

THE FED IS AWARE THE RATE OF PROFIT IS FALLING, SO WHY DO BOURGEOIS ACADEMICS CONTINUE TO DENY IT?

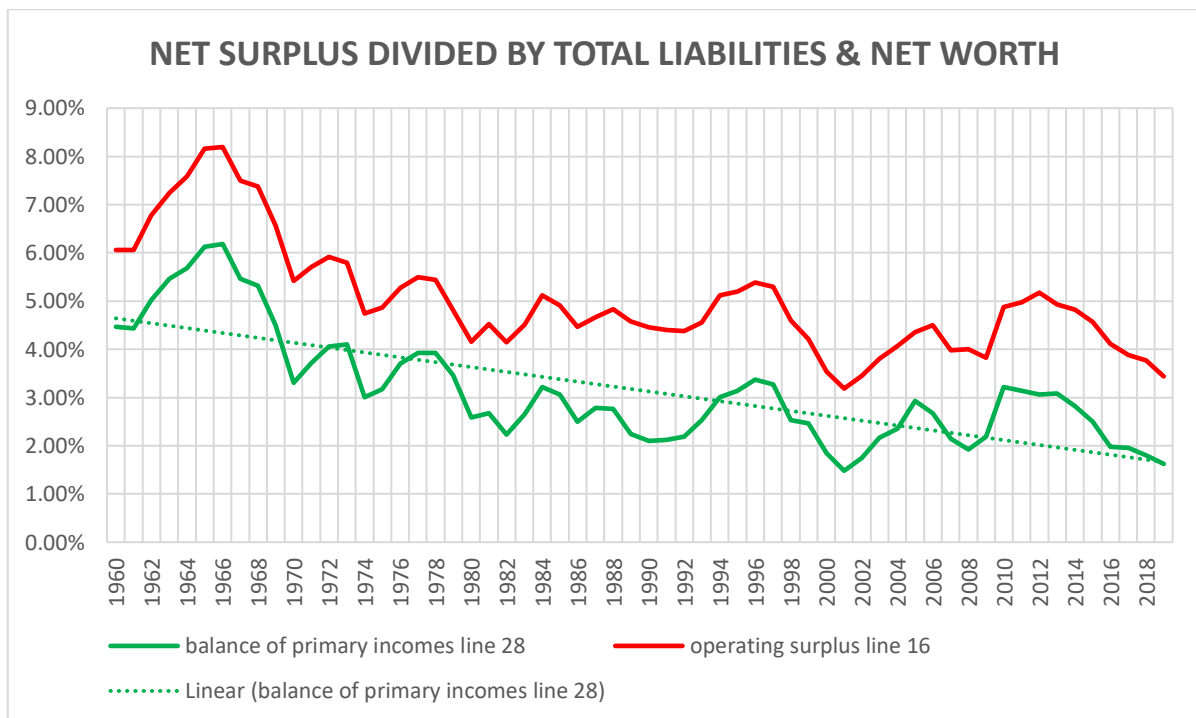
The answer. Marx. In 1884, Friedrich Engels wrote *The Origin of the Family, Private Property and the State*. The patriarchal Victorian Anthropological Professors felt so threatened by his challenge to the family under capitalism, that they closed down all discussion around the “primitive communist” organisation of hunter gatherer societies. This discussion would only resurface in the 1960s almost a century later. Similarly, with Marx’s theory on the tendency for the rate of profit to fall. Neo-Liberal academics fear it and loathe it because it reveals that capitalism is a crises-prone temporary mode of production, historically essential and inevitable, but impermanent.

Investors do not have the luxury of neo-liberal academics cloistered in their ivory towers. Investors need to know the returns on their investments. After Michael Roberts wrote a recent article on the rate of profit, I asked him if he would provide me with the FED sourced data. He kindly obliged and provided me with *Table S.5.a Nonfinancial Corporate Business*. This article results from analysing S.5.

