



## People Before Profits

**W**hether it's Nation of Islam Minister Louis Farrakhan leading the Million-Man March, anti-WTO (World Trade Organization) protesters, or AIDS activists, we're frequently treated to the chant demanding "People Before Profits." Since profit demagoguery is a deceptively appealing tool used by scoundrels everywhere, let's demystify the concept of profits.

Let's first get its definition out of the way. Profits represent the residual claim earned by entrepreneurs. It's what's left after all other costs—wages, rent, interest—have been paid. The entrepreneur is generally seen as the person who takes risks, innovates, and makes decisions. It's important to recognize that profits are a cost of business just as are payments to labor, land, and capital. If wages, rent, and interest are not paid, labor, land, and capital will not be offered; similarly, if profit is not paid, entrepreneurs won't be seen either.

Roughly six cents of each dollar companies take in represent after-tax profits. By far, wages are the largest part of that dollar, representing about 60 cents. As percentages of 2002 national income, after-tax profits represented about 5 percent and wages about 71 percent. Far more important than simple statistics about the magnitude of profits is the role played by profits, namely, that of guiding resources to their highest-

valued uses, determined not by some tyrant but by ordinary people's wants and desires. Let's discuss just a few examples.

Remember when Coca-Cola introduced the "new" Coke? Pepsi president Roger Enrico called it "the Edsel of the 80s," representing one of the greatest marketing debacles of the decade. Who made the Coca-Cola Company bring back the old Coke? Was it Congress, the courts, the President, or other government officials who claim to have our interests at heart? No way. It was the specter of negative profits (losses) that convinced Coca-Cola to bring back the old Coke. Thus one role of profits is to discover what consumers want. If producers make mistakes, profits work to correct them.

After the 1992 massive destruction caused by Hurricane Andrew, South Florida stores sold sheets of plywood for twice the price it had sold for prior to the storm. Escalating plywood prices brought charges of price-gouging and prosecutory threats. But look what higher prices and the potential for windfall profits did. Plywood destined to be shipped to the Midwest, West, and Northeast suddenly was rerouted to South Florida. Lumber mills increased production. Truckers and other workers worked overtime so as to increase the availability of plywood and other construction materials to Floridians. Rising plywood prices meant something else. All that plywood heading south meant plywood prices rose in other locations, thus discouraging "less valued" uses of plywood, such as home-improvement projects. After all, rebuilding and repairing destroyed

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homes is a “higher valued” use of plywood.

What caused these market participants to do what was in the social interest, namely, sacrifice or postpone alternative uses for plywood? The answer reveals perhaps the most wonderful feature of this process: rising prices and opportunities for higher profits encouraged people to do voluntarily what was in the social interest: help their fellow man recover from a disaster.

Profits also force producers to behave themselves. If producers waste inputs, their production costs will be higher. To cover their cost, they’ll charge prices higher than what consumers are willing to pay. After a while the company will make unsustainable losses (negative profits) and go out of business. As a result, the company’s resources will become available to someone else who’ll put them to wiser use. This process is short-circuited if government offers bailouts in the forms of guaranteed loans, subsidies, or restrictions on competitive products from abroad, such as tariffs and import quotas. Government “help” enables failing companies to continue squandering resources.

If we care about people’s wants, rather than beating up on profit-making organizations we should pay more attention to government-owned nonprofit organizations. Government schools are a good example.

Many squander resources and produce a shoddy product, while administrators, teachers, and staff earn higher pay and perks, and customers (taxpayers) are increasingly burdened. Unlike other producers, educationists don’t face the rigors of the profit discipline and hence they’re not as accountable.

How about the U.S. Postal Service? They also provide shoddy and surly services, but the management and workers receive increasingly higher wages, while customers pay higher and higher prices. Again, wishes of customers can be safely ignored because there’s no bottom-line discipline of profits.

Here’s Williams’s law: whenever the profit incentive is missing, the probability that people’s wants can be safely ignored is the greatest. It’s not just the post office and schools, but delivery of police services and garbage collection as well. If a poll were taken asking people what services they are most satisfied with and those they are most dissatisfied with, for-profit organizations (supermarkets, computer companies, and video stores) would dominate the first list while nonprofit organizations (schools, post office, and offices of motor-vehicle registration) would dominate the latter list. In a free economy, the pursuit of profits and serving people are one and the same. □

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