

THE U.S. RATE OF PROFIT 2020, with and without Covid financial subsidies.

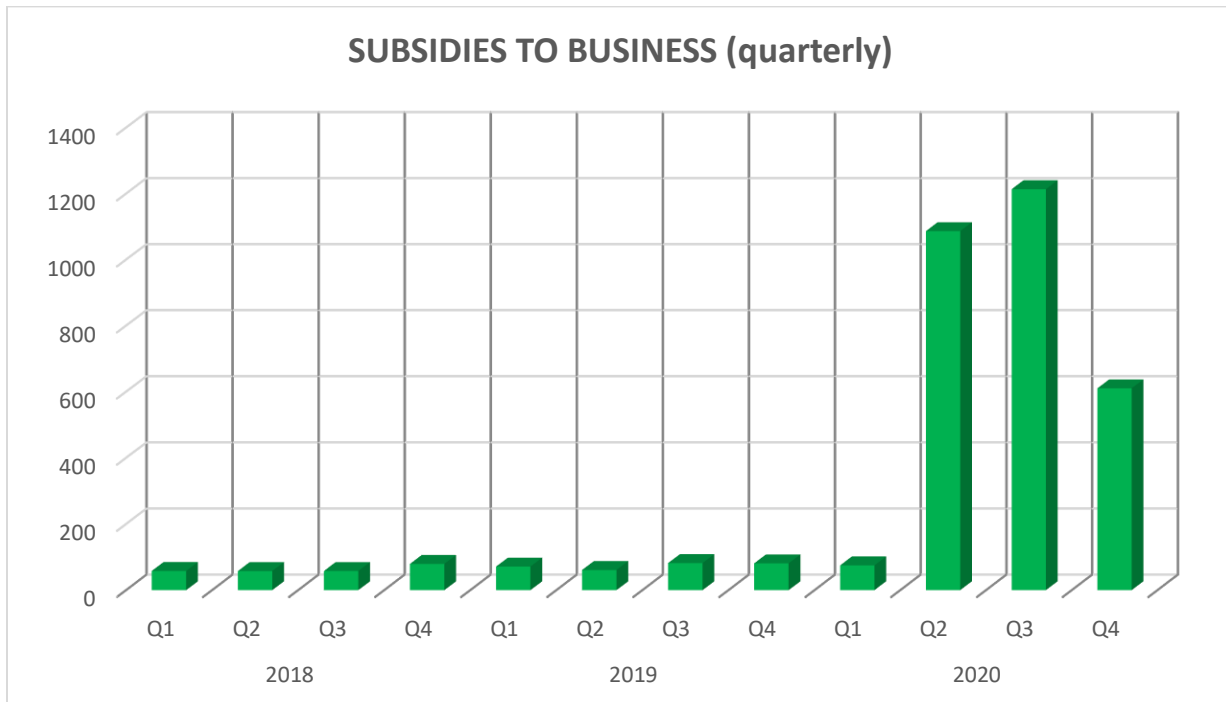
The BEA released fourth quarter corporate profits on the 25th January completing profits for the whole of 2020. 2020 is a curious year. The Pandemic has seen the FED and Congress pump vast amounts of relief funds into the economy. These funds have been claimed as profit by corporations thus distorting the actual rate of profit. In this article there are two series, the rate of profit with and the rate of profit without subsidies. In the short run the rate with subsidies is important, but in the long run it is the rate without, which will be more important.

Methodology.

There are a number of ways of calculating the rate of profit all yielding various accuracies or inaccuracies. The most accurate is to base pre-tax unadjusted non-financial corporate profits over fixed and circulating capital. To obtain circulating capital Gross Output is reduced to the Cost of Gross Output by subtracting the Net Surplus and then dividing the result by Turnover. For the sake of comparison, there will be a graph based on the Marxian method of using variable capital instead of using circulating capital.

To understand why there is such a dramatic difference between pre-subsidy rates of profit and post-subsidy, the scale of the subsidies must first be understood. Over the course of 2020 these subsidies increased ten-fold, a nice corporate earner. The data in Graphs 1 – 3 refer to total corporate which includes non-financial. Later these subsidies will be reduced to cover only non-financial from Graph 4 onwards

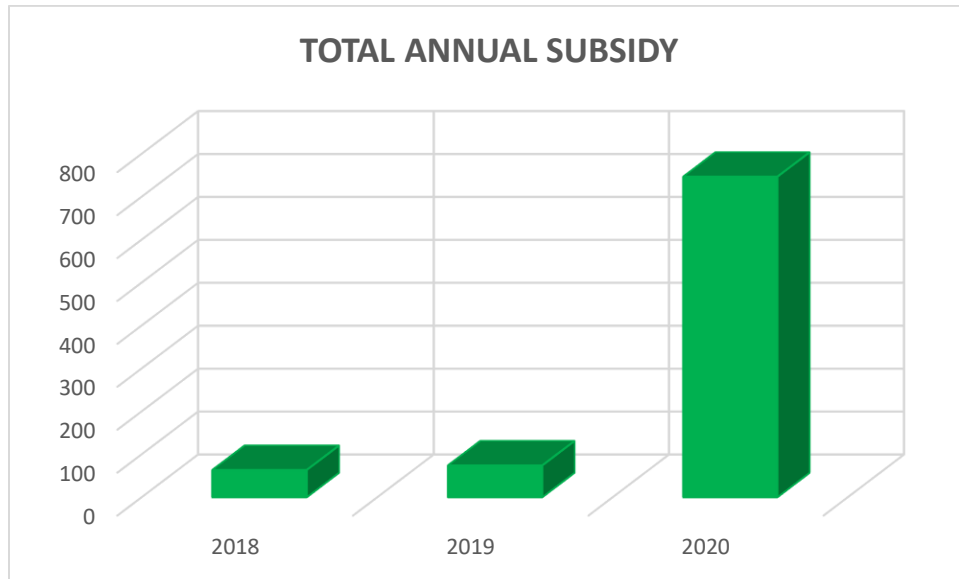
Graph 1.



(NIPA Table 1.12, 25th March release date, attached)

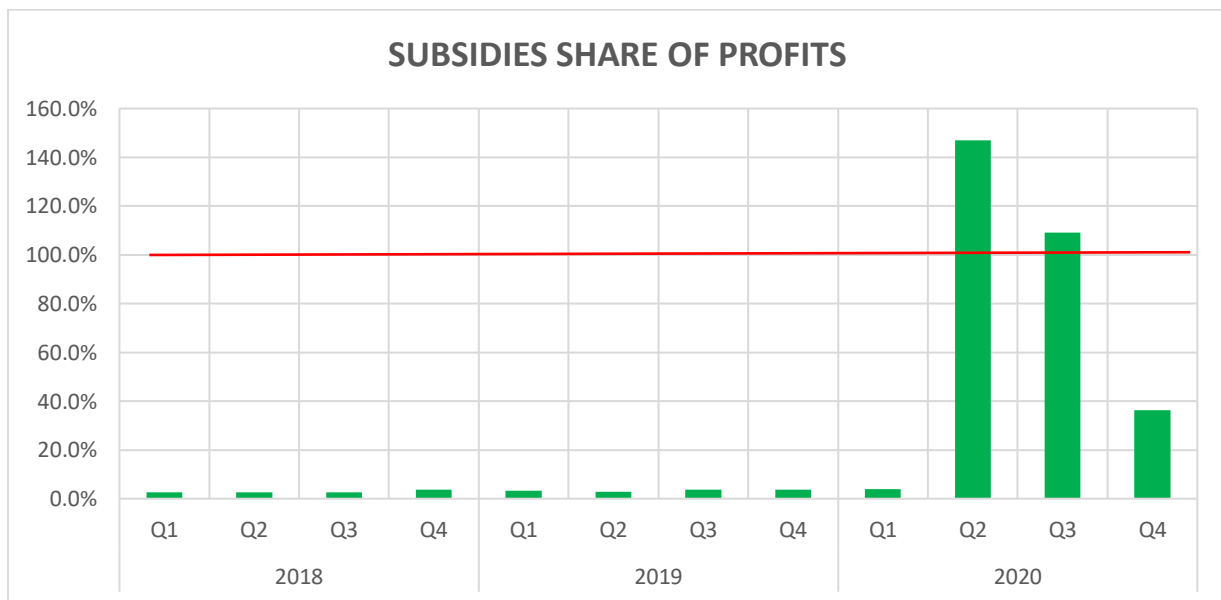
To appreciate the cumulative scale of these subsidies, the annual data is presented. Subsidies in 2020 were ten times larger than the average for 2018 and 2019. The average increase in subsidy throughout 2020 amount to around \$746.4 billion or 25% of the total Covid funds injected into the economy by Congress amounting to \$3.1 billion.

