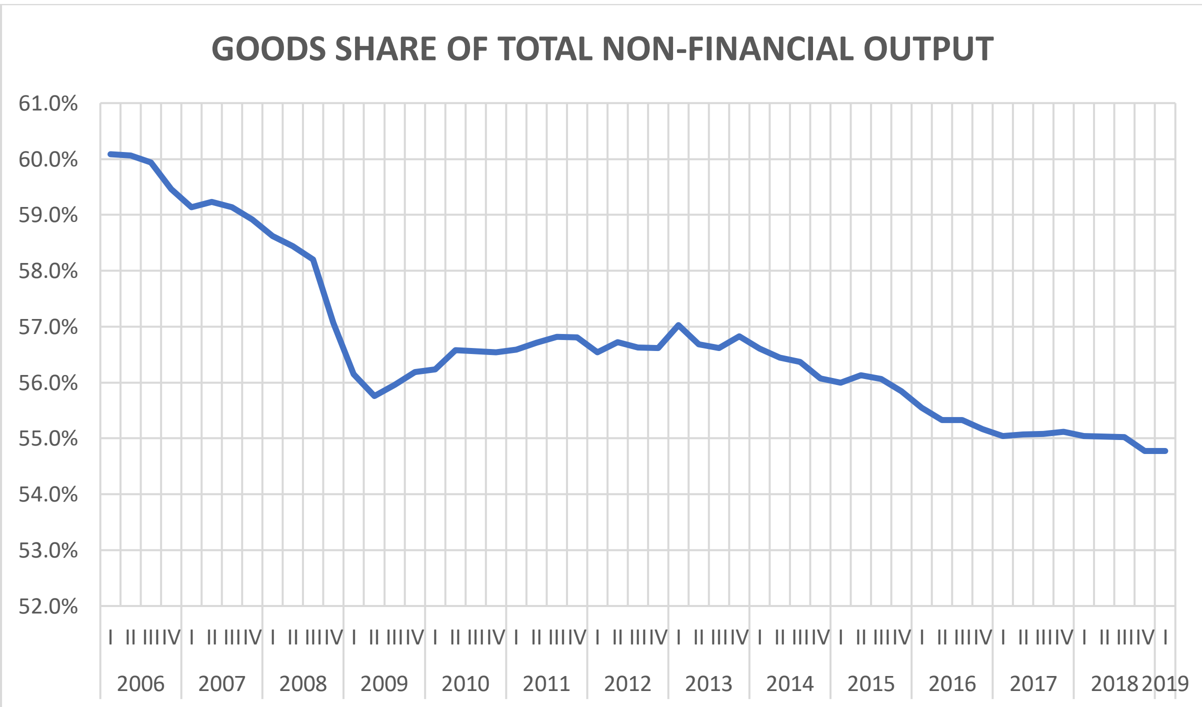
FIRST QUARTER 2019 REPORT ON THE RATES OF TURNOVER, EXPLOITATION AND SURPLUS FOR THE US ECONOMY.

This report begins with a new section. Anyone familiar with the hard and soft data on the US economy knows it points in two directions. The industrial side of the economy is now in contraction while the services sector is still expanding. While a minority of bourgeois economists recognise that recessions begin in the industrial economy, the majority are of the view that the only thing that matters is the service sector because it is over twice the size of the industrial or goods producing sector.

The obvious rejoinder to this nonsense is contained in the following hypothesis. Why should it matter to workers and employers in which sector they work, when all workers and employers have to eat, be clothed, housed, driven around, cooled down or heated up and so on and so forth. That is, they require the sustenance provided by the industrial sector and imports. Thus, if the service sector is buoyant, if employment is growing as well as revenue, then so must the demand for goods from the industrial sector. It is incongruous for wages and profits to rise in the service sector and for that not to translate into an increase in personal industrial consumption expenditures. If not it means it is being saved/speculated with, or, used up paying for things like health insurance and co-insurance or rents.

There are two observations. Firstly, much of the revenue which the statistical agencies log in the service sector emanates from the industrial sector. This transfer of value necessarily reduces the industrial sector while increasing the services sector, because this value cannot be counted twice. Hence most of the income of Google and Facebook, comprising advertising revenue, is a cost to the industrial sector, to the likes of Ford, Whirlpool, Procter and Gamble, and so on. Secondly that the use of Gross Value Added necessarily reduces the size of the industrial sector. For this reason, as I have done here, I have used Gross Output, the value of total sales, as this better shows the transfer of value between sectors by including the intermediate sales that connect sectors.

Graph 1.



