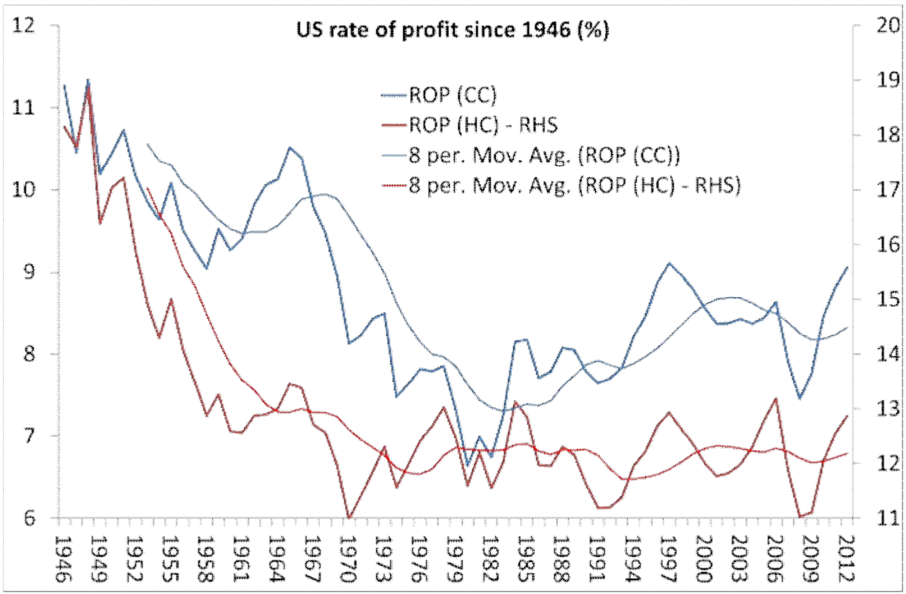
The US rate of profit – extending the debate

Michael Roberts, 19 December 2013

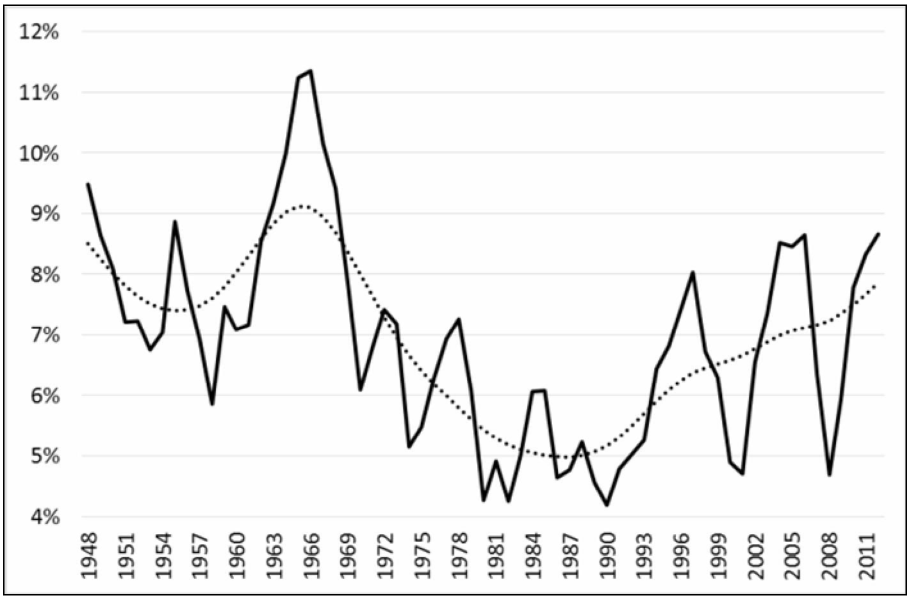
In my last post (*http://thenextrecession.wordpress.com/2013/12/16/us-rate-of-profit-up-slightly-in-2012-flat-in-2013-down-in-2014/*), I updated my calculations on the US rate of profit since 1945 with the latest data on profits and fixed assets provided by the US Bureau of Economic Analysis. Based on my measure of profits and assets, which I reckon is the closest to what Marx considered his rate of profit (with all the caveats and provisos that I and others have discussed at length – see my paper, The profit cycle and economic recession, I found this.