Graph 2.



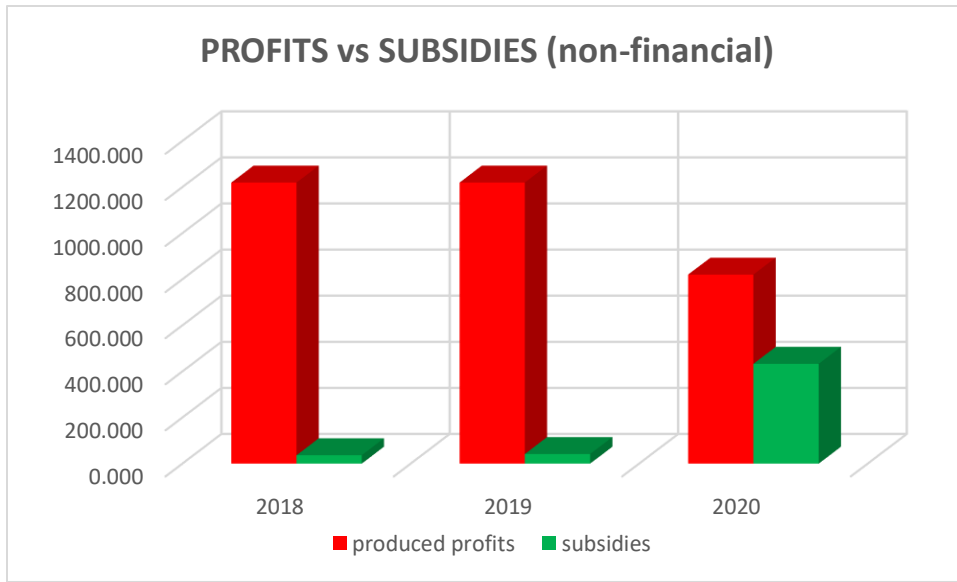
The final graph measures these subsidies against profits stripped of subsidies. We can see that in Quarters Two and Three in 2020 subsidies actually exceeded profits on an annualised basis.

Graph 3.



Graph 4 below represents the subsidies given to non-financial corporations. In 2020 they were 53% as large as the actual profits produced by these corporations.

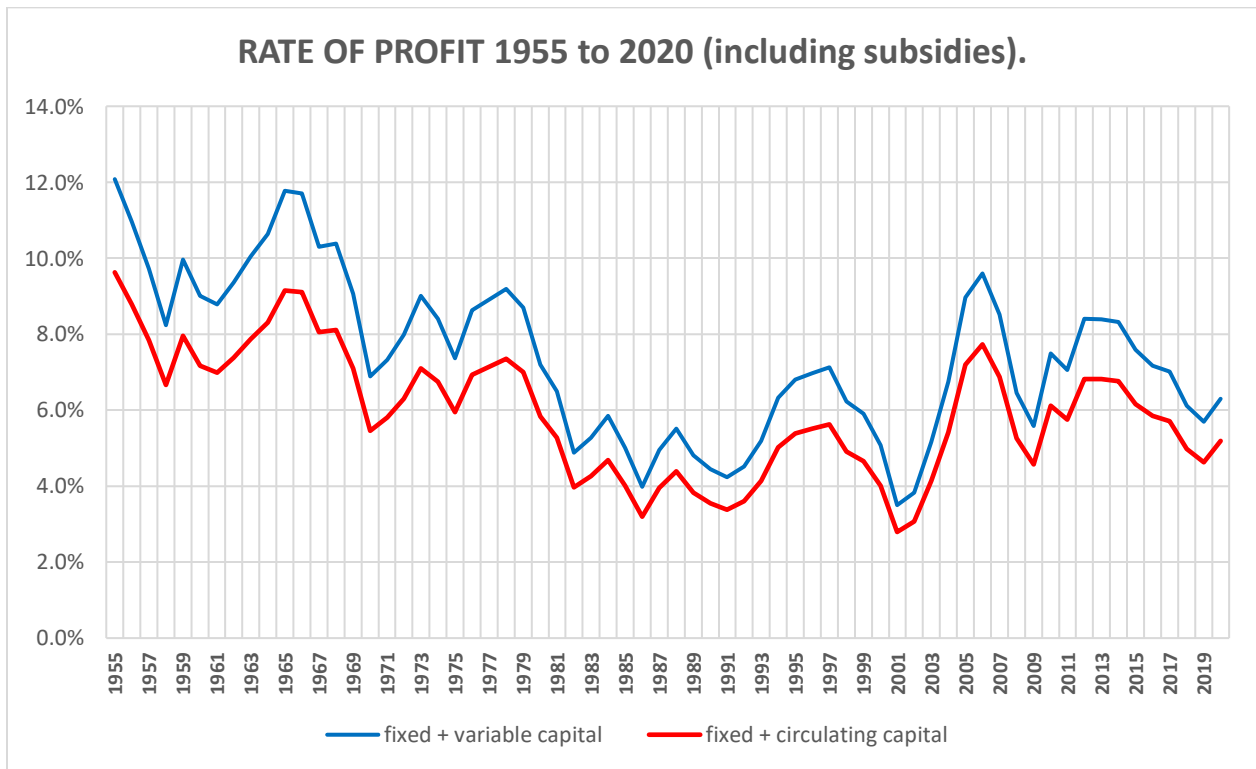
Graph 4.



The rate of profit in two halves.

Clearly the sheer scale of subsidies was going to have a profound effect on the rate of profit. And it has or not. Instead of falling, despite the pandemic and the greatest contraction in production since the War, profits increased because of these subsidies.

