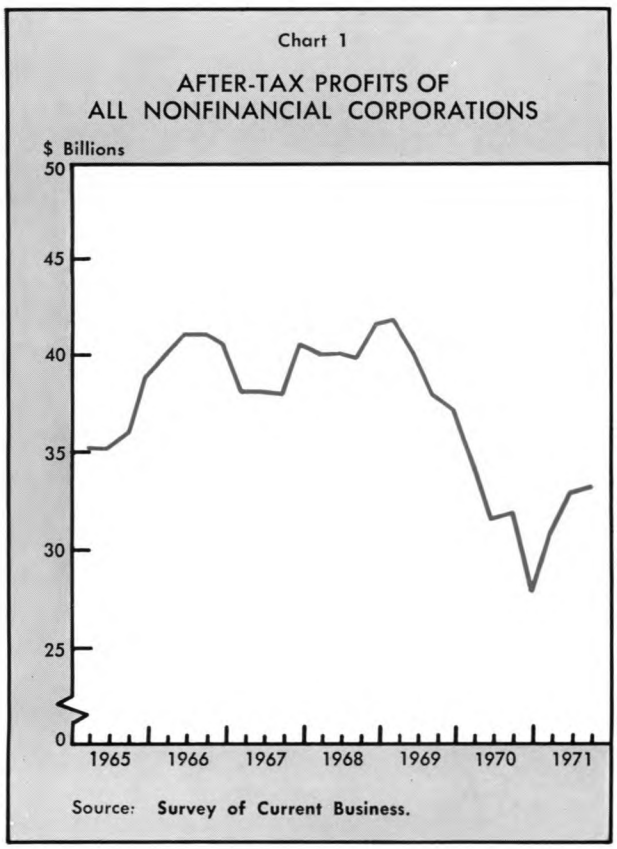
# PROFITS AND WAGES: 1965-1971

### Chart 1: After-Tax Profits of All Nonfinancial Corporations

After-tax profits of all nonfinancial corporations increased slightly between 1965 and 1968 to nearly $42.0 billion, and then declined steadily during the general economic slowdown of 1969 and 1970 to well below $30.0 billion. Although the low point in profits of $27.8 billion in late 1970 was primarily a result of the automobile strike in the fall of 1970, substantial increases in labor costs, in the face of only moderate gains in sales revenues, accounted for the 1969-1970 decline. Recovery from this decline began in early 1971, paralleling a step-up in the pace of economic activity, and since that time total profits have risen markedly. Since profits are often regarded as a "leading indicator" of economic activity, the improved profits picture in 1971 tends to support forecasts of substantial economic gains for 1972.




