figures.
For the 19 years shown, the percentage earned after taxes on net worth was 4.91.

Senator FLANDERS. Do you have any questions, Mr. Wolcott?

Representative WOLCOTT. No.

Senator FLANDERS. Mr. Herter?

Representative HERTER. This is a purely financial question. I notice here on a comparative statement of the various textile mills as to the break-down of the comparison of net profits after taxes to sales and so on, there is a figure that gives the percentage to invested capital. In the case of the American Woolen Co. representative who testified this morning, the 1947 profits were roughly 32 percent of invested capital. Yours run a little higher than that, 38 percent. For the industry as a whole they run 63.1 percent. I mean for this group of textile mills they run 63.1 percent. In the case of one, United Merchants Manufacturers, they run 557 percent of invested capital in the year 1947.

I am wondering, while I do not want you necessarily to comment on a competitor's business, I am wondering how that is possible from the point of view of the origin of the business?

Mr. BRADLEY. Well, I would not really know, Congressman. I would wonder whether that might have to do somewhat with their foreign plant and investment.

Representative HERTER. Foreign plants?

Mr. BRADLEY. They have plants in South America and it might be in that area that the heavy profit might come from because they are in an absolutely unregulated economy and that might have some bearing but I would now know.

Representative HERTER. You take the West Point Manufacturing, they are not outside of the country?

Mr. BRADLEY. No.

Representative HERTER. They are 184 percent of invested capital, profits in 1 year. Botany Mills runs 143 percent.

Here is a statement that is not a confidential statement, as to the earnings of the companies and it so happens that the witness of this morning and yourself are at the very bottom except for Cannon Mills, but way below the average for the other mills and then the figures run into colossally high figures and unless there is some interpretation of the figures the logical one, the inference in seeing these figures, is that this is a colossally profitable business if you can earn 500 percent for $100 invested in one uear; that is pretty good.

Mr. BRADLEY. I would not know how to answer some of those questions.

Representative HERTER. I would not know whether they had had a series of very profitable years in which they had plowed in everything. Most of those companies have a small number of stockholders and probably they plowed over during several years without bringing in new capital of any kind.

Senator FLANDERS. Now, I spoke of Mr. Ruttenberg's criticism, and he has brought in or sent in the information on which he based his criticism, and I would like to read it to you.

His first source is from the Kiplinger letter of Saturday, August 28—that is quite a little time ago now:

> Textile production is heading downward; mills are cutting hours; stocks are high; new orders not coming in at the rate expected; buyers seem to be reluctant to buy, seem to think prices may come down. Exports do not amount to much. Marshall plan has no money for textiles. Mills are not cutting prices much. They cut production, keep prices up. Thus, textiles are probably drifting toward some sort of a forced recession.

How do you react to that statement from the Kiplinger letter?

Mr. BRADLEY. I think that there is a lot of truth in it, except in one or two vital parts. Prices have come down very sharply.

Senator FLANDERS. You think that that is general?

Mr. BRADLEY. I think it is quite general. In some smaller parts of the industry which are more or less specialties, that might not obtain; but all of the broad sizable cloths have come down very sharply.

The individual mills are curtailing where they have inventory that is not moving, and they are not wanting to pile it up too big. But I believe they have chopped their prices pretty sharply.

It is pretty hard to get business. Our new sales are away below our current rate of production, and I think that competitors are in the same spot.

Senator FLANDERS. The next source given is from the New York Times of August 29. That is the day after the date of the Kiplinger letter, so it is practically contemporaneous. This is an article by Mr. Herbet Koshetz, and it is headed, "Workers protest textile cutbacks. Sixty percent of northern mills running on 4-day week to avoid building up of inventories."

Does that figure sound correct to you?

Mr. BRADLEY. It sounds a little high. That would be the northern end, the fine-goods end of the industry, and it sounds high, but I am not sure.

Senator FLANDERS (reading):

> Protest by workers union that the producers are cutting output to maintain exorbitant prices and extortionate prices highlighted the whole pricing problem of the industry last week. Figures gathered by the Textile Workers Union show that in the northern mill areas, close to 60 percent of the mills are operating on a 4-day week. In the Fall River area, widespread lay-offs are reported as mills cut out their third shifts or placed them under skeleton-crew operation. Berkshire Fine Spinning Associates, which operates in this area, had all units on 4 days. Four-day week has become widespread. In Maine, two divisions of Bates Fabrics are on 4-day shifts. Two mills in Connecticut laid off 200 workers. Amoskeag Mills reported to be operating on a 3-day week, and other mills have cut down to 4. The reduced operation it is estimated will cut production in the northern area by 20 percent.
>
> Southern mills, which have also curtailed third-shift operations and overtime, will show a lighter output this year than last, it was predicted. Emil Rieve said reductions in prices made thus far have not been large enough to induce buying on a wider scale. Millmen, however, countered that prices have been cut deeply, citing the reductions in print cloth, which has come down 28 percent since the peak of last year, and reductions of 20 percent in fine goods, and corresponding decreases in sheeting. By and large, these cuts have not induced any great amount of buying.

And then it goes on to suggest that point I just made to you; that is, that if the price cutting looks like panic cutting, there is danger that it may not induce buying.

Do you feel that the inventories in the hands of processors and jobbers and retailers are high? That is important to know in that respect.

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.

Senator FLANDERS. "Leo C. Safir warns of peril in keeping level high." Who is he?

Mr. BRADLEY. He is a cutter in New York, I believe.

Senator FLANDERS. The other relates to shoes, and I cannot lay any burden of guilt on you two gentlemen for the state of the shoe industry.

Thank you.

Mr. BRADLEY. Thank you, Mr. Chairman.

Mr. BILLINGS. Thank you.

Senator FLANDERS. Will Mr. Ballantyne take the stand? Mr. Ballantyne, will you identify yourself for the record?

## STATEMENT OF JOHN BALLANTYNE, CHAIRMAN OF THE BOARD OF DIRECTORS OF PHILCO CORP., ACCOMPANIED BY DR. COURTNAY PITT, VICE PRESIDENT IN CHARGE OF FINANCE, PHILCO CORP., PHILADELPHIA, PA.

Mr. BALLANTYNE. John Ballantyne, chairman of the board of directors of the Philco Corp.; and I have with me Dr. Pitt, who is vice president in charge of finance of the Philco Corp.

Senator FLANDERS. You may proceed with your statement.

Mr. BALLANTYNE. We appreciate this opportunity to appear before your committee to tell you something of the growth and development of the Philco Corp., its earnings record, and its plans for the future. The policies to be adopted by the next Congress will go far to determine whether the growth that Philco has achieved so far can be maintained and continued in the years ahead. Further growth means more jobs, better products, and an increased contribution to the national income, but restrictive policies on the part of Government will make it difficult, if not impossible, to maintain the high levels of employment and production that our company has already achieved.

If only our own business were to be affected by future Government policies on taxation, credit control, and other basic matters, the consequences would be of relatively limited concern and principally affect our own stockholders, employees, distributors, dealers, and customers. The fact is, however, that a great many other American businesses, particularly in the young, expanding growth industries, will be affected in much the same way that Philco will be by Government action. So the facts we are here to give you about our business are representative of those of a considerable cross section of American industry.

The Philco Corp. of today was started in 1892 as the Helios Electric Co., with a total capital of $10,200 contributed by five stockholders. For the first 30 years or so, the business consisted principally of the manufacture of storage batteries for mine locomotives, electric automobiles, and various other uses.

The business gradually grew and prospered over the years, with its expansion largely financed by retained earnings.

In 1906 the name of the company was changed to the Philadelphia Storage Battery Co., and in 1940 it became the Philco Corp.

In 1919, long before Philco became the name of the enterprise itself, we adopted "Philco" as our trade-mark and since that time our products have been sold under the Philco name.

In the year 1919 our total sales amounted to $3,500,000 and our volume of business has steadily increased, with only temporary interruptions, ever since. During the twenties we expanded by developing a socket power unit which ran the early radio sets directly from electric current and eliminated the need for a storage battery. Then in 1927 the a. c. tube was introduced by a competing company and the market for socket power units disappeared almost overnight. We therefore began to manufacture radio receiving sets in 1928. By developing new and improved designs, and streamlining our production, we were able to reduce drastically the cost of a radio set to the consumer, and within 2 years we made and sold more receivers than any other company. We have led the industry in the production and sale of radio receiving sets in every year of civilian production since 1930.

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.

Toward the end of 1938, the present management of Philco initiated a long-range program of expansion and diversification that has not even yet been completed. We made arrangements with a leading air-conditioning manufacturer to produce a line of single-room air conditioners that we sold through our distributor-dealer organization, and in 1939 we made a start at entering the refrigeration business by acquiring the tools and dies and inventory of another manufacturer who wished to withdraw from that field. We were just well started on these expanded activities when war came in 1941, and we immediately converted our factories 100 percent to war work as rapidly as possible.

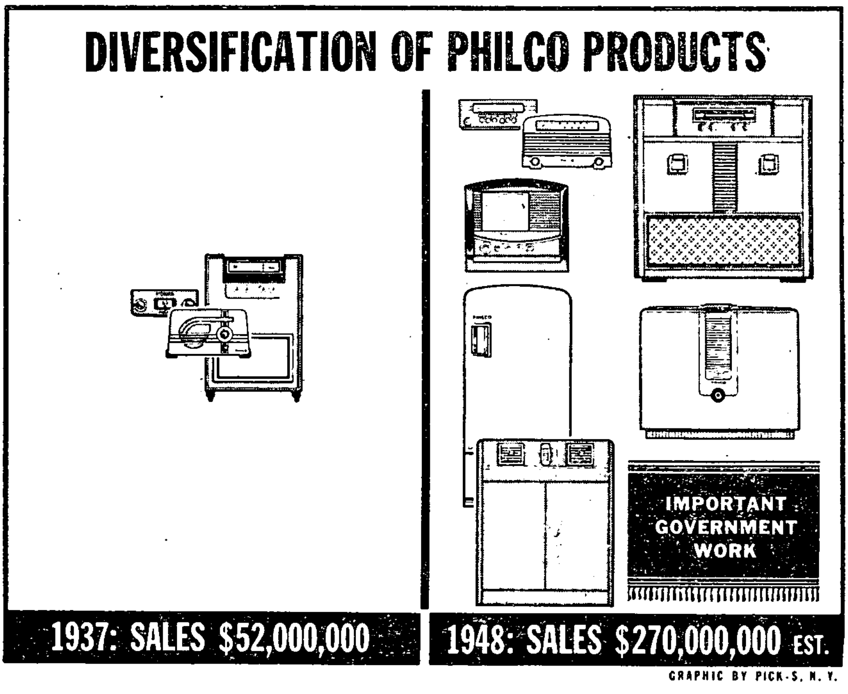
At the end of the war, we decided that we were ready to expand in refrigeration and play a leading part in the industry. To do this, in 1946 and 1947, we acquired a large refrigerator plant in Philadelphia and equipped it with the most modern machinery for the production of refrigerators and home freezers, and last year we purchased the Rex Manufacturing Co. of Connersville, Ind., which had worked very closely with us in manufacturing Philco refrigerators and which we had aided with financial support and engineering assistance. With these facilities, we have in effect added a whole new business with gross sales of nearly $100,000,000 in 1948 to the radio business we had in 1936–39.

We are in the process of developing another very large business with sales of perhaps $100,000,000 in 1949 in television. Commercial television, of course, did not exist in 1936–39, and it became a business as recently as a year ago. 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.

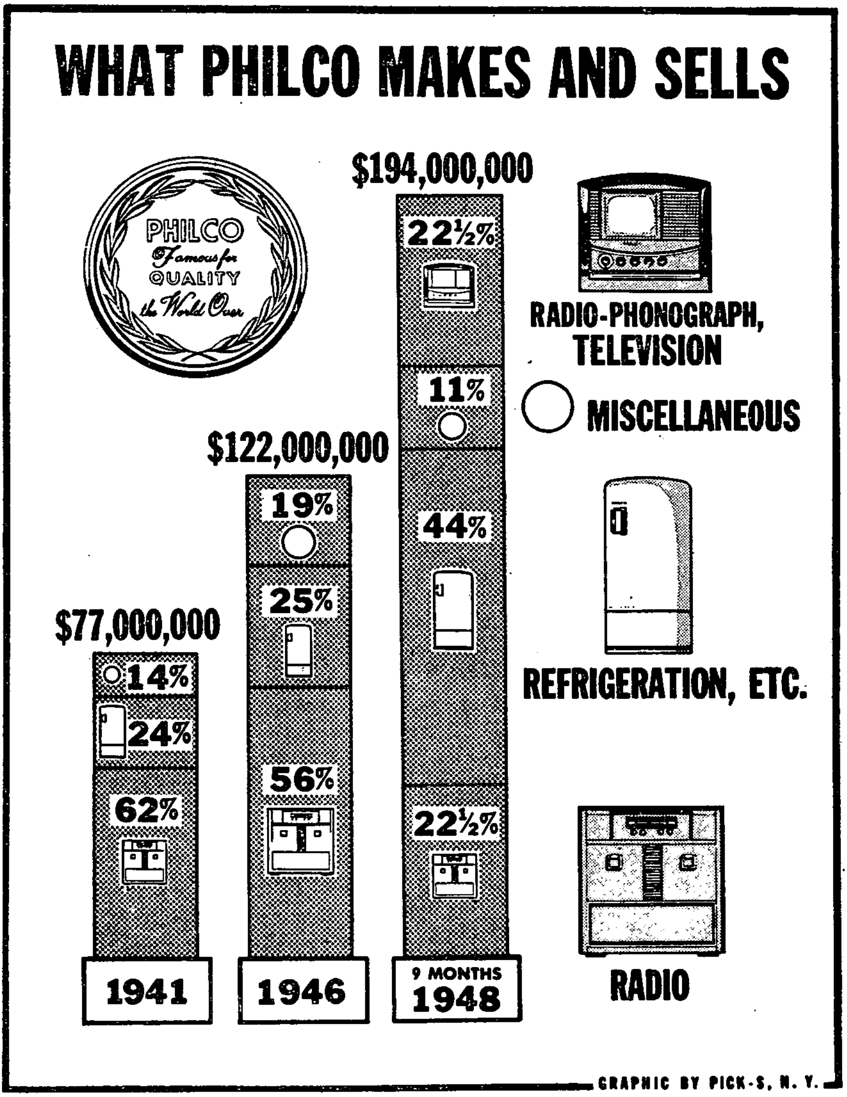
I believe that this background information is essential to make it possible for the members of the committee to familiarize themselves with Philco. In effect, we have added two very large new businesses since the war to the basic radio business that we had in the 1936–39 period. Naturally, therefore, our sales and our earnings, and also our Federal income tax payments, are up very substantially as compared with the prewar years. The following charts, Diversification of Philco Products, and What Philco Makes and Sells, indicate the growth of our company in terms of the products we make and sell now as compared with 1937. In 1937 our sales were approximately $52,000,000, and we have automobile radio and home radio in the form of console and table models. In 1948 we have the same three items, automobile radio, the console models, and table models, together with television, refrigerators, home freezers, single-room air conditioners, and of course now, very important Government work.

(The chart referred to is as follows:)



Mr. BALLANTYNE. The second chart gives in bar form the various products made and sold by Philco in 1941, 1946, and 1948; and in that chart you will note in 1941 refrigeration only accounted for 24 percent of our business, and now accounts for 44 percent of our business, whereas radio in 1941 accounted for 62 percent as against 22½ percent now, and radio-phonograph and television 22½ percent.

(The chart referred to is as follows:)

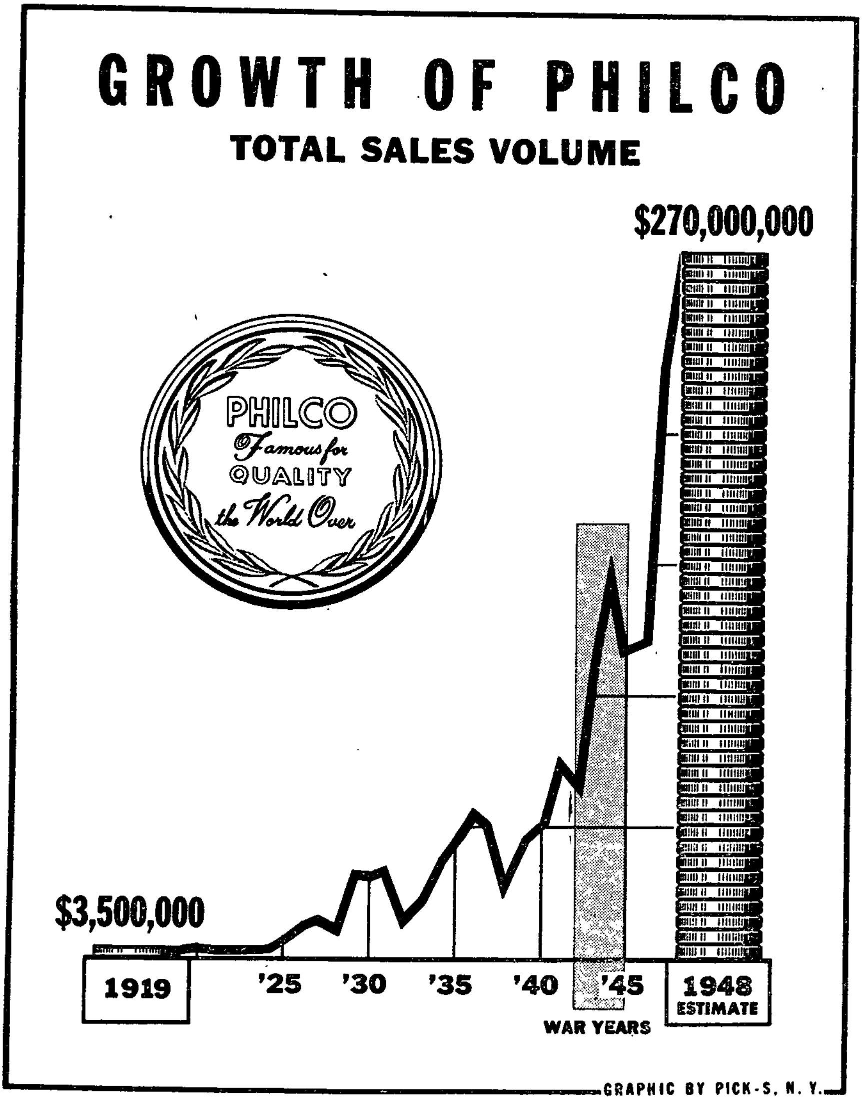


Mr. BALLANTYNE. Reflecting the addition of refrigeration, air conditioning, and television, as well as some increase in our radio business, due to the growing popularity of radio-phonographs, Philco Corp. will have total sales of about $270,000,000 this year—77 times as large a volume as we did 30 years ago.

The accompanying chart, Growth of Philco, presents the picture of the growth of our business since 1919 in terms of annual sales.

In 1919, our sales were $3,500,000; and as you will note, they increased to $270,000,000 (estimated) in 1948.

(The chart referred to is as follows:)



Mr. BALLANTYNE. I should like particularly to emphasize two facts which the chart brings out:

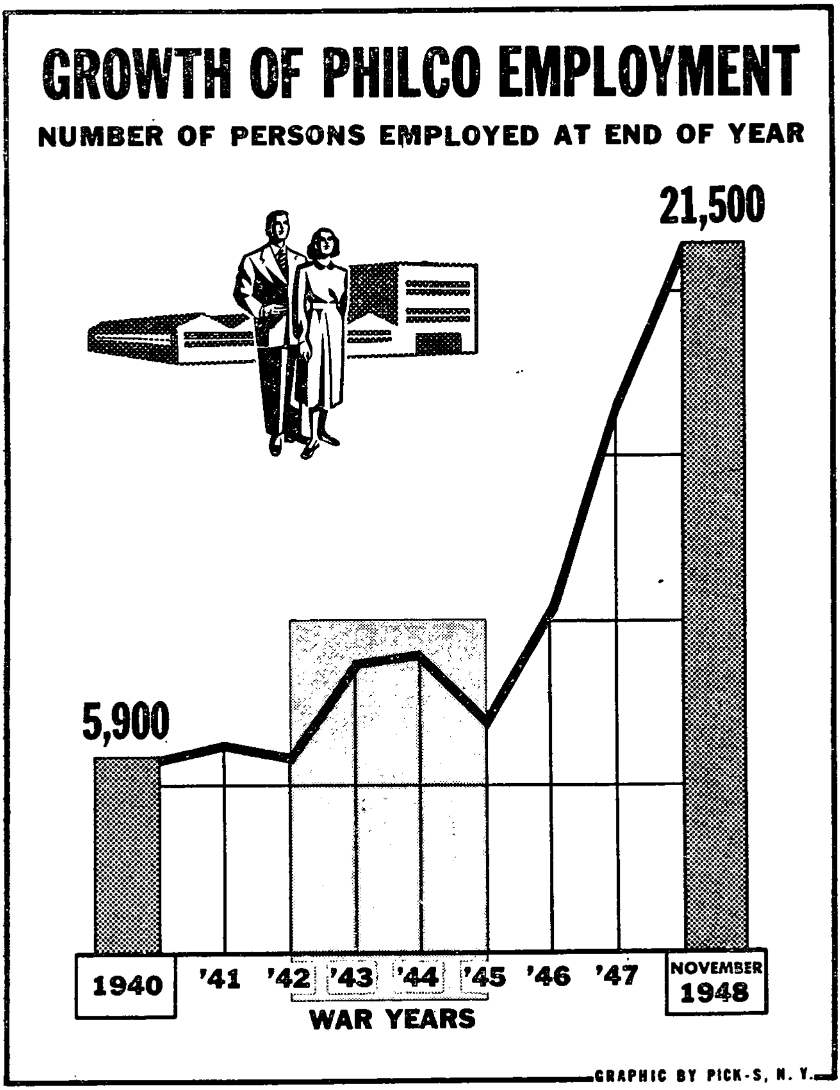
1. The growth of Philco has extended over a period of 30 years and through several business cycles. It is not a result of postwar inflation.

2. During the thirties when many industries were standing still or were in a declining phase, Philco was growing and expanding.

With this historical perspective, let us now turn to a more detailed study of the period from 1940 to 1948.

First of all, you are naturally interested in what the growth in dollar sales of Philco products has meant in terms of jobs. The facts are presented graphically in the chart, Growth of Philco Employment.

(The chart referred to is as follows:)



Mr. BALLANTYNE. In 1940 we had a total number of employees of approximately 5,900; and today we have in our various plants 21,500 employees.

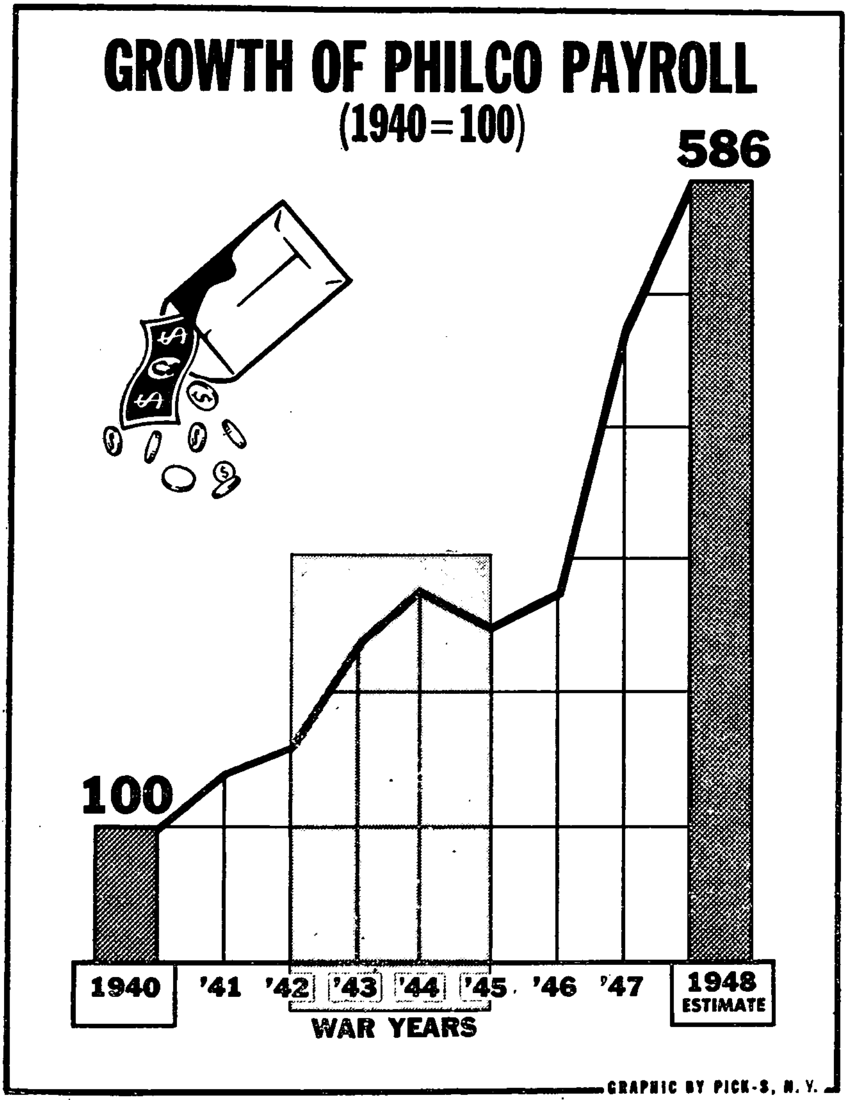
Our year-by-year employment since 1940 has increased as follows:

*Growth of Philco employment*

| End of year— | *People employed* |
|---|---|
| 1940 | 5, 900 |
| 1941 | 6, 318 |
| 1942 | 5, 974 |
| 1943 | 8, 785 |
| 1944 | 9, 080 |
| 1945 | 7, 099 |
| 1946 | 10, 046 |
| 1947 | 16, 705 |
| 1948 (November) | 21, 500 |

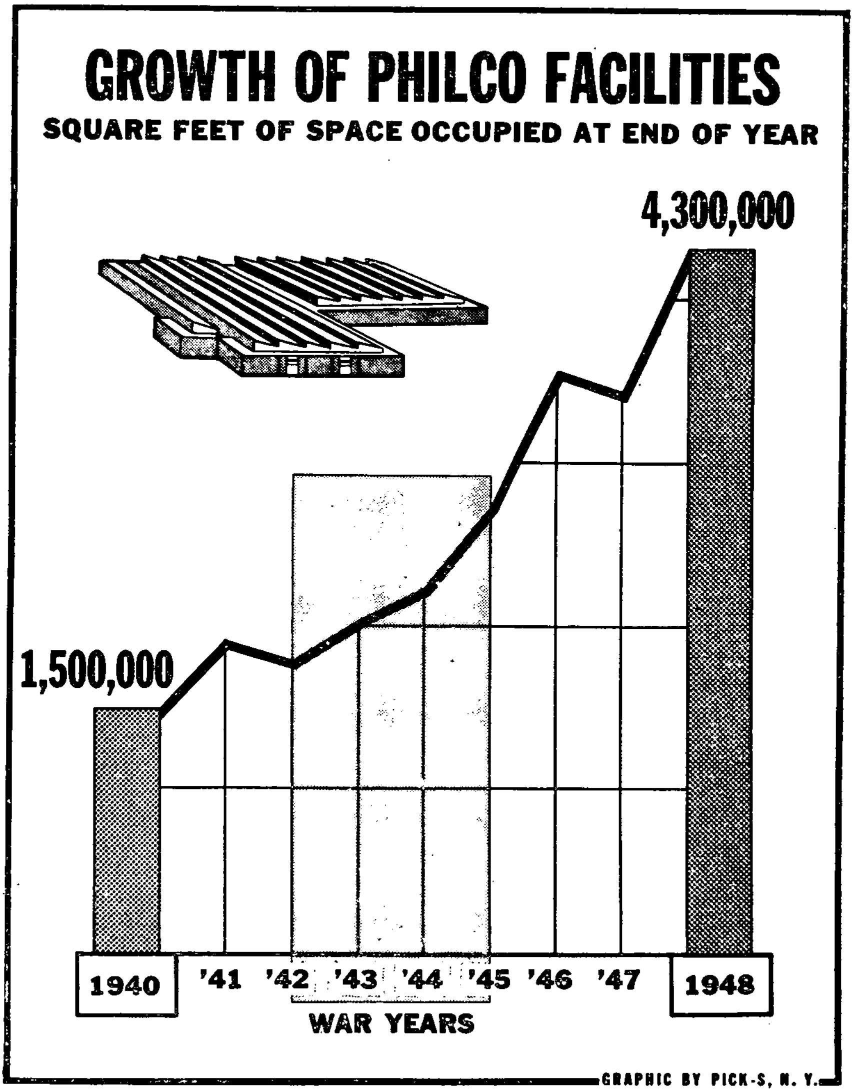
The increase in total wages paid is even more striking because it reflects both the great gain in the number of people we employ and the fact that our hourly rates are today approximately 85 percent above 1940. As a result of both this greater employment and higher hourly rates, our total pay rolls this year are 486 percent higher than in 1940. The chart, Growth of Philco Pay Roll, presents these facts visually, using 1940 as 100 percent and in 1948, 586 percent, or an increase of 486 percent.

(The chart referred to is as follows:)


GROWTH OF PHILCO PAYROLL
(1940=100)
586
100
1940
'41
'42
'43
'44
'45
'46
'47
1948
ESTIMATE
WAR YEARS
GRAPHIC BY PICK-S, N. Y.

Mr. BALLANTYNE. Another important indication of our growth is found in our physical facilities, which have increased from 1,500,000 square feet in 1940 to 4,300,000 square feet at the present time. This is brought out in the following chart, Growth of Philco Facilities.

(The chart referred to is as follows:)



Mr. BALLANTYNE. Sales of Philco Corp., earnings before taxes, taxes paid, earnings after taxes, earnings per dollar of sales, return on net worth, and dividends in 1940, 1941, 1946, 1947, and the first 9 months of 1948 are as follows:

| | 1940 | 1941 | 1946 | 1947 | 9 months, 1948 |
|---|---|---|---|---|---|
| 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: | | | | | |
| Before taxes ... percent | 6. 87 | 11. 00 | 4. 72 | 9. 62 | 8. 43 |
| After taxes ... do | 4. 30 | 3. 26 | 2. 56 | 4. 25 | 3. 42 |
| Return on net worth ... do | 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.

Senator FLANDERS. The earnings per dollar of sales do not indicate that those earnings could result in very largely decreased prices to consumers. That is, they are running at the present time, before taxes, 8.43 percent, and after taxes, 3.42 percent, which is a comparatively small amount for a manufacturing business, much smaller than in the case of the textile industry we were just listening to.

Mr. BALLANTYNE. We think it is quite low, and we will have something to say on our objective with respect to that.

Senator FLANDERS. And your payments on the common, which were $1,355,149 in 1940, have not been increased in proportion to your increase in sales or your increase in net worth or on any other basis, having risen only from that $1,355,149 to $2,248,505.

Mr. BALLANTYNE. I should point out that that is the cash dividend; and in 1947, and also in 1948, we did declare a stock dividend in addition to the cash.

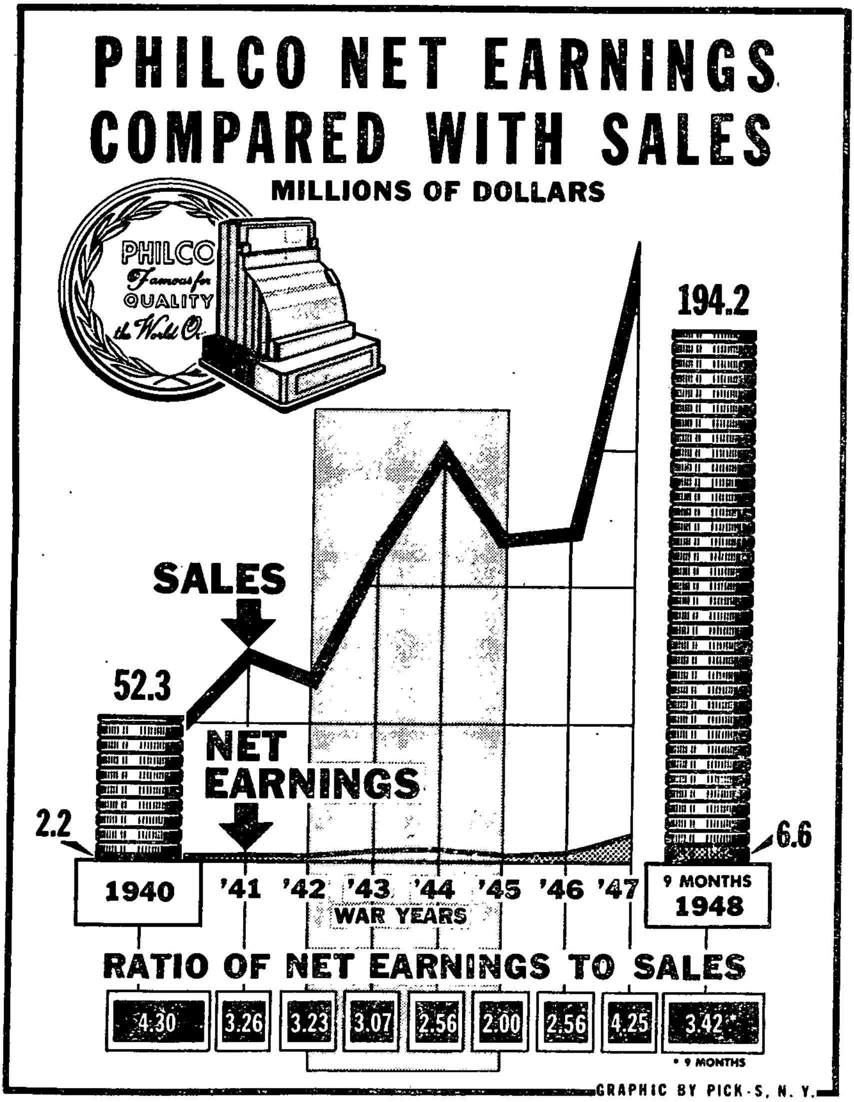
Senator FLANDERS. That is pertinent, also.

Mr. BALLANTYNE. The only other thing I want to make clear is that the last column represents the 9 months for 1948 instead of the full year.

Senator FLANDERS. Yes, I see that.

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 own performance. The relationship between our sales and our earnings for the period since 1940 is indicated in the following chart, Philco Net Earnings Compared With Sales.

(The chart referred to is as follows:)


PHILCO NET EARNINGS COMPARED WITH SALES
MILLIONS OF DOLLARS
PHILCO
Famous for
QUALITY
the World Over
194.2
SALES
52.3
NET EARNINGS
2.2
6.6
1940
'41
'42
'43
'44
'45
'46
'47
9 MONTHS 1948
WAR YEARS
RATIO OF NET EARNINGS TO SALES
4.30
3.26
3.23
3.07
2.56
2.00
2.56
4.25
3.42*
* 9 MONTHS
GRAPHIC BY PICK-S, N. Y.

Mr. BALLANTYNE. In that chart we have set forth the sales in the top bracket from $52,300,000 in 1940 to $194,200,000, our sales 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 we have shown below the ratio of net earnings to sales, in 1940—4.30, and so on, across to 3.42 for the 9 months of 1948.

We have set a goal for ourselves of achieving a margin of 6 percent on sales after all charges and Federal income taxes.

Senator FLANDERS. Excuse me for just a moment. Did you say ratio of net earnings to sales?

Mr. BALLANTYNE. Yes.

Senator FLANDERS. All right, go on.

Mr. BALLANTYNE. 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.

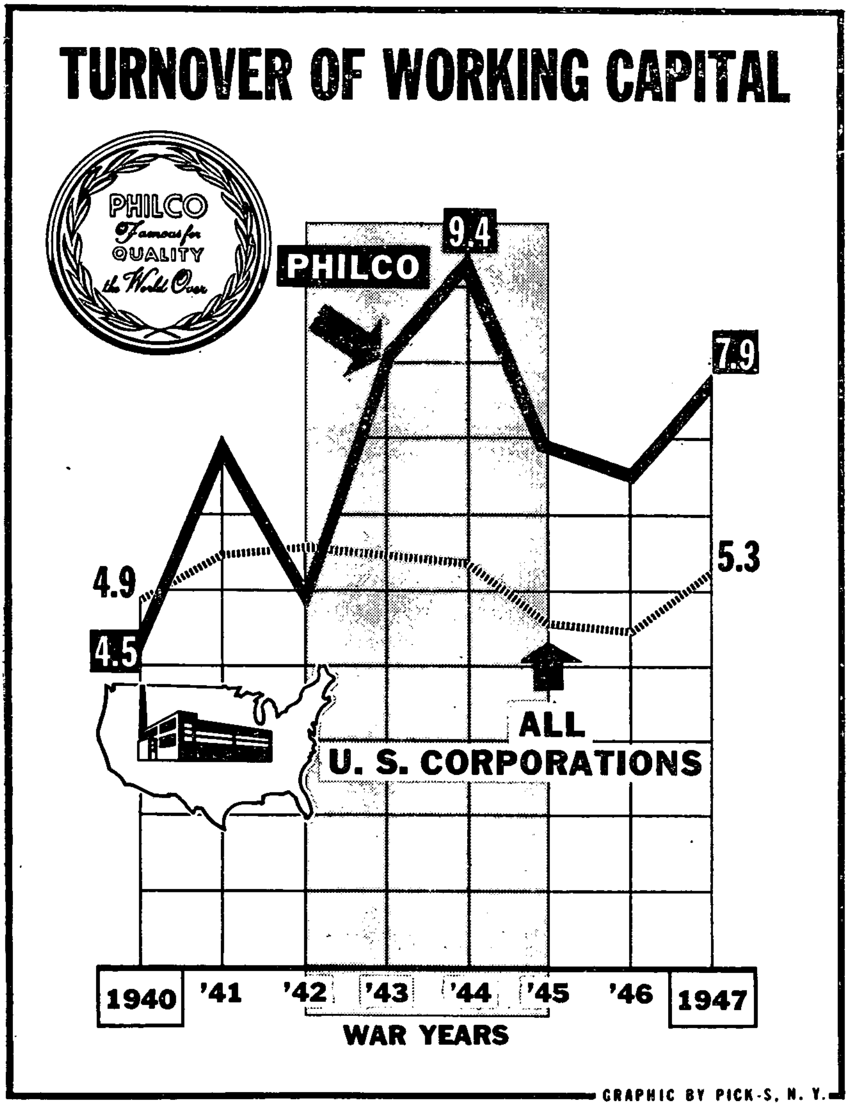
It appears at this time that we will not achieve a 6 percent net return on sales in 1948, either, because we have had to shoulder heavy developmental expenses in television and the cost of training several thousand service and installation experts.

There may be some who may ask whether the ratio of profits to sales is the proper measuring rod for our business. In our judgment it is, and 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 are able to 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 and the rapid rate at which we turn over our working capital. Our rate of turn-over compared with the average for all United States corporations is indicated in the following chart, Turnover of Working Capital.

(The chart referred to is as follows:)




Mr. Ballantyne. Now, this chart shows Philco turning over its working capital as high as 9.4 times, and in 1947 turning it over 7.9 times, as compared with the average of all United States industries of 5.3 times, or almost of 50 percent more rapid turn-over than the national average.

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 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.

Once new Philco products have been created, we are always glad to join hands with other companies who can help us to produce them. When we have designed a tuner for a television receiver, or a speaker for a radio, or some other important component, we look around to see if some company specializing in that particular field can make the part for us, to our specifications, on at least as favorable terms as we can do it ourselves. If so, we are very glad to turn that part of the job over to them, but this is done only when their work meets our exacting engineering specifications so that we can maintain the highest quality standards in our products.

This method of operation, developed many years ago at Philco, came to popular attention during the war when it was called subcontracting. But actually it was nothing new and had been used very successfully in prewar days. It has two great advantages:

1. It enables us to draw on the facilities and special skills of other companies;

2. It enables our company to expand its production far more rapidly and with less actual investment in, and perhaps duplication of, new plant facilities than would otherwise be the case.

In the years 1940, 1941, 1946, 1947, and 1948, Philco earnings have been used as follows:

| | 1940 | 1941 | 1946 | 1947 | 1948 (9 months) |
|---|---|---|---|---|---|
| Earnings | $2, 248, 568 | $2, 513, 569 | $3, 107, 48 | $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 |

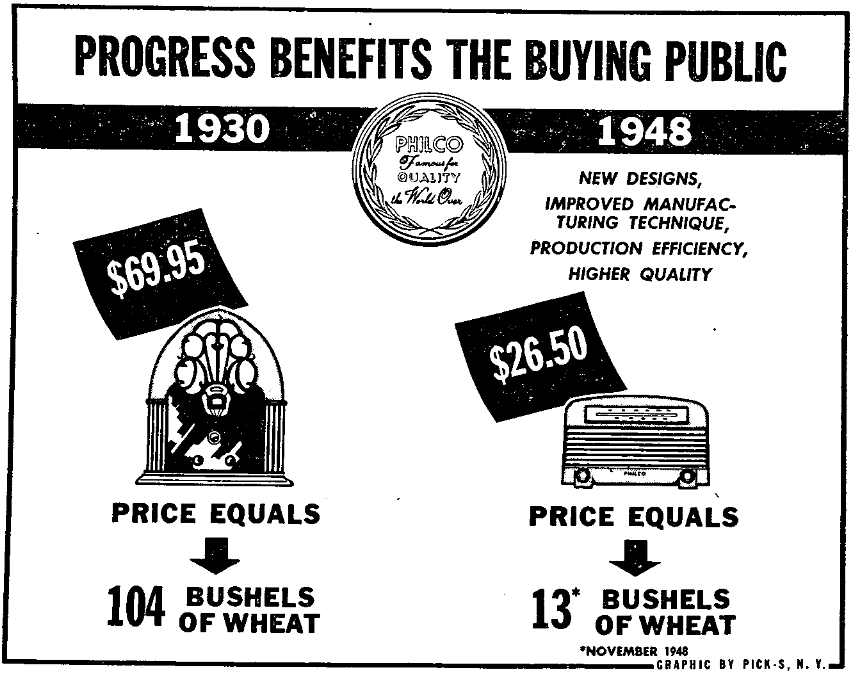
You will observe that because of our growth we have found it necessary to follow a rather conservative dividend policy. In 1946, we raised about $10,000,000 through the sale of 100,000 shares of preferred stock to pay for part of the cost of our plant and equipment expansion program. But in addition 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.

We take great satisfaction in the ways in which our growth and progress have benefited the buying public. One example of this, among many others, is illustrated by the following chart. This chart shows that when we brought out the "Baby Grand" radio set for $69.95 in 1930, it represented a great price reduction at that time. The average list price of all radios sold by the industry in the preceding year was $136, so we just about cut that price in half with our new set.

Based on 1930 prices, it cost the equivalent of 104 bushels of wheat to buy that 1930 Philco radio.

Today in our model 504 we offer a better set for only $26.50 and based on last week's prices, this receiver costs the consumer the equivalent of only 13 bushels of wheat. These facts are presented visually in the following chart, Progress Benefits the Buying Public.

(The chart referred to is as follows:)



Mr. BALLANTYNE. In refrigeration we are equally proud of our accomplishments. In 1939 we sold a stripped 6-foot refrigerator for $149.50, the cost being $25 per cubic foot of capacity.

In 1948 we sold an equipped 7-cubic-foot Philco refrigerator with many features for $199.50, the cost being only $28.60 per cubic foot of capacity, and yet since 1939 the Bureau of Labor Statistics index of the cost of living has increased 75 percent.

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 depressing 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 compnaies 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.

Now, it is very difficult, in the time allotted, to present to the committee all of the facts about Philco, and I would like at this time to extend a welcome on behalf of Philco for the committee to visit our main plants in Philadelphia if you have the opportunity, to just see what we have there and how we operate.

Senator FLANDERS. Thank you.

I have one or two questions. Of the various companies which have appeared before us to date, I think that you have shown a greater rate of expansion than any of the others, and it has not been entirely clear just how that has been done. Has it been in a large measure by acquisition? You mentioned a few acquisitions in the earlier part of your statement. Has that played any important part in your expansion?

Mr. BALLANTYNE. The acquisition of the Rex Co., which had supplied us with refrigerators for several years, was not made until 1947, but one of the main increases in our business is due to refrigeration, in which we started in 1939, and our sales were only $3,600,000 in that year. We were only in the refrigerator business for the period 1939, 1940, and 1941. During 1941, we sold approximately $17,000,000 worth of refrigeration. In 1948 we anticipate that business will run approximately $100,000,000.

Senator FLANDERS. So that the acquisition part of it is a minor element in the total expansion of your refrigeration business?

Mr. BALLANTYNE. We had to acquire the facilities to really get into the business. Prior to the war, our refrigerators were bought under contract from the Rex Manufacturing Co. in Connersville, Ind.

Senator FLANDERS. In making an acquisition, do you do it by an outright purchase, paid for in cash, or do you exchange stock?

Mr. BALLANTYNE. It so happened in the Rex Manufacturing case that we exchanged stock, and we are also in the process of exchanging stock with Electromaster for the range business.

I would like to correct that statement by saying that we are issuing stock for their net assets, but it is practically the same thing.

Senator FLANDERS. Do you have any questions?

Representative WOLCOTT. I am not clear on how you are capitalized. Do you capitalize out of earnings? You mentioned a $10,000,000 preferred stock issue. How are you capitalized?

Mr. BALLANTYNE. At the end of last year we had outstanding 1,495,342 shares of common stock, or a total of $4,486,000. We had preferred stock of $10,000,000, or a total of $14,486,000, plus capital surplus of $7,728,000, and surplus of $20,750,000, or a total of $42,965,000.

Representative WOLCOTT. I think that you have explained satisfactorily your position with respect to your income here on sales. What would your profit be on invested capital?

Mr. BALLANTYNE. I think that that is in a tabulation I gave in my statement.

Our return on net worth was 14.19 percent in 1940, and in 1941 it was 15.48 percent.

Senator FLANDERS. You make a distinction between the terms "net worth" and "invested capital"?

Mr. BALLANTYNE. We have had some argument with our accountants and others in the past few days on that, and we are considering net worth and invested capital as one and the same.

In 1946 it was 8.85 percent, and in 1947 22.42 percent, and in the 9 months of 1948, 19.12 percent.

Representative WOLCOTT. It will run about the same as 1947?

Mr. BALLANTYNE. This is for the 9 months.

Representative WOLCOTT. At the end of the year, according to those figures, you will run about the same in 1948 as you did in 1947.

Mr. BALLANTYNE. The 1948 figures I hope will be a little higher than 1947, although I am not so sure.

Representative WOTCOTT. Do you anticipate any reduction in sales volume in 1949?

Mr. BALLANTYNE. We anticipate a considerable reduction in radio sales volume. This past year it is estimated that there will be between 15 and 16 million radios produced, and the estimates for next year are between 10 and 12 million sets. We, however, expect a tremendous increase in the television end of our business. This year we are producing less than 200,000; and next year the industry anticipates a production of 2,000,000 television sets, and we hope to get 600,000 of them.

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.

Senator FLANDERS. Are there any further questions?

I would like to ask one question, as to your value as an asset to the Government of the United States. Have you handy records of the taxes you have paid during the years under consideration, the income tax you have paid the United States Government?

Mr. BALLANTYNE. We have the figure here of the amount we paid during 1940, '41, '46, and '47.

Senator FLANDERS. You might put that in the record.

Mr. BALLANTYNE. In 1940 the taxes paid were $1,347,000, and in 1941 it was $5,967,000, and in 1946 it was $2,817,000, and in 1947 it was $8,734,000, and for the 9 months of 1948, $7,051,000.

Senator FLANDERS. I had forgotten those figures, and they are in the record already.

Mr. BALLANTYNE. In addition to which, Mr. Pitt points out that we are also taxed under the excise tax laws, as manufacturers of radio and refrigeration, to the extent of 10 percent.

Senator FLANDERS. That is the consumer tax?

Mr. BALLANTYNE. The consumer is taxed, and we collect it and pay it to the Government. That is not in this figure, that was the point. These are income taxes.

Senator FLANDERS. I think that there are no further questions, and we thank you for your attendance and for this interesting statement.

Now, we will have in this room tomorrow Mr. John Schmidt, vice president and comptroller of Armour & Co.; Mr. Howard C. Greer, executive vice president of Kingan & Co., a small packing firm of Indianapolis; and Mr. Walter Reuther we hope to have here if his arm, which is still ailing, permits him to be here; and otherwise Mr. Donald Montgomery of the United Automobile Workers and a representative of the United Electrical Workers.

This session is adjourned. We meet at 10 o'clock tomorrow morning in this room.

(Thereupon, at 4:20 p. m., a recess was taken until 10 a. m., Friday, December 17, 1948.)

# CORPORATE PROFITS

---

**FRIDAY, DECEMBER 17, 1948**

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the caucus room, Old House Office Building, Senator Ralph E. Flanders (chairman of the subcommittee) presiding.

Present: Senators Flanders (presiding), Watkins, and O'Mahoney, and Representatives Wolcott and Herter.

Also present: Fred E. Berquist, assistant staff director.

Senator FLANDERS. The hearing will come to order.

We are expecting other members of the committee, but pending their arrival I would like to read a letter into the record. This is one of a great number of letters I have received from small stockholders, and I thought it might be useful for the record to put one of these letters in. This is from Milwaukee, Wis., and is addressed to me:

MILWAUKEE, WIS., *December 10, 1948.*

Hon. R. E. FLANDERS,
*United States Senator from Vermont.*

MY DEAR SIR: I understand that you are the chairman of the congressional committee investigating profits of business and industry as announced of this past year. May I say a word for the forgotten man, the common-stock holder, the real owner of all business? In the first place, when profits are mentioned, cut them in half, for that is their true worth today. Regardless of the peculiar reasoning of labor economists who have a low value for the wage dollar but a prewar value for the profit dollar. Anyone using the profit dollar, corporation or stockholder, finds it buys no more and goes no further than the wages of the working man. Again, for the past 15 years, profits have been meager or nonexistent and what there was has been largely taken by labor and the Government, the stock holder has received little or nothing. Now, when for the first time in years he is receiving some payment for the use of his money a large outcry is raised because of it. In the case of my husband and myself, we were the old-fashioned kind who never lived up to their income, denied themselves immediate satisfactions in order to save for independence in old age.

However, the depression wiped out much of our savings and the income from what was left dwindled to meager returns. My husband is retired and what we receive in investment income is pathetically important. By strenuous efforts we have been able to maintain a modest life insurance. We own our home with a mortgage on it, but taxes are rising ominously. We need repairs, but only the most necessary are made, costs are prohibitive. Some people seem to have the idea that the owners of industry are callous, wealthy individuals of inhuman character. What about one class of owners, charitable and educational institutions, churches, etc., dependent upon endowments invested in utilities, industry, and business? The dwindling returns on their securities is a cause of anxious concern to them all. Are they not entitled in view of past lean years to some semblance of generous return, is it not of extreme imporance to them and beneficial to all who receive the advantage of their services?

The stockholders' dollar is taxed at its source and taxed again when he receives it. What incentive is there for anyone to save and invest when the results are as described? The result will be, nobody will. The practice will be to live for today and scream for benefits from the Government when immediate resources are consumed. We are seeing it even now on all sides and the resulting irresponsibility is a menace to the stability of our country. We will be a people with no initiative or vitality. With no reward for effort, why make it or for prudence, why exercise it? With no savings, no financing of business, no business, no jobs. Pity the poor stockholder.

Yours respectfully,

(Mrs.) ADELAIDE B. CLARKSON.

And I may say that this was a handwritten letter, written, however, in a clear hand, and I have had the letter transcribed by typewriter for placing in the record.

Our first witness this morning is Mr. John Schmidt, of Armour & Co.

Mr. Schmidt, will you identify yourself for the record, please?

## STATEMENT OF JOHN SCHMIDT, VICE PRESIDENT AND COMPTROLLER OF ARMOUR & CO., ACCOMPANIED BY FRED R. BAIRD, GENERAL COUNSEL, ARMOUR & CO.

Mr. SCHMIDT. Mr. Chairman and gentlemen; my name is John Schmidt, and I am vice president and comptroller of Armour & Co. I have been in the employ of Armour & Co. for 35 years.

Armour & Co. and its subsidiaries are engaged in the meat-packing business, operating packing plants in North and South America for the slaughter of livestock and the processing of meats and animal products and byproducts. In conjunction with their meat-packing operations, the company and its subsidiaries manufacture butter and cheese and purchase and process butter, cheese, eggs, poultry, and other dairy products; extract and process vegetable oils, and manufacture margarine, salad oil, and shortening; manufacture soap, toilet articles, glue, glycerine, fatty acids, curled hair, and sandpaper; and carry on ammonia cylinder-filling operations; tan and prepare hides and skins and manufacture leather products; and manufacture chemicals and pharmaceuticals. They also manufacture and prepare fertilizers, mining certain component materials thereof.

It is an honor to appear before you, and I do so with due regard to the importance of the inquiry you are pursuing.

My statement follows your suggested list of topics and questions.

Furnish and be prepared to discuss comparative sales, cost and profits data for 1940, 1946, 1947, and 1948 to latest available date.

The data furnished in response to this item covers the 10 fiscal years 1939–48 rather than the 4 specific years indicated above. More data is being submitted than that requested since it is believed that the information for the 10 years would provide your committee with a more comprehensive picture of the operations of our company. The figures for the year 1948 are subject to the completion of the examination by independent public accountants, which is now in progress.

(*a*) Relate profits to units of output, number of employees, net worth, invested capital, sales and other reference points which you deem of significance.

In exhibit 1, we have set forth the data required under the above item. The information with respect to units of output is confined to our domestic meat operations, since the other operations cover a wide variety of products with respect to which it is impossible to express the output in terms of one common denominator. The following outline of the information presented in exhibit 1 may be helpful in your consideration of the exhibit.

In column (2) is shown the company's profits before deducting interest. This reflects an average annual profit for the 10 years 1939–48 of $15,640,000. Column (3) shows the company's profits and losses for the 10-year period after deducting interest to have averaged $13,690,000.

Column (4) shows the company's average invested capital, represented by current and long-term debt, preferred stock, common stock, and surplus, including surplus reserves. Average invested capital for the entire 10-year period was $325,500,000. Eliminating current and long-term debt from invested capital leaves the equity of the preferred and common-stock holders in the assets of the company, as reflected in column (5), under the heading "Net worth."

The ratios of profits and losses to invested capital and net worth are shown in columns (6) and (7). 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 hereunder:

| | Percent profit (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) |

Columns (8), (9), and (10) show a segregation of the profits and losses as shown in column (3), as between the company's domestic meat business and the balance of its operations, comprising shortening and oil, pharmaceutical, dairy and poultry, soap, glue, hair, sandpaper, ammonia, chemical, fertilizer, leather and foreign. Columns (12), (13), and (14) show a corresponding segregation of sales dollars, and columns (15), (16), and (17) show the ratios of profits and losses to sales dollars. This information for the specific years requested by the committee, as well as the averages and the high and low for the 10-year period, are tabulated hereunder:

| | Domestic meat | Balance of operations | Total |
|---|---|---|---|
| Profit or loss (−) (million 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 | 8.09 (1947) | 22.82 (1947) | 30.91 (1947) |
| Low | −12.63 (1948) | 5.64 (1939) | −1.97 (1948) |
| Sales dollars (million 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 | 1,400.5 (1948) | 594.2 (1947) | 1,991.4 (1948) |
| Low | 481.8 (1939) | 230.8 (1940) | 715.3 (1939) |
| 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 | 1.02 (1946) | 4.39 (1946) | 2.34 (1946) |
| Low | −.90 (1948) | 1.60 (1944) | −10 (1948) |

Column (18) reflects the sales weight of the company's domestic meat business. During the 10-year period the annual average volume of this segment of the business was 3,949,300,000 pounds, the peak during the period being 5,012,500,000 pounds in 1944, and the low point being 2,855,600,000 pounds in 1946.

The ratios of profit and loss in terms of cents per pound of domestic meat sales are set forth in column (19). The profit for the 10-year period averaged thirty-six one-thousandths—about one twenty-eighth—of a cent per pound. The highest profit during the period was achieved in 1946, when it was only slightly more than one-fourth of a cent per pound. The 1948 loss of thirty-six one-hundredths—about three-eighths—of a cent per pound was the low point in the period.

The average number of employees is reflected in column (20). The figure for 1948 is not yet available. The profit per employee, as shown in column (21) ranged from a low of \$105 in 1939 to a high of \$365 in 1947.

The following comments are presented with respect to the information just outlined.

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 1⅗ 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 column (19) of exhibit 1. This exhibit 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.

The information on average number of employees and profit per employee set forth in exhibit 1 is submitted in response to your request; however, it is submitted with some reservations because, frankly, we do not believe that any sound conclusions can be reached as to a fair and equitable level of profits by relating the profits to the number of employees. Differences in nature of industries, degree of mechanization, and similar factors have a distorting influence upon such a comparison.

In answer to your request for cost data we have prepared and submit exhibit 1–a 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 exhibit 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.

(*b*) The disposition of profits as between dividends and retained earnings.

Exhibit 2 shows that for the 10 years 1939–48, earnings amounted to \$136,900,000, dividends paid amounted to \$58,000,000, and earnings retained in the business amounted to \$78,900,000.

(*c*) The disposition of retained earnings as between debt retirement and new investment.

(*d*) For new investment give types of asset—working capital, cost-reducing plant and equipment, and net expansion of plant and equipment.

Exhibit 3 shows that 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 |
| | | 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 |
| | 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 dividends 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 and 1948.

| | |
|---|---|
| In each of the 8 years (1939–46) depreciation provided exceeded capital expenditures—the aggregate excess for the 8 years amounting to | $20, 611, 000 |
| In the last 2 years capital expenditures exceeded depreciation provided by: | |
| 1947 | (5, 258, 000) |
| 1948 | (6, 593, 000) |
| Aggregate excess of depreciation provided for the 10 years | 8, 760, 000 |

The total of our capital expenditures in the 2 years, 1947 and 1948, was $13,645,000 and $16,470,000, respectively. These expenditures represent, for the most part, urgently needed replacements of existing facilities. Many of these replacements had been deferred from the war years.

Senator FLANDERS. I note you speak of your 1948 figures. What is the end of your fiscal year?

Mr. SCHMIDT. The end of October.

Senator FLANDERS. So that you do have your final figures?

Mr. SCHMIDT. Still subject to final audit, Mr. Chairman.

Senator FLANDERS. Going back a bit, I get the impression from your first page of statistics that you lose on the meat and make on the squeal. In other words, it is your byproduct business and your accessory business that has brought you such profits as you have had.

Mr. SCHMIDT. The balance of the business is leather business, fertilizer business, our South American business, and glue, hair, sandpaper and ammonia business, and our dairy and poultry business, and they are all mostly unrelated to the meat business.

Senator FLANDERS. You may continue.

Mr. SCHMIDT. As to sources of capital, your suggested list of questions had this topic last. We are bringing it in here after "Tabulation of company data" because the questions suggested under these two topics are closely related.

(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?

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 rates. In each case, we have had to go into the bond and debenture markets.

The capital structure of our company breaks down as follows:

[In millions of dollars]

| | 1938 | | 1948 | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| Working capital (1938=100) | 100.15 | 100 | 173.10 | 173 |
| 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 stockholders in the hope that they would reinvest those dividends in additional common stock in our company.

The next subject is 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."

There, of course, is no question but that there are many widely divergent opinions as to whether or not profits are "too high" or "too low." We think that the very fact that we have such varying opinions and the freedom to exercise and express them has been one of the strongest forces in developing the high standard of living we enjoy in this country today. Furthermore, we are convinced that it is essential to our future progress that these opinions continue to be freely expressed and exercised.

(a) What criteria would you suggest to this committee as a fair approach for determing a proper and equitable level of profits in your company? For other industries?

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 stockholder's investment against deterioration. It seems obvious that, except for a few possible rare 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.

(b) Would you agree that profits are ever too high? If so, where or when? Should anything be done about such profits?

We agree that there probably is little doubt that in isolated instances profits are sometimes too high. We would not agree that all profits could ever be too high, except possibly in periods of extensive war. The isolated instances of "too high" profits can, of course, occur at any time and in any place. We do not believe that anything should be done about such profits other than to permit the free play of the many economic forces affecting profits. As previously indicated, it is our belief that these forces are bound to eventually result in the adjustment of profits to a proper and equitable level. Admittedly, there will be, as a result, some individuals who might obtain more than their just share of the efforts of society as a whole in relation to their contributions to society; but we cannot endanger the welfare of the many in order to justly deal with a small minority.

(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?

As previously indicated, the operations of our company for the fiscal year 1948 resulted in a loss. I am sure you will agree that we could not be sufficiently informed with respect to the increased profits of other industries to attempt to express an opinion as to whether or not such increases were justified. We should like, however, to offer the general observation that there are those who might have argued that the profits of our company for the fiscal year 1947 were "too high." We do not agree that, even taking that year by itself, the profits were too high, but certainly even those who would so contend would alter their opinion in the light of the results for the fiscal year 1948.

In concluding our statement on this topic Level of Profits, we wish to observe that we realize it may appear to the committee that we have oversimplified the problem. We have no intention of doing so. We are fully cognizant of the extreme complexity of the problem and the desire of the committee to reach a conclusion that will be satisfactory to the people as a whole and we are sincerely desirous to be helpful. Let us again emphasize that we do not believe that any artificially established measure of the adequacy or inadequacy of profits, no matter how carefully it is designed, can be applied without seriously retarding the continued development of our economy.

The next question relates to 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?

We have not set aside any such special allowances.

The next subject is Pricing Policies.

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 chartered 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.

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.

This back drop should make for a better understanding of the answers we are about to make to this committee's list of questions under this Pricing Policies title.

(*a*) In the light of 1947 record profits, what pricing policy did you follow for 1948? Reduce, raise, or hold them unchanged? Why?

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.

(*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"?

The factors taken into account in prices were outlined under (*a*). 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. The vice president in charge of livestock buying works in close contact with the vice president in charge of sales in forming day-to-day judgment of near term selling prices to make current livestock price evaluations. These evaluations, along with the factors of production overhead, available supply, and so forth, all enter into the price which we finally pay in our day-to-day competitive purchases of livestock.

(*c*) Discuss the factors outside your control which have influenced the profits in your company, e. g., money supply.

We have no control over selling prices or livestock prices, as already dealt with in the opening statement under this Pricing Policies title.

(*d*) To what degree do you consider your own costs in fixing prices to meet competitive conditions?

We explained under (*a*) how knowledge of our costs was one of the considerations in making a determination of our asking prices. We do not fix prices.

(*e*) What profit level do you expect to achieve when prices are determined?

Prices are not determined on the basis of expected profit level. Our average earnings for the 10-year period 1939–48 on our domestic meat business amounted to approximately one-sixth of 1 cent per dollar of meat sales and one twenty-eighth of 1 cent per pound of meat sales, the high in the 10-year period being one-fourth cent per pound profit in 1946, and the low being three-eighths cent per pound loss in 1948.

(*f*) Could you have charged more for your product and thereby realized greater total profits? If so, amplify.

Our product was sold under the competitive conditions described in the opening statement under this Pricing Policies title. Under these competitive conditions we endeavored to obtain the best price possible, but our 1948 operations fell short of a profit.

(*g*) To what extent are your profit expectations responsible for increased prices?

Our answer to that would be the same as we made under (*e*).

In conclusion, the factors which make meat prices have been dealt with in my statement under Pricing Policies. Meat packers have no control over supply. Meat packers' profits are definitely not a factor in the price of meat.

In a free economy, real meat prices are out in the open for everybody to "shoot" at. In a controlled economy of price fixing and rationing, large quantities of meat are taken out of the normal channels of efficient slaughtering, processing, and distribution and driven into the unwholesome and inefficient black market operation with its unpublicized high prices and its additional indirect price through (*a*) tax evasion on the part of the black market operator and (*b*) higher taxes resulting from huge Government expenditures for enforcement, which enforcement has been demonstrated to be unworkable.

Also under price-fixing controls there is the indirect price in Government livestock subsidies which are necessary if production is to be maintained.

Add all of this up and we arrive at some appreciation of the real price of meat in a controlled economy.

Further, let us not overlook the utter chaos that existed in the livestock and meat industry subsequent to the war up until controls were lifted.

I wish to thank you personally and on behalf of the company for this opportunity of appearing to present our convictions on the questions before you; thank you again.

(The tabulations and charts referred to in Mr. Schmidt's testimony are as follows:)

EXHIBIT I.—*Armour & Co., net profit ratios*—Continued

EXHIBIT I.—*Armour & Co., net profit ratios*

[Figures in millions in columns 2, 3, 4, 5, 8, 9, 10, 12, 13, 14, 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 | −.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 | −1.97 | 413.7 | 204.0 | .21 | −.97 | −12.63 | 10.66 | −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 (thousands) | Profit (column 3) per employee |
|---|---|---|---|---|---|---|---|---|---|---|
| | Domestic meat | Balance [4] | Total | 8 to 12 | 9 to 13 | 10 to 14 | | | | |
| (11) | (12) | (13) | (14) | (15) | (16) | (17) | (18) | (19) | (20) | (21) |
| 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 | 925.2 | .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 | −.03 | 2.44 | .81 | 3,709.0 | −.006 | 77.7 | 126 |
| 1946 | 721.8 | 461.7 | 1,183.5 | 1.02 | 4.39 | 2.34 | 2,853.6 | .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 | −.90 | 1.80 | −.10 | 3,507.0 | −.360 | (5) | (5) |
| 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 (2) excluding debt.
[4] Represents shortening and oil, pharmaceutical, dairy and poultry, soap, glue, hair, sandpaper, ammonia, chemical, fertilizer, leather and foreign operations.
[5] Not available.

EXHIBIT 1A.—*Armour & Co., Segregation of consolidated sales dollar*

| | Fiscal years (in millions of dollars) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 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 | 48.9 | 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 | 208.2 |
| 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 | [1] 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 |

| | Fiscal years (in cents per dollar of sales) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1939 | 1940 | 1941 | 1942 | 1943 | 1944 | 1945 | 1946 | 1947 | 1948 |
| 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 | [1] .10 |
| Total sales | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

[1] Red figures.

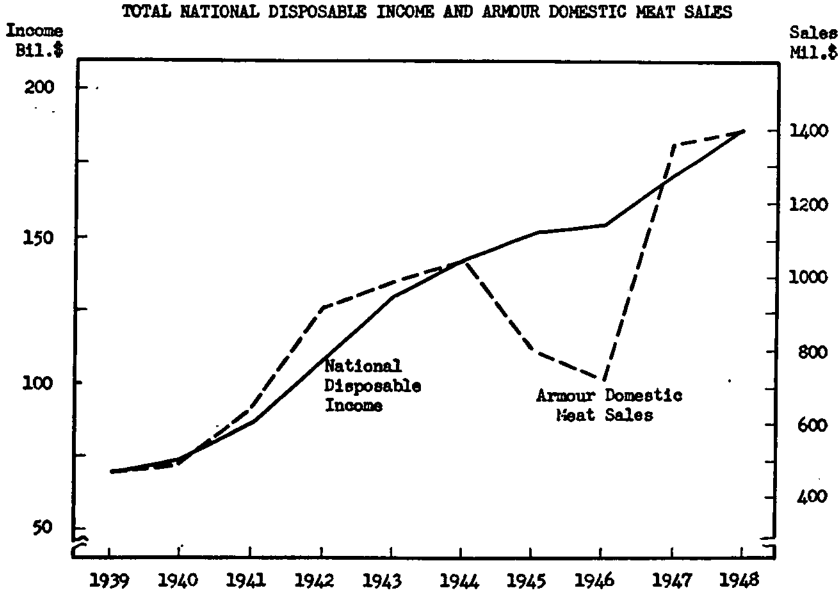
EXHIBIT 2.—*Armour & Co., Disposition of profits*

[Figures in millions, except last column]

| Fiscal year | Profit or loss (—) | Dividends paid | | | | Profits retained | Earnings per share, common [1] |
|---|---|---|---|---|---|---|---|
| | | Armour & Co. of Delaware 7 percent preferred | Armour & Co., Illinois | | | | |
| | | | $6 prior preferred | 7 percent preferred | Common | | |
| 1939 | $6.98 | $3.75 | | | | $3.23 | —$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 | | [2] 5.86 | | | 21.82 | 5.96 |
| 1947 | 30.91 | | [3] 15.52 | [4] 2.30 | | 13.09 | 6.76 |
| 1948 | —1.97 | | 3.00 | | $3.66 | —8.63 | —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] Includes payments on dividend arrearages of $1.87.
[3] Includes payments on dividend arrearages of $13.14.
[4] Includes payments on dividend arrearages of $2.06.

TOTAL NATIONAL DISPOSABLE INCOME AND ARMOUR DOMESTIC MEAT SALES




DATA FOR CHART

| Fiscal Years | Total National Disposable Income Oct.-Sept. Years (Bil.) | Armour Domestic Meat Sales Nov.-Oct. Years (Thous.) |
|---|---|---|
| 1939 | $ 70.2 | $ 481,813 |
| 1940 | 74.1 | 503,084 |
| 1941 | 86.9 | 647,953 |
| 1942 | 108.8 | 918,438 |
| 1943 | 130.4 | 997,733 |
| 1944 | 142.0 | 1,052,947 |
| 1945 | 151.3 | 801,143 |
| 1946 | 153.3 | 721,795 |
| 1947 | 170.9 | 1,362,331 |
| 1948 | 186.7 | 1,400,515 |

Total National Disposable Income is U.S. Personal Income less personal tax payments.
SOURCE: Quarterly data of U.S. Dept. of Commerce from 1947 Supplement to Survey of Current Business and subsequent monthly issues.

EXHIBIT 3.—*Armour & Co., source of funds—credit, retained earnings, how applied, and effect on working capital for the 10 years ended Oct. 30, 1948*

[Figures in thousands]

| Sources of funds | | | Items effecting 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 | | |
| | | −16,723 | |
| Total | | 111,853 | |
| Funds made available through retained earnings: | | | |
| Earnings | 136,967 | | |
| Dividends paid | −58,001 | | |
| Depreciation in excess of capital expenditures | 8,760 | | |
| Reduction in deferred charges | 3,213 | | |
| Surplus adjustments | −11,404 | | |
| | | 79,535 | 79,535 |
| Total funds made available | | 191,388 | |
| | | | 139,606 |

| How applied | | | Items effecting working capital |
|---|---|---|---|
| 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 | |
| | | | 66,658 |
| Net increase in working capital | | | 72,948 |

Senator FLANDERS. Mr. Schmidt, I judge that you lay your losses in this year of 1948 very largely to the strike.

Mr. SCHMIDT. To the strike and the very abrupt drop in markets in February when we had exceptionally large seasonal inventories, and while the prices came back after the February break, our inventories were gradually less, so we were not able to recapture the losses we sustained with the sharp break in February, but the strike had a very definite effect, in addition, on our business in 1948.

Senator FLANDERS. Was the strike general in the industry or confined to your company?

Mr. SCHMIDT. It was general in the industry, but it affected different companies in the industry differently. Many packers were in continued operation during the period of the strike. We were hit very severely because all of our large packing plants, every single one of our large packing plants, were in the CIO union, and it was the CIO union that was on strike. The AFL was not on strike.

Senator FLANDERS. Are you exclusively organized under the CIO?

Mr. SCHMIDT. No; some of our smaller plants are in the AFL.

Senator FLANDERS. But a given plant is exclusively CIO or exclusively AFL?

Mr. SCHMIDT. That is correct.

Senator FLANDERS. Now, in answer to the question as to what is a proper level of profit—I have forgotten just how it is worded—you indicated your belief that it was difficult or impossible to answer that question on broad general grounds. I think what is back of that question is the assumption that if profits are too high in business in general, the consumer probably is not getting enough return in the way of wages or the other way in which he earns his living to purchase the product of the industry. That, of course, is the fundamental Communist assumption, and it is also, I think, the assumption back of a great deal of the criticism of the level of profits in this country, by those who are not themselves Communists.

It looks to me as though from the testimony you have given here this morning that your company at least is free of any suspicion of that sort, as having contributed to a level of profits, or, any contribution of yours to restrict purchasing power; but I thought that I would just make that explanation so that you could realize the purpose of the inquiry.

Mr. SCHMIDT. Thank you, sir.

Senator FLANDERS. I have no further questions to ask.

Senator Watkins, you have been here through most of the testimony.

Senator WATKINS. I would like to call your attention to your conclusion there, where you say:

> The factors which make meat prices have been dealt with in my statement under "Pricing Policies." Meat packers have no control over supply. Meat packers' profits are definitely not a factor in the price of meat.

Now, it would seem to me that those profits, when they do exist, would have something to do with the price of meat. How do you explain that? You make the conclusion that they do not have, and we would certainly have to add something on for profit.

Mr. SCHMIDT. I explained that we expect to get repaid for our service which is the slaughtering and the processing and distribution of meat by pulsing the markets and pulsing the near-term selling market of the meat in our competitive bidding for livestock. In that pulsing and in our asking price pulsing of the market, we certainly expect to be able to work in a return for the services we are performing.

Senator WATKINS. The return for those services would be a profit, would it not?

You get something over and above what you pay your employees?

Mr. SCHMIDT. We did not get anything in the year 1948, Senator.

Senator WATKINS. Let us leave out 1948. You put something in the price, did you not, in order to at least attempt to return something in 1948?

Mr. SCHMIDT. We put something in for our services, and we attempted to get something in for our services, but I think a good answer to your question, Senator Watkins, is that for the 10-year average, we were able to get into our asking prices and trade it out with the retailer to the extent that we made a profit of one twenty-eighth of a cent per pound for the 10-year average.

Senator WATKINS. What is your explanation of the extraordinarily high price that the retailers charge for meat as compared to what is actually paid to the farmers on the other hand?

Mr. SCHMIDT. As our exhibit 1–A shows, we paid out to the farmer in 1948 for our raw materials, livestock, and all other raw materials 79 cents out of each sales dollar.

Senator WATKINS. I have not checked that one. What I would like to get at is how many people are between you and the ultimate consumer in the matter of distribution.

Mr. SCHMIDT. We go to the retailer.

Senator WATKINS. Direct to the retailer?

Mr. SCHMIDT. We sell to the retailer.

Senator WATKINS. Or sell through a broker?

Mr. SCHMIDT. No; we sell to the retailer.

Senator WATKINS. There is only one dealer between you and the consumer?

Mr. SCHMIDT. That is correct.

Senator WATKINS. There is not such a thing as selling to a wholesale house which, in turn, sells again to the retailer?

Mr. SCHMIDT. There are wholesale houses, and we do on occasion sell to a broker, but our business is set up, and we have our branch houses across the country, and we sell directly to the retailer.

Senator WATKINS. In your buying do you buy through a broker or do you have your own buyers?

Mr. SCHMIDT. We have our own buyers on the livestock markets.

Senator WATKINS. There is not any other person through whom the livestock passes except you as it comes from the farmer?

Mr. SCHMIDT. No, sir.

Senator WATKINS. As the farmer would have someone representing him.

Mr. SCHMIDT. On the livestock markets, that is correct. The farmer would have a livestock commission man representing him.

Senator WATKINS. You think that our present distribution system is economically operated?

Mr. SCHMIDT. I think the packer profits demonstrate very abundantly that our distribution system is economically handled.

Senator WATKINS. Are you furnishing services to the people which bring up the cost of meats as finally paid by the consumer?

Mr. SCHMIDT. I would say the payment we get for our services have no effect on the meat price in that they are infinitesimal, one twenty-eighth of a cent per pound has been our average for 10 years.

Senator WATKINS. Do you know what the average mark-up is by the retailer?

Mr. SCHMIDT. I do not know, sir.

Senator WATKINS. You have not made any investigation after the stock leaves your hand and gets in the hand of the retailer?

Mr. SCHMIDT. We have no way of getting that information.

Senator O'MAHONEY. What is the function of a branch house, Mr. Schmidt?

Mr. SCHMIDT. A branch house is a function really of distribution. It is to get the meat to the location where the retailers are and the consuming public is.

Senator O'MAHONEY. What autonomy, if any, does the manager of a branch house have with respect to prices?

Mr. SCHMIDT. Finally the price of meat is traded out between the packer's salesman and the retailer.

Senator O'MAHONEY. Who is the packer's salesman?

Mr. SCHMIDT. The salesman working out of the branch houses.

Senator O'MAHONEY. He is a fieldman?

Mr. SCHMIDT. Yes, sir; that is correct, Senator O'Mahoney.

Senator O'MAHONEY. And does he have free judgment as to what the price shall be?

Mr. Schmidt. He has an asking price, but he has a trading range on that asking price.

Senator O'MAHONEY. What is the trading range?

Mr. SCHMIDT. Well, it depends upon conditions. The meat is perishable, and the meat has got to be moved.

Senator O'MAHONEY. There must be some instructions from headquarters to the salesman in the field. What are those instructions?

Mr. SCHMIDT. There are no definite instructions on it.

Senator O'MAHONEY. Well, what range does he have?

Mr. SCHMIDT. There is a certain range that varies from time to time, Senator O'Mahoney, dependent upon conditions.

Senator O'MAHONEY. Could you give the committee some idea what it is at the present time.

Mr. SCHMIDT. I do not know.

Senator O'MAHONEY. Does anybody in your establishment know what it is?

Mr. SCHMIDT. Well, it is different all around the country, dependent upon supply. We are all over the country, and it is different in every location, dependent upon the local conditions of competition, the local conditions of supply; that all enters into the picture.

Senator O'MAHONEY. Are you telling this committee that you came down here to answer questions with respect to this problem of the profit on the distribution of meat and, in spite of that, you have no knowledge with respect to the authority and the method by which your selling agents in the various parts of the country distribute this meat to the retailers?

Mr. SCHMIDT. No; I have the knowledge I have indicated, Senator O'Mahoney, that we have an asking price. The salesman goes out and contacts the retail trade, and he has a certain range of trading. It may be 1 to 3 cents a pound.

Senator O'MAHONEY. The first time that I asked the question, you said that you had no knowledge; and now you say it is from 1 to 3 cents a pound. Please tell the committee precisely what it is.

Mr. SCHMIDT. I don't believe that I made exactly that statement. I said the conditions differ all over the country.

Senator O'MAHONEY. How many branch houses do you have?

Mr. SCHMIDT. About 250 branch houses.

Senator O'MAHONEY. Would it be possible for you to give this committee definite and specific information, if we gave you time, with respect to the selling instructions which are given to these sales managers out of, say, 100 of these 250 houses?

Mr. SCHMIDT. Yes, sir.

Senator O'MAHONEY. Would you do that? (See appendix).

Mr. SCHMIDT. I will be glad to.

Senator O'MAHONEY. Now, I think that the committee would be pleased to know what the base price is and what this asking price is, and how that varies in different regions of the country, and the extent to which the salesman has the right to bargain with the retailer without reference either to the manager of the branch house or to the vice president in charge of sales. Is that understood?

Mr. SCHMIDT. Yes, sir.

Senator O'MAHONEY. Now, then, in your statement you say it is often charged that profits are too high and at other times and by other people that they are too low. Who are these other people?

Mr. SCHMIDT. That is a question of your committee, Senator O'Mahoney, and it is not my question.

Senator O'MAHONEY. That is the question of the committee. I misread your statement then. I did not see the questions from the committee. Do you know of anybody who says that the profits are too low?

Mr. SCHMIDT. We, for one, say that they are too low.

Senator O'MAHONEY. Why are they too low?

Mr. SCHMIDT. Because we made no money in 1948; we lost money in 1948.

Senator O'MAHONEY. Did you have a record profit, as one of our questions indicated, for 1947?

Mr. SCHMIDT. I would say, "No." I would say our profit was not a record profit. In 1947, we made one-fifth of a cent per pound of meat.

Senator O'MAHONEY. The question which was prepared for you by the staff of the committee appears on page 18, and reads as follows:

> In the light of 1947 record profits, what pricing policy did you follow for 1948? Reduce, raise, or hold them unchanged? Why?

In your answer, you have assumed the correctness of that opening statement—that in 1947 you did have record profits—and that is why I asked you that question. You do not want to make that assumption?

Mr. SCHMIDT. No, sir.

Senator O'MAHONEY. What relation is there between profits and price?

Mr. SCHMIDT. Well, I think that I can repeat everything that I have said, Senator O'Mahoney.

Senator O'MAHONEY. I thought that you overlooked some things. 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. Let us adopt your phrase then. How do you determine the asking price, and who determines it?

Mr. SCHMIDT. I think that I have already stated, Senator, how it was determined, and how the asking price was determined. All of this pulsing is pulled together into an asking price.

Senator O'MAHONEY. Who does it? 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. All I am trying to find out is who finally has the authority to say what the asking price is.

Mr. SCHMIDT. The asking price is reflected in the billing price to the branch house.

Senator O'MAHONEY. Of course, that is just a matter of accounting.

Mr. SCHMIDT. That is right.

Senator O'MAHONEY. I am asking you who exercises the authority to say to the salesman, "Now, this is your asking price." Who does that?

Mr. SCHMIDT. In the final analysis, the branch-house manager, who has a corps of salesmen.

Senator O'MAHONEY. "In the final analysis." Is not that a sort of qualifying statement? I do not want to annoy you, Mr. Schmidt; I merely wanted a direct answer.

Mr. SCHMIDT. I am attempting to make a direct answer to a very complicated situation and proposition, which I think you appreciate, Senator O'Mahoney.

Senator O'MAHONEY. Of course it is; I know that. 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.

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. Within our own company, you mean?

Senator O'MAHONEY. Yes.

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?

Mr. SCHMIDT. They are geographically separated, of course, our branch houses.

Senator O'MAHONEY. But the areas that they serve must adjoin one another.

Mr. SCHMIDT. In other words, one branch does not go into another branch's territory.

Senator O'MAHONEY. Certainly not, but one territory adjoins another.

Mr. SCHMIDT. That is correct.

Senator O'MAHONEY. Now, 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 stock low, and it is moving. The one whose stock is low and moving might conceivably sell at a higher price than the one whose stock is heavy and needs to be moved. Is there then no result, so far 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 to switch 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.

Senator WATKINS. As a matter of fact, if the B branch had too much meat, you would simply shift it over to branch A where they did not have enough, would you not? That would be easily done?

Mr. SCHMIDT. It could be, but I don't think that we do that, because it has got to move too rapidly to be shifting it between one branch house and another. We are out to sell the meat to get it into comsumption because of its perishability. We cannot be moving it around too much.

Senator WATKINS. Would your branch do business with the customers of branch A?

Mr. SCHMIDT. They might in certain instances.

Senator WATKINS. As a rule, you do not permit your branches to take on the customers from any other?

Mr. SCHMIDT. I might put it this way: A salesman out of branch A might sell to his customer, and the meat may be supplied out of branch B, in a case like that.

Senator WATKINS. That is about what would happen if one is moving slowly and the other one is moving rapidly. You would simply call on the other?

Mr. SCHMIDT. They would draw on where the supply was.

Senator WATKINS. That is why I asked you if you did not transfer from B to A.

Mr. SCHMIDT. It does not go from B house to A house, but it goes from B house to an A house customer.

Senator WATKINS. I understood that you would not take it over to the packing plant and then ship it out again. It is simply a matter of filling the orders. I would like to ask you about this matter of pulsing. I am interested in that. What you mean by "pulsing" is that your representatives go out among the customers and find out how much they are willing to pay?

Mr. SCHMIDT. The pulsing is the day-to-day trading with the retailer by our salesmen.

Senator WATKINS. The way you fix your price is largely by what the customer is willing to pay? That is what you said, I think, in the beginning, and you find out about what the market will pay and then you fix your price accordingly. It is not fixed on what it costs you but on what they are willing to pay?

Mr. SCHMIDT. The consumer fixes the price of the meat, that is correct.

Senator WATKINS. And if you make a long profit on that kind of a pulsing, that would be all to the good?

Mr. SCHMIDT. But we have not been able to do that.

Senator WATKINS. You have not been able to, but I am supposing if you could that you would be willing to take it, no matter what it cost you?

Mr. SCHMIDT. That is correct.

Senator WATKINS. No matter how big the profit would be on that particular thing?

Senator FLANDERS. I would assume the pulsing goes back to the price at which the livestock raiser is willing to sell the stock.

Mr. SCHMIDT. The minute the price goes up in the consuming market, the livestock producer knows it, and it is reflected in the livestock markets.

Senator O'MAHONEY. Now, Mr. Schmidt, in response to Senator Watkins just now you said that the consumer fixes the price of meat. Do you mean by that that you charge what the traffic will bear?

Mr. SCHMIDT. That is roughly correct.

Senator O'MAHONEY. How many salesmen do you have throughout the United States who have this bargaining freedom?

Mr. SCHMIDT. Five to six thousand.

Senator O'MAHONEY. Do they report any complaints on the part of the consumers with respect to the price of meat?

Mr. SCHMIDT. They don't meet the consumer; they meet the retailer.

Senator O'MAHONEY. But do they report any complaints?

Mr. SCHMIDT. Oh, surely; that is what the pulsing is, the retailer's reaction to the price, which is the retailer's reaction that he gets from pulsing the consumer market.