This FED spreadsheet (attached) is broader than NIPA Table 1.14 which confines itself to the value and surplus value produced within the confines of the non-financial corporate sector. Table S.5 on the other hand analyses flows into and out of the non-financial corporate sector, for example the income earned outside this sector resulting from investments made by the non-financial corporate sector. It also includes both financial assets as well as non-financial assets.

For this reason, it mirrors in aggregate what is found on individual corporate balance sheets. And it shows, as Michael has pointed out, that the rate of profit found in corporate financial reports, what I call the complex rate of return, has fallen precipitously.

Graph 1.



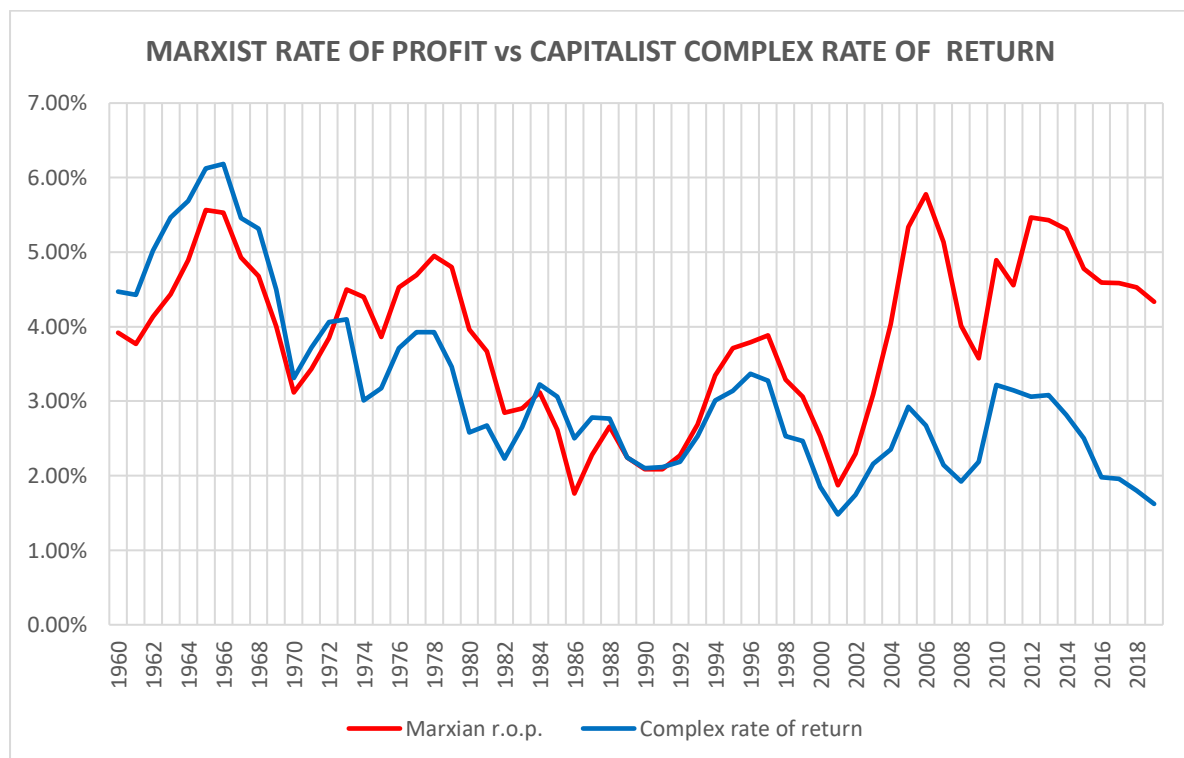
Before proceeding, it is important to disclose how this graph was arrived at. Corporations’ preferred measure of profit, their complex rate of return, uses total liabilities plus equity as the denominator

and net income as the numerator. Why do they use liabilities rather than assets? The reason has to do with T accounts. Both sides of the T account need to balance, so if one side is liabilities and the other is assets, then total liabilities must equal total assets. In effect the profit measure would be identical if total assets were used instead. (compare lines 116 with 150) Investors prefer the liability side because it shows what the corporation owes its external creditors and what it owes its share holders in terms of equity and reserves.