### Chart 2: After-Tax Profits as a Percent of Stockholders' Equity—Manufacturing Corporations Only

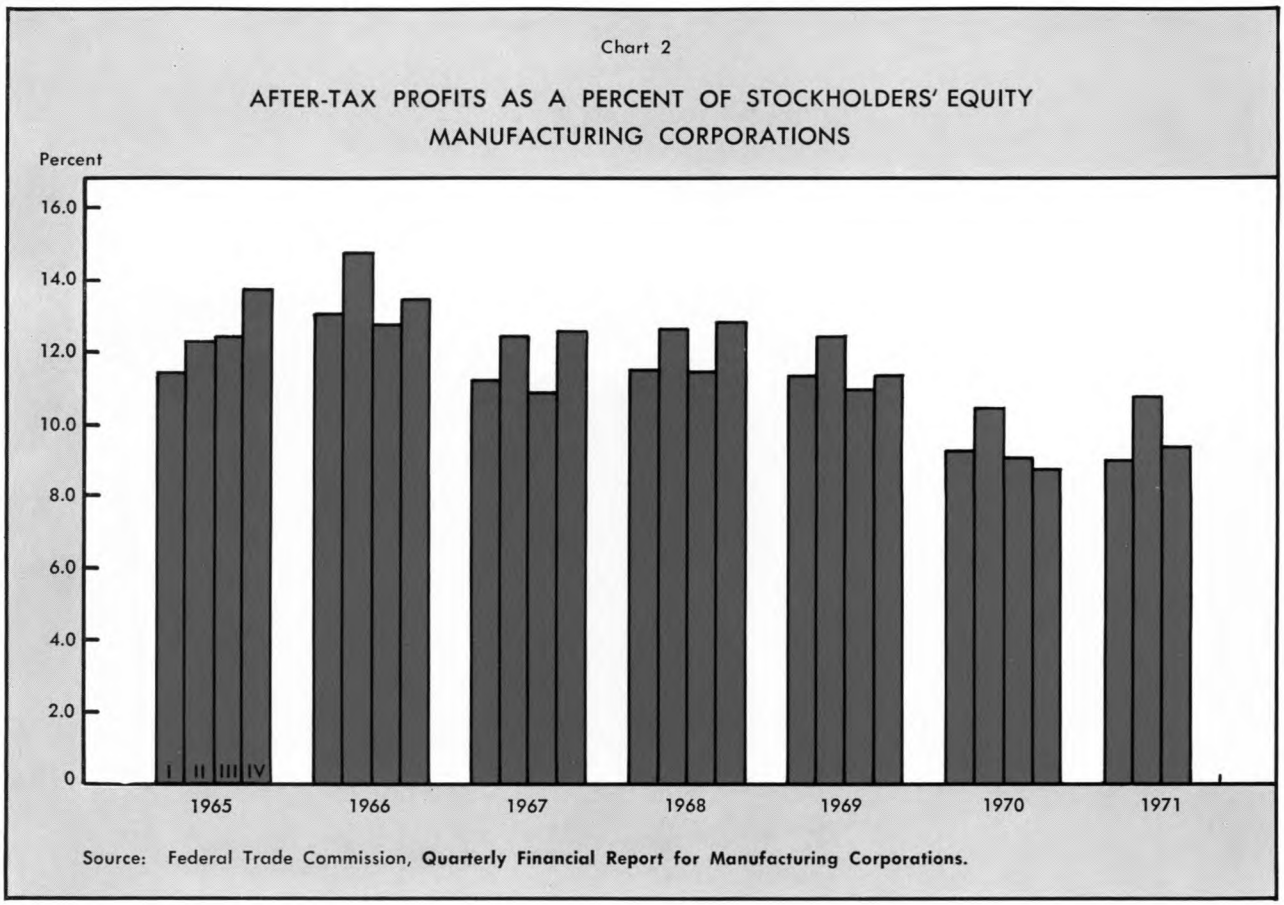
Return on stockholders' equity reached its post World War II peak in 1966. Thereafter, it began a steady decline that lasted through 1970. The return on equity depends on both profits and stockholders' equity. During the latter 1960's stockholders' equity increased fairly steadily, while profits actually declined. Thus, there was a decrease in the return on stockholders' equity. Such declines in the return on equity tend to dampen investor enthusiasm and generally contribute to poor stock market performance, as was observed in 1969 and 1970. Since early 1971, however, the return on equity has tended to improve, as profits have increased.

### Chart 3: Wages and Salaries Paid by Nonfinancial Corporations

From 1965 until the general level of economic activity slowed in late 1969, total wages and salaries paid by nonfinancial corporations increased at about an 8.0% annual rate. With the slowing of economic activity in late 1969, the demand for goods and services tapered off and many firms reduced employment and consequently their total wage bill. These cutbacks accounted for the leveling off in total wages and salaries paid during 1970. Improved economic conditions and substantial wage increases in several major industries contributed to the rapid increase in wages and salaries paid in 1971.

### Chart: 4 Wages and Salaries and Profits as a Percent of Sales

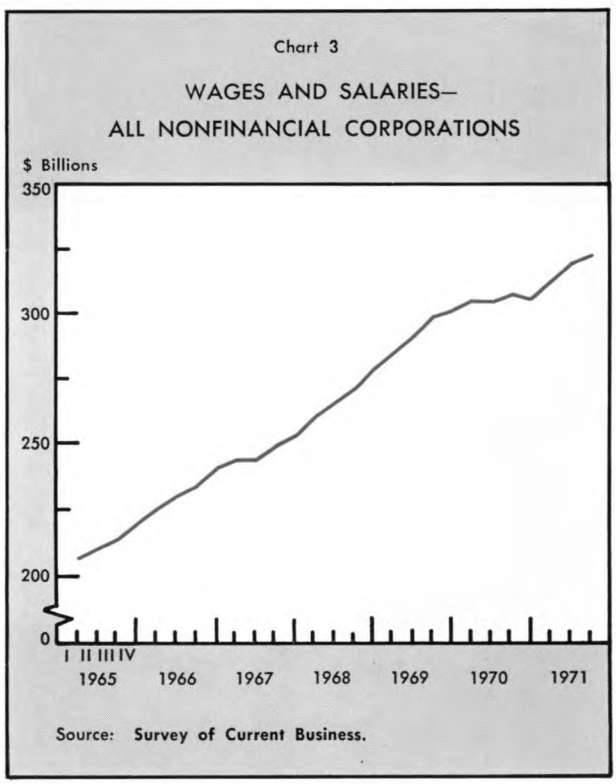
Wages and salaries as a percent of sales and profits as a percent of sales both fluctuated within a narrow range from 1965-1971. Although wages and salaries by themselves exhibited a dramatic increase during this period (Chart 3), sales increased sufficiently to prevent a major decline in profit margins. By 1971, sales increased faster than wage costs, allowing profit margins to improve. Although profit

