The Fall in the Rate of Productive Investment, the Allocation of Profits, and Financialization

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A major economic question about capitalism today – why is there a reduced rate of investment, which is linked to the "long stagnation" (literally, to relatively lethargic growth and accumulation).

A question on the investment/growth link: does low investment causes low growth - Keynesian (problem with that), or does low potential growth causes investors to make low real investment – crisis of overproduction?

To consider - what is a crisis of over production?

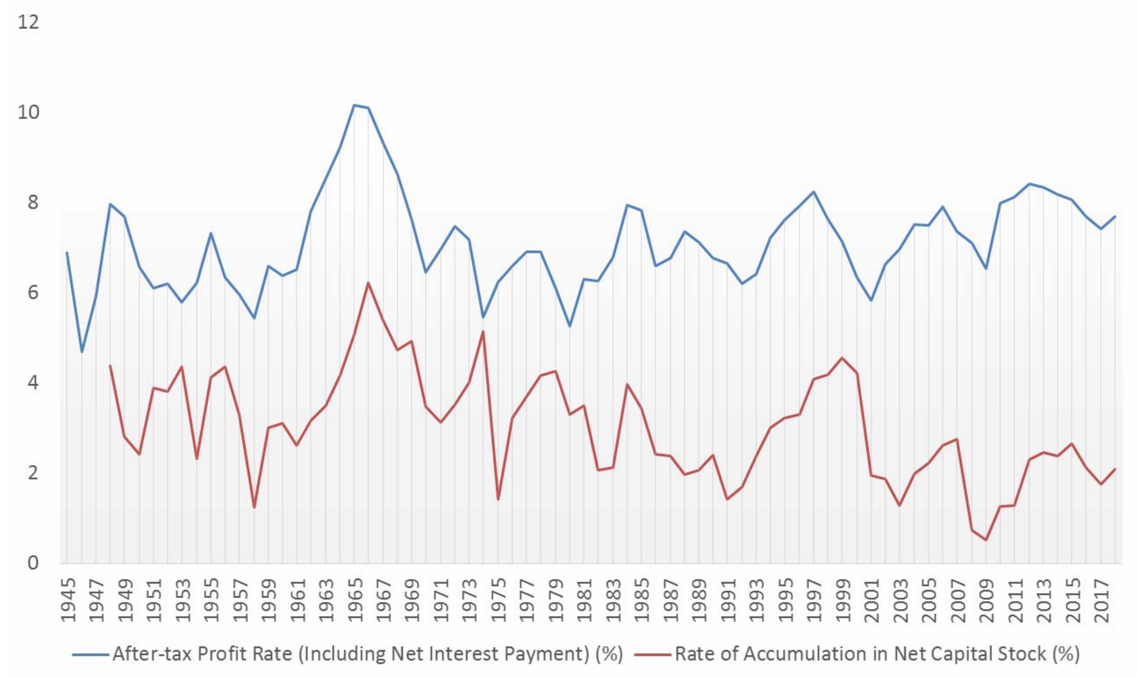
Three Marxist super-basics on profits:

1) In Marxist economic theory, profits are both a pull (high rates of profit motivate more investment) and push (pool of funds available to earn more profits) for real investment.