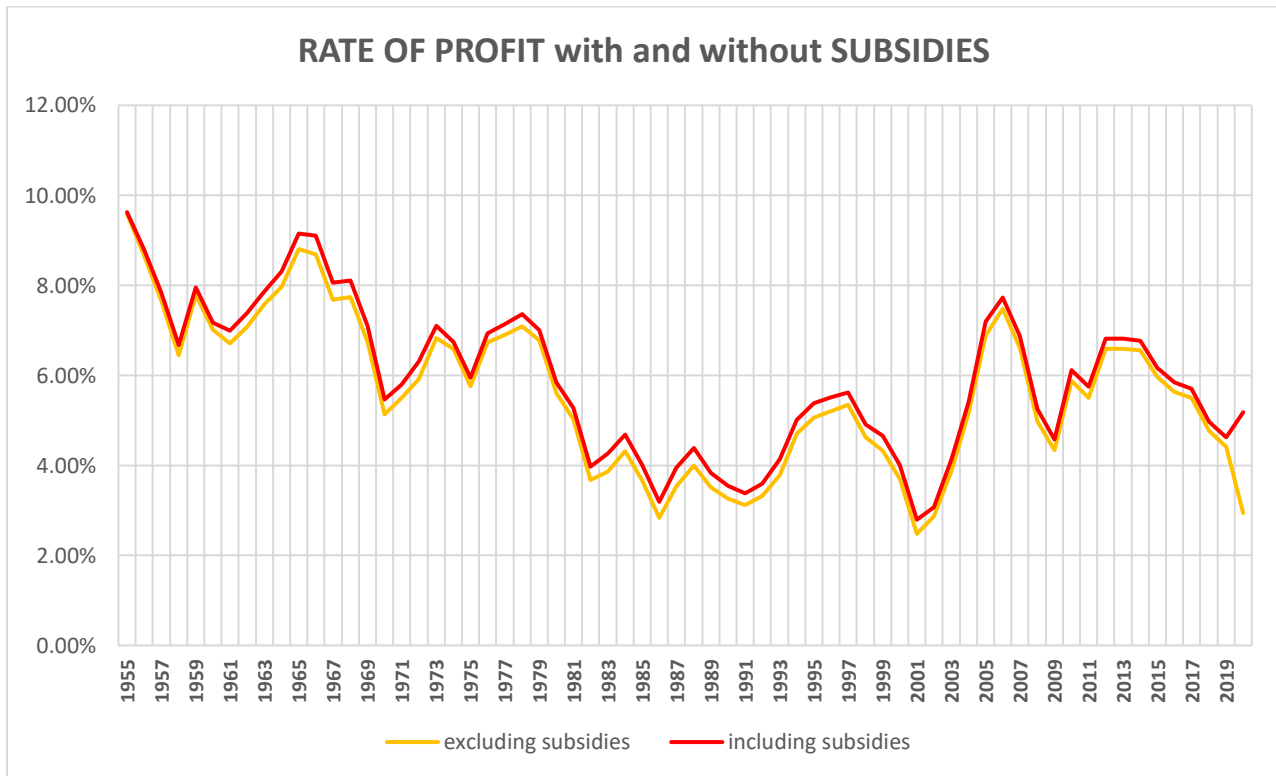
Graph 5.



(Source: Attached spreadsheet 'Table 1.14 attached to Post 2020 profits')

The rate of profit increased from 4.6% in 2019 to 5.2% in 2020 which appears to be as, if not more, remarkable than the rapid evolution of Covid vaccines. This was the first rise in the rate of profit since 2014. But it is illusory, because when the subsidies are excluded, as they have been in Graph 6, the opposite occurs, the rate of profit almost halves between 2019 and 2020. The adjusted rate of profit falls to 2.95% from 4.6%. The two rates of profit, which are almost indistinguishable between 1955 and 2019, diverge by 2.25% in 2020. Its' kind is unlikely to be seen again. (In both cases the base for calculating the rate of profit comprises both fixed and circulating capital.) In fact, without being subsidised, the rate of profit would have fallen to within 0.5% of the low in 2008, the nadir for post war profitability.

Graph 6.

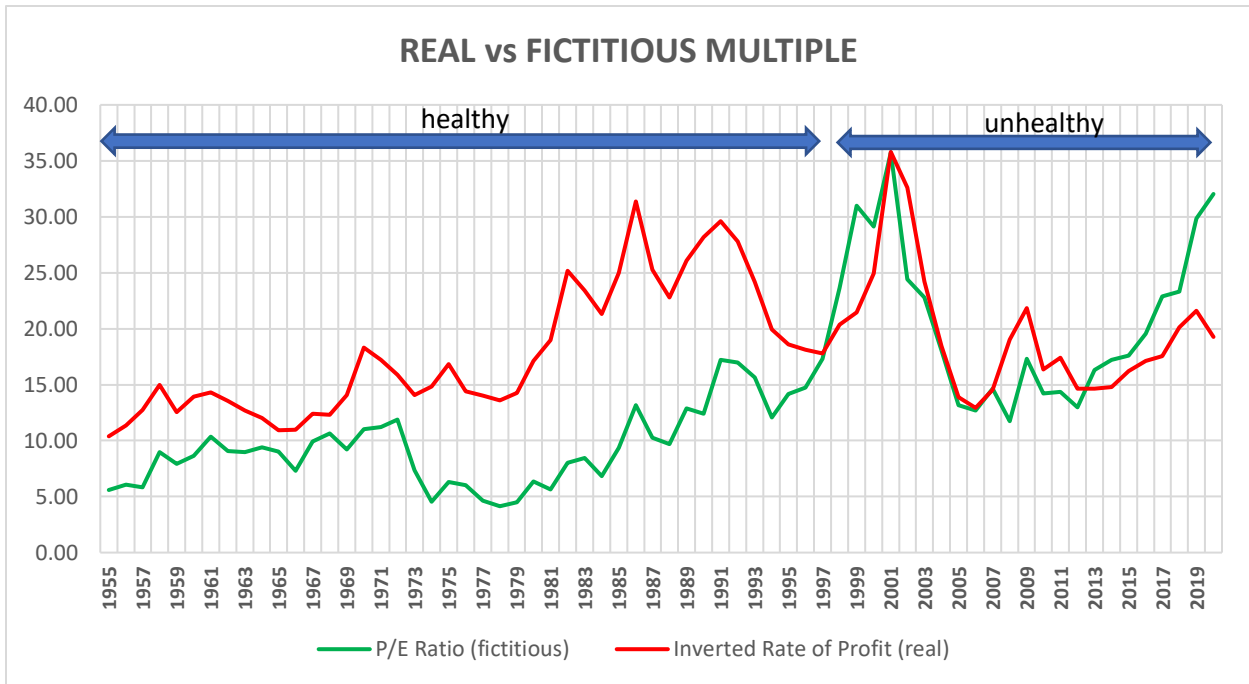


And on to the Market Madness.

Of course the profit figures which the markets will pick up on, is not the profit figure shorn of subsidy, but the profit figure which resonates with subsidy. For that reason, in this section, we will utilise the profit data which contains the subsidies. In other words the engorged profit data. The first graph compares the real multiple with the fictitious multiple to show how frothy the economy is and remains. The real multiple is the inverted rate of profit using circulating and fixed capital. The fictitious multiple is the Price to Earnings multiple where price is based on the market capitalisation of the Wilshire 5000 at each year end. In both cases the income side is based on pre-tax unadjusted non-financial corporate profits. (The Wilshire 5000 represents the market cap of 97% of all US listed companies.)

Normally we would expect the real multiple to sit above the fictitious multiple which happened for 40 years up to 1996. When the fictitious multiple rises above the real multiple then markets enter bubble territory. This has occurred from 1997 onwards.

