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Enterprise and Cooperation. An Address Presented at Dinner Meetings of The Cincinnati and Cleveland Chapters, Ohio Society of Certified Public Accountants, December 11 and 12, 1940

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ENTERPRISE AND COÖPERATION

AN ADDRESS BY

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President

American Institute of Accountants

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Enterprise and Coöperation

BY C. OLIVER WELLINGTON

ACCOUNTING has become more and more vital in the national economy. It is necessary for the determination of net taxable income, which is the base for calculation of such a large proportion of our government revenue. It is necessary for the determination of the cost base for rate making in public utilities, costs and prices for individual enterprises, and special data required in cases under the Robinson-Patman act; in studies by the Federal Trade Commission; and in answer to inquiries by many other government bodies.

The practice of public accounting as a profession in this country is fifty years old, and we are proud of the fact that in that brief span of years such great progress has been made. The profession has created its own discipline, which is an active force at all times safeguarding the standards of public accounting. It has been constantly on the alert to take advantage of opportunities to improve and develop its services to business, government, and the public.

Over a long period of time, committees of the American Institute of Accountants have coöperated with agencies in the federal government, notably with the Treasury Department in tax matters, and with the Securities and Exchange Commission in its efforts to improve corporation reports. In all of this work we have tried to be helpful and constructive.

In their approach to professional work for clients, accountants are inde-

pendent and therefore have a somewhat detached viewpoint. Accountants in the daily practise of their profession have opportunities to observe the progress of many enterprises and the effect on them of various economic factors induced by wars, by business cycles, and by acts of government.

My talk to you tonight is based upon this background of experience that other members of the profession and I have had with the affairs of business enterprises, large and small. I shall seek, in the limited time at my command, to point out what I believe are some of the things accountants, other professional and businessmen, and government officials can do coöperatively for the good of our country. We must agree upon the problems which face us and come together on a basis of understanding and confidence in order to create a situation in which all of us are working effectively together.

TAXATION

One of the most important fields in which accountants can coöperate is that of taxation.

Many tax returns, especially those for income tax, are based on the findings of public accountants. From this experience of many years in preparing returns and discussing details in regard to items of income, expenses, invested capital with clients and with government officials, accountants are in an especially advantageous position to know what is sound and workable.

While the experience of our profession can be of great value in the consideration by states and municipalities of provisions of their tax laws and the forms and regulations for their enforcement, what I will say tonight in regard to taxation will apply primarily to federal taxes, with special reference to those based on income.

Federal taxes are a nightmare to business management, not because they mean that business must pay taxes, but because of the uncertainty and nervousness which they create. It is impossible for management to plan properly for the future when the spectre of new forms of imposts and levies hangs over company executives.

The frequent revision of tax laws has been one of the major causes of hesitancy on the part of business.

Congress could do no one thing of greater importance today, to assure future economic stability, than to set itself seriously to the business of adopting a consistent and permanent policy of federal taxation. Fixed principles of taxation are urgently needed to give businessmen—all taxpayers, in fact—the necessary confidence to face the future. A permanent tax structure should be established, and it should be subject only to changes in rates to meet the varying requirements of the federal budget. Such changes should be made in advance of the taxable year and should never be retroactive. Business can adjust itself to changing rates so long as such rates are not confiscatory, but staggers under the impact of successive changes in the general scheme and incidence of taxation, a procedure which calls for new interpretations of tax provisions from year to year.

We have now had a quarter century of experience with income-tax laws. At no time in the past twenty-five years has an effective attempt been made to study the results of our national and state taxation policies, and the results of particular tax laws or provisions

thereof. There is only one intelligent way to do this and that is through a nonpartisan commission which would report its findings to Congress.

I do not suggest that legislative or administrative powers be delegated to the proposed commission; it is merely expected to function as a study group in examining national tax problems and, on the basis of its deliberations, to recommend to Congress the adoption of such principles and methods of taxation as would promote uniformity and simplicity and remove as much as possible of the present complexity and uncertainty.

I realize that a study by a nonpartisan commission created by Congress will take time and will not immediately produce results, but a start must be made at some time. Pending completion of the study, interim reports and recommendations can be available to Congress.

Tax legislation should be designed only to produce revenue on a basis equitable to those of our people who must ultimately bear the burden thereof, and it should not attempt to accomplish social reforms, however desirable they may be. The prime purpose of revenue laws is to produce revenue to pay for the services of government. When they seek to accomplish other results, both efforts fall short of the mark and neither goal is attained.