(Source: See accompanying spreadsheet titled "GRAPHS GOODS SHARE OF TOTAL OUTPUT")

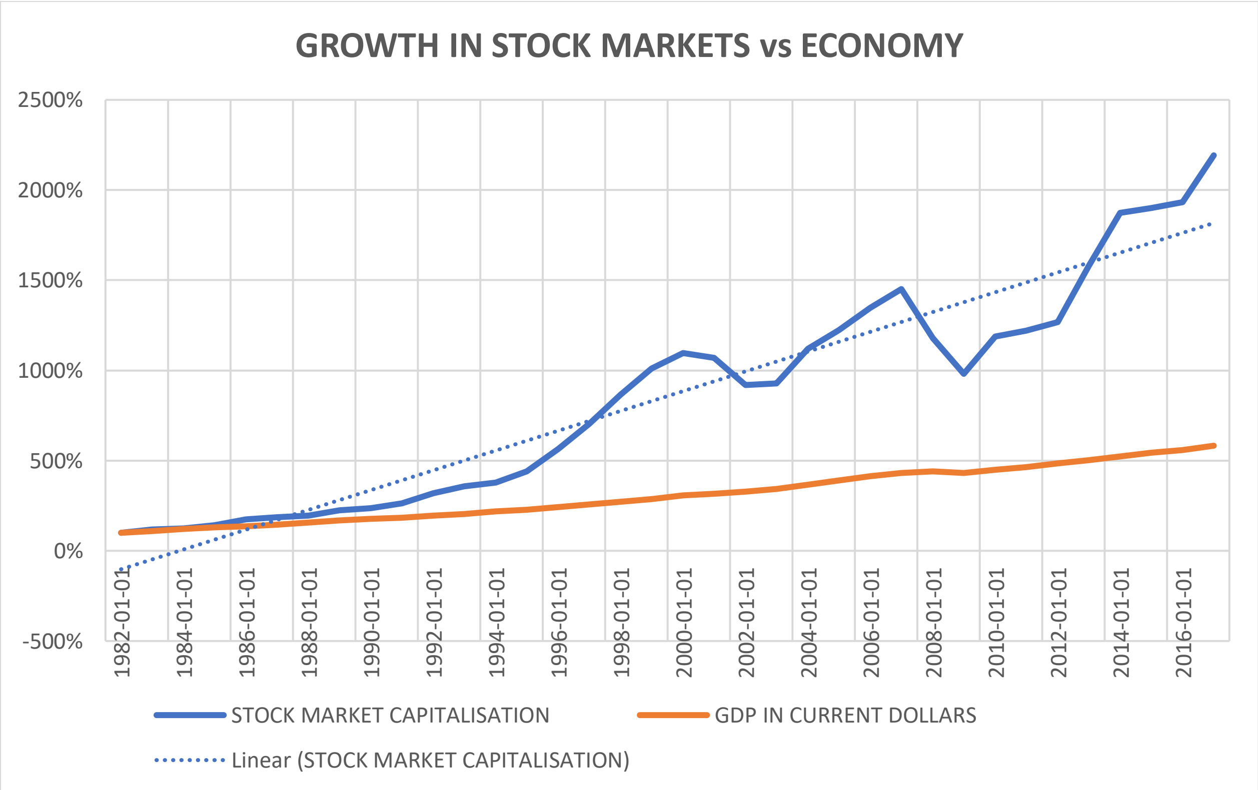
To arrive at this graph, I have modified the Gross Output Tables. I have deleted Finance, insurance, real estate, rental, and leasing, and I have deleted the entire Government sector. Additionally, I have removed legal services from Professional, scientific, and technical services, and because I have included transportation and warehousing I have excluded those sectors which deal mainly with the transport of people. Finally, because the information sector is included in the goods producing sector, I have deleted the industries dealing with the internet. The reader can follow all this on the attached spreadsheet.

Included in the goods sector are the following industries, Agriculture, Mining, Construction, Utilities, Manufacturing, Retail and Wholesale, Transportation and Warehousing, Information as adjusted and Arts and Recreation. Each one of those are value forming excluding retail and wholesale who are funded through the pricing system. Retail and wholesale are included because they circulate industrial products.

The results are interesting. Under these assumptions the industrial economy is now half the economy. The most interesting aspect is the unexpected one, the one that supports recessions having their origin in the industrial economy. Note the almost 5% fall in share of the industrial sector between 2006 and 2009. It shows that the industrial economy is the more volatile. Note further how as the economy expands thereafter, the industrial sector share rebounds up to 2014, only to retreat as the rate of profit falls once again dragging down investment. The changing shares have more to do with the expansion and contraction of the industrial sector than it has to do with movements in the services sector. That being said, 2% of the growth of the service sector is accounted for by the growth of Educational services, health care, and social assistance, notably the health sector.

The service sector itself is critically dependent on the performance of the stock market. Graph 2 examines this putrid relationship.

Graph 2.



(Sources: FRED table DDDM01USA156NWDB for stock market and table GDP for economy.)

Between 2010 and 2017 the average annual increase in shares came to $1965.74 billion or three times more than the $641.91 billion increase in the size of the economy. Compared to wage increases of $330 billion, share values increased 6 times faster. So even if the investors who benefited from these capital gains spent only one sixth of their gains, that would equal the growth in wages. It underlies how critical the economy has become on bubbles and why the FED strains monetary policy to prevent them deflating.