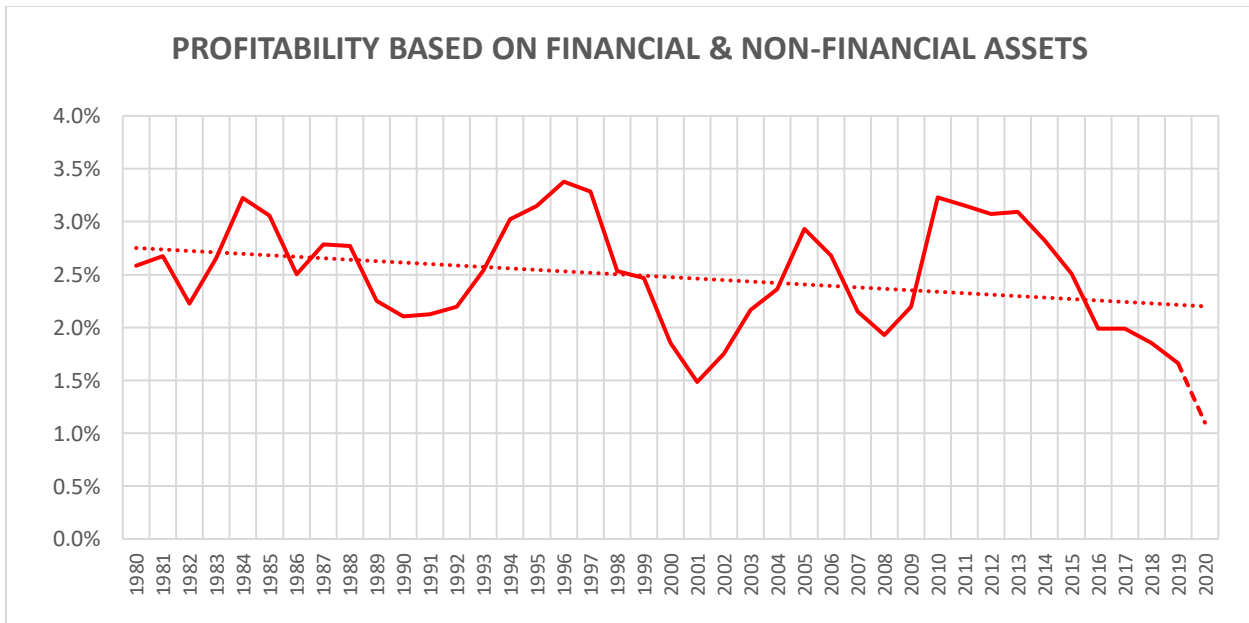
Graph 7.



In the build up to the dotcom bubble prior to 2001 the fictitious multiple overtook the real multiple for three years. Since 2014 this has gone on for twice as long and the gap now exceeds the earlier gap (+68% vs +51%). The current ongoing bubble is the biggest, most sustained bubble in history, and because it has endured for so long, its resolution will be catastrophic.

Another way to view bubbles is found below.

Graph 8.

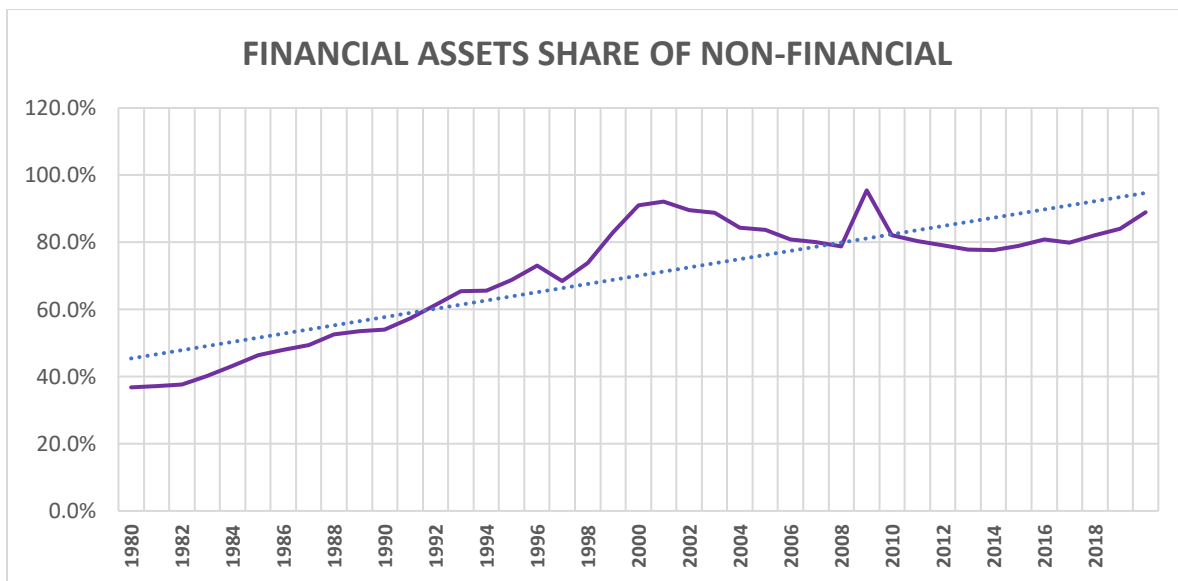


(Source: Federal Reserve Table S.5.a, lines 20 and 118)

By including non-financial assets, which is not the Marxian way, because they do not assist workers to produce profits, the rate of profit is driven lower and falls further. (The dotted extension to the graph is my estimate for 2020.) The significance of this rate lies not so much in decisions taken internally whether to invest or not in current production, but lies in the sphere of finance, where banks and lenders examine balance sheets to decide whether or not to extend further lines of credit to particular corporations. This consideration sits alongside the ratio of earnings to interest payments in calculating corporate solvency. The FED must be aware of the collapse in their rate of return which in turn must have influenced their decision to suppress interest rates to keep the show on the road.

The final graph in this section looks at the growth of financial assets relative to produced assets (structures, equipment and intellectual property).

Graph 9.



(Source: Federal Reserve Table S.5.a, lines 20 and 118)

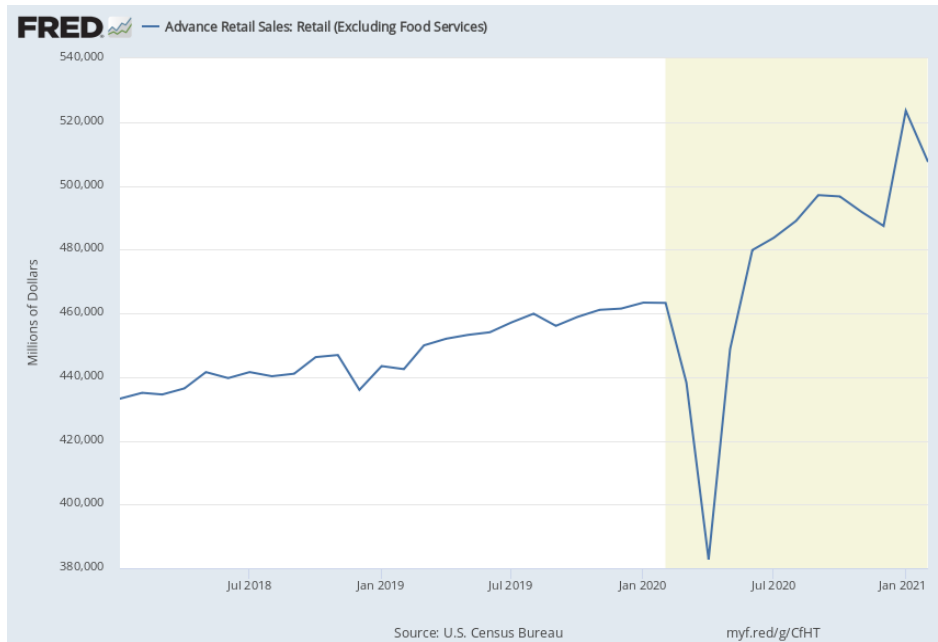
The period of neo-liberalism saw a sharp rise in non-financial assets from 1982 leading up to the dotcom bubble where it peaked at over 90%. After that bubble was pierced there was only a partial reversal of the previous rise of 50% bringing it down to 40%. As a result, financial assets remained on an elevated plateau of around 80% rising back to 90% by the end of the second decade. The most significant aspect is that there was no fundamental repricing of financial valuations post-2008. Additionally, a subsidiary factor in the rise of the ratio post 2008 was the deceleration in the pace of fixed asset investment which reduced accumulation of non-financial assets to a crawl allowing financials to race ahead.

The first casualty of a cold war seems to be data.

