ECONOMIC NOTES:

THE PASSAGE OF CORPORATE PROFITS

One of the major economic objectives of the Labor Government has been to boost the profitability of the private sector. The underlying purpose of this has been to stimulate private investment.

Reports in the financial media suggest this policy to boost corporate profitability has been one of the success stories of Labor's economic strategy. While the growth of money wages has been limited - real wages have declined by some 10 per cent - and there has been a reduction in the level of corporate taxation paid, numerous companies have been reporting quite spectacular increases in profits.

How successful the Government's economic objective has been requires closer examination. This note draws upon official statistics, prepared by the Australian Bureau of Statistics, the Reserve Bank and E.P.A.C., company reports and surveys prepared by the Australian Stock Exchange Research Service to chart the changing fortunes of corporate Australia.

1. Corporate profitability: the aggregate picture

A very general impression of the trend in the **total** surplus produced by the corporate Australia can be gained from the *Australian National Accounts* and data gathered by the Reserve Bank. The average annual rate of growth in the gross operating surplus for "Private Corporate Trading Enterprises" since the mid-1970s in nominal terms was some 13 per cent. (See Table 1 and A.B.S., 1988, Table 1) For the private sector as a whole, including unincorporated enterprises, the rate of growth was somewhat less, being some 12 per cent per annum. Although not a continuous series,

Table 1: Private Corporate Trading Enterprises: Income and Outlays
($ million)

	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
GROSS OPERATING SURPLUS	9130	10611	11257	13187	15523	17676	18135	19033	24444	29049	32854	36287	
											(20034)	(22299)	(265723)*
Rate of change		16.2	6.1	17.1	17.7	13.9	2.6	4.6	28.4	18.8	13.1	10.5	
												(10.7)	*(21.05)*
Depreciation allowances	3419	3919	5500	5106	5831	6669	7623	8871	9884	10715	12547	14630	
											(4976)	(5653)	(6428)*
Net operating surplus	5711	6692	6757	8079	9692	11007	10512	10162	14560	18334	20307	21657	
											(15058)	(16646)	(20144)*
Rate of change		17.2	1.0	19.6	20.0	13.6	-4.5	-3.3	43.3	25.9	10.8	6.2	
												(10.5)	*(21.0)*
Interest paid (net)	1998	2240	2501	2894	3603	4234	5796	7105	7607	8873	11144	13545	
Income tax payable	2540	2793	2692	3047	4336	4573	4081	3700	4600	5056	5324	5651	
Dividends received	101	121	193	198	272	277	271	285	318	278	552	667	
TOTAL NET SURPLUS	1274	1780	1757	2336	2025	2477	906	92	2671	4683	4391	3128	

Source: A.B.S., *Australian National Accounts, National Income and Expenditure 1986-87*, Tables 19 and 29.
(*: A.B.S., *Company Profits, Australia*, June Quarter 1988, Table 1)

the Reserve Bank's *Company Finance* suggests a comparable rate of growth in the gross profits of listed companies. (R.B.A., 1988, 1986, and 1982)

While the rate of growth of gross profits varied from year to year the most striking feature of corporate profitability evidenced from the data is the magnitude of the slump in profitability over 1981-82/1982-83. Taking account of inflation there was a real decline in the total surplus produced by corporate Australia of between 10 and 12 per cent over these two years. The fall off in profitability clearly represented a crisis for Australian capitalism.

The magnitude of this crisis is even more apparent when allowance is made for depreciation. Even though it is apparent from Table 1 that the trend rate of growth in the total net operating surplus produced by corporate Australia, (total corporate sector gross profits net of all direct and indirect costs apart from interest payments and taxation) was comparable with the total gross operating surplus, the slump in profitability over 1981-82/1982-83 was much more dramatic. The net operating surplus actually decreased, in nominal terms, over these two years and this translates into a real decline of almost 25 per cent over two years! The profitability crisis is also borne out by data in the *Company Finance* study, measured in terms of gross profits, although the magnitude of this decline is not as great.

The extent of the profitability crisis confronting corporate Australia when Labor was elected into office is quite striking. Yet what is equally remarkable is the extent to which this this situation appears to have been reversed. The *National Accounts*, the Reserve Bank's *Company Finance* and Statex reports on corporate profitability point to a strong resurgence in corporate profitability for the period up to 1988.

Although the National Accounts suggest a falling off in the rate of growth in the gross operating surplus for corporate Australia as a whole over 1985-86 and 1986-87, the Reserve Bank's *Company Finance* and Statex reports indicate that listed companies have maintained the rate of growth in their profits, a position confirmed by *Company Profits*. Statex reports a 27 per cent increase in the profits of all listed companies in 1988 and anticipates a 22 per cent increase in 1989. (*Australian Financial Review*, 9 September 1988)