Senator O'MAHONEY. On the basis of that pulsing, would you say the consumers of meat in the United States are satisfied or dissatisfied with the present price levels?

Mr. SCHMIDT. I should think that the consumers are generally dissatisfied when prices are high.

Senator FLANDERS. I can answer that as a consumer.

Senator WATKINS. You can add mine to it, Senator.

Senator O'MAHONEY. Let me ask you another question, Mr. Schmidt. In response to an inquiry directed to you by Senator Flanders, you spoke of the profits of the company originating from the sale of ammonia, sandpaper, and other unrelated items. That was your phrase, "other unrelated items." Would you tell us what you mean by an unrelated item?

Mr. SCHMIDT. Well, the leather industry is unrelated to the packing industry in that they start with a hide, that is true, but most packers do not have a leather operation.

Armour has a leather operation, so we are in the leather industry to the extent we have a leather operation. The fertilizer is completely unrelated to the packing-house operations, because it is a chemical operation, and then our foreign business is completely unrelated to the business in this country.

Senator O'MAHONEY. What I was trying to get at was whether or not you are engaged in any other lines which have no relation to the livestock, to the animal itself.

Mr. SCHMIDT. The fertilizer business, for instance, our fertilizer industry and our dairy and our poultry operations are unrelated to the meat business.

Senator O'MAHONEY. The dairy business is a livestock business, and poultry is, of course, a food—it is chickens. But what I am trying to get at is: Are these businesses in which you are engaged in commodities which are derivative from the animal which is the basis of the industry?

Mr. SCHMIDT. I would say in our domestic operations, the principal business that is entirely divorced from its origin in the livestock business is the fertilizer operation.

Senator O'MAHONEY. That has nothing to do with the packing business?

Mr. SCHMIDT. No.

Senator O'MAHONEY. How about sandpaper?

Mr. SCHMIDT. Well, sandpaper, we use glue in sandpaper.

Senator O'MAHONEY. That comes from the animal?

Mr. SCHMIDT. Yes.

Senator O'MAHONEY. Does not the fertilizer come from the animal?

Mr. SCHMIDT. Oh, no; it is a chemical fertilizer.

Senator O'MAHONEY. And the chemical does not come from the animal?

Mr. SCHMIDT. That is correct.

Senator O'MAHONEY. Are there any other items in which you deal which are in that sense completely unrelated to the livestock business?

Mr. SCHMIDT. Probably not.

Senator O'MAHONEY. Would you be good enough to look over your list and then supply the committee with that information? (See appendix).

Mr. SCHMIDT. Yes, sir.

Senator WATKINS. I would like to ask one other question, please.

You mentioned foreign business. Would you tell us something about the extent of your foreign market for your products?

Mr. SCHMIDT. The market is principally England for our production in South America, and Europe.

Senator WATKINS. What you ship to Great Britain, then, comes from South America and not from American production?

Mr. SCHMIDT. That is correct.

Senator WATKINS. It is not from United States production?

Mr. SCHMIDT. That is correct.

Senator WATKINS. Do you ship any meat out of the United States to any foreign country?

Mr. SCHMIDT. A very small amount.

Senator WATKINS. What percentage of your total sales would be foreign?

Mr. SCHMIDT. It would be infinitesimal; it doesn't amount to anything.

Senator WATKINS. Do you sell any direct to the Federal Government?

Mr. SCHMIDT. Yes, sir.

Senator WATKINS. To what branches?

Mr. SCHMIDT. Well, during the war——

Senator WATKINS. I mean now.

Mr. SCHMIDT. Well, to the Army and the Navy, the armed services.

Senator WATKINS. Is there any of that for the use of the residents of occupied countries?

Mr. SCHMIDT. We don't know.

Senator WATKINS. You do not know what it is to be used for?

Mr. SCHMIDT. No, sir.

Senator WATKINS. How much do you ship to the Army in Germany, for instance?

Mr. SCHMIDT. We don't know that, sir.

Senator WATKINS. Is that taken out of the United States production or is it taken out of South American production?

Mr. SCHMIDT. Recently there has been some coming out of the South American production, I am pretty certain.

Senator WATKINS. Do you ship any of the United States production to the Army in Germany?

Mr. SCHMIDT. I don't know whether it goes to Germany or not. We deliver it to the Government in this country.

Senator WATKINS. Do you not pack it ready for shipment to the foreign countries?

Mr. SCHMIDT. Yes; but we don't know what its destination is.

Senator WATKINS. You ship it to a port; do you not?

Mr. SCHMIDT. Yes, sir. It might go to the Government warehouse, too, if it is canned goods.

Senator WATKINS. How about your shipments for Japan? Do you ship to the Army in Japan, or for the account of the Army in Japan?

Mr. SCHMIDT. I can get that information for you, Senator. (See appendix).

Senator WATKINS. I would appreciate knowing just how much is sold to the Army and how much is shipped to both Germany, Austria, and also Japan.

Mr. SCHMIDT. I will get that information.

Senator WATKINS. And in fact, all of the armed forces. I do not want to limit it to the Army, because we might have the Air Force and the Navy in the deal somehow.

As far as you are concerned, you do not sell any directly to the European Recovery Administration, the ECA?

Mr. SCHMIDT. Not that I know of; no, sir.

Senator WATKINS. In connection with the fixing of prices, it would be quite a different situation if it would be a buyer's market rather than a seller's market, would it not?

Mr. SCHMIDT. I think it is definitely a buyer's market.

Senator WATKINS. Now?

Mr. SCHMIDT. I think so.

Senator WATKINS. You mean at the current high prices of meat it is still a buyer's market?

Mr. SCHMIDT. In the case of meat, I think so. That is my opinion.

Senator O'MAHONEY. Let us tell the housewife it is a buyer's market.

Senator WATKINS. The news has not come around to me. I have been paying the price.

Mr. SCHMIDT. If it was a seller's market, we ought to be showing it up in our earnings.

Senator WATKINS. Maybe you made some mistakes.

Mr. SCHMIDT. That may be.

Senator WATKINS. Apparently you have. You say that you are not getting a profit, and meat is extremely high as compared to prewar times.

Mr. SCHMIDT. Meat is high because all prices are high, I think that that is the answer to that. All prices are high, and all costs are up. The farmer's costs are up the same as everybody else's costs.

Senator WATKINS. Do you have any difficulty in supplying your customers with meat, all that they want?

Mr. SCHMIDT. We have no control over the supply. It fluctuates up and down, so at times we have difficulty and at other times we don't.

Senator WATKINS. Generally speaking, do you have difficulty in supplying the trade with the meat they want, to sell over the retail counter?

Mr. SCHMIDT. Within the confines of the day-to-day fluctuation in supply, would be my answer to that; I think there has been enough meat to go around since the lifting of OPA, as far as our company's distribution is concerned.

Senator WATKINS. At the price asked. Do you think the consumption would have been much higher if prices had been lower? Are people getting all of the meat that they want to eat, irrespective of the price factor, in your judgment?

Mr. SCHMIDT. I can only get back to one thing; and that is, the consumer fixes the price of meat.

Senator WATKINS. You mean some of them do. A great many of them do not get any meat at all. We found out last summer, in our cost-of-living investigations, that many people were going without meat; only at rare intervals did they have meat on the table.

Mr. SCHMIDT. The per capita consumption doesn't indicate that.

Senator WATKINS. Somebody else is eating more.

Mr. SCHMIDT. But I would think any given person could only eat so much meat, and that the average per capita consumption is a pretty good indication of how many people are eating meat.

Senator WATKINS. You would not say that the testimony we received was wrong; that literally millions of people were getting only a very, very small supply of meat because of the high prices?

Senator FLANDERS. What can you do about that, Mr. Schmidt?

Mr. SCHMIDT. The supply is the only answer to that, I think. It is a question of supply. If we had more livestock, possibly the prices of meat would be lower.

Senator WATKINS. You say it is still a buyer's market, and that indicates that there is plenty of supply and the supply outdoes the demand; and, otherwise, it would be a seller's market rather than a buyer's market, if I understand the way it works.

Mr. SCHMIDT. The perishability of the meat enters into the picture, and we have to bear that in mind at all times.

Senator WATKINS. Yes; but you have means of holding meat that is being shipped.

Mr. SCHMIDT. Most of the meat is sold fresh; most meat is sold fresh.

Senator WATKINS. How long can a dealer hold that meat?

Mr. SCHMIDT. All beef is sold fresh. In our branch houses, we want to clean out our beef every week, and the beef that comes into the branch house on Monday should be sold by the end of the week, or it loses its bloom. If you carry it over into the next week, you take less money for it.

Senator WATKINS. It is already cured when it reaches the retailer?

Mr. SCHMIDT. The beef is fresh.

Senator O'MAHONEY. Mr. Schmidt, may I ask you, on the average, in the Armour operation, what percentage of the animal is sold as meat?

Mr. SCHMIDT. What percentage of the live weight, you mean?

Senator O'MAHONEY. Yes.

Mr. SCHMIDT. About 65 to 70 on the hog, and about 50 on the cattle.

Senator O'MAHONEY. Of course, that percentage increases with the high-grade beef animal; does it not?

Mr. SCHMIDT. That is right.

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 byproducts are credited to the animal.

Senator O'MAHONEY. Well, I was trying to differentiate between the byproducts and the meat, you see.

Mr. SCHMIDT. Well, for instance, we pay so much for cattle. The hide is credited to the beef operation at its market value, at what the hides are sold for to tanners.

Senator O'MAHONEY. That credit then goes to the meat operation?

Mr. SCHMIDT. That goes to the meat operation; that is right.

Senator O'MAHONEY. Then, with respect to these other unrelated items, but which come from the animal, what do you do with them?

Mr. SCHMIDT. The same operation as in the hides; the animal gets credit for the market value of the product. For instance, bones going to glue.

Senator O'MAHONEY. Does the retailer get credit for that?

Mr. SCHMIDT. It reduces the cost of the animal in the meat.

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. (See appendix).

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 charged against your total pounds of meat?

Mr. SCHMIDT. That is correct.

Senator FLANDERS. So, when you say at any given time that you have got one-fifth of a cent of profit on that meat, it included the profit from the byproducts?

Mr. SCHMIDT. It included the credit to the meat operation of the market value of the byproduct that went—the illustration that I gave you on the hide.

Mr. BERQUIST. When you quoted your figures on profits, you said a fraction of a cent a pound, or a cent or 2 cents per dollar. Was that the total profits of all of Armour & Co. divided by the total number of pounds of meat sold?

Mr. SCHMIDT. No; it was the meat products.

Mr. BERQUIST. The meat products?

Mr. SCHMIDT. Yes. The fifth of a cent was the meat profit on the meat sales dollar, and on the meat pounds.

Senator FLANDERS. In the case of a fifth of a cent a pound, that would be somewhat higher if you put in your profit on byproducts?

Mr. SCHMIDT. No; the meat has received full credit for the byproduct, Mr. Chairman. In other words, you will have a packer that is not in the tanning business, and he takes the hide off of the cattle and he sells the hide to the tanner; and, now, we in effect have done the same thing. We have sold the hide to the tanner at the market price for the hides, so that the cattle has received credit and the meat has received credit for whatever we get for the hide.

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, 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.

Senator FLANDERS. That is the point I wanted to clear up.

Senator O'MAHONEY. That is all, Mr. Chairman.

Senator FLANDERS. You will be excused, Mr. Schmidt, and thank you for your information. We will be glad to receive that other data for which you have been asked from time to time.

In accordance with the plan which we have been following, we will next hear from a smaller packer to put alongside the statement of one of the giants of the industry; and our next witness is Mr. Greer of Kingan & Co., meat packers of Indianapolis, Ind.

## STATEMENT OF HOWARD C. GREER, VICE PRESIDENT AND GENERAL MANAGER, KINGAN & CO., MEAT PACKERS, INDIANAPOLIS, IND.

Senator FLANDERS. Mr. Greer, will you identify yourself for the record?

Mr. GREER. My name is Howard C. Greer, and I am vice president and general manager of Kingan & Co., Indianapolis, Ind.

My statement, Mr. Chairman, is supported by two sets of exhibits; and they may be detached and laid alongside of it, if that is convenient to the committee.

Senator FLANDERS. You may proceed.

Mr. GREER. This statement deals with the profits and financial position of Kingan & Co., a single meat-packing enterprise of medium size, and also with the profit experience and financial problems of meat packers generally. It is based in part on the records of our own company and in part on industry statistics obtained from the American Meat Institute and from Government sources.

Senator O'MAHONEY. May I interrupt you at that point to ask you how long the company has been operating?

Mr. GREER. Our company, as an American company, has been operating for 28 years. It succeeded to the business of a former British company which was founded in 1845; so that the company, with its predecessor, is 103 years old.

Senator O'MAHONEY. Where did the British company operate?

Mr. GREER. Its headquarters were in Belfast, Ireland. The parent company, if you are interested, Senator, is now a subsidiary of the American company and continues to conduct a relatively small business in the British Isles.

Senator O'MAHONEY. When did Kingan & Co. begin operations in America?

Mr. GREER. Back in 1860, or thereabouts, and they gradually grew in size until the child outgrew the parent; and in 1920 the company was reorganized as an American corporation, with the foreign interests as subsidiary to it.

Senator O'MAHONEY. Are you affiliated with any other companies?

Mr. GREER. We are not.

Senator O'MAHONEY. The parent company is now a subsidiary. Do you have any other subsidiaries?

Mr. GREER. None.

Senator O'MAHONEY. So that this operation is conducted entirely by the American company and the British company?

Mr. GREER. The operation is conducted entirely by the American company, so far as the part to which I shall have reference today. The British portion has been almost completely separated by developments of recent years.

Senator O'MAHONEY. Thank you, sir.

Mr. GREER. I think it will develop from the statement that it is a relatively minor part and plays no part in the testimony.

Kingan & Co. is engaged in the production and distribution of meat products of all kinds; also in the wholesale distribution of related products such as poultry, eggs, butter, cheese, margarine, and shortening; also in the sale of unprocessed inedible animal byproducts. The company operates six livestock-processing plants and eight manufacturing branch houses, located in various parts of the United States. Sales average from 10 to 11 million pounds of product weekly.

We have 5,700 employees, 4,400 of them hourly paid plant workers. The company is owned by 1,600 stockholders, many of them employees, former employees, and their families, women and children, charitable and educational institutions, and so forth. No single owner holds as much as 6 percent of the capital stock.

Results of the company's operations for the years 1940, 1946, 1947, and 1948 are summarized in the attached appendix tables A–1 to A–5. The following explanatory comments may be of interest. That is the first of these two appendixes.

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 chart in appendix table A–1 shows the break-down of the Kingan sales dollar for the fiscal year 1948, our fiscal year ending October 30.

Payments for livestock and purchased raw materials took 82.3 cents; wages, salaries, and social security, 8.6 cents; supplies, power, and other operating expenses, 3.6 cents; plant occupancy expenses, plant insurance, property taxes, maintenance, and depreciation, 1.3 cents; transportation and delivery expenses, 2.6 cents; and other selling and administrative expenses, 0.6 cent. Profit before income taxes was 1.0 cent; after income taxes, 0.6 cent. Profit after taxes was equal to 22 cents per hundredweight of product sold, less than a a quarter of a cent a pound.

For our company, 1948 was a relatively good year. Margins in 1947 and 1946 were even narrower, and in 1940 operating profit was nil. A summary of the income statement for these 4 years is given in table A–2.

This table 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 expenses per hundredweight had increased by only about 75 percent. Packing house wages 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 these 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.

Changes in the financial position of the company between 1940 and 1948 are shown in table A–3. The figures represent condensed summaries of the consolidated balance sheets of the company, including its domestic subsidiaries, one of which in 1940 was of substantial size, but all of which had been liquidated by the end of 1948.

Senator, previous to this year we did have two or three small subsidiaries. We do not have those now but we did have them at one time.

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. 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.

The increase in the company's net worth from 1940 to 1948 is approximately matched by the increased investment in plants and equipment, which rose by $3,600,000. Working capital was about the same at the end of 1948 as at the end of 1940, both current assets and current liabilities having increased by approximately $4,500,000. Investment per employee increased from $3,569 in 1940 to $4,133 in 1948.

The percentage of net profit of stated net worth rose to 7.2 percent in 1948, which was the highest rate earned in any of the 8 years since 1940. The average ratio of net profit to net worth for that 8-year period was 4.1 percent. Profits before interest and taxes averaged 5.4 percent on total capital employed. Dividends paid represent an average annual return of about 2 percent on stated net worth.

The average experience of the industry as a whole has been somewhat better, as noted in a later section. Before consideration of the industry figures, it may be of interest to examine the relation of the profits of Kingan & Co. to its financial requirements, since the situation disclosed is quite typical of the packing industry in general and of many other industries also.

Need for additional capital: 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 the business during the 8-year period 1940–48 have been summarized in table A–4. 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.

This condition is well illustrated in the affairs of Kingan & Co. and it is quite typical of the situation confronted by most other meat-packing companies and many enterprises in every line of business.

A factor limiting the amount of cash obtainable from profits has been the high corporation income tax rate. To illustrate the significance of this heavy drain on corporation resources we have shown in the left-hand column of the table, table A–4, the profits of Kingan & Co. before taxes, and have included in the right-hand column the amounts paid out in Federal and State income and profits taxes as though they were a distribution of earnings otherwise available for other purposes. Those are the first two figures in the first column.

We have also shown in the right-hand table the amount of distributions to stockholders and the amounts invested in the replacement and improvement of plants and equipment.

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.

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.

The "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 the table, however, 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 not an insignificant item. The net result was a moderate increase in cash balances, made necessary by the larger volume of sales currently being handled.

The absence of a large increase in investments in merchandise inventories is rather notable. This results partly from the fact that under the last-in first-out method of costing inventories, adopted by the company in 1939, it has been possible to maintain the book values of inventories at approximately 1939 costs, and to exclude from profits the unreal increments which would have been present had inventories been stated at current market values.

The application of this method has relieved meat packing companies of what otherwise would have been for many of them an intolerable burden of taxes on "book" income which could not be reduced to cash. If, for example, Kingan & Co. had followed the market-value method of stating its inventories it would have been called on for more than $2,000,000 of additional income taxes without having one cent of additional cash out of which to pay them.

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 improvement 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 A–5. Since this is a rather theoretical calculation it requires some explanation.

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 turn-over 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 date of purchase, on the short-life items.

This is all very theoretical, but it suggests that under this imaginary program of exact replacement of worn-out assets to the extent that they were depreciated on the books each year, it would have required about $1,500,000 additional cash for this purpose during the 10-year period. This compares with profits after taxes of a little less than $5,000,000 during that period. In other words, about 30 percent operating profits would have been required for the extra cost of fixed-asset replacements at higher costs.

This, however, is only part of the story. Industry does not stand still. To do the world's work better and cheaper takes more and better equipment. To produce and distribute meat under efficient economical and sanitary conditions, with a steady reduction in burdensome manual labor, requires the constant improvement of plant facilities. An increase in total meat production calls for more and larger meat-packing plants.

Since 1940, Kingan & Co. has purchased two small packing plants from private owners, and has substantially enlarged one of its own plant units. These changes were for the purpose of decentralization and increased volume. Very substantial outlays also were required for better processing in existing units.

Recent plant additions have included new and modern smokehouses, with controlled air circulation, to reduce moisture losses and provide a more uniform product; improved rendering and grease-retention facilities, to raise the quality of its byproducts and to eliminate stream pollution; hydrogenation and deodorization facilities to produce bland and stable animal fat shortenings; chemical and bacteriological laboratories to control quality and prevent spoilage; modern locker and dressing rooms, and other employee welfare facilities; insulated and refrigerated delivery trucks to preserve highly perishable products; and many others. Investments of this type have absorbed a substantial portion of the extra $4,500,000 the company has had to find for permanent improvements, over and above its depreciation allowances.

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—when 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. Comment on these points may be deferred pending some brief references to the operating results and financial position of the meat packing industry as a whole.

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.

This situation, which is a matter of common knowledge among investors and financial analysts, is confirmed by the reports on profits of the industry published annually for the past 22 years by the Packers and Stockyards Division of the United States Department of Agriculture. These reports disclose that for that entire period packers' profits have averaged only about 1 cent per dollar of sales and about one-fourth cent per pound of product sold, also that in the most profitable years profits have seldom exceeded 1½ cents per dollar of sales and have never been greater than three-fourths cent per pound of product sold, equivalent to one-half cent per pound of livestock purchased. Over a period of years they have averaged about $3 per week per employee.

A summary of the profit record of the industry, and of other pertinent data on its volume, prices, wage rates, and other factors, appears in the first two tables of appendix B. This material, taken from the published sources identified in the tables, has been supplied by the American Meat Institute as a supplement to the data for our own individual company, which I have previously discussed.

Table B-1 presents basic facts as to livestock slaughter, production, consumption, employment, wages, prices, farm income, and consumer demand for the 9-year period 1940–48, inclusive. The steady advance in incomes, prices, and costs, throughout the period, is plainly evident.

Table B–2 shows that the profits of the industry were higher in 1946 and 1947 than in many previous years. The rate of return on the stated net worth of the reporting companies was between 15 and 16 percent in these 2 years, as compared with about 9 percent in the period immediately before the war and 5 percent for the 22 years since 1925, including the depression period 1930–34.

It is evident, however, that this apparently larger return on investment was primarily due not to higher profit margins on each dollar of sales, but to the much greater dollar volume of business done on the capital invested.

In 1947, for example, the net profit per dollar of sales was only a little greater than in 1940, but dollar sales volume was three times as great as in the earlier year. The same margin thus produced a considerably higher rate of return on net worth, which had shown only a small increase in the intervening 7 years.

Details of the financial statements of the reporting companies have not been summarized in the reports published by the Packers and Stockyards Division. There are, however, some consolidated figures for 14 of the major meat packing companies prepared annually by the Federal Reserve Bank of Chicago. A summary of the combined balance sheets of these companies for the years 1940, 1946, and 1947 is presented in table B–3, along with related data on sales, earnings, and significant financial ratios. Data for 1948 are not yet available.

It is apparent from these figures that, while these selected companies made about three times as much profit in 1947 as in 1940, they also did three times as much business in the latter year as in the former, retaining about the same amount of profit per dollar of sales as in the earlier year. The calculated return on net worth was substantially higher in 1947, but it should be borne in mind that this calculation reflects plant investments valued at original cost and not a replacement cost at today's prices.

If the stated net worth of these 14 companies were expressed in terms of the replacement cost of their assets at today's values, it doubtless would be at least 50 percent greater than the "book values" appearing in the balance sheets. The rate of return on investment at this revised value would have been something under 10 percent instead of something over 14 percent.

A comparison of the combined balance sheets for these 14 major companies indicates that in at least two respects the accounting and investment policy of a majority of these enterprises has differed somewhat from that of Kingan & Co. These differences are significant, both as to the extent of the reported profits and the status of plant and equipment.

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 1941–47, 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.

On the other hand, these companies on the whole apparently have not made replacements of plant and equipment to the extent of the actual depreciation and obsolescence sustained during the period. From the figures of our own company it seems reasonably evident that new capital investment at least one-third greater than the amount of depreciation allowances would have been needed simply to replace existing assets in kind at the continuously advancing prices of the past 8 years. Replacement at that rate apparently has not taken place in a majority of the major meat-packing companies.

There can be no exact measure of the deficiency in "plant reinvestment," but for these companies combined it appears to be something in excess of $50,000,000. Depreciation allowances for the 14 companies totaled about $150,000,000 for the 7 years between 1940 and 1947. Replacement of that amount of fixed assets apparently would have cost at least $225,000,000, and would have produced an increase in the combined plant and equipment accounts of approximately $75,000,000. The actual increase between 1940 and 1947 was less than $25,000,000, leaving a gap which would be substantially greater than the indicated $50,000,000 if replacements all had to be made at today's inflated costs.

From the condensed figures available, not all presented in the appendix itself, but available in the original reports, it appears that during the 7-year period these 14 companies had total profits of about $400,000,000 of which about $275,000,000 apparently was distributed in dividends, or in other distributions to stockholders, since net worth increased only $125,000,000.

This increase evidently was insufficient to provide the working capital required to handle the business at the prevailing high prices, and long-term borrowings were increased by some $55,000,000 during the period.

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 those conditions has prevailed during recent years, in spite of the apparently high level of business profits. These 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.

Senator FLANDERS. At this point in the record, we will insert your group of tables.

(Appendices A and B are as follows:)

APPENDIX A TO STATEMENT ON PROFITS IN THE MEAT PACKING INDUSTRY BEFORE THE SUBCOMMITTEE OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT PRESENTED BY HOWARD C. GREER, VICE PRESIDENT AND GENERAL MANAGER KINGAN & CO., MEAT PACKERS, INDIANAPOLIS, IND., DECEMBER 17, 1948

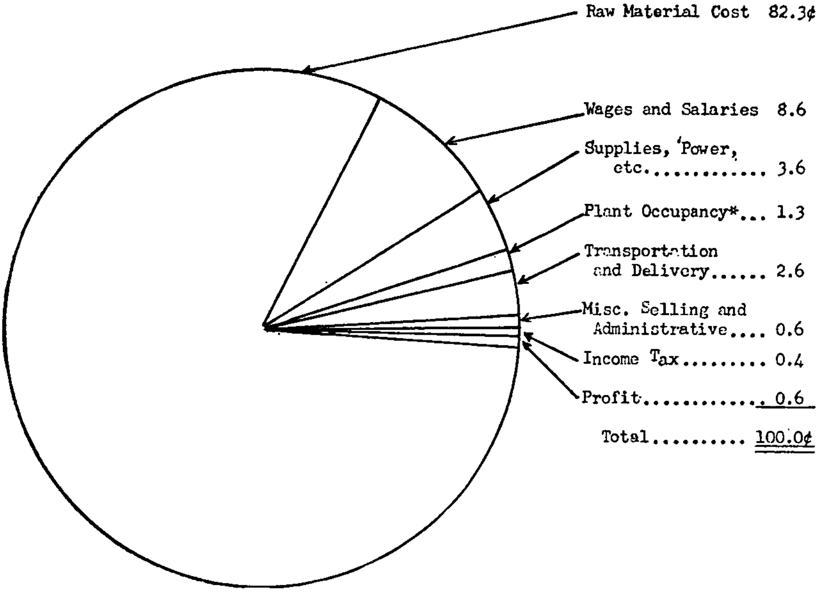



TABLE A–2.—*Condensed income statements for selected years (consolidated to include domestic subsidiaries)*

| | 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 |

[1] Not including weight of sales of domestic subsidiary.
[2] Denotes red figures.

TABLE A–2.—*Condensed income statements for selected years (consolidated to include domestic subsidiaries)*—Continued

| | Fiscal year | | | |
|---|---|---|---|---|
| | 1940 | 1946 | 1947 | 1948 |
| 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 |

TABLE A–3.—*Condensed balance sheets for selected years (consolidated to include domestic subsidiaries)*

| | Fiscal year | | | |
|---|---|---|---|---|
| | 1940 | 1946 | 1947 | 1948 |
| Assets: | | | | |
| Cash | $840,330 | $2,371,147 | $2,142,088 | $1,805,359 |
| Accounts receivable | 2,779,551 | 4,406,920 | 5,676,396 | 6,578,465 |
| Merchandise inventories | 4,638,062 | 4,110,076 | 3,413,660 | 3,850,618 |
| Supplies and prepaid expenses | 673,834 | 1,003,639 | 1,625,451 | 1,300,218 |
| Total current assets | 8,931,777 | 11,891,782 | 12,857,595 | 13,534,660 |
| Plants and equipment | 5,313,146 | 6,091,402 | 8,716,433 | 8,951,964 |
| Outside investments | 568,731 | 604,006 | 591,441 | 659,749 |
| Total | 14,813,654 | 18,587,190 | 22,165,469 | 23,146,373 |
| Liabilities: | | | | |
| Notes payable | 900,000 | | 2,700,000 | 2,700,000 |
| Accounts payable and accruals | 1,185,103 | 2,924,791 | 3,742,266 | 3,725,074 |
| Total current liabilities | 2,085,103 | 2,924,791 | 6,442,266 | 6,425,074 |
| Reserves | 548,500 | 681,500 | 419,500 | 422,500 |
| Preferred stock | 4,503,300 | 4,460,200 | 4,460,200 | 4,460,200 |
| Common stock | 7,063,898 | 7,847,940 | 7,847,940 | 7,847,940 |
| Surplus | 612,853 | 2,672,759 | 2,995,563 | 3,990,659 |
| Total | 14,813,654 | 18,587,190 | 22,165,469 | 23,146,373 |
| Net worth | 12,180,051 | 14,980,899 | 15,303,703 | 16,298,799 |
| Dividends paid | None | $178,408 | $178,408 | $178,408 |
| Percent of net income | | 30.4 | 53.6 | 15.2 |
| Rate of return: Percent net profits to net worth | 1.3 | 3.9 | 2.2 | 7.2 |
| Accounts receivable: Number of days sales outstanding | 15.5 | 9.8 | 11.6 | 11.6 |
| Inventory turn-over: Annual average (weight basis) | 11.0 | 18.9 | 18.4 | 18.4 |
| Investment per employee | $3,569 | $4,463 | $4,214 | $4,133 |

TABLE A–4.—*Statement of sources and disposition of funds for 8 years, 1941–48, 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 A–5.—*Comparison of depreciation allowances and estimated fixed asset replacement costs years 1939–48, inclusive*

BUILDINGS

| Fiscal year | Index | Depreciation taken | Ratio replacement to original | Estimated replacement cost | Additional investment required |
|---|---|---|---|---|---|
| 1939 | 100.0 | $113,231 | 100.0 | $113,231 | ---------- |
| 1940 | 120.7 | 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

| Fiscal year | Index | Depreciation taken | Ratio replacement to original | Estimated replacement cost | Additional investment required |
|---|---|---|---|---|---|
| 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 |

TABLE A-5.—*Comparison of depreciation allowances and estimated fixed asset replacement costs years 1939-48, inclusive*—Continued

UTENSILS

| Fiscal year | Index | Depreciation taken | Ratio replacement to original | Estimated replacement cost | Additional investment required |
|---|---|---|---|---|---|
| 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

| Fiscal year | Index | Depreciation taken | Ratio replacement to original | Estimated replacement cost | Additional investment required |
|---|---|---|---|---|---|
| 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 |

MOTOR VEHICLES

| Fiscal year | Index | Depreciation taken | Ratio replacement to original | 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.

APPENDIX B.—*Tables relating to economic facts about the meat packing industry in general*

TABLE 305.—*Facts about the livestock and meat industry, 1940–48*

| Item | [1] 1948 | 1947 | 1946 | 1945 | 1944 | 1943 | 1942 | 1941 | 1940 |
|---|---|---|---|---|---|---|---|---|---|
| Total livestock slaughtered (million head): | | | | | | | | | |
| Cattle | 19.5 | 22.4 | 19.8 | 21.7 | 19.8 | 17.8 | 18.0 | 16.4 | 15.0 |
| Calves | 12.7 | 13.7 | 12.2 | 13.6 | 14.2 | 9.9 | 9.7 | 9.3 | 9.1 |
| Sheep | 17.2 | 18.8 | 22.8 | 24.6 | 25.4 | 27.1 | 25.6 | 22.3 | 21.6 |
| Hogs | 71.5 | 74.7 | 76.2 | 71.9 | 98.1 | 95.2 | 78.5 | 71.4 | 77.6 |
| Meat production (billion pounds): | | | | | | | | | |
| United States total | 21.4 | 23.4 | 23.0 | 23.7 | 25.2 | 24.5 | 21.9 | 19.6 | 19.1 |
| Federally inspected | 14.5 | 16.2 | 13.8 | 15.4 | 17.9 | 16.8 | 15.5 | 13.4 | 12.9 |
| Percent federally inspected | 67.8 | 69.2 | 60.0 | 65.0 | 71.0 | 68.6 | 70.8 | 68.4 | 67.5 |
| Per capita meat consumption (pounds) | 146 | 155 | 154 | 144 | 154 | 146 | 140 | 143 | 142 |
| Employment meat-packing industry (thousand persons): | | | | | | | | | |
| Production workers | 178 | 182 | 157 | 154 | 171 | 174 | 178 | 152 | 143 |
| Total, including clerical | ([2]) | ([2]) | 245 | 239 | 257 | 257 | 269 | ([2]) | ([2]) |
| Wage rates in the meat-packing industry: | | | | | | | | | |
| Hourly (cents) | 135.5 | 124.5 | 107.3 | 94.1 | 92.1 | 87.2 | 80.8 | 74.1 | 68.6 |
| Weekly (dollars) | 59.50 | 55.31 | 45.71 | 44.57 | 45.42 | 40.43 | 33.02 | 29.35 | 27.60 |
| Net earnings of the meat-packing industry (million dollars) | ([2]) | 149 | 143 | 52 | 72 | 72 | 67 | 65 | 42 |
| Average prices received by farmers (dollars per hundredweight): | | | | | | | | | |
| Beef cattle | 22.73 | 18.50 | 14.50 | 12.10 | 10.80 | 11.90 | 10.62 | 8.80 | 7.55 |
| Veal calves | 25.05 | 20.40 | 15.30 | 13.20 | 12.50 | 13.40 | 12.45 | 10.33 | 8.86 |
| Lambs | 22.81 | 20.50 | 15.60 | 13.10 | 12.50 | 13.00 | 11.70 | 9.58 | 8.10 |
| Hogs | 23.63 | 24.10 | 17.50 | 14.00 | 13.10 | 13.70 | 13.00 | 9.09 | 5.39 |
| Cash farm income from meat animals (million dollars) | 8,575 | 9,319 | 7,046 | 5,907 | 5,720 | 5,865 | 4,791 | 3,246 | 2,397 |
| Index of meat prices: | | | | | | | | | |
| Wholesale (1926=100) | 238 | 213 | 146 | 108 | 106 | 110 | 112 | 90 | 73 |
| Retail (1935–39=100) | 245 | 215 | 151 | 118 | 118 | 124 | 122 | 106 | 94 |
| Consumer-demand factors: | | | | | | | | | |
| Total disposable income (billion dollars) | 190.5 | 173.6 | 159.2 | 149.4 | 145.6 | 131.6 | 116.2 | 92.0 | 75.7 |
| Total civilian employment (million persons) | 59.5 | 57.9 | 55.2 | 52.8 | 54.0 | 54.5 | 53.8 | 50.4 | 47.5 |

[1] Estimated.
[2] Not available.

TABLE NO. 247–R1.—*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 |
| | | | | *Percent* | *Percent* | | |
| 22-year average, 1925–46 | $791 | $3,777 | $41 | 5.18 | 1.99 | $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, USDA. Earnings per 100 pounds live and dressed weight are approximations calculated by the American Meat Institute covering commercial meat production.

TABLE No. 306.—*Financial summary, 14 major meat-packing companies combined, 1940, 1946, 1947*

[Thousands of 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 assets | 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 liabilities | 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.

Senator FLANDERS. Mr. Greer, there are two or three questions I would like to ask you. Do you deal primarily in hogs or in beef animals?

Mr. GREER. Both, Senator, the pork business is larger than the beef business in our operations but we are rather extensively engaged in both.

Senator FLANDERS. Do you distribute in the same way as the previous witness described, directly to retailers, or do you have an intermediary?

Mr. GREER. Almost all of our distribution is direct to retailers. We sell a small percentage of our goods through intermediate wholesalers not to exceed 5 or maybe 10 percent of the total, I would say.

Senator FLANDERS. I did not get from your very rapid and efficient reading of your testimony how much of your capital was derived from common stock. Do you have a large amount of common stock outstanding?

Mr. GREER. Our common stock has a par value of $7,850,000 and our preferred stock, $4,460,000, approximately. It is shown in table A-3, Senator.

Senator FLANDERS. Does that also show the distribution you have been able to make on the common stock?

Mr. GREER. There have been no distributions on the common stock.

Senator FLANDERS. Since when?

Mr. GREER. Since 1920.

Senator FLANDERS. Well, that question is answered.

Mr. GREER. I wish I could answer it as easily to our stockholders.

Senator FLANDERS. Another question I would like to ask came to my mind from your general observations about business conditions and expansion in general in the latter part of your testimony. You refer to the fact that it was difficult to get equity capital, new equity capital, for your industry and we have had the statement from various other types of industry which we have been investigating. The only resource seems to be that of plowing back earnings into the business?

Mr. GREER. That is the only source we have been able to find.

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, but 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 till 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; 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.

Senator FLANDERS. We will put that into the record at this point. We would appreciate it if you would do it as soon as possible.

Mr. GREER. What years would you like to have this cover?

Senator FLANDERS. I would say from 1939 on, because that is the significant period we are investigating.

Mr. GREER. The figures for 1948 are not yet available but we can carry it up through 1947.

Senator FLANDERS. Fine.

(The information is as follows:)

TABLE NO. 309–R1.—*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.

Senator FLANDERS. Those are the only questions I had in mind. Senator O'Mahoney?

Senator O'MAHONEY. Mr. Greer, in response to Senator Flanders you stated, as I recall, that the preferred stock of the company is something over $4,000,000 par value and the common stock about $7,000,000. How long has that been the case?

Mr. GREER. Well, those proportions have been approximately constant for a good many years. In table A–3, Senator, we show what the situation was in 1940 and again in 1947 and 1948. We have some increase in the common stock between 1940 and 1946 which came about as a result of our distribution to the preferred stockholders of some additional shares of common stock in lieu of back dividends on the preferred which had not been made in previous years.

Senator O'MAHONEY. So that the $7,000,000 of common stock does not represent $7,000,000 of fresh capital invested?

Mr. GREER. Just what do you mean by "fresh capital invested," Senator?

Senator O'MAHONEY. New money.

Mr. GREER. It was fresh in 1920, but it has not been refreshed since then.

Senator O'MAHONEY. How much was it in 1920?

Mr. GREER. $7,000,000, approximately.

Senator O'MAHONEY. I understood you to say that a portion of the $7,000,000 represented a stock dividend in lieu of cash dividends?

Mr. GREER. May I refer to the table, Senator. In table A-3 it shows that in 1940 the amount was $7,063,898; that the common stock in 1946 was $7,847,940 and has remained at that figure since then. That change occurred at the end of 1944.

Senator O'MAHONEY. So that the difference between $7,063,000 and $7,847,000, represents a distribution of stock in lieu of a cash dividend?

Mr. GREER. That is correct.

Senator O'MAHONEY. Now was there any other such distribution at any time?

Mr. GREER. No, sir; I believe not, not to my recollection.

Senator O'MAHONEY. Sometimes of course when corporations are organized, investors are offered the opportunity to buy so much preferred and so much common, the preferred stock being the real capital investment and the common stock being a portion of the capital which is expected to be earned out of future operations. That has been commonly done, has it not?

Mr. GREER. Well, the statement is yours, Senator.

Senator O'MAHONEY. Well, it is a common practice. Common stock in many a corporation has not represented actual cash investment but has represented the hopes of the organizers that the common stock would be made worth dollar for dollar out of future operations?

Mr. GREER. I have heard of such instances.

Senator O'MAHONEY. Well, there are many. Now the question, of course, suggested to my mind has to do with whether or not, or what proportion of your stock is represented by that sort of investment. I take it from your answer that it is just the difference between the 1940 and 1946 figures?

Mr. GREER. That is the only change which has taken place in the common stock.

Senator O'MAHONEY. In other words, $7,000,000 of common stock in your small independent company is actually cash investment?

Mr. GREER. The organization of the company in 1920, Senator, is back of my connection with it and I never have gone back over the figures. The inquiry was as to the situation in 1940, 1947, and 1948 which we have tried to cover. But, there was no change between 1920 and 1940 in either the amount of the preferred or common stock outstanding to the best of my knowledge.

Senator O'MAHONEY. When did you become connected with the company?

Mr. GREER. In 1939.

Senator O'MAHONEY. In 1939. So that how much actual capital was invested in common stock at the beginning is a matter to which you have not looked?

Mr. GREER. That is correct.

Senator O'MAHONEY. You spoke in the beginning of your statement of the stockholders of your company. It is on the first page of your statement as I recall it and reads:

> The company is owned by 1,600 stockholders, many of them employees, former employees and their families.

How many employees are stockholders?

Mr. GREER. I could not say offhand. I suppose somewhere between 50 and 100. That is a guess because I have not counted the rolls.

Senator O'MAHONEY. It is a small proportion out of the 5,700?

Mr. GREER. Relatively small, yes.

Senator O'MAHONEY. There is one other question I would like to ask you and it has no direct bearing on the operation of your company, but in the preparation of your statement and your comments upon government policy as to taxation, have you borne in mind the responsibility which lies upon Congress to secure revenue through taxation with which to carry on the operations of the Government and the vast expenditures the Government must make for national defense and for its international obligations and also to balance the budget? You have taken that into consideration, have you?

Mr. GREER. Yes, sir.

Senator O'MAHONEY. You recognize the fact that annoying as it may be to the taxpayers, that taxation is about the only way the Government has to raise necessary funds unless it goes into business?

Mr. GREER. We look on the Government also to determine whether the expenditures are necessary.

Senator O'MAHONEY. Oh yes, yes, of course, and there are frequent debates about that and even when the debate is very strong the answer finally comes that we must have a bipartisan foreign policy and we must pay the interest on the national debt; we must maintain the Army and the Navy and the Air Force. Of course, at the present time we are reaching out and tapping various young men through the country and taking them away from their businesses and putting them in uniform, because it is the judgment of the people and the Congress that that must be done.

So, in presenting this recommendation with respect to tax policy, you do not wish to be understood as not having those functions in mind, do you?

Mr. GREER. No, sir.

Senator FLANDERS. Senator, may I make an observation at this point?

Senator O'MAHONEY. You are the chairman, sir.

Senator FLANDERS. The conviction has been growing on me that maybe we are trying to squeeze more juice out of this lemon than there is in it. I mean out of our whole economy, and I think that we in the House and Senate will have to keep that in mind during the coming session; that maybe there just is not any more juice there.

Senator O'MAHONEY. Well, I think that that probably is advice that will be taken by the coming session in good part from the chairman. May I also add the comment that when these bonds were issued with which to raise the money to fight the war, bringing our total national debt at this moment to about $252,000,000,000, as compared with a national debt of less than $50,000,000,000 when the war began, the Congress of the United States by practically unanimous vote mortgaged the future production of the United States, its businesses and its people, in order to fight the war, so that this national debt actually constitutes a mortgage on future production and in conducting these hearings upon profits and in making up our minds about the policy to be followed by the Eighty-first Congress, we must bear in mind the fact that the Eighty-first Congress is inheriting this huge mortgage for the future. And if that mortgage is not paid off and those bonds are not recognized as being an obligation in the full sense of the term in which they were assumed, it will be pretty tough for the capitalistic system.

That is why I think that the President has been trying to balance the budget through taxation.

Senator FLANDERS. Senator, I think those are some of the facts of life.

Senator O'MAHONEY. Right.

Senator FLANDERS. Have you other questions?

Senator O'MAHONEY. I think not, Mr. Chairman.

Senator FLANDERS. Congressman Wolcott?

Representative WOLCOTT. Mr. Greer, on page 9 at the top of the page, you indicate that with your present financial condition you would be better off if prices and values were generally lower. Would you like to expand on that?

Mr. GREER. What I meant to imply there was that it will be easier to make replacements of plant and equipment as they wear out if they can be purchased at lower prices than at the present time.

Representative WOLCOTT. Even if your own income was proportionate?

Mr. GREER. We have no knowledge of what our income will be at a lower level of prices.

Representative WOLCOTT. Of course, it follows that if your prices remain high and the price of things that you buy declines, it will be much easier for you to replace them.

You say this situation will present a serious problem during the coming years unless price levels generally show a substantial decline.

Now of course, if they generally show a substantial decline, your income will be proportionate?

Mr. GREER. Our gross income but our net income not necessarily so. Profits in the meat-packing industry are not necessarily associated with high prices, book profits, if inventories are carried at replacement costs, tend to rise somewhat in periods of rising prices. I think most everyone in the meat-packing industry would welcome an opportunity to operate at a lower level of prices. Sliding down to that level would be somewhat painful but we do not enjoy this high price situation any more than the consumers do.

Representative WOLCOTT. Let us take a situation which might become a reality. We have now about a 60-cent dollar, based upon

1936–39 levels. Many of the economists tell us that when we do stabilize we will stabilize at about an 80-cent dollar. Adjusted to prices that would mean that prices would be about 20 percent lower than they are now and about 20 percent higher than they were in comparison to the 1936–39 level.

If we did stabilize at that point and maintained that figure over a period of years, assuming of course that all prices would be reflected proportionately, do you think you would be better or worse off?

Mr. GREER. I think we would be better off. As I say, we might have a little pain in the transition, but our working capital situation would be greatly relieved by a lower level of prices. There should be an opportunity for us to operate on a margin of profit at the lower level as in the present level.

Representative WOLCOTT. Consequently, we might assume that the costs of operating the Government would be decreased proportionately and the value of the Government's income would be as proportionately affected as it is at the present time?

Mr. GREER. We would hope to see that happen.

Representative WOLCOTT. So that in view of the fact that the income in dollar volume might be less its effectiveness would be equivalent to what it is now. You would apply that same principle as you would to your own business?

Mr. GREER. Right.

Representative WOLCOTT. Thank you.

Senator FLANDERS. Mr. Herter?

Representative HERTER. I note in the very first table that you have in connection with your testimony a break-down of your raw-material costs, in relation to your total costs. Is there any other industry, any large industry, in which the raw-material cost is as major a factor as it is in yours?

Mr. GREER. Some of the other agricultural commodity processing industries stand pretty high. I would estimate that we stand pretty close to the top of the list.

Representative HERTER. In the complaint of the consumer with respect to the high prices of meat, have you any figure to indicate the relationship of that raw material cost to the retail cost? You have added less than a cent, just over a half cent, per pound; that is, your operating profit?

Mr. GREER. Yes.

Representative HERTER. How large generally is the spread from the time these goods leave your hands to the time the consumer gets them?

Mr. GREER. I have no figures on that and would not want to quote any offhand.

Let me suggest that the committee avail itself of a study made by Dr. Knute Bjorka of the United States Department of Agriculture which came out about 2 years ago in which he made an analysis of the spread all the way from the farm to the table in livestock and livestock products. In that, he has made the best estimates that he could from the available data on the extent of the spread.

Representative HERTER. This very small spread that is indicated in your own business with the demand that has existed in the last 2 years which exceeded by far the supply, you could very easily have increased that spread; that is, the industry as a whole could have increased that spread, without very much evidence of that increase in retail price?

Mr. GREER. Well, if the profit margin of the packing industry had been twice as great as it was I am sure no one would have noticed the difference in the retail price of meat.

However, the competition which is existent in the industry at all times keeps that profit level down.

Representative HERTER. Is it entirely the competitive position or is it that the packing industry is being scrutinized constantly, politically and otherwise?

Mr. GREER. This is a new experience, Congressman. I do not think we have ever been accused of philanthropy before.

The packer would like to make a larger profit. He thinks he needs it and I feel sure he does. If he has not been getting it, it is because it has not been there.

Representative HERTER. You think it is a competitive situation?

Mr. GREER. Yes, sir.

Representative HERTER. In spite of the fact that the country would have consumed more than you have produced?

Mr. GREER. That is true.

Representative HERTER. Thank you.

Senator FLANDERS. If there are no further questions, we will excuse you, Mr. Greer. We are very grateful for your attendance here this morning.

Mr. GREER. Thank you, sir.

Senator FLANDERS. This afternoon we will meet here at 2:15. The witnesses who will appear this afternoon are Mr. Don Montgomery of the United Automobile Workers and Mr. Russ Nixon of the United Electrical Workers for some brief testimony.

Unfortunately, Mr. Reuther who had hoped to come will not be able to be present.

We will meet here again at 2:15 this afternoon.

(Thereupon, at 12:40 o'clock p. m., the subcommittee recessed to reconvene at 2:15 p. m. of the same day.)

## AFTERNOON SESSION

(Whereupon, at 2:15 p. m., the subcommittee reconvened.)

Senator FLANDERS. The hearing will open, and our first witness is Mr. Donald Montgomery, chief of the Washington office of the CIO.

Mr. Montgomery, we are glad to see you. You are required by the rules of the hearings to make your own statement to the reporter as to your name, position, and address.

## STATEMENT OF DONALD MONTGOMERY, CHIEF OF THE WASHINGTON OFFICE OF THE UAW-CIO, ACCOMPANIED BY NAT WEINBERG, DIRECTOR, RESEARCH DEPARTMENT UAW-CIO

Mr. MONTGOMERY. Mr. Chairman and members of the committee: My name is Donald Montgomery, chief of the Washington office of the United Automobile Workers, and I have brought with me, Mr. Chairman, our research director, Mr. Nat Weinberg, to bail me out if you ask embarrassing questions.

Senator FLANDERS. I may say that Mr. Weinberg and I had a preview of this talk in New Haven, Friday, I believe it was, and I can assure you, sir, that you have competent assistance.

Mr. MONTGOMERY. I certainly agree with that.

Senator FLANDERS. You may proceed with your testimony.

Mr. MONTGOMERY. We appreciate very much the opportunity to appear before the committee, and I want to express to you Walter Reuther's regrets that he was not able to appear as you had provided. Since the time that you had arranged for him to appear here on Friday, he learned that he had to come down to the CIO vice president's meeting on Tuesday, and after being here 2 days, it was necessary for him to get back to continue the treatments which he has every day to keep his arm improving as it is.

Senator FLANDERS. We hope that he will continue to improve from that very cowardly attack to which he was subjected.

Mr. MONTGOMERY. Thank you, Senator; and he wanted me to express his regrets to you personally that he could not be here.

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 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 they must get while the getting's good, because they anticipate 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.

If the committee will permit, I would like to just read again to the committee, as was done by Mr. Ruttenberg of the CIO, this statement from Irving Olds, chairman of the board of the United States Steel Corp. in this annual report of 1946, because it boils down to a very short statement this philosophy of boom and bust, to which I have just referred. Quoting him:

> Operations are at an all-time high. Profits should be sufficient to enable a fair return to be paid to the owners of business in the form of dividends and also to permit an adequate amount to be set aside for future needs since the day will come when steel operations are at a lower rate than at the present time.

Also, I might remark that as I read the New York Times account this morning of your hearings yesterday, there seemed to be at least two witnesses who further justified their present high profits on the basis that they are getting them now because they are going to have hard times later.

Senator FLANDERS. I would suggest that you read yesterday's testimony in that connection rather than the news reports.

Mr. MONTGOMERY. 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.

We have made up a compilation for four automobile corporations, showing just how much they could either reduce prices or increase their wages out of their 1948 third-quarter profits if they were content not to take the high return on investment which they are taking, 31 percent, but were satisfied with 8 percent return on their investment.

Representative HERTER. This is not part of your submitted testimony?

Mr. MONTGOMERY. No. I wanted to give this example of the statement I made in the last paragraph, if that is all right with the committee.

Senator FLANDERS. This should be introduced into your testimony, and it would be well if you could give us a résumé of what you are just saying; otherwise, it will be difficult for us to discuss it with you.

Mr. MONTGOMERY. I only have one copy, but I will have copies made and file that with the committee.

Senator FLANDERS. When you are through, you might hand that sheet up, and we will pass it around so that each of us can see it, and then return it for the record.

Mr. MONTGOMERY. This sheet shows what the net worth of these four automobile companies was at the beginning of 1948 and then shows their profits during the third quarter and shows how the calculation is made, to see how much they could reduce their prices or increase their wages if, as I said, their return on net worth were to be 8 percent instead of 31 percent, as it actually was.

The answer is this: They could reduce their prices if they accepted that return on investment, by 11.3 percent, or if they took that reduction in their profits and put it into wages, they could increase their wages by 80 cents an hour. If you would like, I will pass this over to you now.

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 now look only to Government spending for defense and overseas aid to hold the system together for a few more years.

This is our general case against high profits. In support of it I would like to discuss the claim made to your committee that present profits really are not high at all but appear to be high only because industry has failed to use certain available accounting procedures for making those profits look smaller.

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.

In the first of the two sheets I have given you along with my statement are just some examples drawn from corporate profit reports for 1947 of these various reserves that have been used to make the net income of the corporations as reported to their stockholders look smaller than they actually are, and I call your attention to the last column of that table, column 4, which shows that this attempt to reduce the apparent size of profits amounts to very substantial percentages, some of them over 24 percent and some of them over 30 percent.

(The table is as follows:)

*Examples of accounting devices to conceal profits, 1947*

A. DEDUCTIONS FROM INCOME

| Company | Amount deducted from income (1) | Account credited with deduction (2) | Reported profit after taxes (3) | Concealed profit as percent of reported profit (4) |
|---|---|---|---|---|
| | | | | *Percent* |
| American Can Co | $2,500,000 | Contingency reserve | $19,336,624 | 13 |
| Armour & Co | 8,000,000 | Inventory reserve | 22,950,269 | 35 |
| Bethlehem Steel Corp | 10,000,000 | Inventory [1] | 51,088,375 | 20 |
| Borg-Warner Corp | 4,500,000 | Contingency reserve | 20,023,147 | 22 |
| Bower Roller Bearing | 100,000 | Inventory reserve | 2,323,776 | 4.3 |
| Caterpillar Tractor | 3,519,148 | Inventory (change from Fifo to Lifo). | 9,956,912 | 35.3 |
| Continental Can Co | 1,850,000 | Inventory [2] | 12,809,543 | 14 |
| Detroit Aluminum & Brass Corp | 33,000 | Contingency reserve | 448,327 | 7 |
| Doehler-Jarvis Corp | 1,500,000 | do | 6,235,609 | 24 |
| Du Pont Co | 20,900,000 | Provision for excessive construction cost.[3] | 120,009,760 | 17 |
| Electric Storage Battery Co | 1,000,000 | Contingency reserve | 6,238,447 | 16 |
| Four Wheel Drive Auto Co | 202,511 | Inventory reserve | 648,707 | 31 |
| McCord Corp | 250,000 | do | 2,321,609 | 11 |
| Modine Mfg. Co | 250,000 | do | 1,456,961 | 17 |
| National Battery Co | 250,000 | do | 1,484,452 | 17 |
| Phillips Petroleum Co | 5,596,145 | Contingency reserve | 40,893,647 | 14 |
| Raybestos Manhattan | 625,000 | Inventory reserve | 2,335,756 | 28 |
| Timken Roller Bearing | 1,250,000 | Contingency reserve | 11,124,252 | 11 |
| United States Steel Corp | 26,300,000 | Depreciation reserve [4] | 127,098,148 | 21 |
| Westinghouse Electric Corp | 12,009,179 | Inventory reserve | 48,806,417 | 25 |

[1] Effective as of Jan. 1, 1947, Lifo method was used in determining the values of approximately 75 percent of the consolidated inventories. As result of change, net income for 1947 after taxes was about $10,000,000 less than it would have been if change had not been made.

[2] Company on Jan. 1, 1947, adopted Lifo method in valuing inventory. This change in accounting procedure reduced net income by $1,850,000.

[3] Current construction costs are believed to be excessive. Therefore, effective Jan. 1, 1947, the company is setting aside out of "Net operating" and "Other income" a reserve for excessive construction costs in the year incurred. As the plants come into operation, depreciation is provided at normal rates on the gross amount of plant cost. (From Report to Stockholders).

[4] Depreciation (for 1947) of $114,045,483, includes $87,745,483 based on original cost of facilities and $26,300,000 to cover replacement costs.

Senator WATKINS. What evidence do you have for this statement to back this up? What is the authority for this statement?

Mr. MONTGOMERY. These are taken from Moody's Manual of Industrial Reports, these profits as given to stockholders, and I have tabulated here the data taken out of Moody's, showing the reserves they have used before arriving at their net income.

Senator WATKINS. Do those deductions appear in the statements made public?

Mr. MONTGOMERY. That is right.

Senator WATKINS. And you pass judgment on them that they are concealing profits?

Mr. MONTGOMERY. They state their net income after they have deducted these reserves. To an accountant that does not conceal anything. He understands that those reserves are not properly chargeable against net income, and the Bureau of Internal Revenue will not allow it, but to the stockholder it is a very different matter.

As a matter of fact, I would like to give you an example. When I was in the Department of Agriculture back in 1935, the Department published for the year the report of the meat packers' profits, the meat-packing industry's profits for the fiscal year 1935, I think it was. In one of those, reports Swift & Co., there had been a similar deduction of reserves of $6,000,000, and yet the United States Government accepted that as stated in the report and included as a deduction from profit, and as a result put out these profits $6,000,000 less than they actually were. When that was called to their attention, they wrote to Swift & Co. and asked them what their actual profit for the year was, and they wrote back and said, "Yes, you are correct, it should be $6,000,000 larger than it was."

Now, I submit that if this device of subtracting these special reserves can deceive the Department of Agriculture as to the true state of profit, certainly it is deceiving a great many stockholders who have not the opportunity they have to find out what the truth is.

Senator WATKINS. What I am trying to arrive at, it is your judgment, you are the one that passes judgment on these deductions, that they are actually——

Mr. MONTGOMERY. Not deductible from profit. These would not be deductible under the Bureau of Internal Revenue regulations.

Senator WATKINS. I understand for tax purposes probably not, but actually as a matter of good business practice, who passes the judgment on it to say whether they are or are not proper deductions?

Mr. MONTGOMERY. The accounting profession would not consider them proper deductions, nor would the Securities and Exchange Commission, which I worked for, for the first 3 years of its existence.

Senator WATKINS. Now, you name specific companies, and I am interested in knowing whether or not any recognized authority has passed judgment on their particular deductions.

Mr. MONTGOMERY. Would you accept the word of leading firms of certified public accountants, Senator?

Senator WATKINS. I am not saying whether I will accept it or not. I want to hear it.

Mr. MONTGOMERY. Very well.

Senator WATKINS. I am used to hearing evidence and passing on it after I have a chance to weigh it.

Mr. MONTGOMERY. This is from a certificate of the Westinghouse Electric Corp.'s report for the year 1947.

Senator WATKINS. Is it one of these corporations listed here?

Mr. MONTGOMERY. Yes; it is down at the bottom of the list. I will give you the accountant's opinion of that last item on this sheet that you have before you.

Senator WATKINS. Who is the accountant?

Mr. MONTGOMERY. Main & Co., certified public accountants. Here is the last paragraph of their certificate, based on that year's audit:

> In recognition of the hazard existing due to the present extraordinary price levels and the increase in the company's volume of inventories, it is the opinion of the management that a special provision of $8,101,000 for future inventory losses is necessary as a deduction from the net income in the current year.

It goes on to say:

> In our opinion the company's consolidated statement and the related consolidated statements of surplus and the statement of ownership of Westinghouse Electric Supply Co. present fairly the position of the companies at December 31, 1947, and the results of their operations for the year 1947 in conformity with generally accepted accounting principles, applied on the basis consistent, apart from the 1947 special provision for future inventory losses

Now, there those accountants definitely avoid giving a certificate or approving that provision for special inventory losses.

Senator FLANDERS. The stockholder gets that information.

Mr. MONTGOMERY. If the stockholder can understand that certificate, he gets it.

Senator FLANDERS. It sounds pretty plain to me.

Mr. MONTGOMERY. As I gave you an example, if the Department of Agriculture was deceived in such a matter, I think that we can anticipate that most stockholders are as well. Now, I can give you one from the Du Pont de Nemours & Co. annual report for 1947. This is the certificate by Lybrand, Ross Bros. & Montgomery—no relation, I may add. In here, in this certificate, they say:

> In accordance with the procedure instituted by the company early in 1947 and reflected in its published interim statements during 1947, the company has made provision for excessive construction costs in the amount of $20,900,000 and has deducted such provision from net operating and other income in arriving at net income for 1947. In the latter part of 1947 the American Institute of Accountants' Committee on Accounting Procedure published a statement in which it said, "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."

Senator WATKINS. What company is that?

Mr. MONTGOMERY. Du Pont de Nemours & Co.

Senator WATKINS. Is that listed on the list that you gave here?

Mr. MONTGOMERY. Yes, it is. That is on the list also.

Senator WATKINS. As I understand it, your claim is that they are concealed?

Mr. MONTGOMERY. Yes, sir, and that is what I believe.

Senator WATKINS. Is that concealment if they say that they are deducting so much for this?

Mr. MONTGOMERY. They say very frankly after making the deduction that the result is their net profit, and we believe that that item labeled "net profit" is smaller than their actual net profit, and we say that that is concealment from the average, ordinary stockholder, the large number of which they usually boast of in their annual report, and very few of those people are expert accountants.

Senator WATKINS. Apparently it does not deceive anybody else. It did not deceive the Internal Revenue Department, nor you.

Mr. MONTGOMERY. I do not think this is concealed from the Internal Revenue Department.

Senator WATKINS. It is not concealed from the ordinary businessman, is it?

Mr. MONTGOMERY. I do not believe it is concealed from the ordinary businessman; he is probably doing the same in his annual report.

Senator WATKINS. It is a rather frank statement of exactly what they have done, which ought to be perfectly clear.

Mr. MONTGOMERY. My word for it is "concealed," and I will have to stand on my testimony, and I believe it is concealed from the public.

Senator WATKINS. If it is your judgment, that is what I want to know.

Mr. MONTGOMERY. 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. That is what is illustrated here on the second of the sheets that I have given you, along with my statement. Those are credits to earned surplus taken again from the 1947 reports of the companies listed, as reported by Moody's Industrials.

(The table is as follows:)

*Examples of accounting devices to conceal profits, 1947*

B. CREDITS OF PAST CONCEALED PROFITS TO RESERVES

| Company | Amount transferred to earned surplus (1) | Account from which transferred (2) | Profit after taxes (3) | Credit to surplus as percent of reported profit (4) |
|---|---|---|---|---|
| American Car & Foundry | $5, 104, 278 | Contingency reserve | $5, 176, 042 | 99 |
| American Sugar Refining Co | 11, 538, 467 | Postwar reserve | 10, 244, 778 | 113 |
| Babcock & Wilcox Co | 5, 210, 000 | Contingency reserve | 6, 761, 922 | 77 |
| Bohn Aluminum & Brass | 399, 036 | do | 190, 740 | 209 |
| Colt's Manufacturing Co | 350, 000 | do | 149, 186 | 235 |
| Eastman Kodak | 15, 000, 000 | do | 43, 199, 253 | 35 |
| Electric Auto Lite | 772, 153 | do | 10, 714, 987 | 7.2 |
| Foote-Burt Co | 194, 308 | do | 285, 932 | 68 |
| Kelsey-Hayes Wheel Co | 1, 100, 000 | do | 3, 314, 456 | 33 |
| Mack Trucks, Inc | 2, 962, 165 | Reserve for postwar adjustment. | 8, 244, 153 | 36 |
| Shell Union Oil | 12, 000, 000 | Inventory reserve | 59, 874, 698 | 20 |

Source: Moody's Industrials, 1948.

Mr. MONTGOMERY. 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.

Since this point has been raised, and I would like to bring it home to the committee as forcefully as I can, I want to read here from the Accounting Research Bulletin, October 1947, No. 31, and this is the committee on accounting procedure that was referred to in one of these certificates that I have just read you. They are discussing here this matter of inventory reserves, on which I think there has been some testimony before this committee, and they are referring to this business of computing the reserve on some basis other than cost or market, whichever is lower. They say:

When estimates of this character are charged to current costs, amounts representing mere conjecture are combined with others determined with a reasonable degree of accuracy. The committee is, therefore, of the opinion that inventory reserves such as those crated for the purpose of reducing inventories other than to a basis which is in accordance with generally accepted accounting practices are of such a nature that charges or credits relating to such reserves should not enter into the determination of net income, and they should not be used to relieve the income account of any year.

In this Du Pont report to which I have just referred, if you will look at the income statement, you will find that after they have deducted this type of reserve, they then label the resulting figure "net income for the year." That is the corporation's word for it and not mine. I say that it is not approved by this committee of the accountants, and that is their official committee that was appointed and gave long consideration to this question.

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.

I think it would be worth while calling to the committee's attention a letter published in the Journal of Accountancy for October of 1948 by Ralph W. Snyder, a certified public accountant, talking about this question that Mr. Slichter has raised before this committee. I won't read the entire letter but this man finds the thing so astonishing that he can only poke fun at the whole proposition. He says:

> It seems to me that if the low-cost depreciation on a low-cost plant causes its owner to be at an economic disadvantage in comparison with the operator of a high-cost plant, the logical answer ought to be that the low-cost owner should junk his plant and buy a new one at the latest inflated cost. Then he would be at least caught up with his high-cost competitor. Of course, I can see that raising depreciation by a book entry is a lot simpler in some ways than buying a whole new plant.

Then he says:

> If these practices are followed, what if the inventory and plant accounts turn into red balances, or the reserve for the cost of the audit for 1958 amount to astronomical proportions. Reported net income will be low because sales will be matched by costs high enough to be what the cost would have been if they had been as high as they should have been to hold the profits down. If only we can get the Bureau of Internal Revenue to understand how vital the new economics is!

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 so 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.

If you would like an example of that, I give you the United States Steel Corp. annual report for 1947. They both make a statement with respect to their inventory reserves and their depreciation. If you are interested in the figures, I can give them to you. That is an example where they do both of these things at once, although they are on a totally inconsistent theory of what is going to happen to prices and what should be done about it in the corporate accounts.

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 definitely 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. I certainly commend to this committee and to its staff this article by Professor Bliss in the Harvard Business Review.

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 2 to 1 against deducting inventory profits.

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. One brief quote from the report of this same committee of accountants:

> 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.

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.

I have already given you a case of that in the Dupont report for 1947 and I have told you what the accountants said about it.

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, that is from the report which I have twice read to you. 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 book at original cost less normal depreciation and the normal depreciation is now being charged to current income.

Senator FLANDERS. Can you give us examples of that and any references by the accountants to that practice?

Mr. MONTGOMERY. I have no quotations from accountants on it. But this has been done by Dow Chemical and Revere Copper and Brass in 1946, and perhaps since. I know it was done in that year. The Industrial Brownhoist Corp. and the American Optical Co. brought these wartime assets on the books at cost less normal depreciation after having taken advantage of accelerated depreciation. The Koppers Co., and Walter Kidd & Co. brought their assets on the books at what they called fair value, and depreciation on that fair value started all over again, although they had already been fully depreciated under the wartime provisions.

Senator FLANDERS. Do the accountants make any comments on that in their annual reports?

Mr. MONTGOMERY. I imagine they do, but I don't have the citations of them.

Senator FLANDERS. I would like to see what they are. Would you get hold of them from the same source from which you got that information?

Mr. MONTGOMERY. Yes, I will.

Mr. BERQUIST. Has the Bureau of Internal Revenue allowed those restated values?

Mr. MONTGOMERY. I think it very unlikely; and, in fact, I am sure that they do not.

Senator FLANDERS. I think that you had better get that information as to the practice of the Bureau of Internal Revenue and also as to any comments by auditors.

Mr. MONTGOMERY. All right, sir.

(NOTE.—The materials requested could not be prepared in time for inclusion in the printed hearings but will be submitted later for the committee files.)

Mr. MONTGOMERY. 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. What I mean is that the legs have gotten so fat they want longer dresses to cover them up.

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 be borrowed in the first instance, regardless of the fact that in the interim their purchasing power had decreased?

I apologize for taking so much of this committee's time to belabor what seems to me obvious, as I am sure this committee's report to

Congress will uphold the integrity of the accounting profession, which, despite pressure upon it by its clients, has refused and still refuses to approve depreciation on replacement costs as a proper deduction from income in order to make present high profits look smaller than they are.

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.

This raises the question of the source of investment funds for the expansion and modernization of industry today.

When Slichter and others assert that depreciation reserves should not only recoup the cost of used-up capital, but should replace it, they are simply rationalizing, in the manner of economists, a situation which industry has already largely made an accomplished fact. For their theory really means that consumers should be charged prices which will cover not merely costs and a normal profit, but a large additional profit as well which will enable industry to meet a large part of its expanding capital needs out of profits.

The monopolistic aspects of this development have been called to this committee's attention by Mr. Ruttenberg, testifying for the CIO.

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-billion-dollar 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 this capital contribution, 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 to provide much-needed expansion of productive capacity.

Senator FLANDERS. To what are you referring at that point?

Mr. MONTGOMERY. I am referring in particular to the steel industry, and I will add the electric power industry, and I will have some remarks on that in just a moment.

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.

This should further direct public attention to the dim view which much of modern big business appears to take toward the future of this country.

The current high rate of business investment is widely noted. But it should also be noted that current profits are much greater than investment. In fact, we are reinvesting a smaller proportion of our total profit income than in the late twenties.

In the table in this report I give you the figures for 1929 and for the third quarter of 1948 on an annual rate basis. These figures come from the Department of Commerce.

(The table is as follows:)

| | 1929 | Third quarter, 1948, annual rate |
|---|---|---|
| | *Billions* | *Billions* |
| Corporation profits and net income of proprietors | $22.3 | $65.7 |
| Gross private domestic investment (excluding inventory change and residential housing | 11.1 | 28.3 |
| | *Percent* | *Percent* |
| Percent reinvested | 51 | 44 |

In 1929, 51 percent of the apparent total profit income was included in this gross private domestic investment, whereas in the third quarter of 1948, only 44 percent shows up as gross private domestic investment. I think it is pretty well known to everybody, also, that the life-insurance companies are finding it very difficult to find outlets for the funds they have to invest. They cannot find corporate managements enough to take up the funds they have ready and waiting for investment.

I call the committee's attention, also, to Leon Keyserling's article in the New York Times Magazine of June 13, 1948, where he pointed out that the retained profits of corporations alone last year accounted for the total new investment in plant and equipment. Of course, additional investments were made by corporations, but the new plant and equipment investment of corporations was fully provided for out of the retained profits alone. That is what I have called inequity capital.

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 thc 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 know that.

Senator WATKINS. What is your comment on that?

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, if the scrap is not forthcoming. I think all of these things point up what I am saying, Senator, they are 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; but that is what these people are doing.

Senator WATKINS. I did not hear any argument to that effect.

Mr. MONTGOMERY. Do you realize that 10 years from now 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 on, 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 we know 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 project so that we can get the boats up the river and bring it in at proper cost. Certainly, you don't believe, Senator, that we have come to the end of our rope and cannot produce more steel?

Senator WATKINS. I am not here to testify. I am asking for your judgment on it and seeing what is the basis of your judgment.

Mr. MONTGOMERY. 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 on 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, there 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, the chairman, brought them down here and they said the same thing in the record, Wilfred 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.

Senator WATKINS. I think that they are working in that direction.

Mr. MONTGOMERY. America does not go forward without steel, and you know that.

Senator WATKINS. They are working in that direction. They were trying to find means of getting the materials.

Mr. MONTGOMERY. And then only as late as December a prominent official said that the Government will be glad some day that we did not expand capacity and all of this hysterical stuff.

Senator WATKINS. There are steel men that, of course, take one view just like we find in other fields. All people do not think the same.

Mr. MONTGOMERY. At Senator Martin's hearing you had a whole group of them. You never saw so much steel brass in your life; every big guy was there; and they all said the same thing.

Senator FLANDERS. Is that a new alloy, steel brass?

Mr. MONTGOMERY. That is a new alloy, and I believe it was a new alloy that day.

Senator WATKINS. Just to get back for a moment to the question I asked you, if you do have any information, that is what we are here for, and we are trying to get information for the guidance of the committee. Do you have any information on any facts that would show that they are mistaken in their idea that the materials are not present, and there are not enough materials even though they add more capacity? I would be very much interested in getting that factual information, if you have it.

Mr. MONTGOMERY. I could give you a good deal of it if you would give me time to dig it up. I have long reports from the steel workers people.

Senator WATKINS. I would be very happy if you have it, because that is one of the claims that was made. We asked them about it here the other day, and it was their contention that even though we had more capacity they would not have the materials.

Mr. MONTGOMERY. I would be glad to get the information for you, but I don't think that you ought to leave it there. This Joint Economic Committee, it seems to me, ought to start 10 a. m. January 3 and start getting into it. It is awfully late. Let me tell you the electric power story. Do you know that one?

Senator WATKINS. I am not dealing with electric power. We are going to have that later, but I would like to get the information from you.

Mr. MONTGOMERY. We are going to have brownouts in 16 States this winter and next winter because we don't have electric power enough. Edison Electric Institute only last week said, "We are going to revise downward our expansion plans." They were going to add 20 or 24 million kilowatt capacity to the present capacity of around 52 million. Why did they say that? Because for a few weeks from October 23 to the end of November, the rate of increase in power consumption over the year before had become a little smaller increase than before, and just with that little change, they all of a sudden said, "Now we are going to have to revise downward our estimates."

Senator WATKINS. That is all very interesting.

Mr. MONTGOMERY. The power people that look at this know that we need 80,000,000 new kilowatts between now and 1965 or 1970, and we have got to start building them now.

Senator WATKINS. That is all very interesting, but I would like to get your assurance that you are going to get me this information that I asked for.

Mr. MONTGOMERY. I was just saying that I could get a lot of people to work with me in getting that testimony if you will set yourself up here January 3 and let us go after it. You don't want to rely on me, Senator. I am just one of the guys.

Senator WATKINS. I am persuaded to think probably you have a point, that we do have those materials, and I come from a State that is now interested in the manufacture of steel, and I would like to know about it for my own information, as an individual, and, of course, as a public official charged with some responsibility. If you can help us, we will appreciate it. Will you furnish it?

Mr. BERQUIST. Is not it true that the kilowatt rate or production of new power equipment is running as high or higher now than it ever has?

Mr. MONTGOMERY. It is another bottleneck. We only have three big companies that can make large generators. I understand one of them is Westinghouse Electric. I have a report here from Westinghouse that they cannot get steel. Andrew H. Phelps, vice president in charge of purchasing of the Westinghouse Electric, cited August steel production of nearly 7½ million tons as the equivalent of about 90 million tons a year.

> This is still inadequate to handle all of the programs we now have with us and those which will arise in the future. Steel must be provided to care for the increases in population, normal wear and tear, and new developments.

Mr. Phelps added:

> Some of our steel shortages are temporary, but many of them, I feel, will be with us for several years.

Mr. BERQUIST. That raises a question of some priority in steel for more essential uses, is not that right?

Mr. MONTGOMERY. Can we go into that?

Mr. BERQUIST. You do raise the question on that, isn't that right?

Mr. MONTGOMERY. Certainly, and I would like to go into this voluntary allocation program which the steel industry is very busy selling us now. You see, in October they told these people who came in for allocations in the voluntary programs, there was not going to be any more; it was all washed up. And now, on November 3, they started very busily saying how much they want to voluntarily allocate steel. So they have cooked up a lot of programs between November 3 and now in the hope that the Congress will think that that stuff will work, when the experience last year proved it won't work.

Mr. BERQUIST. We should not have dropped the compulsory controls we had in the fall of 1946.

Mr. MONTGOMERY. I agree with you.

Senator FLANDERS. I think that it would be a good idea, and you are nearly through, to finish it up.

Mr. MONTGOMERY. Let me tell Senator Watkins that in the New York Times of December 14, the Aluminum Co. puts out notice that it is going to shut down its Niagara Falls smelter in February—

not enough power. From Alcoa, Tenn., comes the report that 1,000 employees are being laid off during the next 5 or 6 weeks.

Senator FLANDERS. That is also in your testimony.

Mr. MONTGOMERY. Yes, sir.

Senator FLANDERS. Will you proceed with your statement?

Mr. MONTGOMERY (reading):

During the past few months—

said Bonneville Power Administrator Paul Raver last September—

I have turned away applicants for nearly a quarter of a million of industrial kilowatts because I do not have them to sell. The inability to provide power for these plants is costing the region employment opportunities for 25,000 men, and a loss of taxable wealth amounting to about $25,000,000 in plant investment alone.

These are just the high spots. It is not a likely story to tell about America, but more and more the evidence accumulates that we need a new outlook on the part of those who plan and execute investments in future productive capacity.

Businessmen may tell you that this is why they need even greater profits, but the fact is they are not finding outlets for the high profits they are collecting now. They may tell you that costs are too high and that they are waiting for the collapse which they seem to think is inevitable.

This adds up to a failure to accept the grave public responsibility that flows from the power which managements of big business have concentrated in their hands. While public policy sets up stabilized full employment as a basic national goal, these men set their sights on repeated boom and bust as the path of the future. Planning for the worst, they will inevitably bring it about, if they have their way.

This is our view of the challenge which the high-profit policies of big business throw up to Congress. It is not a matter merely of restraining greed. It is a matter of protecting the job opportunities and the basic welfare of all the American people. We want excess profits to be taxed, and we want the bottlenecks removed in steel, power, aluminum, and other basic necessities of our industrial life. If industry won't do it, the Government must. The future of this country must not be put in jeopardy by the managers of giant industry whose grasp for power exceeds their vision.

Senator FLANDERS. Mr. Montgomery, I noted a few questions as you read your report. I would like to put them to you.

One of the things that I believe we had clearly in our minds as a result of the discussions by Professors Slichter and Harris, Mr. Paton, who is a member of the Committee on Accounting Procedures, and whose report you read; also 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 charge 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 to one and I will talk now to 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, but 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 someone 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 overstated for the reasons given by Sumner Slichter, and that there is official accounting 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.

Now I would just like to say a little word about that joy ride and give you, if you are willing to listen to testimony from the top seat instead of from the bottom seat, my analysis of the great mistake which the National Association of Manufacturers made when it told us, so repeatedly and so strongly and apparently so convincingly, that if we took off price controls, competition would bring prices down.

They forgot that we were in a period of full employment and that production would not easily and automatically increase and in so forgetting they made a bad mistake and none of us, whether we are manufacturers or labor leaders or businessmen or bankers or what we are, must forget that we were up to a ceiling for production through which it will be hard to break and that mere increase in money incomes, whether by profits, by dividends, by interest, by wages, or what have you, will not raise the standard of living if we are up against a production ceiling.

Excuse me, I will withdraw from my position of testifying although I would be glad to listen to your comments on that statement of mine.

Mr. MONTGOMERY. You and I certainly are in agreement that N. A. M., when they made that statement, were wrong. I am not in agreement that it was a mistake. I think you are more charitable in the approach you take to it. That was in June 1946 that the blow was dealt to price control.

I have here the shoe industry, their production index, of the Federal Reserve Board in June 1946 was 142. Their wholesale price index for shoes was 130. Now let us see how production increased as N. A. M. said it would and drive prices down.

The production index went from 142 in June 1946, to 114 in the first half of 1947, 118 in the second half of 1947, and it averaged 116 in the first 9 months of the year as compared with 142 the peak month when the N. A. M. said the production would go up.

Senator FLANDERS. Everybody was working. Everybody was working, why did they not produce?

Mr. MONTGOMERY. There are a lot of lay-offs in shoe towns.

Senator FLANDERS. Not very many.

Mr. MONTGOMERY. I have many papers here, Senator——

Senator FLANDERS. You are in the same trouble we are up here.

Mr. MONTGOMERY. Yes, here is just one, a Washington Post story of November 13, they picked an unlucky day.

WHITE PLAINS, N. Y.—The General Electric Co.——

Senator FLANDERS. What year?

Mr. MONTGOMERY. This year.

Senator FLANDERS. We are talking about 1946.

Mr. MONTGOMERY. I thought you said everybody is working.

Senator FLANDERS. No.

Senator WATKINS. You were talking about shoes and not electricity.

Mr. MONTGOMERY. Certainly not everybody is working if the production has been cut from 142 to 114. While that was going on the wholesale price index went from a peak of 130 to 190.

Cotton goods for the peak month, November 1946, production index 164, down to 140. The wholesale price index went from 175 up to 212.

Woolen and worsted goods——

Senator FLANDERS. These dates are what?

Mr. MONTGOMERY. As compared to peak month in the case of shoes, June 1946. In the case of cotton goods the peak month was November 1946.

The last figure I gave is 9 months of this year, the first 9 months average. Cotton goods production down from 164 to 140 and the wholesale price index up from 175 to 212.

Senator FLANDERS. That is between 1946 and 1948?

Mr. MONTGOMERY. November 1946 and 9 months of 1948.

The woolen worsted peak was September 1946 with peak production of 184.

Senator FLANDERS. By the way, is that index on yardage?

Mr. MONTGOMERY. Yes, that is the Federal Reserve index based on units of output.

Senator FLANDERS. Our testimony yesterday or a day before indicated that the yardage has gone down on account of the increase in the quality of the goods, which are produced, which means a smaller yardage production.

Mr. MONTGOMERY. Well, there may be some slight error in the Federal Reserve Board index, production index, but this is a very major drop, 24 points or 15 percent decrease.

Senator WATKINS. Was that on woolen goods?

Mr. MONTGOMERY. Cotton.

Senator WATKINS. We were talking about the other day.

Mr. MONTGOMERY. Woolen and worsteds peak for September 1946 was 184, and it averaged 167 through the first 9 months of this year and has reached very much lower figures in the last month, 132 or 127 in recent months. The wholesale price index for the peak month of September 1946 was 114 and has gone up to 146.

Senator WATKINS. You had reference, did you not, Senator, to the testimony by the president of the American Woolen Co.?

Senator FLANDERS. Yes.

Senator WATKINS. That because of the demand now for higher quality goods the actual yardage production had fallen off?

Senator FLANDERS. Well, I introduced this colloquy to indicate that there are difficulties in expanding production under conditions of full employment and those have on the whole subsisted throughout all of the period since the war's end.

Mr. MONTGOMERY. That, Senator, is why I want to read you about these lay-offs in November 1948.

Senator FLANDERS. Well, the N. A. M. made its mistake in 1945.

Mr. MONTGOMERY. Well, if they had difficulty during that time because of full employment they are now getting relief from that difficulty, but instead of doing something about it they are letting people off from work.

Senator FLANDERS. Now on page 2, the beginning of the last paragraph, I completely subscribe to your suggestion that to avoid this vicious cycle we want to work toward small unit profits on large output.

That is a policy which will be for the best interest in the long run of both business and consumers and all of us together.

Now I find what seems to me to be a rather peculiar statement at the foot of page 2 which reads:

> The temptation of quick profits has created black markets and black markets have created further inefficiencies.

How do high prices create black markets?

Mr. MONTGOMERY. I say that the people have turned their goods loose into the black market because they could get a lot of profit by doing so. These black markets we hear about in steel would not exist if that were not true.

Senator FLANDERS. The black markets you say, created quick profits. I think you have that turned around.

Mr. MONTGOMERY. I think it will work both ways, do you not?

Senator FLANDERS. Was it not the fact that the current prices of steel were below the economic price that created the black market instead of there being high prices that created the black market?

Mr. MONTGOMERY. You are looking at the economic forces and I am looking at the devil. I do not think we would have black markets if these fine steel officials who come here talking to you did not turn the steel over to the people who put it into the market. Like Ford Motor Co., it says it has canceled 24 dealers' franchises because of these bad dealer practices out of 7,000 in the country.

Senator FLANDERS. That is aside from my question to you, in here where you apparently say that high prices create black markets and I think that we would challenge that statement if that is what you mean. It is prices below what customers are willing to pay that creates the black market.

Mr. MONTGOMERY. On that point that you made before about small unit profits, you had somebody here from Studebaker.

Senator FLANDERS. But you are not answering this remark I just made.

Mr. MONTGOMERY. I agree with that, Senator. I think the result is the same; it has created a great deal of inefficiency in our production and a manufacturer has to scramble all over the place to get steel and that makes for additional expenses.

Senator FLANDERS. That is perfectly true.

Mr. MONTGOMERY. On the point you made on small unit profits, I noted that a man from Studebaker told you about the break-even point. We think that a corporation that notoriously followed the high unit profit policy will be before you next Monday by Mr. C. E. Wilson of General Motors and we would very much appreciate it if you would ask C. E. Wilson about his break-even point, or rather, ask him at what reduction below his present level of output would he get down to a 10 percent, an 8 percent or 6 percent return on his investment?

Senator FLANDERS. I am prepared to ask him questions of that sort.

Mr. MONTGOMERY. That is good. On the question we discussed here this afternoon at some length about whether or not these reports to the stockholders conceal profits or whether they do not. He has been quoted as saying that over a period of years these differences offset each other. He is talking about the differences in income as reported to the stockholders and the income as defined by the Bureau of Internal Revenue. Characteristically, the income reported to his stockholders is smaller than that which he has to pay taxes on to the Government.

We would like to find out from him, if you will ask him, in what years General Motors reported more to the stockholders than they did to the Internal Revenue Bureau.

We think it is characteristic of his statements that he always reports less to the stockholders and to the public than he has to pay taxes on, but maybe he could clarify that for you.

Senator FLANDERS. Now these next pages here, 5 and 6 and so on, relate to this same inventory question in which you disagree with the past president of the Accountant's Institute under whom that report you read was made and with one of the men who made it, that disagreed with the report. There is no doubt in their minds whatsoever but that these inventory profits are profits which cannot be distributed under present conditions unless you want to borrow money or hire money or get new money to distribute them with.

This question of inventory reserves, setting up reserves for depreciation of inventory, is an entirely separate question which did not come up and on which we asked no questions and which I think is properly a subject for questioning in the case of any industry before us. It is, however, a question which every businessman has to face and it is completely a matter of judgment as to whether it should be set up and how much. But, that question was not before us at all.