This section seeks to reconcile the sales side of GDP with the production side but fails to do so. Since Trump economically besieged China, I am of the opinion that US data has become inflated. Presumably, the purpose was to show economic strength in the face a still rapidly expanding China.

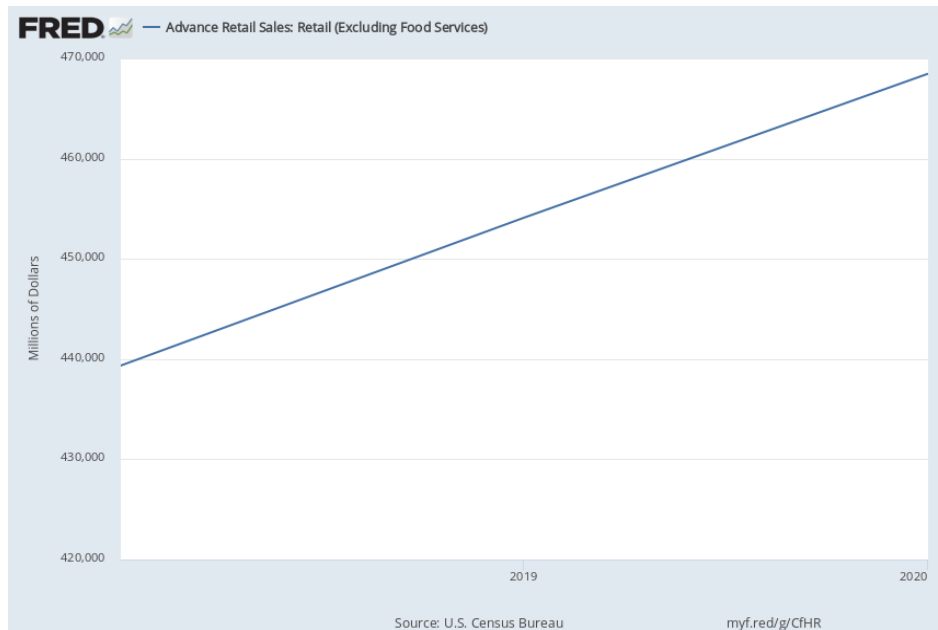
We will begin with retail sales below. The monthly data shows how choppy sales were pre and post the relief funds.

Graph 10.



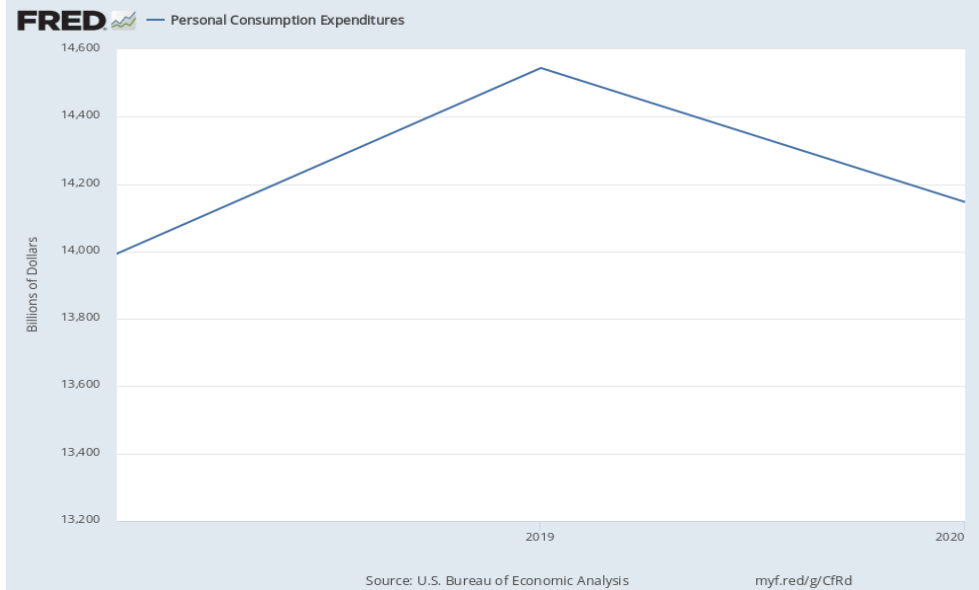
And yet when we examine the annualised figures, no sign of a pandemic is visible. No indentation is to be seen anywhere. Abracadabra.

Graph 11.



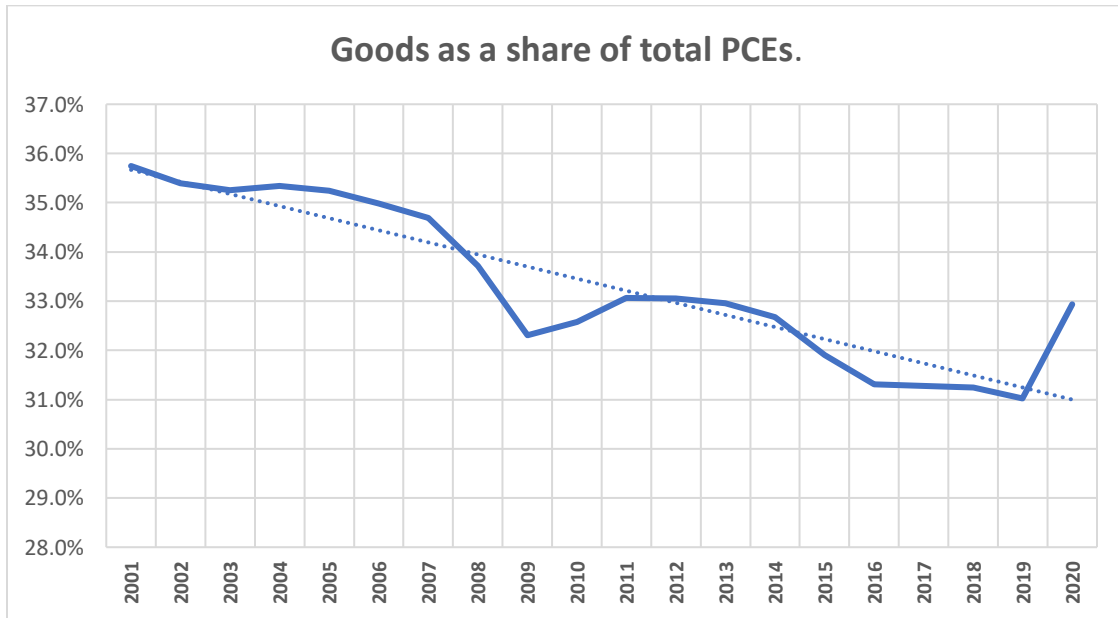
However, the pandemic reappears when we examine Personal Consumption Expenditures (PCEs). Because of the collapse in services, the pandemic is clearly seen in Graph 12. This is because consumption has shifted from services to goods because of lockdown. Incidentally, this has been good for corporate profits as China has demonstrated, because in general, industrial production is of higher value compared to services. The bulk of profits in the S&P 500, other than financial, is goods not services related.

Graph 12.