My main conclusions were that: 1) there was a secular decline in the US rate of profit from 1946 to 2012; 2) but it was not in a straight line, because from about the early 1980s, the rate of profit recovered up until about 1997. The recovery did not restore the previous high level of the rate of profit seen in the 1960s; 3) from 1997 to now the rate of profit has been flat or fallen slightly, with a rise from the recession of 2001 to a peak in 2006 and then a fall during the Great Recession of 2008-9 and then a recovery to now, with the 2013 rate of profit broadly in line with the 2006 peak or a little lower.

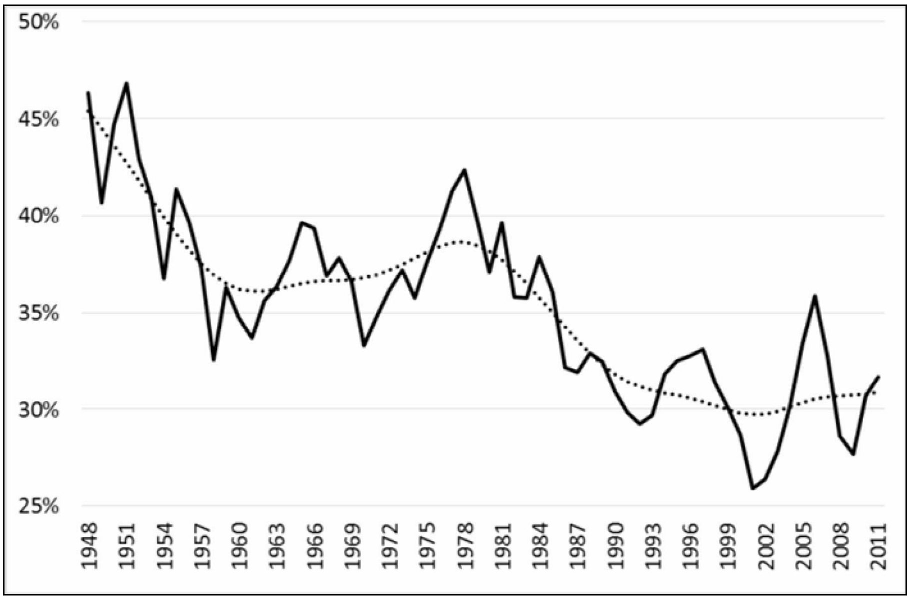
In addition, I concluded that falling or flat profitability from 1997 was the underlying reason for the eventual mild slump in investment, employment and production in 2001 and that only a credit-fuelled boom in property and stocks revived profitability until 2006 before a new fall drove the US and eventually the world economy into the Great Recession like a road runner over a cliff. Also the secular decline in US profitability, mainly achieved between the mid-1960s and the early 1980s, is best explained by Marx's law, namely by a rising organic composition of capital outstripping the effect of counteracting factors like a rising rate of exploitation of labour. From the 1980s to the late 1990s, the counteracting factors dominated in the so-called neoliberal era. But after 1997, Marx's law began to operate again, as a significant rise in the organic composition of capital was not sufficiently counteracted by a large rise in the rate of exploitation (partly revealed in inequality of incomes reaching extremes not seen since the 1920s).

Nevertheless, scepticism remains about both my calculations of the US rate of profit and my interpretation. So to help us with the debate, I would like to bring to your attention the recent work of two brilliant young Marxist scholars, based over ten thousands miles apart. The first is Peter Jones, a PhD student in Australia. In a paper prepared for the 12th Australian Society of Heterodox Economists Conference (Jones, The Falling Rate of Profit Explains Falling US Growth v2), Jones starts by showing the contrasting results that you can get, depending on how you measure the rate of profit and also what rate of profit you reckon is important for understanding the laws of motion of capitalism. Some reckon that the rate of profit that matters is the after-tax rate of profit based on current cost measures of fixed assets, as this is (it is argued) is what matters for corporations' investment decisions. This is what Jones calls the narrowest measure. It looks like this.



We can see that, on this measure, there was a significant recovery in the US rate of profit from the mid-1980s (using the dotted HP trend line). This recovery did not cease in the late 1990s despite two sharp falls in 2001 and in the Great Recession, although the trend rate remains below the peak achieved in the mid-1960s.