2. Corporate Australia and rates of return

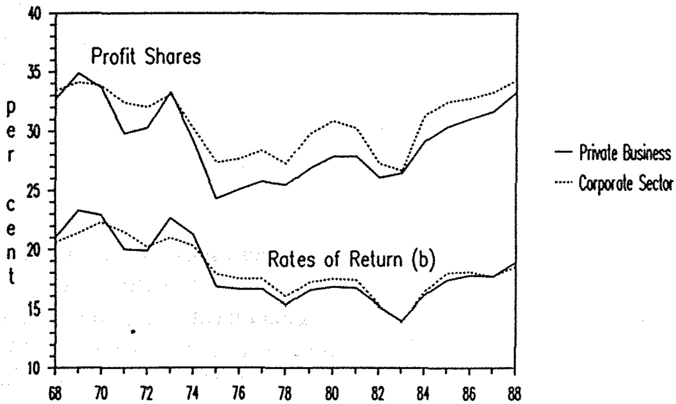
Of crucial concern to the Government's economic strategy is not only the growth in corporate profits as a whole but how this translates into rates of return for the corporate sector. The rate of return on existing corporate investment is a key determinant of future investment so a crucial test of the success or otherwise of Government ambitions will be the extent to which returns on investments, and particularly productive investments, have been lifted.

Statex calculates returns on shareholder funds and these figures confirm the longer term trend that shareholders are benefiting from the recovery in profits following the early 1980s slump.(Statex, *Comparative Analysis*; *Financial and Profitability Study*) However, this is not a terribly adequate measure of rates of return because, in periods of high profits, shareholders can be rewarded with bonus issues rather than in higher dividends so that even during a period of sustained profit growth per capita shareholder yields might not show much improvement when in actual fact returns on shareholders' investments in stock are expanding.

A better measure of the rate of return on investment can be found by comparing profits with total investments (or total assets) which is inclusive of both equity and debt. Figures gleaned from the Reserve Bank's *Company Finance* indicate that following the slump in corporate profitability after 1980/81 through to the calamitous years of 1981/82 and 1982/83, when net returns on total assets declined to 7.0 per cent and 6.3 per cent respectively, there has been a reasonably strong recovery, to 10.1 per cent in 1985/86.

Data prepared for the E.P.A.C. study *Trends in Profitability* bear this out. Figure 1 provides an indication of the trend in the average rate of profit, measured in terms of rates of return on investment in capital and raw material inputs, since the end of the long boom. The severity of the profitability crisis of the early eighties is clearly evident. But what is most noteworthy is that this slump in rates of profit was in line with a longer term trend of falling profitability for the business sector as a whole. The crisis appears to mark the bottom of this depression.

Figure 1: Trends in Gross Profits & Rates of Return on Investment



(a) including depreciation, tax and interest costs
(b) relative to the replacement cost of capital (plus stocks)

Source: E.P.A.C., *Trends in Profitability*, 1988.

The recovery in rates of return evident from 1983 appears to be in line with the increase in aggregate profits noted above. More significantly, however, the E.P.A.C. estimates suggest that the recovery in the average rate of profit will be maintained into the immediate future. Furthermore, profitability on Australian investments appears to be recovering to a level comparable to that of O.E.C.D. economies. (E.P.A.C., Chart 4)

3. Sectoral and industry comparisons of profitability

Corporate Australia is clearly enjoying the fruits of its own and the government's efforts to improve profitability. But there have been noticeable differences in the rate of profit recovery between different sectors and industries within the corporate sector.

The rate of increase in the average profits of larger companies has been greater than that for smaller companies, judging by comparisons of the *Australian National Accounts*' estimates for the 'Corporate Trading Enterprises' with those for 'Unlisted Companies' and by the Reserve Bank's estimates of profitability. 'Corporate Trading Enterprises' now control 6 per cent more of the total private sector gross operating surplus than was the case in the mid-1970s while they employ a smaller proportion of the workforce. *Company Finance* calculates that the fifty largest companies led the recovery in profits and recent evidence suggests that this leadership role has been maintained.

While the E.P.A.C. study *Trends in Profitability* demonstrates that most sectors of the business community have experienced a recovery in rates of profit, the *National Accounts*' estimates point to marked disparaties in the distribution of aggregate profits between different sectors.

The relative decline of manufacturing industry, in terms of its share of the total private sector gross operating surplus, is quite evident. It has declined from 35 per cent in the mid-1970s to 30 per cent. The share of the surplus earmarked for agricultural and pastoral industries has declined by 3 per cent. In contrast, the more striking development has been the dramatic increase in the share of aggregate profits won by the finance sector. This has increased from less than 8 per cent to nearly 14 per cent. (A.B.S., 1988a, Table 19)

4. The bases of the recovery in profits

Government policy has been crucial to relieving the plight confronting Australian capitalism. This has been direct insofar as there has been a decrease in the imposition of corporate taxation and through the implementation of wage controls under the Accord.

The burden of taxation borne by corporate Australia has diminished quite markedly. Corporate Australia now contributes less than 10 per cent to total taxation revenue raised by the Australian government, some three per cent less than was the case in 1981-82 and almost half as much as it did at the end of the long boom. Indeed the decline has been quite steady over the last twenty years. (A.B.S., 1988b, 1982).

