# THE THEORY OF PROFITS

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To

The Memory of my Son

PUSPASREE

Born 1st October, 1925 Died 30th May, 1930

# PREFACE

More light is needed on the theory of profit. This is my plea for publishing these pages. Reflections that have considerably cleared my own ideas are presented here in the hope that they may also prove helpful to others.

The enquiry began at Cambridge in Michaelmas Term, 1929 and ended by the Easter, 1931. The main conclusions were arrived at during the second year of my stay at Cambridge. The award of a Research Studentship at King's enabled me to prolong my study of the problem beyond a year. I owe a deep debt of gratitude to the authorities of the King's College and particularly to Mr. J. M. Keynes, for offering me this opportunity of completing my investigation.

My enquiry started with the belief that profit was the product of Uncertainty-bearing. Uncertainty-bearing was regarded as a distinct factor of production.) I had perfect confidence in Pigou's teaching that uncertainty-bearing was a separate factor and—as I interpreted it at the time—in the same sense as land, labour or capital. Equally strong was my belief that Wicksteed's version of the marginal productivity theory explained the distribution of national dividend between the different factors. The Risk theory and

Marginal Productivity theory were considered complementary to each other in the determination of profit. Risk, I imagined, explained the supply-price of the entrepreneur's service, while marginal productivity governed its demand-price.

A critical study of the American theorists soon led me however to the opinion that the theory of risks only stated the problem and did not point to its solution. A scrutiny of the basic assumptions of the marginal productivity theory revealed that the theory was inapplicable to factors or services which cannot be physically measured, or which do not contribute to the product by way of continuous variation. Its application is moreover vitiated by the presence of non-economic factors which affect the product, but which are often imperceptible, immeasurable or discontinuous. Here we refer to elements, such as flood or fashion, weather or inflation—factors which influence productivity, but which cannot be appropriated privately and cannot claim a share in the economic distribution of the produce. The theory is really a mathematical version of the conditions of productive efficiency of the variable economic factors, so far as it depends on the quantitative relation of the factors and not on their qualities, appertaining to a particular process of technical production. It assumes the stable continuity of one method and the rigidity of its results. The very function of an entrepreneur however is so to administer, alter or modify methods as to secure better return from the resources than hitherto obtained. And the very nature of the entrepreneur's skill or activity is its immeasurability in any kind of physical units. So I had to discard both these theories. My subsequent reflections are embodied in this volume.

The first three chapters seek to classify the various theories of profit, the next four critically examine their underlying assumptions, and the remaining four present the writer's view-point and conclusions.

Profits, in the sense of returns from business undertakings, may be looked at from different points of view. Society is interested in the industrial output of material goods and services. The business man, as the enterpreneur who provides for society's divergent needs and wants, naturally looks upon profits as the monetary return of the resources he himself owns or controls. His view-point is necessarily financial. The two view-points, industrial and financial, social and entrepreneur-*al*, have been kept separate to prevent confusion in thinking.

The two fundamental needs of society, *viz.*, livelihood and leisure, are both satisfied by the modern entrepreneur and with one and the same process. The process of production has been so modified for the purpose that an increased participation of capital is now essential for a cheaper out-turn. The capitalistic production offers the appropriate opportunity for purchasing leisure, that is to say, for securing a property-income through an increased investment of capital. The entrepreneur's activities and his income have been simultaneously examined from both these standpoints.

A short summary of the conclusions regarding the nature of profit will be found in Chapter X. One or two points may however be noticed here. The difference of profit from other incomes cannot be discerned either in the industrial or in the financial process of production. From the view-point of society, the peculiarity of profit lies in the (indirect) *method* of earning this income, and not in the nature of the services that help, industrially or financially, to turn out a product. Profit is not the result of the " industrial process ; " it is rather the result of the mercantile process involved in the excercise of the entrepreneur's social function—the provision of society's needs. Secondly, the nature of profit cannot be described as a "surplus." Surplus really refers to the measure of the income and not to its nature. Thirdly, the theory of value cannot be directly applied to the business man's resources or services, material or personal, to determine his income, as is done in the case of rent, wages, or interest. For, the proximate source from which profit is realised is not his capital and ability, but the saleable product into which his resources, both material and personal, are transformed and embodied.