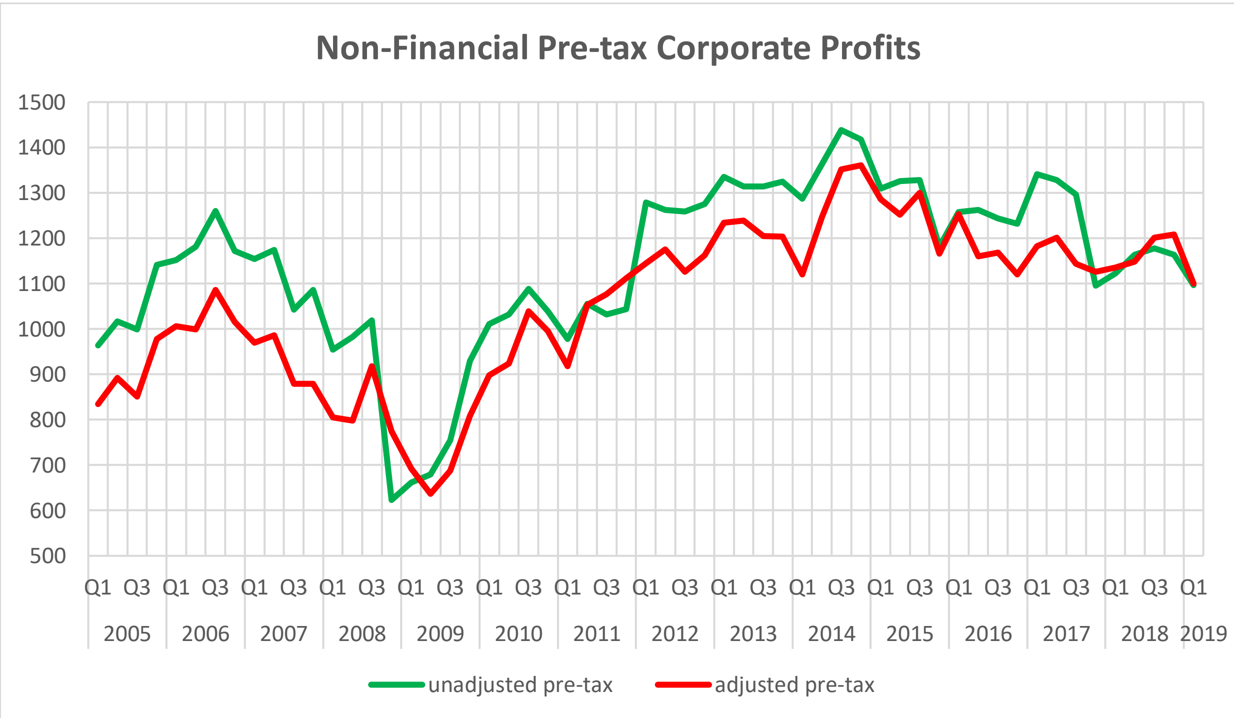
The importance of consumer spending in the recent flash GDP figure of 2.1% cannot be overstated. It provided over three quarters of that increase. Had the stock market not had such a good run in the second quarter, GDP growth would have been far weaker. But as we are about to see, the underlying fundamentals governing the US economy, do not justify this run up in share prices.

Vindicated.

Regular readers of this website will know how concerned I have been recently with the quality of profits in the national accounts particularly the relationship between adjusted and unadjusted corporate profits. It seems the BEA may have shared this concern as well. The recent NIPA revisions released on the 26th July show only one major revision – that of profits. "*Corporate profits was revised up $1.4 billion, or 0.1 percent, for 2014, was revised up $4.3 billion, or 0.2 percent, for 2015, was revised down $23.5 billion, or 1.2 percent, for 2016, was revised down $93.3 billion, or 4.4 percent, for 2017, and was revised down $188.1 billion, or 8.3 percent, for 2018 (Table 9A).*" https://www.bea.gov/docs/gdp/results-of-the-2019-annual-update-of-the-nipas-2014-2018

For the years 2017 and 2018 combined profits were revised down by 12.7% or one eighth. A major revision. The effect of this significant revision amounting to nearly $300 billion are shown in Graph 3 below. Now there is a stronger correlation between the two series with the exception of early 2017. In both cases there is now a much steeper fall. From its peak in 2014, unadjusted profits have now fallen by 24% and adjusted by 19% in nominal terms.

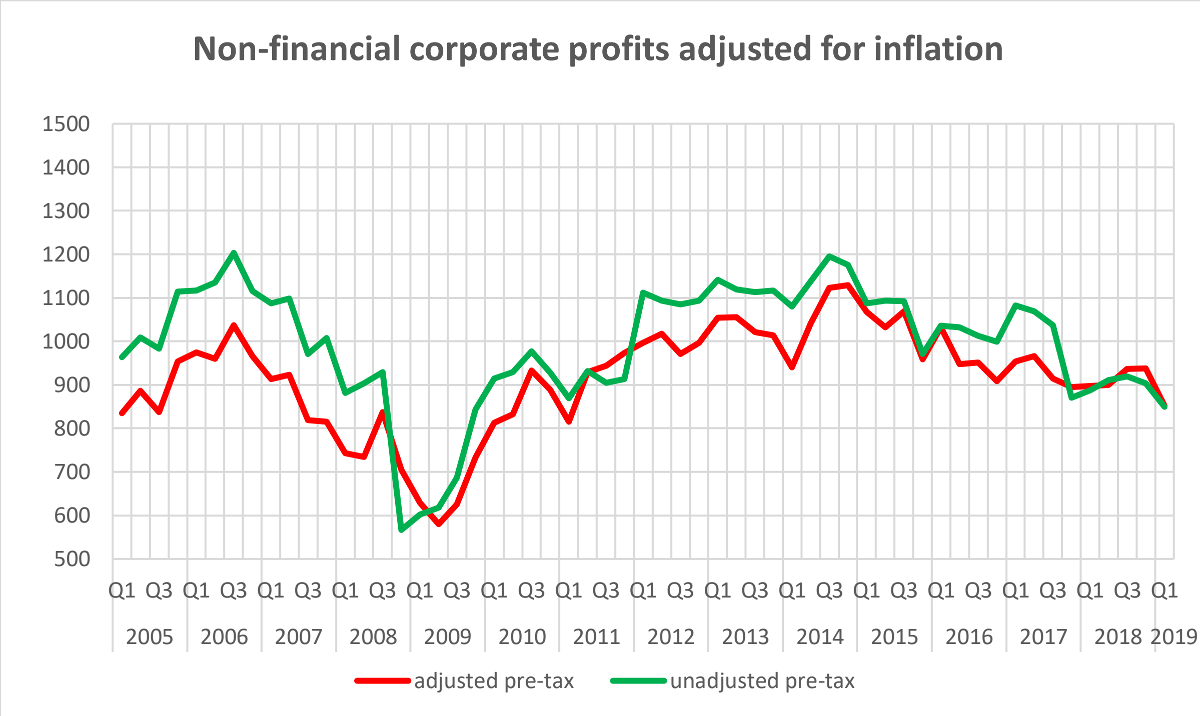
Graph 3.