There can be little disputing the fact that the most effective aspect of the Labor Goverment's economic programme has been its ability to effect a reduction in real wages. Wages as a proportion of the income generated by the private sector have declined quite markedly. The hold on wage growth has more than offset the effects of the wages explosion of 1982-83 and the total value of all income paid in the form of wages and salaries is proportionately lower than it has been since the 1960s. Wages comprised some 75 per cent of total income generated by the private sector in 1975/76 gradually declining until the recovery in 1982-83. Wages now represent only some 70 per cent of the income generated by the private sector. (A.B.S., 1988a, Tables 19 and 26)

It is noteworthy that Australian workers are, in effect, paying for the recovery in corporate profitability in more ways than one. Not ony have real wages declined but the proportion of income taxes paid by wage and salary earners has increased; it now accounts for over two-thirds of all tax revenue compared with a little over half during the early 1970s.

Government policy has also had an indirect effect in boosting profitability for industry as a whole. Privatisation has opened some investment opportunities. But more important has been the deregulation of the financial system. Deregulation explains much of the increase in the fortunes of the finance sector.

However, and this has been one of the major contradictions and paradoxes of Labor government policy, the profitability of the finance sector is also bound up in the high interest rate policy of the government. And it has not only been banks and other financial institutions which have sought to capitalise on opportunities from dealing in money and other financial assets. There has, as has been noted in an earlier issue of *J.A.P.E.*, a general increase in investment in financial assets and this, rather than investments in the expansion of productive capacity, has contributed to increased corporate profitability. (R.B.A., 1988, Graph 3)

It has not simply been left to the state to engineer this. The corporate sector has pursued a number of initiatives in its own right. Capital has sought to more efficiently utilise existing equipment. Another more prominent strategy has been to intensify the labour of workers. Among the various strategies pursued have been the increased employment of part-time and casual workers relative to full-time workers, resorting to employing more contract workers, or effecting changes in working conditions by abolishing "restrictive work practices". (Rosewarne, 1988; Burgess, 1988; Rimmer & Zappala 1988; McDonald, 1988) Statex data suggests that this latter strategy has been highly effective, with the rate of growth of profits per employee across all listed companies increasing at an annual average rate of some 16 per cent over the years of the Hawke government. (Statex, 1988)

Mergers and takeovers, which have been encouraged by the government acquiescing to corporate Australia's ability to write off against revenue the cost of borrowing funds to takeover other companies, have been another means by which capital has boosted profits. There are the winfall gains made from the acquisition and disposal of assets, the so-called leveraged buyouts. Increased centralisation of capital has also brought some economies of scale and greater ability for individual companies to exercise monopoly power in the market. It is also the case that such activity hastens the writing off of obsolete capital equipment and, in the process, makes for a more efficient utilisation and profitability of productive capacity.

Australian enterprises have also sought to improve their competitive position internationally and an important aspect of this has been the internationalisation of what have up until recently been largely Australian-based operations. The removal of restrictions on international capital flows with the government's deregulation of the financial system has facilitated this process. Internationalisation has quite obviously brought some rewards in the form of higher rates of profit. (A rough measure of this can be obtained by comparing the *Australian National Accounts*' estimates of the annual increases in corporate Australia's gross operating surplus - which measures the contribution that private enterprise makes to national income within Australia - with the Reserve Bank's estimates of all listed companies' gross profits - which includes overseas earnings. The rate of increase in listed companies' profits has been almost one per cent per annum higher than the annual increase in the gross operating surplus.)

Profitability and capital accumulation in Australia

The impression gained from official statistics on business sector activity suggest that the profitability crisis confronting corporate Australia is behind us and that capital can take comfort in higher profits. However, it is less clear that a solid foundation has been laid within the Australian economy for securing the future profitability of the corporate sector in general.

While there can be little doubt that the profitability crisis confronting corporate Australia has been relieved there is little evidence that this has led to any substantial increase in capital accumulation within Australia. There has been an expansion in new capital formation but this is not as strong as the growth in profitability. (A.B.S., 1988a, Table 33; R.B.A., Chart 12) What is evident, however, is that business has in general not invested much in expanding productive capacity but rather in substituting more up-to-date equipment for what has been for some time quite obsolete machinery. Indeed, as has been the case with B.H.P., this investment programme has often been associated with a dimunition in productive capacity.

Where individual companies have invested in productive capacity there is much evidence to indicate that this investment has occurred overseas and not within Australia. The internationalisation of corporate Australia has enhanced profitability which, in turn, has reinforced the the impetus for capital accumulation beyond Australia.

The final ingredient in the recovery of corporate profitability, namely the high returns on financial transactions, also highlights the fragility of the recovery. The high returns yielded on financial assets are very much contingent upon the maintenance of a high interest rate policy and can only be secured in the longer term 'hrough real growth and the inflation of the economy. The lack of investment in productive capital will severely constrain the rate of economic recovery necessary for securing corporate profitability in the longer term.

Increased profitability has not stimulated capital accumulation within Australia to any substantial measure. Hence what seems to be the Hawke government's continuing reliance upon wage restraint and changed work practices, tax and other concessions alongside the various subsidies and other perks offered by State governments in the vain hope of encouraging capital accumulation.

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