But while social reform or control should not be sought through tax legislation, the necessary social and business effect of taxation for revenue only cannot be overlooked. Taxation is a monopoly of government and it is subject, as are all monopolies, to the economic law of diminishing returns, not only of revenue, but also of industrial activity and employment.

Tax laws should levy the burden on a basis equitable to all, recognizing ability to pay and benefits received. They should, so far as possible, encourage rather than deter business activity, pro-

duction, and employment. They should be certain and definite so that business will know its obligation and its liability. They should follow business practice rather than run counter to it. They should minimize administrative difficulties, disputes, and litigation, and should encourage taxpayer cooperation.

There are a number of provisions in existing federal tax laws which should be changed for the general good of our whole national economy. The most urgently needed changes at the present time are, in my judgment, the following:

1. Creation by Congress of a qualified and representative nonpartisan commission to undertake a study into the whole tax problem and recommend a consistent and permanent policy of federal taxation.
2. An understanding and agreement that no changes in tax laws or regulations will be retroactive, so that business transactions can be entered into with confidence as to the definite amounts of tax liabilities involved.
3. Broadening of the base of taxation so that all citizens will pay a tax, even if a very small amount, and thus realize that government activities cost money and that every citizen must bear a part of the burden.
4. Elimination or further reduction of taxes on capital gains.
5. Reduction of rates of tax in higher surtax brackets.
6. Inclusion as taxable income of interest on future issues of all state and local as well as federal securities.
7. Provision in the Internal Revenue Code of a requirement for consolidated returns for all taxes based on income, in order to tax a true business unit as one unit.
8. Revision of the computation of taxes for periods of less than twelve months to eliminate unjust hardship and tax avoidance.
9. Elimination of the capital-stock and related excess-profits taxes.

Some of these recommendations have such obvious advantages as to require little further comment. There are cer-

tain ones, however, that are worthy of very careful consideration by every citizen who is interested not merely in the present but also in the future economic status of this country. I am very much worried about the situation confronting our children and grandchildren unless changes are made in some of the present theories and practices of taxation.

One change is the broadening of the base of taxation so that all citizens will pay a tax. This can and should be brought about by a system of deduction at the source, such as has been used successfully in Great Britain. State unemployment and federal old-age-pension taxes are now handled on that basis, and income taxes should offer no greater relative difficulty. The normal tax, at a rate to be determined by Congress, would be deducted by the payor, who would be responsible for turning over to the government monthly, or perhaps quarterly, the amounts withheld. This would apply to payments of wages, salaries, interest, dividends, and royalties—the principal sources of income to individuals, but would exclude rents. No exemption would be allowed for this normal tax, thus saving the filing of numerous reports and avoiding complications, expenses, and administrative difficulties.

The recommendations for taxation of interest on future issues of all state, local, and federal securities; the reduction of rates of tax in the higher surtax brackets; and the elimination or further reduction of taxes on capital gains may well be considered together. The purpose of the changes is not to reduce the taxes of the wealthy, but to encourage capital to enter into productive enterprise and to discourage its use in relatively unproductive forms. Such changes will undoubtedly increase, rather than decrease, the total amount of taxes collected by the government, but I am advancing these suggestions, not from the standpoint of increased tax receipts, but

for their effect on the whole national economy.

Statistics compiled by the International Labor Office at Geneva show that in 1930 the average real wages or standard of living of a wage earner in the United States was approximately double that in Great Britain and Germany, and many times that in some other countries. Other statistics show that there were corresponding differences in the use of power and in the investment of capital per employee. It seems clear that our higher standard of living has come through increased use of capital, and that any improvements in that standard will come through use of larger amounts. What are we doing to insure an increased use of capital?

In the years since 1929 many corporations have lost more than they have earned and, instead of a normal growth that might be expected, they have actually less capital now than in 1929. In general, we as a nation have since 1929 been living in part on the capital accumulated in the preceding years. Obviously this fund of capital is not inexhaustible and we cannot count on it permanently for current living.

In addition to the reduction of capital of corporations a large share of the accumulated capital of individuals is being taken by the federal and state governments through increasingly heavy gift and estate taxes. What is worse, they are spending it as if it were current income. They should at least use tax receipts from such sources to reduce their debts.

Government is not only reducing the total capital available for increased employment and improved standards of living, but is also preventing the accumulation of any new capital by heavy taxes on capital gains and high surtaxes. We have seen the harmful effects of such policies during the last ten years, but these effects will become increasingly bad in the future unless a change is made.