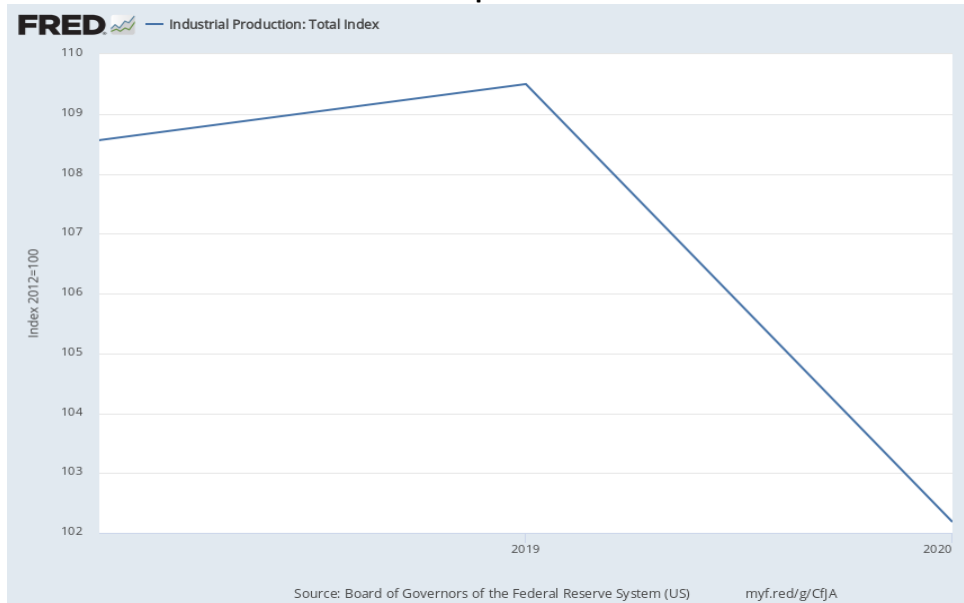
The significant shift in consumption expenditures can be seen below. Having fallen consistently this century, the share for goods jumped in 2020 as the consumption of services fell relatively.

Graph 13.



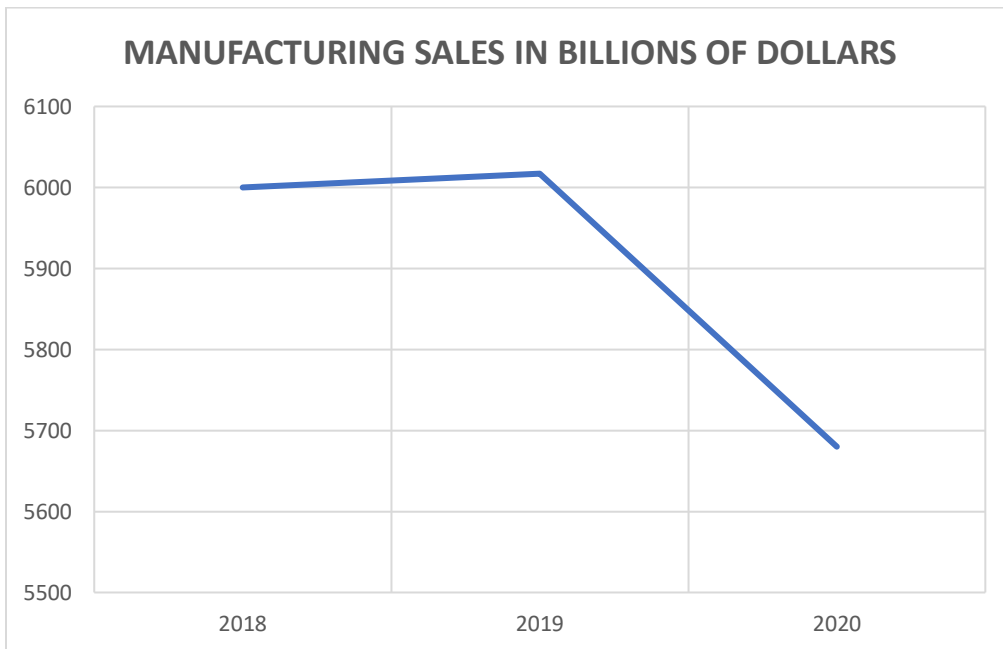
The pandemic is also clearly seen in the sphere of production which took a tumble, a really big tumble.

Graph 14.



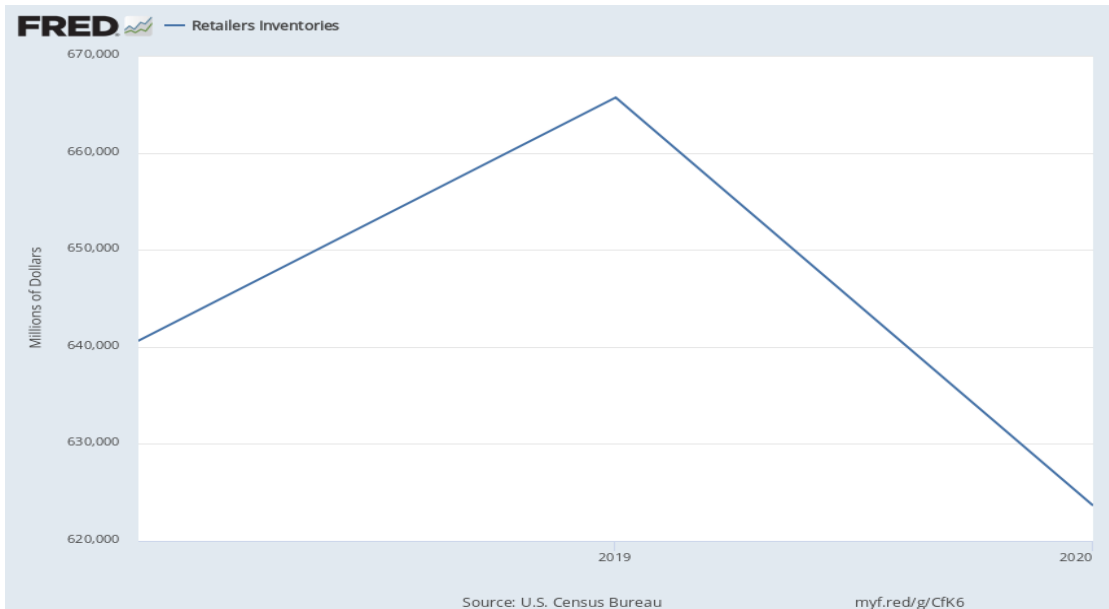
As well as manufacturing.

Graph 15.



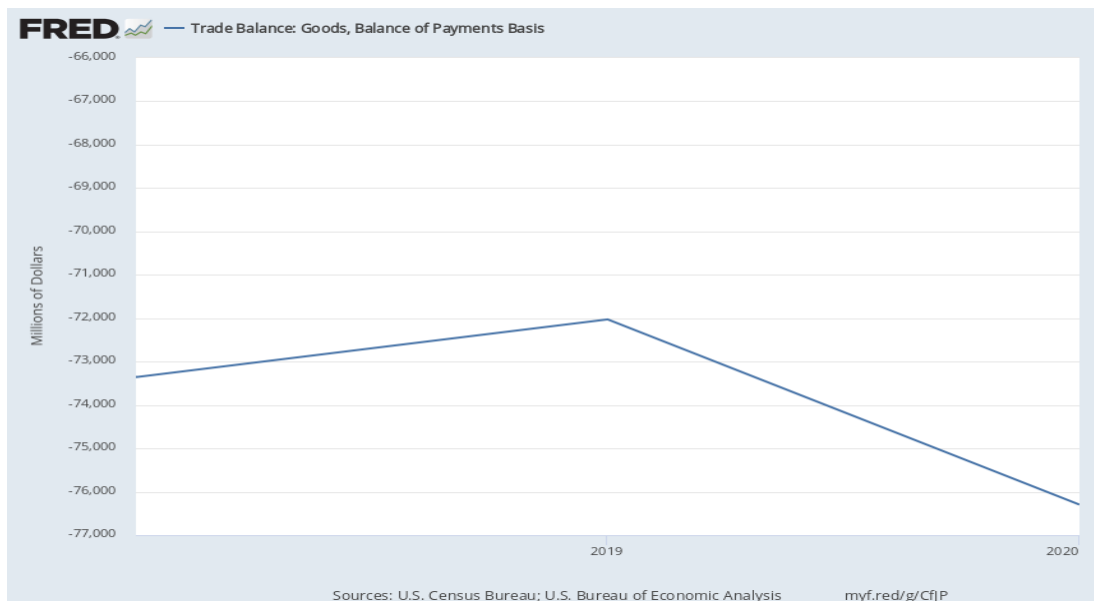
So where did the goods come from to supply retail? Firstly there was the run down in inventories.