Next, the two numerators making up the two graphs. The first is net surplus which results from deducting annual workers' compensation from annual net value added. The second is the FED's computation of the balance of primary incomes which is closer to the profit earned and recorded on balance sheets. This net balance is the sum of profits earned from trading plus financial income from external investments, less financial payments to external vendors such as interest or rent.

Thus, the complex rate of return based on primary incomes is critical. We note that it has fallen toward 1%. Behind the scenes, it is likely this is the primary reason the FED is so accommodative with its financial policies. The next question is, how does this relate to the Marxian rate of profit based on post-tax profits divided by fixed and circulating capital. This is answered in the graph below.

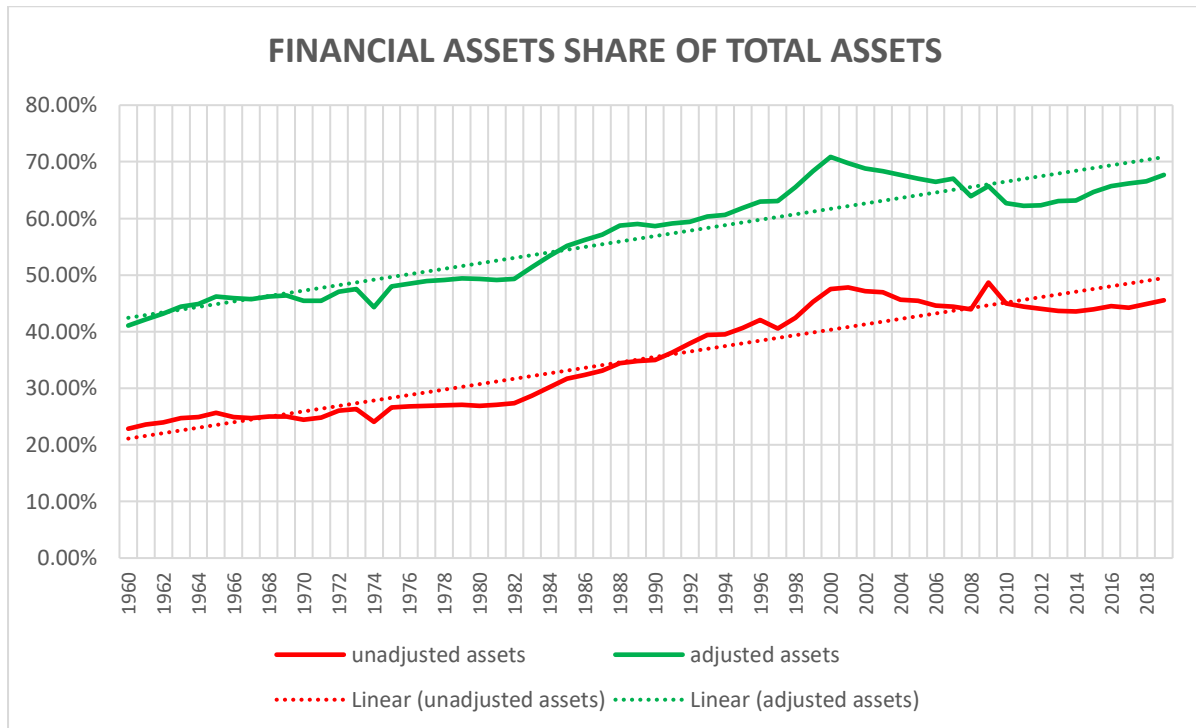
Graph 2.