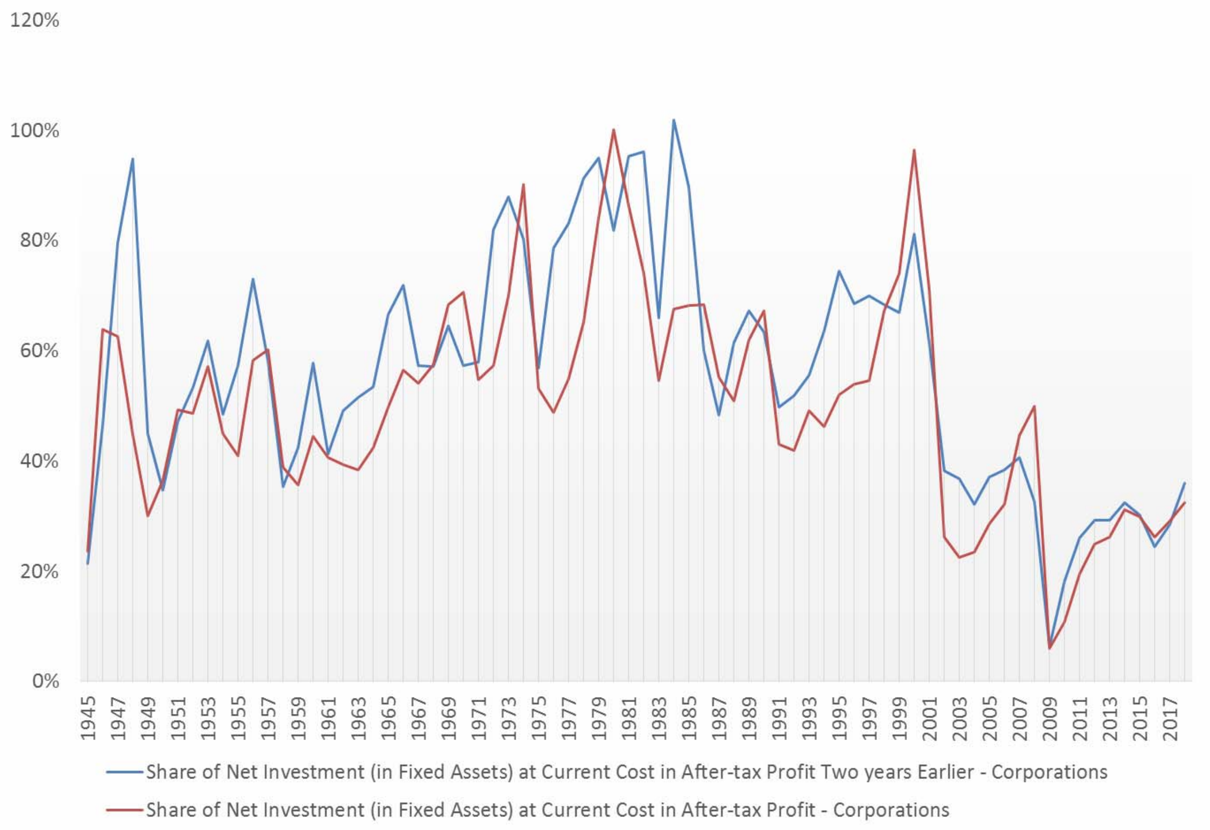
2) Circuits of capital – profits obtained are reinserted into expanded circuits of capital in pursuit of more profits – that is the essential self-expanding nature of capital.

3) Note - capitalist consumption, both in verbal descriptions of circuits of capital and models – is treated as ignorable to a first order approximation of the expansion of capital.

