Journal of Accountancy

Volume 49 | Issue 6 Article 8

6-1930

Book Reviews

F. W. Thornton

W. H. Lawton

Book Reviews

EFFICIENCY AND SCARCITY PROFITS, by CLARENCE J. FOREMAN, *University of Chicago Press*. 343 pages.

"The times are out of joint." The entrepreneur (hateful word) is able to exploit his fellow men "even more extensively than the robber barons of that (medieval) period." "With every turn of the industrial wheel the public must suffer." "We have fallen into an unholy worship of sordid things. On every hand we observe the corrupting use of gold."

With a mental attitude indicated by these extracts the author of *Efficiency and Scarcity Profits* gives what he calls an analysis of the "residual surplus," meaning profits after interest on invested capital. It is not an analysis of any specific profits but rather an exposition of the author's idea of the several sources of profit, classified as he considers them to be legitimate or predatory.

The division of profit into earned or fully legitimate profit, and unearned or less legitimate profit, is a favorite exercise of our theoretical economists. Professor Foreman separates profits, after allowing for interest on capital, into these major divisions: wages of management and profits of efficiency, both of which he considers earned profits, and unearned profits. Each division is further subdivided.

His inclusion in earned profit of profit due to superior efficiency is said to be new to both economists and jurists. Certainly he is right in considering profits arising from superior efficiency as legitimate earned profits, and if jurists and other economists deny it the verdict of Mr. Bumble on the law must be extended to economics also.

As to what he considers unearned profits the author says it is high time that we should "turn the flame of just criticism upon this residual surplus that bears so plainly the earmarks of predatory efforts."

Just criticism is always in order; but there are given no clear directions whereby an humble accountant may determine in any specific case how much of any given profit is earned and how much is unearned. True, the author says that his treatise presents a method of separating the various increments of the residual surplus: I could not find it.

The remedy that is advocated for the evils he sees is, briefly, more law; more restriction of contract; reduction of contractual rights; more public ownership; the enlargement of the province of the state in such manner as to secure a different distribution of profit.

As pure theory it is needless to criticize the views put forth; indeed, if the facts be as bad as the author says they are one could hardly criticize his ideas unless it were to condemn them for being too moderate. Given the mental background that he shows, his remedies seem to be dictated by fair and kindly thought.

If we admit, for the moment, all his statements and arguments, how are they to be made effective? If efficiency be a proper basis for earned profit the determination must be made in each individual case. Who will do it? The accountant? He is troubled quite sufficiently to determine with reasonable correctness the total amount of profit. The lawyer? The legislator? The cloistered economist?

Consider the spectacle of a committee consisting of a senator or two and an enthusiastic professor of economics, charged with the duty of determining how much of the 1928–29 profits of each entrepreneur in the automobile-building business were management wages, how much efficiency profit, and how much predatory gains; with the further duty of pointing out where they were going to get their management wages for 1930 and of explaining why their efficiency profit had disappeared in 1930 although their efficiency had not abated.

"Scarcity profits," being profits due to the scarcity of goods sold, are also reprehended. There is no profit in producing anything of which there is an unlimited supply; some degree of scarcity must exist before anything can be sold at all, and the degree of scarcity that may exist before an undue profit can be realized is a matter of opinion.

The author thinks that additional laws, restricting liberty of contract, might prevent profiteering; like other economists he does not believe that restriction of profit need be accompanied by any guaranty of a minimum profit. We forbid a gas company to charge more than, say $1.00 per thousand; at the same time we guarantee to such a company that within its district no other company shall enter and take its trade; we authorize a price that is not confiscatory and make the customers pay it. Professor Foreman advocates restriction, without any compensating factor. Indeed, we could fix a price for automobiles, but could we make the customers pay it, no matter how low or how high we fixed it?

The book is strongly legalistic: in 320 pages of text are more than 500 references to legal decisions, as if legal decisions affected the equities of the case.

There is little within the sphere of the practical accountant, but much that may interest the follower of pure theory in economics.

A glossary is needed; such terms as "negative utility gains," "disabilities," "external risk profits" are not known to the average man. Perhaps the book is not intended for any but economists.

F. W. Thornton.

PATENT ACCOUNTINGS, by Bert Louis Klooster. *Prentice-Hall, Inc.*, New York. 795 pages.

With the author's remark as a premise, that "The courts have been very patient in seeking the truth from an apparently hopeless mass of accounting data, and have evolved certain principles and rules which, if followed, should work out 'substantial justice' between the parties to an infringement suit," the book, *Patent Accountings*, has a two-fold object: (1) to state these principles and rules in words that any accountant, or layman for that matter, can readily understand, and (2) to point out methods by which time and expense may be saved by a larger use of the independent and impartial accountant's services in ascertaining profits and damages. As a certified public accountant and member of the bar Mr. Klooster is happily qualified in his dual capacity to deal with this complicated subject.

Under patent laws and court decisions three broad principles are stated by the author: "The liability of an infringer of a patent is determined in one of three ways: (1) by the profits which he has wrongfully gained; (2) by the damages of the complainant which could be said to be the profits which the complainant has lost because of the infringement; and (3) by ascertaining what a reasonable royalty would have been for the manufacture and sale of the infringing devices and charging the infringer such a royalty for each device manufactured and sold."

With these principles as a basis, Mr. Klooster devotes the major part of his book to detailed descriptions of the items to be considered in determining profits or damages. Each item is supported by footnote references to court decisions, and if some of the latter are conflicting or seem fallacious to the accountant, he must perforce follow them under counsel's advice.

What causes the great expense of patent litigation at present is the fact that each side must employ its own accountants and all the details have to be brought out piece-meal in protracted hearings before a court or master, practically item by item. In chapter XVII is a quite formidable list of the items of expense likely to be incurred by either or both parties to a suit, certainly by the complainant. It is no wonder, as Mr. Klooster says, that "inventors and owners of patents prefer to allow the continuance of infringements." He thereupon makes a powerful argument in favor of the court's calling in a single, independent accountant whose "report could be substituted for the entire procedure before the master in chancery, and the cost of such a report would be negligible in comparison with the present accounting expense." Such a report would deal only with facts, matters of applicable law being within the sole province of court and counsel.

An appendix contains the sections of the U. S. Code applicable to patent accountings and full reports of several leading cases as decided by federal courts; and at the end is an illustrative patent-accountings problem with its solution, for the benefit of accounting students. A good index furnishes quick reference, which unfortunately can not be said of the cross-references in the body of the text. The latter are by chapter titles only, and it is a nuisance to run down the table of contents to find chapter number and page.

With so large a proportion of the nation's business based on manufacture and sale of patented articles this excellent manual should be welcomed by corporation accountants as well as by public accountants. The latter should also find it a convenient guide in setting up contingent reserves when suits may be threatened or are pending.

W. H. Lawton.