Graph 16.



And there was a growing trade deficit. Much of the loss of US output was made good by imports from China. There is a sarcastic comment making the rounds in Wall Street that the main beneficiary of US relief funds is China. Hence the phenomenon of empty shipping containers littering western ports because most shipping has been one way, from Asia to Europe and North America.

Graph 17.



Readers will know I am wary of the figures provided for Personal Consumption Expenditures. I am of the opinion that they are inflated, especially the Personal Consumption of services, and as Personal Consumption has been the driver of GDP, it implies that GDP growth itself has been overstated.

Below, I have tried to reconcile the consumption of goods with their production, failing once again. The difference between sales and production amounts to around \$577 billion (+\$234bn sales versus -\$343bn production) and is only partly compensated for by the run down in inventories of \$160 billion and an increase in merchandise imports of \$49 billion. This deficit equals 6.0% of annual sales so cannot be accounted for completely by increased mark ups. (It is also equal to 1.5% of GDP.) See Note 1 for caveats.

Table 1.

Annual Increase or Decrease	2020 - 2019	2020 - 2019	2020 - 2019	
Goods PCEs (less gasoline sales)	+\$234 billion ¹			
Inventories (retail + wholesale)			\$160 billion ²	
Production (Manufacturing)		-\$343 billion ³		
Trade Deficit (Merchandise goods)			\$49 billion ⁴	
	+\$234 billion	-\$343 billion	\$209 billion	= -\$368 billion

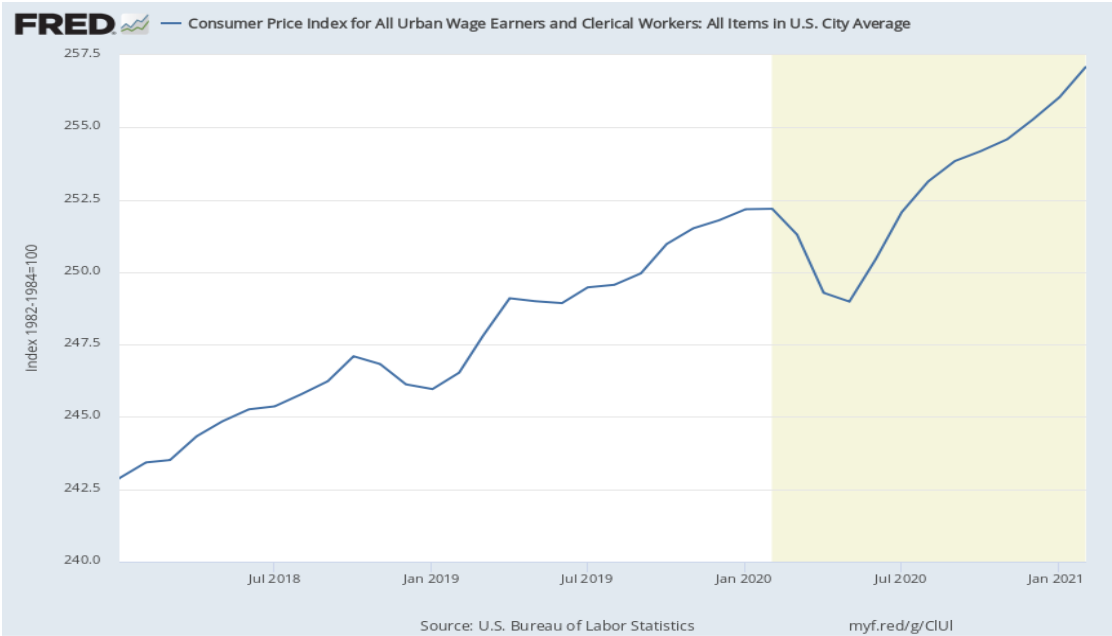
1. NIPA Table 2.3.5 (row 2 less row 11)
 2. NIPA Table 5.8.5B rows 14 plus 17 (Sum of wholesale and retail inventories less fall in wholesale sales of \$21 bn)
 3. <https://www.census.gov/mtis/index.html> Census Bureau
 4. BEA International Section Table 2.1 (merchandise excluding capital goods on both sides)

Of Inflation and Interest Rates.

Today everyone would like to be an “I Specialist” able to discern what is happening with Inflation and Interest rates. The FED is not only expecting, but willing, to allow inflation to exceed its elusive target of 2.0%. This is a nod to the market that achieving its inflation target will not necessarily lead to monetary tightening.

The PCE price index today was of some comfort to the markets. It came in as expected at 1.6% (including food and gasoline). But in the corners of the market inflation is certainly picking up.

Graph 18.



In this relevant CPI index, inflation has already hit 2%. This is as close as we get to a formal working-class price index. It is likely that in the short-term inflation will pick up, but it should subside in the second half of the year when the effects of the final relief package subsides.

The real question is what the pick-up in inflation will mean for interest rates in the short term. The key 10-year yield has risen above the critical 1.6% point and is currently trading in the narrow range of 1.6% to 1.7% pending further inflation news and the outcome of further Treasury auctions.

Graph 19.



The effect of rising interest rates is already making itself felt. In the stock markets the effect has been mainly felt in the Nasdaq, home to many tech stocks. As portfolios are rebalanced, FAANG type stocks have fallen out of favour. As a result the Nasdaq has given up most of its year to date gains.

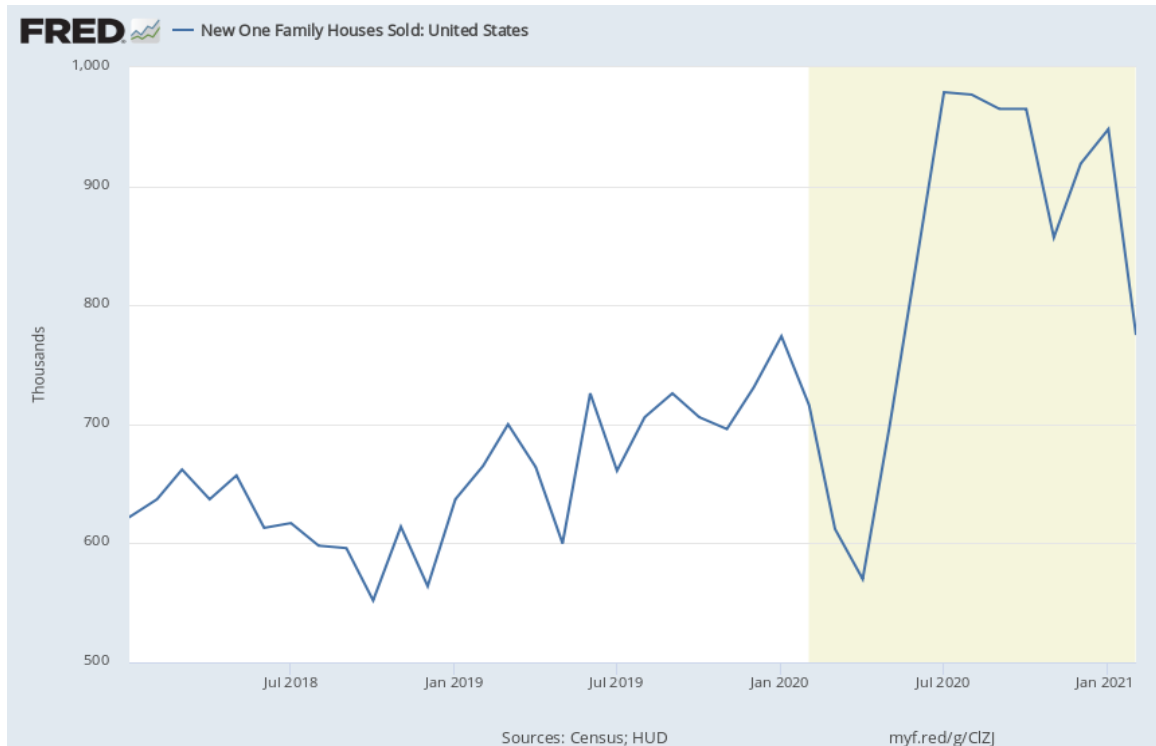
Graph 20.