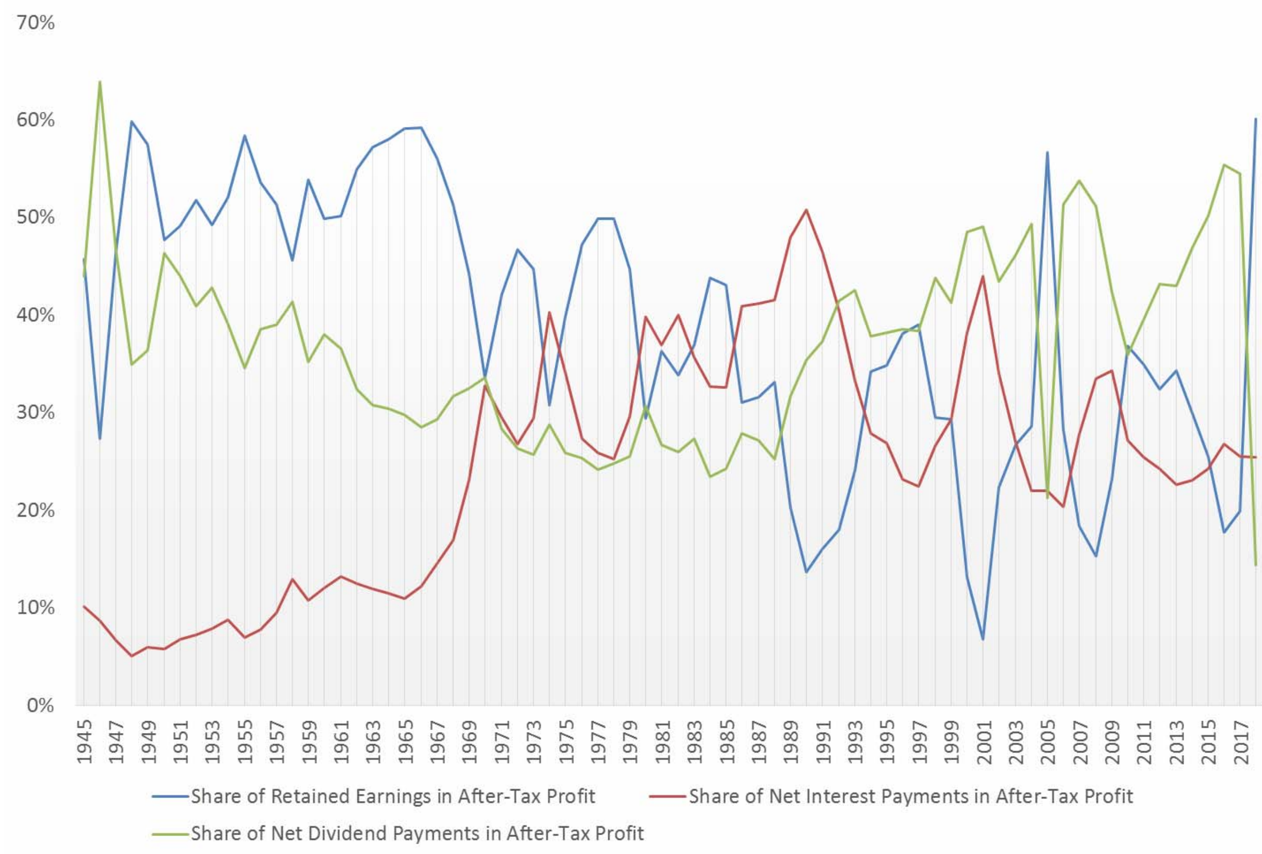
Preliminary conclusion – the rate of investment and hence capital accumulation should move with the rate of profit. But …



(Another measure of the fall in investment)