Until this century, the tracks of the two rates are similar diverging by less than 1%. Then they diverge exponentially with the rate of return falling to less than half that found in the real rate of profit. The explanation for this lies in the denominator. The complex rate of return includes not only produced assets but produced assets as well as financial assets. The complex rate of return additionally includes non-financial non-produced assets (a veritable Aladdin's Lamp so to speak) defined as consisting of natural resources (e.g. land, mineral and energy reserves, non-cultivated biological resources such as virgin forest, water resources, radio spectra and others), contracts, leases and licences as well as goodwill and marketing assets.

The main reason the divergences have grown so significantly is that financial assets and non-produced assets have grown enormously relative to produced assets, typically equipment, structures and Intellectual Property. This can be seen in the graph below.

Graph 3.



Indeed, if we use the green graph which strips out all non-produced assets, then the ration of financial assets reaches out to 70% of the total. In other words, for every three dollars in so called assets only one dollar represents produced assets, the other two being fictitious. We note this growth predates the internet age which began in the first half of the 1990s. In the 1980s there was already a 10% step up in the ratios to between 50% and 60% from 40% to 50%.

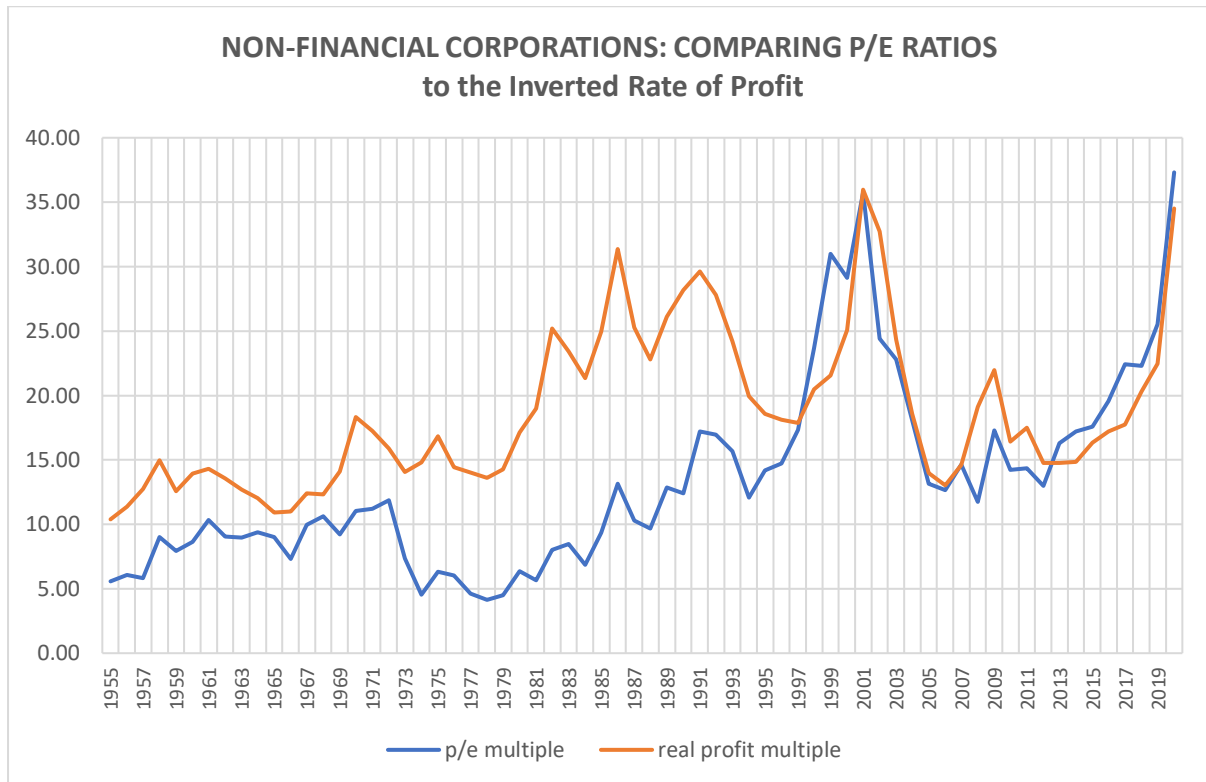
This step up is really is a function of neo-liberalism and the deregulation of the banking and asset market. 1986 saw the Big Bang taking place in the City of London. Although there was no equivalent dramatic regulatory repeal of acts such as the Glass-Steagall Act across the Pond, it was clear that both the FED and the SEC under the various Reagan, Bush and Clinton administrations were turning a blind eye to violations of the Act, which was eventually repealed at the turn of the century.