(Source: National Product and Income Table 1.14)

If we adjust for inflation, the fall is even greater at 29% (unadjusted) and 24% (adjusted). Indeed, the fall in the mass of profits is now well over half of the l fall that occurred between 2006 and 2009. We also note that in real terms the profit peaks in 2006 and 2014 were similar.

Graph 4.



Sources: Table 1.14 for profits and FRED Table GDPDEF for the deflator.)

While profits have slumped 20% for the corporate sector as a whole which includes financials, the S&P 500 share price index is up 30% in real terms. (FRED, Table SP500 for share price index.) This is mainly due to easy money. As Jim Cramer (CNBC) said on July 25th there is a schizophrenic split between the consumer and the industrial economy or between what is happening with shares and with profits.

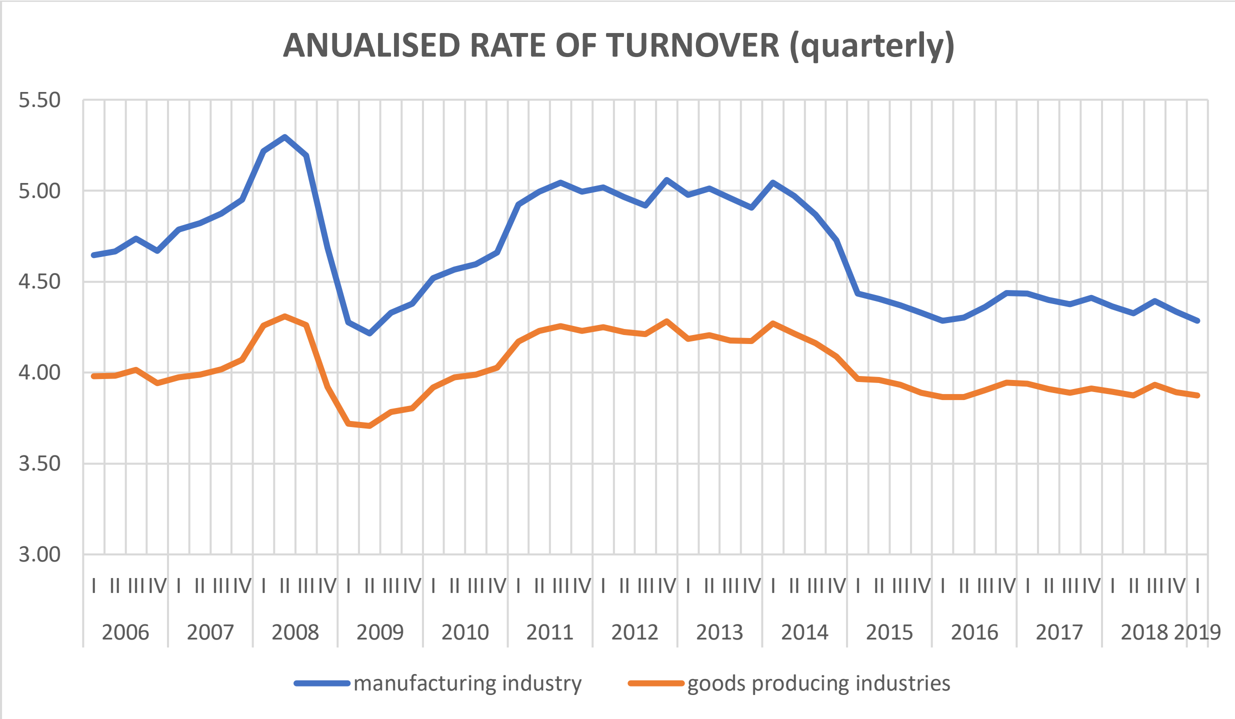
More significantly these revisions are likely to have dropped the rate of profit for the corporate sector to below the critical 5% Japanese level, which explains why the Trump tax cuts did not work, and why he is now crying out for interest rate cuts. As soon as the BEA reports Q2 corporate profits on August 29th, I intend to estimate the current rate of profit. This will be updated in October when the BEA releases the value of produced assets for 2018.