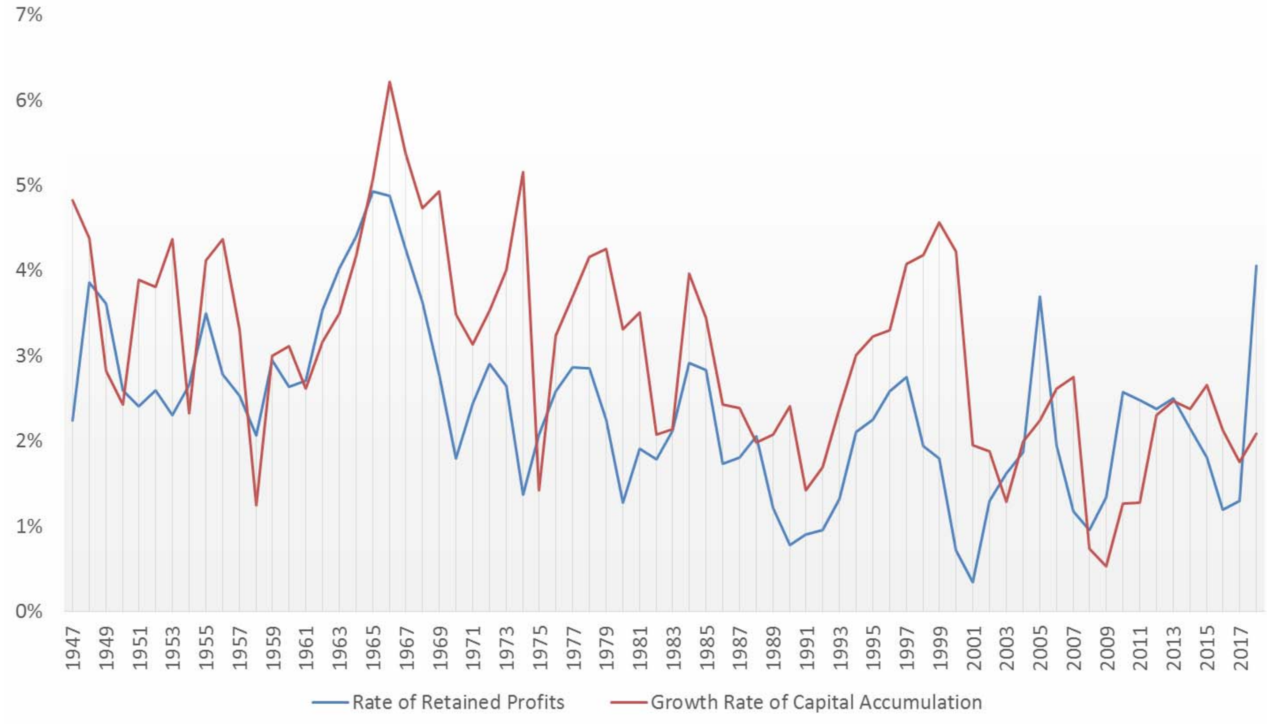


So what's going on?



An “answer” that poses many questions on the specifics of the operation of capitalism today.

1947-2018



So, the “answer” (and it is an answer as far as it goes) – the amount of real investment tracks retained profits. Retained profits have fallen as a share of profits, and so real investment has fallen correspondingly.

Question 1. (“why”) What is it about the operation of contemporary capitalism (apparently about neoliberalism) that has caused the fall in the part of profits retained?

Question 2. What happens to those profits that are paid out as interest and/or dividends?

Start with dismissing something that mainstream theory says should happen and does not. Tobin – because financial markets work so well, it does not matter if profits are retained or paid out – if paid out they will be borrowed back if real investment is desired.

Both Duménil & Lévy (2004, 2011) and Stockhammer (2004) stated that this simply does not happen (and that is why real investment does track retained profits), though neither gave empirical evidence supporting that claim.

To Do (task #1)

So that is a task we have to do as we fully develop this, find appropriate data to indicate that after companies pay out interest and dividends they do not borrow it back for real investment.

Since one of course cannot track each dollar bill that actually ends up being little more than showing that real investment matches retained earnings, as just indicated – but it needs be presented a bit more completely.

Concerning question 1 (why are retained profits falling) – again, is it a pull, a push, or both?

Three considerations:

1) On the pull off of profits by interest payments

An early version (1980s) concerning the falling real investment under neoliberalism saw the financial sector pulling profits out of the nonfinancial sector and thus reducing real investment. This is still at the heart of the liberal vision of people like Krugman and Stiglitz who see a key to a return to a better performance as a *reregulation of finance* to be

… "servant of real production," as opposed to its current role of "master over the real economy," or even a "leech on the real economy."

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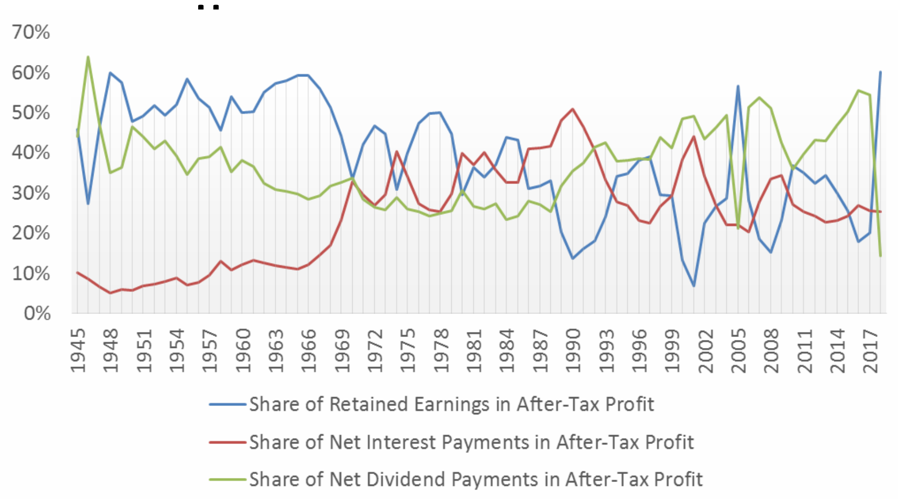

Interest payments are only half what they were at peak and half the payout to dividends

(Note in passing capital adjusted to that problem)