The internet age proper begins in the first half of the 1990s. Therefore, immaterial assets especially those relating to patents, licences and goodwill associated with the information age only appears at this time to contribute to the final jump in fictitious assets of 10%. This also coincides with the dotcom bubble leading up to 2001 making it likely that the boom in traditional assets such as shares and property during this bubble was much more consequential than the rise in immaterial assets.

This jump in share prices can be seen in the graph below. It shows that the sharp rise in shares, the biggest asset group, matches the timing of the step up in Graph 3. Graph 4 has two multiples, the real multiple and the fictitious multiple. The real multiple is the inverted rate of profit based on fixed capital plus circulating capital divided by pre-tax profits. The fictitious multiple is the market cap of outstanding shares divided by the same profit or the P/E multiple as it is popularly known. (Market cap is equal to the total prices of shares.) We note how the blue graph, the fictitious multiple shoots up in the second half of the 1990s when share prices soar.

There are thus two periods in the graph below. The healthy period pre-1996 when the real multiple stood above the fictitious multiple and the unhealthy period which followed during which for 17 out of the 20 years, the fictitious multiple stood above the real multiple, signifying a generalised bubble.

Graph 4.



China.

I first used the term complex rate of return in the context of China. China does not separate out fixed assets from financial assets. It uses the term total assets which combines them. Thus, the rate of return found in China is not comparable to that found in the West which is commonly based on fixed assets and sometimes on fixed assets plus inventories. Additionally, China does not include “non-produced non-financial” assets at scale as in the USA where it amounts to over 50% of non-financial assets. China’s complex rate of return for 2019 at 5.2% was 50% higher than the 3.4% recorded in the US using “operating surplus” as the common numerator. Accounting for non-produced assets, it is likely that the Chinese rate is closer to double that of the USA rather than being half as big. That said, China in common with the USA and other major economies, has experienced a sharp and sustained fall in its rate of return since 2013 which in turn has impacted on its rate of investment.

Discussion.

The question is posed. What is the more important metric, the Marxian rate of profit or the complex rate of return? As far as the capitalist investor goes, focused on the most telegraphed return, it must be the complex rate of return. Trending to 1%, barely able to keep its head above the rate of inflation, and certainly not covering the cost of borrowing, it clearly acts as a disincentive to invest.

The irony of course is that part of the reason for the fall in this return is corporations themselves paying for inflated assets with negligible yields. They are contributing to the same bubble that is undermining their own yield. This proves there are definite limits to bubbles, even when these bubbles are stoked by share buy backs financed with debt.

But the two rates are tied umbilically. Note that it is exceptional for the complex rate of return to either rise above the rate of profit when both peak, or to fall below the rate of profit when both trough. Of the 12 major and mini peaks and troughs found in Graph 2, only twice does the peak or trough of the complex rate of return exceed that of profit. Thus, it can be said the complex rate of return is trapped within the parameters set by the actual rate of profit.