The rate of turnover, exploitation and surplus value.

The reason I was sceptical about the mass of corporate profits originally is that it did not correlate to the deterioration in the underlying fundamentals. These fundamentals begin with the rate of turnover and conclude with the rate of surplus value which requires turnover for its determination. With the current negative revisions for profits, profits as outcome, are now more in line with the relations of exploitation that govern them.

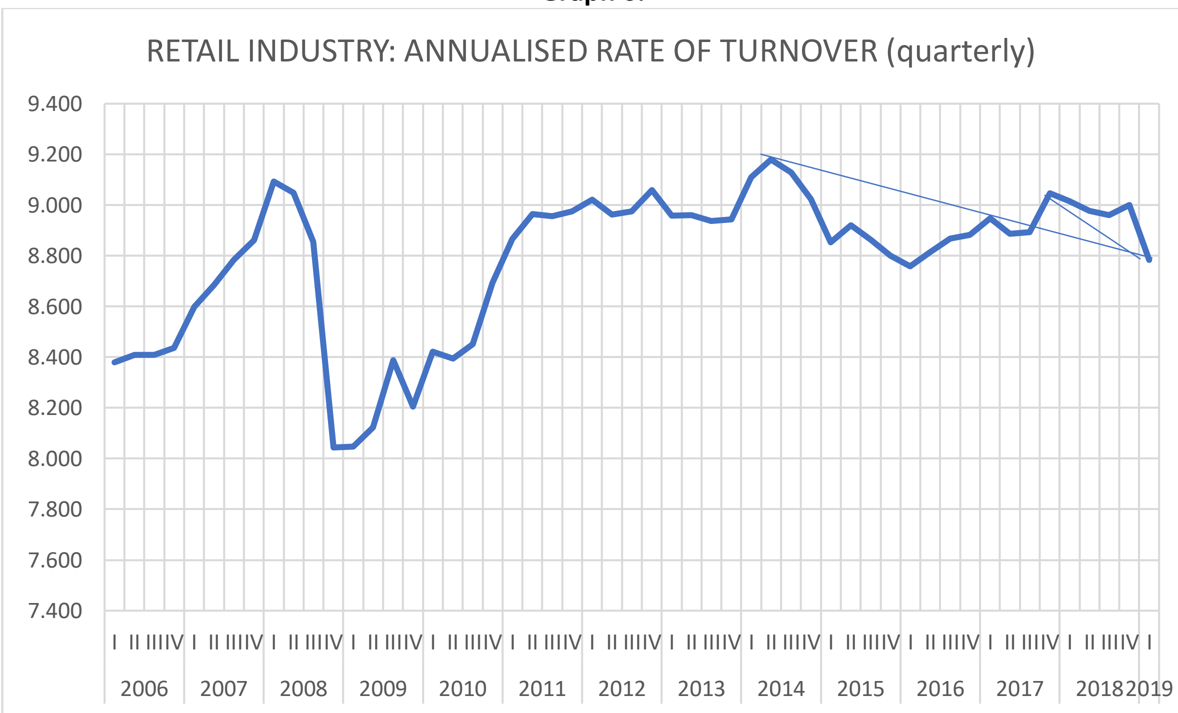
In Graph 5 below, which plots the quarterly rate of turnover on an annualised basis, the first quarter saw a further deterioration both in the manufacturing sector as well as the larger “goods producing” sector. (The BEA includes Agriculture, Mining, Construction and Manufacturing in this sector.)

Graph 5.



In the case of manufacturing, the rate has reached the low points obtaining in early 2016 as well as at the depths of the financial crisis in early 2009. The fall for the goods producing sector, courtesy of the burgeoning oil industry has not been as precipitous. It is this fundamental fall in turnover that is at the heart of the collapse of the mass of profits, because fewer periods of circulation each year results in fewer periods in which to realise profits. If we now turn to the rate of turnover for retail, which is more representative of the economy, we find a sudden reversal in the rate of its turnover too.

Graph 6.