Where is the capital coming from to develop new ideas and methods? All well managed large companies are now spending substantial amounts for research. While that is very helpful in opening up new avenues for production and employment, is it good for our national economy to have these companies grow larger and larger, and become practically the only source for increased employment?

Improvement in our total standard of living must come from the development of new inventions, new processes, and new ideas. Practically all businesses active today started from very small beginnings. However, experience over many years has shown that only a small proportion of new projects become commercially successful. In the past, those who have backed the successful projects in their early stages have made very large profits, and it is the hope of similar success that encourages people with capital to back other new projects.

While it has always been difficult for a man with a new idea to obtain the necessary capital for developing the idea, he had at least some chance prior to the period of high taxes. However, under present conditions, if a new project becomes commercially successful a very large share of the profits is taken by the government in taxes. On the other hand, if the project is unsuccessful there is often great difficulty, under the present administration of the tax laws, for the man who backed the unsuccessful project with his capital to obtain proper deduction for the loss sustained. Under the circumstances, the chances for any net profit after taxes are so far outweighed by the chances for losses that the man with capital naturally prefers to place it in investments carrying little income but with little risk. What we need is more enterprise capital.

Can we blame men with capital, ability, and energy when in recent years they have in effect said, "What's the

use?" Is it not better for the national economy to encourage these men to be active in productive work and to make their capital active? Is it not better for the country to have their help toward increased employment and the increased production of desirable things and services, even if we have to reward the ability and capital of these men instead of penalizing such ability and capital when used for productive enterprise?

Have we not been thinking about this whole question of taxation from the wrong viewpoint? The present tax plans may to some extent "soak the rich," but the soaking is applied to those members of the wealthy classes who are active in their personal efforts and in their use of capital in supporting the enterprise system, and there is a relatively small tax on the wealthy who put their capital into nontaxable and other riskless securities. Our tax plans have discouraged enterprise in recent years when we have most needed it.

Why should we not turn about in our policy and actually encourage the creation and growth of new enterprises? Various localities attract industries by reducing taxes for a period of years. Why is it not equally sound for the federal government to encourage new businesses by eliminating the tax on capital gains, thus giving a definite advantage to enterprise capital over idle capital?

There is nothing novel about this suggestion. The British government does not tax capital gains, although its need for revenue in recent years has been at least as urgent as ours, and social reforms in England have been at least as sweeping as in this country.

Studies made as to the changes in business enterprises show that, over a period of years, a substantial number of the corporations listed on stock exchanges go out of business, in addition to those that fail and are reorganized. Similar studies of all businesses in certain states, including very small as well

as medium-sized and large enterprises, show an average life of less than ten years and an average life of about thirty years for even the largest. It is clear, therefore, that we must have many new enterprises started each year merely to take the place of the old ones that cease to exist, that there must be a substantial increase in the number of new enterprises started if we are merely to keep up with the growth in population and thus continue the present standard of living, and that the increase of new enterprises must be even greater if we are to improve the standard of living.

Yankee ingenuity has been developing and is continuing to develop new ideas and new methods in engineering, in chemistry, in physics, in fact in all fields. Yet we have been so shortsighted in our federal tax policy that many of these ideas are never put into commercial use and others are long delayed. The Ford Motor Company could never have been started without some backing of capital, and it never could have developed as it did if present tax laws had been in force during its period of growth. How many potential Ford Motor Companies are now choked to death at birth and how many others are having their growth stunted by federal taxes?

In the foregoing discussion I have been referring to a viewpoint toward the whole tax situation that I believe is sound as a permanent policy rather than what may be applicable in time of war or abnormal preparation for defense. However, the rather broad contacts of our profession with business give us some knowledge as to the probable effect of present tax laws and the necessity for further increases in tax rates. These contacts with many taxpayers, especially corporations, indicate that the tax yield, based on 1940 taxable incomes under the new acts, will be very much higher than anticipated by the administration or by Congress.

Increased revenue from taxes is pro-

duced not only by tax rates and tax provisions but also by the increase in the level of national income. Is it not likely that, with increased government spending on preparations for defense, the general stimulus will be such as to increase national income very substantially? If so, the increases in the tax yield over last year, and the increases in the total taxes, are likely to be very large. The present tax laws may well produce as great a proportion of the total national budget as is reasonable or safe under current abnormal conditions. Is there not a fair chance that further increases in taxes on business beyond the very heavy present rates will actually result in reducing net taxable income and reducing, rather than increasing, the total tax receipts?