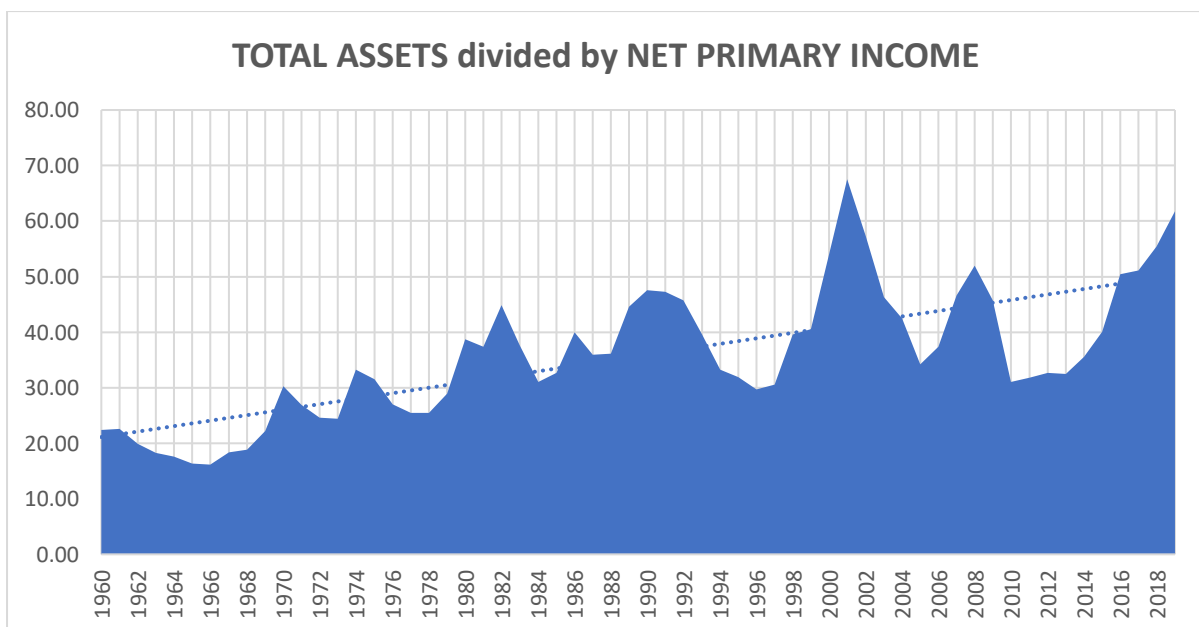
Further, the real rate of profit is determined by the interaction between the rising composition of capital and the rising rate of surplus value. It is these two fundamental movements that generate the capital and profits which yield the rate of profit. Thus, in aggregate both the rate of profit and the complex rate of return both share the same quanta of surplus value in their numerator which is why they move more or less in tandem though the degree of movement may differ. The fact that the rate of return tends to sit below the rate of profit proves that financial assets do not generate their own independent income. And, in all cases the net surplus generated within the non-financial corporate sector from production is greater than the netted-out totals flowing into and out of this sector. If financial assets had their own discreet source of income this could not happen.

This is confirmed when we turn to GDP. GDP seeks to record human value producing activity. It consciously avoids including human speculative activity. Had it included speculative activity, that is the sum of capital gains since 2012, US GDP would be 40% bigger, the rate of growth of GDP would have been amazing, productivity would have soared and inflation would have been in double figures.

All of this of course would simply have produced a false picture of what was really happening in the real economy with its anaemic growth, flatlining productivity, tepid investment and faltering inflation. Similarly, with the relation between the actual rate of profit and the complex rate of return. All that the divergence of the latter from the former tells us is that speculation is at work, no that's the wrong word, speculators don't work.

If we turn the complex rate of return on its head as is done in Graph 1 so that it is now presented not as a ratio but as a multiple, then the following is seen. We are able to identify pyramids shaping the point of maximum rise in speculative "assets" followed by the maximum fall in speculative "assets". This rise followed by an abrupt fall creates the pointed effect.