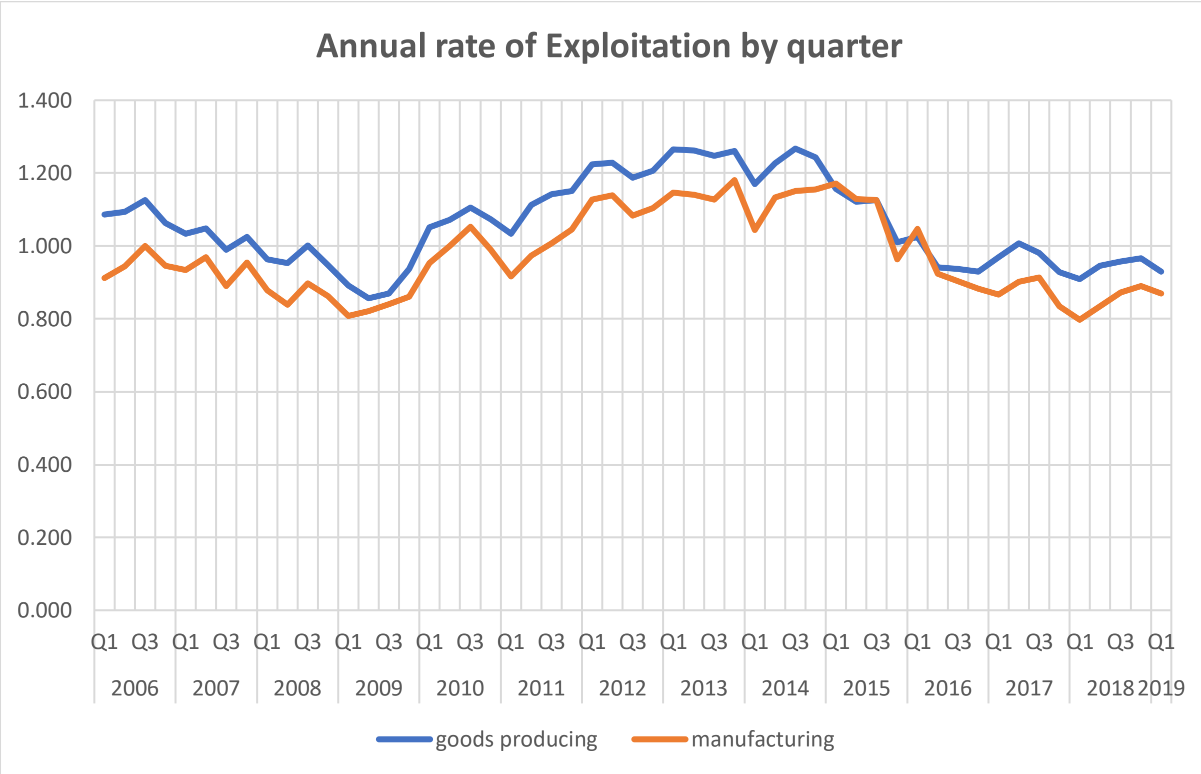


(Source: GDP-by-industry for GO and GVA and Table RXSFS for sales. See accompanying spreadsheet.)

In the case of retail, the slight increase in the final quarter has been more than reversed in the first quarter of this year, and the trend is currently negative. The data on inventories for manufacturing, wholesale and retail is consistent with the elongation of the periods of circulation. Thus, in examining the foundations of the economy, only one conclusion can be drawn, they continue to deteriorate despite being propped up by easy money.

The rate of surplus value requires for its calculation both turnover and exploitation. In the case of exploitation, despite allegedly record margins (now contracting), the actual rate of exploitation has continued to be negative, falling not rising. The rate of exploitation is arrived at by dividing the annual surplus by the annual wages of workers. It implies an annual turnover of 1. (As always the caveat is that as only wages are available at this time, rather than the larger compensation figure, the rate of exploitation is overstated. Compensation equals wages plus benefits especially health insurance.)

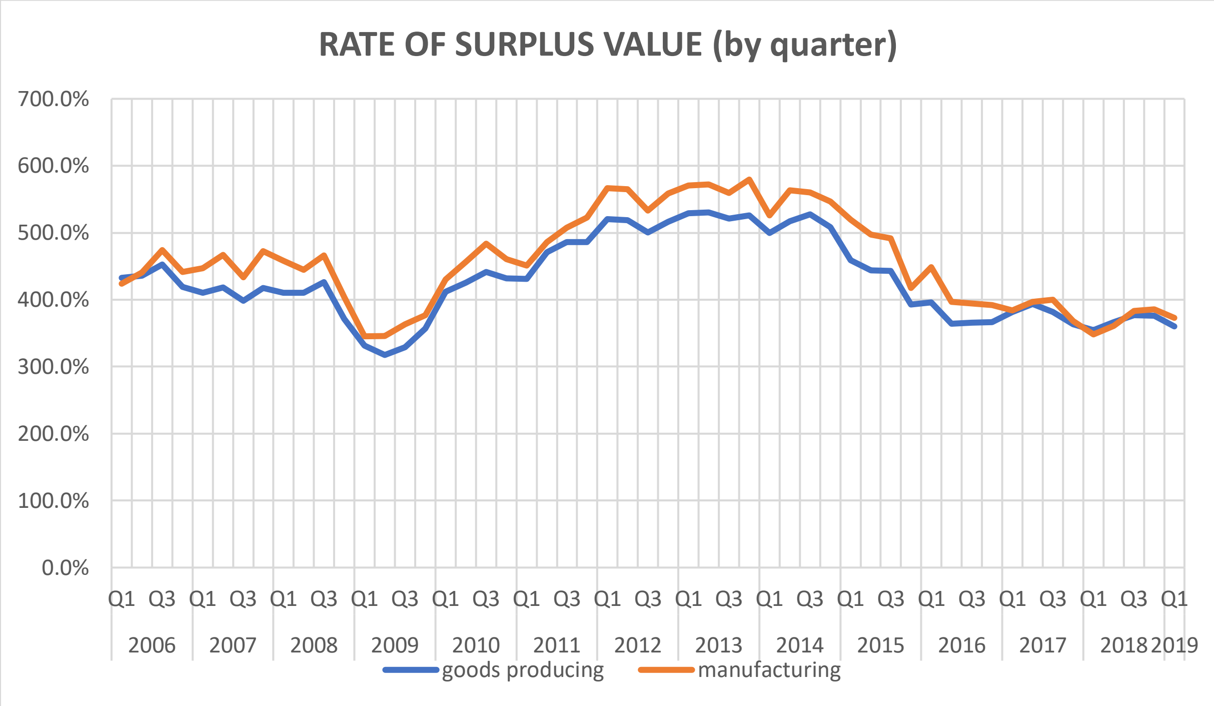
Graph 7.