The relation of normal profits to industrial equilibrium is analysed in the last chapter. My conclusions regarding industrial equilibrium appear to be in harmony with the ecological conditions of biological equilibrium. There is a sort of economic balance between the agents of production and the industrial environment, as there is a biological balance between the inhabitant and its habitat. Vegetable life, animal kingdom, and bacteria must maintain a biological balance in the sense that the stability of their existence is assured only so long as the necessities for each kind of life circulate at a uniform rate in the environment consisting of themselves and the inorganic elements on which the plant-life grows and subsists. Too rapid development of one species relatively to others (or what comes to the same thing, too rapid exploitation of its environment by one species) causes a deficiency in the circulation either of oxygen or of food-supply or of any other essential vital elements. It reacts upon the possibilities of the life and growth of its own kind by the shortage of food or other necessities, for which it depends upon the other species or upon the physical environment. Similarly with the industrial classes of an economic community. Too rapid development of the capitalist class reacts upon the possibility of its life and growth. (This is equally true of labour). Capitalistic production appears in the industrial system to provide employment for the growing surplus of incomes that the capitalists cannot or will not spend. This means in a closed economy displacement of labour and a diminished capacity of its consumption. Consequently social consumption decreases and so does the circulation of wealth. The scope of investment in general and opportunities for earning profits in particular shrink under the process.

No kind of life, ecology points out, can have a stable existence in an environment, unless it gives back to the environment all it takes away for its living. The rapidity at which the living species exploit the environment must not be greater than the rate at which they replenish it. Scarcity of food or of other necessities ensues otherwise and it paves the way for their deterioration and decay. It seems to be true as much in economics as in biology. The capitalist or the proprietor takes his income from the industrial environment in the form of rent, interest and profits. But he gives it back to industry in the form of investment and consumption. So long as an equality is maintained between his income and outgo, his exploitation and replenishment of the economic environment, the equilibrium of the industrial system continues to be stable. But as soon as his income exceeds the amount that he has the opportunity to invest and the willingness to spend, disequilibrium results. And this disequilibrium becomes a chronic condition of industry, when the income of the capitalist as a class continually outgrows the scope of new investment and he is unwilling nonetheless to change his habitual amount of consumption. It may be regarded as the actual condition in many of the capitalistic communities to-day.

The source of the instability of capitalism lies in the capitalist's unwillingness to modify his behaviour in a way that the industrial system demands for its equilibrium. The pressure of the capitalist's greed for investment in excess of the industrial need for it is crushing the productive system of the capitalist countries. It is likely to destroy the economic basis of modern civilisation, as it has destroyed its many predecessors, unless equilibrium is restored to the system by a check to accumulation, investments abroad, or an increased consumption of non-investment goods. But this reflection belongs more to philosophy than to economics. My analysis, therefore, confines itself only to the cause and the nature of the disequilibrium that the modern craze for accumulation and concentration of property has given rise to.

I must mention my obligation to my Cambridge teachers for the direct and indirect stimulus I have received from them in my studies and enquiries, My intimate contact with Professor Pigou and Messrs. J. M. Keynes, D. H. Robertson, P. Sraffa and M. H. Dobb has been very helpful. I have immensely benefited by my association with Mr. Keynes' Political Economy Club. Dr. Sraffa's criticisms greatly stimulated my thoughts, while Mr. Dobb's appreciation emboldened me to develop ideas that would not certainly be regarded as orthodox at Cambridge.

My best thanks are also due to Dr. J. P. Neyogi and Prof. S. N. Sen of Calcutta University and Prof. S. Dutt of Ramjas College, Delhi, who have occasionally helped me by revising proofs and making useful suggestions.

CALCUTTA UNIVERSITY, P. C. GHOSH
*1st March, 1933.*

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