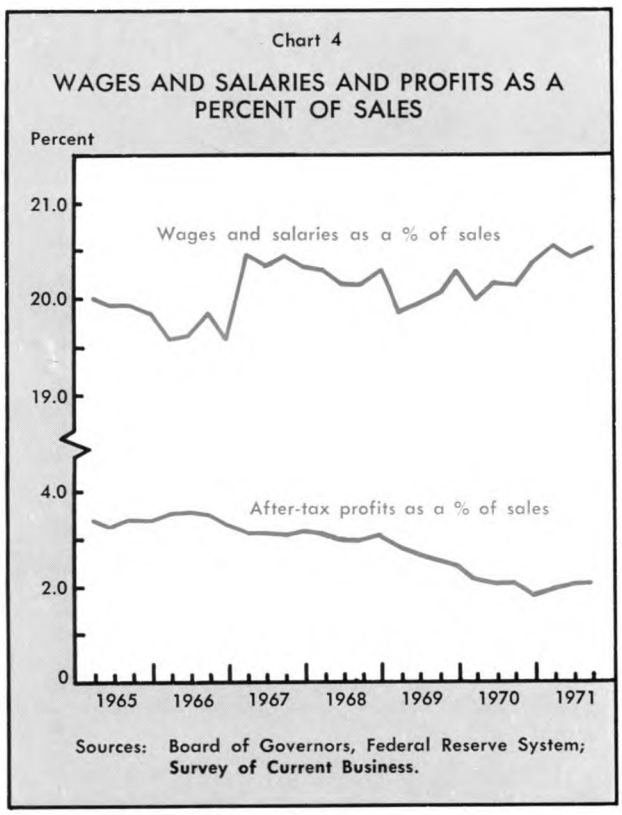


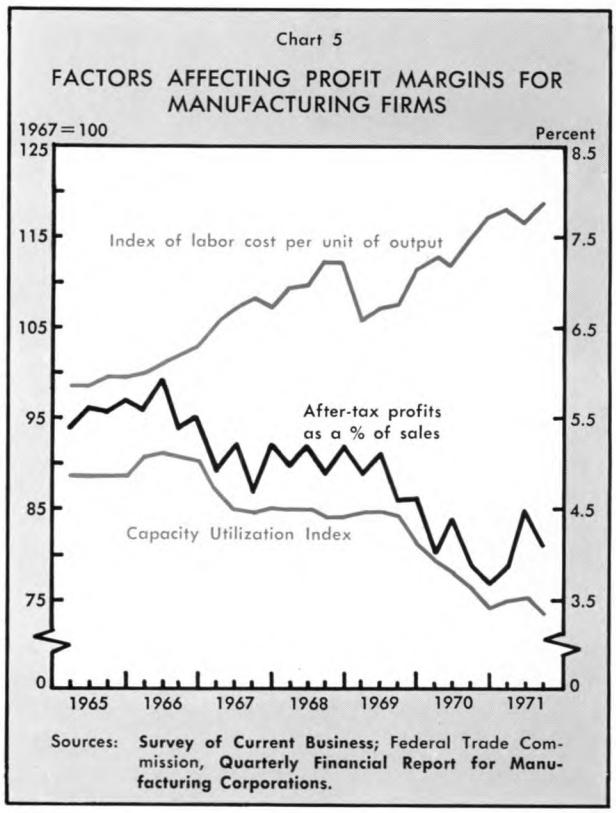

margins have historically declined in the second year of a business expansion, several factors suggest that this pattern may not hold in 1972. First, the improvement in profit margins in 1971 was relatively small. Second, gains in productivity, which serve to offset wage increases, are expected to be substantial in 1972. Finally, the new investment tax credit will reduce the effective tax rate for many corporations, which has a positive effect on after-tax profit margins.

### Chart 5: Factors Affecting Profit Margins for Manufacturing Firms

It is well known that at least two economic measures have a high degree of statistical correlation with profit margins. As shown in Chart 5, these measures are a capacity utilization index and a per unit labor cost index. The capacity utilization index may be interpreted as an indicator of the impact of fixed costs on profit margins, while the index of labor costs per unit of output may be interpreted as an indicator of the impact of variable costs on profit margins. As the capacity utilization index fell during late 1969 and 1970, firms produced fewer units of






output over which to spread fixed costs. Thus, profits per dollar of revenue also declined. The index of labor costs per unit of output is a ratio of hourly wage rates and productivity or output per man hour. The increase in this index, beginning in 1969, reflects both rising wage rates and declining productivity. Combined, these two factors suggest that cost per unit was increasing substantially during 1969-1971, which had a downward effect on profit margins.

*Philip H. Davidson*

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