While the rate of exploitation rose in 2018 from the first quarter, it fell in the first quarter of 2019. Compared to 2014, the pinnacle of the current phase of globalisation, the rate of exploitation has fallen by a quarter. This means whatever additional profits have been earned since then, has been a function of the volume of production rather than exploitation. It should also be added, that indirectly, the fall in exploitation is due to the US commanding less surplus value from the rest of the world, especially China, compared to the period preceding 2014.

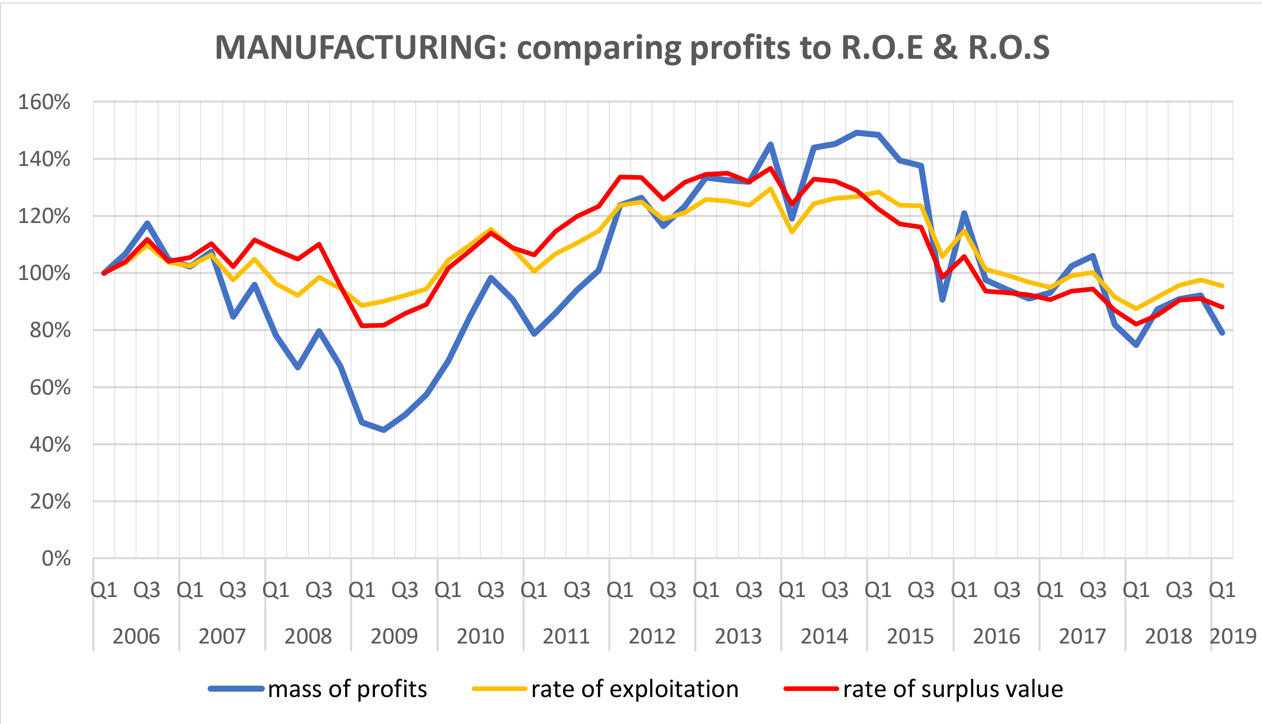
Adding in the rate of turnover which also decelerated, and which acts as a multiplier, the fall in the all-important rate of surplus value was even more pronounced. A falling rate of exploitation can be ameliorated by a rising rate of turnover, but a falling rate of exploitation combined with a falling rate of turnover intensifies the fall in the rate of surplus value. This can be seen in Graph 8 on the following page. The rate of surplus value better tracks the movement in profits.

Graph 8.



In graph 9 below which is indexed, the relative movement in the mass of pre-tax manufacturing profits are compared to the movement in the rate of exploitation (R.O.E.) and the rate of surplus value (R.O.S.). It proves the general rule, that the rate of surplus value must rise above the rate of exploitation for there to be a sustained rise in the mass of profits and if it falls below the rate of exploitation this is accompanied by a fall in profits. We note that since early 2015, the R.O.S. has fallen below and stayed below the R.O.E resulting in a sustained fall in the mass of profit from its peak at that time.

Graph 9.



(Source: Table 6.1D Corporate profits by industry.)

This phenomenon of the rate of surplus value lying above the rate of exploitation on the upward leg for profits, then lying below the rate of exploitation on the downward leg cannot be emphasised enough. Embodied in this inter-relationship are the forces governing the production of profits, namely how much unpaid labour is being produced relative to paid labour and how quickly it is being converted into profits. Those Marxists who continue to ignore turnover in their calculations are doing a disservice to the working class.

Conclusion.

