

judgment we do have a profit squeeze. We do need to give consideration to an adequate level of profits. We do need to encourage business investment through increasing cash flow. But, the historical record in terms of the overall data as reported greatly exaggerate the real decline in corporate profitability which has occurred. More than that, undue concern about the profits situation has in itself caused weakening of business confidence and hurt the cause of adequate recovery. Furthermore, erroneous interpretations of the situation regarding corporate profitability direct attention away from the more basic matters making for the good health of the economy and with that the well being of corporate profitability as well.

As I see it, there have been three fundamental factors causing the decline from the high levels of profit margins and rate of return as reported which prevailed in the early postwar years. These are: First, the unusual circumstances of the early postwar years which led to record levels of profits never reached before or after. Second, the tremendous stepup in depreciation charges during the last decade which has lowered reported earnings but has increased cash flow. Third, the inadequate growth in the economy generally from 1957 on and particularly the sideways movement of real output in the private durable sector.

Unusual circumstances of high demand and short supply made the early postwar years the most profitable period corporate enterprise has ever experienced. Beyond this, costs, including the cost of plant consumed, were seriously understated and reported profits were greatly overstated. In particular, the tremendous burst of demand in the early postwar years brought about a rapid increase in prices which gave rise to major inventory profits included in reported corporate profits. The effect on profits of inventory valuation from changing prices has been specifically recognized and measured by the Department of Commerce. Some aspects of this are shown in the table on page 332 entitled "Inventory Valuation Adjustment in Relation to Corporate Profits Before Taxes."

The degree to which inventory valuation raised reported profits is indicated for selected early postwar years—1947, 1948, 1950—in contrast to certain recent years. When prices are rising, as they were sharply in the early postwar years, higher profits emerge from inventory valuations at lower levels of costs. The Department of Commerce includes corporate profits before taxes in national income only after adjustment for inventory valuation. Thus the high profit margin ratios and rate of return figures in the early postwar period were substantially boosted by inventory profits occurring as a result of rapid inflation and other understatements of costs and overstatements of reported profits. Such years hardly offer a reasonable base of comparison.

As a matter of fact, much of the decline in corporate profitability as indicated by reported data is simply a return to more usual circumstances from extremely abnormal situations prevailing after World War II. This is indicated to some degree by the authoritative data shown on page 4 concerning rate of return on net worth of leading manufacturing corporations prepared and published over the years by the First National City Bank of New York.