Therefore, is it not desirable, before applying new taxes or additional rates, to wait until the Treasury Department has the facts as to the yield from present taxes, so that, with these facts, it can determine the taxes that will be received from the known and expected increases in total national income?

May I suggest the possibility that public statements, both by the Treasury and by Congress, that no changes in tax laws are contemplated to affect incomes of 1941, might bring about a situation which would yield the maximum tax return to the government by enabling business and all taxpayers to go ahead with confidence to increase production and profits, knowing the share of such profits that the government would take. Might not this suggestion be very helpful also in removing one obstacle to maximum production, which is so vital to the effectiveness of our aid to Great Britain and of our own defense program?

GOVERNMENT

I have just referred to the budget of the national government. The total of that budget, the means of raising income to balance the expenditures, and the ex-

tent by which expenses exceed income are of vital concern to all citizens at all times. Unnecessary expenditures, inefficiency, and wastes are bad during prosperity as well as depression. Unfortunately, we look upon them with too much complacency in normal times, but no one will disagree that every unnecessary expenditure must be eliminated during the present intense drive toward adequate preparedness for defense. There will, however, be many disagreements as to what expenditure is and what is not necessary.

Should not all governments, state and local as well as federal, apply to their affairs the same kind of studies that are made by large corporations? The better managed large companies follow the policy of having made, every five or ten years, a careful study of procedures, records, organization, and personnel, to see whether there are not some methods or activities that are no longer required or are unnecessarily cumbersome.

Government is big business. It is the biggest business in the country. From the federal government on down through the state and local governments there are 175,000 public bodies politic which have the right to levy taxes.

This vast network of taxing bodies spends annually upwards of fifteen billion dollars. In 1890, just fifty years ago, it spent a little less than 900 million dollars, or about 6 per cent of the present total.

These taxing bodies have already resorted to what appears to be almost every conceivable sort of tax levy. Yet it is obvious that the end of the variety of taxes is not in sight.

The problem of how to divide the subjects of taxation between the federal, state, and local governments grows more difficult daily. Already there is serious overlapping; overlapping that threatens the fundamental plan upon which our whole scheme of government was founded; overlapping that seems to be carrying us inexorably toward the

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supplanting of state sovereignty by a strong central government.

Government employs four million people, not counting W.P.A. workers and beneficiaries of farm subsidies. At least fifteen million people, therefore, are supported directly and indirectly by the taxpayers. This takes five and one half of the fifteen billion dollars of annual expenditures.

Operations of the magnitude and complexity implied by these figures require accounting and financial control of the highest order. Yet until only a few years ago very little attention was paid to governmental accounting. Even today the federal government does not have an accounting system worthy of the name, and the same can be said for many municipalities and other public bodies.

Through its special committee on governmental accounting, the American Institute of Accountants has taken an active part, as one of the national organizations that constitute the National Committee on Governmental Accounting, in improving the quality and scope not only of governmental accounting and reporting but also of public administration generally.

The administrative device of budgetary control is peculiarly suited to the management of public affairs; the power to tax makes it so. Faithful use of and reliance upon it were never more necessary than they are today. We should know what a budget is. We also should know what it is not. To be more specific, we should know that a budget is supposed to be a financial plan, the result of careful estimating, not just a lot of generalizations put down on paper as a matter of ritualistic procedure and promptly forgotten. As auditors we are particularly qualified to view the acts of management in relation to a budgetary plan.

Good accounting and budgetary control should be helpful in efforts toward economy. The federal government has

embarked upon the greatest peacetime spending program in its history; a program which probably will entail more spending than for the first World War. While national defense is the job of the federal government, the states and their local governments will have to carry a part of the burden. As a matter of fact, they already are doing so. Every level of government will be affected.

In such a situation economy ceases to be just a virtue; it becomes also a patriotic duty, and should be rigidly practised. Every dollar spent for defense should buy a full dollar's worth of defense; and the federal, state, and local governments should not spend a dollar on defense or any other activity that can be saved. Economical management doesn't just happen. It is the result of careful study, intelligent planning, and skilful direction. It presupposes withdrawing from, or refraining from carrying on, any activity that is not essential and also the effective organization of those activities that are essential.

With current increases in production and the improvement in business generally, there has been a reduction in the cost of relief. State and local governments must do their share to see that such savings are not lost by increased costs of other activities or development of new activities, but, on the contrary, that they are either passed along to the taxpayers in reduction of taxes or used to reduce the debt.