There was also the question of depreciation reserves which was raised by Sumner Slichter and again on which we questioned the two representative accountants before us and I think I am right in recollecting that there was no doubt in the minds of the two men, the two accountants, but that there was serious embarrassment when a company had to replace worn out equipment with equipment of a higher value.

I think you yourself indicated that you might have to get new capital to do it. In other words, you might have to get new capital to continue in business at the old rate.

One of the things that was brought out of the discussion was that we should not so much consider depreciation on a unit of production, as depreciation on equivalent production.

Mr. MONTGOMERY. Pardon me, equivalent production?

Senator FLANDERS. Yes.

You yourself have referred to that here somewhere when you say that the new machinery may be so much more productive than the old that there may be an increase in cost. The accountants and I think any businessman who faces the matter could agree completely that what you do is not necessarily to replace one machine with another, but that you must have some funds for replacing one piece of equipment or set of equipment with something which will produce the same amount even though it be of entirely different design and may cost more or less.

My guess is that it would cost a whale of a lot more.

Mr. MONTGOMERY. The official position of the Institute of Accountants is that it is not the function of depreciation reserve to do more than to meet the cost of the machine that is worn out.

Senator FLANDERS. But also the conservative past president felt that if it was necessary to spend more for what you were going to use for replacing equipment, then it was perfectly proper and desirable to put that in the form of a footnote, but he did want it to go into the books and there was one point on which the more radical accountants admitted that there was great difficulty in setting up a formula for putting that thing into the books.

Let us see if there is anything else.

I am sorry about your support of the undistributed-profits tax at the bottom of page 12 because that certainly is going to make it that much more difficult to finance replacements or expansions and that brings us to the question of whether to finance it out of profits or whether to finance it in the capital market.

Now, will you imagine, Mr. Montgomery, that you are running a business and that you need money for replacing worn out machinery, or that you want to expand operations and employ more people, and that you are faced with the question of how to get it.

One way to get it is for you to declare out most of your profits in dividends and hope to get it back. Now, that is a highly dubious undertaking, is it not, for you as an individual businessman? I assume that in suggesting that policy you are suggesting that all businesses do it. Can our individual man safely determine to work it on that basis?

Mr. MONTGOMERY. My first job, Senator, was in Wall Street, and that was back in 1919, a long time ago. At that time we used to think that Wall Street was the money market for American industry, and that is where money came that was seeking investment and that is where business came seeking capital. I think the National City Bank still writes it up that way and still thinks that there is a market place where these things are balanced and the right decisions are made by the impersonal forces of the market.

If it is true that the businessman cannot go to the money market and get money, then something has been added.

Senator FLANDERS. We have had testimony practically from every witness to this effect, most of them indicating that they had tried it. Mr. Francis of General Foods floated, by good fortune, a comparatively small issue at the top of the market but he could not have done it a few weeks before or a few weeks after.

Mr. MONTGOMERY. I wonder how much preference there is to getting it out of profits because that is so much easier to do?

Senator FLANDERS. You can throw that into reverse by saying that earnings seemed to be so necessary. The fundamental thing is, what is the stage of the money market?

Mr. MONTGOMERY. Senator, if your are right, and I would not be at all surprised, but what you are, and I think you recognize in this statement that that is the way American industry is going to be financed. Then I drew what seems to me to be a correct conclusion.

If that is so, it means that industry through the prices it charges is going to collect not only enough to meet cost and a return on its securities at an interest rate or something better, 10 percent or whatnot, on its capital stock, it is also going to collect the new capital from the consumers in the form of high prices and profits.

I say that very seriously raises the question, who will give the consuming public an equity in their investment? I do not see who can do it but the Government. I think there are very long-range implications in this state of affairs which you are describing.

Senator FLANDERS. There are very long-range implications, but I suggested that you might think what you might do as an individual businessman who could not get equity capital on any terms that you could afford to get it on. What would you do?

Mr. MONTGOMERY. I would probably do what the other businessman does. But you are asking me a group of hypothetical questions. Why is it that I cannot get it?

Senator FLANDERS. Even if you paid out all your profits in dividends, would that affect the capital market?

Mr. MONTGOMERY. It might affect the standing of my shares in the money market.

Senator FLANDERS. That question has also been raised and the present prices of the shares in the money market do not indicate that they reflect either the actual earnings positions or dividends positions of industry.

Mr. MONTGOMERY. Certainly you would agree that there would be no difficulty in raising money on bonds today and at a low rate? It is cheaper than having to pay dividends on it. What about that possibility, Senator, of raising this money by issuing bonds?

Senator FLANDERS. That is very much easier than by the sale of equities but also it has always been considered more dangerous for our economy as a whole.

Mr. MONTGOMERY. Yes, because we have always worked on the boom-and-bust theory and if we are still on that basis, God help us; that is all I can answer to that.

Senator FLANDERS. I sympathize with you completely in your theory that there is something wrong when you cannot go into the equity market.

A number of witnesses have suggested that the thing that is wrong is that the double taxation on dividends leaves so little to the investor that he prefers even to buy Governments at their present rate.

Mr. MONTGOMERY. I have been very much moved by those stories about the poor investor, Senator. It is not quite fair to ask me to weep for them. The people I work for are not quite so well off.

Senator FLANDERS. But you can take a pencil and paper and figure out whether if you had $50,000-a-year income and wanted another $1,000 a year whether it was worth it.

Mr. MONTGOMERY. Senator, if I had a $50,000-a-year income, I would hire a secretary to answer my questions for me.

Senator FLANDERS. All right.

I am sorry, gentlemen, for taking so much of this time. This is a sort of general question and I started to put it to Mr. Weinberg the other night. I do not remember whether I quite finished or not. Perhaps he may recognize it as it begins.

Mr. MONTGOMERY. Can I let him answer, I might give a different answer than he. Or, can we go into a huddle after you ask the question?

Senator FLANDERS. As a matter of fact, I do not have any recollection of his having answered.

We have here this year, just estimated, business profits of about $33,000,000,000. That is a lot, more than we ever dreamed of or imagined before. Now I am not going to put the question in such a way as to get you into a trap. I might try to do it, but I am not at all sure that I would be successful. So I am going to state it this way: Those profits are too big. All right, what should they be? Let us say that they should be half of that. Let us say, indeed, having been $33,000,000,000, they ought to be $16,500,000,000. That looks a whole lot better.

Now out of the $33,000,000,000, the Government is going to collect around $11,400,000,000 in taxes. Now for the purposes of this inquiry and this committee, we are assuming that the Government has to have $11,400,000,000—maybe it does not, maybe we can persuade the Government that it does not have to have it—but for our purposes it does. That leaves $21,600,000,000 profits after taxes for various purposes.

Supposing we cut those profits in two to $16,500,000,000 and the Government still wants $11,400,000,000. That leaves for profit after taxes $4,100,000,000 which is less than a fifth of what business would get if its profits were $33,000,000,000 instead of the one-half of that, or $16,500,000,000.

82989—49——29

In other words, the tax necessities of the Government enter into the Government's necessity for high profits in a very direct way. Now with the testimony we have been having from some of those who go to accumulate this $21,600,000,000 of profits after taxes, makes on the face of it a pretty good picture for its all being necessary.

Now these businesses, and you would dispute as to some of the requirements, whether they were necessary or not, in fact you have been disagreeing with them if I have understood you, but it is still a terrific drop from $21,600,000,000 down to $4,100,000,000, and I think any of us would agree that cutting profits in two with present taxation would leave an absurdly small amount of available business profits.

So, I think we have to consider in the aggregate, and do we not have to take into account in the aggregate, some measure of governmental necessity for big profits under the present fiscal limitations under which we are working?

Mr. MONTGOMERY. Was it not a Republican Congress, Senator, that cut some $4,800,000,000 off of the income taxes last year, mostly off the well-to-do who will not now buy your equity shares?

Senator FLANDERS. Wait a minute, I do not think in the aggregate that was mostly off the well-to-do. The individual well-to-do got more taken off but in the aggregate the amount taken off the lower incomes was very large indeed.

Mr. MONTGOMERY. As I remember the figures, about 70 percent went to those above $5,000 income. Maybe you do not call them well-to-do.

Senator FLANDERS. What do you think, sir, about the Government's requirement for taxes? Does it not have an interest in profits?

Mr. MONTGOMERY. It certainly has interest in taxes but let us spell it out further. If industry follows the policy which it is following of collecting too high profits, and it has the effect which we believe inevitably it will have of turning us upside down and bringing us into economic trouble, then the effect on Government revenues plus the effect on additional need for Government revenues is going to be greatly aggravated.

I do not know why you start with a cut in half of these profits, perhaps when you do that you come out with something that looks too small at the end. We have not said in here that profits should be cut in half, we have said that profits ought to be kept down to a level where there is no tendency in the price-wage-profit picture to turn industries into unemployment which is beginning already and which will increase and which will become serious if and when the Government stops spending for these extra things overseas and armaments. You have to link the whole thing up with the present and the future. It just is not a matter of making a reduction.

Senator FLANDERS. Mr. Herter wants to take me off the hook.

Representative HERTER. You passed out a sheet of paper a short time ago dealing with the profits of four automobile concerns?

Mr. MONTGOMERY. Correct.

Representative HERTER. Certainly the implication from that paper is that you feel that instead of running 31.2 percent on net worth, they ought to earn roughly 8 percent on net worth?

Mr. MONTGOMERY. Not at all, it is just a hypothetical statement. If you cut it to 8 percent, how much does it amount to in profit and wages?

Representative HERTER. May I just finish? You are criticizing the earnings that they are making?

Mr. MONTGOMERY. 31 percent is outrageous.

Representative HERTER. What do you think the profit should be?

Mr. MONTGOMERY. I am not going to say.

Representative HERTER. I think that is a practical question. If you are running the business, somebody has to make the decision.

Mr. MONTGOMERY. When I see a proposal that aims to get a functional relationship between wages, prices, and profits which guarantees that we are going to keep this full employment going, then I will say that is a fair profit. Profit is as profit does.

Representative HERTER. You have done some research and you must have come to a conclusion?

Mr. MONTGOMERY. It does not come to 8 percent.

Representative HERTER. No?

Mr. MONTGOMERY. No; it is a functional relationship between prices, wages, and profits. What we are talking about is a relationship which keeps the thing going year after year, so that we get a higher standard of living. We say it is too high now not because it is 31 percent, but because what is beginning to happen is that these profits mean a disparity between the consumer's purchasing power and prices and that is cutting off employment and bringing us out of this period of full employment which we ought to maintain.

Representative HERTER. Let us assume for the sake of argument that the figures that you set up, 8 percent on net worth of the automobile industry, were proper. Then you suggest that the balance of earnings should be distributed either in lowered prices or in increased wages?

Mr. MONTGOMERY, I said "if it were."

Representative HERTER. What?

Mr. MONTGOMERY. This is a purely hypothetical statement. If it were 8 percent on net worth and if it were distributed, that is all that statement before you said, sir.

Representative HERTER. Exactly, but presumably it was written for a purpose?

Mr. MONTGOMERY. For the purpose of finding out what this relationship is when the price and the profits——

Representative HERTER. I assume you have been working on this for some time?

Mr. MONTGOMERY. You are trying to read things into there that I say are not there.

Representative HERTER. Let us assume for a moment that the 80 cents per hour is a way to utilize this, the distribution of that additional, what would be the effect on the tax structure of the country as a whole?

You spoke about the tax reduction last year and it took some six or seven million people completely off the rolls.

Mr. MONTGOMERY. If you increase our wages 80 cents an hour, you will be getting more income taxes from the auto workers.

Representative HERTER. You are reducing about three-quarters, not by one-half. You are saying that the earned profits should be one-quarter under this, not one-half. Then you would have a further deficit if that were applied to all industry, a governmental deficit running into 8 or 9 billion dollars more than that. Immediately that would have to be replaced presumably, under current budgetary requirements and how would you do that?

Mr. MONTGOMERY. I would make the income tax, for example, much more progressive than it is now. I would take away this gravy that is involved in letting a husband and wife split their incomes.

Representative HERTER. Where would you go for your equity capital?

Mr. MONTGOMERY. They are not paying it now.

Representative HERTER. You have to go somewhere for the equity capital.

Mr. MONTGOMERY. Senator Flanders says he still cannot sell them equity shares.

Representative HERTER. If you pay all this out, there is nothing left for replacement or added equipment and you have to go to the equity-capital market, then where do you go?

Mr. MONTGOMERY. Your argument did not work and you cut the taxes last year in order to provide this equity capital and all of the evidence before this committee shows that it still is not there. You certainly do not want to cut it some more on those investor levels. I hope you are not thinking of that?

Representative HERTER. Clearly, to get that same amount of money you have to spread this fairly materially, do you not?

Mr. MONTGOMERY. Certainly.

This whole business about the base for taxes and sources of revenue is most certainly what we are arguing for. That is the most basic thing in the base. If you allow profit policies and what not, that are going to allow things to stand on its head, you will not have anything left for taxes.

Representative HERTER. One other thing, in a lot of the testimony that we received from the textile industry and from the food-processing industry, obviously by far the greater factor in the so-called inflationary cost, the cost of raw material is the largest factor, much larger than the wage factor.

There, would you feel that the deflationary process should begin with the agricultural community?

Mr. MONTGOMERY. I certainly do not, and I certainly wish you would get someone from the Department of Agriculture to consider that problem, as you said, you got from the food processors.

Representative HERTER. These items are the most important in the cost of living.

Mr. MONTGOMERY. That is what they said and food prices are going up and farm prices have started down and it has not been reflected in anything like that in food prices.

Representative HERTER. There will be a lag.

Mr. MONTGOMERY. A year is quite a lag in the price of bread.

Representative HERTER. Who are you referring to as being the one that maintains it? It is not the flour manufacturer?

Mr. MONTGOMERY. The bakers, the big baking companies.

Representative HERTER. Can they control the smaller baker?

Mr. MONTGOMERY. The big baking companies set the selling price of bread. When the little man tries to change it he gets put right. I had a lot of experience in that with the Federal Trade Commission. When you try to cut the price of bread below Continental Baking, believe me it happens and happens fast.

Representative HERTER. What was that, about a cent a unit?
Mr. MONTGOMERY. When they cut the price?
Representative HERTER. Yes.
Mr. MONTGOMERY. This fellow down in Fredericksburg had the impudence of making a 20-ounce loaf and selling it for the same amount that this fellow in Washington was selling an 18-ounce loaf. They sent a fellow down and he said, "I am here until you call up your pan manufacturer to buy the smaller sized pans."

He was asked, "What are you going to do if we do not?"

He was told, "We are going to sell a cheaper loaf all the way out from the District of Columbia until you get tired of selling this loaf at this price."

What did he do? He got the smaller pans.

Senator FLANDERS. That is against the law.

Mr. MONTGOMERY. Sure it is against the law and I brought him to the legal enforcement officers. He raised his price and stayed in business that way.

Senator FLANDERS. It was still against the law.

Mr. MONTGOMERY. Who is kidding who? You do not bring the law against these big fellows very often, Senator, and not in time to save the little fellow from going out of business. Should that little fellow have said, "Get out of here, you are against the law"?

Senator FLANDERS. No, but the United States Government should.

Mr. MONTGOMERY. They did take it up in Arkansas and 3 years later got a cease and desist order. That is one of the first things that you do, and then the court has to rule that it is illegal.

Then the court has to rule you have violated the court's ruling before anything can be done about it.

Senator FLANDERS. I think we have gotten into a less argumentative area than we have been up until now.

I have come out of this, sir, with the impression that maybe cutting profits in half from the standpoint of fiscal necessities of the government is a little bit too drastic but I just want to say that when you said full employment was the great thing, that you have stated the ultimate purpose of this committee and I think every one of us accepts that as the criterion, although that does not quite express it because you can have full employment in Russia.

What we want is full employment, high production, and high consumption, is that not it?

Mr. MONTGOMERY. And political liberty, believe me.

Senator FLANDERS. Yes, sir; political liberty, you bet.

Now the thing which really disturbs me in all this is that I feel we are getting into a pretty tight place where if we try to gain something here we lose something there.

You have indicated from what you have said, I think, that you believe there is a chance for sitting down with industry and on the most objective basis it is impossible for each party to attain. That would not be 100 percent on the part of either of you, but on the most objective attitude in which you can place yourselves to see where that point lies in which the long range interests of both employers and wage earners coincide because there is a point there somewhere.

Mr. MONTGOMERY. Senator, we tried to do that with C. E. Wilson, who is going to be here next Monday. In the first place he would not meet with us because he sends his employees down when we meet to negotiate wages. We raised the question of prices and they would stomp out of the room and say, "Prices are none of your damned business."

They told us that very effectively and made us strike for 13 weeks in 1946. Maybe you can persuade C. E. Wilson on Monday that it might be a good idea if he were willing to talk with labor about such matters as we are talking about today. But at last report, it was his notion that that was none of our business.

Mr. BERQUIST. I was wondering whether Mr. Reuther raised the fundamental question as to whether too much funds were taken out of profits, or wherever they came from, were going into expansion of plant and being used for raw materials rather than being made available for a supply of consumer goods?

Mr. MONTGOMERY. That depends what the greater need is. For example, they tell us we cannot expand steel because it would use too much steel.

Mr. BERQUIST. Actually a time lag there.

Mr. MONTGOMERY Actually it takes a million and a half tons of steel to increase the production 10 million tons. On a program of putting half a million tons into production every 6 months, by the end of the second year you are coming out ahead and you are making more steel.

When we got ready for the war, we were told we would not expand steel, although we did, because we added 15,000,000 ingot tons capacity. And we would not have won the war.

Mr. BERQUIST. We did not have 15,000,000. The program was 10 and we never achieved that.

Mr. MONTGOMERY. It went to 95,000,000 rated capacity.

Mr. BERQUIST. Ten million was never achieved and it fell short of that. I think the 10,000,000 program never was achieved. It takes as you say about 3 years to get it.

I was raising this question on the investment and income generated from the production of new facilities, whether you feel that may be we have gone too fast in that direction and there is some concern about that investment rate because of its drag and drain on available materials for the production of goods that are in short supply? Do you think that is still true?

Mr. MONTGOMERY. Probably a mixed picture. I do not have any doubt that we are getting ahead in a lot of less essential things but when you get down to electric power and these essential things, I do not think we are getting ahead nor are we planning to go ahead, and it takes time to make these decisions.

Mr. BERQUIST. You get into an important point there as to which direct materials ought to flow.

Mr. MONTGOMERY. That is correct.

Senator FLANDERS. Is that all, Mr. Berquist?

Mr. BERQUIST. There is one other comment. This rate of expansion has had a lot to do with the full employment picture as well. We have to credit it from that angle, the amount of employment involved in the expansion of industry coming either from profits or any other source, has done a lot for making that 60,000,000 employment figure.

Mr. MONTGOMERY. In closing, Senator, I would just like to say that all this talk of billions of dollars of profit reminds me of Mark Twain's definition of tainted profits. His definition was, do you remember? "Tain't yours and tain't mine."

Senator FLANDERS. I believe that it would be appropriate to have appear in the record your summary of the four automobile corporations.

(The summary is as follows:)

*Price reducing, wage increase possibilities, 4 auto corporations,[1] third quarter, 1948*

[Dollars in millions]

| | |
|---|---|
| Net worth, beginning of 1948 | $1, 943. 8 |
| Profit before taxes, third quarter | $270, 887 |
| Profit after taxes | $151, 808 |
| Profit after taxes as percent of net worth (percent) | 31. 2 |
| Profit before taxes required for 8 percent return after taxes | $69, 420 |
| Difference between actual and 8 percent profit before taxes, available for price reductions or wage increases | $201, 467 |
| Sales, third quarter 1948 | $1, 785, 438 |
| Number of employees (estimated)[2] | 487, 690 |
| Price reduction possible with 8 percent return [3] per hour | $0. 80 |

[1] General Motors, Chrysler, Studebaker, and Kaiser-Fraser.
[2] Based on corporations' reports for most recent period for which data published.
[3] Assuming 500 hours worked per employee per quarter.

The following revision of the above table has been submitted by Mr. Montgomery for insertion in the final record:

*Wage-increase and price-reduction possibilities of 4 auto companies [1] (third quarter, 1948)*

[Price reductions or wage increases possible if return on investment were reduced to 8 percent]

| | | |
|---|---|---|
| Combined net worth (as of Dec. 31, 1947) | | $2, 004, 023, 000 |
| Profit before taxes | | $270, 887, 000 |
| Profit after taxes | | $151, 808, 000 |
| Tax ratio percent | | 44. 0 |
| Return on investment do | | 30. 3 |
| Profit before taxes needed to have an 8-percent return on investment | | $71, 572, 000 |
| Profit before taxes | $270, 887, 000 | |
| Profit before taxes to have 8-percent return | 71, 527, 000 | |
| Difference | 199, 315, 000 | |
| Net sales | | $1, 785. 438, 000 |
| Possible price reduction percent | | 11. 2 |
| Estimated number of employees [2] | | $487, 690, 000 |
| Possible wage increase (assuming 500 hours per quarter) | | [3] 81. 7 |

[1] General Motors, Studebaker, Chrysler, and Kaiser-Frazer.
[2] Based on latest available information: (*a*) General Motors, 372,635: average for third quarter, 1948; (*b*) Chrysler, 85,577; as of December 1947; (*c*) Studebaker, 17,698; as of December 1946; (*d*) Kaiser-Frazer, 11,780: as of December 1946. Source: Moody's Industrials.
[3] Cents per hour.

Source: UAW-CIO, research and engineering department, Detroit, Mich., Jan. 5, 1949.

Senator FLANDERS. Thank you, sir.

Our next witness is Mr. Nixon, and he has agreed to make a brief presentation. It does not look too brief, but perhaps he can condense it for us.

Mr. Nixon, will you come up?

## STATEMENT OF RUSS NIXON ON BEHALF OF THE UNITED ELECTRICAL, RADIO AND MACHINE WORKERS OF AMERICA (CIO)

Mr. NIXON. My name is Russ Nixon. I am representing the United Electrical, Radio, and Machine Workers of America.

I would like to say at the outset that I appreciate very much the courtesy of yourself and the committee in providing me the opportunity to testify. I know how crowded your schedule has been, and so I particularly appreciate the opportunity to be here.

Of course, I am here representing a union that represents 570,000 workers in the electrical machinery industry. We are employed in more than 1,500 companies, including General Electric, Westinghouse, Sylvania Electric Products, General Motors (electrical division), RCA, Sperry Gyroscope, General Cable, and Philco. The UE is one of the affiliated unions of the CIO. However, this statement is presented solely on behalf of the UE and its members.

We welcome this inquiry into profits and very much appreciate the privilege of presenting our views here. The relationship of profits to prices, wages, and economic stability is of utmost importance to our membership, as indeed it is to all workers. The UE certainly does not have objections to reasonable profits, but in our opinion, industry's general all-out drive for extreme monopoly profits has lowered the standard of living of our members and now threatens to destroy our jobs and economic security.

It happens that your hearing on profits is coming at the end of a 9-year period of an all-out profit drive that has brought to industry, in the 9-year period, $202,000,000,000 in profits. This is the equivalent in profits, for each American family, of around $5,000. We think that this drive began when the defense program began back in 1940, and it has continued through the complete opening of the floodgates against inflation and the opening of the floodgates for profits at the end of the war, up until the present time. And we are sitting in this meeting under circumstances of bonanza peak profits, the bonanza apex of all time as far as profits are concerned, with a cost-price structure that is 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 in America. We are meeting at the apex of the profit drive.

The results of these 9 years of profiteering are the features of what we think is the dangerous economic crisis in which these meetings are being held. I hardly need go over them in any detail.

This profit drive began when American industry exacted heavy financial tribute for its war participation. Corporations insisted upon heavy profits through favorable tax legislation, lenient price controls and generous Government contract terms. As Donald C. Blaisdell put it in the TNEC monograph Economic Power and Political Pressures (TNEC Monograph No. 26, pp. 171–172):

> In the 1940 national defense crisis, business displayed much the same attitude that it had shown 23 years earlier. Business would help the Government and the people, but the basis of payment therefor would have to be fixed before the wheels would begin to turn. Profits, taxes, loans, and so forth, appeared more important to business than getting guns, tanks, and airplane motors into production.

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 economic results of these 9 years of extreme profiteering, the features of the economic crisis in which these timely and crucial inquiries are being conducted can be summarized as follows:

1. Inflation: The index of consumers' prices has risen from a base of 100 in 1940 to 174 today. The prices of food and clothing have more than doubled in this period. People are suffering, standards of living are falling from the $35,000,000,000 profit-inflated prices.

2. Consumers' purchasing power: As the Council of Economic Advisers reported in July 1948, even in 1947 half of the Nation's consumer spending units were falling behind in the race of income with living costs. Even then, one-fourth of the families were spending more than they were earning. By the end of 1948, roughly 50 percent of the Nation's families have less than $200 in cash. The current high flow of consumer income hides great sections of people facing real hardship and fails generally to make up for soaring prices. After 3 years of high profit prices, the reservoir of purchasing power nears depletion, current real income lags and the familiar depression-unemployment creating unbalance of productive capacity and buying power looms ahead.

3. Production and living standards: More than 3 years after the end of destructive actual war production, the to-be-expected upward trends of peaceful living conditions had not developed for most of the people. In 1948, domestic consumption of food decreased around 3 percent per person. The real per capita income in the United States in 1948 has fallen 7 percent since 1946.

Representative Wolcott. Is that 3 percent from 1947?

Mr. Nixon. That is 3 percent less than 1947, sir.

At the same time, there are danger signals of unemployment that are beginning to fly throughout the country. In part these are in the fears of businessmen that are being reported, the rapid eating away of backlogs, the cancellation or orders, and so on. Unfortunately, in addition to these fears, there is the actuality of lay-offs; and in the industries, the section of our industry that deals with electrical appliances, this is particularly true.

This is the parallel of the $35,000,000,000 profit economy, and is hard to explain to working people who know the war is over and 10,000,000 citizens have returned to civilian and potentially productive status. They ask, where are the fruits of peace? They mean something other than the $35,000,000,000 profits of 1948.

4. Unemployment: 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 |
| Hotplates | −38 | Ironers | −10 |
| Heating pads | −33 | Water heaters | −7 |
| Heaters | −26 | Vacuum cleaners | −6 |
| Irons | −25 | | |

[1] These are based on sales figures report by the National Electrical Manufacturea' 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.

We are very much concerned at the beginnings of these lay-offs, and we realize that the reason for this is that the savings that have been put aside for a new car, for a refrigerator or washing machine, have been spent in the past years to pay profit-inflated prices for food and clothing. We are deeply concerned because we think that the peacetime economy today is on very shaky foundations.

We think one other feature that has to be mentioned in passing, as we outline the current economic results of these years of profiteering, is the tremendous growth of economic concentration in the country, a growth of concentratlon that developed during the war and that was consolidated in the immediate postwar years.

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 the 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.

We think it is important to emphasize that the profit situation with which this committee is concerned cannot be separated from the monopoly situation which has dangerously developed in our country.

Senator FLANDERS. I would suggest at this point which you seem to have reached in your statement, that you pay particular attention to this program to curb the profiteers. As I look at it, much of the rest of it parallels and supports positions that have already been maintained before us.

Mr. NIXON. I will go through that very rapidly.

Senator FLANDERS. This profiteering program seems to be something new from what we have heard, and you might well concentrate on that.

Mr. NIXON. All right, and I have only a few points in the other part that I want to emphasize. I will go very quickly.

Representative WOLCOTT. Before you get into that, Mr. Nixon, to what do you attribute these declines in production that are set forth in your statement?

Mr. NIXON. To the inability to sell the product. The salesmen are reporting they have their shelves filled and they can't get rid of them.

Representative WOLCOTT. Is that due to the fact that they are overpriced?

Mr. NIXON. We don't think the people have the money. They call it consumers' resistance. That is a fancy name for saying people don't have the money.

Representative WOLCOTT. It is not because people have enough coffee makers or hotplates, and you have not mentioned refrigerators, but I think the same must apply to that. It is not because they have enough of them; it is because they have been priced out of the market, is that right?

Mr. NIXON. That is our judgment about it.

Senator FLANDERS. How much influence would you lay to the reimposition of regulation W with regard to those goods?

Mr. NIXON. I can only give you an offhand impression. We have talked about that, and we don't have any definite statistical indication We think it has some influence, but not a decisive influence. We think the real influence is the people just don't have the money to buy them.

Senator FLANDERS. All right.

Mr. NIXON. As you can gather, we are deeply concerned about this general profit situation, and we feel it has to be stopped if we are to avoid a very serious impact on our economy. We project here the suggestion that the famous "One Hundred Days" of Roosevelt's first 3 months in 1933 need to be duplicated, beginning in January, with a program of reform, financial reform, that will change the flow of income from profiteers to the people. We suggest the general outlines of such a program. The following steps are outlined:

1. Immediate emergency action to stop all further price increases in essential goods. This emergency action to be followed by strict price controls with vigorous enforcement. All further talk of "stand-by" controls or a "wait-and-see" attitude must be cast aside by immediate action which accepts the fact of existing inflation and the further fact of its increasing danger.

2. Wage increases must be granted generally throughout American industry, not only to make up for soaring prices but to give labor adequate share of the greatly increased productivity of men and machines since the war's end.

3. A broad program of social legislation providing improved social security, housing, health insurance, and aid to education must be enacted.

4. 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.

A strong program is necessary because of the extremes to which profiteering has been carried. No lesser program can be counted upon really to change the flow of income in the direction of the average consumer and thus avoid the replica of a 1929 profits-boom and collapse in 1949.

The statistics of profits are well known to this committee. While economists may argue at length as to how to express "profits," and some may try to use these arguments to smokescreen the facts of exorbitant profits, the basic conception of profits as wealth gained over costs, and profits as the rate of increase in wealth gained per dollar invested in an enterprise, are well established and measurable.

Corporate profits before taxes in the third quarter of 1948 were running at the annual rate of 35 billion dollars a year, and profits after taxes were at the rate of 21.4 billion dollars a year. The rate of profits after taxes was 3.3 billion dollars greater than in 1947 and 2½ times the profits in the boom year, 1929.

During the war, the base years 1936–39 were made by congressional law the normal base from which to compute the excess-profits tax. The rate of profits before taxes in the third quarter of 1948 were more than six times greater than this 1936–39 average.

During the war, corporations registered their peak profits of 10.4 billion dollars in 1943. The current rate of net profits is more than double that wartime peak.

[In billions of dollars]

| | Corporate profits | |
|---|---|---|
| | Before taxes | After taxes |
| 1948, third quarter at annual rate | 35.0 | 21.4 |
| 1947 | 29.8 | 18.1 |
| 1943 | 24.5 | 10.4 |
| 1936–39 | 5.4 | 4.1 |
| 1929 | 9.8 | 8.4 |

Source: U. S. Department of Commerce.

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 [1] (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.

Big business and finance have used every device and resource in their campaign to avoid responsibility for their profiteering. They have attempted to hide the fact of their profiteering, to minimize the extent of corporate profits and, finally, to seek to justify with involved economic rationalizations their profiteering excesses.

Now, I agree with Senator Flanders that much of the next section has been covered, and so I would only like to emphasize a couple of points in agreement with some of the remarks of Mr. Montgomery.

We, too, were shocked to hear Professor Slichter say that the corporations were exaggreating the profits they have been receiving. This, of course, is just the contrary of our experience and of every normal expectation under the circumstances. I think that Senator Flanders' statement to the press at the opening of these hearings, to the effect that some corporations were refusing to come to these hearings, is a further indication of this fact.

Every trade-unionist who has ever engaged in collective bargaining knows that one of the principal tasks of the union is to ferret out the hidden profits of the company—profits that are hidden in order to avoid demands for wage increases. The standard practice for employers, particularly as wage negotiations approach, is to plead poverty, and most corporations are careful in between times to say as little as possible to undermine their poverty plea. Not only are corporations moved to understate their profits because of wage

[1] 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.

demands, but they seek such understatement to the maximum degree possible to avoid the imposition of further profits taxes and controls which would result of an aroused public opinion in full possession of profits facts. Moreover, it is particularly in times of high profits when the drive for concealment of true profits is at its height. It is difficult to conceive how Professor Slichter could have made such an unrealistic and false observation.

It is no accident that corporations and the business organizations refer almost exclusively to profits as a percentage return on net sales rather than as a percentage return on investment. In the national magazines, the press, the forums, and the lecture halls, the spokesmen for big business busily present profit figures calculated to hide the fact, for example, that the return on the investment in 1947 of GE was 26 percent, of the Philco Corp. was 27 percent, of the Westinghouse Electric Corp. was 14 percent, and of General Motors was 20 percent.

This committee is aware of the constant emphasis put upon the alleged low rate of profit per sales dollar. From this allegation are 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 apoligists. 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 arguments against such emphasis on expressing profits purely as cents on the dollar arise from the fact that it hides a pyramiding of profits and it is used to create the impression that there is a very narrow margin or no margin through which you can expect to have a reduction of prices or an increase in wages. It ignores the fact that any product is sold several times in the intermediate processes before it finally is sold to the consumer. In actuality, there is a much larger margin than the 7 cents, for example, that the NAM advertises as the margin of profit per dollar of sales. This fact is clear to anyone who recognizes that there are processors' sales that lie behind the final, ultimate sale.

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.

The phony "cents on the sales dollar" formula also conceals the actual extent of profit per worker. In manufacturing, for example, profits before taxes per worker amounted to $1,145 in 1947. As a result of wage increases, BLS weekly earnings in manufacturing, increased by approximately $7 a week in 1947, or on an annual basis by $364 per year. These wage increases could easily have been absorbed out of profits. Instead, prices of manufacturing groups were increased in this period by about 19 percent.

Examples of propagandistic confusion and misrepresentation of the profit-wage relationship could easily be multiplied.

Now, I want to emphasize to this committee the fact that in our opinion, there is a definite effort by industry to disguise the actual volume of profits, and to hide from the wrath of the people if they knew how much the profits actually amounted to. This goes on in many sections of the press, in national magazines, over the radio, and by corporate spokesmen, and it would seem to us that one of the best services of this committee would be to help clarify public understanding on this question.

If I might, I would like to make just one typical example of what I think to be deliberate distortion, misrepresentation, and confusion of the actual profits situation. This is only by way of example, to show you a typical example.

You are all familiar with this magazine, the U. S. News and World Report. It is an important magazine, and on December 10 it had a pictogram that it labeled, "The Wage-Profit Split, Shares of the United States Income," and that is an important concept, and it shows money bags representing various volumes of income—dividends $7,000,000,000; undistributed profits $13,000,000,000; wages and salaries $111,000,000,000; and you are supposed to look at this and draw the impression, "Look how small profits are and how big wages and salaries are."

There are some very important areas of misrepresentation in this example. For one thing, instead of having one money bag for profits, it is divided into two money bags. That is a convenient way to avoid a clear comparison.

For another thing, profits are reported after taxes; and wages and salaries are reported before taxes.

And one point, just to illustrate how easy it is to mix up on some of these misrepresentations, that I didn't put in my text, is that the profits, of course, refer to corporate profits, and the wages and salaries refer to all wages and salaries in the economy as a whole, including nonincorporated outfits.

Of course, in the money bag of wages is included the salaries and bonuses of executives.

If you were to have a clear and equitable comparison of profits before taxes for corporations, with wages and salaries other than executives, corporate executives, before taxes, you would have a money bag of $34,000,000,000 for profits, and a money bag for wages and salaries of $82,000,000,000. I suggest that that is the correct comparison, and that in this example you have a typical expression of the campaign that goes on daily to misrepresent the relationship of wages and profits.

Of course, we could multiply these examples. I merely cite it as one of the important reasons why the work of this committee has a real role to play in clarifying the understanding of the people as far as the relationship of profits and wages is concerned.

Such propaganda devices repeated over and over again by newspapers, magazines, and radios seeking to satisfy the prejudices and special interests of big business, serve not to enlighten but to confuse and mislead the public. This committee might well make it its business to evaluate this propaganda and to learn how much money American corporations are including in their costs for such public misrepresentation. This dishonest and damaging type of economic misrepresentation which is so extensively fed to the American people by American industry propagandists not only should be noted by this committee but should be directly repudiated in the interests of public understanding.

In connection with what we have described as the corporate efforts to minimize profits, the handling of the question that Professor Slichter raised on the question of replacement cost and counting inventory gains as profits, I have with one exception only to repeat and fortify the arguments that Mr. Montgomery has given you. I will not repeat those; I support those arguments. But there is one point I want to make, and that has to do with the argument that Mr. Slichter raised on the question of inventory replacement.

I think that there is room for discussion among accountants, cost accountants, in which they discuss how to fix the books on this question. The argument that Slichter raises, however, really has to do with how to express the volume of profit and not with what is the extent of the profit.

Of course, if physical equipment is to be depreciated at replacement prices rather than original historical costs, then this will, to the extent of the increased depreciation, lessen the profits reported annually. What is ignored is 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 would leave the actual profits unchanged. And this discussion, in our opinion, only boils down to a question of which is the better way to distribute the profit—through declaration of a windfall profit or gain for the owners, or through a greater profit being declared each year because of the depreciation at the original historical costs.

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. There is no other way to express it.

The same holds true for the claim that inventory gains should not be counted as profits. The simple fact is that they 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.

To an amazing degree, corporations have achieved acceptance of their practice of referring to corporate profits only after taxes. In many respects, profits before taxes are equally or even more significant than profits after taxes. This is true so far as consideration of prices and wages are concerned, since their impact is on the total volume of profits before taxes. The inequity of this practice of expressing profits after taxes becomes clear when it is realized that wages and salaries are never reported after taxes.

An effort is often made to create the impression that American corporations are somehow the victims of financial, accounting, and taxation procedures over which they have no influence and which are thus designed cruelly to lay bare the corporations' innermost financial secrets. Nothing could be further from the truth. The loopholes that exist in financial reporting requirements and tax laws generally are to the advantage of corporations. One of the most fruitful areas of inquiry by this subcommittee could be to learn the real extent, for example, of the special corporate contingency funds and the circumstances under which they are created and not reported as profits.

The reported profits that remain apparent to the public after all efforts to conceal and minimize, must somehow be justified for purpose of "public relations." For this purpose the simple argument is used that high profits must be permitted in order to permit the formation of risk capital. In presenting this argument, usually some worthy but small free enterpriser is used as a front behind which the giant monopolies seek to maintain and justify their huge monopoly nonrisk profits. It is the old case of giant corporations using the "widow and orphan stockholder" disguise, except in this case they usually use a risk-defying little business pioneer.

In evaluating this argument, the following points should be kept in mind. After tax profits rose close to three times, the increase in outlays for new plants and equipment between 1946 and 1947. The same probably holds true between 1947 and 1948. This means that current profit levels are not required for capital formation at the present rate.

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.

I want to make one other point on the question of the rationalization of the high profits, and that has to do with the question of equity capital and the raising of capital formation. I have been interested in the discussions that have gone on about the impossibility of raising capital in the regular financial market. It seems to me that many industrialists are coming here who are really opposed to free, private enterprise, as I understand it, because it seems to me that free, private enterprise means going to the competition of the money market, selling the product that you have—which in this case is an investment opportunity—and getting people to invest.

The thing that impresses me in much of the testimony before this committee is that whenever you ask the question, as you have, "Have you tried to raise equity capital through floating stocks, and have you failed?" there is an invariable tendency to avoid the issue; to not say, "Yes, we tried it and we could not succeed," and to my knowledge——

Senator FLANDERS. We have had that testimony, that they tried it and did not succeed.

Mr. NIXON. I know you have. I think that there are very few examples of established American corporations that have attempted to float new capital issues, new stocks, and have been unsuccessful.

Senator FLANDERS. We have had other testimony to the effect that they made inquiry of investment bankers, whose business it is, and were advised that it would not be successful.

Mr. NIXON. I understand that, and of course in that area it is difficult to evaluate how serious an effort was made.

The point is, though, that there are very few cases in which stock was issued and put out on the market and it could not be sold. I know of no significant example of that character.

It all lies somewhere back in the discussions with the money market, and not through an actual effort to float new stock issues.

It occurs to me highly improbable, Senator Flanders, that established outfits like General Electric or Westinghouse or General Motors, if they made the decision to try and raise money in the regular money market through the issuance of new stock, would not find it possible to float that stock. People generally are investing their money or saving their money in savings accounts or in bonds at 3 percent or less. These concerns have long historical records of earning income on invested capital of 10, 15, or 20 percent. It seems to me entirely improbable that under these circumstances one can realistically say that it is impossible to raise equity capital through floating on the stock market; and the fact that they have not really tried, that they have only talked about it to bankers, is in our opinion an indication that they have not really made the effort, and that if they would make the effort they would find success in it.

Now, I have a few words about our own industry before I conclude.

The foregoing general observations about the profiteering drive of American industry are specifically illustrated by profits in the electrical machinery industry and the major companies under collective bargaining contract to the UE.

For the industry as a whole, profits have mounted to new all-time highs. This is not surprising in the light of the highly profitable business being done by the General Electric Co., and the Westinghouse Electric Corp., the two dominant producers in the industry.

The rate of profits before and after taxes in 1948 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 to 1947 from U. S. Department of Commerce; profits for 1948 estimated from percentage increases in 9-month profits reports for 25 electrical companies.

## PROFITS ON INVESTMENT AT RECORD LEVELS

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.

*Percent of net profit to net worth* [1]

| | [2] 1948 | 1947 | 1945 | 1939 |
|---|---|---|---|---|
| | *Percent* | *Percent* | *Percent* | *Percent* |
| 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 PER EMPLOYEE

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 | 1945 | $708 |
| 1947 | 1,005 | 1939 | 521 |

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

In the case of the major company of General Electric, we have an enormous record of postwar profits.

For the first 9 months of 1948, General Electric's profits after taxes are at the annual rate of $127,700,000, or 34 percent above the previous record 1947 profits.

Its current rate of profits are more than double its 1945 wartime profits and more than three times its 1939 peacetime profits.

| | Profits before taxes | Profits after taxes |
|---|---|---|
| 1948 rate [1] | $217,820,000 | $127,700,000 |
| 1947 | 156,705,000 | 95,299,000 |
| 1945 | 156,105,000 | 56,541,000 |
| 1939 | 52,852,000 | 40,861,000 |

[1] Estimated from the percentage change in the first 9 months reports for 1947 and 1948.

The current rate of General Electric's net profit to net worth is at the astonishing rate of 30.9 percent. At this rate the company's profits would duplicate its net worth every 3 years. It is inconceivable to me that you couldn't float stock for General Electric Co. if you wished to. It is certain that this high rate of earnings is due in large measure to the monopoly profits arising out of the dominant position of the company in the industry.

*Percent of net profit to net worth* [1]

| | Percent | | Percent |
|---|---|---|---|
| 1948 rate | 30.9 | 1945 | 15.9 |
| 1947 | 26.3 | 1939 | 13.5 |

[1] Based on net worth consisting of capital stock, capital surplus and surpluses at beginning of fiscal year.

The estimated rate of profits before taxes for 1948 is $217,820,000, or more than $1,089 per employee. This measure is extremely significant in view of the fact that General Electric increased its prices in 1948 following a wage increase averaging $239 per year per employee.

In addition to this, there are significant areas of profit that are being hidden in the character of inventory reserves, or special reserves that have been put aside. The company'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.

One example of this which we don't entirely understand is that the report of the company to its stockholders for 1947 lists a profit of $95,000,000, and the report to the Securities and Exchange Commission lists a profit of $101,000,000.

The company—and this is relevant to the depreciation question, because in the discussions on depreciation here there has been a tendency to indicate that companies are taking a licking on the depreciation question because of the increased replacement costs—in this case the company is obviously depreciating its facilities at an extremely rapid pace. Plants with an original cost of over $508,000,000 are being carried on General Electric's books at $196,000,000. During the eight years 1940–47, the company made a net investment in plant of some $276,000,000, and this is $80,000,000 more than the entire plant account on the books.

In discussing this situation of General Electric's depreciation policies back in 1945, the Wall Street Journal of June 11, 1945, had this to say:

* * * it seems likely the company will have to bring its depreciation as reported to stockholders more in line with that reported for tax purposes.

If for nothing else, this will be necessary to keep the plant from quite disappearing off the books at the depreciation rates so far applying.

In part, this excessive depreciation arises out of the fact that during the war the company spent $54,000,000 for war-emergency facilities which it was allowed to depreciate at a stepped-up rate in 5 years under special wartime tax legislation passed for the benefit of corporations. These facilities which have no book value are still productive equipment.

Senator FLANDERS. I am afraid, sir, that we will have to close. I, at least, have to leave at this time. I would like to give you an opportunity. Can you pronounce a benediction in the next 2 minutes?

Mr. NIXON. I certainly can, sir. I will leave out Westinghouse and Philco.

Senator FLANDERS. They are all on the record.

Mr. NIXON. That would repeat the general story of General Electric.

(The information referred to is as follows:)

### OTHER HIDDEN RESOURCES

While the company's statements to its stockholders for 1947 show a net profit of $95,000,000, its consolidated statements filed with the United States Securities and Exchange Commission show a net profit of $101,000,000.

### GENERAL ELECTRIC ACQUIRES GOVERNMENT WAR PLANTS

Also bearing on the line of General Electric's profits are the modern up-to-date Government war-built plants that the company was able to buy at a fraction of their cost. General Electric purchased 14 such plants costing $33,800,000 from the War Assets Administration for only $20,500,000 (War Assets Administration Report on Relations between Plant Disposal and Industrial Concentration, December 31, 1946). Thus, in a period of inflation, General Electric was able to buy plants at 39 percent below the cost of building them.

In addition, at no cost to itself, the company, through its operation of the Government atomic plant at Harford, Wash., is getting the scientific theory, know-how, and trained personnel to dominate the future of atomic energy.

### COMPANY'S PROPAGANDA CAMPAIGN

Using an estimated $1,000,000 of its monopoly profits, the company has undertaken one of the most intensive propaganda drives ever initiated by a corporation to bring to the public the advantages of the NAM way of life. An important part of its propaganda echoes the usual NAM profit-concealing devices.

The company tells its workers it makes only 8 cents on the sales dollar, but it conceals the fact that its postwar profits have been far above war and prewar levels.

By using the sales dollar hoax the company misrepresents the actual profit entering into the final product as it passes from the steel, copper, railroad, and other industries which supply material to General Electric, and to the jobbers and retailers who sell the final product. If each of these were to make the same rate of profit on the value they created as General Electric, their total profits would add up to 21 cents on the sales dollar in 1947.

Actually, this percent of profit is far greater than 21 cents in the case of General Electric, for it was impossible to separate out of its figures the salaries, bonuses, and pensions going to its top officials, or to estimate company inventory and excessive depreciation reserves.

### SOME QUESTIONS FOR GENERAL ELECTRIC

There are some questions we believe this Senate committee should direct at the representatives of the General Electric Co. when they testify on Monday. We believe the answers to these questions would throw considerable light on the extent of and reason for the company's profits:

1. Are the company's depreciation charges as shown on its published financial statements greater than those reported for income-tax purposes, and if so, to what extent?

2. Are the company's reserves for possible inventory decline allowed as deductions from income for tax purposes by the Bureau of Internal Revenue?

3. Why does the company's statement of profits for 1947 as reported to its stockholders understate its profits as reported to the United States Securities and Exchange Commission?

4. What is the cost to the company of its extensive propaganda campaign which the company has proudly described in great detail before business organizations and in business magazines throughout the country?

5. In addition, the 12 antitrust proceedings in which the company has been involved since 1940, in what lines of business, if any, does the company still have patent and price-fixing agreements?

### WESTINGHOUSE'S PROFITS

For the first 9 months of 1948 Westinghouse's profits after taxes are at the annual rate of $47,342,000, or virtually the same as its record-breaking 1947 levels.

Westinghouse's current rate of profits are almost twice as much as its 1945 wartime profits and about three and a half times over its 1939 peacetime profits.

| | Profits before taxes | Profits after taxes |
|---|---|---|
| 1948 rate estimated | $85,728,000 | $47,342,000 |
| 1947 | 88,379,000 | 48,806,000 |
| 1945 | 52,832,000 | 26,801,000 |
| 1939 | 17,037,000 | 13,854,000 |

### RETURN ON NET WORTH

The current rate of Westinghouse's net profit to net worth is at the rate of 12.8 percent, as compared to 10 percent in the war year 1945 and 7½ percent in the prewar year 1939.

Profits before taxes per Westinghouse employee in 1948 are at the estimated annual rate of $850.

### WESTINGHOUSE RESERVES

The company has set up a reserve for possible inventory declines amounting to $11,851,000 out of profits in 1947 and 1948. This was in addition to a special free reserve of $3,908,000 provided prior to 1947.

Westinghouse also had the benefit of stepped-up depreciation under the wartime tax laws. Approximately $21,624,000 of such equipment have no book value but are still productive.

From 1945 to 1947 the company has paid $8,984,000 into an annuity fund to provide pensions for its higher paid personnel. The company estimates "that all liability under the plan will be funded in advance of requirements."

Westinghouse was able to buy Government war-built plants at bargain prices. Two plants costing the Government $21,500,000 were purchased for $11,900,000.

### PHILCO'S PROFITS

Philco's profits are at phenomenally high levels. For the first 9 months of 1948 Philco's profits after taxes are at the annual rate of $11,365,000, or 18 percent above the previous record 1947 profits.

Its current rate of profits are about five times larger than its 1945 wartime profits and six times its 1939 peacetime levels.

| | Profits before taxes | Profits after taxes |
|---|---|---|
| 1948 rate estimated | $21,488,000 | $11,365,000 |
| 1947 | 18,366,000 | 9,631,000 |
| 1945 | 5,952,000 | 2,377,000 |
| 1939 | 2,431,000 | 1,899,000 |

### RETURN ON NET WORTH

The current rate of Philco's net profit to net worth is at the high rate of 26.5 percent as compared to 10.5 percent in 1945 and 12 percent in 1939.

INVENTORY RESERVES

So huge were Philco's profits that it set up three special reserves in 1947 and 1948: A reserve for research amounting to $1,176,000; a reserve for advertising amounting to $536,478; and a reserve for inventories and contingencies amounting to $4,260,000.

PROFITS PER EMPLOYEE

Profits before taxes per employee are at the exceptionally high annual rate of $1,535.

Mr. NIXON. I will close on a note which I know you will be interested in—on wages.

It is our feeling that the wage increases that the labor movement won in 1946, 1947, and 1948 helped to stave off depression by maintaining consumer purchasing power. We feel that had American corporations paralleled these wage increases with a willingness to accept moderate profits through price reductions, this Nation would not face today's dangers of inflation and unemployment. In making its demands for further wage increases in 1949, the labor movement will be pushing forward another effort to help stabilize the economy.

The ability of American industry to pay wage increases out of its $35,000,000,000 profits cannot be seriously questioned. These huge profits have twin sources. On the one hand, the corporations have squeezed the consumers by raising prices as high as possible. On the other hand, the corporations have squeezed the workers as producers by increasing their productivity and retaining the gains of increased output for themselves. Even management in the electrical-machinery industry concedes a 19-percent increase in productivity per worker since the war. In actuality the productivity in the factories is much greater. This increased productivity should belong to all the people and should not be used solely to create a $35,000,000,000 profit level in America. The fruits of increased output must be shared with the working people to the end that their standard of living rises steadily through increased real wages and ultimately, as economic progress gains, through achievement of a 30-hour week.

Substantial wage increases are needed by all American workers to offset the economic hardships unnecessarily and unjustly suffered at the present. Electrical workers have found that peace has not improved their standard of living but that their real wages are today 13 percent less per week than they were during the war in 1944. Such a condition hurts the UE members and hurts the entire country. In seeking substantial wage increases, UE and the rest of American labor serve, as in the past, the cause of economic stability and well being for all the people.

Representative WOLCOTT. I assume from the last statement there that you consider that the United Electrical Workers have not increased their standard of living since 1944.

Mr. NIXON. Our standard of living has fallen 13 percent since 1944. The real income of workers in our industry, in the General Electric Corp., Westinghouse, and General Motors electrical division, is down 13 percent from its wartime peak.

Senator FLANDERS. Can you make that comparison with 1944 while prices were held down artificially and yet you could not get the stuff? I raise the question as to whether the actual standard of living was the same as the statistical figure for it.

Mr. Nixon. Well, of course, we only have prices for things that people were buying then.

Senator FLANDERS. But if you could get them, you could do more than I could.

Mr. NIXON. The cost-of-living index doesn't have to do with automobiles.

Senator FLANDERS. Does it have to do with, ordinarily, white shirts? I could not get them.

Mr. NIXON. Workers don't wear white shirts as much as you do, sir, but they bought shirts, and it has to do with shirts. It has to do with clothing and food.

Senator FLANDERS. Could they get as much meat as they want now and are getting now?

Mr. NIXON. Well, of course, working people aren't buying as much meat.

Senator FLANDERS. I think that you are using an artificial reference point.

Mr. NIXON. Well, it is a pretty valid statistical conception to say what is the real value of an income at a given price level, and it is about as standard a method of economic comparison as I know: What are the real wages at one period and at another period?

Senator FLANDERS. You see, what was happening in 1944 was that people could not spend their money for the standard of living statistically possible, and in consequence that money was going very fortunately into savings bonds. We did not enjoy the statistical standard of living in 1944.

Representative HERTER. How does that same figure compare with 1939, the present figure with 1939?

Mr. Nixon. I don't have those exact comparisons, and of course, it would not hold, it would be an increase since 1939 when there were 10,000,000 unemployed in the country, and of course, we had a general depressed condition.

Representative WOLCOTT. Let us not confuse standard of living with purchasing power. Would you not think the members of your union are enjoying a higher standard of living today than they did in 1944?

Mr. NIXON. I don't think that they are.

Representative WOLCOTT. They have not increased their facilities for enjoying life?

Mr. NIXON. Well, there are the ordinary differences.

Representative WOLCOTT. They have not more washing machines and they have not more electrical refrigerators and more electrical appliances and they have not more clothes?

I am asking this because the statistical matter which we have here indicates that the per capita consumption of all of these things is so much higher now than it was, and surely the United Electrical Workers would share proportionately with the other workers.

Mr. NIXON. Workers don't share proportionately in this wealth that we have these days.

Representative WOLCOTT. Well, other employees in the same income brackets.

Mr. NIXON. The trouble is, the income bracket is low. Many of these people are not making enough to make ends meet, and the indication, you know, is that 50 percent of the people have $200 cash, or less, in the country at the present time, that 25 percent of them are spending more than their income. And these are very realistic circumstances, and they describe what is happening among the working people.

Representative WOLCOTT. Now, I know an awful lot of working people, and there are a lot of working people in the neighborhood in which I live, and I know that they are a lot better off today than they were in 1939 and 1944.

What we are trying to get at, are the United Electrical Workers in any different position in that respect than the other wage earners?

Mr. NIXON. Why, members in our union are a little better off than other workers, because they are in our union. They still have these problems, sir.

Representative WOLCOTT. Of course, we all have problems.

Mr. NIXON. By "these problems," I mean the problem of maintaining a standard of living, and they are not able to do that. When they buy clothing now they pay a higher price for it than they did during the war, even though they don't have as wide a range of selectivity.

Representative WOLCOTT. They could not buy an electrical refrigerator during the war.

They were saving against the time when they could buy one, and now they have taken those savings and they have an electrical refrigerator. So their standard of living has been increased by the acquisition of an electrical refrigerator, has it not?

Mr. NIXON. No.

First, to a large extent they have not done that. They have spent the money that they saved for refrigerators for meat and for food and for clothing.

Representative WOLCOTT. There are all of these conveniences, and certainly you do not indicate they have been sold to the very wealthy people of the country solely?

Mr. NIXON. Not solely. We are generalizing now about a great many people. and my general observation is that a great many of the working people have taken their savings and spent them not to buy appliances or some of these finer things of life, but to live, in these last 3 years.

Representative WOLCOTT. Research and studies made by sociologists say that the standard of living in the United States at the present time is the highest of that enjoyed by any country in the world's history, so that people must have increased a little bit.

Mr. NIXON. Since 1944?

Representative WOLCOTT. Yes.

Mr. NIXON. I don't think so. It is a very simple thing, it——

Representative WOLCOTT. I am disappointed to hear you say that.

Mr. NIXON. We have been disappointed to have to say it for a long time, Mr. Wolcott. We don't like to say it.

Representative WOLCOTT. I think it is rather revealing, is it not?

Mr. NIXON. For example, this figure on food consumption, 3 percent less food consumption in this country.

Representative WOLCOTT. On a general basis, the per capita consumption of food is the highest of all time.

Mr. NIXON. No, it is not; it is 3 percent less this year than it was last year.

Representative WOLCOTT. We were told in our economic studies last year that one of the reasons for the high prices of meat was because the purchasing power of the public was so great that they were demanding meat when they did not before, which of course is a reflection of a little higher standard of living, is it not, more people eating more meat?

Mr. NIXON. They are eating less meat this year than last year.

Representative WOLCOTT. That is right, 3 percent less.

Mr. NIXON. That is a pretty important element in the standard of living.

Mr. BERQUIST. They are eating all of the meat that there is that is available; and even at the rate they are eating, we are depleting the source and supply of the meat stocks that we do have, so we have not even kept even with the board on that, and we have fallen a way short on that.

Mr. NIXON. Well, that may well be. I don't know what you mean by "they." Some people are eating meat and others are not.

Representative WOLCOTT. The point is that there are more people eating meat than used to eat meat.

You surprise me when you say that there are not more electrical workers eating meat than used to eat meat, because generally speaking, there are more people eating meat today than ever ate meat before.

Mr. NIXON. There is 3 percent less on a national average than there was last year, and there are a lot of people that are——

Representative WOLCOTT. And last year, I do not remember the figure, but they were eating 30 or 35 percent more meat than they ever ate before, so they can go back 30 or 35 percent, or whatever it is, before they reach the low level of the standard of living which we enjoyed before now.

Mr. NIXON. I don't know whether we enjoyed it a lot; we experienced it.

Representative WOLCOTT. Well, experienced it.

Mr. NIXON. But I think that you have to keep in mind that there are a lot of people that are eating all of the meat they want today, but there are a lot of people that are not eating any.

Representative WOLCOTT. I think that there are a lot of people who are eating too much meat.

Mr. NIXON. That is probably true, too.

Representative WOLCOTT. Thank you very much, Mr. Nixon. Senator Flanders wanted me to express our appreciation for your coming here.

We will resume the hearings in the Senate caucus room at 10 o'clock Monday morning, and I presume that representatives of the General Electric and General Motors will be before us.

(Thereupon, at 5:05 p. m., a recess was taken until 10 a. m., Monday, December 20, 1948.)

# CORPORATE PROFITS

**MONDAY, DECEMBER 20, 1948**

United States Senate,
Subcommittee on Profits of the
Joint Committee on the Economic Report,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders (chairman of the subcommittee) presiding.

Present: Senators Flanders (presiding), Watkins, and O'Mahoney, and Representatives Wolcott and Herter.

Also present: Fred E. Berquist, assistant staff director.

Senator Flanders. The hearing will come to order.

Our witness this morning is Mr. Charles E. Wilson of the General Electric Co.

Mr. Wilson, will you take the chair, please. If you have anyone with you who carries your figures along, you can ask him to sit beside you as well.

I first became acquainted with you on the War Production Board where you served a longer and more useful service than I did. I blew up sooner than you did, in other words. I think that you kept control of yourself through to the end.

Mr. Wilson. Not quite the end, Senator, but for 2 years.

Senator Flanders. You have since, of course, been called into public service by the President on more than one occasion.

You have a statement which I presume you desire to present, and it is not too long for you to do so if you wish. In accordance with the regular rules, I would like to have you identify yourself for the reporter.

## STATEMENT OF CHARLES E. WILSON, PRESIDENT, GENERAL ELECTRIC CO., ACCOMPANIED BY DONALD L. MILLHAM, CONTROLLER, GENERAL ELECTRIC CO.

Mr. Wilson. President of the General Electric Co., 570 Lexington Avenue, New York City.

Senator Flanders. You may now proceed with your statement.

Mr. Wilson. I should like at the outset, before I enter into a factual report on the figures and statistics necessary to give you the complete story on "profits" insofar as they pertain to the General Electric Co., to express something of the beliefs—the philosophy, if you will—of the General Electric Co., as they relate to the general subject of profits and prices. I note from the suggested list of topics for discussion that your committee recognizes the interrelation between these two subjects. And certainly any consideration of profits cannot be complete without some study of pricing policies as well, for both are integral parts of our economic system.

The secret of the industrial revolution and of today's industrial civilization lies in the ever-increasing liberation of man by the substitution of machines for manual labor and the development of yet more efficient machines so that man in turn may devote his time to the devising and development of new products, and to the increased production of the old goods at lower prices, thereby, in both ways, bringing a continually increasing standard of living to a larger number of people.

It is this problem of the sharing of the benefits of progress, the benefits of increased efficiency, labor-saving machinery, scientific discoveries, and increased production, which is, to my mind, fundamental to any approach to the problem of the adequacy of prices and profits. For those benefits are claimed, and rightly, by several groups: the customers, in lower prices; the workers, in shorter hours and higher wages; the owners, who have invested the risk capital, in increased income.

None of these groups can be denied.

The first subject is "sharing with consumers—price reductions." Economists have pointed out to us that the role played by price in our economic system is a multiple one.

1. It influences the purchases by the consumer in accordance with the relative intensity of his need or desire for a given product as compared with other things he could buy for the same purpose or for the same price.

2. It serves as the determining factor as to whether or not the manufacturer will produce those goods which the consumer wants.

3. In deciding the things to be produced and the prices at which they are to be sold, the industrial consumer exercises a control which is governed by the amount of income he in turn realizes from the sale of his own products.

A great portion of our business is in the development, manufacture, and sale of labor-saving devices both for the home and for industry. In this latter connection we undertake to design equipment that will save some of the time which our industrial customer spends on the production of his own product. But to make the sale, we must offer that product to him at a price which, after it goes into his costs of operations, will permit him to retain a substantial portion of the saving effected by our product. It is obvious that if we were to charge this customer an amount for our equipment that would return to us in the form of profit all of the saving in his costs obtained from the improved equipment, he simply would not buy it. It is equally obvious that if our costs of design, manufacturing, and sale of the new product are so high that our price would result in an increase in his cost of operation we would again be out of the market.

Thus it is that our design features, efficiency of the product, our cost of production, the efficiency that the customer is already obtaining in his own plant, and so forth, all have a bearing on the price a customer will pay us for the products, and on the amount of profit that we will have after paying all of our costs.

Equally significant is the bearing of competition on this factor of profit in price. For the customer for every product which we sell will be offered equipment of a somewhat different design, costing approximately the same, to perform the same function in the same plant, by any number of other electrical manufacturers. Except to the extent that our quality of product is better and its operating efficiency is higher, we could not successfully ask a price much, if any, greater than our competitor can get.

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 averages 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 the 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. Expanison 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.

Certainly there is nothing antisocial in profit. I think the truth of of the matter is that—given access to all as buyers and sellers—the profit earned by the wise businessman is a measure of the service he has rendered to his market, in terms of a value placed on those services by the buyers, individually and collectively.

The price that a customer pays to a supplier, to the extent that it covers more than the cost of making and selling the product, is compensation to the supplier for having undertaken to solve the customer's problem, for having the product available at the right time and place, and for the right which the customer enjoys of declining to accept the supplier's goods. The supplier took the risk that the customer might not like it. The risk was underwritten only to the extent of the possibility of profits that would come from efficient operation within the price determined on the basis of the factors outlined above, factors in which the force of competition looms as large as any other.

It should be borne in mind that any idea which a producer develops for the widening of his market, increasing the efficiency and attractiveness of his product, and lowering its cost, will be quickly picked up by others in the market place and adapted to their own uses. So it is that each supplier is impelled to continue his improvements at an ever-increasing rate in order to continue to prosper and grow.

It is our aim and our purpose to so conduct our business that our customers will be better served at lower prices, that our employees will have more and better jobs at high wages, and that we can continue to contribute to and to meet the needs of an expanding economy through the products and services we offer. It is our belief that in order to fulfill this objective, we must seek to make more profits for our stockholders. All of this, of course, must be done by efficient operation within the prices set by the first of these purposes and by the force of competitive conditions.

The significance of General Electric prices and profits does not end with its stockholders, its employees, or even with its customers, as independent groups. Even more important is the indirect impact upon these individuals as members of our national economy, both in peace and in war.

Next to manpower and the spirit of its people, the greatest asset of any country is the strength and productive power of its industry and agriculture. 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. With the population increasing faster than at any previous time in its history, and with that population demanding both a higher standard of living and greater security, we think American industry has its biggest job ahead. We know General Electric has. 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 with the realization of its grave responsibilities that industry seeks that profits be not condemned or prevented.

Many countries of the world are striving to replace their industrial capital that was destroyed by the war. Others are seeking the capital to provide an industrial base for their economy. How to provide an adequate capital structure seems to be the most demanding economic problem in the world today. In this country we already have a substantial capital structure. We know that it can be maintained and expanded only through reinvestment of savings of business and of individuals. We know it can best be accomplished by ever-increasing efficiency which will result in added reward to all sections of our community.

It will be apparent, from the foregoing, that 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. With this background, I should like, therefore, to turn to a portrayal of the pertinent facts of the current profit picture of our company.

I am submitting condensed figures showing a comparison of our current status with that of the immediate prewar years:

[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, 086 | 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 |

That is because there was a mild recession in 1938, as you will remember—

| | Sales | Net income | Dividends | Money at risk in the business, end of period | | |
|---|---|---|---|---|---|---|
| | | | | Total assets | Total permanent capital | Equity capital only |
| 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 |

Now, our 1948 business, as given to you for the 9 months, on a full year basis is estimated as follows:

| | Sales | Net income | Dividends | Money at risk in the business, end of period | | |
|---|---|---|---|---|---|---|
| | | | | Total assets | Total permanent capital | Equity capital only |
| 1948 (annual rate for 9 months) | $1,517,247 | $111,857 | $56,800 | $1,072,945 | $679,630 | $477,230 |

Now, I would like to call your attention to the impact of the changing volume and increased capital and so on in our business as it applies to the numbers of our employees as to the pay roll of our company. In 1935 when our sales were $232,000,000 and we had a net income of $28,000,000, we had 63,000 employees and a pay roll of $98,000,000.

Senator O'MAHONEY. Mr. Wilson, may I interrupt to ask you what your definition of permanent capital is?

Mr. WILSON. Of permanent capital? We will give you that.

Mr. MILLHAM. It is money invested by the stockholders plus long-term debt.

Senator O'MAHONEY. When you say money invested by the stockholders, I assume you mean the par value of the stock.

Mr. MILLHAM. No; I mean the par value of the stock, plus the retained earnings, undistributed earnings.

Senator O'MAHONEY. Thank you.

Mr. WILSON. Here are the rest of the figures on this chart:

| | Number of employees | Total pay-roll |
|---|---|---|
| 1935 | 63,048 | $98,403,000 |
| 1936 | 70,199 | 119,815,000 |
| 1937 | 85,947 | 163,130,000 |
| 1938 | 68,809 | 116,645,000 |
| 1939 | 71,485 | 134,534,000 |
| 1940 | 85,746 | 169,616,000 |
| 1947 | 185,696 | 559,756,000 |
| Annual rate at Sept. 30, 1948 | 196,034 | 681,526,000 |

Senator O'MAHONEY. Mr. Chairman, may I interrupt because I think it is appropriate that the record may show some additional information on this point? Back in 1929 when Mr. Hoover was President, he appointed a Special Research Committee on Social Trends, of which Dr. Wesley C. Mitchell was the chairman. This Committee in the fall of 1932 filed its report. It was entitled "Recent Social Trends," and it was printed by the Government. It contains a table entitled, "Comparison of Certain Corporations, States, and Cities With Respect to Gross Revenues and Number of Employees."

General Electric was listed as No. 7 in that compilation. Ahead of it were United States Steel Corp., with gross revenues of $1,201,000,-

000, and employees, 211,055; and second was the Great Atlantic & Pacific Tea Co., with revenues $1,053,692,882, with 40,000 employees.

General Motors Corp., $996,687,332, and employees 172,938.

The Pennsylvania Railroad System, $616,638,650, and employees were 166,607.

New York City—this is the first public body which appears on the list—with gross revenues of $611,571,726 and employees numbering 86,509.

Standard Oil Co. of Indiana, $465,752,175, with 44,520 employees.

Then comes General Electric with $396,242,631, and 78,380 employees. These figures were taken from the year 1930. I shall ask, Mr. Chairman, that the entire table be printed in the record.

Senator FLANDERS. It will be.

(The table is as follows:)

*Comparison of certain corporations, States, and cities with respect to gross revenues and number of employees, 1930*

| Corporation or political unit | Gross revenues [1] [2] | Employees [3] | Corporation or political unit | Gross revenues [1] [2] | Employees [3] |
|---|---|---|---|---|---|
| United States Steel Corp | $1,201,377,367 | 211,055 | Chicago | $241,748,819 | 41,983 |
| Great Atlantic & Pacific Tea Co | 1,053,692,882 | 40,000 | Detroit | 154,619,790 | 19,436 |
| General Motors Corp | 996,687,332 | 172,938 | Los Angeles | 152,166,523 | 16,975 |
| Pennsylvania Railroad System | 616,638,650 | 166,607 | Philadelphia | 133,522,058 | 21,997 |
| New York City | 611,571,726 | 86,509 | California | 116,919,827 | 17,495 |
| Standard Oil Co. of Indiana | 465,752,175 | 44,520 | New Jersey | 91,068,090 | 8,385 |
| General Electric Co | 396,242,631 | 78,380 | Boston | 79,095,089 | 20,606 |
| American Telephone & Telegraph Co | 292,014,871 | 324,343 | Ohio | 78,527,215 | 6,426 |
| New York State | 272,940,372 | 28,798 | Illinois | 69,901,391 | 13,134 |
| | | | North Carolina | 41,401,317 | 6,506 |
| | | | Maryland | 28,165,361 | 6.962 |
| | | | Maine | 18,014,201 | 2,500 |

[1] Corporation gross revenues include income from all sources for the year 1930. Figures from annual reports or from Standard Corporation Records. State figures are revenue receipts for 1929 and are from U. S. Bureau of the Census, Financial Statistics of States. City figures are revenue receipts for 1928 and are from U. S Bureau of the Census, Financial Statistics of Cities.

[2] These figures include a part of county receipts and receipts of special districts as allocated by the Bureau of the Census.

[3] Figures on municipal and State employees are for 1930 with the exception of the States of New York and New Jersey, which are for 1928. The figures are not necessarily comparable because some of the items include only those in the classified service; some include educational employees and others do not.

Senator O'MAHONEY. I had the Library of Congress make the same comparison for the year 1942. That was the latest available year at the time, and I think that I have a later compilation. In this table General Motors ranks No. 1, and United States Steel No. 2, and American Telephone & Telegraph No. 3, Great Atlantic & Pacific Tea Co. No. 4, and General Electric No. 5. Its gross revenue had increased to $913,656,277, and its employees to 135,939.

Mr. Chairman, I shall ask also that that full table may be printed in the record at this point.

Senator FLANDERS. It is so ordered.

(The table is as follows:)

*Comparison of certain corporations, States, and cities—gross revenues and number of employees, 1942*

| Rank in 1942 gross revenues | Corporation or political unit | Gross revenues | Employees | Rank in 1928, 30 gross revenues |
|---|---|---|---|---|
| 1 | General Motors Corp | $2,250,548,859 | 314,144 | 3 |
| 2 | United States Steel | 1,862,951,692 | 335,866 | 1 |
| 3 | American Telephone & Telegraph | 1,469,263,216 | 327,107 | 8 |
| 4 | Great Atlantic & Pacific Tea Co | 1,378,147,240 | ---------- | 2 |
| 5 | General Electric Co | 913,656,277 | 139,939 | 7 |
| 6 | Pennsylvania R. R. System | 838,474,622 | 151,604 | 4 |
| 7 | New York State | 720,306,000 | 55,873 | 9 |
| 8 | New York City | 714,653,000 | [1] 132,975 | 5 |
| 9 | California | 517,261,000 | [2] 29,010 | 14 |
| 10 | Standard Oil of Indiana | 464,558,256 | ---------- | 6 |
| 11 | Illinois | 368,572,000 | 20,999 | 18 |
| 12 | Ohio | 358,380,000 | [3] 20,277 | 17 |
| 13 | New Jersey | 202,685,000 | 13,898 | 15 |
| 14 | North Carolina | 132,662,000 | 14,616 | 19 |
| 15 | Chicago | 114,763,000 | [4] 31,318 | 10 |
| 16 | Detroit | 104,981,000 | [5] 23,758 | 11 |
| 17 | Philadelphia | 81,405,000 | [6] 19,699 | 13 |
| 18 | Boston | 77,620,000 | [7] 12,606 | 16 |
| 19 | Maryland | 76,887,000 | [8] 9,253 | 20 |
| 20 | Maine | 40,342,000 | [9] 6,196 | 21 |
| 21 | Los Angeles | 39,832,000 | [10] 19,070 | 12 |

[1] General government, 100,626; public-service enterprises, 32,349.
[2] General government, 28,486; public-service enterprises, 524.
[3] General government, 18,928; public-service enterprises, 1,349.
[4] General government, 27,807; public-service enterprises, 3,509.
[5] General government, 16,629; public-service enterprises, 7,129.
[6] General government, 18,696; public-service enterprises, 1,003.
[7] General government, 12,075; public-service enterprises, 531.
[8] General government, 9,176; public-service enterprises, 77.
[9] General government, 5,940; public-service enterprises, 256.
[10] General government, 10,997; public-service enterprises, 8,073.

Notes on public employment: Figures exclude schools, work relief, and contract-work employment. Unless otherwise indicated, employment total relates to general government only.

Source: Standard and Poor's, corporation records; and publications of the U. S. Bureau of the Census.

Senator O'MAHONEY. I think that these figures are very interesting in comparison with the figures which you have given, Mr. Wilson, bearing out what you have said about the growth.

To me, however, the significance is that so many of these large corporations are greater in financial power and sometimes in the number of employees than even the largest city in the United States and the largest State, the State of New York.

Senator FLANDERS. I wonder why they left out the United States Government and the compiler put in the city of New York.

Senator O'MAHONEY. Because it was the States, I suppose, that were creating these corporations which have grown so large. Of course, there is no doubt about it, that the Federal Government's growth has paralleled, if not exceeded, this growth of the corporations.

Mr. WILSON. There is no doubt about that at all.

Senator O'MAHONEY. And I have always believed, and I think it can be demonstrated, that the reason that the Federal Government is growing is because these great industrial units are also growing.

Senator FLANDERS. Would you mind putting the Federal Government in that compilation also?

Senator O'MAHONEY. No; all I am looking for are the facts.

Senator FLANDERS. You may proceed, Mr. Wilson.

Mr. WILSON. 1940 was the last prewar year in which our business was not greatly affected by defense contracts. Figures for this year are the ones that we regularly use to compare our current operations with prewar. You will, of course, wish to make your own comparisons and conclusions, but I should like, if I may, to direct your attention to certain points that seem to me to be significant.

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 two and a half 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.

Representative HERTER. I wonder if at that point we could have the figure on the permanent long-term investment as against the retained profits in the increasing of your capital structure.

Mr. WILSON. It is $200,000,000.

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 incerasing 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 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 enedavor to show progress in the field of industrial achievement.

As I have stated, we have made a sincere and earnest effort to hold the line on prices, consistent with sound business principles, despite sharply increasing costs. Our weighted index of selling prices for the prewar and postwar years shows the following:

| | |
|---|---|
| 1937 | 107 |
| 1938 | 104 |
| 1939 | 102 |
| 1940 | 100 |
| 1946 | 111 |
| 1947 | 133 |
| Sept. 30, 1948 | 140 |

As this index indicates, our selling prices, which were moving steadily downward prewar, have had to be appreciably increased as a result of the postwar inflation pressures, but even with this are now, on the average, only 40 percent higher than in 1940. Our costs, however, have increased very much more than 40 percent.

An example is pay roll and its related items, such as pensions and social security taxes, which constitute about 45 percent of our total costs. At September 30, 1948, the average earnings of all our employees were at the rate of $3,500 per annum, as against the actual average of $1,978 for 1940. As I previously pointed out, the increase for hourly rated employees alone has been approximately 90 percent. Similarly, our index of purchased materials, which is weighted according to our relative use of the principal materials, shows an increase of 81 percent since 1940. Likewise our expenditures for engineering, research, and development have been increased by 200 percent since 1940.

You may well ask how we can absorb such large increases in pay-roll costs and material costs and still stay in business with an average increase of only 40 percent in our own selling prices. Part of the answer is, of course, the previously mentioned fact that we are obtaining a much lower profit rate today. Expressing this somewhat more graphically, we have to deliver $1.68 worth of goods today to obtain the same amount of profit we got from $1 worth of products shipped in 1940. Another part of the answer is today's very high rate of production and the consequent greater spreading of overhead. That is why we are so concerned about our profit margin, which we know will shrink very sharply with any appreciable reduction in volume of business.

Senator O'MAHONEY. You speak of a very high rate of production. What is it, Mr. Wilson?

Mr. WILSON. I gave you the figures, running at the rate of a little better than 1 billion and a half this year.

Senator O'MAHONEY. That is measured in dollars?

Mr. WILSON. Yes.

Senator O'MAHONEY. Can you measure it in units?

Mr. WILSON. Yes. I told you it was coming back to the original dollars, twice as high, or a little more than that, twice as great as in 1940 in units.

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 dollars to one of 36.5 million dollars, depreciation constitutes only 2.6 percent of our 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.

I should like also to point out that the popular yardsticks for measuring or determining excessive profits are falacious 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.

This latter fact is adequately illustrated by this summary of the relationship of our sales and income to the money at risk in the business.

| | Sales per dollar of assets | Net income per dollar of— | | | | Sales per dollar of assets | Net income per dollar of— | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Assets | Total permanent capital | Equity capital only | | | Assets | Total permanent capital | Equity capital only |
| 1936 | $0.77 | $0.12 | $0.14 | $0.14 | 1940 | $0.98 | $0.12 | $0.17 | $0.17 |
| 1937 | .96 | .16 | .19 | .19 | 1947 | 1.30 | .10 | .16 | .22 |
| 1938 | .74 | .07 | .08 | .09 | 1948 (9 months) | 1.41 | .11 | .17 | .23 |
| 1939 | .83 | .10 | .13 | .13 | | | | | |

Senator FLANDERS. May I ask whether the assets base on which you reckoned this has been marked up to agree with the increased cost of replacement?

Mr. WILSON. It has not.

Senator FLANDERS. It has not been marked up?

Mr. WILSON. No, sir.

Representative HERTER. I have just one thing on those figures. Is that adjusted to an annual basis?

Mr. WILSON. It is adjusted to an annual basis.

Representative HERTER. It is not indicated in the table here.

Mr. WILSON. It is a mistake. It should have been. It is adjusted.

I should like to repeat in conclusion my conviction that the welfare of the country will be best served by an economic program designed to stimulate the scientific, technical and economic progress of industry. Only as such progress is achieved will we find it possible to meet the objective of combating inflation without entering the agonizing throes of a depression.

I know I need scarcely tell you that the task which has been delegated to this committee, and the subject into which you gentlemen are making your inquiry, is one of tremendous magnitude, a magnitude which it is impossible to overestimate. The profit system, with which we are here concerned, is the foundation of our whole economy. It is that which gives life and vitality to our entire economic system, which has provided such magnificent results. I think that it behooves us as Americans to pause for a moment from time to time to take stock of the amazing progress which we as a Nation have made. For all our troubles and our trials we are tremendously prosperous—prosperous in the things that make our lives safe, free, and full of enjoyment. Our economic system has through the years been good to all Americans. It has been good to us in groups—to the farmer, to the laborer, to the so-called white collar worker, to the businessman, to the Government employee, and to the aged; but more important, it has been good to us as individuals, in that it has increased beyond belief the welfare of every man, every woman, and every child in the country. It is a commonplace that our economic well-being is beyond comparison to that of any other nation in any past or in the present world.

And as an industrial economy we are still far from attaining our peak. It is, in fact, my belief that we have only begun to recognize our full potentialities. There is fundamentally no reason why we should not continue to go on to ever increasing heights. We have seen how wrong were those gloomy prophets of disaster who toward the end of the war and thereafter predicted a shrinkage in our standard of living—a falling backward rather than a steady march ahead. There were a lot of them down here in Washington. Certainly we have and will always have an ever-expanding market for new and better products so long as our system is not thwarted or impaired, and is able to produce those products at prices which the consumers can afford.

We must therefore, as a nation, see to it that we encourage new growth and new development so that there will continue to be more and better products at prices which increasingly large numbers of our people can meet. In this way we can hope that our economy will overcome the vicious cycle of inflation and depression with which for so many years it has been cursed. To accomplish these objectives there must continue to be encouragement of capital, of the risk capital, which, frankly in the hope of gain but as an essential ingredient of our entire economic structure, is invested by an estimated 12,000,000 Americans.

I urge that your committee consider carefully the effect of any recommendations which you may make upon the profit system, on the incentive to invest in the future progress of America.

It is my belief that one of the greatest services which the Joint Committee on the Economic Report can render to America is to give an interpretation of profits and their true bearing on our economy. You could help tremendously in this regard by clearing away much of the confusion which exists in the public mind, a confusion which causes many people still to look on the existence of profits with a vague feeling of distrust and suspicion. Surely it must be pointed out that with all its shortcomings, and certainly we all wish to work to eliminate abuses where they have arisen, our American system is a truly remarkable one, that it is for good reason the envy of the world.

Senator FLANDERS. Thank you, Mr. Wilson.

I have noted two or three points in your discussion about which I wish to ask you questions. Early in your statement you spoke of increased efficiency in output from the economies of mass production and standardization, in order to increase the demand and enlarge the sales and create new jobs and again reduce the costs of production.

I questioned, as you made that statement, the possibility of increasing in the aggregate new jobs any faster than the growth of the working population. Are we not now at substantially full employment, despite various spots here and there in which employment is not full? Can we increase it much faster than the working population grows?

Mr. WILSON. No; I don't suppose we can substantially; but of course, by improved technology, even the slight growth of the working population will be better utilized to bring about the results that are stated here as being regarded as desirable.

Senator FLANDERS. You speak of again reducing the costs of production. Would you expect, under present conditions, that those reduced costs would show in reduced prices to any extent?

Mr. WILSON. They will in time; yes. In other words, if we were to keep the status quo on raw material costs, labor costs, given time I am sure that industry generally would effect economies and pass them on in lower prices.

Senator FLANDERS. Later in your statement you put on record the two voluntary decreases in price that you had made beginning January 1, and then again on April 1; but at the end of that section you said that you were forced to restore most of the price reductions that you had put into effect. What made it necessary to restore those price reductions?

Mr. WILSON. First, because we had to conform with the national pattern on the third round of wage increases. That was No. 1. Of course, others having to do that, or doing it, rather, that increased the cost of the raw materials and components that we buy, which amounts to something like 40 percent of our business, the purchased raw material and components; and freight rates were higher, and so on. And so it just increased costs and wiped out any chance we had of maintaining the reductions we had made.

Senator FLANDERS. Was it not the assumption of those who asked for the increase in wages, both of your company and of your suppliers, that those increases could be taken out of profits without raising prices? What have you to say on that?

Mr. WILSON. I think that there has been ample demonstration, Senator, that that just cannot be done; that it is a fallacy to believe that you can give as large national increases and not affect cost levels. We have been through it three times now, and it has affected pretty nearly all industry, and the results are about the same, and prices have just had to be raised to hold the companies in business and keep them in a sound position.

Senator FLANDERS. On the assumption that prices are determined by the balance between funds available to purchase and the quantity of goods purchased, have you any observations to make as to the result of raising wages without increasing output correspondingly?

Mr. WILSON. Well, of course, if you raise wages and don't—I think that I have given the answer to that—if you raise wages and you don't raise output to offset it, which you cannot, why, then there is only one alternative: You have got to raise the prices.

By technological progress you cannot keep up with such wage increases as have been prevalent over the last 3 years. A man doesn't seem smart enough to accomplish that; certainly not in my business.

Senator FLANDERS. On the table you have given us, showing a comparison of your current status with that of the prewar years, in the last column which is headed "Equity Capital Only," there is a slow but continuous growth in your equity capital from $316,000,000 in 1935 up to $477,000,000 in 1948. Just what form did those increases in equity capital take? Was that common stock, preferred stock, or what?

Mr. MILLHAM. It was entirely increases in reinvested earnings, the difference between earnings and dividends.

Senator FLANDERS. In other words, you credit the equity capital owners with that increase in your assets?

Mr. MILLHAM. That is right.

Senator FLANDERS. So that in the period from 1935 to 1948 you have had no sale of equities on the market?

Mr. WILSON. That is right.

Senator FLANDERS. Would you prefer to have sold equities of one form or another, or is this your choice?

Mr. WILSON. Yes, it is our choice, in view of the general conditions. We would rather do it this way. And such additional money as we had to obtain, it was desirable to borrow it. We didn't think the atmosphere was good for trying to raise more risk capital by an additional stock issue.