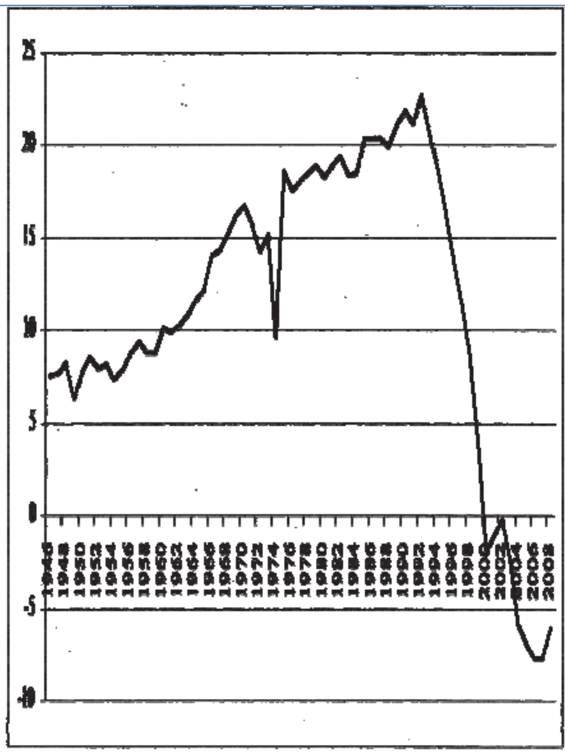

Figure 4: The Ratio of Net Liabilities to Net Capital Stock (%), 1946-2008

2) On a pull off of profits by dividend payments

After the war (see 3 way split again) people wanted dividends, but as the Golden Years set in people were more and more content to leave money in a company to grow. That only reversed after 1984 and especially 1988 as neoliberalism and its share-holder philosophy and governance paradigm took full hold, from which (most) stocks increased value by paying out more dividends.

Question: It was not a particular time of insecurity for the rich – so why the shift to requiring continual payouts?

3) On a push from a crisis of over production

Thinking of this the other way – not interest payments and dividends taking profits that the companies would otherwise invest, but rather the companies do not want to produce more (will invest to lower costs but not to expand production) – a crisis of overproduction.

So after they decide what they want to invest, they pay out the rest in dividends and to interest payments on money that they are borrowing, not to invest but to buy back stocks for asset inflation gains.

Associated questions.

i) Can we see how much stock buyback is going on and how that has evolved over time? (yes) Is there any way to estimate what sort of "profits" that has generated in stock value appreciation? (not sure …)

ii) Again, money is all fungible – but can we see how much total companies are spending on both real investment and stock buybacks together, and compare that to how much they are borrowing? (yes) – and will that tell us anything? (not sure ….)

Finally, to end, there is the big question that as far as I know next to nothing is written on empirically –

Question 2. What happens to those profits that are paid out as interest and/or dividends?

We have argued (and hope to present empirical evidence to support) that it is not lent back, at least not for real investment (maybe for stock buybacks, but again hard to separate which loan is used for what …)

This seems to leave two possibilities for their use.

i) Could capitalist consumption have gone up importantly in the circuits of capital to where it cannot be ignored to a first approximation, and in fact to the extent that it is where much formally reinvested capital is now simply consumed?

ii) Are companies just sitting on piles of profits that they are not investing and not doing anything with? Lots of discussion on this – seems overall there is a buildup (need measure), but also seems it is almost all in a few giant companies especially in tech – so what does that mean for the dynamics of today's capitalism?

Conclusions

1) The rate of investment has fallen under current capitalism (yielding prolonged relative economic lethargy), and this key development can an be explained by the drop in retained profits.

2) While that is an answer to one important economic question (why there is a fall in the rate of investment), it immediately poses the subsequent question - why have retained profits fallen?

Conclusions (cont.)

3) The channels through which profits flow away from real investment are financial, interest and dividend payments.

While one can argue if it is just semantics, I think that wording suggests the actual economics better than saying "financialization caused the fall in the rate of investment" - especially since the latter seems to suggest the Krugman/Stiglitz position that reregulating finance would re-elevate the rate of real investment, which is definitely not certain.

Conclusions (cont.)

4) Finally, what I have not seen any empirical work on is the obvious still next question, also of key importance for understanding the dynamics of today's capitalist system

– if profits flow away from real investment through financial channels to the financial sector and to wealthy individuals, what happens to those profits? What do they end up doing in today’s capitalist system?