As owners and supporters of these governmental bodies, the taxpayers are entitled, as they would be in any business in which they invest money, to a financial accounting. Officials and employees of these public agencies are servants and trustees of the taxpayers. They are accountable to those who provide the necessary resources and are under obligation to make a suitable return of their stewardship. They must have the interest and support of the citizens whom they serve in order to secure the revenues essential to carry on

the public activities for which they are responsible.

The town of Greenwich, Connecticut, begins its annual report with the following statement:

"Whether you pay direct taxes as a property owner, or whether you pay taxes indirectly through rents and purchases, this report is addressed to you as a citizen-stockholder of Greenwich.

"The town government is your business. You finance it. You choose and hire the people to run it. The owners of any business must give it time and attention if they wish it to be run to suit them. How much attention do you give to the business of your town?"

"Here is some of the information you need to begin with."

Many public officials issue comprehensive and informative reports to taxpayers, and the number is steadily increasing. However, a large portion of the 160,000 agencies of local government still make no such accounting, or at best a most inadequate and unsatisfactory one.

Economy and efficiency in government are not a necessary result of better accounting methods and more informative reports, but such methods and reports are almost invariably the first step toward improvement. It is a responsibility of all citizens to see that all services really necessary for the community are administered and operated efficiently, that no such service extends its activities beyond the reasonable requirements of the community, and that unnecessary activities are eliminated. Only by vigilance in these matters can we stop the continuing increase and bring about a decrease in the terrific burden of local and state taxes.

SOCIAL GAINS

The increases in federal taxes and in state and local taxes to which I have referred are undoubtedly justified in part by the social gains achieved and by the greatly increased activities of gov-

ernment in doing for citizens what they formerly did for themselves.

There is serious question as to whether the necessity for each citizen to think and act for himself and for the best interests of his family, may not produce a stronger and sturdier type of citizen than one who learns to lean upon the government. We may discover that the weakening of moral fibre of the people will be far-reaching in its effects as time goes on. This evening, however, I have only time to consider social gains in their relation to enterprise and coöperation.

In the whole economic history of the world the only peoples that have developed any reasonably good general standard of living have done so under a system of free enterprise or private capital. Restrictions and restraints by governments have varied as between nations, but in those that have progressed economically it has been possible to acquire, keep and use private capital.

Over a long period of years there has been accumulation and use of more and more private capital and this has resulted in greater and greater improvement in the standard of living.

I have already referred to the reports compiled by the International Labor Office at Geneva which showed that real wages in the United States were approximately double those in Great Britain and Germany and many times those in other countries. The advantages that the United States has in real wages corresponds closely to the advantage in the use of capital per wage earner as compared with the other countries.

It is interesting to note that, in the United States, each decade for more than the last one hundred years has shown an improvement in real wages and the standard of living, and that in the last ten years for the first time we have seen a decline rather than an increase in per capita income. A recent report based on data from the Depart-

ment of Commerce, grouped by federal-reserve districts and comparing 1929 with 1939 shows that there has been a net decrease of approximately 20 per cent in the average per capita income, and that there is a decrease in every single district, ranging from approximately 9 per cent in Richmond to 25 per cent in New York. Other statistics show that during the same ten years there has been, also for the first time, a decrease instead of an increase in the net capital per wage earner employed in industry.

Considering these and other comparisons based on published indices we must be careful not to be misled by those that show current business activity substantially above one hundred, and give the impression that current conditions are much better than normal. In 1940 the federal-reserve index was changed so that it now appears to be about 30 per cent more favorable than it would appear if it had been continued on the old basis. Three of the well-known indices are adjusted for increases in population and therefore are more correct measures of real average standard of living. Of these, two that take the years 1922 to 1925 as a base, show the current level at less than one hundred, in spite of the defense activities.

It is clear, therefore, that there has been no net social gain, represented by average income per capita, in over ten years, and that any apparent gain has been due to government spending in excess of income, and the increase in the national debt. If any group or groups have made a real net gain it has been at the expense of other groups.

Changes in the basis of distribution as between groups may temporarily help not only those groups but the national economy as a whole, but the only permanent gain is a real improvement in the standard of living of all, expressed not merely in dollars but in the things that the dollars can buy or, in other words, in the reduction of hours of

labor required to make and distribute the things needed.

Human wants are never satisfied, and an ever-increasing satisfaction of human wants and desires represents real progress. Normally, if an individual wants more than he has, he works harder or for longer hours to earn enough to satisfy that want. Unless there is this increased effort his desire will be satisfied only by giving up something else he now has. If we apply this sound reasoning for an individual to the country as a whole, it is clear that we can have an increased volume of things we desire or need only by giving up other things or by working harder to have both.