Senator FLANDERS. In your column of total assets, you show a very small increase between 1947 and 1948. I take it that that indicates that your expansion program for the present is practically completed.

Mr. WILSON. Yes, we are cleaning it up. Of course, we still have maybe $50,000,000 or $100,000,000 more to complete it, but we are not undertaking any new expansions.

Senator FLANDERS. I note that in 1947 you distributed approximately almost one-half of your net income in dividends—do you plan to do that also for 1948?

Mr. WILSON. That is right, and to reinvest the other half in the business.

Senator FLANDERS. That rate of relationship between dividends and net income is very much less than it was up to 1940. Can you explain why it is so much less than it was up to 1940?

Mr. WILSON. For one thing, we didn't have the requirements of very fast growing business up to 1940. This has been an ever-present requirement with us since the year 1940, as you can see from the growth of our business.

Senator FLANDERS. You made the statement:

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.

Business as a whole has been charged by some previous witnesses with protecting itself by providing that necessary cushion and thereby contributing to the recession which the cushion is intended to protect them against. Do I understand from the way you have worded this that you do not feel that you can be numbered among those who have been providing the necessary cushion?

Mr. WILSON. I don't think that we have provided an excessive cushion by any means.

Senator FLANDERS. You have provided some cushion?

Mr. WILSON. When we plowed back our earnings, that is in effect doing that.

Senator FLANDERS. Do you have an increased cushion of liquid assets over what you had? Have you increased your cushion of liquid assets between 1947 and 1948?

Mr. WILSON. Not appreciably, no, it hasn't increased appreciably. I mean it is very close, one year to the other.

Senator FLANDERS. Speaking of your depreciation accounts, the question has been raised as to business in general, and specifically with reference to your company, as to whether your depreciation allowances are larger than that which the Government permits, so that you show on your annual statement for stockholders a different result than would be the case if you showed only the depreciation allowed by the Government.

Mr. WILSON. That is correct.

Senator FLANDERS. You feel that it is perfectly proper to take those two positions, one of Government accounting and one of stockholder accounting?

Mr. WILSON. By all means. That is just being normally prudent.

Senator FLANDERS. In the latter part of your statement you say: "It is only after we have set aside enough of current income to maintain the productive capacity * * *." Does that mean that you are reckoning on the replacement of productive capacity rather than the replacement, unit by unit, with the possibility that the new equipment may be of higher productive capacity than the old, so that you have taken into account increased productive capacity in replacement?

Mr. WILSON. Absolutely.

Senator FLANDERS. And I presume that that is taken into account when you say, "The replacement cost of our plant at today's prices is estimated to be more than 300 million dollars in excess of the actual cost." That again is replacement of productive capacity and not unit by unit?

Mr. WILSON. That is right.

Senator FLANDERS. I take exception to one point in your statement where you speak of our profit system as having been good to us in groups. I doubt whether our present experience is satisfactory to the aged. It seems to me that inflation has hit them very hard, indeed, whether we think of them in terms of trying to live on their own personal savings or on retirement allowances set up by individual companies or by the Government.

Mr. WILSON. I will take it as of today, under the aegis of inflation—I think that that correction is well noted. But I was thinking that over the years it has been good, in my judgment.

Senator FLANDERS. I notice that later in your statement you seem to class yourself among the optiimsts; and I suppose that you are aware of the fact that, not so much in Government circles at the present time as in financial circles, there is a good deal of doubt as to whether we are going to continue with our present high rate.

Mr. WILSON. I meet those prophets of gloom, too.

Senator FLANDERS. You do not associate yourself with it?

Mr. WILSON. I think this; that there is no economic reason that we ought to have a recession. I think if we conduct ourselves in Government and industry, and so on, and conduct ourselves properly, that there is no reason, no economic reason, that we should retrogress, but, rather, should progress. Whether we will or not is something that time will tell, but I don't know of any reason why we should.

Senator FLANDERS. We would be misbehaving ourselves in some way if we do not continue; is that what you are saying?

Mr. WILSON. That is what I am trying to say.

Senator FLANDERS. Here are two other questions which were addressed specifically to your company:

What is the cost to the company of its extensive propaganda campaign which the company has proudly described in great detail before business organizations and in business magazines throughout the country?

Mr. WILSON. It has cost us, or the department that does many other things, the cost of operating that department of our business—now remember, this is a business of $1,500,000,000 this year—I suppose that department costs us something close to a million dollars a year to operate. That is our employee-relations department. I am not going to make a mystery out of it. I know who asked the question. I would say that the amount of money that we have spent trying to undo some of the damage done in the minds of our workers, 200,000 workers, and in the minds of people in the communities in which we operate, the amount we have spent probably does not exceed the amount that has been spent by the agency that the gentleman who asked that question represents. Obviously, industry would be just plain dumb if it didn't try to answer the falsehoods and the propaganda that is spread so widely wherever we operate, in 130 cities, by the very organization that wanted to know how much we were spending on it. They are on the radio, and with their newspapers and everything else, and with paid ads in papers all over the United States, telling their side of every issue. And, now, certainly nobody should think of denying industry its opportunity to give its answer.

Senator FLANDERS. You do not feel at all ashamed of that?

Mr. WILSON. Ashamed of it? I am proud of it.

Senator FLANDERS. I might say that you are not alone in endeavoring to sell yourself and your policies. I had a little experience some years ago. I had thought of taking a walking trip with my son in the High Sierras, and I knew that there were camps located there within easy walking distance of each other, where you could get accommodations overnight and not have to carry your food and your cooking utensils and your sleeping bags on your back. So I wrote to the Department of the Interior to get information on those camps. All I got was a very elaborate and very expensive pamphlet describing the glories of the National Park Service, and that was all I was able to get. So I think that you are not the only one who is spending money in advertising one's undertakings.

Now, there is one other question which was asked specifically of your own company. You are given as a company which makes monopoly profits. I do not know who gives you as a company which makes monopoly profits, but the statement is made; that is, profits not arising from anything remotely like competitive free public enterprise. Will you make any comments on that statement?

Mr. WILSON. Any answer to that is a little bit like the old questions about "When did you stop beating your wife" or "Have you stopped beating your wife"; that is just too general, Senator. If somebody will identify some monopoly profits that we are alleged to have, I would like to know them myself, because I would like to get my fingers on them. I don't know where they are, and I don't know what they are talking about, to be perfectly frank with you. I don't know where there are any monopoly profits mixed up in our operations. They will have to be a little more specific than that.

Senator O'MAHONEY. Why would you like to get your fingers on the monopoly profits?

Mr. WILSON. I have just given you an indication of how low I regard our profits to be—7.2 percent.

What I mean by that is, if there were some alleged monopoly profits that were very large, to sweeten it, that would be wonderful. We just don't have them, unfortunately. That is what I am trying to say.

(Mr. Wilson has submitted an additional statement on this point which will be found at the end of this testimony, p. 505.)

Senator FLANDERS. I would like to go back again to the table to which I previously referred, to clear up my mind. Take the projected current year 1948. The total assets are given as $1,072,000,000, and total permanent capital as 679 million dollars. Will you refresh my memory as to what the difference is between those two columns?

Mr. WILSON. I will let the expert do it.

Mr. MILLHAM. Primarily, it is the money we owe our suppliers and the money we owe the Government as taxes, and that sort of thing—current liabilities.

Senator FLANDERS. That is the money you owe whom, besides the Government?

Mr. MILLHAM. Our suppliers. And, of course, we pay our income tax a year in arrears, and so on.

Senator FLANDERS. I can understand about the income tax, but how do you include, in total assets, money that you owe the suppliers, your sources of supply?

Mr. MILLHAM. Our total assets, for example, include supplies which we have purchased and added to our inventory, for which we have not yet paid the bill.

Senator FLANDERS. You do not subtract your liability to your suppliers from your assets?

Mr. MILLHAM. Not in this tabulation; no, sir.

Senator FLANDERS. That is a little mysterious to me, but probably it is all right.

Mr. WILSON. It is the money we are actually using in the business, that is what we have tried to show.

Senator FLANDERS. It is money used in the business?

Mr. WILSON. For which we have a liability.

Senator FLANDERS. I think it probably properly states that.

Now, another question—I see there was a second page of these questions which I had hidden under the first page, so I am not quite through with you yet.

We were told last week that General Electric made 26 percent on its investment in 1947. Will you comment on that?

Mr. WILSON. We have already commented on it, and it is in the report.

Senator FLANDERS. You have commented on your point of view that the profit on investment, from your standpoint, is not a fair measure of profit, and you have given your reasons for saying so.

Mr. WILSON. That is right.

Senator FLANDERS. The net income which you give for 1947 is $95,000,000 and your total assets are given as $1,026,000,000. That does not figure up to the 26 percent. I presume that the questioner is referring to the relationship between the net income and total permanent capital, but even that does not figure up to the 26 percent. It is not clear where that 26 percent came from.

Mr. MILLHAM. That is not clear to me, Senator. The figures you have before you in this statement represent, so far as equity capital is concerned, the amount of our equity capital at the end of 1947. And on that equity capital our income for 1948 was equivalent to 22 percent.

Senator FLANDERS. Now, this net income is after taxes?

Mr. MILLHAM. Yes.

Senator FLANDERS. I think those are the questions that are pertinent that were asked. I have no other questions to ask you.

Senator O'Mahoney, do you have any questions?

Senator O'MAHONEY. Mr. Wilson, may I say that in my questions to you this morning I am not in any degree antagonistic, and that I am just trying to develop the facts. I do not want you to get the idea that these questions are prompted by any desire to destroy the profit system; and I may say that, from my own point of view, they are prompted by a desire to preserve the American system of independent, competitive enterprise.

Mr. WILSON. It is very heartening, Senator.

Senator O'MAHONEY. There are several statements which you have made with which I completely agree, so let us start with those.

In the latter part of your statement you say:

> We must therefore, as a nation, see to it that we encourage new growth and new development so that there will continue to be more and better products at prices which increasingly large numbers of our people can meet. In this way we can hope that our economy will overcome the vicious cycle of inflation and depression with which for so many years it has been cursed.

I emphasize the word "nation", and I emphasize the phrase "new growth and new development," and I emphasize the desirability of "better products at prices which increasingly large numbers of our people can meet." Finally, I emphasize the "vicious cycle of inflation and depression with which for so many years we have been cursed."

Mr. WILSON. We will agree on that one, Senator.

Senator O'MAHONEY. We will agree on some more. You also say:

> With the population increasing faster than at any previous time in its history, and with that population demanding both a higher standard of living and greater security, we think American industry has its biggest job ahead. We know General Electric has. 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.

Now, I take it there that you are talking about the security of the people, rather than the security of the corporations alone.

Mr. WILSON. The security of the people; and include the stockholders, they are entitled to some security, too. They have made this business possible. But I am including the security of the whole.

Senator O'MAHONEY. You suppose stockholders are people, and I have never heard anyone say that they are not.

Mr. WILSON. They are people entitled to consideration for furnishing the risk capital.

Senator O'MAHONEY. Of course. But I say: I take it that when you said in this statement that we must maintain "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," you were referring to the security of all of the people?

Mr. WILSON. That is right.

Senator O'MAHONEY. And the standard of living of all of the people?

Mr. WILSON. That is right.

Senator O'MAHONEY. And, of course, that includes stockholders?

Mr. WILSON. That is right.

Senator O'MAHONEY. That is naturally true.

Finally, you said:

> 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.

Now, you, as the head of a corporation, are charged with responsibility for the management of that corporation. Members of this committee and Members of Congress and members of the executive branch of the Government are charged with a slightly wider responsibility; that is to say, responsibility toward the Nation as a whole and toward all of the people. You will recognize that, of course.

Mr. WILSON. You bet I do.

Senator O'MAHONEY. And, when you used this last sentence that I have quoted here, were you or were you not thinking of a system and a Government policy which should be designed to preserve the security of a single corporation, or of all corporations as a whole?

Mr. WILSON. You don't ask me that seriously; do you?

Senator O'MAHONEY. I do.

Mr. WILSON. Why, of all corporations, of course.

Senator O'MAHONEY. I had thought that that would be your answer; and now, just that you may know why I asked that question seriously, I recite the fact, taken from Mr. Hoover's table or rather Dr. Mitchell's table of 1930, which listed General Electric as No. 7 in the order of gross revenues among the corporations and the public communities of the country, and the table which I secured from the Library of Congress and which is taken solely from corporate data, the same data that President Hoover's committee used, which shows that after the depression General Electric had gone to position No. 5.

Now, of course, you know that during that depression many little corporations and little businesses completely disappeared from the scene.

Now, do you think that Congress has any responsibility toward the maintenance of a climate, to use the phrase that is currently used, in which little competitive business can thrive; and if you do, is it your advice to this committee that we can sit on our hands and do nothing but let things drift as they did between 1924 and 1929 when we developed this depression which you say we must avoid?

Mr. WILSON. Yes; I said that.

Senator O'MAHONEY. Shall we do something, or shall we let things drift?

Mr. WILSON. It depends, of course, on what you are going to do; what it is; and, in your great wisdom, can you do anything about it.

Senator O'MAHONEY. You are one of the great leaders of industry, sir.

Mr. WILSON. Not by my claims.

Senator O'MAHONEY. You are recognized as such in the country. I am asking you if you have any suggestions to this committee.

Now, you have testified here this morning that this cycle of boom and bust is a vicious one. Have you any suggestions to us for any constructive, positive action to prevent a depression, or shall we just sit idly by and let it come, if it is coming?

Mr. WILSON. I do not think that you have to sit idly by. I think, rather, don't throw monkey wrenches into the machinery that is pretty good at the present time, as demonstrated by the present state of our economy. It is good, basically good. Small business and medium business and big business are all doing very well.

The trouble with all of these things, it seems to me, is that too many people start off as though the whole economy had gone to the dogs. Personally, I don't like that idea, because I don't think the facts and an investigation of the situation justifies it. I think the economy is good and healthy, on the whole, in spite even of inflation.

Senator O'MAHONEY. I am very glad to hear you say that.

But these statements with respect to a depression come equally from those who are prominent in industry, as well as from those economists who are sometimes said to be the guiding minds of some agencies of government.

Let me ask you whether, as an industrial leader, you want to tell this committee and your industrial confreres that in your judgment there is no reason for a depression?

Mr. WILSON. I could not tell them that unless I could also tell them what you were going to do to upset the apple cart.

Senator O'MAHONEY. Why do you assume that? Let me say to you, Mr. Wilson, that the apple cart was upset in 1929 when industry was in charge of the whole Government, and there was no New Deal shooting at industry in Congress, there was no New Deal to take the licking that industrialists have given it ever since it started. The conservative point of view was in complete control of the executive branch of the Government and the legislative branch of Government, and yet you had a depression. And in the last 16 years, sir, your profits have been piling up; have they not?

Mr. WILSON. Sure.

Senator O'MAHONEY. You say that "I cannot say until I know what you are going to do." We are talking about the facts as they exist, and do you know of any existing facts which will prevent you from saying to your industrial confreres that there is no reason for a depression?

Mr. WILSON. No; I could not say that.

Senator O'MAHONEY. Well, are there?

Mr. WILSON. I don't know what you are going to do or what you are going to recommend about the system, the American system as we know it, which has brought us to this very high point. I don't know what you are going to do about it. Leave it alone so that it can grow in the same atmosphere in which it has been growing, and restore confidence of business and industry, and I see no reason for a depression.

Senator O'MAHONEY. The last time that that was done by the Government, the result was a depression.

Senator FLANDERS. May I interject a question there? I would like to suggest that what has always seemed to me the outstanding feature of the 1929 situation no longer exists. There was then a frantic speculation on the stock market, which discounted imaginary future profits and applied them to existing securities.

The present situation is entirely different from that, and I do not see any relationship whatsoever between the 1929 situation and our present one, for that reason.

Mr. WILSON. I think the situation is entirely different today.

Senator FLANDERS. I am admitting that it all happened under a Republican administration, and we went crazy.

Senator O'MAHONEY. I did not raise the question of the name of the party under which it arose.

Senator FLANDERS. I am willing to take the rap.

Senator O'MAHONEY. I do not think that this is exactly the place for an argument between the chairman and any member of this committee with respect to what happened in the past. I am trying to get some illumination from an industrial statesman with respect to what should be done, and all I get is a statement from him that he cannot advise his confreres that there is no danger of a depression until he knows what the Government is going to do.

Mr. WILSON. I thought that I gave what little advice I was capable of. That is that without extensive changes in our present price and profit situation, which I think has made for a healthy economy in spite of inflation, and given time to work out technological improvement as I am sure it will be worked out, so that we can reverse the price trend, I think that we can have a healthy economy and keep the 60,000,000 employed, and employ more as they come along to employment. I believe that sincerely.

Senator O'MAHONEY. The Small Business Committee in this Eightieth Congress, which was not a New Deal Congress, has repeatedly stated that little business was in great danger.

When people use the word "monopoly," sometimes that conveys to gentlemen in your position a conviction that the person who uses that word "monopoly" is out to cut your throat.

Now, I have used the word "monopoly" many times, and I think that I should go ahead and use it; but may I say to you that it is not because of any punitive desire. I would say to you, as I said when I was at the head of the TNEC, that I would be willing to forgive every violation of the antitrust laws that has taken place up to this time if, as a result of it, we could devise a definite system by which organized business and individual business could work together without discretionary controls by Government.

Some of you gentlemen assume that everybody who does not agree with you desires to establish here in the United States a totalitarian government. I want to suggest to you, sir, that some of these giant corporations set the pattern for totalitarianism. The General Electric, for example, is a collectivist economic state. How many stockholders do you have?

Mr. WILSON. We have 250,000.

Senator O'MAHONEY. What is the average stockholding?

Mr. WILSON. The average is—I don't know what the average is; I can't answer it. But we have 100,000 that have only 25 shares, or something like that.

Senator O'MAHONEY. What is the largest individual owner?

Mr. WILSON. Nobody owns 2 percent.

Senator O'MAHONEY. Now, can you tell me what the so-called median stock ownership is?

Mr. WILSON. That is the one that I just said I couldn't tell you.

Senator O'MAHONEY. That is the average stockholding; but by "median," that is a phrase used in the SEC, that is where I got it, to designate the amount of ownership by the lowest half of your stockholders.

Mr. WILSON. I don't know; I couldn't answer that. I did not come prepared with that. I am sorry.

Senator O'MAHONEY. All right; you cannot be expected to load your mind with all of these details, but would you be good enough to get for the committee that statement?

Mr. WILSON. Surely.

Senator O'MAHONEY. The average ownership, the largest individual ownership, and the median ownership.

Mr. WILSON. Yes.

(The data referred to, to be furnished by Mr. Wilson, are as follows:)

The average amount of stock held is 116 shares. The largest stockholder on record is a nominee of a trust company in whose name are registered 418,141 shares. The median ownership is 30 shares.

Senator O'MAHONEY. I think you will find that a very substantial number of your stockholders have less than 10 shares of stock each. You would not be surprised at that; would you?

Mr. WILSON. No. As a matter of fact, I can tell you in advance that if we give effect to a lot of new stockholders we are getting in, of the 200,000 employees—we are just having some 90,000 of our 200,000 people who are just going to become stockholders of our company——

Senator O'MAHONEY. That is a very fine thing.

Mr. WILSON. Do you think so? I am glad of that. I like it, too. So we are going to have about 90,000 out of the 200,000.

Senator O'MAHONEY. At what price are they buying their stock?

Mr. WILSON. You mean the cost to them? It is nothing.

Senator O'MAHONEY. Do you mean to say that when that stock is issued, it will not mean any new capital invested in the company?

Mr. WILSON. It will come out of our earnings. The company is giving them that stock in order to promote the sale of Government bonds.

Senator O'MAHONEY. You are distributing among 90,000 stockholders, shares of stock which represent not new capital which they put up, but capital which is taken away from your earnings?

Mr. WILSON. That is right, it is taken out of earnings.

Senator O'MAHONEY. The corporation earnings.

Mr. WILSON. And turned over to them as a bonus for buying Government bonds.

Senator O'MAHONEY. Now, can you tell me what proportion of the common stock of the corporation is held by management?

Mr. WILSON. By management? It is very small, because most of the management, like myself, never had enough to buy very large amounts of stock, Senator.

Senator O'MAHONEY. Well, some corporations distribute common stock as bonuses to their managements.

Mr. WILSON. Some do. Ours does not.

Senator O'MAHONEY. The General Electric does not?

Mr. WILSON. Well, it has at times through the years, but it has been optional whether you took stock or you took something else, but it has never been done on a scale that has made management hold very much of the stock of the company. It is a handful.

Senator O'MAHONEY. But in any event it is common-stock holdings which does not represent new capital?

Mr. WILSON. The 90,000 we are talking about?

Senator O'MAHONEY. No, the other. If the common stock of a corporation is distributed as a bonus to managers, I take it that that means common stock which is paid to them without any consideration except their efforts on behalf of the company.

Mr. WILSON. That is correct.

Senator O'MAHONEY. So that that stock, whatever it may amount to, does not represent any new capital, like the other; it represents earnings?

Mr. WILSON. That is right, it is earnings. In our own case, whenever we did it we took earnings of the business and bought stock in the open market and paid them for that stock. We didn't even take it out of treasury stock, because we didn't have it.

Senator O'MAHONEY. Will you tell the committee how much treasury stock has been distributed to any group at all, without the payment of new capital?

Mr. WILSON. I think it is none.

Mr. MILLHAM. You mean money payment?

Senator O'MAHONEY. I am talking now about this bonus stock.

Mr. WILSON. The stock paid to management in connection with our extra compensation plan, that stock is bought in the open market with the earnings of the company, in the open market, and we do not, generally speaking, use treasury stock. I cannot remember when we ever did. If we ever did, it is as nothing. Generally speaking, we buy it in the open market.

Senator O'MAHONEY. That stock comes out of the earnings and does not represent new capital?

Mr. WILSON. That is correct.

Senator O'MAHONEY. All right, we have passed that. How much treasury stock do you have?

Mr. WILSON. How much treasury stock? The stockholders of the company, just last April, voted to put—how much money was it?

Mr. MILLHAM. We have a certain number of shares that have never been issued. The stockholders last April authorized an increase in this unissued stock, as I recall it, of about 6,000,000 shares.

Treasury stock, as we use it, means stock which has been issued but which we have reacquired.

Senator O'MAHONEY. Will you state that again?

Mr. MILLHAM. Treasury stock is stock which originally was issued for a consideration but which the company reacquired.

Senator O'MAHONEY. Which the company bought?

Mr. MILLHAM. Which the company has bought with its own funds on the open market.

Mr. WILSON. Correct.

Senator O'MAHONEY. How much was that?

Mr. MILLHAM. In normal times it ran 20,000 to 40,000. We acquired some this year in a liquidation of a subsidiary which was as a result since that subsidiary was one of the major stockholders, we now hold 400,000 to 500,000 shares.

Senator O'MAHONEY. With respect to this new issue, how much is that?

Mr. MILLHAM. About 6,000,000.

Mr. WILSON. We have not done anything with it, we just have the authority.

Senator O'MAHONEY. Does this stock have a par value?

Mr. WILSON. No par value and we have not issued it, you understand. It is just there in case we have to raise some money for some purpose or another.

Senator O'MAHONEY. The purpose then would be to sell that?

Mr. WILSON. To the public.

Senator O'MAHONEY. To the public for new capital?

Mr. WILSON. That is right, in case we need it.

Senator O'MAHONEY. May I ask then what proportion of your expenditures for plant and equipment expansion has come out of earnings and what proportion, if any, from borrowings?

Mr. WILSON. Well, it is hard to distinguish.

Mr. MILLHAM. I think the answer to the Senator's question is that we have put in $350,000,000 of new money since 1940. Of that $350,000,000, $200,000,000 was borrowed and $150,000,000 represents undistributed earnings.

Senator O'MAHONEY. Undistributed earnings?

Mr. MILLHAM. Yes.

Senator O'MAHONEY. $150,000,000?

Mr. MILLHAM. Correct.

Senator O'MAHONEY. So that was not capital produced from the sale of any stock?

Mr. MILLHAM. Right.

Mr. WILSON. We have not sold any, sir.

Senator O'MAHONEY. The amount that was borrowed, was that borrowed on the open market?

Mr. WILSON. Banks and insurance companies, anywhere we could get it.

Senator O'MAHONEY. Do you recognize any question arising out of depreciation with respect to the treatment of bondholders and stockholders?

For example the statement has been made to us that this system of depreciation in current inflated dollars for investment that was made in noninflated dollars is to the great disadvantage of the bondholders, because on the whole one would expect that the operating company, and I am not talking about General Electric now, would operate its plant and its equipment in such fashion as to return to the company a sufficient sum to pay off the bondholders so that when the time came to disband with this new depreciation formula—of course there is no formula, no accounting has been made for suggested formula—but if depreciation were allowed in terms of inflation dollars, then you would begin all over again, borrow money in current dollars and if the inflation continued, pay if off and then the bondholder would be repaid in the exact dollars.

Do you recognize any problem there?

Mr. WILSON. I will let Mr. Millham answer.

Mr. MILLHAM. I do not know whether I follow you, Senator, but the situation of a bondholder is that he expects to be repaid, otherwise he would not be willing to loan us that money.

Senator O'MAHONEY. You feel that he should take the chance?

Mr. MILLHAM. Well, yes.

Mr. WILSON. A minimum risk that he is taking.

Mr. MILLHAM. He elects to loan money and gamble, if you will, on the value of the dollar in return for a more or less guaranteed return on his money, and the repayment of that money. I do not see that there is any difference in principle between the chap that loans the corporation and the chap that buys Government bonds.

Senator O'MAHONEY. The person that buys corporate bonds and is paid back in the same dollars in which the corporation expended those dollars for its plant must be satisfied with being paid in exactly those dollars, whereas the new plant is built in inflation dollars. There is a distinction and I am merely asking for information because the statement has been made to me by a corporate executive, may I say, that this proposed theory of depreciation would be to the great advantage of the stockholder and to the great disadvantage of the bondholder.

But apparently you have not given it any thought and we will pass it for the moment.

Mr. WILSON. I could not answer it on the distinction, Senator.

Senator O'MAHONEY. I had one or two other thoughts here. On page 13 again, you speak of "yesterday's investment dollar," immediately following in the paragraph beginning "I should like also to point out * * *"

Mr. WILSON. I have it, Senator.

Senator O'MAHONEY. So far as General Electric is concerned, can you tell the committee whether or not General Electric has acquired any of the war-financed industrial plants built by the Government?

Mr. WILSON. Yes; it has, Senator.

Senator O'MAHONEY. Do you know how much has been spent by General Electric for that?

Mr. WILSON. On the total number of war plants, we took quite a few. How much we spent for them?

Senator O'MAHONEY. Yes.

Mr. WILSON. And what percentage that was in our total investment in the postwar period, is that what you wanted?

Senator O'MAHONEY. What I wanted to bring out was the depreciation of 20 percent, 5-year depreciation, which was allowed to corporations for the expansion that they made during the war and the great depreciation which the War Assets Administration had to settle when it sold war plants that were built by the public at a very great cost.

Mr. WILSON. Well, I am sorry, I do not know what it amounts to in dollars. My guess would be that the plant that we bought from the Government and the equipment we bought from them would not be more than 7½ percent of the total expenditures we made.

Senator O'MAHONEY. But it probably would be a fact, would it not, that you bought them from War Assets at considerably less than 50 percent of what they cost the Government.

Mr. WILSON. Not by any means.

Senator O'MAHONEY. I know that in some instances that was the fact. You see, I did not check up with War Assets as I might have done on the exact purchases you made.

Mr. WILSON. We would have been proud of it. That is nothing that you could make me feel bad about; we are proud of the fact.

I am sure that it would not be 7½ percent of the total, Senator. I can think of none that we bought for 50 percent of the value. I am quite sure that some of them ran up to as high as 75 percent, Senator, and even if it was 50 percent, remember it was 50 percent of a very inflated cost for which I had some responsibility, in those days. You know we were urged to get the things and cost did not mean much and we went ahead and put the money in.

So, even if we paid 50 and I cannot remember any of that kind, it was 50 percent of an inflated cost.

Senator O'MAHONEY. Of course, inflation did not end when you resigned from WPB.

Mr. WILSON. I am sure they did better.

Senator O'MAHONEY. I am sure they did not, but the expense in the cost of construction is a great deal higher than it was at that time?

Mr. WILSON. That is right.

Senator O'MAHONEY. So here we have a case in which the Government, the people, the taxpayers, built the war plant at an inflated cost, as you have just stated, and then the Government through the War Assets sold that very plant in a continuing period of inflation at much less than it cost the Government to build it and now spokesmen for some of the beneficiaries of that great depreciation are asking the Congress to adopt a new figure for depreciation.

In other words, the complaint is made, it was made by Professor Slichter, for example, that corporate profits are overstated.

Well now, it does not seem to me that when a large corporation, and let us take United States Steel, for example, which bought the Geneva plant at 20 cents on the dollar, or Kaiser-Frazer which bought the Willow Run plant at a similarly low price, is entitled to a new great cut by the adoption of a new method of depreciation, depreciating depreciated dollars.

Mr. WILSON. I think, of course, that the opponents of this higher depreciation allowance are not thinking of just the small fraction.

Senator O'MAHONEY. Oh, no.

Mr. WILSON. As I say, in our own case, 7½ percent, Senator.

Senator O'MAHONEY. Certainly.

Mr. WILSON. Of course, what we have been confronted with is the many plants or equipments that we brought back as far as 1940 at terrifically high costs and where the depreciation is entirely inadequate. That is, the allowable or taxable depreciation is, in our opinion, inadequate. That is the thing; that is the major part. This other would be minor in our case. I am not going to comment on the fellow with which it is a major thing as compared to mine.

Senator O'MAHONEY. Would you be good enough to have prepared and inserted in the record a list of all of the Government plants which have been purchased by General Electric and the price for which they have been purchased?

Mr. WILSON. Surely.

Senator O'MAHONEY. If you have in your corporate records the cost to the Government, I would like to have that in also.

Mr. WILSON. I do not think we have that.

Senator O'MAHONEY. You do not?

Mr. WILSON. No.

Senator O'MAHONEY. We can get it from War Assets Administration.

Mr. WILSON. Every one of them was on a competitive-bidding scheme. We had to bid competitively and did not get all that we were the high bidder on either.

Senator O'MAHONEY. Would you also list the number of competitors that you had in each one of these cases?

Mr. WILSON. You get that also from the War Assets.

Senator O'MAHONEY. Let me ask you, in how many States do you own plants?

Mr. WILSON. Twenty-two.

Senator O'MAHONEY. In how many communities do you operate?

Mr. WILSON. One hundred and thirty-eight. We have 130 plants, but in some communities we have different plants and different lines in the same town. You do not mean sales offices and all that; do you? You mean manufacturing plants?

(The information is as follows:)

*General Electric Co. and consolidated affiliates—list of Government-owned plants acquired from Reconstruction Finance Corporation and War Assets Administration 1946 to date*

| Location | Date of deed | Price |
|---|---|---|
| Acquired from Reconstruction Finance Corporation: | | |
| Price established by negotiation: | | |
| Allentown, Pa | June 3, 1946 | $200,000 |
| Decatur, Ind | Mar. 14, 1946 | 550,000 |
| Erie, Pa.: | | |
| Building 13 | Mar. 21, 1946 | 1,529,413 |
| Building 17 | do | 1,423,220 |
| Fitchburg, Mass | July 17, 1946 | [1] 2,300,000 |
| Fort Edward, N. Y | Feb. 4, 1946 | 589,500 |
| Fort Wayne, Ind | Aug. 27, 1946 | 5,000,000 |
| Lynn, Mass | Feb. 26, 1946 | [1] 323,000 |
| Scranton, Pa | Apr. 29, 1946 | 400,000 |
| Trenton, N. J | Feb. 21, 1946 | [1] 1,408,872 |
| Price established by bids: Lowell, Mass | Jan. 16, 1947 | [1] 2,238,872 |
| Price established by formula under lease: Dover, Ohio | Oct. 10, 1946 | 85,582 |
| Acquired from War Assets Administration: | | |
| Price established by negotiation: | | |
| Bowling Green, Ky | Oct. 15, 1947 | [1] 431,500 |
| Milwaukee, Wis | Aug. 27, 1946 | 3,700,000 |
| Price established by bids: | | |
| Decatur, Ill | Mar. 18, 1947 | 650,000 |
| De Kalb, Ill | (2) | 475,000 |
| Milwaukee, Wis | Nov. 19, 1947 | 2,122,000 |
| Somersworth, N. H | Apr. 24, 1947 | 775,000 |
| Tell City, Ind | June 4, 1947 | 851,001 |

[1] Price includes cost of equipment acquired with plant.
[2] Purchase not closed. Bid has been accepted by War Assets Administration but is subject to approval by Department of Justice.

Senator O'MAHONEY. I meant manufacturing plants, of course.

Mr. WILSON. Between 90 and 100.

Senator O'MAHONEY. Well, it would be interesting to know how many sales offices you have, too.

Mr. WILSON. I should have brought it.

We will put it in the record.

(The information is as follows: General Electric and its affiliates have 127 manufacturing plants in 94 cities and sales offices in 149 cities.)

Senator O'MAHONEY. Do you know what proportion of your present sales are on Government contract?

Mr. WILSON. Yes, sir.

Senator O'MAHONEY. The reason I ask that is because I regard—and I hope correctly—a Government contract as a riskless contract. You take no risk on that, or do you?

Mr. WILSON. Is that right? If you do not take a risk, I do not know what you call it, but I think you take a risk. Some you do and maybe some you do not.

Let me answer your first question. You are thinking largely of the war-preparation or defense contracts; are you not?

Senator O'MAHONEY. Naturally.

Mr. WILSON. You do not have reference to a generator that we might build, be successful in getting the order for some power company in the Northwest; you do not mean that?

Senator O'MAHONEY. No.

Mr. WILSON. It is all the same money, the taxpayers' money. Sixty-five million dollars for 9 months, and probably it will go over 100 million dollars for the year. My guess is that 1949 ought to double.

Senator O'MAHONEY. That is pretty good business.

Mr. WILSON. You mean pretty good business in what way?

Senator O'MAHONEY. It is pretty good business, certain payment?

Mr. WILSON. All our business is pretty near certain payment. I would not differentiate between sure pay and others because other people are pretty good, too. You are thinking of profitwise; are you not?

Senator O'MAHONEY. Yes.

Mr. WILSON. It is rotten business.

Senator O'MAHONEY. Is it figured in in this amount which you gave?

Mr. WILSON. The whole 65 million dollars is within that $1,500,000,000.

Senator O'MAHONEY. In what respect is it rotten?

Mr. WILSON. Because it only makes us on the year, to date, 1$\frac{7}{10}$ percent net. Would you call that good business?

Senator O'MAHONEY. Well, of course, there are a lot of bonds, current bonds, that are a part of our national debt that do not bring any greater return than that.

Mr. WILSON. Of course, Senator, there are a lot of things that have to be taken into consideration besides whether you made 1$\frac{7}{10}$ on 65 million dollars over the year or 100 million dollars as I think it will be.

Just let me take the mystery out of why I say it is not good business. I would like to go on record that I think we ought to do it, and we will continue to do it, and we will give it everything we have; and that at one time, 6 months ago, when I investigated it, I found that we had 905 of the best scientists and the best engineers in the General Electric involved in Government stuff for 65 million dollars' worth of business in the first 9 months.

Senator O'MAHONEY. These contracts are being renegotiated; are they not?

Mr. WILSON. They have not as yet.

Senator O'MAHONEY. They are subject?

Mr. WILSON. Some of them are subject to renegotiation; that is right.

Senator O'MAHONEY. I recall that last year when we were appropriating for some of the defense contracts, at least particularly with respect to the Air Force, that we wrote that authority into the appropriation bill.

Mr. WILSON. Of course, many of the things we are charged with doing, and properly so, by the Government, I think are rather the blue-sky things; and it is very difficult to figure out what they are going to cost; and we made our mistakes in trying, and that accounts for the 1 percent.

Senator O'MAHONEY. I suppose you are aware that practically every Member of the Congress is constantly receiving suggestions and requests on behalf of little business?

Mr. WILSON. Yes.

Senator O'MAHONEY. The Small Business Committee of the Senate was continued during the Eightieth Congress, in both Houses, of course. It held hearings all through the country; and even now, representatives of little business are asking Members of Congress to do something for little business. They make this suggestion and that suggestion.

Mr. WILSON. Yes.

Senator O'MAHONEY. I noted the other day a speech that was made by a very prominent and patriotic leader of the Investment Bankers' Association deploring what he called the passion of the people for security.

Your statement indicates that you believe we ought to provide for security?

I have noticed some of this talk about risk capital; that it comes from those who are leaders in the speculative splurge to, which the chairman, referred back in the twenties. Now, have you any suggestion to make to this committee as to what it should recommend with respect to creating a stable climate for little business to survive?

Mr. WILSON. No, I do not have, unfortunately, Senator; because I believe that the atmosphere that is needed for progress and security for little business is really the same as for medium business and big business. I do not differentiate.

You see, in my business—and it is about the only business that I know anything about which is worth while, if at all—we deal so intimately and are so dependent, if you please, on literally hundreds and thousands of small businesses, and I find them in a pretty healthy state, going along well, making money, growing. I think they are coming along fine, which of course delights me.

Just remember that in the distribution of our goods we are dependent on the abilities and the financial position and all that sort of thing of literally hundreds of thousands of small businesses in the securing of our materials, which amount to almost a billion dollars a year. We are dependent on the supply for raw materials and components from more hundreds of thousands.

So, I never can see much in this differentiation between the requirements of little business, medium business, and big business. I think the atmosphere necessary for the growth of one is the same as it is for the growth of the other. I was brought up in small business, which may surprise you, Senator; I came from a small business.

Senator O'MAHONEY. I know that.

Mr. WILSON. I operated a little business; and I, as the operator of that little business, asked no favors of the big business, nor of the medium business, nor of Government, nor anything else, and did not need it.

Senator O'MAHONEY. But the fact remains that, when nothing was done by Government, the result was the great crash of 1929. Senator Flanders thinks that conditions do not exist now which existed then.

Mr. WILSON. I do not either, Senator, just for the record.

Senator O'MAHONEY. But there are witnesses who come to us from industry that say that soft spots are beginning to develop in industry.

Mr. WILSON. I think they are correct, Senator.

Senator O'MAHONEY. All right.

There are witnesses who cannot be regarded as spokesmen for Government who say that many industries—at the moment they are chiefly consumers' goods industries—which are being priced out of the market because of inflation. There was a pretty general feeling in the Congress last year and in the year before that Congress should take some positive action to prevent a continuation of inflation. There was a unanimous report both by the Democrats and by the Republicans of the House and Senate after the western subcommittee on the cost of living made its study; and, believe it or not, one of the recommendations of those Republicans and Democrats on that committee was that there ought to be an excess-profits tax.

In any event, there were recommendations that there should be positive action. Little business is asking us for positive action. When we did not have it, we got a depression; and if this pricing out of the market in the consumer industries, which is beginning to appear, according to the testimony of industrialists, if that should rise and begin to manifest itself in the durable-goods industries; would there not be some difficulty?

Mr. WILSON. Oh, great difficulties, Senator.

Senator O'MAHONEY. But you say that you have no recommendation to make to this committee for any Government action to prevent the depression which you know will be a very vicious and disastrous thing?

Mr. WILSON. Yes; just do not upset the applecart.

Senator O'MAHONEY. May I ask you: Do you feel that business should bear a substantial share of the cost of raising Government revenue sufficient to balance the budget and prevent a depression?

Mr. WILSON. Well, is not industry carrying a very substantial part of it, Senator?

Senator O'MAHONEY. Well, of course, the profits are going up and the tax rate has not.

Mr. WILSON. The tax dollars increase right with it; do they not?

Senator O'MAHONEY. Not ratably, sir.

Mr. WILSON. The same percentage is taken out of every dollar earned; is it not?

Senator O'MAHONEY. I am not testifying at the moment, and it is getting pretty late; but there are any number of things that could be said to compare the profit dollar of 1948 and 1949 with the profit dollar of 1941, 1944, and 1945. The cost of Government goes up with every dollar of increased inflation, with every dollar of goods for the Army, the Navy, the Air Force, for the Bureau of Reclamation, for the Army engineers for flood control, by every dollar by which the prices of durable goods go up.

Mr. WILSON. That is right.

Senator O'MAHONEY. For my part I do not believe that industrial leaders can safely, in defending their own companies and their own stockholders, come before committees of Congress and just shrug their shoulders and say, "We have no suggestions. Let it drift." I do not think that is wise.

That is all, Mr. Chairman.

Senator FLANDERS. Congressman Wolcott?

Representative WOLCOTT. I do not know whether we want to get into the President's 10-point program here; that is what Senator O'Mahoney has reference to.

Senator FLANDERS. Congressman Herter?

Representative HERTER. Yes, please.

There is an item on page 3 of your testimony where you speak about the competitors in really every line that you put out?

Mr. WILSON. Yes, sir.

Representative HERTER. How does your growth compare with that of the electrical industry in general for the same period for which you have given us the figures?

Mr. WILSON. Many, many units of the electrical industry have grown, their businesses have increased in about the same proportion that ours has.

Some were more substantial and some less.

Representative HERTER. In other words, you think that your growth has been more or less typical and not exceptional in the electrical industry?

Mr. WILSON. That is right.

Representative HERTER. My second point; we had some testimony last week in regard to the possibility of the brown-outs in certain cities because of the lack of power and there being a real shortage at the present time. That must necessarily be of real concern to you in your business?

Mr. WILSON. It is, sir.

Representative HERTER. I wonder if you care to comment as to how that shortage is being met?

Mr. WILSON. I think it is on the way to being met pretty substantially, Mr. Congressman. For example, our output of generating equipment in 1948 is more than double that of 1947. Since the output in generating equipment was more than a million-kilowatt capacity, that will have a very substantial effect as it is put on the lines in various parts of the country.

Representative HERTER. Do you expect that when you have those orders filled, replacement orders and new orders will maintain your capacity?

Mr. WILSON. Again I go back to my confidence in this American system of ours being a dynamic thing. I do not think we have reached the end of the road on growth yet. To show our confidence in it, sir, although the new plant that we have just provided does not increase our output by more than 15 percent, we have just put $30,000,000 into a new plant for generating equipment.

We would not do that if we did not feel that the country was going to require new kinds and larger kinds of generating equipment.

Representative HERTER. You feel that there will be a steady flow of demand?

Mr. WILSON. Yes, sir; I believe there will be a steady flow of that and the utilities will buy to match the country's growth.

Representative HERTER. What has been the effect of consumer credit regulation, reimposition of regulation W on your business?

Mr. WILSON. Of course with regard to that, I only know what I hear because to date it has been a small issue with us, but dealers pretty generally around the country tell me that with respect to the major items in our business such as refrigerators, electric ranges and dish washers, the big items, the $200 and $300 items, that regulation W has definitely reduced the volume of those dealers. The public just had to forego the purchase.

Representative HERTER. At the same time would you care to comment on the desirability of maintaining that kind of credit restriction in the inflationary situation?

Mr. WILSON. Well, I believe it may be desirable to change the figures somewhat, Mr. Congressman, to hold up the volume and keep up employment sometime in the next year. I think it would be desirable.

Representative HERTER. You think there should perhaps be an easing of those restrictions.

Mr. WILSON. That is right.

It would be helpful to keeping the economy perking in good shape.

Representative HERTER. You are not afraid that it would increase the inflationary factors?

Mr. WILSON. If done wisely, I do not think it would.

Representative HERTER. Thank you.

Representative WOLCOTT. On regulation W, Mr. Wilson, I have heard it said, and you have repeated it here, that regulation W has slowed up sales somewhat. I wonder perhaps if the slowing up of sales was not attributed as much to the so-called buyer resistance in anticipation of lowering prices as to regulation W?

Mr. WILSON. I do not think so. But it is a matter of opinion. I talked to our dealers, of course, in various parts of the country and that is where I get the best information and we shopped the dealers all over the country to try to get the feel of the situation. I do not think that has been a great factor. I think one of the things that has been a factor is that, of course, in pretty nearly every one of those lines, while there is not yet a free supply in every one, there is a better supply. I mean it is growing and has been mounting month by month and I think as the supply came up and there was not such a mad scramble to get the item for any price, I think people have bought more cautiously and that, I think, has had an effect.

Many of them, of course, saw it up here and thought it might go up here.

Representative WOLCOTT. People have seen the appliances come into the market rather rapidly.

Mr. WILSON. That is right.

Representative WOLCOTT. I had a reaction just the other day, a man who is in my acquaintance who would not be influenced by regulation W. He was going to buy his wife an automatic washing machine for Christmas. She had been talking with the women in the neighborhood and she suggested that he give her a Christmas card with an IOU in it for one washing machine because of the certainty that the price of washing machines was going down next month.

Mr. WILSON. Yes.

Representative WOLCOTT. I wondered how general that was?

Mr. WILSON. You picked out an item and I could name you a couple more. There are a number of businesses, not only my own, but I know dealers handling other lines are telling us the same story, where there has been quite a sudden falling off and an obvious great resistance. Maybe the washing machine, the automatic washing machine, I think you said, is an illustration.

Certainly a dishwasher is an example. For a while our dishwashers were going up like that, but we notice resistance there and resistance is very largely due to the cost of installation. I suppose 10 years ago the cost of installation might have been $25. Today, sometimes, it amounts to 50 percent of the cost of the dishwasher.

So, people naturally resist that and it is almost hard to believe, but we get dealers all over the country telling us that wherever you have these very high installation costs, people will not buy.

Representative WOLCOTT. There are all these other factors which have slowed up sales that cannot be attributed to regulation W?

Mr. WILSON. I think that is true because in small appliances regulation W has nothing to do with it. Some of them have slowed up. There are a number of notable cases. Incidentally, and a very strange thing, in two notable cases among them business fell off sharply, but in the last 60 days we have seen it gradually begin to creep up again. What that portends, I do not know, but it is a strange fact.

So, the various items are a little confusing yet. In other words, the trend is not very positive.

Representative WOLCOTT. Thank you.

Senator FLANDERS. Mr. Wilson, we thank you for your testimony and for the frank way in which you have answered questions and we will now excuse you.

This session will reconvene at 2:30 this afternoon when we will have as our witness Mr. Coyle, vice president of the General Motors Corp.

(Thereupon, at 12:35 p. m., the subcommittee recessed to reconvene at 2:30 p. m. of the same day.)

GENERAL ELECTRIC CO.,
*New York 22, N. Y., December 29, 1948.*

Senator RALPH E. FLANDERS,
*Chairman, Subcommittee on Profits,*
*Joint Committee on the Economic Report,*
*United States Senate, Washington, D. C.*

DEAR SENATOR FLANDERS: I have, in the course of my reading of the stenographic transcript of the hearings covering my appearance before your subcommittee on December 20, 1948, discovered that one or two statements which I made in an attempt at humor are subject to serious misconstruction if read literally.

The statements in question appear on pages 1031 and 1032 of the typewritten transcript [p. 488 of the printed hearings], and relate to the questions which you and Senator O'Mahoney put to me in regard to "monopoly profits."

I am sure you and others of the committee realized at the time that my replies were not made in a serious vein; however, in order to clarify the record I wish to emphasize that the General Electric Co. is not engaged and does not wish to be engaged in any enterprise resulting in monopolistic profits. I am completely opposed to any such activities, and we have made it abundantly clear to our entire organization that it is our policy to observe both the letter and the spirit of the antitrust laws in every respect.

I would appreciate it very much if this letter can be made a part of the record of my testimony before your subcommittee.

Very truly yours,

C. E. WILSON.

AFTERNOON SESSION

(Whereupon, at 2:45 p. m., the subcommittee reconvened, pursuant to the taking of the noon recess.)

Senator FLANDERS. The hearing will come to order.

Our witness this afternoon is Mr. M. E. Coyle, of General Motors. We had hoped to have Mr. Charles E. Wilson, president of General Motors, here. I thought it would be a bit intriguing to have two Charles E. Wilsons here together and add up the sum total of the sales of the two organizations into a figure of unparalleled magnitude—profits also, I think, Senator O'Mahoney—but Mr. Wilson has the best of excuses for not being here. He is on a Government mission to Germany in connection with the question as to how much of German industry should be dismantled.

Mr. Coyle, will you take the chair?

## STATEMENT OF M. E. COYLE, EXECUTIVE VICE PRESIDENT, GENERAL MOTORS CORP., DETROIT, MICH., ACCOMPANIED BY ALBERT BRADLEY, EXECUTIVE VICE PRESIDENT, AND FREDERIC G. DONNER, VICE PRESIDENT, GENERAL MOTORS CORP., NEW YORK, N. Y.

Senator FLANDERS. For the sake of the record, Mr. Coyle, you will give your name, your position, your connection, and your address.

Mr. COYLE. Mr. Chairman, my name is M. E. Coyle. I am executive vice president of General Motors. My address is at General Motors Building, in Detroit, Mich. That is my business address.

I have since early 1946, in June of 1946, been executive vice president of General Motors, with supervisory jurisdiction over the passenger car, truck, body assembly, and accessory division operations of General Motors.

Senator O'MAHONEY. Are those all in one division?

Mr. COYLE. No; all of those are separate divisions: Buick, Olds, Cadillac, Chevrolet, Pontiac, the truck company, Fisher Body, the various assembly plants over the country, and the various accessory divisions.

Senator O'MAHONEY. I understood you to use the singular. That is why I asked you.

Mr. COYLE. No. They are all separate divisions.

Senator O'MAHONEY. How many divisions?

Mr. COYLE. There are 12 accessory divisions, I believe. There are 23 divisions under my jurisdiction. It represents approximately 70 percent of the total volume of General Motors. They exclude the engine divisions like Allison and Electromotive, Diesel engine, and the household equipment such as Frigidaire and the overseas operations.

Senator FLANDERS. Mr. Coyle, you have a rather lengthy manuscript here of some 30 pages. It all, of course, will be in the record. Do you feel that you could shorten it somewhat?

Mr. COYLE. I think I can, very definitely, Senator. If I might, I would like to make just a preliminary statement prior to dealing with the manuscript, and then refer to only some of the high lights within the manuscript itself. We submitted this on Friday, I believe, and we hope you have had an opportunity to go over it and familiarize yourself with some of the points. There are some things in it we would like to high-light briefly. I think it would be a waste of your time to attempt to read it all into the record as long as it can be filed.

I would like to introduce my associates here. Mr. Albert Bradley, over on the right, is also executive vice president. I neglected to say that I have been a member of the board of directors since 1937; Mr. Bradley has been a member of the board since 1933.

Senator FLANDERS. What does General Motors do with the two executive vice presidents?

Mr. COYLE. We do better than that. We have four. We are really a large institution with 380,000 people. The executive vice presidents have only the jurisdiction and responsibilities that are assigned to them by the president. They are merely assistants to him on any assignment that he gives to them.

Mr. Bradley is a member, as I am, of the administration and operations policy committees. The latter committee is comprised of 12 members of the board. They have jurisdiction over the prices of their products and of all operations, expansion, and so forth, up to the point where it becomes a financial operation, and then it goes over to the financial policy committee. Mr. Bradley is chairman of the financial policy committee. I am not a member of that. He has supervision over the financial operations of the corporation and of the legal staff and of the outside investments of General Motors, like GMAC and operations of that kind.

Mr. Donner, next on my right, is a vice president of General Motors and a member of the board of directors since 1942. He has direct jurisdiction, under Mr. Bradley, of all the financial operations of the corporation. He is a member of the administration and operations policy and of the financial policy committees.

So taking the 3 of us, there are 30 directors of General Motors and 3 of us are here before your committee.

Senator O'Mahoney. That is a pretty good representation.

Mr. Coyle. Yes, sir; it is.

Senator O'Mahoney. May we have the full names?

Mr. Coyle. Albert Bradley and Frederic G. Donner.

We have the statement that you referred to, Mr. Chairman. As you say, it is rather long but, on the other hand, we undertook to make as complete an answer as we could. Quite naturally our statement is based on our viewpoint, and our viewpoint always is based upon our experience.

I mentioned to you that I had been executive vice president since 1946, for 12½ years, prior to that I was general manager and chief administrative officer of Chevrolet. But I have been with the General Motors Corp. since December 26, 1911. That is a period a little less than a week of being 37 years, which is, after all, quite a long time. The industry itself was quite young in those early days when I first came with it.

In 1911 the automotive industry produced 210,000 units. In March 1948 General Motors Corp. produced 209,597 units, almost equivalent to the 1911 production of the industry, of which there were many, many producing units in those years. The accumulated production of automobiles through the first 12 years from 1900 through 1911 was only 746,544 as against the 737,227 General Motors made in the first 4 months of this year. We would have made more in the early part of this year if we had been able to get the necessary materials because we did have the capacity and there was a demand for our products.

Strangely enough, people in 1911 and 1912 were talking about the saturation point of our industry. The bankers were quite reluctant to make an investment and many stockholders felt likewise. That is easily understood because there were more than 1,850 different makes of cars offered through the years here in America, and there are only 34 of those names still surviving. That is counting separately each unit of General Motors and Ford, Chrysler, Kaiser-Frazer and so on, but not duplicating where, as with Chevrolet, there are passenger cars and trucks. That name is counted only once.

1916 was the first year in which the industry made a million cars in one calendar year. It made over 1,600,000 that year. 1926 was the first year, 22 years ago, that the industry made more closed bodies than open bodies. So the tourings and roadsters were in predominant numbers up to that time.

There has been a very high profit, as you well know, in the automotive industry for those companies that survived, but there were 98 percent of the companies that entered the industry that did not survive. So the risk is exceedingly high, with a mortality rate of 98 percent. That is the pattern. Wherever there is a high profit, there is a very high risk.

The General Motors Corp. had been in existence only slightly more than 3 years when I became associated with it in 1911. It was formed by putting several companies together with the idea of benefiting through mass production, of which the automotive industry is, I think, perhaps the best example we have in this country. There was also another reason. The mortality rate in the industry being so high, a company that had a poor product in 1 year—some mechanical difficulty, or a design that did not appeal to the trade—could quickly and sometimes did pass out of existence just in a single year or in a few months, the financial hazard was so great.

By putting several of them together it appeared and was later proved that some of these companies could survive by having one company in the group have a good year and thereby help to tide over some of the others.

In 1910 General Motors owed over $5,000,000, which seems in the present General Motors picture, a rather small sum of money. But they had to have another $10,000,000, and if they hadn't got it, they would have gone broke. The General Motors units would have been added to those one-thousand-eight-hundred-odd that did actually pass out of existence.

Other people had an opportunity to invest in it at that time. The bankers did, and they established very hard and rigid terms for General Motors to get that extra $10,000,000. General Motors had to mortgage all of its plants and properties. Its principal stockholders had to hypothecate their stock and General Motors was to repay the loan over the next 5 years in which $3,000,000 a year was repaid, plus interest.

Senator O'Mahoney. What was that period?

Mr. Coyle. Five million owing in 1910. General Motors borrowed another 10, which made 15 in the aggregate to be paid back over 5 years from 1910 to 1915 at $3,000,000 a year, plus 6-percent interest. The bankers demanded mortgages on all the properties. Some of the principal stockholders had to hypothecate their stock as security for this loan and turn the management of the corporation over to a voting trust which was paid out in 1915, when it went back into the hands of the stockholders.

Then again in 1920 the situation was duplicated following the First World War. Business conditions were bad. At that time $80,000,000 rather than $15,000,000. The reason for that partially was overexpansion, overoptimism, if you will. The General Motors Building in Detroit was part of it. Some $20,000,000 was invested in that particular building. They had a bit of trouble arranging that loan. They finally did work it out and paid off that debt.

So the first period of about 1908 to 1920 was the formative period in General Motors, rather troublous times. There were a couple of periods when they might have checked out, as a lot of others have done. The 1920's was a period of growth and expansion. The period of the thirties following the depression of 1929 was the period of stabilization, where we had a little time to review our capacities and see what should be done with them and attempt to put ourselves on a more solid basis.

As we came up into the war years I would like to point out—there is a schedule I will refer to a little later—I think that without any question at all General Motors was one of the best assets our Nation had in time of war, as were the other companies in the automotive industry. If it had not been for the huge quantities of war materials that were made and turned over to the Government at exceedingly low prices, I cannot believe that America could have won the war. Many others helped, of course, but we did make a real contribution and we shut down as far as all of our domestic operations were concerned.

For instance, in 1941, with civilian production curtailed drastically in the second half, we produced nothing much but our parts business and a limited amount of cars and trucks and we did about 2½-billion-dollar business, of which 85 percent was commercial sales. In the year 1942, the first year of the war, we did almost the same amount of dollar volume and 85 percent of it was war production.

Now we have gone to the postwar period, and naturally this statement that we have presented to you which I had a good part in preparing—I didn't actually write all the words naturally, but the sense of the statement, the principles it sets forth here I am heartily in accord with and, as I first stated, it has much to do with the experience that I have had not only in General Motors, but in the industry.

## DESCRIPTION OF GENERAL MOTORS

We are outlining in this statement certain operating policies of General Motors. Also included are summaries of sales, employment, and profits as well as a discussion of the pricing policy that has been followed by General Motors over a long period of years. We hope that the information we are furnishing in this prepared statement will be helpful to your committee.

As background for the subject you have asked us to discuss, we feel that it would be desirable first to give you a thumbnail sketch of General Motors and how it operates. First of all, General Motors is not a holding company. It is an operating company, composed of a number of divisions with plants in 54 communities over the country in addition to activities in a number of countries abroad. It employs some 380,000 men and women, 340,000 of them in the United States, and is owned by more than 430,000 stockholders. In addition to our five makes of automobiles—Chevrolet, Pontiac, Oldsmobile, Buick, Cadillac—we manufacture in the United States, among other things, trucks and busses, Diesel locomotives and engines, Frigidaires and other household appliances, and fractional-horsepower electric motors. We also make automotive parts and accessories for our own divisions and for other manufacturers as well as service parts for cars already in use.

General Motors is highly integrated. In other words pay rolls are high in relation to sales since it manufactures many of the components used in its products. General Motors makes its own automobile bodies instead of purchasing them from outside sources. It makes its own engines, its own bearings, its own heaters, its own automotive electrical equipment, and innumerable other items that, in the case of other automobile manufacturers, are bought from other companies. In the 12 months ended September 30, 1948, the total value of all components and parts manufactured and sold to the car and truck divisions by other divisions of General Motors was about $1,350,000,000.

General Motors operates on a highly decentralized basis. Its operating divisions are largely self-contained organizations. Each divisional management is responsible, subject only to broad corporation policies, for the successful design, manufacture, and sale of its products.

General Motors was organized in the latter part of 1908 with Buick, Oldsmobile, Oakland—now Pontiac—Cadillac, Cartercar and Elmore passenger cars and Reliance and Rapid trucks, as a nucleus. The latter two passenger-car companies were later discontinued and Reliance and Rapid subsequently became GM Truck. In 1909 total factory sales of the industry were 127,000 vehicles, of which the General Motors companies turned out 19 percent. GM's proportion dropped to 9 percent of the industry's sales of 1,600,000 units in 1916; was 19 percent in 1923; and rose to 28 percent of 4,300,000 in 1926 and 44 percent of 3,400,000 in 1927. In the immediate prewar years of 1939–41, General Motors' proportion was 45 percent of a total industry average annual volume of 4,300,000 units. See Chart 1. Estimated 1948 sales are 5,300,000 vehicles, of which about 40 percent will come from General Motors plants in the United States.

General Motors growth, particularly in the last 20 to 25 years, has not been so much the result of absorption of other companies as of growth from within that has reflected its success in meeting the wants of customers in an efficient manner. General Motors has grown because it has been able to manufacture products of good quality at prices people could afford and were willing to pay. It has devoted large sums both to improvement of old products and development of new ones. Some General Motors developments have been successful. Some have not and have been written off as losses. The net result has been a series of substantial contributions to all forms of transportation and to the economy over the past 40 years. Many of these contributions are familiar to all of you. They include the self-starter, the two-cycle Diesel engine, Ethyl fuel, Hydra-Matic and Dynaflow automatic transmissions, the Turret Top, crankcase ventilation, "knees action" front springs, and the automatic choke.

Another result has been more and better jobs. Not only have employment and pay rolls increased greatly in General Motors, but there has been an even greater indirect increase. One out of seven persons gainfully employed is at work because of job opportunities created by the automobile industry.

## GENERAL MOTORS PHILOSOPHY

A cardinal point in General Motors' philosophy is summed up in our slogan, "More and better things for more people." Another way to state this is that we are always striving to give more for the money.

General Motors' success and progress over the years has been built on its ability to produce steadily greater values—lower prices or higher quality, or both—for the customer. Under inflationary conditions it is not always possible to achieve lower prices in this effort, but we still aim toward the lowering of costs in terms of what the dollar will buy. Only in this way can an organization continue to grow. Automobiles are durable goods which customers can buy or postpone buying as they see fit. At the moment, a shortage of transportation exists, but over the long term only by constant improvement can we hope to keep our products attractive to the customer.

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.

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.

## PRICING POLICY

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 prospect 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 mathematically 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.

It is estimated that since the industry was first started, over 2,000 makes of cars and trucks have been offered to the public at one time or another. Of this number only 54 are now on the market. Among those which have disappeared are many once in a strong position. Others have lost ground compared with earlier periods. Still others which came on the market in later periods now are selling in large volume and are more profitable than many older lines. This record clearly shows that the automobile business is one in which the risks are large and the need for skillful management great.

There are only two fundamental reasons for these shifts in and out of the industry and in position within the industry: (*a*) Ability to operate at a profit by keeping costs below the prices of a competitive market; (*b*) ability to design and offer to the public products with customer appeal from the standpoint of value, price, quality, and appearance. In other words, it is a case of the efficient and progressive producer coming out ahead over the long pull. In our industry a company's standing depends on its public reputation for delivering the most per dollar in a given price area.

### GENERAL MOTORS POSITION, PREWAR

There are several criteria that can be applied to measure the progress of a business. From the standpoint of the customer, the most important is improvement in the value of the product. As pointed out, value is determined by measuring price in terms of quality. Improvement in value can take place when the price is being reduced, stays the same, or even when it is increased. During the automobile industry's early period of rapid growth, improvement in value was reflected in lower prices. More recently greater car value has taken the form of increased roominess, and improved performance, durability, appearance, economy, and safety features.

Final judgment upon a business is rendered by the customer. This is true both in a sellers' and in a buyers' market. In our competitive society millions of customers vote every day for or against a product. How the customer votes depends upon the price and quality of the product. Thus some businesses, started in a small way, get large. Others stay small. Still others are voted out of the picture altogether.

The historical record of increasing customer approval for General Motors products is to be found in the figures which show how our share of the market has increased over the years. See chart 1.

Historical evidence of how this customer approval, combined with General Motors ability to produce efficiently and on an economically sound basis, produced results for the stockholders is to be found also in our profit record. In the 10 years from 1929–38, inclusive, General Motors was the only automobile manufacturer to show an unbroken record of earnings. Even in the best years there were a number of companies which showed losses. General Motors had to pay market prices for materials and the same wages as other companies in the industry. It has been profitable because of efficiency in operations and the outstanding customer appeal of its products.

As a progressive, successful business General Motors has meant widespread benefits not only for those directly connected with it—employees and stockholders—but, beyond that, for millions engaged in distributing its products and in supplying material. This is demonstrated by our record of expanding employment and pay rolls over the years.

Some businesses in other parts of the world have operated on the theory of restricting production and keeping prices high. The traditional American approach has been to keep costs low, values attractive and volume high. This has been the General Motors approach. Over the years it has produced constantly better values for customers.

### THE WAR YEARS

Up to this point this statement has been confined to discussing General Motors' record before the war. During the war years the situation was quite different. General Motors ceased to produce passenger cars, trucks, and other products for a competitive civilian economy; instead it converted its plants to the manufacture of weapons for the Government.

Among the war products turned out by General Motors for the armed forces were the following: 119,562,000 shells, 39,181,000 cartridge cases, 206,000 airplane engines, including jet propulsion engines, 13,000 complete bomber and fighter planes, 97,000 aircraft propellers, 301,000 aircraft gyroscopes, 38,000 tanks, tank destroyers, and armored vehicles, 854,000 trucks, including amphibious "Ducks", 190,000 cannon, 1,900,000 machine guns and submachine guns, 3,142,000 carbines, 3,826,000 electric motors of all kinds, 11,111,000 fuzes, 360,000,000 ball and roller bearings, 198,000 Diesel engines for Army and Navy use, and many other products.

General Motors early realized that due to the war the nature of the business had completely changed. There was only one customer—the Government. Early in 1942, in advance of the enactment of the renegotiation law, General Motors adopted a wartime pricing and profit limitation policy which can be summarized as follows: (1) to take war production contracts on a fixed price basis wherever possible and, where not possible in the first instance, to change to that basis as soon as circumstances permitted; (2) to make price reductions, applicable to products already delivered as well as to future deliveries, as cost reductions materialized; and (3) to limit the over-all rate of profit from its manufacturing operations before provision for income and excess profits taxes but after all other charges, to approximately one-half the profit margin, expressed as a percentage of sales, realized in the year 1941 largely under the conditions of a competitive market.

General Motors income from manufacturing, excluding income from investments but after providing for income and excess-profits taxes, averaged 4.1 percent on net sales for the four war years 1942 through 1945.

### THE POSTWAR PICTURE

So far we have outlined the historical development of General Motors—its basic policies of organization and conduct of the business, and the economic results of those policies over the long term. The war and war-born inflation produced vast changes in our business as they did in the economy as a whole. As a result of price inflation and expansion in production and employment, the national income in terms of dollars is now at about three times prewar levels. The physical volume of production is probably about two-thirds higher than in 1936–41, and per capita real income has increased about 50 percent.

Figures on General Motors postwar business likewise are larger than prewar and for the same reasons: inflation and the increase in physical volume of production. An important point in this connection is that the increase in physical volume is accounted for principally by products other than passenger cars—replacement parts, trucks, Diesel locomotives, household appliances, Diesel engines, et cetera. For example, the replacement-parts business of GM's five car divisions and the truck division in terms of tonnage in the first 6 months of 1948 was at an annual rate nearly three times that of 1941. The postwar parts volume includes more than 1,000,000 automobile engines manufactured to replace worn-out engines in older cars. General Motors has been making a special effort during this period of shortages to supply owners of older cars with the parts they need to keep their cars operating even though such production has reduced the number of new cars that could otherwise have been made.

Products other than passenger cars currently account for a proportion of total sales up to 75 percent greater than prewar. For this reason it should be emphasized that in our business profit and other ratios cannot be based on passenger car volume alone. It is impracticable to express our physical volume in terms of one single unit of measure. There is no way to add up such diverse items as automobile spark plugs, Diesel locomotives, Frigidaires, ball bearings, fractional horsepower motors, and Diesel engines.

Reflecting inflation, dollar volume of sales has of course increased at a greater rate than physical volume. Total sales in 1948 are at an annual rate of 4.5 billion dollars as compared with an average of about 1.6 billion dollars in 1936–41. (See chart 7.)

Employment and pay rolls show large increases. Currently employed in the United States and abroad are 380,000 men and women as against 243,000 in 1936–41. Our average monthly pay rolls have nearly tripled—$104,000,000 in 1948 as compared with $37,000,000 in 1936–41. (See chart 2.)

## GENERAL MOTORS PRODUCT AND PRICE PICTURE

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.

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 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. (See chart 3.)

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. (See chart 4.) An interesting sidelight 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. (See chart 5.)

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.

### COMPETITORS' PRICES

Dealing specifically with General Motors passenger cars, the record shows that our prices today compare even more favorably with prices of competitors' cars than they did before the war. This is due to the stabilizing influence of our long-term pricing policy as well as to our efficiency as a manufacturer. As compared with the 75 percent increase in the latest GM list prices (including announced 1949 models), prices of competitors' cars (including announced 1949 models) are up 89 percent on the average since 1941. (See charts 3 and 3a.)

### PRICES AND DEMAND

It is common knowledge that since the war list prices of all but a few makes of cars have been lower than the customer has been willing to pay. This has been and is especially true of General Motors cars. This has been shown by our own surveys of so-called new-used car prices and was recently corroborated by one conducted by the Wall Street Journal. (In 1946 and 1947 premiums paid for new-used cars were much larger.) These surveys show that General Motors cars command among the highest premiums. They indicate what many people have been willing to pay for a General Motors car. (See chart 6.)

### POSTWAR VALUES

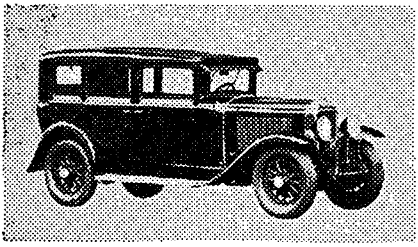
Inflation has pushed up prices of postwar automobiles as it has pushed up prices of other products. To what extent has the value the customer gets for his automobile dollar been affected from a long-term viewpoint?

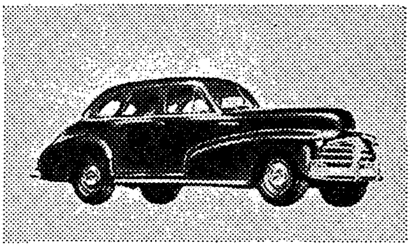
We would like to illustrate this point by a specific comparison of a present-day car with one of 20 years ago. Take the 1929 Buick, Model 27, four-door sedan which was priced at $1,320, manufacturer's list price, and the 1948 Stylemaster Chevrolet, four-door sedan, which is priced at $1,280, manufacturer's list price. Following are photographs of the two cars.

(The photograph referred to follows:)

## PROFITS FOR THE CUSTOMER

| | 1929 BUICK | 1948 CHEVROLET | | 1929 BUICK | 1948 CHEVROLET |
|---|---|---|---|---|---|
| Manufacturer's List Price | $1320 | $1280 | Shoulder Room -- Front | 49.5" | 54.1" |
| Horsepower | 74.0 | 90.0 | Shoulder Room -- Rear | 52.0" | 54.4" |
| Maximum Speed | 64.75 mph | 81.8 mph | Hip Room -- Front | 47.4" | 58.0" |
| Fuel Economy (Miles per Gallon-30 MPH) | 14.7 | 22.7 | Hip Room -- Rear | 47.5" | 48.5" |
| Curb Weight | 3,764 lbs. | 3,225 lbs. | Head Room -- Front | 36.3" | 37.3" |
| Number of Cylinders | 6 | 6 | Head Room -- Rear | 35.0" | 35.6" |
| Wheelbase | 115.75" | 116" | Leg Room -- Front | 40.2" | 42.4" |
| | | | Leg Room -- Rear | 41.6" | 39.3" |
| | | | Overall Width (Fenders or Body) | 69.3" | 72.8" |
| | | | Overall Height (Loaded 5 Passengers) | 72.5" | 66.1" |





Mr. Coyle. The following details about the two cars show how much more car the customer is getting today when he buys a 1948 Chevrolet than he did 20 years ago when he bought the 1929 Buick, that was introduced in July 1928.

| | 1929 Buick | 1948 Chevrolet |
|---|---|---|
| Manufacturer's list price | $1,320 | $1,280 |
| Horsepower | 74.0 | 90.0 |
| Maximum speed (miles per hour) | 64.75 | 81.8 |
| Fuel economy (miles per gallon—30 miles per hour) | 14.7 | 22.7 |
| Curb weight ... pounds | 3,764 | 3,225 |
| Number of cylinders | 6 | 6 |
| Wheelbase ... inches | 115.75 | 116 |
| Shoulder room, front ... do | 49.5 | 54.1 |
| Shoulder room, rear ... do | 52.0 | 54.4 |
| Hip room, front ... do | 47.4 | 58.0 |
| Hip room, rear ... do | 47.5 | 48.5 |
| Head room, front ... do | 36.3 | 37.3 |
| Head room, rear ... do | 35.0 | 35.6 |
| Leg room, front ... do | 40.2 | 42.4 |
| Leg room, rear ... do | 41.6 | 39.3 |
| Over-all width (fenders or body) ... do | 69.3 | 72.8 |
| Over-all height (loaded 5 passengers) ... do | 72.5 | 66.1 |

It should be pointed out that the manufacturer's list price for both cars excludes freight, taxes, and dealer handling. The Buick price did not include the spare tire and bumpers, which are included in the Chevrolet price. In addition the 1948 Chevrolet price includes a number of features not found on the 1929 Buick, for example, all steel body, 4-wheel hydraulic brakes, safety glass, sealed-beam headlights, synchro-mesh transmission, hypoid differential gears, automatic spark advance, voltage regulator, thermostatic controlled pressure cooling system, knee action suspension, low pressure tires, built-in luggage compartment, dash glove compartment, No-Draft ventilation, gear shift lever on steering column, and so forth.

Buick and other General Motors cars have made comparable advances during this period.

### POSTWAR ABILITY TO BUY

Some people have made the statement that the automobile industry is pricing itself out of the market. The implication is that automobile prices have gone up at a faster rate than the incomes of people who buy cars. The opposite is true.

More people can afford to buy new cars now than before the war in spite of the rise in new car prices and living costs. This is due to the fact that the number of families has increased by over 10 percent and the average disposable income per family by 1948 had increased about 85 percent over prewar, which was greater than the increase in the cost of living index or the prices of low-price cars. This improvement in family income was mainly the result of increased farm income and increased employment at higher wages. Employment was about 18 percent above 1941.

In addition to this, the income distribution has changed and family units at the middle and at the lower end of the income distribution are now receiving a larger share of the total income than before the war. This has enabled a larger proportion of families to become potential new car buyers.

Incomes of some segments of the population have increased much more than the average. For example the incomes of independent businessmen and farmers are considerably greater than before the war. In 1939, when farm prices were low, it took cash receipts from the sale of eight beef steers to buy a Chevrolet. Today the same number of steers would bring the price of two Chevrolets.

After consideration of all of the foregoing, it is reasonable to estimate that the number of people who are able to purchase new cars has increased as much as one-third over prewar.

### GENERAL MOTORS PROFIT POSITION

With a dollar volume of business nearly three times that of the 1936–41 period, and with a like increase in wage and salary payments, our dollar profits currently are less than two and one-half times their 1936–41 level. Our margin of profit—the return, including income from investments, on each dollar of sales—was 11½ cents in the 1936–41 period. For the 12 months ended September 30, 1948, this return averaged 8¾ cents. This is 2.75 cents or one-fourth less than in the earlier period which included a year of severely depressed business. (See chart 8.)

Any consideration of postwar profits must start with the fact that inflation has greatly increased the cost of doing business. In other words, the cost of living for business has gone up too. With sales in 1948 averaging $375,000,000 per month compared to $135,000,000 per month in 1936–41, General Motors at the present time is carrying $670,000,000 more of inventories and accounts receivable than in the 1936–41 period. Most of this increase is due to today's inflated price levels. Average inventories in 1936–41 were $230,000,000. Today they are $720,000,000. Receivables are up from $90,000,000 to $270,000,000. Larger cash balances are also needed to meet the higher dollar volume of business being done. All other capital requirements are greater. Machines, tools, and other facilities during 1948 cost about two-thirds more on the average than in 1936–41. Building construction costs have more than doubled.

Previous witnesses have already dealt at length with the difficulty of the economic measurement of profits in a period of inflation, and we do not want to add unnecessarily to their statements. We do feel, though, that it is worth while and revealing to lay before you what has been happening within General Motors so that our own figures may be more easily understood in terms of distributable profits.

As an example of the effect of inflation, let us look at the following: The average yearly net income of the business for the 3 years ended September 30, 1948, was $250,000,000. If an adjustment had been made during this period to measure the economic impact of the increase in the price level of inventories over prewar, $80,000,000 per year would have had to be set aside out of net income over the last 3 years to provide for this. If an adjustment had also been made to take into account the current inflated costs of plants and equipment, there would have been set aside for the replacement of plant some $15,000,000 on the average in each of these years. Thus, a total of $95,000,000 annually would have been set aside because of the impact of the higher price level on these two asset accounts and to reflect the amount by which distributable profits were reduced on account of increased price levels.

This leaves $155,000,000, which amount more nearly measures the distributable profits after allowing for the retention in the business of enough dollars to maintain the purchasing power of the funds invested in the business. Dividends paid averaged $136,000,000 in these 3 years. Some would refer to this figure of $155,000,000 as "economic income" which means the amount of net income left in terms of present dollars after provision has been made for the recovery of capital in real purchasing power or the preservation of the real invested capital.

Over and above this, expenditures for real estate, plant, and equipment in excess of the amount of depreciation provided on the basis of replacement cost values aggregated $400,000,000 over the last 3 years. There was also required additional working capital amounting to $160,000,000 excluding the effect of higher price levels on inventories alone. These capital needs had to be met, of course. They were met in part by the sale of securities to the public, and in part through the reinvestment of earnings over the years.

BENEFITS FROM REINVESTED EARNINGS

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. (See charts 11 and 12.)

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 result has been that General Motors has been able not only to hold its own in the highly competitive automobile market, but, through quality merchandise and good management, gradually to attract more and more customers. In addition, it has been able through pioneering research in a number of fields to create new products of outstanding value.

Our presentation has shown that General Motors' postwar profits are not out of line, at least on the upside, with prewar results in a highly competitive market and that higher dollar earnings are not the result of overpricing. It is a management responsibility to earn a profit. It is the directors' responsibility to decide how profits are to be used in the best interests of the business—what proportion to pay out in dividends and whether to retain a part of them for reinvestment in the business.

DIVIDENDS PAID TO GENERAL MOTORS STOCKHOLDERS

The fact that General Motors has had to reinvest a substantial portion of earnings in the business since the war has 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.

General Motors has more than 400,000 common stockholders and over 30,000 preferred stockholders. Most of the holders of common stock are small investors with 320,000 owning 50 shares or less. About 140,000 have holdings of 10 shares or less. More than 55 percent of the individuals owning stock are women. No individual holds as much as 1.5 percent of the outstanding General Motors common stock. The 22.7 percent common stock holding of E. I. du Pont de Nemours & Co. is, in turn, indirectly owned by about 91,000 du Pont stockholders.

In the year 1948, General Motors stockholders received dividends totaling $4.50 per share of common stock. This compares with average yearly dividend payments in the 1936–41 period of $3.46 per share. Thus, dividends in 1948 on a per share basis increased 30 percent above 1936–41 as against a 56 percent increase in employment, a 180 percent increase in pay rolls and a 180 percent increase in dollar sales.

Measuring dividends in another way, 1948 dollars are worth only about 60 percent of 1936–41 dollars in terms of purchasing power. This means that the 1948 dividend of $4.50 per share would buy only what $2.65 bought in 1936–41. This is what the stockholder looks at when he considers his "take-home pay." (See chart 10.)

## EFFECT OF TAXES

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 each 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, but 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.

### THE FUNCTION OF PROFITS

To limit discussion of profits to statistical terms is to overlook the fundamental question—the function of profits in our economy. This function is to provide incentive and the means for progress. The higher the profits the greater the incentive to competition. The hope of profits is the driving force of venture and enterprise. The realization of profits provides the seed corn for further growth. It should be added that only a profitable business can attract and hold able people.

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.

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.

General Motors is only one case. Other examples by the thousands could be chosen from among our more than 3,500,000 operating businesses, large and small. Their combined progress is the story of the function of profits in constantly renewing and reinforcing the vitality of our competitive system. It is the story of the growth and strength of America and of still greater opportunities ahead in the years to come.

CONCLUSION

It has seemed to us that it would be most helpful to your committee if we told our story in terms of General Motors. We have endeavored to do this in terms of our own prices and products and our policies and philosophy, which is the best way to explain how we operate. Our sales, costs, and profits can be understood only in terms of this background.

With respect to the financial data in which you indicated an interest, we would direct your attention to the following charts and tables accompanying this statement:

1. GM percent of total car and truck industry.
2. GM employment and pay rolls.
3 and 3a. Index of list prices (GM and others).
4. Bureau of Labor Statistics index of wholesale prices shows that motor vehicle price increases are smaller than most groups.
5. The increase in price of a Chevrolet since 1941 compared with price increases for certain important cost-of-living items.
6. Premiums shrink on "new-used" autos.
7. Tabulation: GM sales, earnings, dividends, income reinvested in the business.
8. GM net income as percent of sales.
9. GM percent return on net capital employed and percent return on total assets employed.
10. Earnings and dividends per share of present $10-par-value common stock in constant dollars.
11. Percentage of GM net income paid in dividends and retained in the business.
12. Net capital employed.

These statements, we hope, will meet your needs as set forth briefly in the section, Tabulation of Company Data, attached to your chairman's letter of December 1.

Your inquiries as to "level of profits" we have tried to answer by outlining our record in an industry that has, by common consent, been acknowledged as a most competitive one. We can do little more than place our present record against that background, for we know of no other way to judge whether profits are "too high" or "too low." It is prices that must be judged as "too high" or "too low" and it is the marketplace that passes that judgment.

You asked about "special reserves"—General Motors, since the war, has continued its policy of providing for depreciation on the basis of the cost of its plant in order to spread that cost over the anticipated useful life of the plant, taking into account technological and economic obsolescence as well as physical wear and tear. Depreciation continues to be provided on the basis of cost of the assets whose useful life is being depleted in the business. If we attempted to reflect the replacement equivalent of depreciation required, as pointed out earlier, the amount required as a charge against current earnings would have been still greater. In our own case, we have restricted the depreciation currently provided to that which is calculated on the basis of currently accepted accounting practices. As has been true for the last 20 years or more, such depreciation allowances, though acceptable on the basis of approved accounting practice, prove to be more than those allowed for tax purposes under present administrative procedures which concentrate on physical wear and tear.

In general, expenses allowable for tax purposes are normally limited to those which are currently incurred and paid out, while good accounting practice requires that provision be made currently for those charges which today's business is responsible for. An example is the type of long-term warranty (5 years in our own case), made on electric refrigerators. We provide a reserve currently when the unit is sold, but for tax purposes the cost is allowed only when the expenses are incurred over the 5-year period. Thus, the amounts currently provided will ultimately be allowed for tax purposes—it is only a matter of timing. This is true generally of such provisions, and in our own case, as in many industries, the amount allowed currently as a tax deduction may vary considerably from the amounts provided on the books, but only in the short run.

Thus, it is fair to say that our reserve provisions, including depreciation, are of the type allowed for tax purposes. The timing of their allowance for tax purposes may differ from that of the provision which good accounting practice requires for internal accounting purposes. The deferment of such deductions for tax purposes means, however, that tax payments today are higher than they would otherwise be.

We have told you the story of our pricing policies in the body of our statement. We believe that our pricing policies have successfully met the test of a highly competitive market in the 1920's and 1930's. We believe that these policies have resulted in lower profits currently than might easily have been realized by unrestrained, short-term pricing policies. Our record, we hope, will speak for itself.

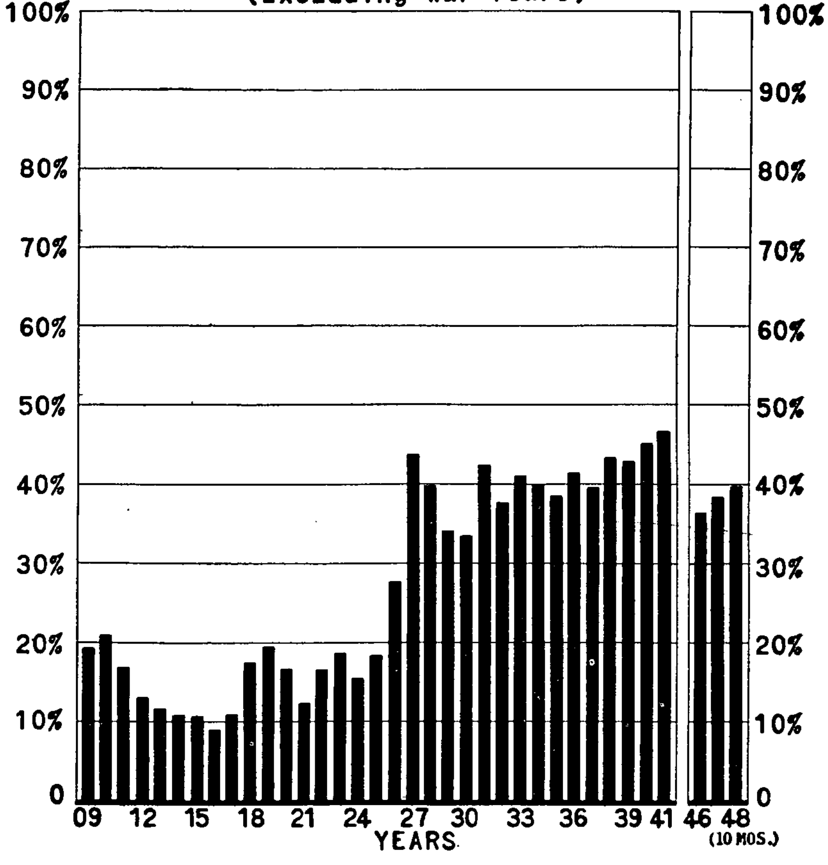
Finally, you asked us as to the sources of our capital. Exhibits 7 and 12 tell that story in a statistical form. We have already outlined it briefly in our statement. A different financial policy would have had a different result, of course, but it was our considered judgment that it was in the best interest of the stockholders, and of our employees and customers as well, to accomplish this as we have done. The impact of inflation presented us with a tremendously increased capital requirement. We could not afford to fail in meeting these needs.