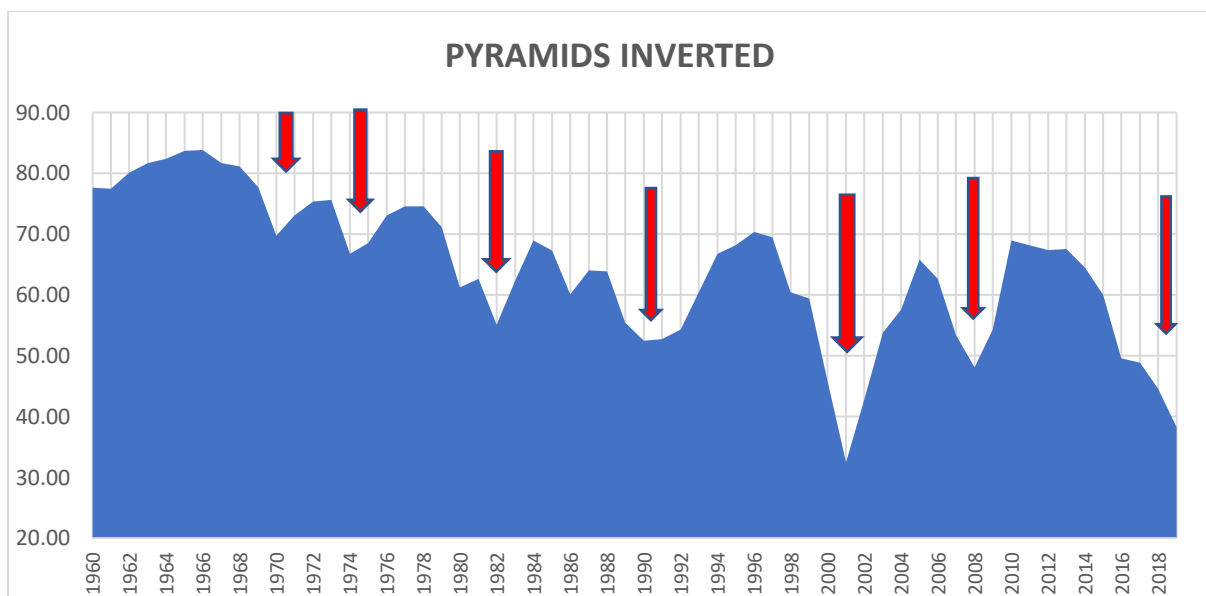
Graph 5.



But in reality, speculation creates an inverted pyramid. Recall the scene around the casino table in the film, the Big Short. There it is explained how leverage works or what is the same thing successive bets on bets based on the same income stream or price. Each layer of speculation, or bet on a bet, potentiates a bigger gain or loss. In terms of a physical presentation, this creates bigger and wider blocks creating the inverted pyramid shape. However, speculation has no influence on the pedestal upon which the pyramid rests or rocks. The size and capacity of this pedestal is set by the existing pool of surplus value, and for this reason, as the pyramid grows in size, that pedestal reduces relatively in size and so does its capacity to support this pyramid resting on its nose.

So, if you cannot imagine these inverted pyramids the graph below does it for you. Every arrow points to the moment of toppling when recessions whip away the pedestal.

Graph 6.



Conclusion.,

As winter approaches in the northern hemisphere, and with the virus reasserting itself, these fictitious financial assets are beginning to wobble once more. This time round, it is unlikely that the US FED and Treasury will be able to muster sufficient firepower to shore up the markets. We can expect the real and bourgeois rates of return to converge as fictitious capital is flattened, proving once more there is only one rate of profit and it is the one Marx set out.

On the 27th of September, the BEA will release turnover figures for quarter 2, allowing me to refine the rate of profit for the first half of 2020. By then as well, events on world stock markets will be more established and the outlook for winter clearer. That said, markets are already beginning to discern the rocks ahead as the rose-tinted FED fog lifts, up ending their complacent economic outlook.

However, we will only know how bad 2020 was at midnight on December the 31st and not before.

Brian Green, 22nd September 2020.