This logic is especially deserving of emphasis at this time with the imperative necessity for greater and greater production for national defense. We cannot win a war or build up adequate defense against a possible war and still carry on business as usual. Each of us must make some sacrifice. We are asking young men to give up their business and professional careers to enter the armed services, we are asking capital and management to take increased risks and pay increased taxes, and we must expect all other citizens, agriculture, labor of all kinds, and all professional and businessmen to make equivalent contributions.

We are vitally in need of greater total production. To obtain this requires the elimination of wastes and inefficiencies, the elimination of restrictions or controls that interfere with production, and also greater efforts and coöperation. If, in addition, it requires greatly increased hours of work, such increases should be given willingly and cheerfully.

The danger is that we will not provide defense fast enough, first for Great Britain and then for ourselves. As a nation we have grown soft, we work shorter hours and we take long week-ends and vacations.

Our wage-and-hour law was advocated to help increase employment, but

there is already a shortage of trained and qualified men in some industries. The reduction of hours is much more dangerous than the requirements for increased wages. It seems obvious that the production needed for adequate defense in time to be of value will require many more hours and much harder work by all of us. France did not give up her forty-hour week until it was too late. England was very slow to change its business customs to make possible adequate preparations for defense. Are we willing to look the situation frankly in the face and do what we obviously should do for our own protection?

If we now seek to emphasize our social gains, and as a result fail to produce and lose the war and come under the control of the dictators, where will our social gains be then? Even if the United States is not attacked in war, it will be attacked economically. We must be prepared to defend ourselves economically.

I realize that you may be tired of hearing about the attempt of France to extend social gains beyond what that nation could afford, and the contrast in the situation before the war between France and Germany, yet this contrast cannot be emphasized too often or too strongly. Progress by nations as well as individuals is based upon experience. Many will believe that a theory is sound until they have seen in actual practice that it does not work. Communism appealed theoretically to many people in all countries, but when given an actual trial in Russia worked so badly that Russia has already gone back to a partial recognition of private property. National prohibition had many theoretical advantages and it took actual trial in this country over a period of years to prove that it would not work.

Too many people in this country in the last ten years have attempted to ignore the lessons of history. Let us hope the recent experience of France will con-

vince practically everyone that social gains cannot be forced at a greater rate than the economy of the country can support, and further that we must not set up any inflexible system, which, even if it fits conditions of one year, may be grossly out of proportion to the conditions of another year, such as the present when we are faced with the necessity for extraordinary preparations for defense.

While, as I have stated, reduction of hours is more dangerous than increased wages, we must realize that increased wages, caused by paying time and one-half for time over forty hours or any other limit set by law, will be paid by all of us and not by the employer. The employer merely increases his costs and increases his prices accordingly, and we pay the increases in what we buy, or we pay through taxation for the increased prices of the products the government buys. Broad approval or disapproval of the wage-and-hour law must be based on whether the total wages of one group, including time and one-half for the overtime which must be put in if each of us is to do his share in the present emergency, are unreasonably large in comparison with wages of others and with the net return, after deducting taxes, to capital and to management.

PRICES

I have mentioned increased prices because of increased costs of labor. Increased costs are one influence and probably the most important influence in increasing prices, but prices are also affected by increases in demand, by a scarcity of supply, or by artificial price controls on the part of the government, or management, or labor. The government can and should use every reasonable effort to keep prices from increasing unduly and can bring some influence to bear upon demand, supply, and price controls. It has relatively less control over costs, but even with costs it can use its influence if it is willing to do so.

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Costs are made up of materials, labor, operating expenses, and taxes. The material cost itself is largely the result of the cost of previous labor, operating expenses, and taxes. Every time we have additional federal, state, and local taxes, or additional governmental restrictions on enterprise, there is an increase in costs. Every time there is an additional restriction through action of a labor union there is an increase in costs. All of these increases must be covered by increase in prices, if business is to survive.

In only a few cases can we fairly blame price increases on excessive profits. Business as a whole makes a very small profit; in fact, profits are too small for the economic well-being of the country. The enterprise system is rightly referred to, not as the "profit system" but as the "profit and loss system."

Reports by the Treasury Department based on the income-tax returns of all active corporations show that, for the twelve years 1927 to 1938, inclusive, the net profit after taxes was on the average for all twelve years only 3 per cent of the net worth or capital invested. The highest rate of return, 7.5 per cent, was earned in 1929 and the lowest, a net loss for all corporations of approximately 3 per cent, was made in 1932.