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.

It is on that record that we must rest, and we believe, most earnestly, that it has been good for our customers and employees as well as for our stockholders that we have followed the financial policies that we have. It is hard to see who has suffered if it is the purpose of a business to keep itself in such condition that it can go forward, aggressively and confidently, in a competitive industry and a dynamic economy such as ours.

(The documents referred to follow:)

GM % OF TOTAL CAR & TRUCK INDUSTRY
BASED ON U.S. FACTORY SALES
(Excluding War Years)

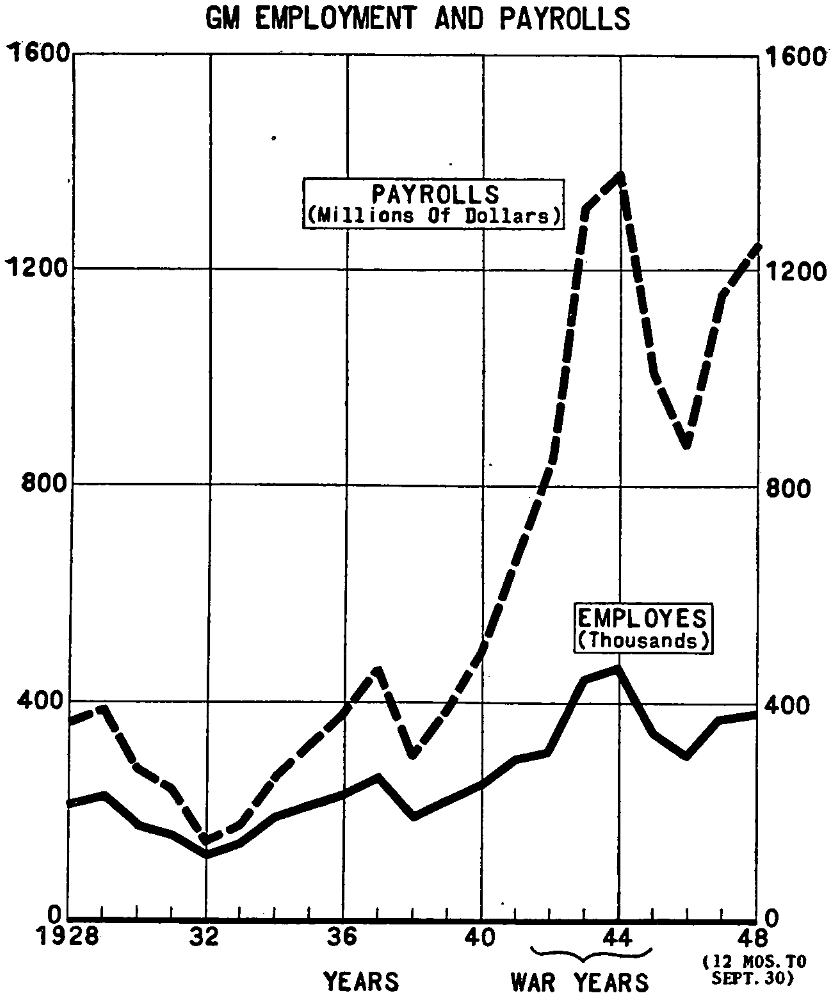



SOURCE: GM ACTUAL, INDUSTRY AS REPORTED BY AUTOMOBILE MANUFACTURERS ASSOCIATION

*GM percent of total car and truck industry, based on United States factory sales (excluding war years)*

| Years: | Percent | Years: | Percent |
|---|---|---|---|
| 1909 | 19.4 | 1927 | 43.8 |
| 1910 | 21.0 | 1928 | 39.9 |
| 1911 | 17.0 | 1929 | 34.1 |
| 1912 | 13.1 | 1930 | 33.5 |
| 1913 | 11.8 | 1931 | 42.3 |
| 1914 | 10.7 | 1932 | 37.6 |
| 1915 | 10.6 | 1933 | 41.1 |
| 1916 | 9.0 | 1934 | 40.0 |
| 1917 | 10.8 | 1935 | 38.5 |
| 1918 | 17.4 | 1936 | 41.4 |
| 1919 | 19.6 | 1937 | 39.6 |
| 1920 | 16.6 | 1938 | 43.3 |
| 1921 | 12.3 | 1939 | 42.8 |
| 1922 | 16.5 | 1940 | 45.0 |
| 1923 | 18.7 | 1941 | 46.7 |
| 1924 | 15.4 | 1946 | 36.4 |
| 1925 | 18.5 | 1947 | 38.5 |
| 1926 | 27.7 | 1948 (10 months) | 39.9 |

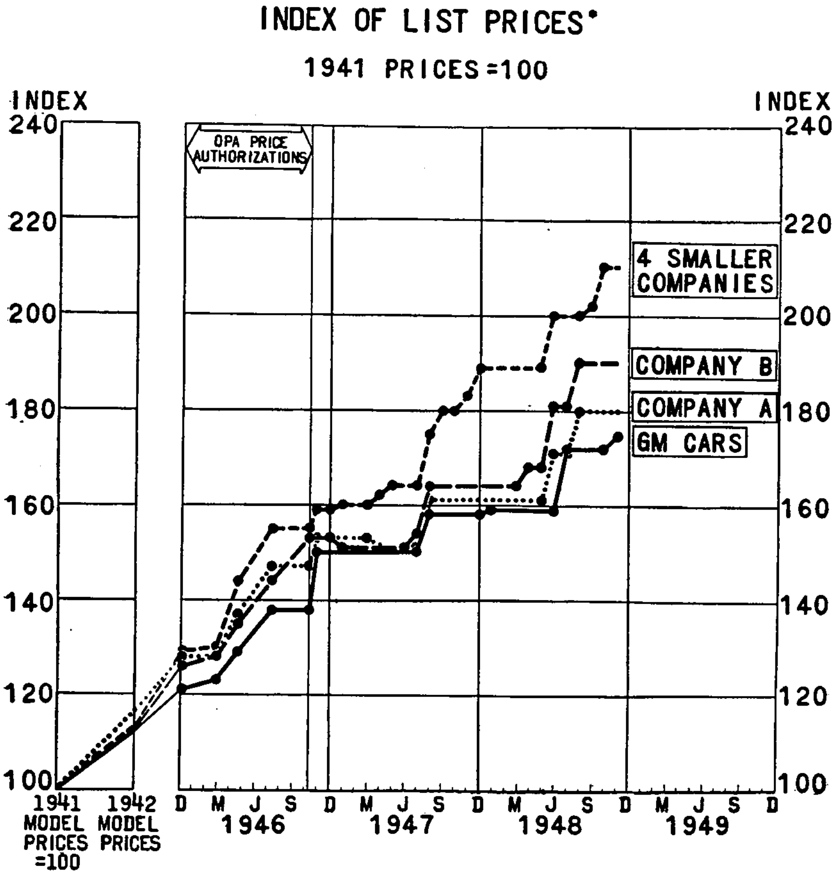
Source: GM, actual; industry, as reported by Automobile Manufacturers Association.


GM EMPLOYMENT AND PAYROLLS
PAYROLLS
(Millions Of Dollars)
EMPLOYES
(Thousands)
1600
1200
800
400
0
1928
32
36
40
44
48
(12 MOS. TO SEPT. 30)
YEARS
WAR YEARS

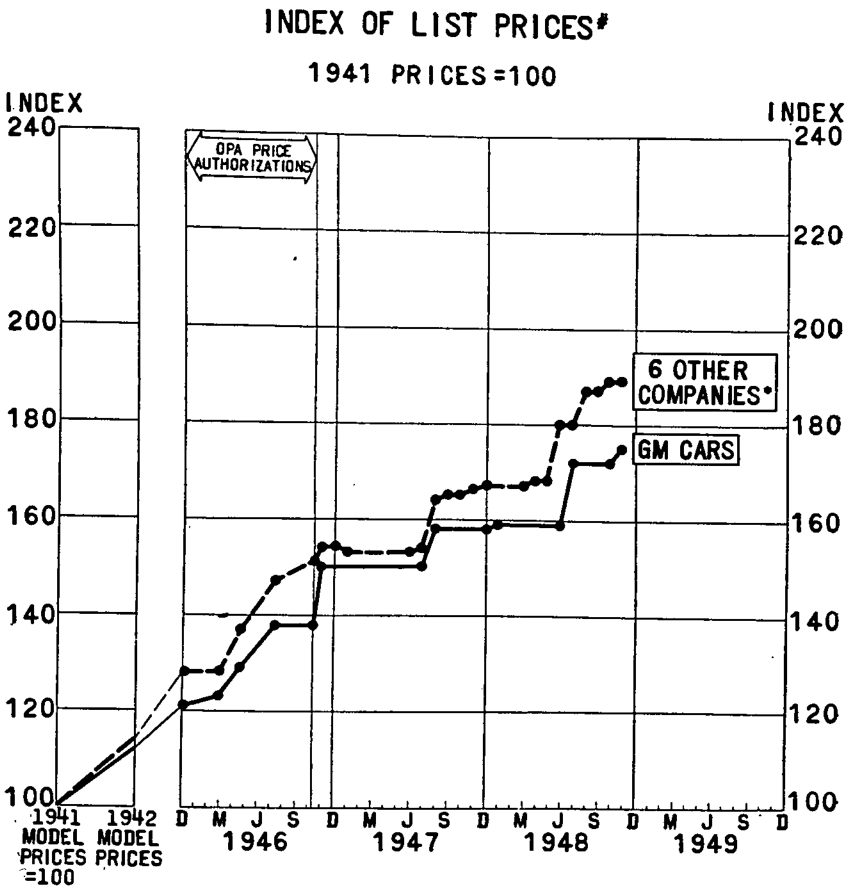
*General Motors Corp. employment and pay rolls*

| Year | Total pay rolls | All employees | Employees in the United States |
|---|---|---|---|
| 1928 | $365,352,304 | 208,981 | 200,000 |
| 1929 | 389,517,783 | 233,286 | 225,431 |
| 1930 | 279,410,144 | 172,938 | 164,189 |
| 1931 | 236,520,474 | 157,586 | 144,868 |
| 1932 | 143,255,070 | 116,152 | 112,128 |
| 1933 | 171,184,315 | 137,764 | 134,655 |
| 1934 | 263,204,225 | 191,157 | 173,539 |
| 1935 | 327,677,624 | 211,712 | 189,142 |
| 1936 | 384,153,022 | 230,572 | 206,657 |
| 1937 | 460,451,744 | 261,977 | 236,054 |
| 1938 | 300,825,930 | 189,039 | 163,301 |
| 1939 | 386,292,203 | 220,434 | 194,887 |
| 1940 | 492,246,017 | 249,386 | 224,181 |
| 1941 | 669,744,870 | 303,827 | 272,478 |
| 1942 | 859,314,062 | 314,144 | 279,030 |
| 1943 | 1,321,999,829 | 448,848 | 411,657 |
| 1944 | 1,380,032,467 | 465,617 | 427,905 |
| 1945 | 1,007,563,689 | 345,940 | 313,975 |
| 1946 | 870,215,992 | 300,634 | 273,392 |
| 1947 | 1,155,388,163 | 375,689 | 337,939 |
| 1948 (12 months to Sept. 30) | 1,247,088,752 | 380,488 | 341,209 |

NOTE.—These data represent combined annual pay rolls, including salaries and wages, and average number of employees for General Motors Corp., GMAC, GEIC, and other wholly owned subsidiaries. They exclude, however, 2 foreign manufacturing subsidiaries and Yellow Truck & Coach Manufacturing Co. prior to the acquisition of the property and assets of that company on Sept. 30, 1943. The number of employees represents an average for the year based on employees actually working each week.




* BASED ON PRICE OF 4-DOOR SEDAN OF EACH SERIES WEIGHTED BY 1941 MODEL YEAR REGISTRATIONS OF THE COMPARABLE SERIES.




* SIX COMPANIES ACCOUNTED FOR 89% OF THE INDUSTRY'S U.S. FACTORY SALES EXCLUDING GM IN THE FIRST TEN MONTHS OF 1948.

# BASED ON PRICE OF 4-DOOR SEDAN OF EACH SERIES WEIGHTED BY 1941 MODEL YEAR REGISTRATIONS OF THE COMPARABLE SERIES.

*Index of list prices* [1]

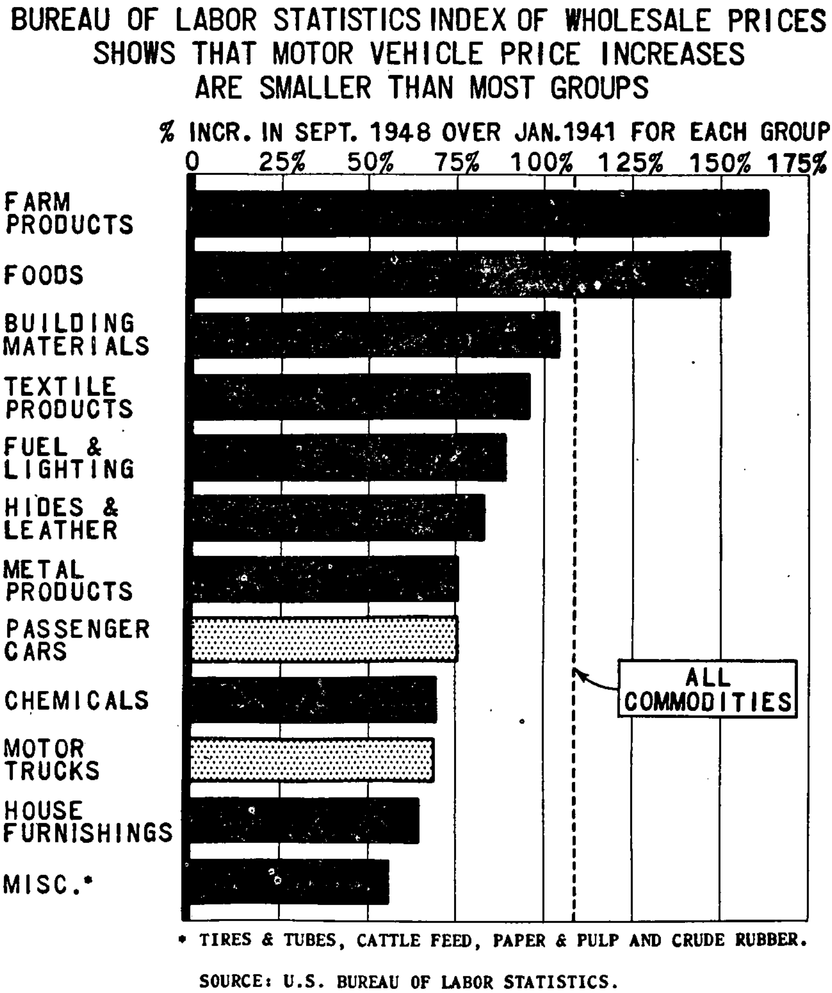
[1941 prices=100]

| | GM | 6 other companies [2] | Company A | Company B | 4 smaller companies |
|---|---|---|---|---|---|
| 1941 | 100 | 100 | 100 | 100 | 100 |
| 1942 | 112 | 114 | 116 | 112 | 113 |
| OPA price authorizations: | | | | | |
| OPA reconversion price late in 1945 and early 1946 | 121 | 128 | 128 | 126 | 129 |
| Including wage increase, March–April 1946 | 123 | 128 | 128 | 128 | 130 |
| Including wage and material increase, May 22, 1946 | 129 | 137 | 137 | 135 | 144 |
| Including prewar discount Aug. 12, 1946 | 138 | 147 | 147 | 144 | 155 |
| Last OPA price, Nov. 10, 1946 | 138 | 151 | 147 | 153 | 155 |
| 1946: | | | | | |
| November, after decontrol | 150 | 154 | 153 | 153 | 159 |
| December | 150 | 154 | 153 | 153 | 159 |
| 1947—January | 150 | 153 | 153 | 151 | 160 |
| February | 150 | 153 | 153 | 151 | 160 |
| March | 150 | 153 | 153 | 151 | 160 |
| April | 150 | 153 | 151 | 151 | 162 |
| May | 150 | 153 | 151 | 151 | 164 |
| June | 150 | 153 | 151 | 151 | 164 |
| July | 150 | 154 | 151 | 154 | 164 |
| August | 158 | 164 | 161 | 164 | 175 |
| September | 158 | 165 | 161 | 164 | 180 |
| October | 158 | 165 | 161 | 164 | 180 |
| November | 158 | 166 | 161 | 164 | 183 |
| December | 158 | 167 | 161 | 164 | 189 |
| 1948—January | 159 | 167 | 161 | 164 | 189 |
| February | 159 | 167 | 161 | 164 | 189 |
| March | 159 | 167 | 161 | 164 | 189 |
| April | 159 | 168 | 161 | 168 | 189 |
| May | 159 | 168 | 161 | 168 | 189 |
| June | 159 | 180 | 171 | 181 | 200 |
| July | 172 | 180 | 171 | 181 | 200 |
| August | 172 | 187 | 180 | 190 | 200 |
| September | 172 | 187 | 180 | 190 | 202 |
| October | 172 | 189 | 180 | 190 | 210 |
| November | 175 | 189 | 180 | 190 | 210 |

1949 model announcements in 1948: 2 makes of company B (April); 1 make of company B (June); 2 smaller companies (October); GM, 2 makes full line, 1 make partial line (November).

[1] Based on price of 4-door sedan of each series weighted by 1941 model year registrations of the comparable series.

[2] 6 companies accounted for 89 percent of the industry's United States factory sales excluding GM in the first 10 months of 1948.




*Bureau of Labor Statistics index of wholesale prices shows that motor-vehicle price increases are smaller than most groups*

| | Percent increase in September 1948 over January 1941 for each group | | Percent increase in September 1948 over January 1941 for each group |
|---|---|---|---|
| Farm products | 164.1 | Passenger cars | 75.4 |
| Foods | 152.8 | Chemicals | 69.6 |
| Building materials | 104.7 | Motortrucks | 69.2 |
| Textile products | 96.5 | House furnishings | 64.7 |
| Fuel and lighting | 89.6 | Miscellaneous [1] | 55.5 |
| Hides and leather | 83.1 | All commodities | 108.7 |
| Metal products | 75.9 | | |

[1] Tires and tubes, cattle feed, paper and pulp and crude rubber.

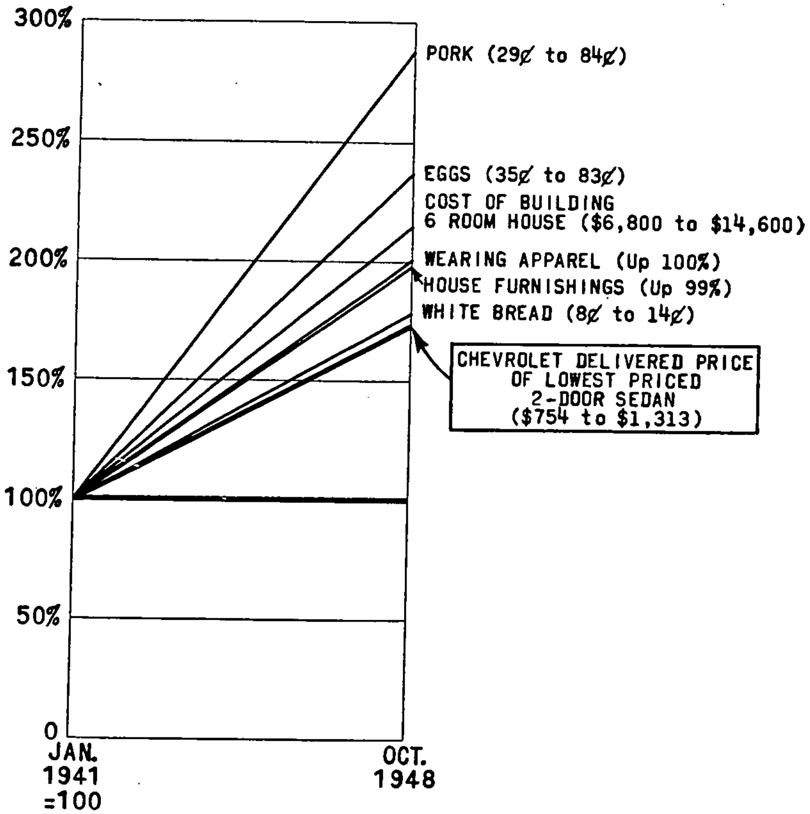
Source: U. S. Bureau of Labor Statistics.

*The increase in price of a Chevrolet since 1941 compared with price increases for certain important cost-of-living items*

| | October 1948 | January 1941 | Percent of 1941 |
|---|---|---|---|
| (a) Pork (per lb.) | $0.837 | $0.291 | 287.6 |
| (b) Eggs (per doz.) | 0.827 | 0.349 | 237.0 |
| (c) Cost of building six-room house | $14,623 | $6,797 | 215.1 |
| (d) Wearing apparel | 201.6 | 100.7 | 200.2 |
| (d) House furnishings | 198.8 | 100.1 | 198.6 |
| (b) White bread | $0.139 | $0.078 | 178.2 |
| (e) Chevrolet delivered price of lowest-priced two-door sedan at main factory city | $1,313 | $754 | 174.1 |

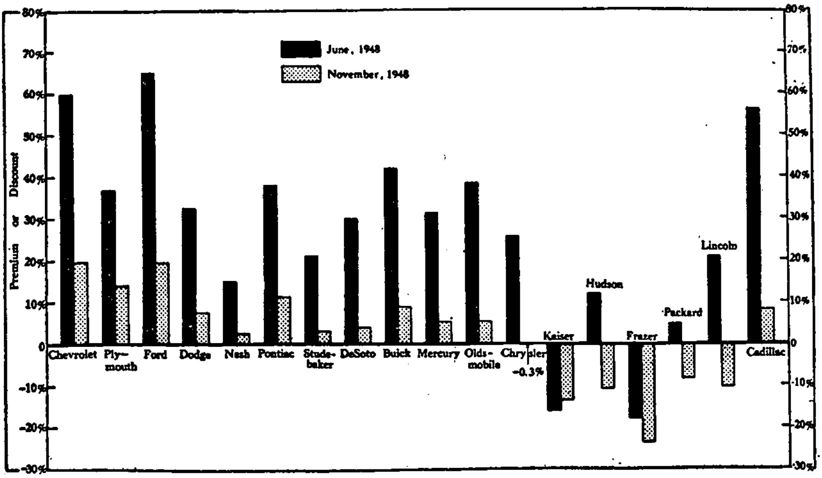
Source: (a) Bureau of Labor Statistics retail price of pork chops; (b) Bureau of Labor Statistics retail price; (c) Roy Wenzlick, St. Louis, Mo.; (d) Bureau of Labor Statistics consumers' price index of retail prices 1935–39=100; (e) actual list price plus excise tax and dealer handling charge.

THE INCREASE IN PRICE OF A CHEVROLET SINCE 1941 COMPARED WITH PRICE INCREASES FOR CERTAIN IMPORTANT COST OF LIVING ITEMS




SOURCE OF DATA - SEE SUPPORTING DATA SHEET.

## *Premiums Shrink on New-Used Autos; Six Makes Now Sell At Discounts; November Market Compared With Last June*




A GOOD MEASURE of the demand for various makes of autos today is the price at which each sells on the used car lots. The chart above shows the percentage premium or discount from delivered price which 18 different makes averaged in a survey of 16 cities. The results obtained from a late November survey are compared with a similar one in June.

Back in early summer only two cars, Kaiser and Frazer, were selling at discounts from the dealers' delivered prices. Now six makes—Kaiser, Frazer, Hudson, Packard, Lincoln and Chrysler—average less than they do when new. Chrysler in November was only 0.3% below the new price; several larger models of this car were included. New-used cars checked in this survey all had less than 1,000 miles of driving.

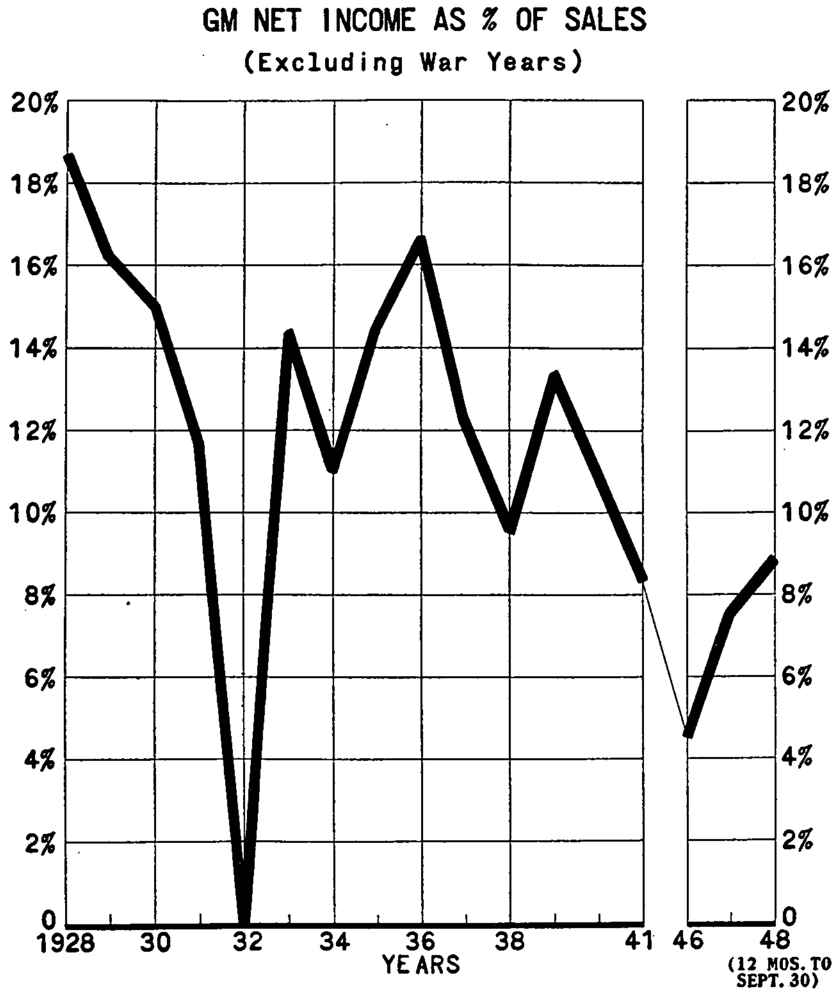
All 12 other makes showed sharp declines in their premiums from the summer report. The seasonal let-up in demand for autos played a part in this but used car dealers emphasized the drop was more than seasonal.

*General Motors Corp., record of sales, earnings, dividends, and income reinvested in business, 1928–48*

| | Net sales | Net income available for dividends | Percent net income to net sales | Preferred dividends | Balance available for common stock | Cash dividends paid on common stock | Percent income disbused 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 |
| Years: | | | | | | | | | | |
| 1928 | $1, 481, 745, 323 | $276, 468, 108 | 18. 7 | $9, 404, 756 | $267, 063, 352 | $165, 300, 002 | 63. 2 | $101, 763, 350 | $6. 14 | $3. 80 |
| 1929 | 1, 532, 213, 745 | 248, 282, 268 | 16. 2 | 9, 478, 681 | 238, 803, 587 | 156, 600, 007 | 66. 9 | 82, 203, 580 | 5. 49 | 3. 60 |
| 1930 | 1, 005, 327, 903 | 151, 098, 992 | 15. 0 | 9, 538, 660 | 141, 560, 332 | 130, 500, 002 | 92. 7 | 11, 060, 330 | 3. 25 | 3. 00 |
| 1931 | 828, 207, 978 | 96, 877, 107 | 11. 7 | 9, 375, 899 | 87, 501, 208 | 130, 500, 001 | 144. 4 | (42, 998, 793) | 2. 01 | 3. 00 |
| 1932 | 440, 899, 312 | 164, 979 | ---------- | 9, 206, 387 | (9, 041, 408) | 53, 993, 330 | ---------- | (63, 034, 738) | (. 21) | 1. 25 |
| 1933 | 583, 746, 596 | 83, 213, 676 | 14. 3 | 9, 178, 845 | 74, 034, 831 | 53, 826, 355 | 75. 7 | 20, 208, 476 | 1. 72 | 1. 25 |
| 1934 | 862, 672, 670 | 94, 769, 131 | 11. 0 | 9, 178, 220 | 85, 590, 911 | 64, 443, 490 | 77. 7 | 21, 147, 421 | 1. 99 | 1. 50 |
| 1935 | 1, 155, 641, 511 | 167, 226, 510 | 14. 5 | 9, 178, 220 | 158, 048, 290 | 96, 476, 748 | 63. 2 | 61, 571, 542 | 3. 69 | 2. 25 |
| 1936 | 1, 439, 289. 940 | 238, 482, 425 | 16. 6 | 9, 178, 220 | 229, 304, 205 | 192, 903, 299 | 84. 7 | 36, 400, 906 | 5. 35 | 4. 50 |
| 1937 | 1, 606, 789, 841 | 196, 436, 598 | 12. 2 | 9, 178, 220 | 187, 258, 378 | 160, 549, 861 | 86, 4 | 26, 708, 517 | 4. 38 | 3. 75 |
| 1938 | 1, 066, 973, 000 | 102, 190, 007 | 9. 6 | 9, 178, 220 | 93, 011, 787 | 64, 386, 421 | 72. 0 | 28, 625, 366 | 2. 17 | 1. 50 |
| 1939 | 1, 376, 828, 337 | 183, 290, 222 | 13. 3 | 9, 943, 072 | 173, 347, 150 | 150, 319, 682 | 87. 4 | 23, 027, 468 | 4. 04 | 3. 50 |
| 1940 | 1, 794, 936, 642 | 195, 621, 721 | 10. 9 | 9, 178, 220 | 186, 443, 501 | 161, 864, 924 | 87. 4 | 24, 578, 577 | 4. 32 | 3. 75 |
| 1941 | 2, 436, 800, 977 | 201, 652, 508 | 8. 3 | 9, 178, 220 | 192, 474, 288 | 162, 608, 296 | 85. 2 | 29, 865, 992 | 4. 44 | 3. 75 |
| 1942 | 2, 250, 548, 859 | 163, 651, 588 | 7. 3 | 9, 178, 220 | 154, 473, 368 | 86, 992, 295 | 58. 8 | 67, 481, 073 | 3. 55 | 2. 00 |
| 1943 | 3, 796, 115, 800 | 149, 780, 088 | 3. 9 | 9, 178, 220 | 140, 601, 868 | 87, 106, 758 | 64. 3 | 53, 495, 110 | 3. 23 | 2. 00 |
| 1944 | 4, 262, 249, 472 | 170, 995, 865 | 4. 0 | 9, 178, 220 | 161, 817, 645 | 132, 063, 371 | 82. 6 | 29, 754, 274 | 3. 68 | 3. 00 |
| 1945 | 3, 127, 934, 888 | 188, 268, 115 | 6. 0 | 9, 178, 220 | 179, 089, 895 | 132, 066, 520 | 75. 0 | 47, 023, 375 | 4. 07 | 3. 00 |
| 1946 | 1, 962, 502, 289 | 87, 526, 311 | 4. 5 | 9, 782, 407 | 77, 743, 904 | 99, 158, 674 | 124. 5 | (21, 414, 770) | 1. 76 | 2. 25 |
| 1947 | 3, 815, 159, 163 | 287, 991, 373 | 7. 5 | 12, 928, 310 | 275, 063, 063 | 132, 167, 487 | 50. 4 | 142, 895, 576 | 6. 24 | 3. 00 |
| 1948 [1] | 4, 563, 335, 808 | 401, 929, 119 | 8. 8 | 12, 928, 313 | 389, 000, 806 | 142, 975, 458 | 38. 8 | 246, 025, 348 | 8. 84 | 3. 25 |
| Averages: | | | | | | | | | | |
| 1936–41 | 1, 620, 269, 790 | 186, 278, 914 | 11. 5 | 9, 305, 696 | 176, 973, 218 | 148, 772, 080 | 84. 9 | 28, 201, 138 | 4. 12 | 3. 46 |
| 3 years ended Sept. 30, 1948 | 3, 246, 005, 488 | 247, 730, 618 | 7. 6 | 11, 567, 169 | 236, 163, 449 | 124, 770, 506 | 55. 0 | 111, 392, 943 | 5. 36 | 2. 83 |

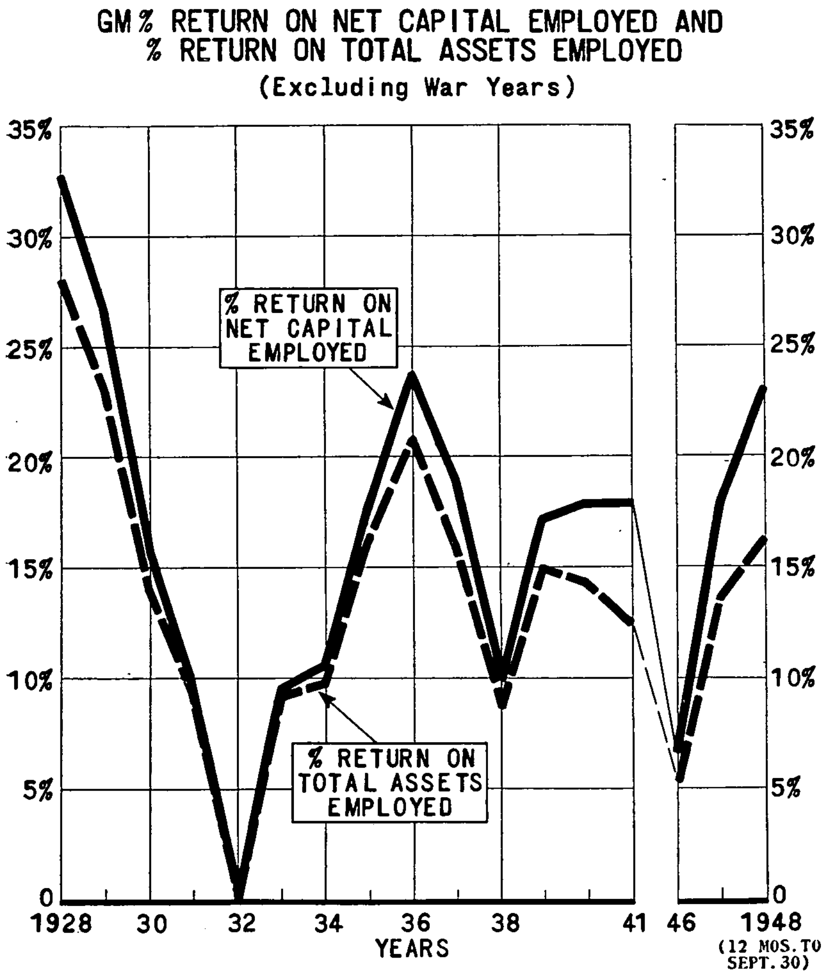
[1] 12 months to September 30.

Note.—Parentheses indicate red figures.




*G. M. net income as percent of sales (excluding war years)*

| Year: | Percent | Year—Continued | Percent |
|---|---|---|---|
| 1928 | 18.7 | 1937 | 12.2 |
| 1929 | 16.2 | 1938 | 9.6 |
| 1930 | 15.0 | 1939 | 13.3 |
| 1931 | 11.7 | 1940 | 10.9 |
| 1932 | ---- | 1941 | 8.3 |
| 1933 | 14.3 | 1946 | 4.5 |
| 1934 | 11.0 | 1947 | 7.5 |
| 1935 | 14.5 | 1948 (12 months to Sept. 30) | 8.8 |
| 1936 | 16.6 | | |


GM % RETURN ON NET CAPITAL EMPLOYED AND
% RETURN ON TOTAL ASSETS EMPLOYED
(Excluding War Years)
35%
30%
25%
20%
15%
10%
5%
0
% RETURN ON NET CAPITAL EMPLOYED
% RETURN ON TOTAL ASSETS EMPLOYED
1928
30
32
34
36
38
41
46
1948
(12 MOS. TO SEPT. 30)
YEARS

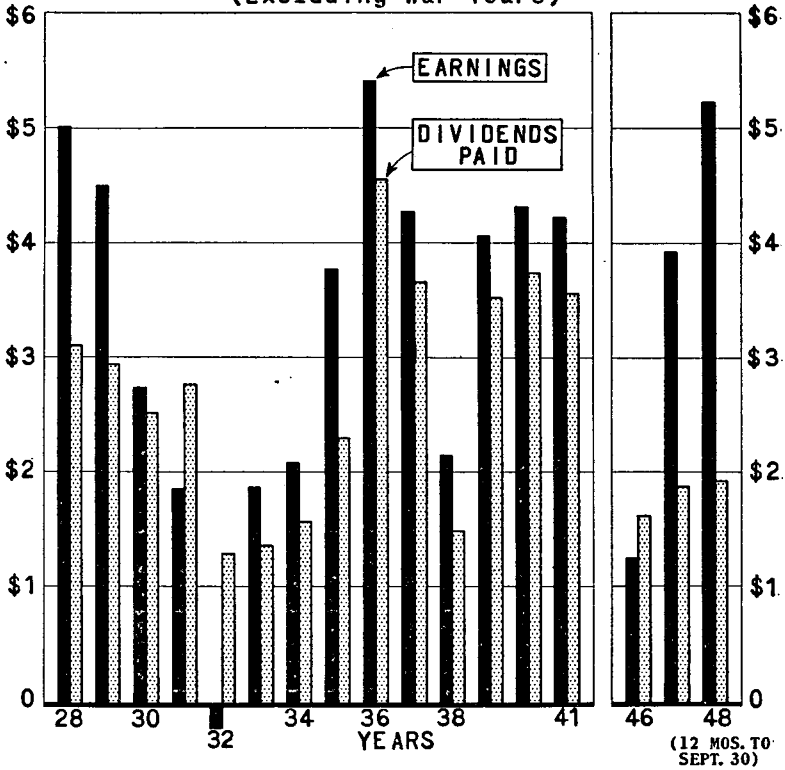
*General Motors percent return on net capital employed and percent return on total assets employed (excluding war years)*

| | Average net capital employed | Average total assets employed | Percent return on net capital employed | Percent return on total assets employed |
|---|---|---|---|---|
| Year: | | | | |
| 1928 | $844,766,000 | $987,954,000 | 32.7 | 28.1 |
| 1929 | 931,387,000 | 1,089,782,000 | 26.7 | 22.9 |
| 1930 | 976,839,000 | 1,077,842,000 | 15.5 | 14.0 |
| 1931 | 965,024,000 | 1,045,628,000 | 10.0 | 9.3 |
| 1932 | 894,354,000 | 942,330,000 | | |
| 1933 | 872,173,000 | 908,472,000 | 9.5 | 9.2 |
| 1934 | 901,692,000 | 968,411,000 | 10.5 | 9.8 |
| 1935 | 937,853,000 | 1,036,751,000 | 17.8 | 16.2 |
| 1936 | 1,005,211,000 | 1,154,346,000 | 23.7 | 20.7 |
| 1937 | 1,040,665,000 | 1,224,992,000 | 18.9 | 16.0 |
| 1938 | 1,024,165,000 | 1,160,847,000 | 10.0 | 8.8 |
| 1939 | 1,062,988,000 | 1,228,534,000 | 17.2 | 14.9 |
| 1940 | 1,092,103,000 | 1,366,189,000 | 17.9 | 14.3 |
| 1941 | 1,125,722,000 | 1,630,645,000 | 17.9 | 12.4 |
| 1946 | 1,354,924,000 | 1,666,123,000 | 6.6 | 5.3 |
| 1947 | 1,614,593,000 | 2,122,984,000 | 18.0 | 13.7 |
| 1948 (12 months to Sept. 30) | 1,755,773,000 | 2,504,456,000 | 23.1 | 16.2 |

NOTE.—"Total assets employed" represent gross assets after deducting reserve for depreciation and good will.

EARNINGS AND DIVIDENDS PER SHARE
OF PRESENT $10 PAR VALUE COMMON STOCK
IN CONSTANT DOLLARS

BASED ON AVERAGE 1935-1939 COST OF LIVING*
(Excluding War Years)




*SOURCE: U.S. BUREAU OF LABOR STATISTICS, CONSUMERS' PRICE INDEX, COMBINED INDEX.

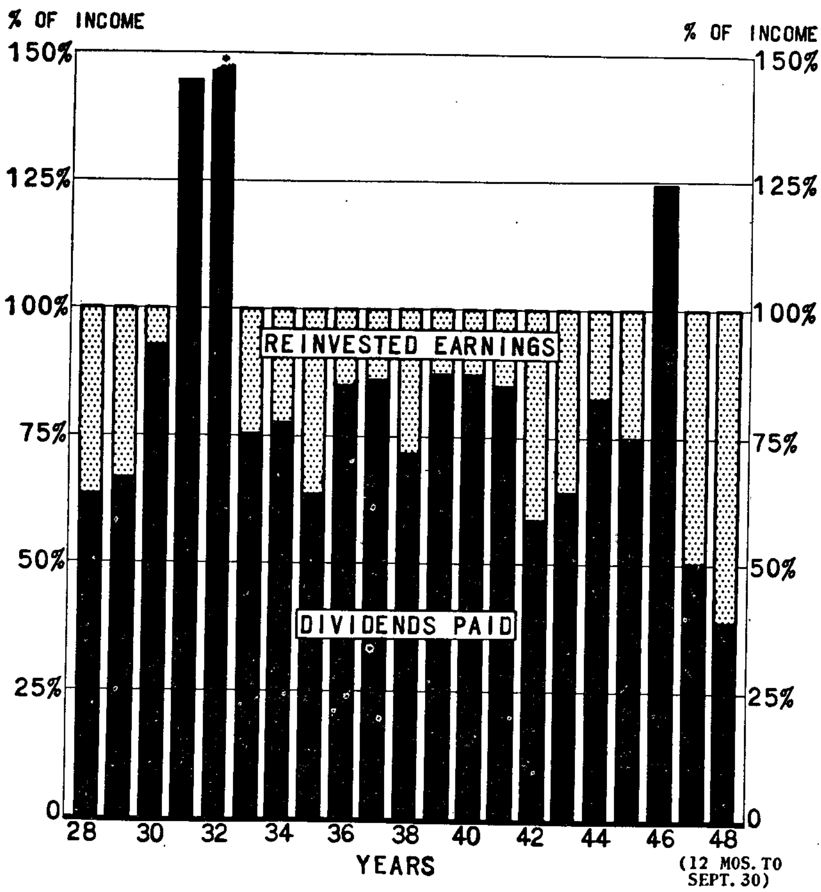
*Earnings and dividends per share of present $10-par-value common stock in constant dollars—based on average 1935–39 cost of living* [1] *(excluding war years)*

| | Per share in constant dollars based on 1935–39 cost of living | | | Per share in constant dollars based on 1935–39 cost of living | |
|---|---|---|---|---|---|
| | Earnings | Dividends paid | | Earnings | Dividends paid |
| Year: | | | Year—Continued | | |
| 1928 | $5.01 | $3.10 | 1937 | 4.26 | 3.65 |
| 1929 | 4.48 | 2.94 | 1938 | 2.15 | 1.49 |
| 1930 | 2.72 | 2.51 | 1939 | 4.06 | 3.52 |
| 1931 | 1.85 | 2.76 | 1940 | 4.31 | 3.74 |
| 1932 | (.22) | 1.28 | 1941 | 4.22 | 3.56 |
| 1933 | 1.86 | 1.35 | 1946 | 1.26 | 1.62 |
| 1934 | 2.08 | 1.57 | 1947 | 3.92 | 1.88 |
| 1935 | 3.76 | 2.29 | 1948 (12 months to Sept. 30) | 5.22 | 1.92 |
| 1936 | 5.40 | 4.54 | | | |

[1] Source: U. S. Bureau of Labor Statistics, Consumers' Price Index, Combined Index.

NOTE.—Parentheses indicate red figures.

## PERCENTAGE OF GM NET INCOME PAID IN DIVIDENDS AND RETAINED IN THE BUSINESS




* 1932 EARNINGS WERE $165,000 AND DIVIDENDS WERE $63,200,000.

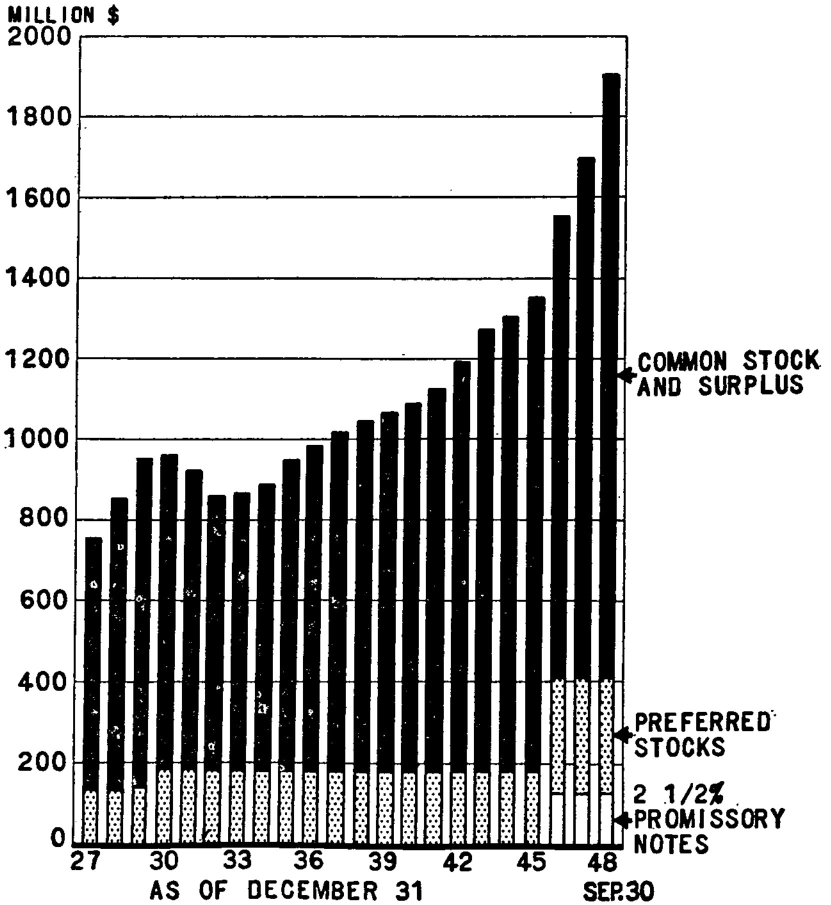
*Percentage of G. M. net income paid in dividends and retained in the business*

| | Percent of net income | | | Percent of net income | |
|---|---|---|---|---|---|
| | Paid in dividends | Retained in the business | | Paid in dividends | Retained in the business |
| Year: | | | Year: | | |
| 1928 | 63.2 | 36.8 | 1940 | 87.4 | 12.6 |
| 1929 | 66.9 | 33.1 | 1941 | 85.2 | 14.8 |
| 1930 | 92.7 | 7.3 | 1942 | 58.8 | 41.2 |
| 1931 | 144.4 | (44.4) | 1943 | 64.3 | 35.7 |
| 1932 | (1) | (1) | 1944 | 82.6 | 17.4 |
| 1933 | 75.7 | 24.3 | 1945 | 75.0 | 25.0 |
| 1934 | 77.7 | 22.3 | 1946 | 124.5 | (24.5) |
| 1935 | 63.2 | 36.8 | 1947 | 50.4 | 49.6 |
| 1936 | 84.7 | 15.3 | 1948 (12 months to Sept. 30) | 38.8 | 61.2 |
| 1937 | 86.4 | 13.6 | | | |
| 1938 | 72.0 | 28.0 | | | |
| 1939 | 87.4 | 12.6 | | | |

[1] 1932 earnings were $165,000, and dividends were $63,200,000.

NOTE. Parentheses indicate red figures.

## NET CAPITAL EMPLOYED
### DECEMBER 31, 1927 TO SEPTEMBER 30, 1948



*Net capital employed—Dec. 31, 1927, to Sept. 30, 1948*

| | 2½-percent promissory notes | Preferred stocks | Common stock and surplus | Total net capital employed |
|---|---|---|---|---|
| As of Dec. 31: | | | | |
| 1927 | | $134, 916, 000 | $622, 819, 083 | $757, 735, 083 |
| 1928 | | 134, 916, 000 | 720, 458, 595 | 855, 374, 595 |
| 1929 | | 138, 916, 000 | 815, 560, 273 | 954, 476, 273 |
| 1930 | | 186, 428, 900 | 779, 346, 971 | 965, 775, 871 |
| 1931 | | 184, 804, 400 | 736, 534, 258 | 921, 338, 658 |
| 1932 | | 183, 714, 400 | 673, 886, 512 | 857, 600, 912 |
| 1933 | | 183, 564, 400 | 684, 666, 338 | 868, 230, 738 |
| 1934 | | 183, 564, 400 | 705, 813, 758 | 889, 378, 158 |
| 1935 | | 183, 564, 400 | 767, 385, 300 | 950, 949, 700 |
| 1936 | | 183, 564, 400 | 803, 786, 206 | 987, 350, 606 |
| 1937 | | 183, 564, 400 | 830, 494, 723 | 1, 014, 059, 123 |
| 1938 | | 183, 564, 400 | 859, 120, 089 | 1, 042, 684, 489 |
| 1939 | | 183, 564, 400 | 882, 147, 557 | 1, 065, 711, 957 |
| 1940 | | 183, 564, 400 | 906, 726, 134 | 1, 090, 290, 534 |
| 1941 | | 183, 564, 400 | 940, 670, 360 | 1, 124, 234, 760 |
| 1942 | | 183, 564, 400 | 1, 008, 308, 419 | 1, 191, 872, 819 |
| 1943 | | 183, 564, 400 | 1, 090, 743, 838 | 1, 274, 308, 238 |
| 1944 | | 183, 564, 400 | 1, 120, 507, 220 | 1, 304, 071, 620 |
| 1945 | | 183, 564, 400 | 1, 167, 530, 595 | 1, 351, 094, 995 |
| 1946 | $125, 000, 000 | 283, 564, 400 | 1, 144, 115, 825 | 1, 552, 680, 225 |
| 1947 | 125, 000, 000 | 283, 564, 400 | 1, 287, 011, 401 | 1, 695, 575, 801 |
| 1948 (at Sept. 30) | 125, 000, 000 | 283, 564, 400 | 1, 494, 508, 559 | 1, 903, 072, 959 |

NOTE.—For the years 1930–40, preferred stock as shown on the published balance sheet has been reduced by the preferred stock held in treasury, to conform to the practice followed for 1941 to date.

Mr. COYLE. I would like to refer briefly to the statements. If you would pass over to page 4, at the bottom of the page, there is a paragraph there from which I would like to read one little item, because this is the principle on which our entire philosophy of operation is based, to which I shall refer:

> 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 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 the product improvement.

Rather than to read on, there is that one point that I wanted to make, and I wanted to make it for this particular reason. Too many people look at the function of setting a price as merely taking all of your costs and adding the profit that you want to arrive at, the ultimate selling price. That is not true. What we have to do in our industry—and it has been one of the most highly competitive there is—is to realize what we are offering in the way of a product in relation to what our competitors are offering also—in power, performance, comfort, facility, and other things. Then we have to operate within that cost picture. After paying the expenses of the business, buying materials, paying labor, and so forth, what is left is profit. You don't start with cost and add the profit factor to it.

At the bottom of page 5, pricing policy is referred to; but I would like to skip that and go to the second paragraph of page 6.

Senator O'MAHONEY. Before you leave that, Mr. Coyle, you want to make it clear, as I understand your statement, that profit is not obtained in your industry by adding to the price after the costs of operation have been determined. Did I correctly understand your statement?

Mr. COYLE. I am sorry, Senator, I don't quite follow your statement.

Senator O'MAHONEY. I understood you to say that for your industry profit is not an element that is added after cost, but you get your profit by reducing cost and increasing volume.

Mr. COYLE. We hope to, yes, because you see, Senator, our prices must be determined and made known to the public before we ever make the car.

Senator O'MAHONEY. In other words, you are telling the committee your price is a competitive price——

Mr. COYLE. That is right.

Senator O'MAHONEY. And, having fixed your price on a competitive basis, you then endeavor to make a profit——

Mr. COYLE. We work within that.

Senator O'MAHONEY. By efficiency in operations to reduce the cost.

Mr. COYLE. That is right.

Senator O'MAHONEY. And by increasing the volume, so that on an increased number of units sold with a small margin of profit per unit, you have a better profit all over.

Mr. COYLE. That is the philosophy on which we have operated through the years; yes, sir.

Now, on this question on page 6, I want to give you this: I would like to read just a little of this, not all of it, and then point out the pertinent part.

> 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.

All of this is extremely important, but I would like just to take that one statement there and develop it a little bit. We have in each of our units, each of the divisions, what we determine to be a standard volume. Standard volume means we have a definite capacity rate of production. It may be a thousand a day in the case of one unit and in the case of Chevrolet perhaps 6,000 a day.

Senator O'MAHONEY. How do you determine the standard? You say you have a standard volume?

Mr. COYLE. Yes. The standard volume, Senator, is what we have established in relation to facilities to produce. If in 16 hours a day we make so many pieces an hour, and if we want 1,000 a day, we would set it up for 65 an hour.

Senator O'MAHONEY. When you speak of this standard, you are referring to the standard which, as an operating function, you have chosen?

Mr. COYLE. That is right.

Senator O'MAHONEY. You are not referring to the factors which go into your decision as to what that standard should be?

Mr. COYLE. That is right. I didn't attempt to tell the committee how we arrived at it at all. Perhaps our judgment may be wrong in having arrived at a standard volume higher or lower than the market will absorb. It certainly is higher in many months of the year than the market can possibly absorb because ours is a seasonal business. It is lower than what the public may want in the spring season of the year. But, nevertheless, we have to take a figure and say that this amount of capital will provide facilities for so much production.

Senator O'MAHONEY. To what extent, on the average, could your production volume exceed the standard?

Mr. COYLE. I would like very much for you to state that again, so I will be sure I understand what you are talking about.

Senator O'MAHONEY. To what extent could the actual production in any particular division exceed the standard which you had set up when you determined what the facilities should be?

Mr. COYLE. Let me give an illustration. Let's assume that in the case of Chevrolet—please, I am more familiar with Chevrolets. I was 29 years in the Chevrolet division. I was general manager of it for 12 years plus, so I will have to use it. I can't gain the same familiarity with the others.

Senator O'MAHONEY. Let me say I made my first campaign for the Senate in a Chevrolet and it delivered me.

Mr. COYLE. Congratulations, Senator.

Take the case of Chevrolet. If we set out on the basis of a million cars a year—thinking that we could sustain that volume and sell them, that does not necessarily mean that over 12 months we would produce 83,333 cars a month, or 12 times that—1,000,000. The reason is that there are certain winter months when the public doesn't want any new cars, or few in number. In the warmer climates of the South and West and other places, on the west coast—I didn't mean in your particular part of the country—they will buy perhaps 40,000 cars a month, but in the peak selling season in the spring, 120,000 cars a month. If we are going to make a million cars we must be prepared to make 6,000 cars a day in a 20-day month, a 5-day week, to establish 120,000 cars a month. If we don't get that 120,000 volume a month we can add all the others together and we will never make a million cars. Any month in which we make fewer than 120,000 cars, any day we make fewer than 6,000 we have some idle capacity. That is part of the over-all picture and one of the hazards of the business. Sometimes we have too much idle capacity for too long a period of time.

Senator O'MAHONEY. But you can exceed 120,000 a month?

Mr. COYLE. No, not if that is the figure. That would be the maximum. If, having to set up for a million, we wanted to go 20 percent higher than that, naturally we would also provide facilities for the next mark-up.

Senator O'MAHONEY. I was trying to get through my head whether or not "standard" and "maximum" are the same.

Mr. COYLE. No, they are not.

Senator O'MAHONEY. I understand them not to be the same.

Mr. COYLE. They are not.

Senator O'MAHONEY. What is the differential?

Mr. COYLE. The only importance of the standard is in our pricing, in the allocation of our fixed charges. The variables are unimportant because you have so many tires, so many frames, wheels, and so on for each car produced. Every time you build a car you have to expend money and buy that material. But in the allocation of our fixed charges of tools, overhead, depreciation, insurance, and so on, we divide that and spread it over 1,000,000 units whether we make that number or not. If we get a good volume in certain of those low months in which we can sell more than we had anticipated, 40,000 going up to 60,000, for example, then we have overabsorbed these fixed charges; but if we make less, we have underabsorbed them. All through the years, regardless of business cycles, we use the same principle in arriving at these, and that is based on our standard volume.

I have asked Mr. Donner any time he thinks I am not making our policies clear to amplify any statement that I make.

Mr. DONNER. This may help you, Senator. We have to consider two things. One is the fluctuation in volume during the year, which is the seasonal one. You may do 12 percent of your volume in one month and 4 percent in another. The second thing we have to consider is the cyclical fluctuations between years. If we take the years 1928 to 1941, which is a good, long period, it worked out that our actual volume over that period in units was only 86 percent of standard volume. In two individual years, 1928 and 1941, we got as high as 25 percent above standard volume.

Another way that we look at it is this: We consider that on the average we can probably expect to run our car plants about 80 percent of the rated daily capacity. So if you look at that 80 percent up to 100 percent maximum, it is very close to the 25 percent above standard volume that we ran in the two highest years prewar. But on the average, as I pointed out, we were able to achieve only 86 percent of the standard volume that we set up as the normal or average volume.

Senator O'MAHONEY. If you run 86 percent or 80 percent of standard volume, do you expect to operate at a profit?

Mr. DONNER. You misunderstood. The 80 percent is the standard volume.

Senator O'MAHONEY. Eighty percent of capacity is the standard volume. Very good.

Mr. DONNER. That is right.

Senator O'MAHONEY. If you run, then, at 80 percent of capacity otherwise, at a standard, do you anticipate operating at a profit?

Mr. DONNER. Yes.

Senator O'MAHONEY. Inasmuch as price is not changed with volume, immediately at least, the larger the volume the better your profit.

Mr. DONNER. Or turning it around, the lower the volume the worse our profit in the low years. It works both ways.

Senator O'MAHONEY. Oh, yes; that is true.

Mr. DONNER. It works both ways, but what I wanted to point out is that the standard volume wasn't achieved over a long period in the markets we had and, as Mr. Coyle pointed out, you must have a capacity there to meet your peaks, that you can't achieve on the average, and it isn't all your boom and depression fluctuation. It is the basic seasonal fluctuation in the industry. So we have to have the capacity there to meet both at the peak. That enables us to achieve a given average which we were barely able to do prewar.

Senator O'MAHONEY. Then, as I understand it, increased volume is quite as important a factor in making profit as reduced expenditure.

Mr. DONNER. More important.

Senator O'MAHONEY. They are the two factors you have given us.

Mr. COYLE. Oh, yes. Either one is most helpful.

Mr. DONNER. You have to consider whether your increased volume is coming through greater utilization of the plant you have or whether you are going to get increased volume through building new plants and getting new capacity.

Senator O'MAHONEY. Oh, yes, of course; but I am talking about this 80 percent of capacity. In other words, with the capacity which you have, your profit will increase according to two factors: The reduction of expense and the increase of volume.

Mr. COYLE. That is right.

Senator O'MAHONEY. Do you care to give one or the other the primary weight?

Mr. DONNER. What is a little confusing is that you have to offset that anticipated higher profit through increased volume over the average by your lower profit in the years you aren't achieving the average.

Senator O'MAHONEY. Oh, yes, of course. That is understood.

Mr. DONNER. We have to look at this on the average. Over these prewar years we weren't able to achieve the standard volume at which we rated our plants.

Senator O'MAHONEY. Yes, I would imagine that to be the case.

Mr. DONNER. So it is hard for me to answer your question how you rate the increased volume when we have to look at the final result on an average over a period of years.

Senator O'MAHONEY. But in the present period in which we are living there has been a demand greater than you have been able to supply.

Mr. COYLE. That demand, however, Senator, was of course very largely built up by the lack of production for 4 years during the wartime.

Senator O'MAHONEY. I realize that. It is not a question of what was the cause of the demand. Here is the demand.

Mr. COYLE. That is right.

Senator O'MAHONEY. Perhaps you might agree with me that the increased purchasing power of the people—I think, in fact, you have said it here in other words—has tended to increase the demand. More people are able to buy more units now than ever before. That is your testimony.

Mr. COYLE. Yes; and I am going to elaborate that testimony, if I may.

Senator O'MAHONEY. That is what I thought.

Mr. COYLE. In other words, it is definitely stated in our statement.

Senator O'MAHONEY. What I thought is that more people buying your product will increase your production and your volume; and the increase of your volume in turn increases your profit.

Mr. COYLE. That is true. But don't overlook the fact that the only increase in profit when you get above standard volume is merely in respect to the fixed charges that were priced in on a lower volume. Your variables, your tire costs, your frame costs and wheel costs, and those things, stay constant.

Senator O'MAHONEY. I can see that. That is perfectly clear. Mr. Donner is worried about the fact that there may be a change of climate, when the demand will not be as great as you can supply.

Mr. DONNER. I want to make this point, Senator, that if the ability of the country to buy automobiles through greater population, a greater number of employed, greater purchasing power, whatever you want to call it, if there is greater ability to buy over a period of years, we would have to meet that volume by increased capacity, undoubtedly, and that increased capacity gets back into your standard volume base, so you haven't got any more ability to earn, versus plant capacity, than you had before. Those stay in balance.

Senator O'MAHONEY. When you have to increase your plant capacity, then you move into another segment.

Mr. DONNER. That is what we had to do to meet this postwar demand.

Senator O'MAHONEY. Surely.

Mr. DONNER. I just wanted to make that point.

Mr. COYLE. It also accounts for the difference in the capacities of the smaller units of General Motors as related to Chevrolet. In other words, we arrive at a totally different demand for each, dependent on what we think the market will absorb of each.

If I might pass on here, there is another excerpt from our statement I would like to offer:

> 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 mathematically calculated to cover costs and return a profit, however accurately determined, does not necessarily mean that the customer will pay that price.

Again I would like to point out that we do the pricing before the cars are produced, before the model is announced. When we announce the car in the various showrooms over the country, we have already establish a price on it. We hope it can sell at that price. Down through the years we have been——

Senator O'MAHONEY. But you will change the price if you have to.

Mr. COYLE. We have had to. The record proves that we will do that—reluctantly—but nevertheless, we will.

Going back to our statement:

> Final judgment upon a business is rendered by the customer. This is true both in a seller's and in a buyer's market. In our competitive society millions of customers vote every day for or against a product. How the customer votes depends upon the price and quality of the product. Thus some businesses, started in a small way, get large. Others stay small. Still others are voted out of the picture altogether. The historical record of increasing customer approval for General Motors products is to be found in the figures which show how our share of the market has increased over the years.

There is a chart which shows that—chart 1. The particular point that I would like to call to your attention is the fact that in the postwar period of 3 years we have not attained our prewar average. In other words, General Motors made 2,300,000 units in the calendar year 1941. In 1947 it made 1,930,000 vehicles. In the year, 1948, while the year is not quite finished, it looks as if we will make about 2,150,000. That is 150,000 less than in 1941. The industry itself is larger than it was in 1941, so our percentage of the industry is lower.

I made reference to the contribution General Motors had made to the war effort. It is in the record. I thought it was exceedingly interesting, particularly the third item, 206,000 airplane engines, including jet propulsion engines. I don't know what our current production of jet engines is, but I would say that early this year General Motors was producing over 90 percent of the jet engines that were being produced in this country. I think they are about the only ones that are in production as a production engine. There are many experimental engines as you know.

Also, I think, if I remember the figures right, General Motors made about a quarter of the aircraft engines that were produced in the war effort. I mean combat engines, not trainers. Through Buick, Chevrolet, and Allison, those three units, we made these 206,000 airplane engines.

There is a point in our statement I wish to call to your attention.

General Motors early realized that due to the war the nature of the business had completely changed. There was only one customer—the Government. Early in 1942, in advance of the enactment of the renegotiation law, General Motors adopted a wartime pricing and profit limitation policy which can be summarized as follows: (1) To take war production contracts on a fixed price basis wherever possible and, where not possible in the first instance, to change to that basis as soon as circumstances permitted; and (2) to make price reductions applicable to products already delivered as well as to future delivery as cost reductions materialized; and (3) to limit the over-all rate of profit from its manufacturing operations before provision for income and excess profits taxes but after all other charges, to approximately one-half the profit margin, expressed as a percentage of sales, realized in the year 1941 largely under the conditions of a competitive market.

General Motors income, from manufacturing, excluding income from investments but after providing for income and excess-profits taxes, averaged 4.1 percent on net sales for the four war years 1942 through 1945.

I would like to point out one item that I think is exceedingly interesting. Chevrolet took over the Pratt & Whitney aircraft engine contract at about the same price competition was making it. That was the early part of 1941. General Jones, the contracting officer, stated he hoped that with the automotive industry going into aircraft production, the Government would be able to procure aircraft engines at a cost not to exceed $10 a horsepower. This particular engine has 1,200 horsepower, so that would be $12,000. After our first 2,000, which were supplied at $16,000, we cut the price to $13,500. After the next 2,000, which made a total of 4,000, we cut the price to $9,000. More than 125,000 of the Pratt & Whitney aircraft engines were made by the Buick and Chevrolet divisions, of which nearly one-half were delivered at about $5.50 per horsepower. So on our total volume in relation to sales, I think we did an outstanding job.

Senator O'MAHONEY. May I ask you, Mr. Coyle, with respect to that third element of pricing policy during the war, do you think that the profit margin figured on the basis of sales in 1941 before the war was comparable with figuring the profit margin on the amount of sales during the war when the Government was the sole purchaser and when, therefore, there was no risk involved in the sale?

Mr. COYLE. I think there was risk. We had a fixed-price contract subject to renegotiation if we made too much. I don't recall any instance in which the renegotiation worked to our benefit.

Senator O'MAHONEY. I am sure you didn't get a higher price anywhere, but you were——

Mr. COYLE. Don't overlook the fact that there was risk.

Senator O'MAHONEY. In what was there risk?

Mr. COYLE. There is always risk in a fixed price contract. We agreed to build these things for the Government at a price.

Senator O'MAHONEY. My recollection—I was sitting on an appropriations committee at the time—was that all the testimony which the committee received was to the effect that, there being no previous experience by which any prices could be fixed, in most instances the fixed prices were above what turned out to be the real price, and as your volume increased again, the rate per unit was reduced, and most producers of war goods were very happy to have their profits renegotiated.

Mr. COYLE. I just testified to the fact that in the Pratt & Whitney engine experience, we started out, with various unknowns because it was new to us, at $16,000, which was the best figure that anybody else quoted. The basis on which we based it was the Pratt & Whitney productive hours, the number of hours they had in their own experience. We used those. That was the best basis we had. We started with that. I don't know what their final price was. We didn't exchange information at all. We just did the best job we knew how.

Senator O'MAHONEY. It seemed to me from this statement you were comparing your margin of profit in a civilian economy to your margin of profit in a war economy, and you fixed the rule of one-half of the margin of profit on the dollar volume of sale.

Mr. COYLE. Yes; and, Senator, during the war period we felt, and I think the records show, there was not over a $3 dividend paid in any of those years. Although our volume was practically twice what it was in peacetime, substantially less went to the stockholders.

Senator O'MAHONEY. We are not going to renegotiate those contracts now, of course.

Mr. COYLE. I certainly hope you don't think we came down here not willing to pat ourselves a little on the back for the job we think we did.

Senator O'MAHONEY. I think you did a good job, too, sir. I never have hesitated to say so.

Mr. DONNER. The measuring stick I had after 4 years of renegotiation was that this formula, so far as the relation of profits to performance, however measured, was satisfactory to the Price Adjustment Boards. I am not saying the yardstick was satisfactory, but the amount of profits that resulted from it was considered not to be excessive in their estimation. So we did have an outside check on the reasonableness. We always felt that one of the best yardsticks was the prices that we were able to give the Government during the war, so we always urged them to concentrate their attention on the prices that we were able to develop.

Senator O'MAHONEY. In any event, it is clear that your relationship with the Price Adjustment Board—that is to say, with the Government—was satisfactory to you and satisfactory to the Government.

Mr. DONNER. That is true as far as our position is concerned.

Senator O'MAHONEY. A lot of people now seem to think that this same Government is about ready to cut every businessman's throat on the morning of the 21st of January.

Mr. COYLE. No. We have operated over a period of a great many years under varying business conditions. Whatever condition applies to us, even though it is difficult and we don't know quite what to do with it at the moment, we are comfortable in the fact that the same identical condition applies to our competitor. If he can survive, we think maybe we can succeed. We just have confidence in our ability.

Senator O'MAHONEY. I am betting on General Motors when it comes to a matter of survival.

Mr. COYLE. We are going to try to.

Senator O'MAHONEY. May I ask you the meaning of that last sentence on page 12?

> The physical volume of production was probably about two-thirds higher than in 1936–41, and per capita real income has increased about 50 percent.

What is the basis of that?

Mr. COYLE. I will ask Mr. Donner to reply to that.

Senator O'MAHONEY. What do you mean by "per capita"?

Mr. DONNER. Per capita; total population.

Senator O'MAHONEY. Total population of the United States?

Mr. DONNER. The total population has increased considerably over this period. We took the Federal Reserve Board index of industrial production to get the two-thirds. October 1948 it was 167 percent of the 1936–41 base. Population has increased from 130,000,000 to 146,000,000. Adjusting for the increase in the cost of living, there is an increase of about 50 percent in what the national income will buy in real goods per individual in the country, as near as we could estimate from the Government figures. We were trying to relate what could be bought to the number of people in the population.

Senator O'MAHONEY. You were referring to the per capita income of all the people of the United States?

Mr. DONNER. The whole 146,000,000, all the people. We took the national income and deflated it for the cost of living, and divided by the population.

Senator O'MAHONEY. Thank you very much.

Mr. COYLE. Mr. Chairman and members of the committee, I hope you understand that as we skip from one item in our statement to another, it doesn't mean that we consider the parts we are omitting as unimportant. But we are trying to pick up the more important items.

We have a statement on postwar values.

> Inflation has pushed up prices of postwar automobiles as it has pushed up prices of other products. To what extent has the value the customer gets for his automobile dollar been affected from a long-term viewpoint?

I don't know whether you have had a chance to look at the photograph of the 1929 Buick and the 1948 Chevrolet.

Senator O'MAHONEY. I have, and it is very interesting.

Mr. COYLE. The cars are across the street. The committee might like to see them. We went out and got one and painted it and trimmed it and cleaned it up. It was a pretty bad looking car.

Senator FLANDERS. Did it come up under its own power?

Mr. COYLE. Not to here. From Madison, Ind., to Detroit, Mich. It might be interesting to you that Mr. Donner was the one who suggested the comparison. I thought of getting the car physically. I called the Chevrolet sales manager from New York. I was then in New York and he was in Detroit. In 2 hours he had that car. He purchased it. You go to the secretary of state of the different States and they have that information. He went out and picked it up. It was disassembled and cleaned up. If you raise the hood up, the motor is all painted. All the bright work has been put on, upholstery and everything. It was a pretty dilapidated car in the beginning.

Without attempting to talk about postwar values and prewar values of the dollar—because I do think we can get ourselves quite involved in that one—I would like to point out the list price of the two cars. The 1929 Buick, introduced in July of 1928—that was why we took that particular car—was priced at $1,320 against $1,280 for the 1948 Chevrolet. In other words, the Chevrolet is some $40 lower. The horsepower, 74 against 90. That is a 20-percent increase in horsepower. There is a 20-percent increase in speed. Instead of 14 miles per gallon with the Buick you get 22 miles per gallon with the Chevrolet. The wheelbase is almost identical. It is a six-cylinder car in both cases, and there is about 500 pounds less weight in the Chevrolet.

There is a list of items to which I want to call your attention:

In addition the 1948 Chevrolet price includes a number of features not found in the 1929 Buick. For example: All-steel body, four-wheel hydraulic brakes, safety glass, sealed-beam lights, synchromesh transmission, hypoid differential gears, automatic spark advance, voltage regulator, thermostatic controlled pressure cooling system, knee-action suspension, low-pressure tires, built in luggage compartment, dash glove compartment, no-draft ventilation, gearshift lever on the steering column, and so forth.

Incidentally, I would also like to say that Buick has made like progress in their product over this 20-year period. It isn't a case of Chevrolet catching up and taking the Buick position. I can say Buick likewise has gone forward and improved its product.

We now come to the question that you asked about a while ago.

More people can afford to buy new cars now than before the war in spite of the rise in new car prices and living costs. This is due to the fact that the number of families has increased by over 10 percent and the average disposable income per family by 1948 had increased about 85 percent over prewar, which was greater than the increase in the cost of living index or the prices of low-price cars. This improvement in family income was mainly the result of increased farm income and increased employment at higher wages. Employment was about 18 percent above 1941.

In addition to this, the income distribution has changed and the family units at the middle and at the lower end of the income distribution are now receiving a larger share of the total income than before the war. This has enabled a larger proportion of the families to become potential new car buyers.

Incomes of some segments of the population have increased much more than the average. For example, the incomes of independent businessmen and farmers are considerably greater than before the war. In 1939, when farm prices were low, it took cash receipts from the sale of eight beef steers to buy a Chevrolet. Today the same number of steers would bring the price of two Chevrolets.

Senator O'MAHONEY. I think you probably would agree that the farmer started from a lower base.

Mr. COYLE. Oh, yes, there is no question of that at all.

Senator O'MAHONEY. As I recall your testimony a little while ago, the prices of General Motors products on the whole were up about 77 percent while the cost of living was up about 74 percent.

Mr. DONNER. Seventy-five on the prices and 77 on the cost of living. They were very close.

Senator O'MAHONEY. My thought was the cost of living was less than the price.

Mr. COYLE. Chart 3a shows our prices of cars, and the page next behind the bar chart gives the actual percentage. It is easier to read there. It shows General Motors prices are 175 percent above 1941.

Senator O'MAHONEY. My point in interrupting you was to ask if you do not agree that it is highly desirable in the interest of General Motors, as of all industry, that the disposable income per family has increased over what it was prewar.

Mr. COYLE. Oh, yes. General Motors can only prosper provided we have a good national economy. We can't make a good living by selling in a low economy at very high prices.

Senator O'MAHONEY. So you have to have mass purchasing power to complement the mass production power that you have developed.

Mr. COYLE. Certainly.

Our reason for putting this in was merely in answer to the questions that have so frequently been raised that the automotive industry was pricing itself out of its market. We have to recover our cost. We may or may not recover a profit over and above that, but if we don't recover our cost we merely distribute our assets and, if continued over a long period of time, we become insolvent, go out of the picture and don't employ anybody and don't buy anything. The distributing organization we have also goes out of business. A great many of our sources of supply are small-business people. All of our distributors are. They are dealers. Individually they don't employ many people, but there are some 208,000 people employed in the General Motors distributorships, not to mention the service and maintenance establishments, gas stations, and other things run by independents.

Senator O'MAHONEY. Without interrupting you at this point, I call Mr. Donner's attention to the statement on page 15, the beginning of the last paragraph:

> 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.

Mr. DONNER. What confused me, I remember our price was 75 and the cost of living is 72. The wages were up 77. I had seventy-odd percent floating around. We were below our wage increase, slightly above the cost of living.

Mr. COYLE. I know that your committee is interested in profits. So are we. In our statement we say that the ratio of our profit to sales was 11½ cents per dollar of sales in the 1936–41 period, and for the 12 months ending September 30, this year, it was 8¾ cents, a reduction of 2¾ cents, or one-fourth less.

Senator O'MAHONEY. There has been a great deal of discussion in this committee from time to time about these two standards of measuring profits: The standard of measuring them in accordance with sales, and the standard of measuring them in accordance with net worth.

You may want to make some comment about that in addition to what you have said.

Mr. COYLE. I would rather have Mr. Donner do that because he is the financial man here.

Senator O'MAHONEY. We will let it wait until after you have completed your statement.

Mr. COYLE. Anyway, there is a statement here. I am not going to read it. It outlines the additional amount of capital that has been required for our operation, working capital, inventories, and accounts receivable—a very large sum of money that has been involved in that.

I know your committee has dwelt upon the reinvested earnings considerably. This subject so far as we are concerned is covered in our statement. The record is complete on that without my reading it. I would like to read just the last part:

> It is management's responsibility to earn a profit. It is the directors' responsibility to decide how the profits are to be used in the best interests of the business—what proportion to pay out in dividends and whether to retain a part of them for reinvestment in the business.

That is the philosophy on which we operate, that it is up to us to earn a profit and then it is up to the directors.

Senator O'MAHONEY. Of course, that deals with this question that I raised a moment ago, namely, the computation of profits on net worth and profits on sales. According to this statement, since 1928 you have had $900,000,000 of profits which have been plowed back into the business. How much capital did you have in 1928 when that began?

Mr. COYLE. Schedule 7, the large sheet here, I think, will show you.

Mr. DONNER. The last schedule in the presentation. It is behind exhibit 12. It shows the capital by years. It was $855,000,000 at the end of 1928. Have you got that, Senator, the very last sheet?

Mr. COYLE. The sheet following that gives it in money. You have the bar chart there.

Mr. DONNER. That shows at the end of each year the amount of capital employed in the business.

Senator O'MAHONEY. That shows the percent of the net income retained in the business.

Mr. DONNER. Then you haven't turned far enough. There is a chart there, and then following the chart is a table.

Mr. COYLE. That table merely reflects the figures.

Senator O'MAHONEY. This chart on net capital employed has a graph which represents common stock and surplus. There is another designation for preferred stock, and then one for promissory notes.

Mr. DONNER. Long-term debt, yes.

Representative WOLCOTT. Senator O'Mahoney, I think the succeeding chart will give you what you want.

Mr. DONNER. The figures are on that page.

Senator O'MAHONEY. Of course, the common stock I assume has increased all during this period in one way or another, has it not, the amount of outstanding common stock?

Mr. DONNER. Through reinvested earnings.

Mr. COYLE. But there was no stock issued as such.

Mr. DONNER. There was one issue when we took over Yellow Truck. We issued common stock to the minority holders of Yellow Truck in exchange for their assets. That was in 1943. Aside from that, we haven't issued common stock. We issued $100,000,000 of preferred stock in December of 1946, and in August of 1946 we borrowed this $125,000,000 on long-term notes.

Senator O'MAHONEY. During this period there has been some distribution of stock, common stock, maybe preferred, as bonuses to employees and officers, has there not?

Mr. COYLE. That is right, but that stock was bought on the open market, acquired by the corporation, and it was given out in lieu of cash. I mean it didn't increase the number of shares outstanding.

Senator O'MAHONEY. That is right, but since it was purchased out of earnings it ought to be part of this $900,000,000.

Mr. COYLE. No. It becomes an expense of the business. It was a bonus. In other words, you pay a certain compensation to an individual for his job and if he does a good job, he has a bonus consideration. So both the compensation we pay him and the bonus that he earns becomes an expense of the business.

Senator O'MAHONEY. Oh, yes; of course.

Mr. COYLE. But you said paid out of earnings.

Senator O'MAHONEY. Was it not? If the company bought it on the open market——

Mr. COYLE. But they bought it with the funds of the company.

Senator O'MAHONEY. Yes, with corporate funds.

Mr. COYLE. But the expense was charged off. Understand, if they had closed their books and said, "These are the earnings," and so forth, "and now we will take so much of the profit of the business," surplus, if you will, "and go on the market and buy the stock"—maybe I am talking technicalities here, but the point I am making is that the purchase of stock by the corporation was just the same as if they had gone out and purchased a material of some kind.

Senator O'MAHONEY. Certainly. That is precisely the point I want to make.

Mr. COYLE. They charge the material against the cost of doing business and they charged the bonus against the cost of doing business. The earnings are diminished by the amount that they bought.

Senator O'MAHONEY. We are talking about different things now.

Mr. COYLE. I believe we are.

Senator O'MAHONEY. Your statement here was that $900,000,000 has been plowed back under earnings.

Mr. COYLE. That is right.

Senator O'MAHONEY. Then I was prompted to ask what the capital stock of the corporation was during that period. That led to a question of the distribution of bonuses. That stock you say was purchased out of earnings. So in a sense it was also plowed back into the corporation. It was not as capital.

Mr. COYLE. Now, Senator, may I just interject here. That stock that was bought and passed over to an employee was in lieu of cash that might otherwise have been paid to him. If the corporation had not elected to give it to him in stock and elected not to go on the open market and buy that, but rather handed him the money, would you say that was plowed back into the business?

Senator O'MAHONEY. No, I would not, but I would say it was distributed out of earnings.

Mr. COYLE. That may be.

Senator O'MAHONEY. That is all I am talking about.

Mr. COYLE. But you did say that it was plowed back into the business. I would like to have that one not plowed back into the business.

Senator O'MAHONEY. I will agree with you on that. I will withdraw that statement. But it is clear that the amount of corporate funds which were invested in the purchase of stock for distribution in lieu of cash to compensate employees came out of earnings. It was not new capital invested.

Mr. COYLE. It was not new capital invested. Everything we buy comes out of earnings, and is then put into the proper channels of accounting, either added to the assets or not.

Did you have a point?

Mr. DONNER. I am not sure that we are clear yet, and I just wanted to make a point that the common stock and surplus of the company was neither increased nor diminished, because we bought stock in the market for bonus as against paying the bonus. I just want to make that clear.

Senator O'MAHONEY. It came out of surplus, naturally, that is clear.

Mr. DONNER. Whether we paid it in stock or whether we paid it in cash had no effect on the amount of earnings reinvested in the business, or no effect on the common stock and surplus.

Senator O'MAHONEY. I fancy that the total value of the stock that has been distributed through the years to reward employees may be only a small percentage of the total outstanding stock. I do not know what it is, but certainly it came out of earnings.

Mr. DONNER. Just as the cash came out.

Senator O'MAHONEY. Just as your plant expansion out of earnings came out of what you made, is that not right?

Mr. DONNER. If we carried that further, you could apply it to wages as a whole, if you carry your simile far enough. That is what is bothering me, where one begins and the other ends, Senator.

Senator O'MAHONEY. The difference, in my mind, is simply this—and I do not intend to take up your time, Mr. Coyle.

Mr. COYLE. Our purpose in coming here is to be of service to you.

Senator O'MAHONEY. But the wages that you paid to the worker is an expense which does not add to the invested capital of the corporation, is that not right? That is an expense.

Mr. COYLE. Neither does the bonus.

Senator O'MAHONEY. But the amount of common stock which you distribute as compensation becomes a part of your common stock.

Mr. DONNER. I was afraid that we misunderstood you, Senator, because that is not correct. If we buy in the market 10,000 shares of common stock and pay that as bonus, we have had no effect on the common stock.

Senator O'MAHONEY. You have not increased your common stock at all?

Mr. DONNER. It is just as though we bought a bond with it and distributed it, and I wanted to make that clear. We don't affect the amount of employed capital by that transaction.

Senator O'MAHONEY. I see, that is correct. But it does come out of the earnings just as the $900,000,000 comes out of the earnings.

Senator WATKINS. It does not come out of net profits, however. It is just part of the wages.

Mr. DONNER. The net profits after that is deducted—it is a contingent charge, variable with profits, but I think the stockholder would look at it as a deduction prior to the determination of profits. You can get a play on words there when you contrast expenses with distribution of earnings, and it depends on what viewpoint you are looking at.

Senator WATKINS. You pay all of your expenses out of earnings; do you not?

Mr. DONNER. That is what I said earlier; you could apply it to wages if you wanted to push it a little further.

Senator O'MAHONEY. The $900,000,000 was not distributed in dividends. It was plowed back into the corporation, and it is producing additional output?

Mr. DONNER. Just as any additional capital would produce additional output.

Senator FLANDERS. Under good management.

Senator WATKINS. That is assumed.

Senator FLANDERS. In this case, it is.

Mr. COYLE. I would like to draw the attention of the committee to some observations on taxes. Without trying to avoid some of the more difficult parts of this presentation, I think that we ought, every once in a while, to bring out one of the tough subjects and talk about that.

Senator WATKINS. Is that an invitation?

Senator O'MAHONEY. Mr. Coyle is asking for all that comes.

Mr. COYLE. We came down here to be of service to you, and I do not think that we can be if we run away, in a sense.

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 along 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 not in that classification, Mr. Coyle; I will say that right now.

Mr. COYLE. Well, sometimes I wish that I were not. But did you have that in mind merely because we make large profits——

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.

Mr. COYLE. Now, let me explain that, if I may.

Senator O'MAHONEY. 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, then that 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 taxpayer, why should it not be an equally justifiable principle when applied to the corporate taxpayer?

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 is diminished.

Did you have a point?

Representative WOLCOTT. I think if Senator O'Mahoney will pardon me, the last paragraph on page 27 sets forth pretty well your position with respect to the difference between a corporation tax and an individual tax, and it seems to me that it might settle this question between you and the Senator with respect to which is which.

Mr. COYLE. Yes. I might read that.

"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 each 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 FLANDERS. Mr. Coyle, I have two or three questions that I would like to ask, and I think now is as good a time as any.