However, Jones contrasts that measure of the rate of profit with what he calls the broadest measure of profit – of corporate gross value-added less depreciation and employee compensation and before interest or tax is deducted, against fixed assets measured in historic costs. This measure is pretty similar to that used by Andrew Kliman in his book, *The failure of capitalist production* (see my post *http://thenextrecession.wordpress.com/2011/12/08/andrew-kliman-and-the-failure-of-capitalist-production/*). This measure looks like this.



On this measure, the rate of profit makes no recovery on a trend basis (dotted line) in the 1980s, although it appears to flatten out in the last decade and was even rising slightly going into the Great Recession.

So where does that leave us? Well, we are helped out of our dilemma by the recent work of Themis Kalogerakos, based in the University of Lund, Sweden, just about as far away from Australia as you can get. TK is doing a master's degree there and his thesis (EKHR61_Themistoklis_Kalogerakos) analyses all the various rates of profit from broad to narrow, as Deepankar and Vasudevan did last year.

TK finds that the US rate of profit, however it is measured, appears to have two main periods: one where a high rate falls from the 1960s to the 1980s; and one where it recovers from the 1980s. Nothing new there. But TK also identifies within those two periods, two sub periods. The first is the high and slightly rising rate of profit from 1946 to 1965, then the decline from 1965 to the early 1980s, then the rebound up to 1997 and then, finally, a period of decline from 1997. This matches exactly my own interpretation of the data, starting back in 2006 (see my book, *The Great Recession*).

What is helpful about TK's paper is that he shows that, however you measure the rate of profit, whether by the broadest or the narrowest measure or in between, the US rate of profit exhibits the four phases described above. The average rate of profit for the whole period 1946-2011 (TK has not updated for 2012) was 17.99% for the broadest measure and 6.03% for the narrowest. Between 1946-65, the rate of profit was 11% above this average of the broadest measure and 15% above for the narrowest. In the neoliberal period from 1982 to 1997, the rate was still 9% below the average (broadest) or 18% below (narrowest). And the average for 1997 to 2011 was still below the overall average by 5% (broadest). It was 5% higher than the average for narrowest measure from 1997-2011. But in this latest period, the rate in both cases was still below the 1946-65 golden age period by 10% and 15% respectively. These measures were based on current costs fixed assets. If historic costs are used, then TK's results are no different. On the broadest measure, the closest to Marx's, the average rate of profit from 1997 to 2011 was 23% lower, while on the narrowest measure it was 16% lower. So my conclusion that there has been a secular decline in the US rate of profit is clearly confirmed by TK's calculations.

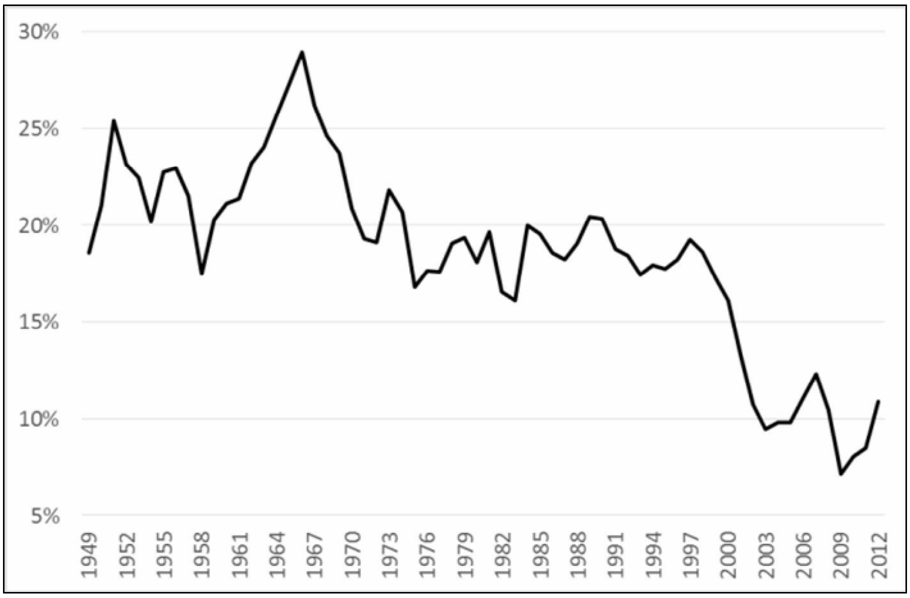
What these results also reveal is that a key counteracting factor in reviving corporate profitability after the 1980s in the US has been the significant reductions in corporate tax and interest costs. This is expressed in the narrow after-tax profit measure in the 1997-11 period exceeding slightly its overall average since 1946, although it was still below the period of 1946-65.