A recent compilation of reports for two hundred active companies shows that, while profits have increased substantially for the nine months ended September 30, 1940, over the similar period for the year 1939, the rate of increase in profits is not equal to the rate of increase in volume of sales.

Therefore, with the very small average margin of net profit, if we are to prevent price increases, we must prevent increases in costs, both the costs of industry and the costs of government which industry must pay through taxes.

It is well known that, with a high level of operations and pressure for increased output, costs are likely to get out of

hand unless continuously and carefully checked. One of the best tools for management to use in checking is budgetary control. I have already mentioned its value in connection with governmental accounting, and it is equally important for business enterprises. Another effective tool for management is a detailed control of operations through setting of standards as to what materials, labor, and overhead expenses or burden should cost. Then actual current operations are compared with such standards, and management is advised promptly as to any points at which actual costs are exceeding the standards that have been set.

While in the past it has been the practice to report such variations between actual costs and standards monthly, or perhaps weekly, such reporting periods are not effective under present conditions, and industrial accounting should now be planned to give daily control. Daily reports not only help toward current correction of matters that should be corrected, but keep the idea of cost control constantly before each man, and keep the whole organization on its toes.

After the present war there will be intense competition for trade all over the world, and the only way that we can exist in competition outside of our own tariff walls is through lower costs of production. With our higher wages and higher living standards we can compete only through greater uses of capital and better methods by which we will produce a vastly greater total of items per man-hour.

We would all like to see the present standards of wages and living conditions not only continued but improved, and the only way in which this can be accomplished is by doing everything possible to eliminate waste and increase efficiency, and on the other hand by removing every law or regulation which tends to retard or limit production.

After a fairly long experience working with numerous enterprises in this coun-

try, I have great confidence that American management will direct American labor in effective use of American capital so that, if government will cooperate with and not obstruct the enterprise system, improvement in the real standard of living will continue to be made in the future as it has in the past one hundred years, prior to the last ten.

LABOR UNIONS

I have referred at some length to social gains. Probably the greatest increases in social gains of the last ten years have gone to wage earners. While, in these ten years, length of the work week has decreased approximately 25 per cent, the average weekly wage is greater, and, inasmuch as the cost of living is less, the purchasing power of the substantially shorter week is nearly 20 per cent higher now than in 1929.

With these increased rewards, and with increased opportunities, labor—and especially union labor—must also assume increased responsibilities.

Recently several labor leaders who have been honest with their members have stressed to them the relations between wages, costs, and prices, have pointed out the necessity for a business making a profit if it is to continue, and have warned against unreasonable restrictions of output or increase of wages which will drive costs up to a point where the company would have to cease doing business.

A recent editorial by William Green in the *American Federationist* calls attention to an agreement between a large metropolitan union and a commercial concern which contains a provision that the concern will permit examination of all its records by a certified public accountant chosen by the union for the purpose of "ascertaining those representations which have been made by the company with respect to losses sustained in the operation of this business."

In view of the fact that labor disputes may often rest upon misunderstanding

of the profits made by a particular concern, an agreement of this character seems most appropriate. As Mr. Green points out, under this procedure discussion between company and union is properly confined to the "consideration and interpretation of facts."

It is quite possible that wide adoption of this method of negotiation, resting on figures and statistics provided by an independent certified public accountant, will do much to eliminate distrust and to expedite the solution of many labor-employer conflicts. Controversies of this sort should not be clouded by emotional recriminations. They should be settled as business problems, on the basis of the law and contractual provisions as applied to the facts of the individual case.

It has recently been reported that some of the larger unions are considering the employment of a firm to handle public relations for them. Let us hope that they will go through with this plan, as the public should know more about unions—what their ideals, policies, and practices are. However, in advance of efforts toward better public relations, they may well take the advice that has been given to corporations: that, before undertaking any work in public relations, they should be sure that their own internal relations are in the best possible condition—as sound internal relations are a necessary foundation to any effective campaign for improved public relations.

We have heard a great deal in recent years about the "forgotten man." I wonder if the real forgotten man is not the average union member, who does not aspire to office in the union but merely does his day's work conscientiously and effectively. Such a man is entitled to protection from possibly dishonest or racketeering officers of his union.