I confess that I was somewhat disturbed 3 or 4 weeks ago when you announced increases in two of your lines of cars. It seemed to me that increases announced at that time, when the talk of a fourth round of wage increases was in the air, were most unfortunate, to say the least.

Can you defend the action, and can you defend it as being given at that time?

Mr. COYLE. I think that I can sir; yes.

The amount of increase that was passed on to the public in the price of the first new models, the first new models that we have had since 1941—and taking into consideration the tools that we had to make to produce these new models, and the cost of the change-over period with the lower volume—the prices that we put on that product compensated us only for the added cost of those cars, as we estimated it, over and above the cost of the cars that were going out of production.

Senator FLANDERS. Let me say, with regard to that, that the news items of two different papers which I read did not bring that point out.

Mr. COYLE. I think one reason for that, Senator, is the fact that it is a little difficult for us and a little troublesome for us to take the public into our confidence too much on costs. That is a confidential item in a very highly competitive industry. We don't like to tell too many people just what our costs are on the various items.

Senator FLANDERS. It would seem, nevertheless, that it would have been a good idea to have explained in the releases that these were the costs on new cars for which you had to tool up. You do not have to tell what the costs of that tooling up are. You may have said in your releases just what you have said publicly here today, but it did not get into the news items as I read them.

Mr. COYLE. That may be true, but we assumed the public would know new cars would cost more than those designs that had been in production for many years. I will admit in one case we failed to explain that the Hydramatic transmission was included as standard equipment.

I am frank to admit that in our company we do sometimes make a very serious mistake, and we do make mistakes.

Senator FLANDERS. You doubtless are aware of the fact—someone has told you perhaps at some time—that General Motors' profits seem to warrant either a reduction in prices or an increase in wages, or both. Have you ever heard that?

Mr. COYLE. Well, yes; frequently, I would say. At least we have considerable conversation on that about every year, and on a 2-year labor contract we have had it less frequently.

Senator FLANDERS. I must confess that your system of setting prices was too elaborate for me to follow. As I look through it here, and I have only had it before me at the table and as you explained it, does it not result in as high a profit per car, when applied to your automobile section, as any manufacturer is making?

Mr. COYLE. I think perhaps it is, and I think it is higher than most other manufacturers are making.

Senator FLANDERS. Probably higher?

Mr. COYLE. Our prices are still competitively below what other manufacturers are securing for their cars, so our cost control and our efficiency of operation must certainly be more effective and more efficient than that of our competitors.

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 much attention to it—were $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, because 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 post-war cars—those cars are priced below competition. That is reflected in the chart.

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: If, 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.

Senator FLANDERS. What do you think of the suggestion that has been made here, and I myself have been guilty of making it to one of the largest industries of the country, that the process of protecting one's self at a peak level of production and profit, may perhaps tend to bring on the lower level of operations against which you are protecting yourself?

Mr. COYLE. You mean by pricing ourselves out of the market?

Senator FLANDERS. No, by building up surpluses which do not get back into the general purchasing stream of the country. That is the point I am making.

Mr. COYLE. Well——

Senator FLANDERS. It is not an individual matter of what happens to your individual company, but what happens in the aggregate to the economy of the country, of all companies doing that.

Mr. COYLE. I would like to make a comment on that. As you know, General Motors set out on a postwar program of some $500,000,000 worth of expansion, and Mr. Sloan and Mr. Wilson both made statements to that effect, and that was done.

The rising cost of construction and equipment and other things made us exceed the amount that was originally contemplated. We then set out to complete our tooling, and within the next month we will show you some nice products. We have needed additional funds for inventory and we have needed additional funds for accounts receivable, because of the higher level of dollar sales. We have not yet attained an easy or comfortable cash position in ratio to the total volume of business we are doing.

Senator FLANDERS. You do not think that you are holding any supply of liquid purchasing power out of the market?

Mr. COYLE. We are not. When we come to the point where we have idle cash capital, then the determination of whether that should be paid in dividends or reduced prices, or just how to dispose of it, will come up for consideration.

Senator FLANDERS. You did not mention raising wages.

Mr. COYLE. Purposely I didn't mention raising wages; no, sir.

Senator FLANDERS. You have answered my question, then, with respect to whether what you are currently doing would tend to weaken the whole market for goods in general in the country.

Mr. COYLE. There is one other observation, and then I would like to ask if Mr. Donner or Mr. Bradley has a comment.

As far as we are concerned in General Motors, the fact that we borrowed $125,000,000 on notes, long term, and sold $100,000,000 worth of preferred stock, even above the plowed-back earnings that have been previously referred to, indicates that we were running on a close margin of cash at that time. We have needed to reestablish our cash to take care of the size of the business.

There is a chart in here, and I didn't refer to it, but——

Senator FLANDERS. I have noted it; yes.

Mr. COYLE. We paid out 1¼ billion dollars this year in wages, in total compensation, wages, and salaries. That means $100,000,000 a month, on a 20-day month, which is what we work, 5 days a week, and it means $5,000,000 a day for each working day. It takes a considerable sum of money to do these things.

Did you have some comment you wanted to make?

Mr. DONNER. I think that you have made the point, but th( vested earnings, at least sitting where I sit, certainly appea getting back into the spending stream pretty rapidly, because ıı you will look at our cash position relative to our sales, which is the normal measuring stick of what you need over the years, we were not able to maintain that in 1946, '47 and '48, particularly 1946 and '47. And that is why we got the increased capital. And this $900,000,000 if you go back to 1928, or $500,000,000 if you go back to 1941, is money that was required for new plant, new inventories, and the receivables, necessary to carry on the business. That is, it seems to me it certainly was getting into the spending stream awfully quickly.

Senator FLANDERS. Now, let us go from current facts to prophecy. I do not know which of you gentlemen to elect as prophet—and I am not speaking of it with an "f" this time but with a "ph"—but I think probably Mr. Coyle, since he is the official testifier.

Do you see any indications that we are over the hump so far as concerns these increasing needs for working capital?

Mr. COYLE. I think that becomes an individual problem with each company.

Senator FLANDERS. No; I am speaking about the possibility which seems to be generally accepted by certain quarters in the financial world, that we are close to the end of rising prices, which has required more capital investment in your inventories and more capital investment in your accounts receivable and in other ways.

Mr. COYLE. There has been a slowing down, a tendency, certainly, in that respect. In other words, our inventories have not, in the last year, risen to the same degree that they did in the prior year and the year immediately following the war. Our accounts receivable have been held at a normal level. We have been able to catch up on some of the shortages of cash that we did have.

But the point I was going to make is that I don't think I am quite qualified to speak of business generally across the board because I have, after all, devoted too much of my time, or as much time as I have, to the business of General Motors and not to the analysis of business generally.

Now, maybe Mr. Donner, who handles the financial end of it, might have a totally different impression, and I would like to ask him if he has.

Mr. DONNER. If we narrow it to General Motors for the moment, if our price level—and you mentioned the price level—if the price level holds anywhere near where it is today and our volume is at about this level, we wouldn't expect our net working capital needs to increase seriously, because, you are familiar with it of course, those needs are a pretty steady ratio in relation to sales, and in our case they run from 25 to 30 percent of sales, our total net working capital.

So far as our plant expenditures are concerned, with the amount of the postwar rehabilitation and conversion that we have done, we we would think we could probably more nearly live within the depreciation and tool amortization that we are setting up.

So that barring further price inflation, we probably have got our arms around this much better than we have had.

Senator FLANDERS. In that case, would you feel that if it becomes clear to you that this situation has become established, you would feel like reducing the price of your cars a bit, for instance?

Mr. DONNER. I will pass the ball back to you now.

Mr. COYLE. Naturally, only 10 percent of us cannot speak for the other 90 percent of the board of directors on matters of that kind. On the other hand, there is very definitely this——

Senator O'MAHONEY. Just think of the powerful 10 percent that is here.

Mr. DONNER. You would be surprised, Senator.

Mr. COYLE. I would say this, that you may be sure, looking back on the history of General Motors, and the management of it, the organization period, the growth period, the stabilization period, and the war period—I am very proud to be associated with General Motors, and it is a good institution and a fine place to work—I am sure that we are not going to retain unduly large sums of capital that we don't need. What disposition may be made of that, whether it be in the form of lower prices, greater dividends, and I will include greater wages, perhaps, whatever may happen, you may be sure that General Motors will take good aggressive action when the time comes.

Senator FLANDERS. How much of the short-term debt is it that you have to retire?

Mr. DONNER. Medium term debt, $125,000,000.

Mr. COYLE. That is notes, but part of it is 20-year and part of it 30-year notes.

Senator FLANDERS. Is that payable before the expiration of the time?

Mr. COYLE. At a premium; yes, sir. It is callable at a mark-up.

Senator FLANDERS. That might be one of the things which you might elect to do.

Mr. COYLE. It is undoubtedly one of the things that we would do.

Senator FLANDERS. I have a couple of other questions, and in fact I have three more, and the third one you will not be able to answer, so I will give you the first two, first.

You seem to be in a better profit position than the industry as a whole. Do you feel that you have to give any consideration to the industry as a whole? You have not mentioned it on prices. Could you not for a time at least, or for a considerable time, reduce prices to a point where other automobile manufacturers would be seriously handicapped?

Mr. COYLE. I don't think that they would be, for this reason: General Motors at the present time, if we could get all of the material we wanted of all types, would be limited to about 2½ million units production annually. That would be the best we possibly could do. That is an abnormal situation because it gets away from this 12 percent in 1 month and 4 percent in another month, because the demand is out there and it takes whatever you can produce, month by month. So the best we could do would be 2½ million units. The remainder of the industry would have to produce additional units to meet the full demand, whatever that might be.

Even in the 8 years prior to the war—and the reason I use 8 years prior to the war is that those are the 8 years that I was general manager of Chevrolet before the war came on—the average market for passenger cars was 3,300,000 a year, and the average market for trucks was just under 800,000. The average of the industry was just over 4,000,000, and that was only replacement market, and we had to over-allow on used cars rather than sell used cars at a profit as we do today. Some day we are going to come back to that.

But don't you see, the point I am trying to make is that while there is a shortage of vehicles, and we don't like to speak of our competition, but it has been proven that we have got the best automobile on four wheels——

Senator FLANDERS. I have heard your competition express similar sentiments.

Mr. COYLE. I think that they do a good job, they usually do.

Senator FLANDERS. I may say that I have two of your cars.

Mr. COYLE. Would you like another one? There is a Buick across the street, and I am just itching to go over and sell that.

Senator FLANDERS. One of my two cars is 10 years old.

Mr. COYLE. Well, you are a prospect for that 20-year-old job over there. I would love to sell one of you gentlemen a car, and it would just make me feel good.

Senator FLANDERS. You are one of the people who came out of the sales department.

Senator WATKINS. Senator, in connection with the reduction of prices that you are talking about, I am wondering if the consumer would get any of the reduction in the price that he would have to pay for your product, even though you did reduce?

Mr. COYLE. That is one of the most troublesome problems that we have had, the question of the so-called gray market, black market, and what have you. Regardless of the fact that we have recommended prices, they are not always followed. They are not followed in a sufficient number of cases to give us a very bad reputation that is going to haunt us in the postwar period, and we don't like it at all. We are not taking advantage of it, but that doesn't mean that others are not.

Senator WATKINS. The demand is greater than the supply, and that accounts for the situation that has come up.

Mr. COYLE. That is right.

Senator WATKINS. If you did reduce your prices, actually would the consumer get any benefit, or would that same money go anywhere else?

Mr. COYLE. It would, for the dealers who didn't take advantage of their position, and provided the dealer delivered a car to the customer, who wouldn't likewise take advantage of his opportunity.

Senator WATKINS. You can follow it through, and you do not know what happens.

Mr. COYLE. As a matter of fact, this is one that perhaps I should stay a little closer to shore on, and not get too far out on the thin ice, but I do think that if you people could realize the restrictions that are placed upon us by the Sherman law and the Clayton Act, and read the charge of the judge in the South Bend suit, the charge to the jury, and the finding of the jury in that case, you would understand why we don't take a little more aggressive action than we have. We would like to.

Senator WATKINS. I am just trying to find out if the suggestions that has been made several times by our chairman would result, even though you reduced the prices to your dealers, would actually result in any reduction in the price to the consumer.

Mr. COYLE. It would in some cases where the thing was followed through. On the other hand, you are right in saying that we cannot possibly follow these transactions through to a final conclusion, because after all, limited as our production is, we are still running in the area of between 9,000 and 10,000 units a day, and that is just too many jobs scattered over the country for us to follow and find out if the customer is treated well; even with a little help I don't think that we could do it.

Senator FLANDERS. Now, going to this question of presently lowering prices or increasing wages, or both, do I understand that your answer to that, in spite of the very healthy profits shown on your investment and the presumably healthy profits shown per car, taking the automobile part of your industry, that in spite of those profits, which look pretty large from my business experience, that you still had to borrow money in the last 2 or 3 years?

Mr. COYLE. Yes.

Senator FLANDERS. Is that your answer?

Mr. COYLE. That is part of the answer.

Senator FLANDERS. What is the rest of it?

Mr. COYLE. The rest of it is this: The members of this committee right here would be the first to criticize us—and I think justly—if we came out with another round of large wage increases. After all, what we do within our own economy and within our own corporation is carried back into the sources of supply and is carried on beyond us and you start another spiral of inflation that is already bad enough. We were criticized a year ago when we made our last wage settlement because I happened to be available this morning and listened to the witness testifying on price reductions that had been made. It happens that the union with whom that company was dealing had not cleared itself under the Taft-Hartley law so that it could call a strike without losing its bargaining rights or jeopardizing them. It also happens that the union with whom General Motors deals was not in that position and was threatening a strike. Chrysler had already been on the street, and had demanded a 17-cent wage increase an hour at Chrysler. And in the discussion with the union people they said, "Would you really bargain at 17 cents?" And the union people said "No," they would not. And Chrysler said, "Then you intend to strike?" And they said "Yes." We settled for 11 cents. It happens there were some 4,000 other settlements prior to the General Motors settlement of 11 cents—and some of them very large companies—for increases of 6 to 20 cents an hour. And that was ignored.

One of the reasons for that is the high visibility of General Motors. What we do stands out in the floodlight and is subject to criticism, and perhaps it should be criticized, I don't know. But we have to run the business the best we know how.

So that on this wage increase, we feel that we have got to meet competitive prices, competitive wages. And we are not critical of what has happened; we have just done the best we could with it.

Let me explain it this way: In 1945, coming out of the war, after a long record of war production, we didn't get our plants reconverted until we were out on strike. We were out on strike for 113 days because we didn't know what the wage pattern would be and how much inflation the country was going to take.

Now, Mr. Wilson—I am sorry he is not here, but you, Mr. Chairman, told of his overseas assignment—I think he appeared before this committee or one on which some of you gentlemen have served, and made the comment about the three different steps or levels that did occur before the situation became clarified by a wage pattern established at 18½ cents, and the $5 a ton increase in steel prices. We were kept on strike for 30 days after that, because the union wanted another penny an hour, and they wanted 19½ cents to show they were a little better than the steel people.

So those are just some of our problems, and we are accustomed to dealing with them, and we don't lie awake too much nights about them. We feel the other fellow is, so why should both of us be awake.

Senator FLANDERS. That is an interesting story, sir, and I have one final question that I wanted to ask you.

Senator O'MAHONEY. This is the unanswerable question?

Senator FLANDERS. Yes. At least I haven't the answer, and I do not know whether Mr. Coyle has or not.

You represent, I suppose, the greatest economic empire in the world, and it has not grown, in my judgment, by unfair competition, it has not grown by the holding of limited natural resources; and it has grown, so far as my knowledge and judgment goes, simply by good business management and open competition.

If we add to the General Motors operations the Du Pont operations, with which they have some sort of a tenuous financial connection, you have the biggest set of business operations that the human race has ever seen. You are still working efficiently, and it looks as if you were still going to grow and grow and grow.

I cannot conceive, from what I look at, by and large—I do not mean the individual situations, the individual instances and individual mistakes—I do not see but what you have grown fairly and in the service of the public. Yet your history preeminently, and that of other large companies to a less degree, seems to be leading us into an economy of great economic empires, and that poses problems with which this Congress will ultimately have to deal in ways which I cannot foresee at the present moment.

Does the responsibility of your company for this situation ever keep you awake nights? I think perhaps you can answer that one.

Mr. COYLE. I would like, before I give the final conclusion as to the sleepless nights and the cause of them, to make a few observations along the same line, and I would like to ask, first: Would you have any objections to our public relations people using your own statement here?

Senator FLANDERS. I have no objection to it.

Mr. COYLE. That would be so nice of you.

Senator FLANDERS. Providing they will also put in along with it my expression of concern. Will you do that?

Mr. COYLE. Yes, I will put it in.

Senator O'MAHONEY. Take the whole statement.

Senator FLANDERS. Yes.

Mr. COYLE. I think that is a rare statement of a very high compliment to us.

Senator FLANDERS. It was intended to be.

Mr. COYLE. Thank you so much.

Now, I would like to make this observation, and I have made it many times within our own organization, and I have made it in the days when I was operating as general manager of Chevrolet and I have been called upon to do it in my current assignment in General Motors, which has covered the last 3 years. We did not grow large by reason of any desire on the part of the people that organized the company just to get big and have a lot of money and build a lot of plants. We did it because the public wanted the products we were making at the prices they could afford to pay. We gradually plowed back some of the earnings. We increased our capital and we did the other things that were necessary to take care of a clientele that apparently made us into what we are today, and we hope that they are satisfied. We try to keep them that way.

Now, we have not a single, solitary asset carried on our books that other people with a profit opportunity can't duplicate, not one. I wish we didn't have plants that were 20 and 30 years old that we acquired in earlier times. They are not located right due to population shifts. Other people with a like sum of money and profit opportunity can buy better plants, better located, and build better buildings. They have just as much machinery of modern type available as we have, and we have got a lot of it that is old. They could buy as good material and they have the market available to them just as we do.

Now, the physical facts we are dealing with, the inanimate things, are there. The difference is the ability of the people operating the business. So long as General Motors can attract and retain capable people that will do a better competitive job than the other fellow, we can't help but be larger than the other fellow.

Now, I am sorry to say that is the only answer I can give you, and I am not lying awake nights worrying about it. I expect I will when someone begins to overtake us.

One other point. In 1921, General Motors and Ford jointly had about 75 percent of the business. Later, Chrysler came in and took 20 percent. General Motors and Ford today have about 60 percent, and the only thing is that the Ford proportion that was previously as high as 60 percent or 62 percent at the time we were 12, has now become around 20, with General Motors at 40. In other words, Ford has about 20 percent of the business and we have about 40 percent that brings us up to the total. We have the actual figures here.

Representative WOLCOTT. I think it might make Senator Flanders feel a little better, and it would help Senator Flanders if you put those in the record. It seems to me that you are spreading out a little bit instead of concentrating.

Mr. COYLE. We have a chart in here, Congressman Wolcott, showing what our percentage of the business has been over the years, and we did not show it for competition because we felt that they should testify for themselves.

Representative WOLCOTT. At one time General Motors had about 70 percent of the business?

Mr. COYLE. Oh, no. Ford had more than 60 percent back in the old model T days, and General Motors had 10 or 12.

Mr. DONNER. Ford and General Motors had 75 percent of the business combined in 1921 when Ford had 63 percent and General Motors had 12 percent. In 1948 we have got about 40 percent, and Ford has about 20 percent; that is less than the 75 percent, and in the meantime Chrysler, which originally was Maxwell, had virtually no position in the market in the middle twenties, and today has about the same unit position as Ford. So, there has been plenty of shifting around in this business through competition. It has not been one company that has had a great share of business steadily through the year.

Senator O'MAHONEY. It prompts me to make a comment, that during this period of change when Ford dropped from a high point of over 60 percent to his present position of 20 percent plus, and General Motors went from 12 percent to 44 percent, which I think is the figure that you had in your statement.

Mr. COYLE. About 40; a little less than 40.

Mr. DONNER. In 1941 it was about 46 percent.

Mr. COYLE. That was prewar.

Senator O'MAHONEY. That transposition came about during a period when Ford was sticking pretty closely to the model T, and the one-class car, while you were building cars to meet every purchaser's pocket, so to speak?

Mr. COYLE. That is true. On the other hand—and it is a matter of great pride with me, because I had over 29 years with Chevrolet—Chevrolet, in the light years that I had it, prewar, sold one out of every four passenger cars on the highway, regardless of price class; it was 24½ percent. One out of every three trucks, regardless of weight class, was Chevrolet. That was a third of the truck business and a quarter of the passenger-car business, and we had just one line, Chevrolet.

Senator O'MAHONEY. What was Chevrolet's percentage position?

Mr. COYLE. I just mentioned 24 percent or 24½ percent.

Senator O'MAHONEY. One out of every four.

Mr. COYLE. Yes, and now if you take the prewar percent, 24 of the 44 were Chevrolet, and the other cars made up the other 20, and the way they did that was to use our body on their chassis.

Senator O'MAHONEY. But in any event, the combined experience of Ford and Chevrolet clearly indicates that the purchasing power of the people in the low-income groups who were buying the Fords and the Chevrolets built two of the most effective automobile producers in the world, is that right?

Mr. COYLE. I think that is right.

Mr. DONNER. You had better add Plymouth and make it three, and there was no Plymouth prior to 1929. That came from nothing.

Senator O'MAHONEY. We will add that to it.

Mr. COYLE. As a matter of fact, Plymouth is entitled to that position, because of the fact that the 1948 Plymouth car—which is just as antiquated as the Chevrolet of 1948, not the new models—is still selling at a premium above what the manufacturer is selling it at.

Senator O'MAHONEY. But this experience, Mr. Coyle, of Ford, and General Motors through Chevrolet, and Chrysler through Plymouth, demonstrates the great desirability in the maintenance of a prosperous economy of holding up the purchasing power of the lower-income brackets?

Mr. COYLE. There can be no question of that at all, Senator.

Senator O'MAHONEY. So any industrial leader who is misled into believing that by reducing wages or producing unemployment any profit can be gained for industry is a little bit off the beam?

Mr. COYLE. Oh, surely.

Senator O'MAHONEY. Now, Senator Flanders spoke to you in passing, this very excellent statement of his, which you want to pass along.

Mr. COYLE. Would you endorse the statement?

Senator O'MAHONEY. Oh, yes, indeed. You remember when the TNEC held its investigation of patents, it brought the motor industry in first, because there seemed to be every indication that the automobile industry was doing a competitive job with respect to production. Now, then, you stated that Du Pont has about 22.2 percent.

Mr. COYLE. That is 22.7.

Senator O'MAHONEY. That is of the stock of General Motors, and that, in turn, you said was controlled by 90,000 stockholders of Du Pont.

Mr. COYLE. Might I make an observation while I am thinking of that. You may recall in my opening comments that I mentioned that General Motors was in a little difficulty back in 1920 and needed $80,000,000 which it borrowed from the banks. Du Pont had previously a stock ownership position and extended it further by purchasing a large block of stock then overhanging the market.

Now, other investment people and other people had the opportunity to buy that stock at that time. So let us not blame Du Pont too greatly.

Senator O'MAHONEY. I am not blaming them.

Mr. COYLE. We know them well, and they are good people.

Senator O'MAHONEY. I cannot understand, when I ask questions, some people think that I am trying to blame someone.

Mr. COYLE. Oh, no. I certainly did not have any such thought at all, but you know—as a matter of fact, did you know that over in Chicago at the present time there is a suit going on over there, trying to find out about Du Pont and United States Rubber and General Motors, and a few other things—so it is not that we are blaming you, but we do get a little skittish about that.

Senator O'MAHONEY. That is part of the question that Senator Flanders asked.

Mr. COYLE. That investigation is going on at the present time, and perhaps I should go to Chicago now and defend the Du Pont people over there, and I didn't mean it here.

Senator O'MAHONEY. But the point I was getting at is, without regard to any antitrust proceeding of any kind—and I am not concerned with any that may be pending at this moment, sir—I was going to ask you if you do not also have a member of the board of directors on United States Steel.

Mr. COYLE. I don't know.

Mr. DONNER. There is no member of the GM board on United States Steel; no, sir.

Senator O'MAHONEY. Is it through Du Pont?

Mr. DONNER. I don't know of any member of the Du Pont Co.'s board that is on United States Steel.

Senator O'MAHONEY. I have not checked it up at all, but I had the impression.

Mr. COYLE. I am ashamed to make this admission, but, frankly, if you only attended some few of our board meetings and realized how little the board members know about the business, I don't think that you would be worried at all about who is on the board of my company.

Senator FLANDERS. Is that for the record?

Mr. COYLE. My associates in New York might give me the jump on that, but I still mean it.

Senator O'MAHONEY. Of course, I think that I ought to say, as is evident when you come to a meeting of a Senate committee, you find that the members of the committee do know something about the business.

Mr. COYLE. Mr. Donner makes a correction. He said I should exempt present company so far as the board is concerned.

Senator O'MAHONEY. We will make no exceptions.

Representative WOLCOTT. Would you change that to congressional committee?

Senator O'MAHONEY. I will add congressional committees, yes. Shall I limit it to a joint House and Senate committee?

Representative WOLCOTT. I get facetious about this opinion that is expressed in the paper. They refer to this committee as a subcommittee of the Senate, and they are wondering why I am here.

Senator O'MAHONEY. I think the witnesses at least should know that Congressman Wolcott is the vice chairman of the committee.

Representative WOLCOTT. I am speaking for the House and not myself. I take particular pride in the fact that the House is a part of the Congress.

Senator O'MAHONEY. Now, if you will refer to your statement, you say that in the 12 months ending September 30, 1948, the total value of all components and parts manufactured and sold to the car and truck divisions of General Motors was about $1,350,000,000. That is a very sizable business going on among the divisions.

Mr. COYLE. Yes; highly integrated. We make more of our own component parts than other manufacturers do. We make our own bodies.

Senator O'MAHONEY. Do any of the purchasers there complain about the prices that the sellers exact?

Mr. COYLE. We have in General Motors a pricing committee merely to referee the fights.

Senator FLANDERS. May I interrupt for a moment? I know less about General Motors than I did a few years ago when I was in business. It was my impression at that time that, in part, its high efficiency was due to the fact that there was intense competition inside of the whole General Motors organization and that you fought just as hard with each other as if you were competing, rival companies with no connection.

Mr. COYLE. I think that we fight harder. I know that is true of our car divisions, and I know it was with Chevrolet. We envied every sale that Olds or Pontiac got away from us if they were in the low-price field, and there is another reason, going back to this reference here on the intercompany sales. There are two guiding factors in that. The original producer has to sell the car division on a competitive basis. If the car divisions can go on the outside and buy the same product at a cheaper price, they do that.

Second, we encourage the parts divisions to try to go out and get some Chrysler and Ford business on the outside and to sell them at the same price that they sell it to us, because if they can do that against competition, that is a good business.

Senator O'MAHONEY. Now, to go back to this question that disturbed Senator Flanders, before he changed his question and merely asked you could you sleep at night. Let us refer to your testimony with respect to the number of stockholders. That is on page 26.

> General Motors has more than 400,000 common-stock holders and over 30,000 preferred-stock holders. Most of the holders of common stock are small investors with 320,000 owning 50 shares or less.

May I ask you what I asked Mr. Wilson of General Electric this morning, to supply to the committee the average share ownership of each common-stock holder and the median share ownership? I mean by that, you take one-half of your common-stock holders.

Mr. DONNER. I think that I can answer that, Senator. We have 400,000 common-stock holders, and 44,000,000 shares outstanding, and the arithmetic average would be 110 shares.

Mr. COYLE. That includes the du Pont holding?

Mr. DONNER. Yes, and if you adjusted that to 91,000 du Pont stockholders and raised it to 500,000, you get about a 90-share holding on the average. Now, if you are talking about the median, my breakdown holdings would make it somewhere around 20 shares. We have 241,000 stockholders with 25 shares or less, so if your median was at 200,000, it would be short of 25, and if you adjust again for the Du Pont stockholders, the 91,000, I imagine the median would come to the 25 shares.

Senator O'MAHONEY. Half of the stockholders own probably less than 25 shares?

Mr. DONNER. That does not mean they are small investors necessarily, so far as their holdings of stocks as a whole are concerned. They are small investors in General Motors.

Senator O'MAHONEY. It does mean that their income on dividends from General Motors is not by any means a living income for them?

Mr. DONNER. It is that part of a holding that they are just as interested in getting returns from.

Senator O'MAHONEY. Some investing company may be the holder of just a few shares.

Mr. DONNER. I don't know whether that makes them less critical or more critical; judging by our mail, I would say it makes them more critical when they are a small holder.

Senator O'MAHONEY. The small holders find it more critical. I was reading in the New Yorker the other day the story of a small stockholder who has made it a practice of attending stockholders' meetings. He is Mr. Gilbert.

Mr. DONNER. His total holdings are fairly sizable, with three hundred-odd companies.

Senator O'MAHONEY. Do you know how many States these people live in?

Mr. DONNER. They live in all of the States and the District of Columbia, and a number of foreign countries as well, and I don't know if the foreign countries would be 20 or 30, but it is quite a sizable number of foreign countries.

Senator O'MAHONEY. Somewhere in your statement you gave us the number of employees.

Mr. COYLE. Yes; there is a table at the back. It is a little easier to find on the chart.

Mr. COYLE. It shows pay rolls, about $1,250,000,000.

Senator O'MAHONEY. There are just under 400,000 employees?

Mr. COYLE. It is about 340,000 employees in the United States.

Senator O'MAHONEY. And you add 340,000 employees to 400,000 common-stock holders, and you have a total of 740.000 persons who are economically interested in General Motors.

Mr. COYLE. On top of that you must add the 208,000 that are working for our dealers in the distributing of our products; that is another 208,000. We are getting up close to a million.

Senator O'MAHONEY. So you have a perfectly tremendous industrial population?

Mr. COYLE. A responsibility; yes.

Senator O'MAHONEY. It is a tremendous thing.

Mr. COYLE. We have a great responsibility to those people to manage our business as well as we know how.

Senator O'MAHONEY. With respect to these dealers, do I understand it to be a fact that the automobile companies as a group prefer not to have a dealer incorporate?

Mr. COYLE. Oh, no; I never heard of that.

Mr. DONNER. I never heard of a preference one way or the other. I would say that the dealers are quite able to make up their mind on that, based on their own individual financial situation. A number are partnerships and a number are sole proprietorships and a great number are corporations.

Senator O'MAHONEY. How about the agency? Is the agency an individual contract?

Mr. COYLE. The operator has a contract, and it may be a corporate operator with a president of the corporation, and so forth. Generally we have about half. We sold half of the vehicles in the number of units, and I have known individually, personally, a great number of those dealers over the years that I was associated, naturally, with Chevrolet, and I have known them to shift back and forth into partnerships and into individual ownership and into corporations. They were trying to get every tax benefit that they could.

Senator O'MAHONEY. Do you make dealer contracts with corporations?

Mr. COYLE. With anybody, yes; with an operator; and we certainly do not determine what manner of doing business the fellow is going to go into, if he signs to distribute our products. If he qualifies, he can work as a corporation.

Senator O'MAHONEY. If he qualifies, and you find him to be a good operator, you don't care whether he incorporates or not, but your agency contract is with him as an individual?

Mr. DONNER. It is with the corporation, with the operator specified. The operator is specified, but the contract would run to the corporation.

Senator O'MAHONEY. If an operator should die, for example, the contract terminates, regardless of the corporation?

Mr. COYLE. That is the only reason for it.

Senator O'MAHONEY. But it is another aspect of this industrial empire to which the Senator has referred.

Mr. COYLE. No industrial concern is too big if it is well and honestly operated.

Senator O'MAHONEY. I am not criticizing it, but I have been very much impressed by the fact that it is a collective institution of this kind which you represent here which is affecting so much of our legislation today, and which is the distinction between little business and big business.

Mr. COYLE. Don't overlook this; there is one page in here that I did not touch on, and I thought perhaps I would read it to keep you people awake nights. We mentioned it in here some place. It is that our taxes this year for the 12 months were $650,000,000 against the profits that we had. Do not overlook the taxes we pay. When Congressman Wolcott called my attention to the statement we have made regarding corporations as a method of doing business I didn't read the first paragraph. That paragraph stated we had collected and paid to the Government—Federal, State and city—$650,000,000 in taxes. We are an asset to the Government and you need us.

Senator O'MAHONEY. You produce a lot of money, but here is this terrific change that has come about in the corporate development.

Mr. COYLE. The people who made us big will whittle us down to size if we do not give them good products.

Senator O'MAHONEY. That may be, but it is increasingly more difficult for an individual to get into business in the conditions that now exist. An individual cannot compete with General Motors, for example.

Mr. COYLE. Kaiser-Frazer did a pretty good job of getting into the business during the war.

Senator O'MAHONEY. But it is a corporation, too. I mean as an individual they could not do it. They had to do that.

Mr. COYLE. We specified in here the amount of capital risk; few people have enough, and I think the Ford is about the only one that has, and they built it up in the early days.

Senator O'MAHONEY. And if he had not built it up in the early days, it could scarcely be built up now.

Mr. COYLE. He could not do it now.

Senator O'MAHONEY. What is this enterprise that started? The Tucker Corp. He has had some difficulty.

Mr. COYLE. He is having continually more difficulty. I don't think that he will get going.

Representative WOLCOTT. He has had his difficulty with the Government, has he not?

Mr. COYLE. He bought a pretty big plant in Chicago, among other things.

Senator O'MAHONEY. But in a corporate economy, with a few giants, and you were here this morning when I put those tables in the record.

Mr. COYLE. I am very proud of the fact that we were No. 1 on your second reading.

Senator O'MAHONEY. You, too, survived the war, but it is one of the reasons, it seems to me, why Senator Flanders can ask this question and why Members of Congress are constantly receiving pressure to do something to protect little business.

Mr. COYLE. We are the best customer that little business ever had. Little business could not survive without big business, and I will leave it to Senator Flanders if he would not agree with that.

Senator O'MAHONEY. I understand that that is true.

Mr. COYLE. We don't want to go into all of these businesses, and they can do a lot of the smaller things so much better than we can.

Senator O'MAHONEY. In many instances, these little business suppliers of yours are practically retainers of yours. They engage in that business and that business alone, is not that true?

Mr. DONNER. That is not true of the suppliers; no, sir.

Senator O'MAHONEY. That is not?

Mr. DONNER. No.

Senator O'MAHONEY. It is true of some of them.

Mr. DONNER. Only of their own volition.

Senator O'MAHONEY. Certainly.

Mr. DONNER. I would not say it is typical of even our small suppliers, Senator.

Senator O'MAHONEY. Here you have these giants on that list, and other lists, which operate throughout the United States and which get their license to do business from one or more States. In what State is General Motors incorporated?

Mr. COYLE. Delaware.

Senator O'MAHONEY. How many subsidiaries do you have?

Mr. COYLE. Practically none at all now.

Mr. DONNER. We are virtually an operating company except for our financing and insurance subsidiaries in the United States. All of our operating business is done through the single company, Senator.

Senator O'MAHONEY. Now, you are talking of the United States?

Mr. DONNER. Outside of the financing and insurance companies, yes. We have a great number of foreign subsidiaries incorporated in foreign countries because that is a better way of doing business abroad.

Senator O'MAHONEY. I have here what purports to be a list.

Mr. DONNER. What date is that?

Senator O'MAHONEY. December 1, 1945. It says—

> Subsidiaries included in consolidated financial statement, 100 percent owned, directly or indirectly. Companies indented are subsidiaries of preceding companies.

And that is in parentheses. "AC Spark Plug Co."

Mr. DONNER. That is a small sales subsidiary through which we make our spark plug sales, and it is not an operating subsidiary.

Senator O'MAHONEY. "Argonaut Real Estate Corp."

Mr. DONNER. That owns some property, but it is not an active company.

Senator O'MAHONEY. "Avalon Building Corp."

Mr. DONNER. I think we have done away with that one.

Senator O'MAHONEY. "Fisher Lumber Corp."

Mr. DONNER. That owns a tract of land down in Arkansas and Louisiana, and now we go to all-steel bodies. We don't need it.

Senator O'MAHONEY. "Frigidaire Products of Canada, Ltd."

Mr. DONNER. That is a Canadian subsidiary.

Senator O'MAHONEY. "General Motors of Canada," with four subsidiaries, "Border Cities Industries, Ltd.; General Motors Products of Canada, Ltd.; Modern Dwellings, Ltd.; Regina Industries, Ltd."

Mr. DONNER. That is Canadian.

Senator O'MAHONEY. "General Motors Institute."

Mr. COYLE. That is a training school.

Senator O'MAHONEY. "General Motors Interamerica Corp."

Mr. COYLE. That is a Western Hemisphere trading corporation for South America.

Senator O'MAHONEY. "General Motors Overseas Corp."

Mr. DONNER. That is a subsidiary that deals through branches in a few countries abroad where we don't have plants.

Senator O'MAHONEY. "The McKinnon Industries."

Mr. DONNER. That is Canadian.

Senator O'MAHONEY. "Thirteen foreign subsidiaries, one foreign subsidiary. These were not identified by SEC as it is believed that the disclosure of the names would be detrimental to the interests of security holders of General Motors."

That is the comment of the library.

"Subsidiaries not included in consolidated financial statements. Except where otherwise indicated these subsidiaries are 100 percent owned, directly or indirectly."

And this is your insurance and finance group. "General Exchange Insurance Corp.," and "General Motors Acceptance Corp. and its consolidated subsidiaries," of which there are six.

Mr. DONNER. Largely doing business abroad, the subsidiaries.

Senator O'MAHONEY. "Motors Insurance Corp., a nonconsolidated subsidiary of General Motors Acceptance Corp."

Then it says, "175 subsidiaries engaged in retail distribution of General Motors products."

Mr. COYLE. That is Motors Holding.

Mr. DONNER. Those are dealerships in which the operator has not sufficient funds to get started, and we go in partnership with him until he pays us off.

Mr. COYLE. As soon as he pays us off, it becomes a rotating fund.

Senator O'MAHONEY. At the time this fund was prepared, 50 percent of the voting stock was controlled by you.

Mr. DONNER. Those change very rapidly. It is really a revolving fund.

Mr. COYLE. A lot of fellows have paid out during this high profit period.

Senator O'MAHONEY. Then there is a list of those, some which are apparently less than 100 percent, or some of them at least. "The Bristol Realty Co."

Mr. DONNER. Isn't that practically an inactive housing company in Connecticut?

Mr. COYLE. Back in the First World War we had trouble in getting employees, and we went into housing.

Senator O'MAHONEY. "De Lux Cab, Ltd."

Mr. DONNER. That is a Canadian subsidiary.

Senator O'MAHONEY. "General Exchange Corp."

Mr. DONNER. That was an insurance brokerage outfit.

Senator O'MAHONEY. "Hertz Drivurself Sales Corp."

Mr. COYLE. Yes.

Senator O'MAHONEY. You still have that?

Mr. COYLE. Yes. We own some of those branches.

Senator O'MAHONEY. There are six of those.

Mr. COYLE. And the rest are operators where we let them use the name.

Senator O'MAHONEY. "Sterrett Operating Service," and "Vauxhall Motors," and "Yellow Manufacturing Acceptance Corp."

Mr. DONNER. That does the truck financing.

Senator O'MAHONEY. Then we have 16 foreign subsidiaries located in former enemy or enemy-controlled territories, 23 inactive subsidiaries, 7 foreign subsidiaries, and in addition to this, there is a list of affiliated companies, among which is the Ethyl Corp.

Mr. DONNER. We have a half interest in that.

Senator O'MAHONEY. "Bendix Aviation Corp."

Mr. DONNER. We sold our stock, and we have no interest in that.

Senator O'MAHONEY. "North American Aviation."

Mr. DONNER. We sold that. We have no interest in it now.

Senator O'MAHONEY. "Kinetic Chemicals."

Mr. DONNER. We have a 49 percent interest in that.

Senator O'MAHONEY. "Broad Brook Co."

Mr. DONNER. That is a little textile outfit in Connecticut in which we have just under 50 percent.

Senator O'MAHONEY. That is a textile outfit?

Mr. DONNER. It makes upholstery for Fisher.

Senator O'MAHONEY. "International Freighting Corp."

Mr. DONNER. We have a third interest in that. That is very small.

Senator O'MAHONEY. We have this memorandum that may be of interest:

E. I. du Pont de Nemours Co. owns 10,000,000 common shares, or 22.7 percent of the issued common stock of General Motors. However, General Motors disclaims that it is controlled by this major stockholder.

E. I. du Pont de Nemours Co. has its president, vice president, and four directors on General Motors board of directors. The chairman of General Motors board of 28 members is Alfred P. Sloan, Jr., also a du Pont director.

Mr. COYLE. He still is, but the numbers of directors of du Pont have changed.

Mr. BRADLEY. It is still six.

Mr. DONNER. I think it is four. I might say, Senator, on those subsidiaries, the 100 percent owned, that as you read them through, you probably realized that outside of this small spark-plug subsidiary, none of our business is done through them in the United States, none of our operations are carried on through them, and you might say that outside of AC Spark Plug, 100 percent of our sales are done directly in the United States through our parent company.

(The lists and memorandum referred to by Senator O'Mahoney are as follows:)

## GENERAL MOTORS CORP.

### AN OUTLINE OF ITS CORPORATE STRUCTURE, SUBSIDIARIES, AND MANUFACTURERS

General Motors is primarily an operating corporation which carries on activities through its divisions.

#### PRINCIPAL PRODUCTS

The principal products manufactured by General Motors and its subsidiaries are:
Automotive and directly related lines.
Chevrolet passenger cars and trucks.
Pontiac, Oldsmobile, Buick, and Cadillac passenger cars.
Fisher bodies.
GMC trucks.
GM motor coaches.
Delco batteries, horns, shock absorbers, etc.
AC spark plugs, speedometers, fuel pumps, oil filters, gages, etc.
Harrison radiators, defrosters, heaters, and thermostats.
Hyatt roller bearings.
New Departure ball bearings.
Saginaw Arma steel and malleable iron castings.
Saginaw steering gears.
GM Hydramatic transmissions.
Packard automobile cable and wiring.
Guide lamps and mirrors.
Nonautomotive diversified lines.
GM Diesel locomotives.
GM Diesel engines for trucks, tractors, marine, oil field and other applications.
Allison aircraft engines.
Aeroprop propellers.
Frigidaire refrigerators, home freezers, electric ranges, water coolers, commercial refrigerating and air conditioning equipment, electric water heaters, and room air conditioners.
Delco oil burners, oil and gas water heaters, automatic stokers, boilers and water systems.
Delco radios, electric generators, electric motors, and household appliances.
Harrison heat transfer units and oil coolers for aircraft.

#### OPERATING DIVISIONS

In order to examine the ramifications of General Motors it is necessary to look at the divisional structure. Each division is a self-contained administrative unit with a general manager responsible for all functional activities of his division. Some subsidiaries are included in these divisions. These divisions are as follows:

AC Spark Plug.
Aeroproducts.
Allison.
Brown-Lipe-Chapin.
Buick Motor.
Buick-Oldsmobile-Pontiac Assembly.
Cadillac Motor Car.
Chevrolet Motor.
Cleveland Diesel Engine.
Delco Appliance.
Delco Products.
Delco Radio.
Delco-Remy.
Detroit Diesel Engine.
Detroit Transmission.
Diesel Equipment.
Eastern Aircraft.
Electro-Motive.
Fisher Body.
Fisher Body-Ternstedt.
Frigidaire.
General Exchange Insurance Corp.
G. M. Acceptance Corp.
GM Institute.
GM of Canada, Ltd.
GM Overseas Operations.
GM Parts.
GM Proving Ground.
GMC Truck and Coach.
Guide Lamp.
Harrison Radiator.
Hyatt Bearings.
Inland Manufacturing.
McKinnon Industries, Ltd.
Moraine Products.
Motors Holding.
Motors Insurance Corp.
New Departure.
Oldsmobile.
Packard Electric.
Pontiac Motor.
Research Laboratories.
Rochester Products.
Saginaw Malleable Iron.
Saginaw Steering Gear.
United Motors Service.
Yellow Manufacturing Acceptance Corp.

COMPANIES IN WHICH GENERAL MOTORS HAS STOCK OWNERSHIP

*A. Subsidiaries*

Since its organization General Motors has acquired or formed numerous concerns in the process of developing and expanding its multifarious activities. However, it also owns stock in many companies. These companies which it controls by voting stock ownership are as follows as of December 31, 1945:

(1) Subsidiaries included in consolidated financial statements—100 percent owned, directly or indirectly (companies indented are subsidiaries of preceding company):

AC Spark Plug Co.
Argonaut Real Estate Corp.
Avalon Building Corp.
Fisher Lumber Corp.
Frigidaire Products of Canada, Ltd.
General Motors of Canada, Ltd.
  Border Cities Industries, Ltd.
  General Motors Products of Canada, Ltd.
  Modern Dwellings, Ltd.
  Regional Industries, Ltd.
General Motors Institute
General Motors Interamerica Corp.
General Motors Overseas Corp.
The McKinnon Industries, Ltd.
13 foreign subsidiaries
  1 foreign subsidiary

(These were not identified by SEC as it is believed that the disclosure of the names would be detrimental to the interests of security holders of General Motors.)

(2) Subsidiaries not included in consolidated financial statements. Except where otherwise indicated these subsidiaries are 100 percent owned, directly or indirectly:

General Exchange Insurance Corp.
General Motors Acceptance Corp. and its consolidated subsidiaries.
  General Motors Acceptance Corp., Continental
  General Motors Acceptance Corp. of Delaware
  General Motors Acceptance Corp. of Indiana, Inc.
  General Motors Acceptance Corp. of Mexico, S. A.
  General Motors Acceptance Corp. of South America
  Vauxhall and General Finance Corp., Ltd.
Motors Insurance Corp. (a nonconsolidated subsidiary of General Motors Acceptance Corp.)
175 subsidiaries engaged in retail distribution of General Motors products (more than 50 percent of voting stock owned).

(General Motors considers this a temporary activity as the Motor Holding Division of General Motors Corp. seeks primarily to secure properly qualified dealers. An arrangement is made so that each dealer is allowed to purchase out of profits General Motors interest in his dealership.)

(3) Less significant subsidiaries not included in consolidated financial statements. Except where otherwise indicated, these subsidiaries are 100 percent owned:

The Bristol Realty Co. (74.37 percent owned)
De Lux Cab, Ltd. (62.81 percent owned)
General Exchange Corp. (100 percent owned by General Motors Acceptance Corp.)
  Hertz Drivurself Sales Corp.
  Hertz Drivurself Stations, Inc.
  Hertz Drivurself Stations, Inc. (Eastern States)
  Hertz Drivurself Stations, Inc. (Pacific) (99.71 percent owned)
  Hertz Drivurself Stations of Florida, Inc. (98.89 percent owned)
  Hertz Drivurself System, Inc.
  Sterrett Operating Service, Inc.
  Vauxhall Motors, Ltd.
  Yellow Manufacturing Acceptance Corp.
    Yellow Manufacturing Credit Corporation.
16 foreign subsidiaries located in former enemy or enemy controlled territories, carried at no value.
23 inactive subsidiaries, carried at no value.
7 foreign subsidiaries (6 100-percent owned and 1 60-percent indirectly owned).

(These names are not disclosed to SEC because it is believed that it would be detrimental to the interests of security holders of General Motors.)

Among these subsidiaries the AC Spark Plug Co. is a distributor of spark plugs, instruments, and other accessories; the Argonaut Real Estate Corp. is engaged in real estate service; the Fisher Lumber Corp. has timber tracts and operates lumber mills; Modern Dwellings, Ltd., is engaged in employee housing in Canada; and the General Motors Institute operates a school.

Two subsidiaries, General Motors Acceptance Corp. and Yellow Manufacturing Acceptance Corp., finance installment purchases of the company's products. Cars sold at retail under this installment plan are insured by two other subsidiaries, the General Exchange Insurance Corp. and Motors Insurance Corp.

*B. Affiliated companies*

In addition to the above-named subsidiaries General Motors holds substantial stock interests in other companies, but does not consider that it controls these companies. These companies, with the extent of General Motors ownership of voting stock shown in parentheses, are Bendix Aviation Corp. (18.9 percent); North American Aviation, Inc. (29.1 percent); Ethyl Corp. (50 percent); Kinetic Chemicals, Inc. (49 percent); Broad Brook Co. (49.9 percent) and the International Freighting Corp., Inc. (33.3 percent).

Of these affiliated companies Bendix Aviation is a major supplier of products used widely in the automotive, aviation, communications, marine, and industrial fields.

North American Aviation, Inc., is one of the largest domestic manufacturers of military aircraft. They also produce a four-place private plane.

The Ethyl Corp. was formed for the commercial development of ethyl gasoline. The remaining 50 percent of its voting stock is owned by Standard Oil of New Jersey.

Kinetic Chemicals, Inc., manufactures a chemical refrigerant for use in automatic refrigerators, air-conditioning systems, etc. The other 50 percent of voting stock is owned by E. I. du Pont de Nemours & Co.

The remainder of International Freighting Corp., Inc., is also owned by E. I. du Pont de Nemours & Co. This company operates a steamship service and general chartering business between Atlantic coast, Gulf coast, and South American ports.

RELATIONSHIP TO E. I. DU PONT DE NEMOURS & CO.

E. I. du Pont de Nemours & Co. owns 10,000,000 common shares, or 22.7 percent, of the issued common stock of General Motors. However, General Motors disclaims that it is controlled by this major stockholder.

E. I. du Pont de Nemours & Co. has its president, vice president, and four directors on General Motors board of directors. The chairman of General Motors Board of 28 members is Alfred P. Sloan, Jr., also a du Pont director.

Sources: Moody's Manual of Investments, Industrial Securities. Moody's Investors Service, New York, 1946. Securities and Exchange Commission. Form 10-K for Corporations. Annual Report of General Motors Corporation for Fiscal Year Ended December 31, 1945. Standard Corporation Records. Current News Edition, Section F-K. Standard and Poor's Corporation, New York, 1947.

(H. D. Gewehr, General Research Section, April 11, 1947.)

Senator O'MAHONEY. Are these the divisions; Chevrolet, Pontiac, Oldsmobile, Buick, and Cadillac?

Mr. DONNER. Those are all departments, you might say, of General Motors, and the assets are owned by General Motors.

Mr. COYLE. They operate under the franchise of General Motors.

Senator O'MAHONEY. Fisher bodies, GMC trucks, GM motors, GM motor coaches, Delco batteries, AC spark plugs, Harrison radiators, defrosters, heaters, and thermostats.

Mr. DONNER. Each of those is a division.

Senator O'MAHONEY. The roller bearing company, New Departure ball bearings, Saginaw Arma steel and malleable iron castings, Saginaw steering gears, GM Hydramatic transmissions, Packard automobile cable and wiring, Guide lamps and mirrors, and then there is listed the Diesel locomotives and so forth. I will not take the time to read those.

Representative WOLCOTT. Is Frigidaire on there?

Mr. COYLE. Yes; it is in the household group.

Senator FLANDERS. Do you have any questions?

Representative WOLCOTT. I think in view of the questions that have been asked, you might want to stress in addition to your dealer relations the number of your suppliers.

Mr. COYLE. It is about 12,400. I think the text carries more than 12,000, but it is about 12,400. Now, in that case, Congressman, that 12,400 includes United States Steel and Bethlehem Steel, along with some very small concerns. Those are people with whom we do business. They are not related to us, and they may have corporate ownership or not, either way.

Representative WOLCOTT. And they include all classes?

Mr. COYLE. Yes; but no company is counted more than once. Each of the divisions that are metal-fabricating divisions—and there are 34 of those—and they might qualify from 1 company, but that 1 company is counted only once and not duplicated.

Representative WOLCOTT. Then you might offset the qualms of conscience or otherwise that you might have for being a big concern by the fact that you are an outlet for 12,000 other concerns?

Mr. COYLE. Yes; and that was the point that I tried to make a while ago, that small-business houses, many of them, could not exist if they did not have big business to deal with. That does not mean just General Motors, but it means other companies as well, the small fabricating plants, they make the bolts and nuts and washers and all of the rest of it.

Representative WOLCOTT. In my home town, the reason I brought this up, Port Huron, Mich., the industry there is a diversity of very small industries, paper, textiles, brass, and iron foundries, and so forth, all of which are dependent upon the automotive industry; and I presume that there are many of your suppliers among these small industries, but they are not subsidiaries. You buy directly from them.

Mr. COYLE. We buy at arms' length, and they come in competitively, and we get what we want, and they quote their prices, and if they are competitive and are in position to make delivery and so on, we buy from them.

Senator FLANDERS. Do you have any further questions?

Representative WOLCOTT. I had one question which I think has been covered, with respect to whether your capital position has kept pace with what you consider your obligation to produce efficiently to meet your demands.

Mr. COYLE. We had to borrow the money, as I have mentioned, and I think that we have covered that. We had to borrow from the insurance companies, and we had to sell some preferred stock, and we did have to retain larger earnings than we would normally have in order to reestablish the amount of working capital we required. It is mentioned in here somewhere that our average inventory in the prewar time, when we were making 2,300,000 units, was below $300,000,000. It is not $720,000,000, and we are building fewer units than we did prewar.

Representative WOLCOTT. Taking into consideration fluctuations in production and that sort of thing.

Mr. COYLE. It is the difficulty of getting certain materials and balancing them out with others, and establishing a flow of inventory where we receive the fabricated material. We are operating under a totally different situation today because of a shortage than we were in the prewar time.

Representative WOLCOTT. When we started these hearings, there was some thought that we would explore the possibility that capital, the amount and volume collectively, had not kept pace with normal production demands, and that is why I asked the question. In your case, you think that your capital is sufficient?

Mr. COYLE. We think that we are seeing our way out of it now, but it has been very close running.

Senator FLANDERS. If there are no further questions, we thank you, Mr. Coyle, and your two associates.

The hearing will be recessed until 10 o'clock tomorrow morning, to hear Mr. Voorhees, the chairman of the finance committee of the United States Steel.

Mr. COYLE. I thank you and the members of your committee, and we enjoyed being with you. Before I take the plane and go back, if you would be interested in this Buick that is across the street, and if you would like to buy it, we would be glad to show it to you.

Senator FLANDERS. Let us go look at it.

(Whereupon, at 5:15 p. m. the subcommittee recessed, to reconvene Tuesday, December 21, 1948, at 10 a. m.)

(The following table has been supplied in answer to questions on the relative proportions of automobile and truck industry accounted for by General Motors and Ford:)

*General Motors and Ford percent of total car and truck industry*

| Factory sales and new car and truck registrations | Percent of total industry | | Number of cars and trucks | | |
|---|---|---|---|---|---|
| | General Motors [1] | Ford [2] | General Motors | Ford [2] | Total industry |
| United States factory sales: | | | | | |
| 1908 | | 9 | | 5,986 | 65,000 |
| 1909 | [3] 19 | 10 | [3] 24,681 | 12,292 | 127,287 |
| 1910 | 21 | 10 | 39,300 | 19,293 | 187,000 |
| 1911 | 17 | 19 | 35,752 | 40,402 | 210,000 |
| 1912 | 13 | 21 | 49,696 | 78,611 | 378,000 |
| 1913 | 12 | 38 | 57,270 | 182,809 | 485,000 |
| 1914 | 11 | 45 | 61,584 | 260,720 | 573,039 |
| 1915 | 11 | 37 | 102,388 | 355,276 | 969,930 |
| 1916 | 9 | 36 | 146,185 | 577,036 | 1,617,708 |
| 1917 | 11 | 43 | 203,119 | 802,771 | 1,873,949 |
| 1918 | 17 | 34 | 204,014 | 402,908 | 1,170,686 |
| 1919 | 20 | 41 | 367,407 | 777,694 | 1,876,356 |
| 1920 | 17 | 48 | 370,667 | 1,074,988 | 2,227,349 |
| 1921 | 12 | 63 | 199,415 | 1,016,207 | 1,616,119 |
| 1922 | 16 | 53 | 419,682 | 1,356,838 | 2,544,176 |
| 1923 | 19 | 52 | 754,810 | 2,098,784 | 4,034,012 |
| 1924 | 15 | 56 | 553,833 | 2,000,535 | 3,602,540 |
| 1925 | 19 | 47 | 790,880 | 1,999,410 | 4,265,830 |
| New car and truck registrations, United States: | | | | | |
| 1926 | 26 | 37 | 957,881 | 1,354,857 | 3,645,645 |
| 1927 | 42 | 17 | 1,230,518 | 499,258 | 2,951,422 |
| 1928 | 42 | 16 | 1,449,341 | 553,309 | 3,480,881 |
| 1929 | 33 | 35 | 1,446,292 | 1,539,689 | 4,406,831 |
| 1930 | 34 | 41 | 1,032,685 | 1,256,786 | 3,036,306 |
| 1931 | 42 | 30 | 931,924 | 670,915 | 2,221,678 |
| 1932 | 41 | 26 | 521,882 | 329,043 | 1,276,812 |
| 1933 | 43 | 22 | 753,039 | 375,622 | 1,739,663 |
| 1934 | 40 | 29 | 920,331 | 660,839 | 2,292,443 |
| 1935 | 38 | 31 | 1,230,868 | 1,014,737 | 3,254,591 |
| 1936 | 42 | 23 | 1,698,176 | 941,365 | 4,016,141 |
| 1937 | 40 | 24 | 1,641,382 | 980,552 | 4,102,001 |
| 1938 | 44 | 22 | 987,759 | 488,473 | 2,256,370 |
| 1939 | 43 | 22 | 1,355,920 | 693,950 | 3,127,571 |
| 1940 | 47 | 20 | 1,849,154 | 803,691 | 3,975,055 |
| 1941 | 46 | 20 | 2,024,193 | 876,680 | 4,371,863 |
| 1946 | 36 | 22 | 883,055 | 530,276 | 2,440,445 |
| 1947 | 40 | 21 | 1,611,682 | 854,339 | 4,046,363 |
| 1948 (10 months) | 40 | 19 | 1,507,881 | 705,368 | 3,756,171 |

[1] General Motors includes GMC truck prior to acquisition of Yellow Truck Oct. 1, 1943.
[2] Ford sales for years 1908 through 1925 as reported by company.
[3] General Motors sales in 1909 are for fiscal year ended Sept. 30, 1909.

# CORPORATE PROFITS

**TUESDAY, DECEMBER 21, 1948**

UNITED STATES SENATE,
SUBCOMMITTEE ON PROFITS OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
*Washington, D. C.*

The subcommittee met, pursuant to recess, at 10 a. m., in the caucus room, Senate Office Building, Senator Ralph E. Flanders (chairman of the subcommittee) presiding.

Present: Senators Taft, Flanders (chairman of the subcommittee), Watkins, and O'Mahoney, and Representative Wolcott.

Also present: Fred E. Berquist, assistant staff director.

Senator FLANDERS. The committee will be in order.

First I will list two statements for which there has been no time to make oral presentation, but which will be received for the record. One of them is from the Socony-Vacuum Oil Co., and the other is a document from Dr. Emerson P. Schmidt, the economist of the United States Chamber of Commerce. These will be received for the record and will have the attention of the committee before a final report is made.

(The statements are as follows:)

REPORT TO THE SUBCOMMITTEE ON BUSINESS PROFITS OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT SUBMITTED BY SOCONY-VACUUM OIL CO., INC.

We have reviewed a considerable portion of the testimony given before your committee in answer to a memorandum sent to industry suggesting a list of topics and questions for discussion. The testimony of two representatives of the petroleum industry was reviewed in detail and we quite generally concur in their presentations. We realize that it was impossible for your committee to hear from all of the people who might have desired to have presented testimony at your hearings. We do feel, though, that you might be interested in our ideas on some of the subjects which you suggested, and for this reason we present the following for your consideration.

The most important topic before your committee was apparently that of industry profits. There is no question that the published reports from the petroleum industry for the year 1948 will show large profits after taxes. In a normal economy, such earnings would be considered extraordinarily high, and perhaps properly so, but we do not now have what might be termed "normal conditions." Under present conditions the real consideration is, Do the published statements reflect real profits? If they do not, what is the true situation? We should also like you to see how the real profits were used and consider if they benefited the general economy.

As we said before, we agree in general with most of the comments and conclusions introduced by the witnesses from the petroleum industry because the conditions which they described we find equally true in our own case. We are submitting specific data showing just how these general factors worked out for our company, and hope this will be helpful to the committee.

Statements have been made many times in the past 2 or 3 years that reported profits included certain unrealistic profits which were created as a result of the application of standard accounting methods to the pricing of inventories. This is not only true in theory, it is true in practice, as we shall demonstrate.

Accounting methods used by our company are in accordance with generally accepted accounting principles and are, in our opinion, fair if consistently used and viewed over a long period of time. At any given time, however, the application of these principles may result in the creation of an unrealistic statement of profits, sometimes extending over several years. We can illustrate this by a typical example:

| | |
|---|---|
| Sales | $4,000,000 |
| Current replacement cost of products sold | 3,500,000 |
| This would result in a real profit of | 500,000 |
| Whereas by using up low cost inventories acquired in prior year the cost of sales was only | 2,000,000 |
| Or a book profit of (which is $1,500,000 in excess of the real profit) | 2,000,000 |

In the case of our company we find that without changing the physical quantities of inventories, the dollar values of those inventories have increased over the last 3 years by about $37,000,000. This increased value has been included in the reported profits in our annual statements. We wish to emphasize that this part of our reported profits is not truly profits as most people think of them, although they are technically correct under law and recognized accounting practices. Profits in the ordinary sense of the word are net earnings which can be used by the owners either for their own benefit, for reinvestment in business facilities, or for increasing working funds. In the case of the inventory profits reflected in our statements, they could not be used for anything except to carry the inflated inventory on hand. They did not produce any more cash for us to use, but on the contrary represented cash tied up in working capital. In spite of this, the present income tax laws require that taxes be paid on these inventory "profits," which is in fact equivalent to a tax on capital. It is very important in looking at any statement of profits to understand how much of these profits are real profits which the company can disburse in any way it chooses, and how much are unrealistic profits which must be tied up in the business, as were the inventory book profits. Anyone who wants to use published statements as the basis for a critical analysis, must understand that these statements do include so-called inventory book profits, and that such profits do not contribute in any way to a company's cash position, nor do they provide the funds from which the taxes on these unreal profits must be paid.

Another main point which we want to emphasize is that reported profits seem high because of the insufficiency of the charges against profits for depreciation and depletion of plants and equipment. We find that this is not only true in our case, but it is one of the most important problems with which our company has to cope. As an example, during the 3 years ending December 31, 1948, we will have charged off against income approximately $215,000,000 for depreciation, depletion, abandonments, etc. We have no way of telling exactly how much it would have cost us to replace at current prices the exact equipment worn out, or used up during this period. We made studies some time ago for our own use which are typical of the average conditions. These studies dealt with a refinery and a marketing operation. They indicated that current replacement costs of equipment and properties are from two to three times as great as the original book costs.

This simply means that the profits shown in our reported statements were not our real profits and that these profits must be discounted to the extent that reserves for depreciation and depletion are inadequate. In other words, the profits created as a result of not charging off enough depreciation and depletion not only did not produce cash with which to pay dividends or use for expansion or other purposes, but actually depleted cash because of the need of paying taxes thereon. What was left from these so-called profits after taxes were paid, simply had to be tied up in new equipment or properties necessary to keep the company in the same operating condition that existed at the beginning of 1946.

There is another very important part of our business which has required the use of a lot more cash, and that is the carrying of accounts owed to us by customers. These "accounts receivables" just like inventories, when prices go up require a lot more money to be tied up, even though you have sold to customers only the same quantity of goods. Our customers owe us a lot more money under these conditions, or to say it another way, the company has advanced to the customers a lot more credit, but this extra credit extended by the company requires additional cash or working capital. The company must in many cases buy the raw materials, or pay wages, etc., for its production, pay refining and marketing wages, transport the goods itself or pay freight to outsiders, all with cash. When the costs of all of these items go up, it requires more and more cash to carry customers' accounts on the books. So again, where the company's regularly reported statements show profits after taxes, a substantial amount of cash realized from such profits must be tied up in these inflated accounts owed to the company.

In connection with the funds needed for additional facilities, it is true that we have increased the size of some of our plants and equipment, but the company felt that it had no real choice in this matter. The Government, industry, and individual consumers very definitely indicated that they wanted to use considerably more petroleum products. We felt that we had a social obligation to meet our share of these increased demands and, although the owners probably would have liked to have had their dividends increased, the final judgment was that a large share of these so-called unconscionable profits would have to be used to increase facilities to help meet that increased demand. What the results would have been if we and others in the industry had not done this, is not hard to imagine.

From the foregoing you will observe that one of the most important effects on our business is the fact that these unrealistic book profits made on inventories and the inadequate write-off of plant and property are for tax purposes considered real profits and we have to pay taxes on them. When it is realized that the so-called profits for these items, which are included in our regular statements as profits, did not produce cash that we needed to run the business on, and then they were taxed, which required a cash outlay, the business suffered doubly from a cash standpoint. There is no theory or accounting argument about this. We simply did not have the money in the business which the inflated earnings statements indicated, and we did have to pay out the money for the taxes imposed upon these unrealistic and inflated profits.

It is our sincere conviction that unless the oil industry is permitted to deduct from its taxable profits amounts which will enable it to replace equipment and crude oil, it will gradually lose its purchasing power as well as its productivity.

To illustrate clearly the points made in this memorandum, we show below a brief summary of cash funds made available to the company from all sources and how the company was required to use such cash funds. The tabulation covers the 3-year period ended December 31, 1948. The results for 1948 are estimated, as completely accurate information is not available.

| | |
|---|---|
| Cash funds made available: | |
| From operations, after eliminating all noncash items, such as charges for depreciation, depletion, insurance reserves, etc | $538,000,000 |
| From borrowings from outside sources | 75,000,000 |
| From cash on hand at the beginning of the period which had to be used | 89,000,000 |
| Total cash funds made available | 702,000,000 |
| These cash funds were used: | |
| For replacement and acquisition of properties, plants, and equipment | 395,000,000 |
| For additional investment in foreign and domestic affiliated companies and branches (for purposes similar to above) | 88,000,000 |
| For investment in inventories and accounts receivable, less increased amounts due others for purchasers, taxes, etc | 77,000,000 |
| To pay dividends to stockholders—averaged 92 cents per share per year—equivalent to 3.1 percent on investment | 86,000,000 |
| To pay Federal income taxes (taxes affecting 3 years under review will be $102,000,000) | 56,000,000 |
| Total cash funds consumed | 702,000,000 |

It is clearly evident from the above tabulation that during the three-year period ending December 31, 1948, with the exception of very modest dividends paid to the owners of the business, the company has been forced to reinvest in the business all of its earnings and, in addition, it has used up $164,000,000 of cash including $75,000,000 it was forced to borrow.

We believe that the conditions reflected above are true of the oil industry generally and that, unless profits continue at a high level and tax increases can be avoided, the industry will be forced to curtail many of its replacements and expansion projects. Under present conditions it is virtually impossible to secure outside capital except through borrowing and there is a limit to the amount of money industry should borrow. Selling capital stock is becoming more and more difficult and this condition will continue as long as most corporate earnings must be reinvested in the business instead of being paid out to stockholders as dividends.

Sincerely yours,

JOHN F. SEAL, *Vice President.*

## PROFITS AND ENTERPRISE INCENTIVES

Statement presented to the Profits Subcommittee of the Joint Committee on the Economic Report by Dr. Emerson P. Schmidt, director, department of economic research, Chamber of Commerce of the United States, Tuesday, December 21, 1948.

To some people the purpose of joint committee's investigation seems to be a question of whether profits are too high, too low, or just right. To others it is a question of the role of profits in the inflationary spiral. Again, it may be a question of where can the Government, with promises and commitments beyond its means, find more dollars to meet its revenue requirements and the pressures for more spending.

### HIGHER WAGES, FARM INCOME, AND PROFITS

Profits are high—at an all-time high, both before and after taxes. The same is true of wages and salaries. Farm income is more than 300 percent of its prewar level.

The following tabulation indicates that since prewar our national income has risen by about 148.5 billion dollars; wages and salaries have risen 85 billion dollars; farm income is up 20 billion dollars; and profits are up 15 billion dollars.

[All shown in billions of dollars]

| | 1939 | 1947 | 1948[1] | Rise since 1939 |
|---|---|---|---|---|
| National income | 72.5 | 202.5 | 221.2 | +148.7 |
| Wages and salaries | 45.7 | 121.9 | 131.2 | +85.5 |
| Farm income | 8.7 | 30.5 | 28.7 | +20.0 |
| Net corporate profits | 5.0 | 18.1 | 20.3 | +15.3 |

[1] First 9 months, annual rate.

These figures, however, do not mean that the average person is proportionately better off, or that the worker can live three times as well as he did in 1939. The dollar has depreciated by one-third or more, since prewar.

True, production has risen by perhaps one-half or two-thirds but we have more mouths to feed, both at home and abroad. Government budgets call for some $55,000,000,000 as against the prewar figure of around $20,000,000,000.

The phenomenal rise in our national money income, personal income, wages, and profits is due largely to the expansion of the money supply. In mid-1939, we had approximately $33,000,000,000 of currency and check-book money, demand deposits. Today, the figure is about $113,000,000,000. Over the decades, we have tended to have about $2.50 to $3 of national income for each dollar of money. The multiplication of the money supply inevitably was destined to reflect itself in the upward drift of dollar income, wages, salaries, farm prices, and profits.

Once the individual or business unit has more than a certain cash balance, the owner wants to put the surplus to work, either for consumption or by investing in earning or other useful assets. This propensity to spend or invest the extra dollars expresses itself through the market place. It intensifies the demand for goods and for labor. Unless production can be correspondingly and concurrently expanded, the relatively limited supply of goods tends to be valued at a higher and higher price figure. In other words, the increased money supply was inevitably destined to work its way into our cost-income-price structure.

### PRICE CONTROL MAY RETARD THIS PROCESS BUT IT CANNOT STOP IT

The pressures will reflect themselves in either black markets or in bidding up the prices and incomes of noncontrolled sectors. Price control is a device for trying to make the price tag say something which is not true.

### RELATION OF PROFITS AND INFLATION

Profits, being a residual item, what is left after all costs are met, may be either a plus or minus quantity. In 1939, profits were too low to put the total work force to work. As the economy expanded toward ceiling operations and full employment, the margin between costs and prices widened, as it always has done during recovery or inflation.

In spite of this widened margin, it is clear from the previous table that both farm income and the incomes of workers have expanded far more rapidly in dollars, although not in percentages.

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.

Sumner H. Slichter in his testimony before the joint committee (December 6), demonstrated that the postwar profit figures are in part fictitious. In 1947, for example, operating profits were about 12 billion dollars, as against the reported figure of 18.1 billion dollars; of the latter figure, 5.1 billion dollars represented the cost of replacing inventories; and because assets were largely depreciated on the basis of prewar costs, between 1 and 2 billion dollars of reported profits actually represented exhaustion of capital. Only 7 billion dollars of the 18 billion dollars was paid out in profits and perhaps half of the 7 billion dollars was recaptured by State and Federal Treasuries in the form of personal income taxes.

During inflationary booms, when profits mount percentagewise, it is easy and popular to blame inflation on the profit rise. Lord Keynes, the spiritual father of the deficit-spending policies during the 1930's, had this to say about the situation after World War I:

"Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. * * * In the latter states of war all the belligerent governments practiced from necessity, or imcompetence, what a Bolshevist might have done from design * * * the governments of Europe, being * * * reckless in their methods as well as weak, seek to direct on to a class known as 'profiteers' the popular indignation against the more obvious consequences of their vicious methods. These 'profiteers' are, broadly speaking, the entrepreneur class of capitalists, that is to say, the active and constructive element, * * * who in a period of rapidly rising prices cannot but get rich quick whether they wish it * * * or not. By directing hatred against this class * * * the European governments are carrying a step further the fatal process which the subtle mind of Lenin had consciously conceived. The profiteers are a consequence and not a cause of rising prices."

During the current postwar inflationary boom we have had in our country similar attempts to put the blame for inflation on what Keynes calls the entrepreneur class, a tactic more impregnated with Marxian ideas of the class struggle than is commonly realized.

Actually in a sense we are all to blame—our method of 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, etc.) which is in the market fighting for goods and services.

### PROFITS AND COST OF LIVING MAY BE DECLINING

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.

RECESSION PENDING

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.

In this sensitive situation, the mere threat of higher corporation taxes is already causing hesitation. Mr. Robert G. Dunlop, president of the Sun Oil Co., testifying before the joint committee, said:

"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."

Many other business executives are experiencing similar uncertainty. Whether higher corporate taxes would, in general, have this effect is not determinable at this stage. The reaction of the businessman will be governed largely by whether he thinks he can maintain a reasonable return on new investment or whether it will be too risky.

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 employers 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.

The administration is under terrific pressure to spend more money, a pressure which it, itself, has helped to generate by promises and more promises to articulate pressure groups.

"25 PERCENT TAX-TAKE" WARNING

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.[1]

The crying need is for statesmanship which will convince the American people that they have passed the margin of safety and are now entering the critical stage. While these pressures on our economy for more and more constitute, indeed, a high compliment to the productivity of our economic system, in the short-run further production increases are limited by our ceiling operations and full employment. Rising wage demands, rigid maintenance of existing farm income and higher and higher taxes—all in a full employment economy, with only about 2 percent or 3 percent annual increase in goods and services, cannot be safely met. Taxes divert resources from the people to Government. The nation that taxes on business or corporations affect only investors or stockholders is not valid and can become a dangerous delusion in terms of the people's welfare.

[1] A Survey of Contemporary Economics, by Howard S. Ellis, et al., The Blackiston Co., 1948, p. 19;

So long as markets continue strong, the developing pressures will at some time reflect themselves in policies which lead to further dilution of the money supply and the inevitable rise in prices. That is what history indicates.

CONCLUSIONS

Reported net profits today constitute a normal peacetime relationship to national income. If we correct reported profits for the nonrecurring inventory mark-up and the underdepreciation of wearing assets, profits are below their normal level relative to the size and magnitude to the rest of economic activity.

Whether higher taxes on business would send the economy into a tailspin or stimulate further inflationary pressures, would be determined by the relative strength of the deflationary-inflationary forces. The growing number of filled pipe lines and soft spots suggests that additional tax levies might be deflationary at this time.

In a free democratic society the individual has a strong preference for spending his income in his own individual way. When once the total tax burden approaches or equals 25 percent of the national income, the growing restlessness, the rising pressures, and the difficulty of making both ends meet, sets in motion forces in the direction of loose fiscal policy which translates itself into further inflation.

The greatest contribution which the Government could make to the stabilization of our economy and lower prices must take the form of vigorous pruning of inflated Government expenditure. So long as inflationary pressures persist the best antidote is a budgetary surplus with which Federal Reserve Bank-held debt is paid off. This in turn will check credit expansion and help foster the readjustments which we still face.

Senator FLANDERS. We have as our witness this morning Mr. Enders Voorhees of the United States Steel Corp., and I note that Mr. Voorhees has with him certain other officers of the United States Steel Corp.

You, Mr. Voorhees, are the official witness?

Mr. VOORHEES. That is right, sir.

Senator FLANDERS. Do you wish the names of your associates entered on the record, or are they going to keep quiet?

Mr. VOORHEES. I think that we will ask them that, Mr. Chairman.

Senator FLANDERS. We had better enter their names on the record. First, will you give your own name, company connection, position, and address?

## STATEMENT OF ENDERS M. VOORHEES, CHAIRMAN OF THE FINANCE COMMITTEE, UNITED STATES STEEL CORP. OF NEW JERSEY, NEW YORK, N. Y. (ACCOMPANIED BY IRVING S. OLDS, CHAIRMAN OF THE BOARD, BENJAMIN F. FAIRLESS, PRESIDENT, AND R. M. BLOUGH, GENERAL SOLICITOR, UNITED STATES STEEL CORP.)

Mr. VOORHEES. My name is Enders M. Voorhees, and I am chairman of the finance committee of the United States Steel Corp. of New Jersey. My business address is 71 Broadway, and my home address is 14 East Sixty-eighth Street, New York City.

Senator FLANDERS. And you have with you Mr. Olds?

Mr. VOORHEES. Mr. Irving S. Olds, chairman of the board, and Mr. Benjamin F. Fairless, president of our corporation.

Senator FLANDERS. Thank you.

Now, you do have written testimony?

Mr. VOORHEES. I have a short statement, sir.

Senator FLANDERS. You may proceed.

Mr. VOORHEES. Corporate profits constitute the main topic under consideration by this subcommittee on profits. In fact, there is evidence that these hearings are being conducted on the supposition that corporate profits are at "record breaking" levels. While I do not feel qualified to discuss corporate profits in general, I am prepared to discuss the costs and profits of United States Steel Corp.

The statements made in these hearings that business profits are exorbitant and are soaring to new all-time dangerous highs—that American corporations are making as much profit as they can while the making is good—that corporations are raising prices with little regard to existing costs, but with concern almost solely for what the market will bear—certainly do not apply to United States Steel. 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.

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. Although 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-month 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. 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. I will have more to say about this later in my statement. 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.

In the past few years the buying power of the American dollar has been cut almost in half. So great a change in so short a time cannot happen without serious repercussions for producers, for consumers, for Government, and for the measuring, the appraising and the taxing of profits. Measuring must be accurate before appraising can be adequate or taxing be equitable.

A profit—or an income as I sometimes prefer to call it—is the arithmetic result of subtracting from one's receipts from customers the cost of producing and selling the goods sold. Counting up the dollars received from customers presents no great difficulties; and subtracting costs, once they are known and measured, is also easy. It is knowing and measuring the costs that is the hard part.

Practically my entire business career has required me to study continuously this subject of costs, and it is in this field that I hope I may be of assistance to this committee in its inquiries. At no time have I been as concerned as I have been in recent years at the hidden erosion of the American tools of production that is resulting from a lack of understanding of costs. It is upon these tools of production that peacetime abundance in America, both past and prospective, rests. It is upon those tools of production that America's potency in war and power to defend herself also rest.

In United States Steel we classify the costs to be subtracted from sales receipts according to the factors of production. Our latest figures, which are the first 9 months of 1948, are for as follows:

| | |
|---|---|
| For that period we received from customers for products and services sold | $1,754,700,000 |
| Costs: | |
| Employment costs | 739,300,000 |
| Products and services bought | 705,800,000 |
| Wear and exhaustion of facilities: | |
| Based on original cost | 66,300,000 |
| Added to cover replacement cost | 39,700,000 |
| Interest and other costs on long-term debt | 1,800,000 |
| Taxes—State, local, and miscellaneous | 37,600,000 |
| Federal taxes on income | 76,200,000 |
| Total | 1,666,700,000 |
| Income | 88,000,000 |
| Dividends | 51,500,000 |
| Reinvested | 36,500,000 |

Employment cost would appear to be reasonably self-explanatory. It covers wages, salary, pension, and social security tax cost experienced by United States Steel as a result of employing people. Payments to or for employees constitute United States Steel's biggest cost. Currently they are more than 14 times dividend payments to owners and are 42 percent of sales. United States Steel has very little control over employment costs. It must pay "going wages" to secure the services of people needed efficiently to operate the tools of production.

The cost of products and services bought is also self-explanatory. It is the second biggest cost. United States Steel has even less control over this cost. It has no power to compel people to sell to it the goods and services it needs to do business at prices less than they choose to quote. It has been United States Steel's long experience that when wages go up in major segments of the economy, there follows a readjustment of wages throughout the economy, with the result that the cost of the products and services United States Steel must buy reflect such wage increase. Such purchases in 1940 represented 33 percent of sales, but in 1947 and 1948 they had increased to about 40 percent.

The next largest cost is the tax cost, which amounted to approximately \$114,000,000 for 9 months of 1948. This cost is determined by Congress and by the authorities of various States. It is therefore, not subject to change by United States Steel. Federal taxes on income are, it is true, based on the difference between products and services sold and cost acceptable to the Bureau of Internal Revenue. This part of tax cost could therefore be extinguished only by not earning income—not earning anything to pay to the owners or to reinvest in the business. There would then, of course, be no reason for owners further to provide tools of production and that would not be good for the country.

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 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—see accompanying chart—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 $57,000,000, 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.

Senator FLANDERS. May I ask you, Mr. Voorhees, whether this is on the basis of replacement of an identical facility, or not an identical facility but a unit of production, and whether it takes into account, or not, any possibly increased productive capacity of that unit?

Mr. VOORHEES. Mr. Chairman, in this particular case, these figures that have just been quoted represent the additional cost over the amount that was originally appropriated by our board for specific projects, and hasn't anything to do with this particular point. Later on I will come to that.

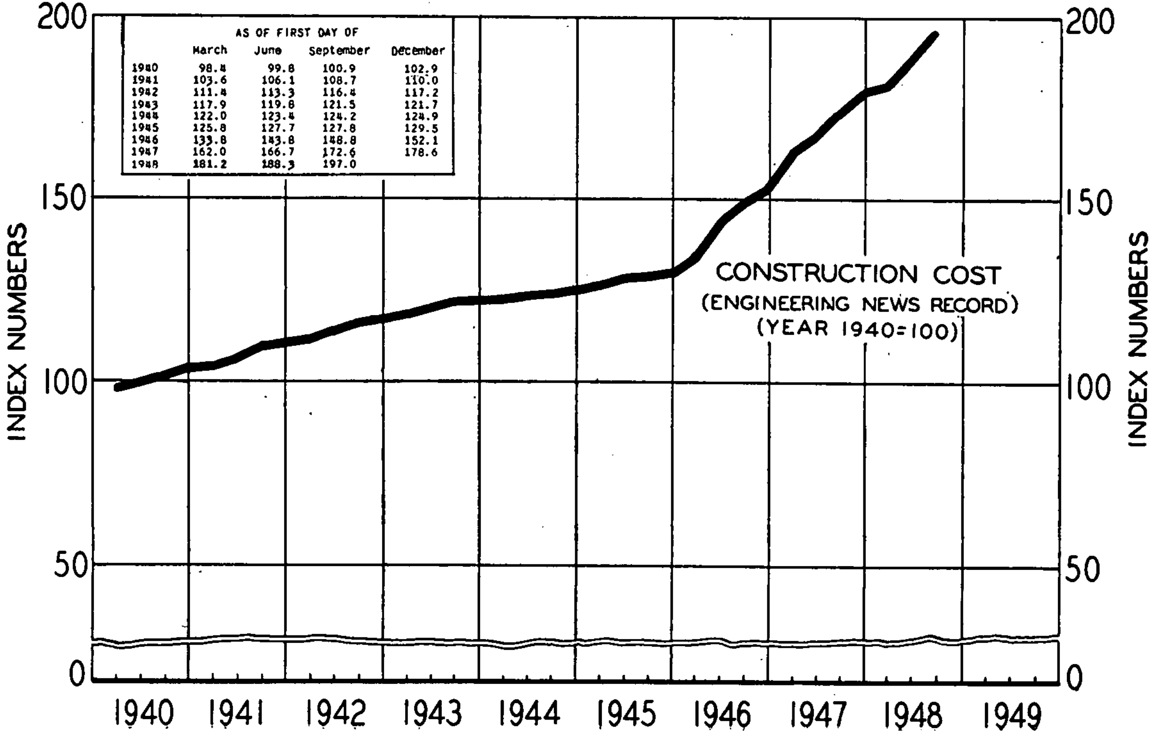
Senator FLANDERS. I think that I misread the paragraph.

Mr. VOORHEES. We are giving you later on the figures with respect to identical items of equipment.

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.

(Chart, Trend of Cost of Plant, is as follows:)

# TREND OF COST OF PLANT




AS OF FIRST DAY OF

| | March | June | September | December |
|---|---|---|---|---|
| 1940 | 98.4 | 99.8 | 100.9 | 102.9 |
| 1941 | 103.6 | 106.1 | 108.7 | 110.0 |
| 1942 | 111.4 | 113.3 | 116.4 | 117.2 |
| 1943 | 117.9 | 119.8 | 121.5 | 121.7 |
| 1944 | 122.0 | 123.4 | 124.2 | 124.9 |
| 1945 | 125.8 | 127.7 | 127.8 | 129.5 |
| 1946 | 133.8 | 143.8 | 148.8 | 152.1 |
| 1947 | 162.0 | 166.7 | 172.6 | 178.6 |
| 1948 | 181.2 | 188.3 | 197.0 | |

Senator FLANDERS. Excuse me again. With regard to the coke-oven capacity, the cost of replacement is evidently based on the replacement of identical capacity. Would there be any difference in the capacity of the blooming mill?

Mr. VOORHEES. All of these facilities, Mr. Chairman, are practically identical from the standpoint of these figures that you have here. They are identical facilities.

Senator FLANDERS. With identical productive capacity?

Mr. VOORHEES. That is right.

What this means to the measurement of depreciation is that it is thoroughly unrealistic to assume that present-day dollars are the same kind of dollars originally expended for existing facilities. 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.

Senator WATKINS. May I interrupt a moment? I call your attention to some testimony presented to the committee earlier in which it was claimed that your company, together with a large number of other companies, had actually hidden some of the profits. Are you going to answer that in this paper, and are you getting at it now in this very paragraph?