But more important, TK looks not just at the level of profitability but also at the annual change in the US profit rate. Across the whole period from 1946, whatever the measure of the rate of profit and whether measured from trough to trough in the cycle or from peak to peak, the US rate of profit has fallen, by about 0.6% a year. And even more useful for deciding whether profitability can be seen as the underlying driving cause of the Great Recession, in the period of 1997 to 2011, the rate profit fell annually by 0.6% (broadest) and 0.3% (narrowest). This confirms the analysis that G Carchedi and I made in our recent paper, The Long Roots of the Present Crisis (The long roots of the present crisis).

As young TK puts it: *"in the last period, that includes the Great Recession and the years leading up to it, the CAGRs (compound annal growth rates) of all profit measures are negative in both sectors. The average profit rates are slightly higher than in the preceding period, but still lower than in any other phase of the long wave and lower than the average rates for the whole period under scrutiny (except for the after-tax profit rate for the whole corporate sector). In addition to that, the trend of the TSVR (total surplus value rate) in both sectors is slightly descending and that of the other measures is leveling off. What is more, it is obvious from the peak-to peak and trough-to-trough CAGRs, that the long-term profitability in the corporate and non-financial corporate sectors, aside from the partial revival of profit rates during the 1980-1997 period, is one of declining or at best stagnating nature. This denotes that prior to the crisis, the accumulation process in the US economy was certainly problematic, and profit rates in the "real" economy may have led to the boom of the financial sector."*

And TK's last sentence brings me back to the paper by Peter Jones. In his paper, Jones wants to isolate that part of the official profit figures provided by the BEA National Income and Production Accounts (NIPA) that are really 'fictitious' so that we can get to the 'deeper' rate of profit that more closely matches Marx's value measure. Then we can judge better the validity of Marx's law of profitability and whether it provides the best indicator of likely economic growth and accumulation in the US economy. I tried to do something similar in my paper, Debt matters ((Debt matters) by measuring profits against corporate net worth. But I think Jones' approach has greater merit over mine, or over the recent attempt by Alan Freeman to adjust for fictitious capital.

Jones recognises that a large part of fictitious profits is already excluded in the NIPA because they do not include capital gains. But in his view (correctly I think), the official figures for profit need to be adjusted for other fictitious profits, namely those made by banks from lending to government (bond purchases) and from utilising the savings of workers (mortgages etc). Government spending that is financed by borrowing is recorded as output in NIPA. But it is really fictitious income. Jones goes through the NIPA accounts to deduct what he reckons are the components of this fictitious profit to come up with a measure of profit that best represents surplus value created in production and realised y the corporate sector. When he puts this against net fixed assets, the result looks like this.



Now the US rate of profit based on this non-fictitious profit clearly shows a secular decline over the whole period and the same sharp fall after 1965. It also shows a stabilisation and slight rise after 1982 before falling sharply after 1997. Thus the US rate of profit leading up to the Great Recession had taken a significant tumble, suggesting again its role in that slump. If Jones is right, it also reveals that the rise in the rate of profit recorded from 2002 onwards in both his broadest and narrowest NIPA measures (as above) is down to fictitious profits that evaporated in the Great Recession.

Jones goes on to show that, on this 'non-fictitious' measure, the rate of profit is closely correlated with the growth of corporate output, thus confirming *"the explanatory power of Marx's law* ". Back in Sweden, TK also looked at that explanatory power in his paper. As others before him (including me), he examined the relationship between the movement in the US rate of profit and the organic composition of capital. He found a negative correlation of 0.66 between the two on the broadest measure of profitability. And he found a similar positive correlation between the rate of accumulation and corporate output growth, as Jones does. And TK also found that that there appears to be a cycle of accumulation of capital and profitability from trough to trough of about 33 years, nearly the same as I found in my 2006 calculations (see my book, *The Great Recession*). But the accumulation rate has been falling secularly trough to trough and peak to peak, so the movement in the organic composition cannot be the only factor. But that's another story and as it's my birthday, I'm out of here!