Stockholders have been protected by annual audits by independent public accountants and this protection has

been extended by the activities of the Securities and Exchange Commission, requiring greater disclosure of facts regarding the operations of companies and especially of the relationship between a company and its officers and directors. If such protection is deemed to be necessary for the average stockholder, is it not even more important to give similar protection to the average member of a union? All unions should be required—not only by their own by-laws, but by legislation if necessary—to have audits by independent public accountants and publication of such audits at least to all members.

An inquiry made recently of forty unions affiliated with the American Federation of Labor brought the following information: Replies were received from seventeen of the forty affiliates. Fifteen were audited by independent certified public accountants, but of this group only two reported that their statements were published in the magazine of their union. Two of the seventeen reported that their audits were made by members of the union, not certified public accountants. Of these two, one reported that its statements were made public.

From the above record it is clear that the importance of independent audits has been recognized, but the protection to the individual member is much less than it should be in the case of the majority of these unions.

That protection is needed for members of unions is clearly indicated by recent cases of unfaithful union officials that have been reported in the newspapers. The recent report of the Citizens Committee on the Control of Crime in New York lists and comments upon nine conspicuous cases of rackets involving labor unions in New York City that have been uncovered in the year 1940.

The English trade-union act provides for voluntary registration of unions, the chief benefits of which are that they may carry on their affairs through a board of trustees having a continuing

existence and that their benevolent funds gain a limited exemption from taxation. In return, the unions must file with the registrar an annual accounting of their general funds as well as a copy of their rules, which must provide for an annual audit for inspection of books and membership lists by any person having an interest in the funds of the union.

Every English trade union, whether registered or not, must make a periodic accounting of its political funds.

Honestly administered American unions will not oppose but will welcome independent examinations, for independently audited published financial statements support a presumption of their officers' integrity; they inspire the trust of the membership and the confidence of the general public.

COÖPERATION

The enterprise system includes all involved in an enterprise—not merely the management, not merely the capital, but all concerned—capital, management, and labor. They are all interested in the success of the enterprise, and to make it successful all must coöperate.

The normal condition in this country is that of intense competition, between all enterprises in an industry, and between one industry and another. If an enterprise cannot meet this competition and is forced to close there is an immediate loss of capital and a loss to management, but the greatest loss is to labor. Any attack on business hurts labor more than it hurts either management or capital.

Our whole civilization is built upon the enterprise system. Every citizen of this country is directly or indirectly supported by enterprise and all the money spent by government must eventually come from enterprise, out of its margin between other costs and selling prices. With such mutuality of interests should there not be the friendliest and closest coöperation between all enterprises and all governmental bodies in an

endeavor to improve the conditions of all citizens?

At the present time nothing would be more stimulating to the American people than the public spectacle of government and enterprise working more closely together, with government really doing everything it can to encourage enterprise, and with enterprise doing everything it can to help government.

Government can encourage enterprise, as I have already suggested, by improving the tax structure and by more efficient control over expenditures of government funds. In addition, government can assist in the following ways:

1. Make it a basic policy to avoid any activity which will compete with private enterprise.
2. Give full protection to the employer as well as to the employee in labor disputes which require government action in their adjustment.
3. Remove in so far as possible the burden on enterprise of excessive numbers of reports or excessive volume of information required.
4. Remove restrictions and obstructions, local, state, or federal, to the free interchange of goods and services.
5. Remove any restrictions as to expansion of enterprise and encourage all expansion that is in the public interest.
6. Provide the leadership necessary to awaken all citizens from complacency and indifference, and to stimulate public enthusiasm toward cooperation in advancing the defense program with utmost speed.

The defense program is lagging. Few groups or individuals have thrown themselves wholeheartedly into the work and forgotten their own selfish interests. The public is in doubt as to whether an emergency actually exists, and if so how acute it is. Each group is suspicious that an alleged emergency may be merely an excuse to take away something that group now has.

I believe there is an emergency. I think the President believes there is an emergency. If so, he should make the facts known to the public, so there can be no doubt on the part of any individual or any group. To remove any thought of politics, I suggest that the leader of the "loyal opposition" also tell the American people what must be done and emphasize the need of speed.

The first step toward improvement must be taken by the President. He must put the defense program in the hands of those who know how to provide the things needed for defense. He must tell all groups and all citizens exactly what sacrifices each must make, and how they can cooperate most effectively.

I firmly believe that, with cooperation in spirit and action, the system of free private enterprise will produce defense materials and supplies in immense quantities and with the utmost speed, and that, after the present emergency, it can and will go forward to standards of living and real social gains for all, which will be far in advance of any we have known.