The underlying conditions in the industrial heart of the US economy continued to deteriorate in the first quarter. For manufacturing as a whole, total profits from their peak of $489 billion at the end of 2014, fell by 47% to just $260 billion in the first quarter. (Table 6.1D). (Adjusted for inflation the fall amounts to 52% compared to the abrupt fall of 75% from 2006 to 2009.) In short a crisis of profitability, with a few exceptions exists in the industrial heart of the US economy. The outlook for profits remains bleak. FactSet has announced a continuing fall in S&P profits in the second quarter. With 44% of companies having reported, the expected blended fall is 2.6% per share or 5.6% when adjusted for share buy backs. No doubt the BEA will revise these figures downwards in the future. https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_072619.pdf Something has to give. Something has to break.

POSTSCRIPT.

A short note on the UK. "Levelling up" or an unguarded level crossing with a train approaching.

As expected Boris Johnson was elected Prime Minister. *He really is the mushroom growing on the rot of empire*. He promises great things, declaring all it takes is for the British people to be positive and to cosy up to the USA. It seems his enthusiasm has caught on leading to a bounce in the polls. It is interesting to see, now that he has been elected, how the press and TV have closed ranks to shine the best light on him.

Mr Johnson is a classical scholar who idolises Pericles, a slave owning provocative diplomat from ancient Athens. One wonders how much emphasis was put on the slave owning bit as Mr Johnson wended his way through Eaton then Oxford. However, if Mr Johnson ever contemplated becoming Prime Minister during his formative years, he would have been well advised to study economic history instead. Had he done so he would have realised just how treacherous and ruthless the USA was and is. He would have learned how the USA bankrupted its arch-rival Britain during the war via Lend Lease. How this propelled the dollar into pole position as the world's dominant currency. How this was later consolidated through Bretton Woods. How his more recent idol, Churchill, came to describe Britain's entrapment by Bretton Woods as the biggest defeat suffered by the British Empire outside of war. Or how Keynes, who died a broken man, went cap in hand to beg for a grant to rebuild the UK after the war, only to be shown the door in Washington unless he agreed to a loan. It seems the relationship between the USA and Britain since WW2 has been more a sadomasochist relationship rather than a special relationship.

If Trump seeks to seduce the UK, he does so for only one reason, to use Britain to batter the EU which he sees, together with China, as the US's main rivals. Thus, he favours Britain leaving with no deal. In this way he kills two birds with one stone, the EU is damaged and Britain is made ripe for the picking.

Or perhaps Johnson is harking back to and trying to replicate the love affair between Reagan and Thatcher, the political architects and schemers at the dawn of the neo-liberal era. Now that we are at the sunset of the neo-liberal era, which incidentally has helped wreck the world economy, he seeks to stoke a fire that is flickering out by blowing optimism over it and providing hyperbole as kindling. Tragedy followed by farce.

And like a kid who is given his first credit card, all Johnson can talk about is spend, spend, spend, mainly on projects stolen from Labour. But the fact is that Britain is in recession where the so-called "sound government finances" are rapidly unravelling. However, Mr Johnson has one ace up his sleeve. He is more likely to get a variant of May's Exit deal through parliament. Unlike May, right-wing Tories will not rebel against him, and of course, he can count on at least 17 treacherous Labour MPs who support Leave. So, with a tinkering here and a fudge there Britain may soon exit the EU on time.

It is unlikely that Britain will leave with a no deal. Under those circumstances, the more sober Tories, despite the shadow of Farage hanging over them, will force a general election.

And while we wait for this to happen he will be levelling up Britain. This is the new mantra being sprouted by cabinet creatures that have no empathy for the poor. Clearly this slogan was coined by Dominic Cummings, he, famous for the slogan "taking back control". No more trickle down. Now it is level up. So, the rich are not to be touched, and maybe even given a tax cut. Instead it will be the lower layers of society that will be elevated.

What a slogan, it even defies the gravity of economic logic. The rich only exist because there are the poor and the super-rich only exist because the poor have been made super-poor. No, it seems Mr Johnson is about to bake a bigger cake, so it will be bigger slices all round chaps. Except that this is not chocolate but a turd. This slogan has but one purpose, to disarm and hoodwink workers. It serves the same purpose as "taking back control", behind which a section of British Capital hid their intention of turning this little island into a low waged, low taxed and deregulated sweatshop off the coast of Europe.

As the finances of the British economy deteriorate and as it is stripped bare by the tax dodgers, austerity will endure until workers decide no more. Austerity is not the new normal it is the ugly normal. There will be no levelling up, instead workers are being invited to blindly cross an unguarded level crossing by Mr Johnson who is sitting safely on the other side with his mates enjoying a sterling silver banquet.

History is moving more quickly, and this is what demagogues represent. In the end Boris Trump, like all demagogues, can be compared to a sparkler which burns furiously and brightly, but burns out quickly. Unless Boris Trump can force a departure from Europe, he may turn out to be one of the most short-lived Prime Ministers in history joining the likes of The Duke of Devonshire or Bonar Law or George Canning whose tenure in office was measured in months.

How did an incapable politician like Boris Trump ever become Prime Minister? Simple, he personifies and symbolises the decay and despair of a capitalist system that barely survived 2008. He like Trump are the political night watchman. The end of a political era which their bluster cannot disguise. What follows them has to be crafted by the working class or all will be lost.

Brian Green, July 2019