Mr. VOORHEES. I am sure that question, Senator Watkins, will be very well answered, or I don't know the English language, before we get through this testimony.

Senator WATKINS. I wanted to call it to your attention so that we will get an answer.

Mr. VOORHEES. You are talking about the $39,000,000 added depreciation that will be considered all the way through here. But if you want to talk about our reserves, I will be very glad to answer any question specifically and in detail.

Senator WATKINS. I am calling your attention to an exhibit that was put in the record by a witness, I think it was the CIO witness, the other day, in which it was claimed that you had concealed profits to the extent of 21 percent.

Mr. VOORHEES. In that case I think the witness was talking about the same figure that we are talking about at the present time, which is the 60 percent added depreciation; but if there is anything else, I will be glad to cover it.

Senator WATKINS. This has been called to your attention so that you will be attempting to meet it.

Mr. VOORHEES. That is right; we will meet it.

Senator WATKINS. I wanted to be sure about that.

Mr. VOORHEES. 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 million 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 $114,000,000. 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 $114,000,000, 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. Callling a cost a profit does not make it so.

The 30-percent increase in the provision for wear and exhaustion was determined partly through experience 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 Bros. Co., petitioner, against Commissioner of Internal Revenue, respondent. Although this case deals only with costing short-term inventories, that is, stocks of goods, the principles set forth are just as applicable to costing the wear and exhaustion of long-term inventories, such as 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.

I can understand the committee's very serious interest in proper accounting for the cost of the tools of production consumed, for the present nonrecognition of part of that cost in computing taxable income means that the Federal Government itself is participating in, and even forcing, the erosion of the Nation's tools of production. More than that, those who would avoid that erosion in the management of their own enterprises are compelled not only to provide against it, dollar for dollar, but for every dollar of disallowed cost they must find an additional 67 cents for the Government in taxes.

This brings me now to a presentation of our profit situation. First, I would like to repeat what I said at the outset with respect to United States Steel's income for the first 9 months of 1948, and for 1947. Profits in those periods were not record breaking in terms of any kind of comparison one wishes to make with the income figures of past years. In terms of fair comparisons, income in 1947 was extraordinarily low and income currently is still lower.

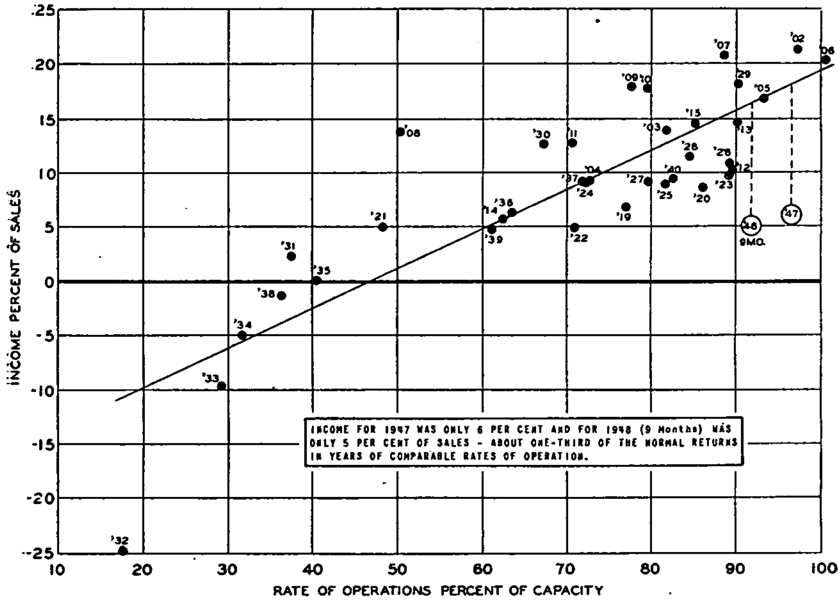
Income and loss, especially in heavy industry, characteristically fluctuates more violently than the fluctuations in volume and in the larger items of costs and sales of which the profit or loss is the relatively small difference. If one wants to do so he can therefore readily abuse the principles of historical comparison to come out with any result he desires. He can make profit in 1 year look big by comparing it with profits or losses in years of relatively small volume—and vice versa. To have any validity at all, comparison must be between like situations. In the steel industry this means as a minimum that meaningful comparison can only be made between periods of similar operating rates.

It is equally an abuse of the elemental principles of comparison to compare dollars in one period with dollars of widely different purchasing power in other periods. The simplest and quickest way of avoiding this error is to express the income or loss as a percent of the sales dollar, thus establishing a ratio of profit compensation to economic contribution, with both being measured in the same kinds of dollars.

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, or 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.

(Chart, Percent Income on Sales vs. Percent of Operations is as follows:)

U. S. STEEL: PERCENT INCOME ON SALES VS PERCENT OF OPERATIONS
(ALL PRE-WAR PEACETIME YEARS)




| YEAR | PER CENT CAPACITY | PER CENT ON SALES |
|---|---|---|
| 1906 | 100.6 | 20.3 |
| 1902 | 97.2 | 21.3 |
| 1905 | 93.2 | 16.8 |
| 1929 | 90.4 | 18.0 |
| 1913 | 90.1 | 14.5 |
| Average | 94.3 | 18.2 |
| 1912 | 89.8 | 10.2 |
| 1923 | 89.1 | 9.9 |
| 1926 | 89.1 | 10.8 |
| 1907 | 88.6 | 20.7 |
| 1920 | 86.2 | 8.5 |
| 1915 | 85.2 | 14.5 |
| 1928 | 84.6 | 11.4 |
| 1940 | 82.5 | 9.5 |
| 1903 | 81.8 | 13.9 |
| 1925 | 81.7 | 8.9 |
| Average | 85.9 | 11.8 |
| 1927 | 79.8 | 9.2 |
| 1910 | 79.5 | 17.8 |
| 1909 | 77.8 | 17.9 |
| 1919 | 77.0 | 6.8 |
| 1904 | 72.8 | 9.3 |
| 1924 | 72.2 | 9.2 |
| 1937 | 71.9 | 9.2 |
| 1922 | 70.9 | 4.9 |
| 1911 | 70.5 | 12.8 |
| Average | 74.7 | 10.8 |

| YEAR | PER CENT CAPACITY | PER CENT ON SALES |
|---|---|---|
| 1930 | 67.2 | 12.6 |
| 1936 | 63.4 | 6.4 |
| 1914 | 62.3 | 5.7 |
| 1939 | 61.0 | 4.9 |
| Average | 63.5 | 7.4 |
| 1908 | 50.3 | 13.8 |
| 1921 | 48.3 | 5.0 |
| 1935 | 40.7 | 0.2 |
| Average | 46.4 | 6.3 |
| 1921 | 37.5 | 2.4 |
| 1938 | 36.4 | - 1.3 |
| 1934 | 31.7 | - 5.1 |
| 1933 | 29.4 | - 9.7 |
| 1932 | 17.7 | -24.7 |
| Average | 30.5 | - 7.7 |
| AVERAGE | 70.8 | 8.79 |

| YEAR | PER CENT CAPACITY | PER CENT ON SALES |
|---|---|---|
| 1948-9 Mos. | 91.9 | 5.0 |
| 1947 | 96.7 | 6.0 |

Mr. VOORHEES. As I said before, 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. For the first 9 months of 1948 it was even lower.

This committee has suggested a comparison of the level of profits currently in 1948 with profits in the prewar year of 1940.

In 1940 United States Steel's finished steel shipments were 15,000,000 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 |

Finished steel shipped 12 months 1940, 15 million net tons.

Finished steel shipped 9 months 1948, 15.1 million net tons.

From the tabulation it is apparent that the higher prices in 1948 are overwhelmingly—over 90 percent—attributable to increased costs of employment and of purchased goods and services; and to a lesser degree they were attributable to increased cost of taxes and of wear and exhaustion. Since payments for goods and services bought are used by suppliers, and by subsuppliers in their turn, largely to cover their increased wage and tax costs—and since amounts recovered through wear and exhaustion are similarly destined to be spent mostly as wages—this evidence indicates that wages and taxes are primarily responsible for United States Steel's higher prices.

The tabulation also shows that there was no increase in United States Steel's income contributing to price increase, because income on 15,000,000 tons in 1948 was less than income on similar tonnage in 1940.

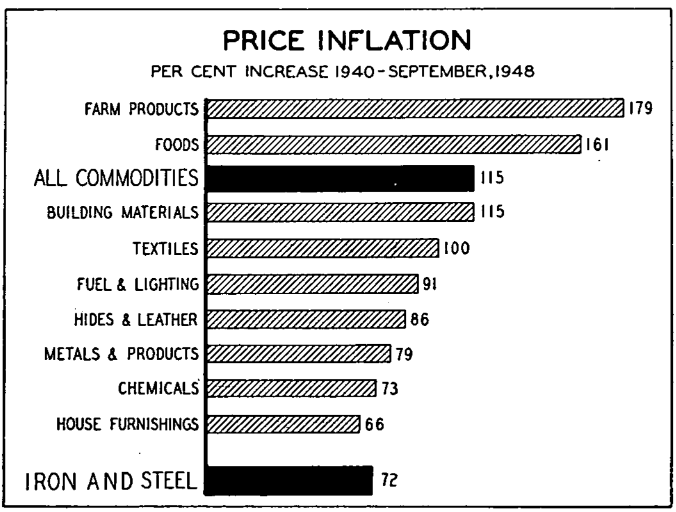
While I am on this matter of price increases I wish to direct the committee's attention to the wholesale price indexes published by the Bureau of Labor Statistics. These indexes show that from 1940 to September 1948, iron and steel prices increased by 72 percent. Those indexes also show that in the same 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.

But to return to the question of whether profits in 1948 were excessive in comparison with 1940. The answer is obvious from the tabulation—for equal outputs there were fewer 1948 devalued profit dollars than there were of the 1940 more valuable dollars.

The comparison is more striking when the purchasing value of the 1948 profits are compared. In terms of blast furnaces, as I indicated before, 1940 profits would have bought about 30 furnaces, but the 1948 profit would be stretched to buy as few as 13 furnaces.

Any judgment of the fairness of current profits by historical comparison which does not take into account the propriety of the base period, and which does not give due weight to the depreciated value of the dollars earned, is doubly in error. This double error of failing to consider historical earnings at comparable operating rates and of misinterpreting the purchasing value of the income dollar is a certain road to improvident capital erosion.

(Chart, Price Inflation, is as follows:)




SOURCE: U.S. BUREAU OF LABOR WHOLESALE PRICE INDEXES

Mr. VOORHEES. Consider next what happened to the income earned. Out of income of $88,000,000 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 $2,000,000. Toward that expenditure there was also available 105.9 million dollars recovered in wear and exhaustion. The two combined, however, fell short, by $58,000,000, of meeting the bill. In short, we spent $58,000,000 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 to 1947, inclusive.

*Income account for 20 years, 1928 to 1947, inclusive*

| | In 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 | 1,165.2 | 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.

This table shows that out of goods and services sold in the amount of 22.3 billion dollars, 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 $153,000,000. 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.

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.

(Various tabulations and charts submitted by Mr. Voorhees are as follows:)

*Data requested by subcommittee on comparative sales, cost, and profits, 1940, 1946, 1947, and 9 months of 1948—United States Steel Corp. and subsidiaries*

| | In millions | | | | Percent on sales | | | |
|---|---|---|---|---|---|---|---|---|
| | 1940 | 1946 | 1947 | 9 months, 1948 | 1940 | 1946 | 1947 | 9 months, 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 | 100.0 | 100.0 | 100.0 | 100.0 |
| Costs: | | | | | | | | |
| Wages, salaries, social security taxes, pensions | 464.3 | 704.5 | 903.6 | 739.3 | 43.0 | 47.1 | 42.6 | 42.1 |
| Products and services bought | 358.3 | 589.6 | 841.9 | 705.8 | 33.2 | 39.4 | 39.7 | 40.2 |
| Wear and exhaustion of facilities: | | | | | | | | |
| Based on original cost | 72.6 | 68.7 | 87.7 | 66.3 | 6.7 | 4.6 | 4.1 | 3.8 |
| Added to cover replacement cost | | | 26.3 | 39.7 | | | 1.2 | 2.3 |
| Total wear and exhaustion | 72.6 | 68.7 | 114.0 | 106.0 | 6.7 | 4.6 | 5.3 | 6.1 |
| War costs included herein provided for in prior years, less associated Federal income tax adjustment | | [1] 29.2 | [1] 2.5 | | | [1] 1.9 | [1] .1 | |
| Interest and other costs on long-term debt | 13.6 | 4.8 | 2.5 | 1.8 | 1.3 | .3 | .1 | .1 |
| State, local, and miscellaneous taxes | 41.8 | 37.1 | 45.2 | 37.6 | 3.9 | 2.5 | 2.1 | 2.2 |
| Estimated Federal taxes on income | 26.3 | 32.0 | 91.0 | 76.2 | 2.4 | 2.1 | 4.3 | 4.3 |
| Total costs | 976.9 | 1,407.5 | 1,995.7 | 1,666.7 | 90.5 | 94.1 | 94.0 | 95.0 |
| 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 |
| T tal 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] Red figures.

*Data requested by subcommittee on 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 | 9 months 1948 | 1940 | 1946 | 1947 | 9 months 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=100.0 | |
| 1940 | 100.2 |
| 1946 | 139.3 |
| 1947 | 159.2 |
| 1948 (9 months) | 170.8 |

[2] Red figures.

*Data requested by subcommittee on comparative sales, cost, and profits, 1940, 1946, 1947, and 9 months of 1948—United States Steel Corp. and subsidiaries*

| | Dollars per employee | | | |
|---|---|---|---|---|
| | 1940 | 1946 | 1947 | 1948 [1] |
| Average number of employees | 254,393 | 266,835 | 286,316 | 294,847 |
| Products and services sold | $4,241.86 | $5,606.84 | $7,414.19 | $7,934.96 |
| Costs: | | | | |
| Wages, salaries, social-security taxes, pensions | 1,825.13 | 2,640.21 | 3,155.95 | 3,343.43 |
| Products and services bought | 1,408.45 | 2,209.61 | 2,940.46 | 3,191.82 |
| Wear and exhaustion of facilities: | | | | |
| Based on original cost | 285.39 | 257.46 | 306.30 | 299.82 |
| Added to cover replacement cost | | | 91.86 | 179.41 |
| Total wear and exhaustion | 285.39 | 257.46 | 398.16 | 479.23 |
| War costs included herein provided for in prior years, less associated Federal income-tax adjustment | | [2] 109.43 | [2] 8.73 | |
| Interest and other costs on long-term debt | 53.46 | 17.99 | 8.73 | 8.14 |
| State, local and miscellaneous taxes | 164.31 | 139.04 | 157.87 | 169.92 |
| Estimated Federal taxes on income | 103.38 | 119.92 | 317.83 | 344.59 |
| Total costs | 3,840.12 | 5,274.80 | 6,970.27 | 7,537.13 |
| Income | 401.74 | 332.04 | 443.92 | 397.83 |
| Dividends declared: | | | | |
| Preferred stock | 99.06 | 94.44 | 88.02 | 85.47 |
| Common stock | 136.80 | 130.42 | 159.61 | 147.53 |
| Total dividends | 235.86 | 224.86 | 247.63 | 233.00 |
| Income reinvested in business | 165.88 | 107.18 | 196.29 | 164.83 |

[1] Year 1948—first 9 months is projected to annual bases by adding one-third.
[2] Red figures.

*Data requested by subcommittee—Disposition of income and income relationships, years 1940, 1946, 1947, and 9 months, 1948, United States Steel Corp. and subsidiaries*

| Items | 1940 | 1946 | 1947 | 9 months, 1948 |
|---|---|---|---|---|
| Disposition of income (million dollars): | | | | |
| Expended for: | | | | |
| Property | $71.9 | $201.0 | $206.6 | $198.5 |
| Debt retirement | 42.4 | 5.2 | 4.6 | 1.9 |
| Total | 114.3 | 206.2 | 211.2 | 200.4 |
| Amounts from current operations: | | | | |
| Income after dividends | 42.2 | 28.6 | 56.2 | 36.5 |
| Wear and exhaustion | 72.6 | 68.7 | 114.0 | 105.9 |
| Total | 114.8 | 97.3 | 170.2 | 142.4 |
| Excess of expenditure over amounts from current operation | [1] .5 | 108.9 | 41.0 | 58.0 |
| United States Steel's income divided by: | | | | |
| Tons of finished steel shipped [2] (dollars per ton shipped) | $6.81 | $5.84 | $6.28 | $5.82 |
| Net worth at end of period [3] (percent) | 7.5 | 6.1 | 8.4 | [6] 7.5 |
| Invested capital at end of period [4] (percent) | 7.0 | 5.6 | 7.4 | [6] 6.5 |
| Sales [5] (percent) | 9.5 | 5.9 | 6.0 | 5.0 |

[1] Red figures.
[2] Income is not to be interpreted as resulting solely from steel operations.
[3] Net worth is taken as book (not replacement) value of assets less liabilities and reserves.
[4] Investment is taken as book (not replacement) value of total assets less liabilities other than long-term debt.
[5] Sales taken as total receipts from customers for all products and services sold.
[6] Year 1948—first 9 months is projected to annual basis by adding one-third.

82989—49——39

*Profits before and after taxes, all private corporations, 1929–48*

| Year | Billions of current dollars | | | Billions of 1948 (9 months) dollars | | |
|---|---|---|---|---|---|---|
| | Corporate profits before taxes | Dividends payments | Undistributed profits | Corporate profits before taxes | Dividends payments | Undistributed profits |
| 1929 | 9.8 | 5.8 | 2.6 | 13.7 | 8.1 | 3.6 |
| 1930 | 3.3 | 5.5 | −3.0 | 4.7 | 7.9 | −4.3 |
| 1931 | −.8 | 4.1 | −5.4 | −1.3 | 6.4 | −8.5 |
| 1932 | −3.0 | 2.6 | −6.0 | −5.3 | 4.6 | −10.5 |
| 1933 | .2 | 2.1 | −2.4 | .4 | 3.9 | −4.4 |
| 1934 | 1.7 | 2.6 | −1.6 | 3.0 | 4.6 | −2.9 |
| 1935 | 3.2 | 2.9 | −.6 | 5.6 | 5.1 | −1.0 |
| 1936 | 5.7 | 4.6 | −.3 | 9.8 | 7.9 | −.5 |
| 1937 | 6.2 | 4.7 | 0 | 10.3 | 7.8 | 0 |
| 1938 | 3.3 | 3.2 | −.9 | 5.6 | 5.4 | −1.5 |
| 1939 | 6.5 | 3.8 | 1.2 | 11.2 | 6.5 | 2.1 |
| 1940 | 9.3 | 4.0 | 2.4 | 15.8 | 6.8 | 4.1 |
| 1941 | 17.2 | 4.5 | 4.9 | 27.9 | 7.3 | 8.0 |
| 1942 | 21.1 | 4.3 | 5.1 | 30.9 | 6.3 | 7.5 |
| 1943 | 24.5 | 4.5 | 5.9 | 33.8 | 6.2 | 8.1 |
| 1944 | 24.3 | 4.7 | 6.1 | 33.0 | 6.4 | 8.3 |
| 1945 | 20.4 | 4.7 | 4.0 | 27.1 | 6.3 | 5.3 |
| 1946 | 21.8 | 5.6 | 7.2 | 26.7 | 6.9 | 8.8 |
| 1947 | 29.8 | 6.9 | 11.2 | 32.0 | 7.4 | 12.0 |
| 1948 [1] | 30.5 | 7.4 | 11.2 | 30.8 | 7.5 | 11.3 |

[1] Annual rates as estimated by the Council of Economic Advisers.

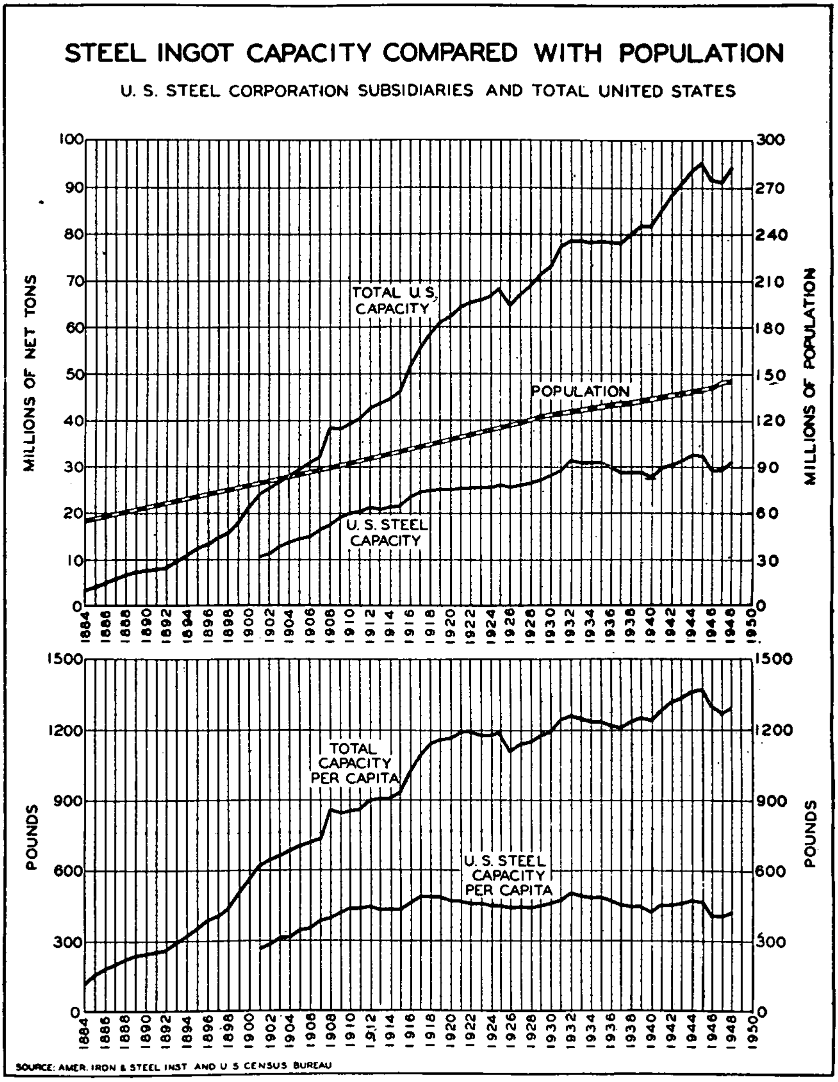
Source: Midyear Economic Report of the President, July 1948; p. 100. Current dollars converted to dollars of 1948 (9 months) purchasing power on basis of Consumers Price Index, compiled by the Bureau of Labor Statistics.

*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 percentage of industry |
|---|---|---|---|---|
| 1901 | 10,562,400 | 13,476,664 | 24,039,064 | 43.94 |
| 1902 | 11,236,900 | 14,187,100 | 25,424,000 | 44.20 |
| 1903 | 12,555,843 | 14,212,157 | 26,768,000 | 46.91 |
| 1904 | 12,934,170 | 15,278,977 | 28,213,147 | 45.84 |
| 1905 | 14,428,250 | 15,027,750 | 29,456,000 | 48.98 |
| 1906 | 15,058,400 | 15,629,600 | 30,688,000 | 49.07 |
| 1907 | 16,550,000 | 15,370,000 | 31,920,000 | 51.85 |
| 1908 | 17,460,400 | 20,776,943 | 38,237,343 | 45.66 |
| 1909 | 19,216,000 | 18,864,000 | 38,080,000 | 50.46 |
| 1910 | 19,986,000 | 19,438,000 | 39,424,000 | 50.70 |
| 1911 | 20,252,500 | 20,067,500 | 40,320,000 | 50.23 |
| 1912 | 21,080,900 | 21,479,100 | 42,560,000 | 49.53 |
| 1913 | 20,715,300 | 22,964,700 | 43,680,000 | 47.43 |
| 1914 | 21,277,700 | 23,174,277 | 44,451,977 | 47.87 |
| 1915 | 21,535,900 | 24,713,246 | 46,249,146 | 46.56 |
| 1916 | 23,342,000 | 27,940,314 | 51,282,314 | 45.52 |
| 1917 | 24,691,400 | 30,876,155 | 55,567,555 | 44.43 |
| 1918 | 24,872,000 | 33,974,418 | 58,846,418 | 42.27 |
| 1919 | 25,020,400 | 36,000,269 | 61,020,669 | 41.00 |
| 1920 | 25,035,800 | 37,277,791 | 62,313,591 | 40.18 |
| 1921 | 25,417,200 | 38,844,827 | 64,262,027 | 39.55 |
| 1922 | 25,417,600 | 40,009,082 | 65,426,682 | 38.85 |
| 1923 | 25,537,600 | 40,144,414 | 65,682,014 | 38.88 |
| 1924 | 25,553,400 | 41,010,115 | 66,563,515 | 38.39 |
| 1925 | 25,899,800 | 42,573,422 | 68,473,222 | 37.82 |
| 1926 | 25,479,000 | 39,271,035 | 64,750,035 | 39.35 |
| 1927 | 25,958,200 | 41,277,917 | 67,236,117 | 38.61 |
| 1928 | 26,612,800 | 42,228,112 | 68,840,912 | 38.66 |
| 1929 | 27,105,700 | 44,332,816 | 71,438,516 | 37.94 |
| 1930 | 28,182,600 | 44,802,806 | 72,985,406 | 38.61 |
| 1931 | 29,204,000 | 48,053,803 | 77,257,803 | 37.80 |
| 1932 | 31,182,300 | 47,598,613 | 78,780,913 | 39.58 |
| 1933 | 30,622,900 | 47,991,503 | 78,614,403 | 38.95 |
| 1934 [1] | 30,622,900 | 47,505,516 | 78,128,416 | 39.20 |
| 1935 | 30,622,900 | 47,829,030 | 78,451,930 | 39.03 |
| 1936 | 29,855,800 | 48,308,500 | 78,164,300 | 38.20 |
| 1937 | 28,865,100 | 49,283,274 | 78,148,374 | 36.94 |
| 1938 | 28,885,000 | 51,300,638 | 80,185,638 | 36.02 |
| 1939 | 28,885,000 | 52,943,958 | 81,828,958 | 35.30 |
| 1940 | 27,795,000 | 53,824,496 | 81,619,496 | 34.05 |
| 1941 | 29,915,956 | 55,242,544 | 85,158,500 | 35.13 |
| 1942 | 30,600,256 | 58,286,294 | 88,886,550 | 34.43 |
| 1943 | 31,241,492 | 59,347,698 | 90,589,190 | 34.49 |
| 1944 | 32,537,000 | 61,317,420 | 93,854,420 | 34.67 |
| 1945 | 32,307,000 | 63,198,280 | 95,505,280 | 33.83 |
| 1946 | 29,208,258 | 62,682,302 | 91,890,560 | 31.79 |
| 1947 | 29,547,200 | 61,694,050 | 91,241,250 | 32.38 |
| 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


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

*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 | 195,500 | 68.8 | .216 | 14.85 |
| 1910 | 28,275 | 5,606 | 26,365 | 13,650 | 13,25[illegible] | 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 | 214,9[illegible]1 | 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 | 24,295 | 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 | 22,931 | 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 |

NOTE.—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.

*United States Steel's Financial Story—1902–47*

[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 | 33'.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 |

[1] Deficit.

NOTE.—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.

*Annual steel ingot capacity and production compared with population of United States*

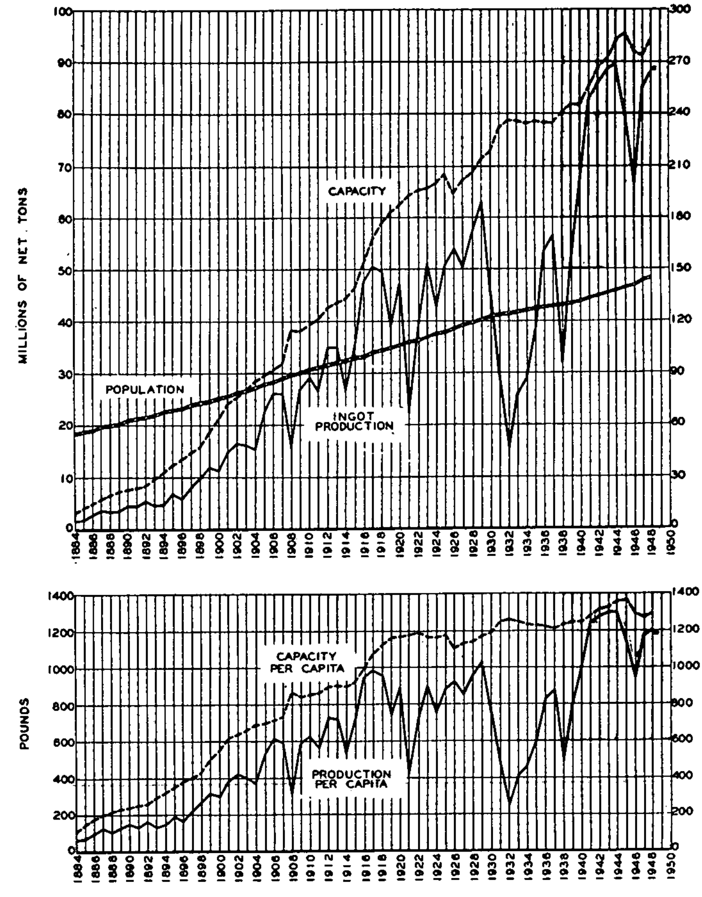
[000's omitted]

| Year | Population continental United States | Annual steel ingot capacity: Net tons | Capacity per capita: Net tons | Capacity per capita: Pounds | Annual steel ingot production: Net tons | Percent of capacity | Production per capita: Net tons | Production per capita: 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.

STEEL INGOT CAPACITY AND PRODUCTION COMPARED WITH POPULATION

TOTAL UNITED STATES



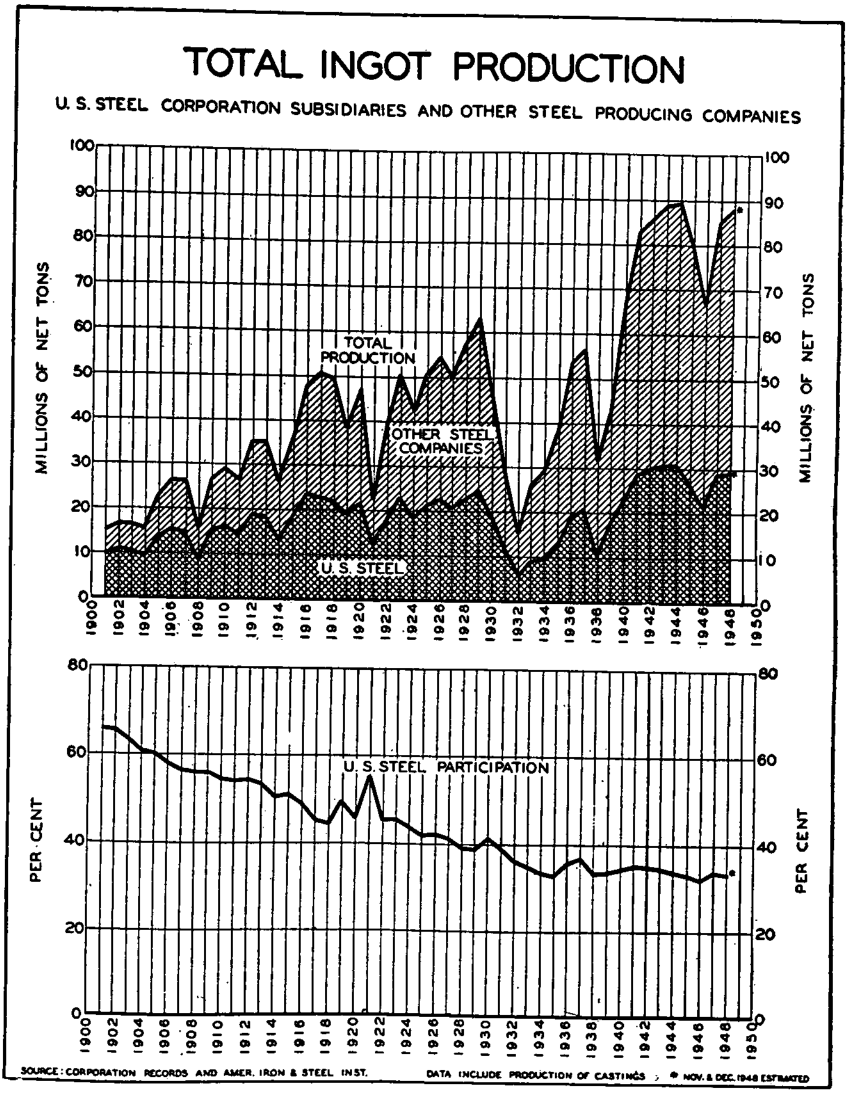

Source: Amer. Iron & Steel Institute, U. S. Census Bureau and Iron Age

*United States Steel Corp. subsidiaries and other steel-producing companies—Production of ingots and castings*

[Net tons]

| Year | United States Steel subsidiaries | Other steel-producing companies | Total industry | United States Steel percent of industry |
|---|---|---|---|---|
| 1901 | 9, 917, 398 | 5, 173, 028 | 15, 090, 426 | 65. 72 |
| 1902 | 10, 920, 432 | 5, 820, 488 | 16, 740, 920 | 65. 23 |
| 1903 | 10, 274, 734 | 6, 004, 441 | 16, 279, 175 | 63. 12 |
| 1904 | 9, 422, 062 | 6, 101, 012 | 15, 523, 074 | 60. 70 |
| 1905 | 13, 447, 147 | 8, 979, 674 | 22, 426, 821 | 59. 96 |
| 1906 | 15, 152, 703 | 11, 053, 210 | 26, 205, 913 | 57. 82 |
| 1907 | 14, 727, 934 | 11, 438, 171 | 26, 166, 105 | 56. 29 |
| 1908 | 8, 779, 359 | 6, 926, 678 | 15, 706, 037 | 55. 90 |
| 1909 | 14, 957, 812 | 11, 871, 812 | 26, 829, 624 | 55. 75 |
| 1910 | 15, 880, 893 | 13, 345, 416 | 29, 226, 309 | 54. 34 |
| 1911 | 14, 283, 774 | 12, 233, 464 | 26, 517, 238 | 53. 87 |
| 1912 | 18, 929, 370 | 16, 072, 089 | 35, 001, 459 | 54. 08 |
| 1913 | 18, 655, 124 | 16, 401, 855 | 35, 056, 979 | 53. 21 |
| 1914 | 13, 245, 653 | 13, 088, 941 | 26, 334, 594 | 50. 30 |
| 1915 | 18, 341, 671 | 17, 667, 490 | 36, 009, 161 | 50. 94 |
| 1916 | 23, 419, 860 | 24, 486, 662 | 47, 906, 522 | 48. 89 |
| 1917 | 22, 719, 268 | 27, 748, 612 | 50, 467, 880 | 45. 02 |
| 1918 | 21, 933, 512 | 27, 864, 411 | 49, 797, 923 | 44. 05 |
| 1919 | 19, 264, 418 | 19, 567, 361 | 38, 831, 779 | 49. 61 |
| 1920 | 21, 591, 315 | 25, 597, 571 | 47, 188, 886 | 45. 76 |
| 1921 | 12, 282, 309 | 9, 875, 544 | 22, 157, 853 | 55. 43 |
| 1922 | 18, 012, 271 | 21, 863, 006 | 39, 875, 277 | 45. 17 |
| 1923 | 22, 769, 544 | 27, 567, 396 | 50, 336, 940 | 45. 23 |
| 1924 | 18, 456, 320 | 24, 027, 452 | 42, 483, 772 | 43. 44 |
| 1925 | 21, 166, 541 | 29, 674, 206 | 50, 840, 747 | 41. 63 |
| 1926 | 22, 743, 468 | 31, 345, 546 | 54, 089, 014 | 42. 05 |
| 1927 | 20, 704, 817 | 29, 622, 590 | 50, 327, 407 | 41. 14 |
| 1928 | 22, 518, 439 | 35, 211, 042 | 57, 729, 481 | 39. 01 |
| 1929 | 24, 493, 074 | 38, 712, 416 | 63, 205, 490 | 38. 75 |
| 1930 | 18, 733, 649 | 26, 849, 772 | 45, 583, 421 | 41. 10 |
| 1931 | 11, 292, 286 | 17, 766, 675 | 29, 058, 961 | 38. 86 |
| 1932 | 5, 520, 744 | 9, 802, 157 | 15, 322, 901 | 36. 03 |
| 1933 | 9, 012, 634 | 17, 007, 595 | 26, 020, 229 | 34. 64 |
| 1934 [1] | 9, 699, 546 | 19, 482, 378 | 29, 181, 924 | 33. 24 |
| 1935 | 12, 466, 655 | 25, 717, 050 | 38, 183, 705 | 32. 65 |
| 1936 | 18, 936, 956 | 34, 563, 043 | 53, 499, 999 | 35. 40 |
| 1937 | 20, 756, 151 | 35, 880, 794 | 56, 636, 945 | 36. 65 |
| 1938 | 10, 525, 056 | 21, 226, 934 | 31, 751, 990 | 33. 15 |
| 1939 | 17, 625, 676 | 35, 173, 038 | 52, 798, 714 | 33. 38 |
| 1940 | 22, 933, 653 | 44, 049, 033 | 66, 982, 686 | 34. 24 |
| 1941 | 28, 963, 018 | 53, 876, 241 | 82, 839, 259 | 34. 96 |
| 1942 | 30, 029, 950 | 56, 001, 981 | 86, 031, 931 | 34. 91 |
| 1943 | 30, 540, 427 | 58, 296, 085 | 88, 836, 512 | 34. 38 |
| 1944 | 30, 814, 648 | 58, 826, 952 | 89, 641, 600 | 34. 38 |
| 1945 | 26, 478, 949 | 53, 222, 699 | 79, 701, 648 | 33. 22 |
| 1946 | 21, 286, 938 | 45, 315, 786 | 66, 602, 724 | 31. 96 |
| 1947 | 28, 570, 436 | 56, 323, 635 | 84, 894, 071 | 33. 65 |
| 1948 [2] | 29, 000, 000 | 59, 000, 000 | 88, 000, 000 | 32. 96 |

[1] In 1934 and subsequent years only castings made by ingot producers are included.
[2] November and December estimated.


TOTAL INGOT PRODUCTION
U. S. STEEL CORPORATION SUBSIDIARIES AND OTHER STEEL PRODUCING COMPANIES
MILLIONS OF NET TONS
TOTAL PRODUCTION
OTHER STEEL COMPANIES
U. S. STEEL
PER CENT
U. S. STEEL PARTICIPATION
SOURCE: CORPORATION RECORDS AND AMER. IRON & STEEL INST.
DATA INCLUDE PRODUCTION OF CASTINGS ; * NOV. & DEC. 1948 ESTIMATED

Senator FLANDERS. Thank you.

Now I have a few questions that I would like to ask Mr. Voorhees. 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.

Senator FLANDERS. That was the last time they have been sold?

Mr. VOORHEES. That is right.

Senator FLANDERS. To what extent have you sold bonds?

Mr. VOORHEES. We sold bonds of the corporation in 1938 to the extent of about $100,000,000.

Senator FLANDERS. That is in 1938. To what extent have your subsidiaries sold bonds?

Mr. VOORHEES. They have sold bonds in that period, the subsidiary railroads, I would say probably to the extent of $45,000,000. It was $45,000,000 to $55,000,000.

Senator FLANDERS. That is for the railroads such as the Iron Range?

Mr. VOORHEES. The Duluth, Missabe, Iron Range, and the E. J. & E., those are the larger subsidiary railroads, and equipment trusts are included in that figure.

Senator FLANDERS. When was that done?

Mr. VOORHEES. Various times throughout the entire period.

Senator FLANDERS. The entire period commencing when? In 1938, or when?

Mr. VOORHEES. I would say between 1938 and 1948, the 10-year period.

Senator FLANDERS. That is entirely with reference to the subsidiary railroads, bonds, and equipment notes?

Mr. VOORHEES. That is right.

Senator FLANDERS. Now, I wonder whether question could not be raised with regard to replacement facilities, the cost of replacement with reference to the method of financing, that $100,000,000 in 1938, could that not be considered as having been applied to facilities for production?

Mr. VOORHEES. That is right. It was. That was the reason it was borrowed.

Senator FLANDERS. Now, in that case, the bond purchasers took the risk of the depreciation of the dollar. Presumably they did not recognize the present situation. I think few of us would. It does raise the question whether if you can float bond issues for replacement of facilities as they become due and still replace them without the necessity of setting aside the replacement costs you are setting aside at the present time.

Mr. VOORHEES. Let me clarify the situation. 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 to 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.

Senator FLANDERS. That is a matter—you are stating that as a matter of principle?

Mr. VOORHEES. A matter of principle.

Senator O'MAHONEY. Would you repeat that, Mr. Voorhees?

Mr. VOORHEES. Insofar as the replacement of the tools of production is concerned, I think that the person or the customer who gets the products should pay for the cost of replacement in the purchase price. Insofar as increasing capacity is concerned or starting out with new products, then I think new capital and new borrowing are justified.

Senator FLANDERS. Have you had to borrow any other way than bond issues since 1938?

Mr. VOORHEES. Outside of the basis that I have told you about, with respect to equipment trusts and subsidiary railroad borrowing, and the $100,000,000 bond issue; no.

Senator FLANDERS. I did not see the word "depletion" used at all in your testimony. Does the depreciation include depletion in your ore properties?

Mr. VOORHEES. That is right; it does.

Senator FLANDERS. Can you give the percentage in your 1947 figures of depreciation which accounts for depletion?

Mr. VOORHEES. For 1947 it was 7.5 million dollars.

Senator FLANDERS. Out of a total of 87 million dollars?

Mr. VOORHEES. Yes, based on original cost, or 9.8 million dollars out of the 114 million dollars total.

Senator FLANDERS. The total based on original cost and added to based on original cost, cover replacement costs amounts to what?

Mr. VOORHEES. 87.7 million dollars based on original cost, plus 26.3 million dollars to cover replacement costs, would be a total of 114 million dollars for 1947.

Senator FLANDERS. And your figures given on your page 5 would seem to indicate 66.3 and 39.7 million.

Mr. VOORHEES. That is right. That is for 9 months of 1948.

Senator FLANDERS. This is an incidental question: Have you any interest in the St. Lawrence seaway, pro or con?

Mr. VOORHEES. I think with respect to that problem, Mr. Chairman, it depends upon the question of raw materials and an eastern plant for United States Steel. Now, those problems are pretty much going around, so that there is some interest. We have some interest in the situation, but how much I am not prepared to state because our plans are in the process of formulation.

Senator FLANDERS. That does not help me very much. I probably will have to vote on that question within a few months.

Senator O'MAHONEY. Have you figured out the profit and loss on that, Senator Flanders?

Senator FLANDERS. The profit and loss on the St. Lawrence seaway? I wish that somebody could.

Now, all of the figures you have given and on which you, on the face of it, have rather conclusively shown that present earnings are not excessive, are based on this added sum to cover replacement costs, which seems to be in the neighborhood of 35 or 36 percent of the total you are laying aside. If you did not lay aside that additional to cover replacement costs, your income for the first 9 months of 1948 would have risen from $88,000,000 to approximately $128,000,000 or thereabouts?

Mr. VOORHEES. That is right, on an overstated basis.

Senator FLANDERS. Yes; that is distinctly your point of view. So that if we were going to disregard those figures, we would have to add to them—I do not have the pencil of a ready reckoner.

Mr. VOORHEES. You can add them directly.

Senator FLANDERS. I was trying to see how much in percentages we would have to mark up your profits. It would be 88 into 40. We will take a short recess while I endeavor to make a little calculation. We have to mark up your profits a little better than 45 percent.

Mr. VOORHEES. Oh, no.

Senator FLANDERS. Your profits for the first 9 months are given as $88,000,000, that is your income, and you are adding to cover replacement costs a little less than $40,000,000, and I make out that that is an addition of about 45 percent.

Mr. VOORHEES. Well, if you will look at the first statement that is attached.

Senator FLANDERS. You would not get all of that; the Government would get some of it. No; the Government has got it anyway because they do not agree with you.

Mr. VOORHEES. They get it anyway.

Senator FLANDERS. Yes, they get it anyway.

Mr. VOORHEES. That is right. So that, insofar as this case is concerned, you can see on that statement our income in 1940 was 9.5 percent of sales and in 1946 it was 5.9. In 1947 it was 6; if you threw back the added amount for replacement costs, it would be 7.2, taking together the 1.2 and the 6. It would be 7.3 percent of sales insofar as the 9 months of 1948 are concerned, if there were no added amount for depreciation. You see, I am referring, Mr. Chairman, to the appendix chart here.

Senator FLANDERS. I was looking at page 5.

Mr. VOORHEES. I am looking at the appendix, the first statement there. You can get the figure directly from that statement. It is the first statement under the appendix. It is the page directly after page 19.

Senator FLANDERS. I hope, by the way, that page 5 agrees with this appendix.

Mr. VOORHEES. I think it does. But you can get it directly in the chart.

Senator FLANDERS. All right, the income is $88,000,000, and that agrees with page 5.

Mr. VOORHEES. Now, if you will look right opposite the $88,000,000 and see those percentages there, Mr. Chairman, the percent on sales is 9.5 for 1940 and 5.9 for 1946. For 1947 it was 6. Adding the 1.2 would make that 7.2, and 5 plus 2.3 would give you 7.3 percent on sales for 1948, on the basis that you are talking about.

Senator FLANDERS. That is just about what I reckoned, just about 45 percent. You can get it directly there, as you indicate.

Mr. VOORHEES. Where does the cash come from to replace facilities?

Senator FLANDERS. That is the question. In other words, I was just making the point which seems to me obvious that your profit comparisons do depend on this principle which you are upholding of adding enough to cover replacement costs. However, may I inquire whether the same principle was applied to the other periods with which you are making comparison?

Mr. VOORHEES. No; I would say that I have to go back a little bit in history and show you what really happened. We learned this the hard way. Of course during the war period, we had not been able to proceed with our major replacement and modernization programs, and as soon as VJ-day happened, we thought that there might be a lull before we got on the long road from the standpoint of peacetime operations, and it would be a good thing for us to carry on with respect to replacing some of our fixed assets in the modernization program. So, if I recall correctly, on December 31, 1946, we had $370,000,000 of appropriations in process, of which $278,000,000 was unexpended. Since we were closing our books, as we always do, we asked the engineering department, "What about these appropriations, are there over-runs and so forth on them?" They studied the situation, and came back and said: "It is going to cost us $30,000,000 more to complete those appropriations than you have got recorded in your records." So that caused us to tighten up our belt, because we were talking about $30,000,000 more cash. And then along came June 30, 1947, and we asked the engineering department to check up again, and they said, "It is going to cost us $30,000,000 more," or $60,000,000 additional in all. Well, that is cash, and not reserves or anything else. That is cash. So, we went into this thing by the cash route.

Now, our reported earnings for those quarters were running somewhere between $25,000,000 and $30,000,000 a quarter, but here was coming an additional amount of $30,000,000 insofar as our expenditures for fixed assets were concerned, and the question came up as to whether or not those were really earnings. So we went back and studied our problem very carefully. We went back through the construction cost index numbers. We studied those in March 1947, and we found that construction indexes were going up. Through the first quarter of 1947 and in the last part of 1946 the construction indexes were about 50 percent above 1940.

So, knowing our own situation with respect to the increased costs of replacements, we said, "This depreciation on original cost is the spot where we are falling down in costing our sales, and we have just got to add something to it to get our figures on the proper basis," and so we started with 30 percent. Now, you say, "Why 30 percent?" The figure in the indexes was 50 percent, but we had to pay taxes on it of 40 percent, and so 30 was the figure. We thought also that nobody could criticize us from the standpoint of the increased cost of replacing fixed assets being, certainly, 30 percent.

So, we started out on that basis, and in the second quarter of 1947 we added 30 percent, and that gave us $26,000,000 for the year 1947, but that was not the end. We came along to December 31, 1947, and with appropriations to the extent of $510,000,000, had to have $36,000,000 more added, and that was not the end. On June 30, 1948, we had to have $40,000,000 more added, and just last October we had to add $10,000,000 more; so we have got $146,000,000 more to provide for in cash. That is not bologna; that is cash.

Now, in the meantime our earnings are going along here. Mr. Pogue in his testimony said, "I like to look at the cash flow to see whether or not there are real earnings in the situation," and so do I, because I have to provide the cash.

Now, let me ask you a few questions here from the standpoint of this problem.

Senator FLANDERS. Remember which side of the table you are on, sir.

Mr. VOORHEES. I am just thinking out loud, sir. Is it reasonable to suppose that with labor rates up 100 percent since 1940; is it reasonable to suppose that with the cost of purchased goods and services up approximately the same amount insofar as United States Steel is concerned; is it reasonable to suppose that the cost of machinery and equipment and buildings during that period is not up 100 percent?

I am still thinking out loud.

Now, so far as construction costs are concerned in this problem, you see its magnitude with respect to United States Steel. Now you may say, "Why haven't other companies done it?" The problem is really complex with United States Steel because our depreciation is so great in proportion to our earnings. When we are talking about $87,000,000 or $90,000,000 based on original cost as compared to $127,000,000 earnings, that is pretty close to 65 or 70 percent of our total earnings.

Now, where depreciation represents a big proportion of our earnings, we must be accurate, more accurate, with respect to cost, because it is such a big proportion and you can go so wrong. So we increased the added amount to cover replacement costs from 30 to 60 percent, and that brought the figure up for the first 9 months to $39,000,000. I am just as sure as fate that the 60 percent is on the low side, and that on the maximum side, the figure is somewhere around 100 percent increase for the facilities that we must replace.

Senator FLANDERS. There is another point that I would like to get clear on, this added amount to cover replacement costs. Do I understand that that is based on your current problem, or is there also involved in it an undertaking to work back of the date when you began this policy to recover replacement costs, added replacement costs which were accumulated before that time?

Mr. VOORHEES. I think that that part, Mr. Chairman, will have to take care of itself when the time comes.

Senator FLANDERS. In other words, this is a current problem and you have made no endeavor to go back?

Mr. VOORHEES. I would hate to do that with respect to my accounts. I might say at this point that United States Steel, our management and our board of directors, does not take new procedures with respect to financing and accounting very lightly, because we are used as examples by American industry, and, therefore, we have to make certain that both from the economic and business standpoint we are sound.

Senator FLANDERS. I have marked one or two other places in your testimony. Have you made any provisions of any sort for cushions against deflation in any of the items in your assets?

Mr. VOORHEES. Let me go back. In the latter part of 1940 and in 1941 when the conditions that faced us became pretty much apparent, we made a very thorough study of our assets and liabilities and our income account during and after the first war period, the years 1915, 1916, 1917, 1918, and especially 1919, 1920, 1921, and 1922. We saw what happened with respect to hidden losses that were not observable at the time the accounts were made up during those years, and we saw the losses that occurred thereafter. As a result of that study, we did two things; first, at the end of 1940 we went on the last-in first-out inventory basis with respect to the major part of our inventories. No. 2, as the war actually came to us, we set up $25,000,000 a year after taxes to take care of the things that we discovered, as a result of our studies, were the aftermath of the First World War. So we set up during that period a reserve of some $100,000,000.

At the present time some $74,000,000 of that $100,000,000 has been used, and there remains $26,000,000. I think that that $26,000,000 will mainly be used for the replenishment of inventories involuntarily liquidated during the period that we have not yet been able to replenish. The major part of it will be used for that purpose.

Senator FLANDERS. You are making no current set-aside for that?

Mr. VOORHEES. We have some $26,000,000 still open. For instance, take tin. Under our last-in first-out method, I think our tin is valued at 46 cents a pound. We usually carried from 10,000 to 15,000 tons of tin in our inventories. The present price is somewhere, I believe, around $1.10 a pound. Our present inventories are between 2,500 and 3,000 tons. When we get back to a normal supply by adding 10,000 tons, the additional cost resulting from the price rising from 46 cents to $1.10 a pound will be applicable to that reserve.

Senator FLANDERS. I am led to ask this question, because Mr. Montgomery of the CIO in his testimony the other day referred to a statement of Mr. Olds in his annual report of 1946, and I will read the quotation:

> Operations are at an all-time high. Profits should be sufficient to enable a fair return to be paid to the owners of business in the form of dividends and also to permit an adequate amount to be set aside for future needs, since the day will come when steel operations are at a lower rate than the present time.

Did you set anything aside in 1946 on that basis?

Mr. VOORHEES. In 1946 we did not so set anything aside. Our earnings, however, were not all paid out in dividends in 1946. I think there were some $26,000,000 or $28,000,000 earnings reinvested in the business, but nothing was set aside specifically for that purpose if that is what you mean.

Senator FLANDERS. So that the principle enunciated by your chairman was not carried out in practice?

Mr. VOORHEES. I would not say that was a principle. I would not say that.

Senator FLANDERS. It is put down in durable print.

Mr. VOORHEES. Well, you see, that does not mean that.

Mr. OLDS. Senator, I hope at the conclusion of Mr. Voorhees' testimony, you will permit me to say a few words on that subject, because this witness did not quote exactly what I said. I would like to put in the record what I did say and also explain it.

Senator FLANDERS. That we will be glad to do.

Much has been said, not merely by that particular witness, but over and over again, with regard to the necessity for an increase in steel production, which the industry is accused of ignoring. May I get a statement from you on that question?

Mr. FAIRLESS. I have a statement if you want it, now or later.

Senator FLANDERS. Perhaps you might do that now.

Mr. Fairless, I think that we might wait until after you have finished with Mr. Voorhees.

Those are all of the questions that I have to ask.

Senator FLANDERS. Senator O'Mahoney?

Senator O'MAHONEY. Thank you, Mr. Chairman.

May I ask you, Mr. Voorhees, to turn to page 2 of your statement?

Mr. VOORHEES. Yes, sir.

Senator O'MAHONEY. You have a very interesting record of achievement in United States Steel of which I think you can take a good deal of pride. However, I am wondering whether it is altogether complete. [Reading:]

> United States Steel broke all its earlier records for the production of steel ingots.

What are the precise figures on that? I know you have them somewhere through the statement.

Mr. VOORHEES. We have the production records right here.

Mr. FAIRLESS. This will all come out in my statement, Senator.

Senator O'MAHONEY. I just want the summary at this moment, Mr. Fairless. Page 2 of Mr. Voorhees' statement, item No. 1 reads:

> United States Steel broke all its earlier records for the production of steel ingots.

Let us get the precise figures for the high production, just a simple answer.

Mr. FAIRLESS. For what year?

Senator O'MAHONEY. I merely want to know what Mr. Voorhees meant when he said, "United States Steel broke all its earlier records for the production of steel ingots."

Mr. VOORHEES. In peacetime. Our production record for 1947 was 28,570,000 tons.

Senator O'MAHONEY. Will you give me that again, please?

Mr. VOORHEES. 28,570,000 tons. For 1948 we are going at the rate of 29,000,000 tons. Those are records for peacetime years.

Senator O'MAHONEY. What was the previous peacetime record?

Mr. VOORHEES. Previous peacetime record, I would say it was probably somewhere around 24,000,000 tons. It was 24,000,000 tons in 1929.

Senator O'MAHONEY. Then do I understand in 1929 you produced 24,000,000 tons and that was the highest of any peacetime year until 1947?

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Now, No. 2 reads:

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

What was that tonnage?

Mr. FAIRLESS. Slightly over 20,000,000 tons for 1947.

Mr. VOORHEES. In 1947 it was 20,242,000 tons.

Senator O'MAHONEY. And the previous high record?

Mr. VOORHEES. The previous high record was in 1929, when it was 16,800,000. That is all shown, Senator O'Mahoney, in my statement. Let me get the page in our index here. It is page 6 of this first long table.

Senator O'MAHONEY. On No. 6?

Mr. VOORHEES. The sixth unnumbered attachment after page 19. The first printed statement.

Senator O'MAHONEY. The one entitled, "United States Steel's Operating Story, 1902–47"?

Mr. VOORHEES. That is right. The only figure that is not there is the estimated 1948 figure.

Senator O'MAHONEY. Thank you, that gives the details.

Mr. VOORHEES. Yes.

Senator O'MAHONEY. Now you proceed with the record breaking down through the employment of people, the largest annual pay roll, the average hourly earnings, the highest on record, the cost of goods and services purchased by Steel which reached a new all-time high.

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

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

How about a product measured in terms of productivity life? For example, your steel rails, are they better than ever before in history?

Mr. VOORHEES. I think so.

Mr. FAIRLESS. We think so and many of our customers think likewise.

Senator O'MAHONEY. You can get testimony from your customers to that effect, can you not?

Mr. FAIRLESS. That is right.

Senator O'MAHONEY. How about your other products?

Mr. FAIRLESS. We think generally speaking that that is generally true of all of our products.

Senator O'MAHONEY. Generally speaking it is true of all your products?

Mr. VOORHEES. That is right. We believe that technological improvements can continue and have been continuing ever since the steel industry was formed, and that such improvement is continuing today. We believe that we are holding our place in that direction.

Senator O'MAHONEY. Perhaps you might say you were even leading the procession?

Mr. FAIRLESS. That would be possible, but certainly we are holding our place.

Senator O'MAHONEY. Certainly you would not quarrel with me if I said you were leading the procession in technological improvement?

Mr. VOORHEES. I would be very happy to agree with you.

Senator O'MAHONEY. The reason I am asking these questions is because I was very much impressed with an exhibit that was presented to this committee yesterday by Mr. Coyle of General Motors. He invited the members of the committee, not only to examine the chart which was presented to us, but he also asked us to go down on the street and have our pictures taken with a 1929 Buick compared with a 1948 Chevrolet—all to the advantage of the Chevrolet. I want to hand one to you.

Now, may I ask Mr. Voorhees and Mr. Fairless to look at this exhibit of General Motors. It is not a CIO exhibit, I might add, nor is it a New Deal exhibit. It is an exhibit of General Motors.

The 1929 Buick, Mr. Coyle told us, had a manufacturers list price of $1,320. The 1948 Chevrolet in these inflated dollars costs only $1,280. Yet, this cheaper car in inflated dollars of 1948 gives the consumer 90 horsepower as against 74 of 20 years ago; it gives the consumer a speed of 81.8 miles per hour as against 64.75 miles an hour; it consumes gasoline at the rate of 22.7 miles per gallon at 30 miles per hour as compared with only 14.7 in 1929. It has a weight of 3,225 pounds as against 3,764 pounds in the earlier car. It is a six-cylinder car, exactly as the other one was. It has a wheel base of 116 inches as compared with 115.75.

Then there are further comparisons with respect to shoulder room in front and rear and hip room and head room and so forth.

You have this chart before you and I will ask Mr. Voorhees or Mr. Fairless if that is not a pretty clear demonstration that modern technology has resulted in producing far more per dollar than was ever produced before by industry?

Mr. FAIRLESS. No doubt about it and also, Senator, in agreeing with you, I would like to point out that steel has played a very important part in that progress.

Senator O'MAHONEY. Oh, yes.

Mr. FAIRLESS. An automobile of course is largely steel.

I would like to point out to you that even though cold rolled steel sheets are considered high in price, they are lower today than they were in 1929 and that is because of the technological developments in steel.

So, industry and steel have produced the developments which you have stated and with which I heartily agree.

Senator O'MAHONEY. That leads me to that other question based upon one of Mr. Voorhees' statements. This is on page 8 and reads:

> 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.

The technological evidence presented by General Motors yesterday and by both of you gentlemen today, makes it clear that the consumer today of industrial products is getting more for his dollar than he was 20 years ago?

Mr. VOORHEES. Insofar as the consumer is concerned, there is not any doubt but that he is getting more. But, what is the implication with respect to that question, Senator?

SENATOR O'MAHONEY. When you buy tools now for replacement, or when you build new plants, are you in fact buying the same commodity? Are you, in other words, buying the 1929 Buick or the 1948 Chevrolet?

Mr. VOORHEES. That is a different question; that is a different question.

Senator O'MAHONEY. Well, we can ask several questions, sir.

Mr. VOORHEES. That is right. I want to be very sure that you understand my answer.

Senator O'MAHONEY. I will do my best to try to understand it, Mr. Voorhees.

Mr. VOORHEES. We have given examples insofar as my testimony is concerned where the facility is exactly the same. But now we are talking about technological improvements. There is gradual technological improvement insofar as some, and we will say most, of the equipment we buy over a period of years is concerned.

Senator O'MAHONEY. The president of the Machine Tools Association says that modern tools that are available now are at least 50 percent more productive than the old tools.

Mr. VOORHEES. What was the period?

Senator O'MAHONEY. Well, I do not recall.

Mr. VOORHEES. That is important because insofar as technological improvement in the steel industry is concerned, it is probably somewhere on the average between 1½ and 2½ percent per year. Now just so we get the story straight, insofar as United States Steel is concerned, the results of technological improvement, insofar as equipment that has been put in since 1940 is concerned, I cannot find anywhere in the income account. It has either all gone to labor, or to the people that supply us with materials, or to the Government in taxes, or the customer has it free of charge.

Senator O'MAHONEY. Well, perhaps I might say to you now, Mr. Voorhees, what you said to me a moment ago; that is another question. We are talking now about the productivity.

Mr. VOORHEES. You are talking about the technological improvement and who got the benefit of it.

Senator O'MAHONEY. Do you mean to say that the steel company did not get any benefit from it?

Mr. VOORHEES. Not from the standpoint of showing it in the till. I cannot find it.

Senator FLANDERS. May I ask a question?

Mr. VOORHEES. I cannot find it in the till. I hope to some day, but I have not as yet.

Senator O'MAHONEY. We will see about that in just a moment.

Senator FLANDERS. I would like to inquire whether when you made your calculations for replacement, you do make those calculations on the basis of replacing a given amount of production rather than a given unit for unit? I do not know whether you have any old style sheet mills in use or not, but if you were going to replace an old style sheet mill with a modern continuous mill, do you say simply that it is going to take that many more millions of dollars to replace that mill, or do you reckon into it the fact that you are replacing it with a great increase in capacity?

Mr. VOORHEES. That all receives consideration, Mr. Chairman, insofar as passing that appropriation is concerned. It is a question first of its necessity from the standpoint of keeping our production up, and, second, it is a question of what the return should be insofar as the expenditure of that money is concerned.

Senator FLANDERS. That is not exactly the question. We have had testimony of other manufacturers to the extent that in reckoning their replacement costs they reckoned it on the basis of replacing a given capacity, not replacing a given unit. So, I am asking you whether in reckoning your replacement costs you reckon on the replacement of an obsolete unit with a more highly productive unit or whether you reckon on the basis of replacing equivalent production capacity?

Mr. VOORHEES. That is about right.

Senator FLANDERS. Both?

Mr. VOORHEES. It is more on the basis of replacement of certain productive capacity.

Senator FLANDERS. If you can stand by that I think that question is answered. You are sure of that, are you?

Mr. VOORHEES. I mean, it sometimes may be both.

Senator O'MAHONEY. The question is, which rule did you use in preparing your testimony for the committee today? You said just a moment ago that you gave your examples upon the basis of the replacement of identical facilities.

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Now, do you wish this committee and the country to understand that for the most part the facilities of the United States Steel and its subsidiaries which had been constructed since the end of the shooting war are not technologically superior to those which you had before the war?

Mr. VOORHEES. I would say that they are.

Senator O'MAHONEY. They are what?

Mr. VOORHEES. Technologically superior.

Senator O'MAHONEY. So that when you gave us your testimony upon the basis of the purchase of identical facilities, you are not giving us a picture of the exact condition that exists?

Mr. VOORHEES. No; I gave identical items there, Mr. Senator.

Senator O'MAHONEY. Oh, certainly, but we must look at this in an over-all picture.

Mr. VOORHEES. That is right, but then I said also that I cannot find in the net income or the dividends to the stockholders, the technological improvements.

Senator TAFT. Except that if there had not been those improvements, it comes from his pocket, so it comes to the same thing?

Mr. VOORHEES. Not the same thing.

Senator O'MAHONEY. Are you figuring your profits now upon the same basis as you did before the war?

Mr. VOORHEES. What do you mean?

Senator O'MAHONEY. Well, what is the relationship?

Mr. VOORHEES. Which kind of dollars are you talking: 1939 compared to 1947?

Senator O'MAHONEY. I am talking about the kind of dollars you are using. I have here the United States Steel Corp. annual report for 1947 with man-hour productivity and hourly real earnings compared; labor costs and profits per ton of steel shipped compared. There are two columns here at the end showing labor costs and profits.

Now in 1940, for example, labor cost was $29.02 per ton, and profits were $6.81 per ton. Back in 1930, the labor cost according to your statement, was $30.46 per ton and your profits were $8.16 per ton.

Now we go down to the present decade and we find for 1947 your labor cost was $43.94 per ton and your profits were $6.29 per ton. The question that is in my mind is, are you figuring your profits in 1947 and in 1948 upon the same basis upon which you figured them prior to the war?

Mr. VOORHEES. No.

Senator O'MAHONEY. What is the difference?

Mr. VOORHEES. Well, the difference is that we are trying to make an adjustment in the purchasing power of the dollar.

Senator O'MAHONEY. So that these profits are up or down according to this adjustment?

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Which is it, up or down?

Mr. VOORHEES. The profits are down because the purchasing power of the dollar is down.

Senator O'MAHONEY. Yes. But, your testimony to us is that the customer gets much more for his dollar than he ever did before.

Mr. VOORHEES. All right. If you will look at the second statement, Mr. Senator, the second statement attached, I would like to show you exactly what has happened in 1948 dollars.

Senator WATKINS. Your printed statement?

Mr. VOORHEES. That is the nineteenth page and the first statement and the second statement.

Senator O'MAHONEY. What is the heading?

Mr. VOORHEES. The heading is "Data requested by subcommittee on comparative sales, cost, and profits—1940, 1946, 1947, and 9 months of 1948."

It is shown in current dollars on the left-hand side and in 9 months 1948 dollars on the right-hand side.

Now the tonnages in 1940, 1946, and the first 9 months of 1948 are approximately the same, being from 15 million tons to 15.2 and 15.1. Now if we use 1948 dollars for the first 9 months, our sales actually for the 9 months were $1,754,000,000 and our sales for 1946 with the same tonnage were $1,834,000,000 and in 1940, $1,839,000,000.

Senator O'MAHONEY. I do not see those figures, Mr. Voorhees. I am probably looking at the wrong place.

Mr. VOORHEES. You have the right-hand chart?

Senator O'MAHONEY. Is it under the line beginning "Products and services sold"?

Mr. VOORHEES. No; I am taking the last four columns.

Senator O'MAHONEY. But what line?

Mr. VOORHEES. I am taking the first item, "Products and services sold."

We have $1,754,000,000 for 9 months of 1948, $1,834,000,000 for 1946, and $1,839,000,000 for 1940, all in approximately the same neighborhood and we have approximately the same volume.

Let us see what has happened. We have wages and salaries, social security and pensions amounting to $739,000,000 for the 9 months of 1948, $863,000,000 for 1946; and $791,000,000 for 1940. Those are all calculated in the same dollars.

Products and services bought, 9 months for 1948, $705,000,000; 1946, $722,000,000; and 1940, $610,000,000.

Then we have wear and exhaustion of facilities. Now we come to a point where this gets interesting. With our 60 percent added to cover replacement costs, we get $106,000,000 for the 9 months of 1948, $84,000,000 insofar as 1946 is concerned with the same volume; but we get $124,000,000 in 1940 as compared to 72.6 million dollars for 1940 in current dollars.

In other words, putting our depreciation on a uniform dollar basis for the several periods, we get more in 1940 on 15,000,000 tons than we did, even after we add such 60 percent, for the first 9 months of 1948.

Senator O'MAHONEY. Why do you add the 60 percent?

Mr. VOORHEES. We add the 60 percent to recover the purchasing power that was originally invested in the tools that are wearing out.

Senator O'MAHONEY. You convert the prewar dollar to the postwar dollar, is that what you mean?

Mr. VOORHEES. That is right; we are using an index number of depreciation or increase in cost, but we are not using it all, Senator. The actual index would be close to 100.

Senator O'MAHONEY. On this basis of depreciation as shown in 1940 of 123.8 million, to what extent has that depreciation already accounted for the value of the plant?

Mr. VOORHEES. There is not any doubt that insofar as 1940 is concerned, the depreciation of 72.6 million dollars is equivalent in purchasing power to $124,000,000 of 1948 dollars.

Senator O'MAHONEY. Now then, we find on your other exhibit here, the one to which you directed my attention a while ago, United States Steel's Operating Story, 1902 to 1947, I find in the column on wear and exhaustion that your depreciation runs as follows: 1941, 98.6; 1942, 128.2; 1943, 134; 1944, 139; and 1945, 123.4.

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Now you want to depreciate those same facilities again?

Mr. VOORHEES. No, no, Senator. The reason for those larger figures during the war is for the reason of depreciating with the 5-year amortization certificates.

Senator O'MAHONEY. The Government gave you the 5-year depreciation amortization plan?

Mr. VOORHEES. I do not think the Government gave them; it did not tax them, let us put it that way.

Senator O'MAHONEY. Well, the Government allowed them. That depreciation was at what rate?

Mr. VOORHEES. At the rate of 100 percent.

Senator O'MAHONEY. And in what dollars?

Mr. VOORHEES. In what dollars?

In approximately the dollars paid for these facilities.

Senator O'MAHONEY. Practically in the dollars in which they were paid?

Mr. VOORHEES. That is right, because they came so fast.

Senator O'MAHONEY. Now, I find, going on to 1946 that you have a figure of 68.7 million and for 1947 a figure of 114 million?

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Now when did you begin to use this new depreciation?

Mr. VOORHEES. We began in the middle of 1947.

Senator O'MAHONEY. In 1947?

Mr. VOORHEES. And as I explained, it was because we were getting these extraordinarily large amounts of overappropriations, and it did not seem right.

Senator O'MAHONEY. To what particular plants does that apply?

Mr. VOORHEES. It does not apply to the facilities that were amortized during the war, if that is what you are talking about.

Senator O'MAHONEY. I want to know.

Mr. VOORHEES. It applies to our net undepreciated assets. It applies to everything that has not been completely written off.

Senator O'MAHONEY. Do you have here a statement showing the amount that has been written off?

Mr. VOORHEES. I do not believe so. I can give you the amount.

Senator O'MAHONEY. Can you give us the plants?

Mr. VOORHEES. So far as the plants are concerned——

Senator O'MAHONEY. You cannot do it now?

Mr. VOORHEES. I can give you the amount with respect to amortization. It is about $300,000,000.

Senator O'MAHONEY. I think it would be helpful if you would let the committee have a table or statement showing the plants which have been written off insofar as depreciation is concerned, but which are still being used.

Mr. VOORHEES. I do not think it is plants; I think it will be more parts of plants.

Senator O'MAHONEY. Whatever it may be.

Mr. VOORHEES. That is right. We have a list of the things that we had 5-year certificates of necessity for.

Senator O'MAHONEY. Yes, and anything else. It may not all be the war plants.

Mr. VOORHEES. Wait just a minute. We are on the remainder life basis of depreciation, so consequently nothing is written completely off, except just amortization, for all practical purposes unless it is scrapped.

Senator O'MAHONEY. Nothing then is written off for purposes of depreciation unless it is completely scrapped?

Mr. VOORHEES. Nothing is completely written off unless it is scrapped; that is the basis of depreciation we have insofar as the Internal Revenue Bureau is concerned—except in amortization.

Mr. FAIRLESS. Of course these plants are continually being added to in replacements; they do not stand just pat, you know.

Senator O'MAHONEY. Oh, yes, of course, but the story is told to us in broad general terms, so necessarily in order to break it down we ask for a few details.

Senator O'MAHONEY. Now then on page 4 you made this statement in the second paragraph:

> A profit, or an income, as I sometimes prefer to call it, is the arithmetic result of subtracting from one's receipts from customers the cost of producing and selling the goods sold.

Now do I understand that you mean by that what you said first to Senator Flanders and then repeated at my request with respect to the difference between producing facilities and basic plant, or did I correctly understand you?

Mr. VOORHEES. I just do not understand what you have in mind.

Senator O'MAHONEY. All right. Does the cost of producing and selling the goods include tools and plant or just tools?

Mr. VOORHEES. Tools and plant? I just do not understand what you mean. It includes all of the fixed assets that are wearing out.

Senator O'MAHONEY. Well, you made the statement with respect to your belief as to the function of new capital.

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Now I understood that statement to be that new capital, whether obtained by the sale of stock or borrowed, should be used to provide new plant facilities?

Mr. VOORHEES. That is right.

Senator O'MAHONEY. But that the customer in the price he pays should bear the burden of the replacement of the tools.

Mr. VOORHEES. Of tools consumed in the production of the product he gets.

Senator O'MAHONEY. That is right; the wear to which you apply the rule of wear and exhaustion.

Mr. VOORHEES. That is right. Because, if that procedure is not followed then there is an erosion of capital insofar as the original investment is concerned.

Senator O'MAHONEY. I get your point.

Mr. VOORHEES. Which I think is most important.

Senator O'MAHONEY. When you speak of erosion of capital you are speaking of course from the point of view of the corporation itself?

Mr. VOORHEES. Or the stockholder and the customer too.

Senator O'MAHONEY. The customer too?

Mr. VOORHEES. Sure.

Senator O'MAHONEY. Let me put it this way: During the years which you have covered in the preparation of this study, how much new capital has United States Steel obtained?

Mr. VOORHEES. How far back?

Senator O'MAHONEY. During the period in which you prepared this statement.

Mr. VOORHEES. How much new capital?

Senator O'MAHONEY. Yes.

Mr. VOORHEES. From 1940 to 1948?

Senator O'MAHONEY. Oh, I think your statement covers a very much longer period than that.

Mr. VOORHEES. Well, that goes back to the corporations coming into existence in 1901. Perhaps from the standpoint of new capital, I might be able to go over it here. I think probably the figure I have in mind, from the standpoint of new capital, that goes back to 1901, long before I was with the corporation——

Senator O'MAHONEY. I do not want to go into that because that would go into the old story of watered stock and all that.

Mr. VOORHEES. In 1940 it was about $400,000,000.

Senator O'MAHONEY. You told Senator Flanders that the last time there was any sale of equities it was in 1928 or 1929?

Mr. VOORHEES. I think that is right.

Senator O'MAHONEY. And that since that time the only borrowing, if I understood correctly, was about $100,000,000 in 1938 for railroad bonds?

Mr. VOORHEES. No, no; that is not right—$100,000,000 was for the corporation itself, and about $45,000,000, or somewhere in that neighborhood, was for the subsidiary railroads in equipment trusts and mortgages. So that about $145,000,000 has been the total borrowings of United States Steel from 1937 on.

Senator O'MAHONEY. Now plant expansion in that time and replacement of equipment have come wholly from earnings?

Mr. VOORHEES. Earnings and depreciation and the additional amount that we are now setting up to cover replacement costs.

Senator O'MAHONEY. That is all the accounting procedure and the prices that the people have paid?

Mr. VOORHEES. That is right.

Senator O'MAHONEY. Now, of course you are aware of the fact that many people from the financial district make representations to Members of Congress, if not to this committee, that the market for risk capital is disappearing because some great corporations like United States Steel are able to finance themselves out of the prices they charge the consumer. That is to say, out of their earnings. Or, when they want to borrow, they can go to the big insurance companies which gather in the savings of the people from all over the United States.

In other words, the complaint is made by certain persons who are interested in the trading in industrial securities that this development is freezing them out of business. You are aware of that; are you not?

Mr. VOORHEES. Not too greatly; not too greatly.

Senator O'MAHONEY. You have not heard about that?

Mr. VOORHEES. No; not too greatly. The answer to your question is that for the period from 1928 to 1947, the amount we had for reinvestment out of savings was less than 1 percent on sales of $22,000,000,000. I do not think you should come to our door with that problem.

Senator O'MAHONEY. Well, Mr. Voorhees, when you get a corporation with the tremendous assets of United States Steel it is easy to divide the whole thing up into segments of one one-hundredth and talk about percentages and it appears small. But 1 percent of the expenditures of United States Steel in a single year would amount to a great deal in the financing of many of the States of the Union.

Mr. VOORHEES. Yes; but $153,000,000 of earnings for reinvestment over 20 years is not so much with respect to a total turn-over of $22,000,000,000. Still I agree it is a lot of money.

Senator O'MAHONEY. And you got it out of your earnings?

Mr. VOORHEES. That is right.

Mr. FAIRLESS. It is a lot of steel, too; 400,000,000 tons of steel over 20 years.

Senator O'MAHONEY. Of course it is; indeed it is.

May I say without any invidious implication at all that the Soviet Government proceeds upon the same theory. It pushes the private capital out of the picture and gets whatever capital it needs out of prices which it levies upon the consumers. See, we are dealing with a tremendous movement here, sir, and I ask you to believe that when I raise these questions they have no personal implications at all, but we are confronted face to face with a problem of whether or not little business can continue to survive in an economy where a few giant corporations actually call the turn.

It is going to be a very serious question before this Congress.

Mr. VOORHEES. Well, I feel, looking at the matter of new capital, there may be a period in the future when we are going to require capital for expansion. This is not a foreclosed matter—that we are not going to require capital.

Senator O'MAHONEY. Mr. Chairman, I do not want to wear out my welcome here. I want to compliment the witnesses on their ready responses to my inquiries. I think that the answers to the questions that I have asked have been satisfactory, perhaps from both our points of view.

Senator FLANDERS. Senator, I might remark that there is no question of welcome involved because you are a host and not a guest.

Senator O'MAHONEY. Well, I had the idea that I was a guest.

Senator FLANDERS. Congressman Wolcott?

Representative WOLCOTT. No, thank you.

Senator FLANDERS. Senator Taft?

Senator TAFT. There is one line I would like to suggest, one that occurs to me. It seems to me that in a way you confuse two arguments that you are making at the same time. One is that this exceptional replacement cost should be a deduction for tax purposes and the other that this extraordinary condition of inflation justifies higher profit. It seems to me that those are two different things. I do not think to make your case on higher profit you necessarily have to make your case on taxes. This is a rather simple line of questioning, but take it from the point of view of the stockholder and after all from the tax standpoint, that is what we are looking at, more from whether people are being so benefited by a condition whether it is justified or not, but they ought to pay taxes on it.

I take my savings and put it in a bank and my dollars go down in value. I lose in a condition like inflation today. Of course, if it were deflation, I would be gaining, but I put them in dollars. Or, I buy bonds and I lose under these conditions. I buy life insurance and I get my money in dollars that are worth half of what I put into them.

But, on the other hand, and this is part of our whole economic system, supposing I buy wheat or pig iron, then I make a profit on it and I have to pay on that profit. I am taxed on the profit. I make the profit but I certainly am going to pay taxes on it.

Now these stockholders put their money in a business; that is like putting money into some physical thing and it increases in value.

In effect, if it is going to cost you twice as much now to build a new steel plant as this one, this one has gone up in value and the stockholder gets the benefit of that increase in value, but I do not see why he should also get the benefit of a deduction for money spent in replacing it. I can see the argument that since that is gone up in value, you have to earn more profit on it. If you do not earn more profit on it, no one is ever going to build another one because it costs twice as much to build it.

I mean, your argument, if you want to make it your argument on higher profits, is justified. It seems to me that all the property has gone up in value and the cost of replacement has gone up, which justifies the insistence from an economic standpoint that you make the profit or nobody will ever make plants; nobody will ever invest in plants.

I can see why your argument that this cost has gone up is a perfectly good argument to justify a return. Those stockholders' investment decreased in value if we had a deflation; however, it increased in value because of an inflation; and an increase in value means that they have more earning power, and they are entitled to more earning power if the economic system is going to work, but I cannot see a deduction in taxes for that additional cost that it takes you to build a new plant. That seems to me to be a little more for that stockholder than he is entitled to, even under inflationary conditions.

Mr. VOORHEES. Senator Taft, you are saying that the stockholder has received something more. He has not received anything more. In fact, you say the value of the plant has increased. Only in one respect, and that is in money. In everything else it has decreased from the standpoint of real worth in exchange for other goods and services as shown by the chart, and that is only one indication.

Senator TAFT. Why has it decreased?

Mr. VOORHEES. Because the earning power is such that you cannot buy or exchange as much of that earning power for as many tons of wheat or as much copper as you could in 1940 or in previous years.

Therefore, the real worth of it has gone down because the earning power in exchangeable things has gone down.

Senator TAFT. I do not agree at all. The plant has gone up compared to the fellow that I say has bought life insurance. That stockholders' value has substantially increased and it has increased because the earning power is there. As a matter of fact, you admit, I would think, that your earning power is greater than you held it. You could have gotten much more for steel?

Mr. VOORHEES. That is right.

Senator TAFT. The earning power was there, but for various reasons of policy you have not charged what you might have charged. The stockholder has not made the profit. That is your fault or our fault. It is not the result of an economic condition of this increase.

Mr. VOORHEES. That is right.

Senator TAFT. His property has increased as all physical property has increased in value and since he is the owner of that he is the beneficiary of that as he would have had had there been an inflation.

I do not see that you can deny that increase in value and I do not begrudge him that, but the result of that, it seems to me, is that he is entitled to the economic results of a profit based on the new value rather than being entitled to a new tax deduction.

Mr. VOORHEES. I agree with you 100 percent in principle, but so far as the detail is concerned, that I am not going to argue with you.

Senator TAFT. That is all.

Senator FLANDERS. Senator Watkins?

Senator WATKINS. No.

Senator FLANDERS. We have testimony here by Mr. Fairless and also by Mr. Olds.

Will you state for the record your position and business address?

## STATEMENT OF BENAJMIN F. FAIRLESS, PRESIDENT, UNITED STATES STEEL CORP.

Mr. FAIRLESS. My name is Benjamin F. Fairless. I am president of the United States Steel Corp. My place of business is 71 Broadway, New York, and my home is in Pennsylvania.

Senator FLANDERS. This is the one formality which is the same for big business and little business. You all have to go through this particular mill.

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 in 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.

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.

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.

I have a table here which tells the story. You will note that 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.

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.

As I have said on other occasions, the steel industry will continue to improve and increase its production. Inability to meet simultaneously all 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. Already, the upward swing of the pendulum, except for that portion of the demand which is under Government controls, appears to be less rapid. When a more normal time will appear is, of course, uncertain, and when it appears, how much over the prewar level that normal will be, remains equally uncertain. Whatever develops, I am satisfied the steel industry will continue to accept full responsibility for steel production in the United States.

(The table referred to by Mr. Fairless is as follows:)

*Steel ingot capacity, compared with ingot and finished steel product production*

| Year | Ingot capacity | Ingot production | Tons of finished products | Year | Ingot capacity | Ingot production | Tons of finished products |
|---|---|---|---|---|---|---|---|
| 1941 | 85, 158, 000 | 82, 839, 000 | 60, 942, 000 | 1945 | 95, 505, 000 | 79, 701, 000 | 56, 602, 000 |
| 1942 | 88, 886, 000 | 86, 031, 000 | 60, 591, 000 | 1946 | 91, 890, 000 | 66, 602, 000 | 48, 775, 000 |
| 1943 | 90, 589, 000 | 88, 836, 000 | 62, 210, 000 | 1947 | 91, 241, 000 | 84, 894, 000 | 63, 057, 000 |
| 1944 | 93, 854, 000 | 89, 641, 000 | 63, 250, 000 | 1948 | 94, 233, 000 | [1] 88, 000, 000 | [1] 65, 000, 000 |

[1] Estimated.

| | 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 |

Senator FLANDERS. Mr. Fairless, will you explain to us what causes the difference in this 1948 figure between the 65,000,000 tons of finished products and the 90,000,000 tons of ingots?

Mr. FAIRLESS. Well, there is much scrap that accrues. You start with an ingot of steel and you reduce it to finished products which may be wire or it may be nails or it may be a rail or it may be structural steel. Each one of those products varies so far as the amount of steel used or what we call our practice. The difference between the 88,000,000 tons of ingots and the 65,000,000 tons of finished product is represented right in that scrap figure.

Senator FLANDERS. That is accounted for in the scrap?

Mr. FAIRLESS. That is right.

Senator FLANDERS. Now, I want to ask you a question or two about the possible increasing of steel production. I am not sure that the general impression I have got is right or wrong, but from reading the papers I would assume that perhaps the demand for sheet is rather more insistent than the demand for any other type of finished product. Is that true?

Mr. FAIRLESS. I would have to add plates at this point, along with sheets. I believe that the supply of sheets is more in balance with the production than is the plate production today.

Senator FLANDERS. What are the peacetime uses of plate? Of course, in wartime the heavy shipbuilding production, they went largely into shipping, and what are the peacetime uses of plates? Is that tanks, and so on?

Mr. FAIRLESS. For our railroad-car program, and for construction, buildings and bridges, plates go into a myriad of uses, of course. Also the defense program that we are now undertaking is a large consumer or user of plates.

Senator FLANDERS. Are you prepared to give, without forewarning, any estimate of the amount of steel that would go into a new plate mill, the tonnage?

Mr. FAIRLESS. The plate mill itself?