<https://www.macrotrends.net/2489/nasdaq-composite-index-10-year-daily-chart>>Macrotrends

Of equal significance has been the effect on the housing market. A mere half a percent increase in the 30-year mortgage rate, linked to the rise in the 10-year yield, has been sufficient to stall the housing market, which has been arguably the most dynamic part of the economy of late.

Graph 21.



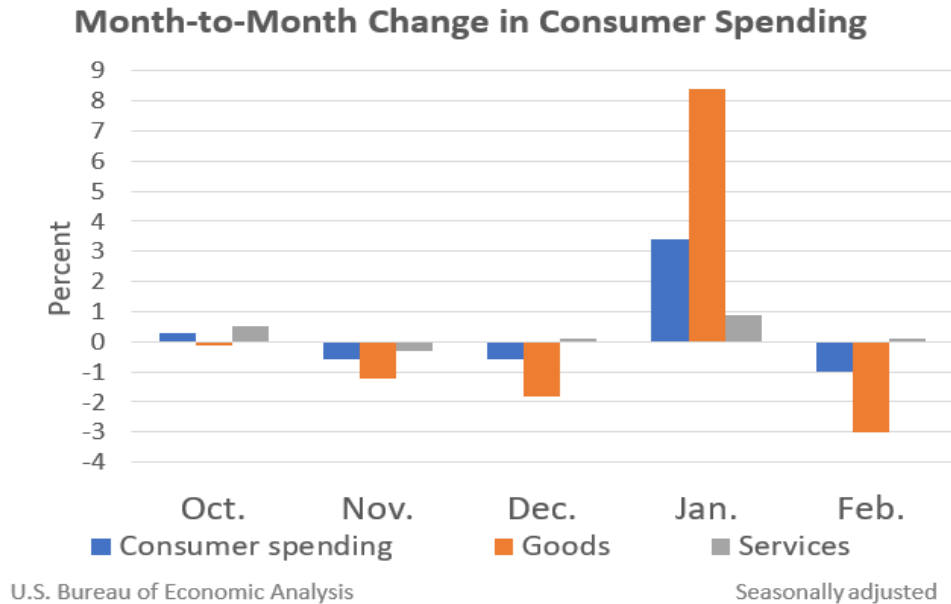
This shows the sensitivity of markets to interest rates. It also explains the longevity of the upturn since 2016. It also explains the growth in the accumulation of debt, which in the corporate sector now exceeds \$10 trillion. That said, there is one aspect of the Relief Bills which is seldom spoken about, and that is how they have helped recapitalize many corporations. Already \$746 billion has been deposited in corporate bank accounts. By the end of this quarter it will have reached over \$1 trillion. This will make a substantial impact on those corporations close to insolvency.

The real test will come in the second half of the year once this financial gift is used up.

Conclusion.

The effect of the final relief bill of \$1.9 trillion is unlikely to extend beyond the second quarter. This view is based on the impact of the smaller December Bill which can be seen in the graph released by the BEA on the 26th. By February its impact had petered out. It turned out to be a one-month wonder, though this view needs to be tempered by the fact that consumers knew a further and larger Bill was about to be enacted.

Graph 22.



By the third quarter of 2021 a degree of normalcy should return to the markets marked by the absence of major relief funds and the presence of extensive vaccination. Only then will we be able to discern the damage this pandemic has done to an economy which was already sluggish before the pandemic. Up to now, the cost of the pandemic has amounted to 27.5% of GDP comprising relief funds of \$5 trillion or 24% and a contraction in GDP of over \$700 billion or 3.5%. However this is the maximum hit, as some of the cost will be undone in the fourth quarter of 2021 when growth resumes. The best period to evaluate the pandemic globally is from April 2020 to March 2021.

The two major countries with the highest costs from the pandemic in economic terms is therefore the US and the UK. However, given the scale of the final relief package, the rebound in the US will exceed that of the EU. EU legislators must look longingly at the Federal structure of the US, the absence of which prevents them from following suite. As in post 2008 the EU will be the laggard.

Talking stimuli. The irony of course is that if the US could collect the taxes on the rich this would amount to a permanent stimulus. The IRS recently released its wildly understated assessment of tax dodging by the rich in the USA. *"The wealthiest Americans are failing to report more than a fifth of their taxable income to the Internal Revenue Service, according to new research, using sophisticated forms of tax evasion to avoid paying Uncle Sam. Unreported income for the top 0.1% is 1.8 times higher than previously estimated, the recent paper from economists and IRS analysts found, while it is 1.3 times higher than originally calculated for the top 1%." "The tax gap is substantially larger than the IRS estimate," Daniel Reck, a professor at the London School of Economics and one of the authors of the report, told Yahoo Money. "For the top 0.1% of the distribution, our estimates suggest that it's almost doubling the tax gap." The IRS failed to collect over \$38.5 billion from individuals making \$200,000 or more as of May 2019, the Treasury Inspector General for Tax Administration said in a report recently. (Yahoo Money 23rd Feb.)*

Well, if the income of the wealthiest 0.1% is 1.8x higher than reported then the tax missing is well beyond the absurd \$38.5 billion estimated by the IRS. Currently the top 0.1% enjoy an income of \$1 trillion. If

there is an underestimate of 80%, this means \$800 billion is untaxed. Add in the top 1%, excluding the top 0.1%, and there is another \$600 billion. If the IRS could enforce its 37% tax rate on these capitalists, this would yield an additional \$592 billion in annual tax revenue. This is a minimum figure. Nonetheless, this figure would have covered the average budget deficit over the last 20 years. In the UK tax dodging amounts to at least £120 billion p.a. Not so much a question of trickle down as trickle away.

In the long run, collecting the taxes of the richest niche of society would be a more effective stimulus than the short and reactive Relief Bills. These taxes could fund long term programmes to support society such as Medicare. Such permanent programmes would turn Biden into a Roosevelt, but this is unlikely. Instead US society will have to do with short term relief measures, which when they are gone they are gone.

Finally, we are entering the final pages of the first chapter of the Pandemic, defined as the successful roll out of vaccination in a number of countries. This means the US military has been vaccinated making it combat ready once more. Alongside this, there is an upsurge in youthful discontent around the world. It is likely to be a hot summer, but one which has nothing to do with global warming.

Note 1. The correlation between manufacturing and retail is strong but needs to be qualified. Manufacturing does not only supply retail, but capital goods as well the military. Further some of the output of manufacturing is sold directly to the public. On the other hand the wholesale sector also supplies manufacturing with some of their supply derived from imports. Wholesale inventories have been reduced by the \$21 billion decline in annual wholesaler sales. Finally, retail is supplied by other sectors such as agriculture. This said the gap is still too large to be explained except by inflation on the PCE side.

Brian Green, 26th March 2021