Senator FLANDERS. Everything relating to it, the structure in which it is housed.

Mr. FAIRLESS. Building just a plate mill itself you mean?

Senator FLANDERS. What other equipment and processes have to go along to build up your plate production or capacity?

Mr. FAIRLESS. Mr. Lawrence—do you mind if Mr. Lawrence would give that? Is it about 8,000 or 10,000 tons?

Mr. B. H. LAWRENCE (vice president, engineering, United States Steel Corp. of Delaware). What is the question?

Mr. FAIRLESS. The amount of steel required, including buildings, to install a new plate mill, a modern plate mill.

Mr. LAWRENCE. Eight thousand or ten thousand tons.

Mr. FAIRLESS. That would be my guess.

Senator FLANDERS. I see. How long does it take from the time you decide to build a plate mill before it gets into action?

Mr. FAIRLESS. Two or three years.

Senator FLANDERS. What is the condition of the builders of plate-mill machinery so far as taking new orders are concerned?

Mr. FAIRLESS. I believe, and I am not too up to date on this, but I believe that builders of equipment such as you refer to are in a position to take on new business and give reasonable deliveries.

Senator FLANDERS. With deliveries which would bring the mill into operation in 2 or 3 years?

Mr. FAIRLESS. That is right.

Senator FLANDERS. What is the situation with regard to continuous sheet mill builders?

Mr. FAIRLESS. I would say largely the same; they represent the same people, generally speaking.

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 not trying to do anything except present the facts. We believe and we have been working on the theory that there is a shortage of steel. 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 FLANDERS. Senator O'Mahoney, do you have any questions?

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.

Senator O'MAHONEY. I am sure that that is right.

Mr. FAIRLESS. You or any other Member of Congress can do so. I think if you would keep in touch with what is going on, you would agree with me that this job is being taken care of expeditiously and in good shape.

Senator O'MAHONEY. What are we going to do about the black market?

Mr. FAIRLESS. The black market disappears just as soon as production and demand for steel get into balance. The United States Steel Corp. is not engaged in the black market, you know that, of course.

Senator O'MAHONEY. I make no such charge.

Mr. FAIRLESS. I make the statement that we are not.

Senator O'MAHONEY. I am willing to accept it. I have no evidence that what you say is not correct, of course.

Mr. FAIRLESS. I only make that statement because I believe that we typify ninety-some-odd percent of the industry.

Senator O'MAHONEY. I think it is probably true that you are not charging what the market will bear, because I think that you probably know pretty well that if you did, it would more rapidly cut down your sales and bring on very much worse situations, but nevertheless here is the record. Here is one industry in agricultural equipment that cannot get enough for its needs except through an inefficient and very costly method.

Mr. FAIRLESS. That will not continue.

Senator O'MAHONEY. Now, what should we do about it—just let it run its course, or should we do something about it?

Mr. FAIRLESS. What would the alternative be, to build a steel plant that would come into production 3 years from now?

Senator O'MAHONEY. That might be one, or another alternative might be to provide compulsory allocation of steel products. That might be an alternative.

Mr. FAIRLESS. What would that cure? You cure the agricultural problem by taking steel away from an equally deserving segment.

Senator O'MAHONEY. If we cannot produce enough to meet the demand, then the argument can easily be advanced that the allocation should be made by public authorities rather than private authorities, because private authorities will make the allocation according to one set of standards and public authorities will make it according to another. Now, that is one possibility.

Mr. FAIRLESS. My dear Senator, the United States Steel Corp. is producing for and distributing to the agricultural industry today more steel than that industry has ever asked us to supply them.

Senator O'MAHONEY. There has been a greater demand, and there is a greater demand for civilian peacetime uses than ever before.

Mr. FAIRLESS. That is right.

Senator O'MAHONEY. I do not know what percentage of the entire steel output now goes to Government.

Mr. FAIRLESS. It is very small.

Senator O'MAHONEY. Well, I have seen statistics showing that it is up to about 10 percent.

Mr. FAIRLESS. Oh, no.

Senator O'MAHONEY. How much?

Mr. FAIRLESS. Steel—of course, you have to be very clear as to what the question means. Now, we ship steel, and when we say sales to the Government we are talking about direct sales to the Government, and when we sell steel to General Motors and they make a truck and that truck goes to the Government, we cannot follow our steel through that sort of sales, but our sales to the Government today are certainly less than 1 percent, and I would estimate about half of 1 percent.

Senator O'MAHONEY. That is of the United States Steel Corp.?

Mr. FAIRLESS. That is correct.

Senator O'MAHONEY. However, assume that to be the fact for the entire industry, and then it means that more than 95 percent of the output goes to the civilian economy, and it is not enough.

Mr. FAIRLESS. Today it is not enough; that is right.

Senator O'MAHONEY. Do you think that this civilian economy demand is going to fall so that you cannot have and should not have—I am speaking of the industry now and not United States Steel—a broader program of expansion than you do have?

Mr. FAIRLESS. I think two things are going to happen. I would think the demand, 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.

Senator O'MAHONEY. Why is the demand not going to continue?

Mr. FAIRLESS. That is one thing that I believe will happen, and is happening, and the other is just what I have quoted, we are increasing our production of steel products, and materially so.

Senator O'MAHONEY. Why do you think the demand will not continue?

Mr. FAIRLESS. Because I see signs of it. I don't believe that you are up to date on the agricultural industry.

Senator O'MAHONEY. Personally I am not up to date at all. I am just telling you what the report of the Small Business Committee was, and there is no personal application here.

Mr. FAIRLESS. I understand that thoroughly.

Senator O'MAHONEY. Do not blame me for not knowing as much about the industry as you or Mr. Voorhees do. I am asking questions in order to find out.

Mr. FAIRLESS. I just received a note from our commercial vice president, who is in touch with this problem daily, and his note reads as follows:

> Agricultural industry rapidly coming in balance.

Senator O'MAHONEY. That is a conclusion, and we might put that vice president on the stand and get a lot of information from him, but that is merely a conclusion that he has reached.

Mr. FAIRLESS. It is our business to watch this.

Senator O'MAHONEY. Then, do you say that the black market is disappearing?

Mr. FAIRLESS. I do not make the statement that it has entirely disappeared.

Senator O'MAHONEY. In what respect is the demand decreasing?

Mr. FAIRLESS. What is that?

Senator O'MAHONEY. In what respect is the demand decreasing?

Mr. FAIRLESS. I cannot give you figures, Senator.

Senator O'MAHONEY. Well, in what lines is it decreasing? Your vice president says in his note to you that the agricultural equipment industry is rapidly coming into balance. The first 6 months of 1948 it was getting 17 percent as against a little over 6 percent in 1947 according to the Small Business Committee, so that is a very good change.

Mr. FAIRLESS. That is your measuring stick, but now I will tell you our measuring stick. Here is a customer, just as an example only, and he has been getting 1,000 tons of steel per month, and he was asking and demanding 2,000 tons or 3,000 tons, and he was very much dissatisfied, and today he is satisfied with the 1,000 tons that he is getting. Do I make my point clear?

Senator O'MAHONEY. He is more nearly satisfied, but not quite.

Mr. FAIRLESS. Now, we see signs all over this country cropping up here and there in all products and in many industries; not every industry; in some industries the pressure is still on just as great; we see signs, but I cannot give that to you in some table or some definite statistics. I can only give you the benefit of our experience.

Senator O'MAHONEY. I thought that you might be able to give it to me in categories of use. Now, some of the industrialists and economists who talk with us or testify to us, some of the experts of the United States Chamber of Commerce, for example, say that soft spots are developing in the consumer trades, that inventories in certain lines are not moving as rapidly as they did. There is a great deal of complaint about the Christmas trade in the department stores. I have heard some say that we are falling away below last year. I have heard others say that this is due to the extraordinary mild month of November and early December, and that perhaps it will pick up now, but in any event we are told that with certain commodities we are being priced out of the market; but we were also told that so far as the durable industries are concerned, the demand is still high. Now, you tell us——

Mr. FAIRLESS. I tell you the same thing.

Senator O'MAHONEY. You tell us that with respect to the durable industries, the demand is lessening.

Mr. FAIRLESS. I will repeat what I said. It is still high. It is still very high, and it is still beyond our ability to produce at the moment, but there are signposts which we follow very closely that indicate that we are approaching, and not too far distant, that time.

Senator O'MAHONEY. Does not that mean that supply and demand are coming into balance, that demand is falling?

Mr. FAIRLESS. What you are telling me affects the steel business, your so-called soft business, steel is affected there.

Senator O'MAHONEY. Mr. Fairless, we are not engaged in an argument. I am trying to find out.

Mr. FAIRLESS. What do you want me to tell you that I have not told you?

Senator O'MAHONEY. Here are the facts as I get them: We are being told in the consumer goods field, soft spots are developing. Now, you tell me that with respect to steel, supply is catching up with demand, or demand is falling to meet supply. Your vice president hands you a paper and he says that the agricultural equipment industry is coming into balance, which I take to mean that the demand for steel by that equipment industry is being supplied by the steel industry to a better degree and not by the gray market. I assume that that is what he meant. So, the question is, are we going to sit here and see this demand gradually fall and fall and fall, or are we going to take action which will maintain the demand, because on every hand you find that there are many evidences of popular desire for things which are not being supplied, but you find also that because of inflation people are finding their needs outrunning their income. Shall we just wait?

Mr. FAIRLESS. I have a little difficulty following on which side of the street you are on.

Senator O'MAHONEY. That was your mistake, you see. You just assumed that I am on some side of the street.

I know the side of the street on which you are, Mr. Fairless. That is very clear.

Mr. FAIRLESS. I think that I am with you.

Senator O'MAHONEY. I am here trying to find out some facts, and then I will make up my mind. Of course, you think my mind is made up before I come here.

Mr. FAIRLESS. Oh, no, no.

Senator O'MAHONEY. All right, then.

Mr. FAIRLESS. I am just as anxious or more anxious to talk to you than you are to talk to me.

Senator O'MAHONEY. You cannot imagine how I just long for these conversations.

Mr. FAIRLESS. I thought we started to discuss what was being done to overcome the present shortage of steel, and that is what I thought we were talking about. Now apparently we are talking about what should be done to prevent the demand for steel falling off.

Senator O'MAHONEY. Because you said in your statement, "Nor is there any proof that the demand will continue indefinitely at the present pace"; and all I am trying to determine is whether or not the steel industry is setting its sights to accord with a falling market, and whether or not the Government of the United States should form its policies in a manner designed to keep purchasing power and demand up.

Now, that is the problem that we are confronted with, sir, and I do not have to be on any side of the street except that which is best for all of the people of the United States, including the steel industry.

Mr. FAIRLESS. That is the side I am on.

Senator O'MAHONEY. But I do not like to see a lot of businessmen and a lot of people scattered throughout the country and in my State lacking these commodities which they now can use, but which they cannot use if prices go too high or if production facilities are not available. Now, there is our problem.

Mr. FAIRLESS. It is our problem, too.

Senator O'MAHONEY. Have you any suggestions to make on that?

Mr. FAIRLESS. I have just made them. I will put them in writing if you would like to have them.

Senator O'MAHONEY. I did not quite understand whether you wanted us to sit still and let the steel industry handle this itself, or whether Government should take any action at all.

Mr. FAIRLESS. My testimony stands.

Senator O'MAHONEY. We will let it ride at that, Mr. Fairless.

Senator FLANDERS. Congressman Wolcott?

Representative WOLCOTT. I have no questions.

Senator WATKINS. Mr. Fairless, you started to say something about signposts, and I think that you were interrupted and I never did get the answer about the signposts that you said you could see.

Mr. FAIRLESS. It is just what I have been discussing, Senator Watkins. I have not some formula that just lays out how much the demand for this product and that product is receding, but just the very things that you pick up here in the testimony, what you read in the papers daily.

Senator WATKINS. Could you be more specific on what these signposts are?

Mr. FAIRLESS. It is the lesser demand from the people who buy steel from us, the people who use our product, that is where we get our information.

Senator WATKINS. Of course, some people have in mind that during the war we had an accumulated demand for commodities that use steel, an accumulated demand increased to the point that it has not even been filled yet since the war.

Now, is it your theory that when that demand has been taken care of, the accumulated demand, that we will not have as big a demand as we now have for steel products? Is that one of the signposts?

Mr. FAIRLESS. That is my opinion, yes, obviously, certainly. You take any user of steel, fabricator of steel, whose business is suddenly multiplied two or three or four times; obviously he requires a larger inventory as well as larger shipments of steel to carry on that production.

Now, once he gets his inventory in balance, then you overcome one phase of his difficulty, and then you have only his current needs to take care of. We call that "filling the pipe line." You don't get any oil out of the pipe line until the pipe line itself is filled, and then you get out what you put in.

Senator WATKINS. There seems to be a theory stated to the committee that the demand for goods, steel goods, will increase and really overcome any filling of the pipe line. In other words, you will have an increased demand for commodities that will take care of any lessening demand by the filling of the accumulated orders.

Mr. FAIRLESS. I am not predicting a falling off in steel production or the use of steel. I am only predicting that we are going to recede somewhat from this present very high unrealistic demand. That is purely the prediction that I am making.

Senator WATKINS. You do think it is unrealistic?

Mr. FAIRLESS. Of course it is, in my opinion.

Senator WATKINS. Can you add any other reasons to the point I mentioned?

Mr. FAIRLESS. Well, everyone will arrive at his own conclusions.

Senator WATKINS. We were informed the other day that even the increase in capacity of the steel plants would not bring greater production. Do you agree with that?

Mr. FAIRLESS. I would like to read these figures, and you have them, and you just need to look at them. It says finished products shipped in 1941—60,000,000; about the same for 1942. And then we come up to 65,000,000 in 1948, which is our estimate, and we predict 68,000,000 tons of shipments for 1949.

Now, I claim that that is a very fine record of something that is being done to take care of the demand.

Senator WATKINS. I agree it is a very fine record, and I am trying to find out if the increase in capacity—there has been some talk of the Government doing a little job of building to increase steel capacity. Now, a witness told us the other day, a steelman, that even if we had greater capacity we would not get greater production, because of the lack of raw materials, particularly the type and kind needed for the making of steel.

Mr. FAIRLESS. You don't get more steel by just building a steel plant. You don't get more steel that way, unless that steel plant is backed up with raw materials available in the proper quantities and qualities, all of which I said in my statement.

Senator WATKINS. Could you be more specific about the raw materials?

Mr. FAIRLESS. Yes; I will be more specific.

In your own State, where we have an operation, because of the quality of the coal involved there, and by comparison, metallurgically speaking, with coal that our operators have been accustomed to using, it has taken us some time to get up to near capacity of those blast furnaces out there. They are not there yet, but they are more nearly there; with the result that Geneva is producing more steel, and it will produce more steel in 1948 than it did in 1947, and it will produce more steel in 1949 than it did in 1948. There are no new facilities that have been added, and it would not have produced any more steel had facilities been added because they would not be in production now, nor would the raw materials have been available.

Senator WATKINS. That is by reason of the ability to use the knowledge or the knowledge to use the materials that they have?

Mr. FAIRLESS. And in addition, there is more productive capacity being built, as I have pointed out. Some companies are going one route in the industry and others are going another route, and some are doing both. We are going both routes. We will add 600,000 tons, and bring in 600,000 tons of new steel production next year.

Senator WATKINS. I think that your statement answers my question. That is all.

Senator O'MAHONEY. I would like to ask one more question.

Mr. Voorhees, in response to my inquiry—and I think you could elaborate on this answer, Mr. Fairless—stated that in 1929 the peak production, that was the prewar peak of the United States Steel, was approximately 24,000,000 tons of ingots. You stated that in 1947 it was 28,570,000, and in 1948 you are running at approximately the same rate, about 29,000,000 tons of steel production.

Now, do you estimate that the business of United States Steel is going to remain stationary at 29,000,000 tons, or going to fall back to the record of 20 years ago or 24,000,000 tons, or is it going lower?

Mr. FAIRLESS. Senator, you have inferred that the United States Steel Corp. is too big.

Senator O'MAHONEY. I have made no inference or implication at all.

Mr. FAIRLESS. Yes, you have.

Senator O'MAHONEY. Not at all. I do not intend to.

Mr. FAIRLESS. Then I misunderstood you.

Senator O'MAHONEY. Certainly you misunderstand me. I am trying to find out how you set your sights. You tell us that we have got practically enough capacity; and now I say your testimony this morning is that in 1929, your peak production was 24,000,000 tons, and now your peacetime peak is only 5,000,000 tons greater. Is that the measure of your faith in the growth of America?

Mr. FAIRLESS. No, that was our desire not to become too large a segment of this great industry. The industry has grown to a greater extent than we have, and we are following your philosophy.

Senator O'MAHONEY. Good, that is a great compliment, sir. If I thought the United States Steel Corp. was following my philosophy, I would feel very happy, indeed.

Senator WATKINS. Your philosophy relating to monopolies, is that right?

Senator O'MAHONEY. No, the United States Steel is following the philosophy that it never should grow so great as to have more than 40 percent of the entire market for steel in the United States.

Mr. FAIRLESS. Oh, no.

Senator O'MAHONEY. What was the peak production prior to the war of the entire steel industry?

Mr. FAIRLESS. You have it right there in front of you.

Senator O'MAHONEY. I know that the figures are there, but I have to go through a number of pages, and I thought you could put your finger right on it.

Mr. FAIRLESS. Do you want to start in 1901?

Senator O'MAHONEY. You gave me the peak for United States Steel, and you have got this at your tongue's end.

Mr. FAIRLESS. Well, in 1919 it was——

Senator O'MAHONEY. 1929 ought to be about the peak. What was the steel industry's production of steel ingots in 1929?

Mr. FAIRLESS. It was 71,000,000 tons, but the industry's capacity was almost 73,000,000 tons in 1930.

Senator O'MAHONEY. Give me the 1929 figure again.

Mr. FAIRLESS. No, I beg your pardon, that is wrong.

Senator O'MAHONEY. 1929 was the peak?

Mr. FAIRLESS. You are talking about capacity or production?

Senator O'MAHONEY. 1929 production.

Mr. FAIRLESS. Well, in 1929 the total industry produced 63,000,000 tons.

Senator O'MAHONEY. What did it produce in 1947?

Mr. FAIRLESS. It produced 85,000,000 tons, or almost 85,000,000 tons.

Senator O'MAHONEY. It produced practically 22,000,000 tons more.

Now, my question is: For the entire steel industry, are we going to fall back to the 1929 figure of steel production, or to some other figure, or is there any possibility of our maintaining the same production that we have reached since the war if we permit America to expand, if we build the great projects that are needed out in the West to furnish opportunities for new business? The Colorado-Big Thompson project, which all of the people of northern Colorado are begging for, is being delayed because of the lack of steel, I am told by the Small Business Committee. Other projects in the West, power projects and others, are being delayed for the lack of steel.

Now, shall we forget those, or shall we have the private steel industry set its sights at a figure that will accommodate the needs of the people of America?

Mr. FAIRLESS. That is exactly what we are trying to do, and what we are doing.

Senator O'MAHONEY. Are we going to fall back from $85,000,000?

Mr. FAIRLESS. The United States Steel Corp., Senator, would not be spending $900,000,000 for betterments if it had any idea of going backward in the steel business. That is some real money, and that is not just conversation. We are spending that much money, which I think clearly indicates our faith in not only the future of the steel industry but in the future of the United States of America.

Senator O'MAHONEY. You tell us the demand is going to fall off, and in response to Senator Watkins you said the present demand is unrealistic. And now, is it unrealistic measured by the capacity of the people of America and their demands and their needs?

Mr. FAIRLESS. I have given you the opinion which you asked for, and why argue with me when I give you an honest opinion?

Senator O'MAHONEY. I do not want to argue with you. I am just trying to emphasize that you think that that demand is unrealistic.

All right, Mr. Chairman.

Representative WOLCOTT. As I have been listening to this, it seems to me that some of the confusion arises from the fact that you expect that the ingot production in 1949 will be about 4,000,000 tons greater than 1948, and yet there are these soft spots.

Now, in summarizing the whole thing, I think that we should take cognizance of the fact that there are some soft spots in the demand for steel, but that your total demand will be sufficient to absorb all of your proposed increased production; is that not what we are getting at?

Mr. FAIRLESS. For next year?

Representative WOLCOTT. Yes, and probably more than that.

Mr. FAIRLESS. I don't think that there will be any fall-off next year in the percent of operations.

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—quite the contrary.

Senator FLANDERS. If there are no further questions to be asked, Mr. Fairless, you will be excused.

Now, I believe Mr. Olds has a statement to make; and I prefer, if you do not mind, Mr. Olds, that you wait until Senator O'Mahoney has returned.

Mr. OLDS. I can assure you what I have to say will be very brief, Mr. Chairman, and only addressed to the one point you referred to me earlier this morning——

Senator FLANDERS. We will wait just a moment, and then we will proceed.

All right, Mr. Olds, will you give us your name and position for the record?

## STATEMENT OF IRVING S. OLDS, CHAIRMAN OF THE BOARD OF DIRECTORS OF THE UNITED STATES STEEL CORP., NEW YORK, N. Y.

Mr. OLDS. My name is Irving S. Olds, and I am chairman of the board of directors of the United States Steel Corp. My office is at 71 Broadway, New York, and my residence is at 141 East Seventy-Second Street, New York.

Senator FLANDERS. You may proceed.

Mr. OLDS. Mr. Chairman, during the testimony of Mr. Voorhees you referred to a statement made by an earlier witness in which he attributed to me a certain statement. I should like to clear up the record to the extent of having included in the record what I did say.

In the first place, I think there were perhaps two witnesses before this committee who made reference to this alleged statement of mine. I am not familiar, except to the extent that you made mention of it this morning, as to what the witness you referred to did say. I did read, however, what another witness said when he quoted what he said were my remarks, and paraphrased those remarks by saying that I had said that a depression was inevitable.

Now——

Senator FLANDERS. Will you excuse me a moment? May I just read this again? It says, "Quoting him"—and that is quoting yourself, and this paragraph is in quotation marks and I will read it:

> Operations are at an all-time high. Profits should be sufficient to enable a fair return to be paid to the owners of business in the form of dividends, and also to permit an adequate amount to be set aside for future needs, since the day will come when steel operations are at a lower rate than at the present time.

Mr. OLDS. The statement which you have just read is a part of the statement which I made. That particular witness put together various sentences and did not give my complete statement, which is very brief. I should like to read it for the record. But what I am particularly concerned about it the paraphrase that another witness made of that same alleged quotation, where he said that I had said in substance that a depression was inevitable. What I said was not contained in the annual report of the Steel Corp. for the year 1946, but was said by me at the annual meeting of the stockholders of the Steel Corp. held at Hoboken on May 5, 1947. I hold in my hand a printed copy of my remarks at that meeting. What I said was this, and it doesn't differ, perhaps, in substance from what you have read:

> When United States Steel is operating at high rates of production, as has been generally true for a long time past, except for interruptions resulting primarily from labor difficulties, the profits of the corporation should be sufficient to enable a fair return to be paid to the owners of the business in the form of dividends, and also to permit an adequate amount to be set aside for future needs. All of us should realize that we cannot expect to have continued indefinitely the present flow of business permitting near capacity operation of most of the corporation's facilities. The day will come when steel operations are at a lower rate than at the present time.

Now, I submit that no fair interpretation of my remarks can justify a statement that I predicted a depression.

At that time, in May of 1947, our operations were approximately at full capacity. I think our operating average rate for the first quarter of 1947 was 98 percent of full capacity. We knew that the demand which we then were experiencing came in large measure from the pent-up demand that resulted from the war when many consumers' products, to mention automobiles as a notable example, could not be had.

Now, we also knew from past experience that we have had many years when our operations were relatively much lower than 98 percent. Still, no one can fairly characterize those years as having been depression years.

At a meeting of the stockholders, it seems to me it was a part of my duty to point out to them that the then present earnings and present high operations were the result of wartime conditions, and it was something that they could not expect to continue indefinitely.

That is all that I have to say, Mr. Chairman.

Senator FLANDERS. Senator O'Mahoney?

Senator O'MAHONEY. I have no questions.

Senator WATKINS. I have no questions.

Senator FLANDERS. You are excused, sir.

This session will be adjourned, and we will meet again this afternoon in this room at 3 o'clock. We have asked Mr. Montgomery of the CIO to return at 3 o'clock in this room.

Thank you very much.

(Thereupon, at 1:15 p. m., a recess was taken until 3 p. m. of the same day.)

AFTERNOON SESSION

(Whereupon, at 3:10 p. m., the subcommittee reconvened.)

Senator FLANDERS. The hearing will come to order.

We have asked Mr. Montgomery to return again to the table.

I do not think that you need to go through the rigmarole again of identifying yourself, because you are already sufficiently identified.

## STATEMENT OF DONALD MONTGOMERY, CHIEF OF THE WASHINGTON OFFICE OF THE CIO

Mr. MONTGOMERY. I appreciate this opportunity for a return engagement. I do not know yet what it is to be about, but I am armed here as well as I can contrive.

Senator FLANDERS. I think that you are entitled to know what it is about, and you doubtless heard this morning my passing on of some of your questions to the United States Steel Corp.

You shot quite a number of figures at us, Mr. Montgomery, in your testimony, and I want to return to some of the figures.

One of your figures, which you gave with some hesitation, is this one. You say here:

> As I remember the figures—

we were speaking of the distribution of income—

> As I remember the figures, about 70 percent went to those above $5,000 income.

Now, that question of income distribution is one which has interested me a great deal. While I was chairman of the research committee of the Committee for Economic Development, I tried to get a project set up for getting a good study and report on the distribution of income. It is very important.

When we were discussing the housing bill in the first session and the second session of the Eightieth Congress, as perhaps you know, I supported public housing; but all of the time the thing which fundamentally worried me was: Why are there so many people with such low incomes that they cannot afford to pay economic rent? It seemed to me that we ought to know more about who they are, and how many there are, and what kind of industries they are working in, and where they are, and what is the cause for these unsocially low incomes of people who cannot pay their way.

I have had no success in finding out very much about these people. The only figures which I have been able to get, aside from figures on taxable income—which is another thing and which is, of course, available in the records of the Department of Internal Revenue—are some recent studies of the Federal Reserve Board. I do not know the process by which they are assembled, but I assume that it is done with some statistical competence. They report that, using $5,000 a year as the separation point, 60 percent of the income went to people below $5,000 and 40 percent went to those above.

I asked for the figures for $10,000 incomes, and was told that that was not available, but that they did have the $7,500-income basis. Those above $7,500, on the basis of that calculation, received 24 percent of the income, and those below $7,500 received 76 percent.

I am sorry that we do not seem to have available more extensive or better figures, but those were the best that I was able to get; and I am sure that you will be glad to get those figures, in view of what you said in your testimony, because it does make a difference in many of the things we are discussing.

The next thing that I wanted to take up with you, that I thought we ought to take up with you, is the figures for the four automobile corporations, and I wish again to call your attention to the relationship between business profits and the fiscal problems of the Government, because we do have to take those into account.

Using the quarterly basis, figures which you gave showed profits before taxes in the third quarter of $270,887,000, and profits after taxes of 152 million dollars, approximately, leaving a return to the Government in taxes of 118 million dollars.

Now, on your suggestion that those profits might be reduced to 69 million dollars by raising wages or lowering prices or by other means, that would leave profits after taxes—and I am making the assumption that the ratio of taxes to profits remains the same, to the extent that real-estate taxes, of course, are included in this, and that would not be the case; but I have no other basis than assuming that the ratio remains the same. On the proposed reduction of profits to 69 million dollars, on that basis, there would be a tax return to the Government of 30 million dollars and profits of 39 million dollars. The profits before taxes would be reduced to 201 million dollars, and the tax return to the Government would be reduced 88 million dollars, and the net after taxes would be reduced by 113 million dollars.

Now, you can raise questions, any of us can raise questions as to the adequacy of a remainder of 39 million dollars in profits. That has to be judged in connection with the testimony of these men from the automotive industry, and they make a prima facie case, particularly in view of the fact that they borrowed money, for a necessity for profits of this order, of the order of 152 million dollars.

But now let us forget that for this purpose, and look at this loss in taxes as a result. To lose, from this proportion of the total Nation's business, 88 million dollars in taxes per quarter is fairly serious. It is not merely fairly serious but it is tremendously serious, if we employ the same yardstick to business as a whole. It makes our fiscal problem impossible of solution without such a drastic cut in expenses as would affect not merely such things as national defense but would affect veterans' benefits; it would affect the social services which the people of the country have become accustomed to and which are due them. It would affect a great many things which we are not willing to cut down.

It strikes me that, in any suggestions that you make, you will have to keep the fiscal necessities of the Government in mind. It may well be that you have given this matter thought and feel prepared to tell us where, in this case, the 88 million dollars per quarter is coming from.

I suppose that probably is the longest question that has ever been asked anyone who has appeared before a congressional committee, and I apologize for its length.

Mr. MONTGOMERY. Well, Senator, on Friday afternoon, I tried to make clear to Congressman Herter, when he was discussing that table with me, that the table was not made as a recommendation that this be done; that is to say, we know perfectly well the automobile industry is not going to reduce its profits to a point where it makes an 8-percent return on investment. They have lived in a much higher level than that for so long it would be fantastic to expect them to go there, unless depression forces them to go there or below. The table is drawn up to show what is the relationship between profits and wages and prices.

We think that the relationship between those three things is perhaps the key factor in our economy. We all have to keep our eye on it, and this table was to show what is the nature of the relationship between those things, with these four automobile companies.

Now, if there is a reduction in automobile-company profits, a substantial reduction, as we think there should be, and have that reflected in reduced prices or increased wages, or both, certainly the loss in taxes that you refer to in the first place will not be anything like the figure you speak of, because the reduction in profit will not be so great. But it is not a net loss. This income is not going to disappear. It is going to be paid out in increased wages; and, if so, it is going to increase the taxes that you are going to get from people.

The purpose, from our point of view, of any such reduction is so that purchasing power of people shall be increased. If the purchasing power of people has increased, your source of taxes for Federal taxation is increased, both income and the excise taxes that you are levying.

There is one further point. While there might be an apparent reduction in taxes to the Federal Government by such a reduction in profits, if, as we believe, the current high-profit rate is threatening the continuation of profits and employment, then this current high rate of profits, while it is producing high taxes now, is threatening the future tax base to the Federal Government. It is not only the profits this year that must be considered, but what is the present profit rate and tax rate, if you like, doing to the future prospect of a continuing base for Federal taxes out of corporate income.

The same question arises, I think, with the proposition the industry has been putting up to you all week, and which we heard so preposterously advanced this morning, that you should stop taxing this part of their profit which they say is necessary to provide replacement cost of their fixed capital. What they are arguing for there is that you forgive them taxes on this additional amount of money, and it will be some 53 million dollars for this year in the case of United States Steel Corp. They want you to forget that much profit when you are levying taxes on them.

You are concerned with taxes. I hope that this will make you equally concerned with the soundness of this proposition which the corporations have been putting up all week: the proposition which I would like to address myself to, if you will permit me, after hearing this morning's testimony.

Senator FLANDERS. I think it is only fair that you should do so, after we clear up the questions I had in mind to take up with you.

Mr. MONTGOMERY. Thank you, sir.

Senator FLANDERS. Now, you say very properly that the loss of this 88 million dollars per quarter is not a net loss, because some of it will be recovered in income taxes and excise taxes from consumers.

You would not say, would you, that anything except a very small part of that 88 million dollars would be so recovered?

Mr. MONTGOMERY. I don't have any estimate of how much it would be. There might be a great deal more than 88 million dollars involved in possible recovery in the other point that I make: that, if this present policy is spelling trouble as soon as the extraordinary Government expenses come to an end, there is a lot more than 88 million dollars at stake.

Senator FLANDERS. You recognize that the percentage of tax relief in the wage earners is very much smaller than the percentage of tax recovery on the part of corporations; so, on the face of it, it would seem that recovery by that means would be quite small, comparatively.

Mr. MONTGOMERY. But there are a great many of them.

Senator FLANDERS. But there is no more to tax than what they get out of this.

Mr. MONTGOMERY. They are not taxed at the 40-percent rate, of course; that is obvious.

Senator FLANDERS. Now, as to getting it by increasing other taxes—as, for instance, by increasing the sums laid aside for replacement beyond that which the Government allows—you still cannot recover, it seems to me, anything more than a small part of that 88-million-dollar loss, because, under the example we have been discussing, all that the companies have left is 39 million dollars; and you surely would not want to tax away all of that 39 million dollars in the effort to get back something less than half of the taxes that the Government has lost in the process.

Mr. MONTGOMERY. Well, if the Government has the need for more Federal revenues and taxes, our recommendation would be, No. 1, that you restore the tax cut that you made last year and recover $4,800,000,000 from income taxes. How much more you might recover by doing away with this privilege of splitting incomes between husband and wife, I do not know; but probably it would be considerable.

Senator FLANDERS. We cannot change part of that. That is, in the States which have the community-property tax, that has to stay as is.

Mr. MONTGOMERY. I have heard it suggested that perhaps you can. The solution to that problem always seemd to be assumed that the Federal Government can only fall in line with the States for the purpose of Federal taxes. I am not convinced that that is so, and I don't think it was even seriously considered by the Eightieth Congress that they might have adjusted that inequity as between different States by adjusting it in the right direction instead of in the wrong direction.

Senator FLANDERS. You would be willing to restore the old tax bill complete?

Mr. MONTGOMERY. That is correct. We were strongly against the cut last year, and we think it ought to be restored.

Senator WATKINS. Even the cuts for those who were taken off the tax roll completely?

Mr. MONTGOMERY. We think income tax is a good tax, and we are very much disturbed by the discussion of the need for excises, once these income taxes had been cut.

Senator FLANDERS. Do you mind my agreeing with you completely on that point of view?

Mr. MONTGOMERY. Yes; I think that you and I agree on many things.

Senator FLANDERS. I think we made a mistake on the tax bill. I voted for it on one of the very rare occasions in which I voted for the sake of party regularity. I regretted it while I was doing it, and I have regretted it since. And I also agree with you that excise taxes—I suppose you take the position that I do—are grossly unfair in that they tend to fall heaviest on those least able to pay for them.

Mr. MONTGOMERY. That is correct.

Senator FLANDERS. Do we agree on that?

Mr. MONTGOMERY. Yes. That, in fact, is the virtue claimed for them by the National City Bank in one of its letters, that taxes, to be sound, must rest on the broad base of the people. It is perfectly clear what they want; they want a sales tax.

Senator FLANDERS. Well, we are getting on pretty well.

Senator WATKINS. In what direction?

Mr. MONTGOMERY. In our direction.

Senator FLANDERS. I want to suggest to you, and the men associated with you, something which I am not sure that you need my suggestions on. I think probably they are already in your minds. Organized labor is now the most powerful political force in the country. I say that because if I have read the press correctly, you admit it yourselves. Do you think that that is a fair statement?

Mr. MONTGOMERY. I think that we have been generous and want to share credit with a lot of others, especially the farmers.

Senator FLANDERS. Yes; the two of you together certainly are.

Mr. MONTGOMERY. I don't think labor put Iowa in the Democratic column, for example.

Senator FLANDERS. I think that you will have to recognize that that was turned over by the farmers.

Mr. MONTGOMERY. We helped.

Senator FLANDERS. The suggestion I am making is not made in view of any criticism of the past, but just in view of the new power of organized labor, which seems to me to carry with it very serious new responsibilities. It seems to me, at least, that if labor and Government, let us say, or better, labor, industry, and Government, or better yet, labor, agriculture, industry, and Government, can look at the whole problem together, we can arrive at some measure of statesmanship. I am not so much concerned with the negotiations, say, so far as labor is concerned, of organized labor with any individual company, as I am with looking at things along the broader lines of this particular illustration which I have just brought to your attention this afternoon. You do have to consider, organized labor has to consider, industry has to consider, agriculture and the Government have to consider, the relation of the Government's fiscal problem to all of the questions which these groups have to determine on, in determining their own long-range personal interests.

It seems to me that if we can, in joint conference such as was proposed earlier in these hearings, approach the broad elements of the thing, and get those pictured in some sort of a way, then we will have a background as a foundation on which to negotiate our smaller elements of the thing for which each of us is responsible. And I must say that I took the liberty of calling you back and bringing up perhaps somewhat unfairly these figures that you presented, just because I did want to make that point and make that suggestion, and I am not sure that it is necessary to make it, but I wanted to make sure that it did not go by default.

So that was fundamentally my purpose in calling you back, Mr. Montgomery.

Mr. MONTGOMERY. It seems to me, Senator, I remember your making a speech, I think in Michigan, in which you stated a lot of these decisions that are made affecting prices and profits, and so on, are not literally private decisions because they affect everybody so directly and so immediately they must be looked upon as public decisions.

Senator FLANDERS. I have said that.

Mr. MONTGOMERY. We, too, have said it over and over again, and we believe it, and we think means should be worked out whereby the big major decisions affecting the whole trend of the economy and the chance of continuing full employment are public decisions and should be dealt with in a public forum.

Senator FLANDERS. You see, in this you are not committing me to saying the same thing about the day-by-day negotiations. I am saying this about the background against which those negotiations must be considered.

Mr. MONTGOMERY. That is what we mean, too, sir.

Senator FLANDERS. Congressman Wolcott?

Representative WOLCOTT. I have no questions.

Senator FLANDERS. I am sorry you have not been here, Senator O'Mahoney. We have had a very pleasant session.

You asked if you might make some reference to the testimony this morning, and I said having called you back, we should permit you to.

Mr. MONTGOMERY. I want to speak with reference to the whole problem that has come before you this week in the statements made by these corporations about their profits, and the necessity of getting out of their profits the depreciation at replacement cost.

I want to call your attention again to the fact that the Institute of Accountants have a committee which has considered this question, and in December of 1947 issued that research bulletin in which their opinion was set forth very carefully and fully. I certainly would urge this committee to get the people who can speak for that institute or for that committee to come before this committee and state their position in the matter.

I would like particularly, and I think it would be helpful to the committee, if they would take the statements you have received this morning from the United States Steel Corp. and examine those claims and arguments in the light of what they found to be the case.

I just want to point out a couple of other things that you don't have to be an accountant to see, in what we heard this morning.

First is the obvious point which I think that you made, Senator Flanders, that while they now say, "We must adjust our depreciation reserves because prices are rising," they agree that they didn't make any such adjustment in the opposite direction during the thirties when the costs of replacing their equipment were falling. If they had, the result would have been to reduce the depreciation charge in a given year and to increase the apparent profits they received in those years. If they had been required to do that to be consistent with what they are now saying, they then would come back and say, "Look, you are taxing profits which we really haven't earned, just paper profits created by this reduced depreciation charge that you say we have got to make."

If they can make this adjustment they are making now on the up side, they certainly should make it on the down side.

Senator O'Mahoney called attention to these extra depreciation charges by United States Steel during the periods 1941 to 1945, and Mr. Fairless and Mr. Voorhees said that that was the result of accelerated amortization they were allowed on war facilities. If you will take that table and see what the depreciation charge was before and after that period, you will agree that we can assume that $80,000,000 would have been a normal wear and exhaustion figure for those years. Actual figures were $72,000,000 in 1940 and $69,000,000 in 1946. Now, assuming they had a normal depreciation requirement there of $80,000,000 a year, this extra depreciation they charged from 1941 through 1945 amounted to $223,000,000. That is accelerated depreciation which they received actually at the expense of the general taxpayer.

Now, with that $220,000,000 bonus under their belt only so recently as 1941 to 1945, they come in and say they need $26,000,000 additional depreciation in 1947 to meet replacement costs, and they need $53,000,000 in 1948 to meet replacement costs.

Just as a matter of arithmetic, they don't make a convincing case.

It might also be pointed out that they got the Geneva steel plant at 20 cents on the dollar, at 20 cents on the dollar of cost. I dare say the plant isn't worth today dollar for dollar what the Government paid to put that plant there, but there is certainly very large additional amounts of depreciation reserve they have tucked away in that plant.

Then there was discussion also this morning as to what is replacement. If you are going to charge depreciation on the basis of replacements, what is that? We have in the auto plants now these long machines where you put a cylinder block in at one end and it comes out the other, and in between nobody has seen it, but all of the machining and drilling and tapping has been done on that automatic machine all the way down the line.

Let us say it replaces four or five or six specialized individual machines that did that work before. Then when the specialized machine wears out, what is the replacement of that machine that you should provide for by these accounting things?

Senator FLANDERS. I think it has been generally agreed in the discussion, although not so clearly brought out this morning, that the proper basis for depreciation is on equivalent productive capacity and not on unit for unit.

Mr. MONTGOMERY. What is equivalent productive capacity? Does the machine turn out the same unit now as it did when it was bought? Even units change, and the accountants point out if you go into this sort of thing, you get into a conjecture that leaves your profit figure with very little significance.

Senator FLANDERS. It is a conjecture which in some form the accountant has to make. There is no escape from making some sort of provision for depreciation, if the company expects to stay in business, so that conjecture has to be made in some form.

Mr. MONTGOMERY. The only conjecture that is ordinarily necessary is the number of years over which you had better prepare to write it off. You may be wrong in that, and you can adjust it afterward, but if you are depreciating on cost, you know what the cost was, and there is no conjecture in the figure there at all.

They are proposing—they backed up exactly what I said Friday afternoon—they are proposing that whereas consumers of the product used to be required or expected, in paying for the product, to replace what the investors had put into the capital equipment, they have now added they must do that, and also provide whatever additional amounts are needed to "replace" that capital, whatever replacement may mean. In the case of United States Steel Corp., for the 9 months, it means we should pay $66,000,000 of cost and an additional $40,000,000 for this elusive replacement figure. Now, they made quite clear in their discussion with you that that is just what they expect the consumers to have to do over and above what they have done and still do under normal accounting practice.

I leave with you the question, if that is to become the practice, and if that is the way corporations are to charge depreciation, then this $40,000,000 extra the consumers have put into United States Steel Corp. this year is reflected by no equity in the hands of the consumers. If we consumers are going to provide them this investment, then somebody has got to find somewhere some means whereby we follow it and have something to say about the thing we have invested in.

Of course, the question also arises in talking in terms of current dollars, as they did, how are they going to pay off the $100,000,000 of bonds on which they borrowed in 1938, if it is not already paid off? Are they going to pay that off in 1938 dollars or in 1948 dollars? And, of course, you know the answer. They are going to pay it off in 1948 dollars.

Senator FLANDERS. The United States Government decided that debts could be paid in flexible dollars.

Mr. MONTGOMERY. Are savings bonds going to be paid off in 1937 dollars?

Senator FLANDERS. They are going to be paid off in the dollars of the period in which they became due. That was decided when the United States Supreme Court said that money was not tied to gold.

Mr. MONTGOMERY. So, then, why do these corporations come in and think that they alone with respect to their investment shall have this guaranty against the fluctuations in the value of the dollar? It seems to me a very preposterous assumption to themselves that they need a very special place in the economy.

Senator O'MAHONEY. Boiled down to 10 words, perhaps, they want to charge prices in inflated dollars but compute profits in the noninflated dollar.

Senator FLANDERS. Now, have you other points that you want to mention?

Mr. MONTGOMERY. I don't think so. I brought a lot of material here on steel needs in case there was a question in your mind about the argument we had made on Friday about the very great need for providing for increased steel capacity. I don't think anybody can express any more pessimism toward the future than was done by Mr. Fairless this morning.

Senator FLANDERS. I would like to make one or two comments on what you have just now said. In the first place, I believe that we had those accountants here. They were both members of the committee which presented those reports, or that report, and we picked them out because they were on two opposite sides of the question, so as to get both sides of the story. However, they both agreed that the problem was a real one; one wanted it expressed in the accounting system, and the other wanted to keep the accounting system conventional and express it in footnotes. I think that we have had those men here.

Mr. MONTGOMERY. Did they submit the statement which that committee prepared?

Senator FLANDERS. The committee has received that statement, and it is in the record, and it is on the basis of that statement that we selected these two men.

Mr. MONTGOMERY. I understood that one of them had disagreed with the report of the committee as to this point.

Senator FLANDERS. He did. He wanted that figure put into the accounting system bodily instead of being handled in footnotes.

Senator O'MAHONEY. But neither one of them suggested a formula by which the proposed depreciation could be carried out.

Senator FLANDERS. The depreciation, no. They admitted that it was very difficult and impossible, so far, to set up a formula for handling depreciation. They did have a formula for the increased costs of inventories. That is the last-in first-out formula.

Now, with regard to the increased set-aside for depreciation, it was my understanding of the testimony this morning that they already had to have that money in hand, that it was not a theoretical thing, that the costs of the new replacements they had planned increased so much for the period of authorization that they just had to have that money and more, too.

Mr. MONTGOMERY. It is this same assumption that the money has to come from the consumers. When they find their replacement costs are great and they have got to modernize their plant or expand, would they expect the consumers to provide that, or are they going to get it from investors or borrow it from life-insurance com. panies who are so eager to lend them money at low interest rates- That is the whole. issue.

Senator FLANDERS. In other words, one of your suggestions leads to saying that if you get it from consumers, we should have some consumer representation on the board? That was one of your suggestions?

Mr. MONTGOMERY. I also expressed an opinion that I thought only the Government was adequate to speak for the consuming public, and I think that their proposition vests a public interest in what these corporations do.

Senator FLANDERS. As I remember, the statement was made this morning that borrowing they felt to be suitable for expansion, but that replacement they felt to be a cost of production. How does that strike you?

Mr. MONTGOMERY. I gather that to be their point of view.

Senator FLANDERS. That is not your point of view?

Mr. MONTGOMERY. Obviously not.

Senator FLANDERS. That is an interesting difference of opinion.

I have no other remarks to make. Senator O'Mahoney, do you have any?

Senator O'MAHONEY. May I make this comment? Perhaps in the nature of a question: To what extent is it to be expected that capital shall be continuously obtained from the consumer in price? When an ordinary business is established, it is established by new capital which represents the savings of some person or some group. That is true whether the business is started by capital which is borrowed or whether it started by savings of the people who started the business. In either event, that capital is a product of savings. Now, all of this theory of depreciation allowances, depletion allowances in the case of petroleum, and all of the others are deductions which Government makes from profit income for one reason or another. Actually, do they affect the profit picture whether those deductions are made or not?

There has been quite a legal conflict as to the difference between allowable and allowed deductions. The courts have disagreed in times past as to what the effect of these deductions are, including depreciation. The question is whether or not, for example, if no profit has been made and therefore the depreciation has not resulted in reducing taxes, it should be carried to some future period when profit is made. But does it not seem that the contention which is being presented to us today on behalf of those who support the position of Professor Slichter, is that new capital must come not from the savings of the business but from the payments made by the consumer?

Mr. MONTGOMERY. That is right. It is "inequity" capital.

Senator FLANDERS. Excuse me a moment. I have hard work making any distinction between the savings of the business and the payments made by the consumers. Are not any savings in business the result of payments made by the consumer?

Senator O'MAHONEY. Yes, of course.

Senator FLANDERS. Then, what is the distinction?

Senator O'MAHONEY. The distinction is that after you have established your business with your savings, then they want a tax system set up which will enable the businessman to restore that capital on an expanding basis, continually from the consumer. In other words, the larger the production and the greater the profit, the greater the return and the higher the price and the greater the expansion; that goes on and on and on; and by that means corporations grow bigger and bigger, and the position of little business becomes constantly more difficult.

Senator FLANDERS. The witness will excuse us for a moment or two. What then is the other process by which a business grows and grows than by the savings in business? I understood that you mentioned two methods, one by the consumer paying for it and the other was by the savings in business.

Senator O'MAHONEY. I don't know that I follow you.

Senator FLANDERS. Maybe I do not follow you. I thought that you mentioned a good process and a bad one. There is no good process then, is there?

Senator O'MAHONEY. Everything is good, particularly when it comes from Vermont, but I said you start a business either with your own savings or with the savings of somebody else.

Senator FLANDERS. That I can understand.

Senator O'MAHONEY. Either you have your own capital to start with or you borrow it from somebody else, and the system that is being presented to us here, it seems to me, is one which is designed constantly to produce expanding capital from the consumer without taking in these new fresh capitals.

Senator FLANDERS. There is no company with whose history I am familiar, and I am talking about intimately familiar and not familiar from reading books or looking at business statements, which has not grown after an initial investment by the process of plowing back earnings. That is the normal process.

Senator O'MAHONEY. Yes; I think it is.

Senator FLANDERS. I am wondering if the customer was not paying for it.

Senator O'MAHONEY. Oh, yes; the customer actually pays for it all, but we are discussing the measurement of profits, and that is what we are discussing, the measurement of profits, and this whole story is being presented to the committee at a time when corporate profits have reached the highest level in history, and our friends who have testified here before us are doing their best to make us believe that these profits are not as great as they seem to be.

The current dollar to which the chairman referred is used by everybody in fixing prices, in paying prices, in every other commercial transaction, but here our friends want to be able to make the computation of profits in a different dollar, a dollar which, so far as anything presented at this committee is concerned, is purely a figment of the imagination. It is not a realistic dollar.

Senator FLANDERS. I think that we are in agreement on the growth by plowing back profits being a normal way in which a business grows. You perhaps can make the point, or at least raise the question as to whether that should be the normal method when a business gets of such size that it has access to an active securities market.

Senator O'MAHONEY. No. You misunderstand me. I have no objection to the plowing back of profits. My objection goes only to the legerdemain by which we are asked to believe that these profits which are plowed back are really overstated profits; and I do not think that they are, because it is demonstrated by the testimony which is presented here that by reason of technological improvements the modern inflated dollar, even that dollar, buys more productivity on the average perhaps than the old dollar.

Senator FLANDERS. So long as we agree on the process, I am not going to raise any question about the name we call it.

Senator O'MAHONEY. I am talking about the measurement of profits, sir, and you are talking about the propriety of plowing profits back. I agree with you on the propriety of plowing profits back, and I hope that you agree with me on the measurement of profits.

Senator FLANDERS. I have an open mind on that matter.

Mr. MONTGOMERY. I wanted to pay tribute to your witness from General Motors yesterday as having added something really new to the economics of profits when he discussed the price of a Chevrolet car in terms of pounds of round steak. Talk about the fluctuating dollar we have been hearing about this morning, I think that he really gave us a good one yesterday. Of course, the price of round steak went up, as everybody knows, because of the shortage of corn in the 1947 crop, but there evidently is not any shortage of corn in General Motors' explanation of Chevrolet prices.

Senator FLANDERS. That, sir; will go in the record.

Have you any further questions, Senator?

Senator O'MAHONEY. No; I have none.

Representative WOLCOTT. I have no questions.

Senator FLANDERS. You will be excused, and I just want to make one observation. I think in fairness that the rebuttal is supposed to have the last word, and so if the representatives of the United States Steel Corp. wish to make a documentary rebuttal, I think that they should be allowed to do so.

This series of hearings is now closed.

(Thereupon, at 4 p. m., the hearing was closed.)

(The following letter from Prof. Seymour Harris to the New York Times is included in the record of the hearings at the suggestion of Senator O'Mahoney, as an addition to Professor Harris' testimony:)

DECEMBER 18, 1948.

ARE PROFITS TOO HIGH?

To the EDITOR OF THE NEW YORK TIMES:

This letter is a reply to criticisms of the New York Times editor of my views on profits as presented to a Joint Congressional Committee on the Economic Report (the New York Times, December 9, 1948). The main issues revolve around the adequacy of profits.

First, I deal with a suggestion in the editorial that although I had concluded profits were too high, I did not tie them to appropriate measures. In my prepared statement, I suggested that it made a substantial difference whether profits were related to income on the one hand, or net worth and sales on the other; and in my oral evidence, I presented for the record the relation of profits to (1) income and (2) sales. Even on the basis of a comparison with income, the index generally used by those disposed to show that profits are not excessive, profits seem too high. Even in relation to 1929, the percentage of corporate profits before taxes had risen from 9.5 percent of gross national product to 12.8 percent in 1947; and profits after taxes declined only from 8.1 to 7.8 percent. Incomes of unincorporated businesses rose from 7.8 to 10.5 percent. These comparisons are, we need not repeat, with the boom year of modern history.

The comparison usually made is between corporate profits after taxes on the one hand, and sales, net worth or income on the other. I hold to the view that all profits and corporate profits before taxes are also relevant. Hence their inclusion above. Should all profits—inclusive of noncorporate incomes—be considered, then the rise in profits would seem greater than if the usual comparisons were made; for noncorporate incomes have risen more than corporate profits. (Profits of noncorporate business have undoubtedly risen more than their incomes.)

Nor is it entirely clear that the appropriate index of corporate profits is profits after taxation. The Times editor and economists and accountants supported by him seem to assume without argument that the relevant corporate profits in 1948 are the $18,000,000,000 after taxes, not the $30,000,000,000 before taxes. But it is well to point out that it is corporate profits before taxes that are related to the wages paid and the prices set. And the profits before taxes are also relevant in an examination of the relation of profits and income. Surely from the viewpoint of stabilization policy, the rise of profits before taxes from $5,500,000,000 average in 1936-39 to $30,000,000,000 in 1948 is at least as significant as that from $4,000,000,000 to $18,000,000,000 after taxes. In fact, one might question the effectiveness of a tax system which allows a rise of $18,000,000,000 or three and one-half times after taxes despite an increase of taxes from $5,000,000,000 to $12,000,000,000. Business is succeeding only too well in doing what it is not supposed to do: Passing on the taxes on corporations to consumers or labor.

Let us turn now to the relation of profits and sales. Despite a vast rise in sales, corporate profits after taxes in relation to sales are roughly at 1929 levels (the decline is from 9.1 to 8.4 percent), and noncorporate income and corporate profits before taxes to sales substantially above. The rise for corporate profits before taxation and incomes of unincorporated businesses was from 19.4 percent of consolidated sales in 1929 to 26.1 percent in 1947. One may indeed ask Why in view of the economies of increased output and sales, businessmen generally should increase their profits as a percentage of sales even in comparison with 1929? (Even corporate profits after taxes plus noncorporate incomes were a larger proportion of sales than in 1929.)

Let us move from a consideration of these relationships to another vital issue raised in the Times editorial. The Times editor and those whose views he supports make much of the fact that profits are overstated because replacement costs of capital exceed acquisition or book value. Should prices remain at their present level, then indeed there may be some substance in this argument; for if allowance is made for the high replacement value of inventories and other capital, then book inventory profits would have to be whittled down and depreciation allowances increased—with a resulting reduction of profits.

But too much is made of this point; first, because, as accountants will tell you, business generally covers itself against a higher replacement cost of inventories. Second, it is well to allow for the fact that over our entire history there has been little net change in prices: Rises have been offset by declines. We, therefore, would be wrong to assume replacement at present high prices. And we would not leave out of account that in an advancing economic society it is generally possible to replace worn-out plant and equipment with capital costing less in dollars of stable value. (This will be an important offset to any rise of prices of capital over book value.) Recall that in the thirities there was no net investment and yet we ended the decade with an improved plant and with an income close to twice that in the depths of the depression; and by 1944 we raised our money income by about one and one-half times, and our real income by at least 75 percent, even though private net investment was negative; and the expenditures for war plant and equipment were but $20,000,000,000. In short, those who emphasize the higher price of replacement should also allow for the increased effectiveness of a stable dollar spent on plant.

We should also point out that any attempts to change accounting methods when profits have attained an all-time peak are bound to arouse suspicion. The present system of accounting has been in vogue for a long time. There were no protests in the depression period when with replacement values falling below book values or costs business could, for example, charge depreciation at high acquisition costs and thus cut its losses or raise its profits. We have to weigh any overstatement of profits in periods of rising prices against understatement in those of falling prices.

My main argument in support of the thesis that profits are too high is, however, not based on comparison of profits and income or sales, but on the thesis that the current high profits jeopardize any stabilization program. For example, they offer a potent excuse for labor leaders to demand and receive inflationary wage increases.

Furthermore, they stimulate and provide part of the funds for an investment boom of dangerous proportions. With investment at about $100,000,000,000 in the last 3 years as compared with $16,000,000,000 in 1929—and I would hazard a guess that despite the rise of prices a dollar of investment is at least as effective today as in 1929—we are in the midst of a dangerous investment boom. I am not, therefore, impressed by the argument that high profits are required in order to finance new investment.

Authorities quoted in the Times make much of the point that business is dependent almost exclusively on their profits to finance their capital needs. But this does not take into account the fact that they still have used up only about one-half of the funds accumulated and not used during the war; that the security markets yielded corporations the substantial sum of $5,000,000,000 or more of new money in 1948 (compared with $8,000,000,000 in 1929); and that in 2¾ years ending September 1948 bank loans rose by $17,000,000,000, or almost 60 percent. This compares with a rise of but $5,000,000,000 or but 14 percent in the spectacular years 1927-29, inclusive.

Indeed business needs less, not more, investment in this inflationary period; and it has adequate liquid funds even if allowance is made for the rise in prices. In the 18 months ending July 30, 1947, business disposed of but $7,000,000,000 of its vast liquid assets accumulated in the years 1942-45; and in the following year maintained its position.

The New York Times editor makes much of the fact that the present situation is unlike that of 1929, and in particular since 1929 was not a year of rising commodity prices. From this the implication is drawn that profits of the 1929 level are not a threat. Nevertheless, I adhere to my original position that the late twenties were a period of great inflation, as revealed in rising security and real estate prices and in a large excess of prices over costs.

In many respects the situation now is more dangerous than in 1929. The expansion of bank loans, of investments, of commodity prices and profits, the dependence of the economy upon Government spending in war and postwar, and the likely collapse once this peg is removed—all these are signs of danger. Once the government peg is removed, the decline may be serious. It is, after all, the $350,000,000,000 war, more than anything else, which accounts for the continued high demand and high profits. And the more we allow prices, wages, and profits to rise the more warped our economy will become. It would be fortunate indeed if profits were to return to a more normal level, and with that, reduced demands for higher wages and a moderation of investment. A slow adjustment to a normal situation would be a break indeed. The year 1949 may well be a year of balance, if profits decline substantially in response to increased taxes or reduced demand, and if, as a result, labor adjusts its demands to reduced profits and lower prices. Fortunately, we are in a better position than in 1929 in one important respect: our economy is better geared to stop a decline than in the early thirties. For this we owe much to the economic theorists and practitioners who in the last 20 years have preached sound fiscal policy.

Surely, it is not asking too much to suggest that taxes on corporate profits be raised from the current 40 percent to the 60 percent of the war period, when profits were much lower than they are today. In view of the business prospects for 1949, a reasonable compromise might be 50 percent. It is well to speculate on the vast gains in the antiinflation fight and the healthier economic situation which would prevail today had the Government not relinquished about $10,000,000,000 of annual tax revenues in the unfortunate tax bills of 1945 and 1948.

SEYMOUR E. HARRIS,
*Professor of Economics, Harvard University.*

# APPENDIX

The following statistical materials were assembled by the staff of the committee for the use of the members of the committee and other persons during the hearings:

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 |
| 1931 | −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 1929–48 series. 1929–1947: Survey of Current Business (Department of Commerce), July 1948. 1948: Economic Indicators, November 1948. Based on Department of Commerce data.

TABLE II.—*Dividends and undistributed corporate profits as percentages of corporate profits after taxes, 1926–48*

| Year | Dividend payments (percentage) | Undistributed corporate profits (percentage) | Year | Dividend payments (percentage) | Undistributed corporate profits (percentage) |
|---|---|---|---|---|---|
| 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 | | | 1942 | 45.6 | 54.4 |
| 1931 | | | 1943 | 43.2 | 56.8 |
| 1932 | | | 1944 | 43.3 | 56.7 |
| 1933 | | | 1945 | 54.0 | 46.0 |
| 1934 | [1] | [1] | 1946 | 43.7 | 56.3 |
| 1935 | | | 1947 | 38.1 | 61.9 |
| 1936 | | | 1948 [2] | 36.0 | 64.0 |
| 1937 | | | | | |

[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 IV.—*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–A.—*Corporate profits after taxes of all private corporations and of leading corporations, 1929–47* [1]

[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, 1930–1948 April issues.

TABLE VI.—*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 $1,000,000,000 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 VII.—*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 VIII.—*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 |
| | *Billion dollars* | *Billion dollars* | | *Billion dollars* | | | *Billion 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 | n. a. | n. a. | n. a. |

[1] 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; Monthly Letter, 1940–48 April issues, National City Bank of New York.

TABLE IX.—*Corporate sales and net corporate income after taxes for all industries, excluding finance, insurance, and real estate, 1929–47*

| Year | Sales | Net corporate income after taxes | Net income as percentage of sales | Year | Sales | Net corporate income after taxes | Net income as percentage of sales |
|---|---|---|---|---|---|---|---|
| | *Billion dollars* | *Billion dollars* | | | *Billion dollars* | *Billion dollars* | |
| 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 X.—*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 |
| | *Millions dollars* | *Millions dollars* | | *Millions dollars* | *Millions dollars* | |
| 1929 | 70,305 | 4,403 | 6.3 | 43,108 | 651 | 1.5 |
| 1030 | 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 | 176,730 | 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 XI.—*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 |
| | | *Million dollars* | *Million dollars* | | | *Million dollars* | *Million dollars* | |
| 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 XII.—*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 |
|---|---|---|---|---|---|---|---|---|---|
| | | *Million dollars* | *Million dollars* | | | | *Million dollars* | *Million dollars* | |
| 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 | .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 XIII.—*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 |
| | | *Million dollars* | *Million dollars* | | | *Million dollars* | *Million dollars* | |
| 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.

## 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 includes 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.

*Automobile manufacturers*

| | Sales | Net income after taxes | Net worth | Common stock: Earnings per share | Common stock: 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 | [7] 1,508,000 | | [7] .95 | ---- |
| 1946 | 120,715,000 | [8] 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] Deficit.
[8] Before deducting $365,466 or 20 cents per share nonrecurring loss on sale or vacant land net of tax reduction.

*Electrical equipment*

| | Sales | Net income after taxes | Net worth | Common stock: Earnings per share | Common stock: Dividends paid per share |
|---|---|---|---|---|---|
| Cable Electric Products, Inc.:[1] | | | | | |
| 1940 | $1,565,000 | $49,000 | | $0.19 | |
| 1947 | 2,435,000 | 240,000 | | .94 | $0.10 |
| 1948 | 3,139,000 | 234,000 | $974,000 | .92 | |
| 1947: First 3 months | 592,000 | | | | |
| 1948: First 3 months | 546,000 | | | | .10 |
| The Gamewell Co.:[2] | | | | | |
| 1940 | 5,276,000 | 465,000 | | [3] 3.07 | 1.75 |
| 1947 | 10,043,000 | 875,000 | | 2.44 | 1.00 |
| 1948 | 11,910,000 | 1,160,000 | 6,642,000 | 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 | | 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 | 412,926,000 | 3.06 | 1.60 |
| 1947: 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 | | [5] 3.87 | 3.00 |
| 1946 | 45,940,000 | [6] 5,119,000 | | 3.87 | 1.80 |
| 1947 | 60,596,000 | 6,694,000 | 32,396,000 | 5.10 | 2.00 |
| 1947: 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 | | [7] 4.56 | 2.80 |
| 1946 | 29,155,000 | 2,705,000 | | 1.96 | .60 |
| 1947 | 36,941,000 | 4,228,000 | 14,707,000 | 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 | | [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 | 370,475,000 | 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.

*Foods except meats*

| | 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) | ----- | | ----- | 1.35 |
| 1948: First 9 months | (1) | ----- | | ----- | ----- |
| **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.

*Oil refining*

| | Sales | Net income after taxes | Net worth | Common stock: Earnings per share | Common stock: Dividends paid per share |
|---|---|---|---|---|---|
| Gulf Oil Corp.: | | | | | |
| 1940 | [1] $273,078,000 | $22,150,000 | | $2.44 | $1.25 |
| 1946 | [1] 562,241,000 | 58,285,000 | | 6.42 | 2.50 |
| 1947 | [1] 797,211,000 | 95,540,000 | $534,589,000 | 10.53 | 2.75 |
| First 9 months | [1] 560,525,000 | [2] 66,700,000 | | 7.35 | ---------- |
| 1948: First 9 months | [1] 792,827,000 | [2] 117,000,000 | | 10.31 | 2.25 |
| Shell Union Oil Co.: | | | | | |
| 1940 | [1] 254,104,000 | 15,655,000 | | 1.05 | .75 |
| 1946 | [1] 444,828,000 | [3] 32,880,000 | | 2.44 | 1.50 |
| 1947 | [1] 628,105,000 | 59,875,000 | 306,879,000 | 4.44 | 2.25 |
| First 9 months | [1] 440,120,000 | 38,678,000 | | 2.87 | ---------- |
| 1948: First 9 months | [1] 609,055,000 | 82,333,000 | | 6.11 | 1.00 |
| Socony-Vacuum Oil Co.: | | | | | |
| 1940 | [4 5] 444,004,000 | 36,409,000 | | 1.17 | .50 |
| 1946 | [4] 761,235,000 | 58,311,000 | | 1.87 | .75 |
| 1947 | [4] 1,028,634,000 | 97,709,000 | 921,556,000 | 3.13 | 1.00 |
| First 9 months | [4 6] 730,658,000 | 66,000,000 | | 2.12 | ---------- |
| 1948: First 9 months | [4] 977,982,000 | 103,000,000 | | 3.30 | .75 |
| Standard Oil Co. of California: | | | | | |
| 1940 | [1 7] 176,145,000 | 22,488,000 | | 1.73 | 1.00 |
| 1946 | [1] 372,797,000 | [8] 66,957,000 | | 5.15 | 2.30 |
| 1947 | [1] 530,132,000 | [8] 107,269,000 | 709,546,000 | 8.25 | 3.20 |
| First 9 months | [1] 372,543,000 | 66,545,000 | | 5.12 | ---------- |
| 1948: First 9 months | [1] 535,585,000 | 117,073,000 | | 9.00 | 3.00 |
| Standard Oil Co. (Indiana): | | | | | |
| 1940 | [1] 358,849,000 | 33,579,000 | | 2.20 | 1.50 |
| 1946 | [1] 650,616,000 | [9] 67,650,000 | | 4.43 | 1.75 |
| 1947 | [1] 910,746,000 | [9] 94,881,000 | 924,870,000 | 6.21 | 2.00 |
| First 9 months | [1] 637,174,000 | (10) | | ---------- | ---------- |
| 1948: First 9 months | [1] 912,967,000 | (10) | | ---------- | [11] 1.62½ |
| Standard Oil Co. (New Jersey): | | | | | |
| 1940 | [1] 821,684,000 | [12] 123,886,000 | | 4.54 | 1.75 |
| 1946 | [1] 1,622,339,000 | [12] 177,610,000 | | 6.50 | 3.00 |
| 1947 | [1] 2,354,917,000 | [12] 268,627,000 | 1,817,822,000 | 9 83 | 4.00 |
| First 9 months | [1 13] 1,571,629,000 | 203,000,000 | | 7.43 | ---------- |
| 1948: First 9 months | [1 13] 2,428,958,000 | 290,000,000 | | 10.25 | [14] 1.00 |
| Sun Oil Co.: | | | | | |
| 1940 | [1] 147,673,000 | 7,969,000 | | 3.03 | 1.00 |
| 1946 | [1] 306,644,000 | 14,727,000 | | 4.17 | 1.00 |
| 1947 | [1] 356,841,000 | 24,340,000 | 185,566,000 | [15] 5.28 | 1.00 |
| First 9 months | [1 13] 253,832,000 | (10) | | ---------- | ---------- |
| 1948: First 9 months | [1 13] 332,744,000 | (10) | | ---------- | [16] .75 |
| The Texas Co.: | | | | | |
| 1940 | [1] 350,260,000 | 31,548,000 | | 2.90 | 2.00 |
| 1946 | [1] 586,537,000 | 71,089,000 | | 6.32 | 3.00 |
| 1947 | [1] 819,211,000 | 106,313,000 | 828,638,000 | 7.90 | 3.00 |
| First 9 months | [1] 568,403,000 | 78,396,000 | | 6.97 | ---------- |
| 1948: First 9 months | [1] 783,248,000 | [17] 113,617,000 | | 8.44 | 2.25 |

1 Gross operating income.
2 Approximate.
3 After $970,151 profit from sale of capital assets.
4 Sales of products and services. In 1946-47 Federal excise taxes were eliminated from sales.
5 In 1940 $29,075,402 was included in "sales" and in "Federal and other taxes."
6 Includes $5,639,000 net income of foreign subsidiaries in Western Hemisphere for first 6 months of 1947 not previously reported.
7 In addition State sales and motor-fuel taxes and Federal gasoline and lubricating-oil taxes are deducted from sales of products.
8 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.
9 After profit on sale of capital assets and investments of $7,571,191 in 1946 and $1,353,318 in 1947.
10 Not available.
11 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.
12 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.
13 Excludes excise taxes.
14 Stock dividend 5 shares for each 200 shares held.
15 Reflecting stock dividend of 10 percent (412,068 shares) paid Jan. 30, 1948.
16 Stock dividend of 10 percent paid Jan. 30, 1948.
17 After deducting $6,000,000 special inventory reserve.

*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 |
| First 9 months | 24,949,000 | [2,3] 1,585,000 | | [2,4] 1.98 | |
| 1948: First 9 months | 21,229,000 | [2] 1,326,000 | | [2,4] 1.66 | [5] .65 |
| Hoffman Radio Corp.: | | | | | |
| 1940 | 122,000 | [6] 12 | | [6] .09 | |
| 1946 | 3,437,000 | 118 | | [7] .45 | |
| 1947 | 3,452,000 | [6] 54,000 | 833,000 | [6] .21 | .10 |
| First 9 months | [8] | [8] | | | |
| 1948: First 9 months | [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 |
| 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 |
| 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] | | | |
| 1948: First 9 months | [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.

*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 | ------ |
| 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 |
| 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 | ------ |
| 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 |
| 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 | | [17] 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.

*Textile fabrics*

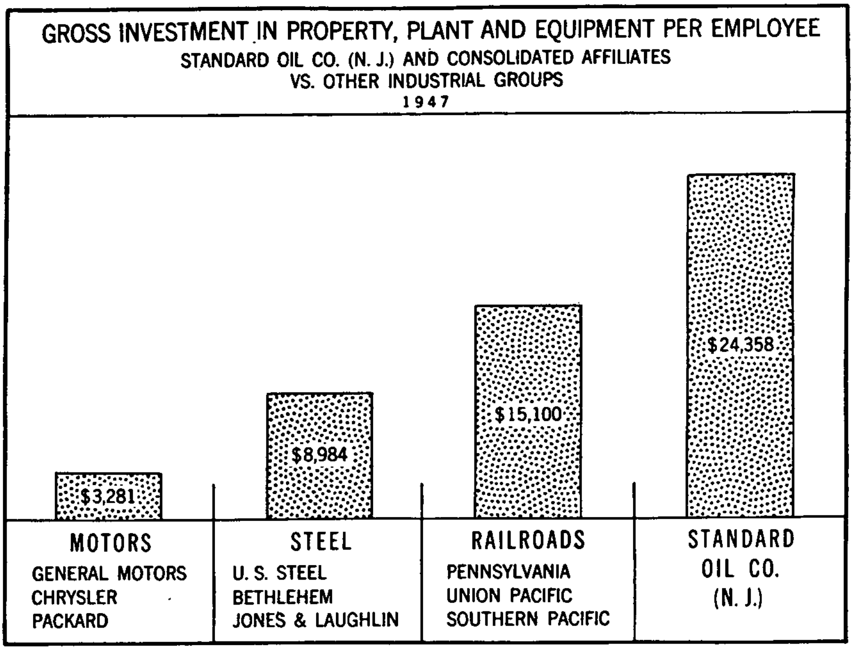
| | Sales | Net income after taxes | Net worth | Common stock: Earnings per share | Common stock: Dividends paid per share |
|---|---|---|---|---|---|
| American Woolen Co.: | | | | | |
| 1940 | $76,560,000 | $3,154,000 | | $1.76 | ----- |
| 1946 | 170,811,000 | 19,398,000 | | 21.05 | $12.00 |
| 1947 | 175,993,000 | [1] 15,270,000 | $79,071,000 | 15.37 | 10.00 |
| First 9 months | 125,153,000 | [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 |
| 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 | | [14] .44 | ----- |
| 1946 | 78,304,000 | 9,503,000 | | 11.99 | [15] 2.76 |
| 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 |

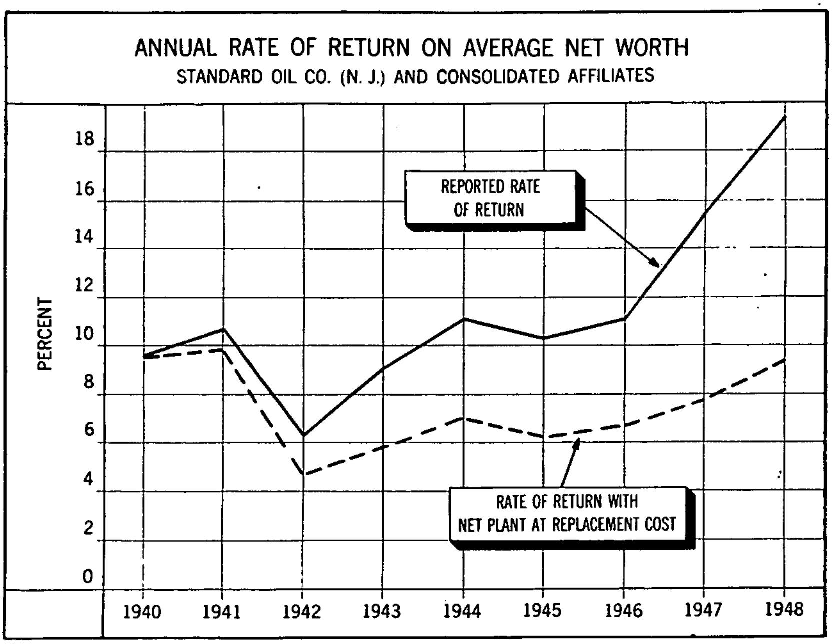
[1] After provision for contingencies of $1,000,000.
[2] After provision for contingencies of $3,000,000.
[3] Year ends Sept. 30.
[4] After provision for contingencies of $300,000.
[5] Adjusted to reflect 2 for 1 split in March 1945 and July 1946. Actual earnings per share amounted to $4.79.
[6] After 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 2 for 1 split in March 1945, and 3 for 1 split in July 1946. Actual earnings were $3.37.

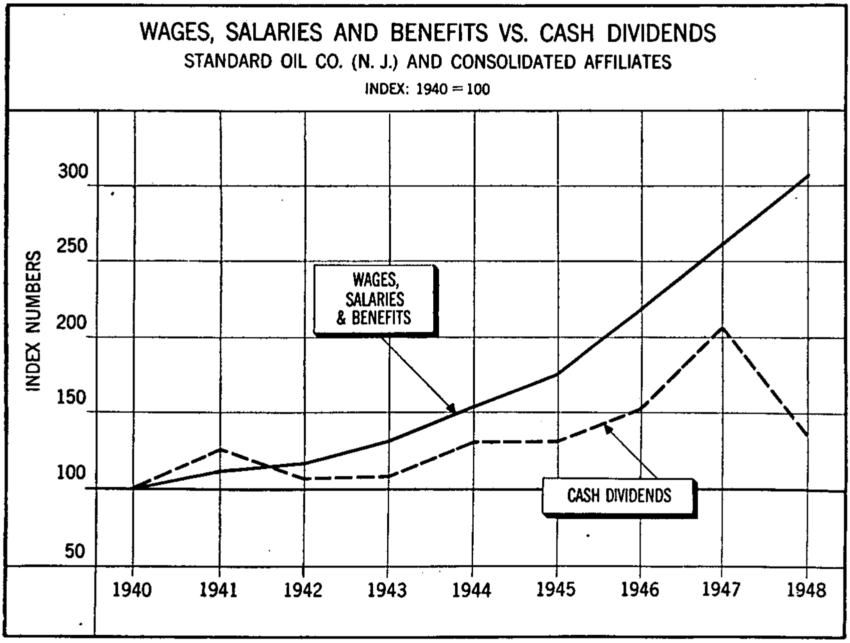
*Meat packing*

| | Sales | Net income after taxes | Net worth | Common stock: Earnings per share | Common stock: 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 | (7) | | (7) | ---------- |
| 1948: First 9 months | 407,095,000 | (7) | | (7) | .45 |
| Oscar Mayer & Co., Inc.:[1] | | | | | |
| 1946 | 81,494,000 | 1,330,000 | 11,097,000 | [8] 9.36 | 1.00 |
| 1947 | 136,247,000 | 1,440,000 | | [8] 9.76 | 1.00 |
| The Rath Packing Co.:[1] | | | | | |
| 1940 | 58,259,000 | 2,206,000 | 21,357,000 | [9] 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 | (7) | | ---------- | ---------- |
| 1948: First 9 months | 134,981,000 | (7) | | ---------- | 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 | [10] 22,335,000 | | 3.77 | 2.10 |
| First 9 months | 1,662,413,000 | (7) | | (7) | ---------- |
| 1948: First 9 months | 1,756,268,000 | (7) | | (7) | 2.20 |
| Wilson & Co., Inc.:[1] | | | | | |
| 1940 | [11] 280,000 | 3,619 | 78,982 | .84 | ---------- |
| 1946 | [11] 441,000 | [12] 8,312 | | 3.44 | .60 |
| 1947 | [11] 738,000 | [12] 15,449 | | 6.82 | .90 |
| First 9 months | 525,524 | (7) | | (7) | ---------- |
| 1948: First 9 months | 516,289 | (7) | | (7) | 1.50 |
| Kingan & Co., Inc.:[1] | | | | | |
| 1940 | [13] 52,691 | [14] 21 | 15,304 | [14] .26 | (7) |
| 1946 | 89,915 | 587 | | .52 | ---------- |
| 1947 | 192,608 | 333 | | .20 | ---------- |
| 1948 | (15) | (15) | (15) | (15) | (15) |

[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] Not available.
[8] After allowing for preferred dividends.
[9] Adjusted to reflect 40 percent stock dividend paid in 1942. Before adjustment earnings amounted to $4.11 per share.
[10] After provision for high-cost additions to fixed assets of $12,000,000.
[11] Approximate sales.
[12] Before deducting $2,000,000 set aside out of surplus as a reserve against future price declines in 1946; $3,000,000 in 1947.
[13] Includes rental and other operating income.
[14] Deficit.
[15] Recent data not available.


GROSS INVESTMENT IN PROPERTY, PLANT AND EQUIPMENT PER EMPLOYEE
STANDARD OIL CO. (N. J.) AND CONSOLIDATED AFFILIATES
VS. OTHER INDUSTRIAL GROUPS
1947
$3,281
$8,984
$15,100
$24,358
MOTORS
GENERAL MOTORS
CHRYSLER
PACKARD
STEEL
U. S. STEEL
BETHLEHEM
JONES & LAUGHLIN
RAILROADS
PENNSYLVANIA
UNION PACIFIC
SOUTHERN PACIFIC
STANDARD OIL CO. (N. J.)


ANNUAL RATE OF RETURN ON AVERAGE NET WORTH
STANDARD OIL CO. (N. J.) AND CONSOLIDATED AFFILIATES
REPORTED RATE OF RETURN
RATE OF RETURN WITH NET PLANT AT REPLACEMENT COST
PERCENT
18
16
14
12
10
8
6
4
2
0
1940
1941
1942
1943
1944
1945
1946
1947
1948


WAGES, SALARIES AND BENEFITS VS. CASH DIVIDENDS
STANDARD OIL CO. (N. J.) AND CONSOLIDATED AFFILIATES
INDEX: 1940 = 100
INDEX NUMBERS
300
250
200
150
100
50
WAGES, SALARIES & BENEFITS
CASH DIVIDENDS
1940
1941
1942
1943
1944
1945
1946
1947
1948

JANUARY 24, 1949.

STATEMENT OF JOHN SCHMIDT, VICE PRESIDENT AND COMPTROLLER OF ARMOUR CO. SUPPLEMENTING TESTIMONY GIVEN DECEMBER 17, 1948, BEFORE SUBCOMMITTEE OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT

I

The following table reflects the autonomy as to trading range of the individual salesman in selling to the retailer.

*Cents per pound selling margin or (selling loss) (before deducting from selling margin or adding to selling loss, selling expenses) from a standard plant billing price on 10 products (covering fresh meats, smoked meats, sausage, and lard) for the fiscal year ended Oct. 30, 1948*

| Product | As between 13 branch house district territories (encompassing a total of 229 branch houses) | | | As between 22 branch houses in one of such branch house district territories | | |
|---|---|---|---|---|---|---|
| | High | Low | Range | High | Low | Range |
| | *Cents* | *Cents* | *Cents* | *Cents* | *Cents* | *Cents* |
| 1 | 1.78 | 0.14 | 1.64 | 2.60 | 0.10 | 2.50 |
| 2 | 1.99 | (.71) | 2.70 | 2.41 | (1.19) | 3.60 |
| 3 | 2.30 | (.74) | 3.04 | 2.38 | (4.00) | 6.38 |
| 4 | 1.49 | (3.28) | 4.77 | 1.88 | (3.61) | 5.49 |
| 5 | 2.69 | .94 | 1.75 | 3.63 | 1.10 | 2.53 |
| 6 | 1.78 | (.39) | 2.17 | 4.04 | .05 | 3.99 |
| 7 | 2.34 | .79 | 1.55 | 4.99 | .62 | 4.37 |
| 8 | 2.86 | (.41) | 3.27 | 4.30 | .90 | 3.40 |
| 9 | 3.27 | .42 | 2.85 | 5.08 | .71 | 4.37 |
| 10 | .76 | (.61) | 1.37 | .97 | (1.11) | 2.08 |

Figures in parentheses indicate loss.

II

The company segregates its business and results as between (*a*) domestic meat (cattle, hogs, sheep and calves) and (*b*) balance of operations. The balance of operations comprise:

Group A:
- Shortening and oil
- Dairy and poultry
- Ammonia
- Fertilizer
- Foreign

Group B:
- Pharmaceutical
- Soap
- Glue
- Hair
- Sandpaper
- Chemical
- Leather

Raw materials of group A operations are not derived from the domestic slaughter of cattle, hogs, sheep or calves.

Raw materials of group B operations are, in part or in whole, derived from the company's domestic slaughter of cattle, hogs, sheep, or calves. These group B operations are individually separate industries. Meat-packing companies do not, generally, engage in these group B operations. They sell their materials for these group B operations to companies operating in the field of these individual industries. Companies doing no slaughtering have, by far, the largest part of the production in these individual industries.

The company sells its group B materials, in part, to its divisions operating in its group B field, and in part to outside companies. In both cases sales are made at commercial market prices. The company also buys group B materials on the outside. To illustrate: a large part of the company's production of hides is sold to outside companies and the company's leather division supplements its purchase of hides from the company with the hide purchases on the outside. The reason for this is that the company's leather division operation is principally in the heavy leather field.

III

Of its total $1,991,434,000 sales in the fiscal year ended October 30, 1948, the company sold to United States Federal agencies out of its domestic production $40,377,000—about 2 percent of its total sales, as follows:

| | |
|---|---|
| United States armed forces: | |
| To domestic camps | $4,604,000 |
| To seaboard for export destination unknown | 23,129,000 |
| Veterans' Administration hospitals | 3,624,000 |
| Rubber Reserve | 683,000 |
| Miscellaneous Federal agencies: Penitentiaries, etc | 8,337,000 |
| Total | 40,377,000 |

IV

The following table illustrates how the value of byproducts reduces the price of meat to the consumer:

| | Per hundredweight dressed |
|---|---|
| Live cost: Middle of range in prices at which good steers 900–1100 pounds were reported sold on Chicago market by U. S. Department of Agriculture in Daily Livestock Market Report from Monday, Oct. 4, 1948, to Friday, Oct. 8, 1948, inclusive ($28 to $36.50 per hundredweight; 1,000 pounds alive, at $32.25 per hundredweight, carcass yield, 60.5 percent; carcass weight, 605 pounds | $53.31 |
| Add plant expense: Buying, slaughtering, dressing, chilling; loading in cars | 2.16 |
| Total | 55.47 |
| Less: Value of byproducts (hide, liver, and other variety meat items, edible fats, inedible materials, etc.) | 5.38 |
| Cost of carcass beef (f. o. b. Chicago plant) | 50.09 |
| Cost of freight, icing, and branch house selling expense | 2.86 |
| Shrink in transit and in branch house coolers 0.758 percent=5 pounds | .44 |
| Total cost of beef sold (New York) 600 pounds | 53.39 |
| Wholesale price: Middle of range in prices at which good beef was reported sold in New York City by Department of Agriculture in Daily Report of Meat Trade Conditions and Wholesale Quotations from Monday, Oct. 18, 1948, to Friday, Oct. 22, 1948, inclusive ($49 to $55 per hundredweight) | 52.00 |
| Loss | 1.39 |
| Note: | |
| Expense per hundredweight: | |
| Processing | 2.16 |
| Freight, icing, and branch house selling expense | 2.86 |
| Shrinkage in transit and in branch house coolers | .44 |
| Total | 5.46 |
| Value of byproducts | 5.38 |
| Excess of expense over the value of byproducts | .08 |

# INDEX

O