THE STATE OF THE US ECONOMY. RATE OF TURNOVER AND OF SURPLUS VALUE, Q3 - 2017

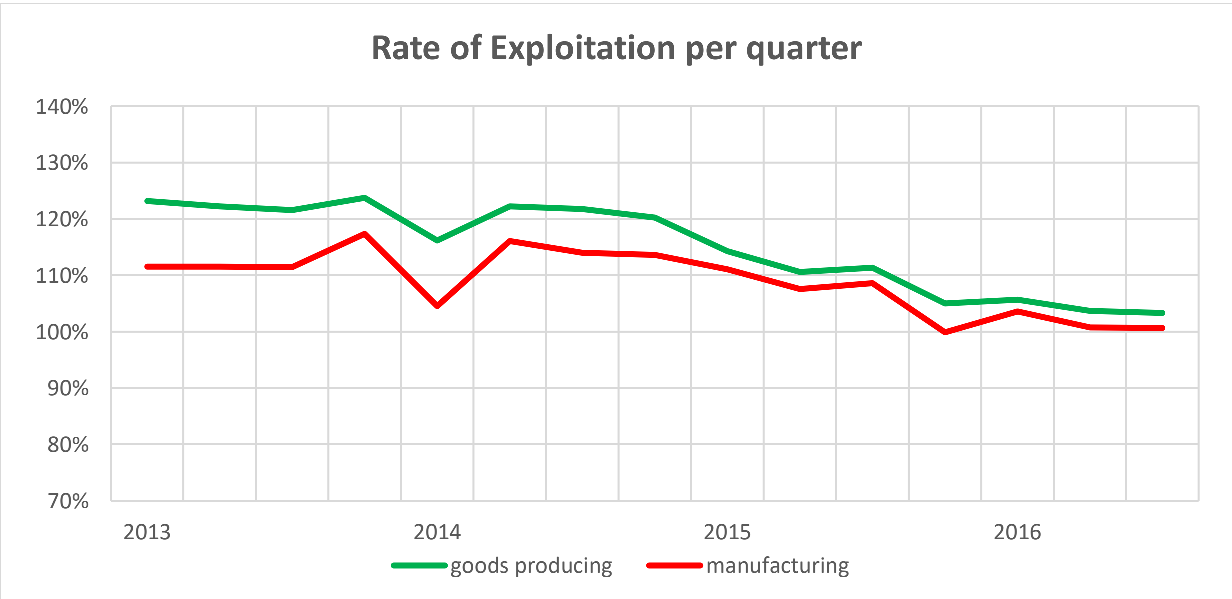
The irrational exuberance following Trump's election has been replaced with demonstrations on the street. The Democrats crow that their president has bequeathed a strong economy for Trump to build on, unlike the previous succession 8 years ago, when Bush Jnr handed over an economy still reeling from the financial crash in 2008. There can be only one health test for capitalism and that is profitability. In this posting, the latest rate of surplus value covering the third quarter of 2016, based on the BEA's 19th January release, is presented. It shows that profitability remains subdued in the USA standing well below the 2013-2014 plateau. The historical irony of a man symbolising the decline of the USA boasting that he will make "America Great Again" seems to escape the 46% of voters who cast their ballot in his favour.

Determining the rate of surplus value.

In common with all previous analyses seeking to determine the rate of surplus value, quarterly wages are substituted for "compensation of employees" which includes not only wages and salaries but supplements like health care as these are not available yet. The same caveat pertains, there is an overstatement in the rate of exploitation and that of surplus value because wages and salaries are smaller than compensation. However, because this is a consistent overstatement it does not affect the all-important trends found here and in earlier postings.

It should also be noted that the BEA and the Commerce Department, in compiling Corporate Profits for the National Accounts, adjusts reported profits to exclude non-GAAP factors (BEA%20METHODOLOGY%20PAPER%20CORPORATE%20PROFITS.pdf). The issue of the divergence between GAAP and reported profits which include exceptionalls is currently wider than it was pre-2008. The rate of exploitation avoids this predicament. It is obtained by deducting wages and salaries from **net** value added. (BEA Table 6.1D for net value added and Table 2.2B for wages and salaries.) This is the underlying profitability of the economy before the actual surplus is divided into its components such as enterprise profit (where GAAP anomalies reside), rent, interest, tax etc. The gross surplus is thus the blood pressure of capitalism free of distortion. It is not built up by adding rent, interest and tax to enterprise profit, rather these are deducted from the overall surplus which results from the division of the working day into its paid (wages and salaries) and its unpaid parts (the surplus).

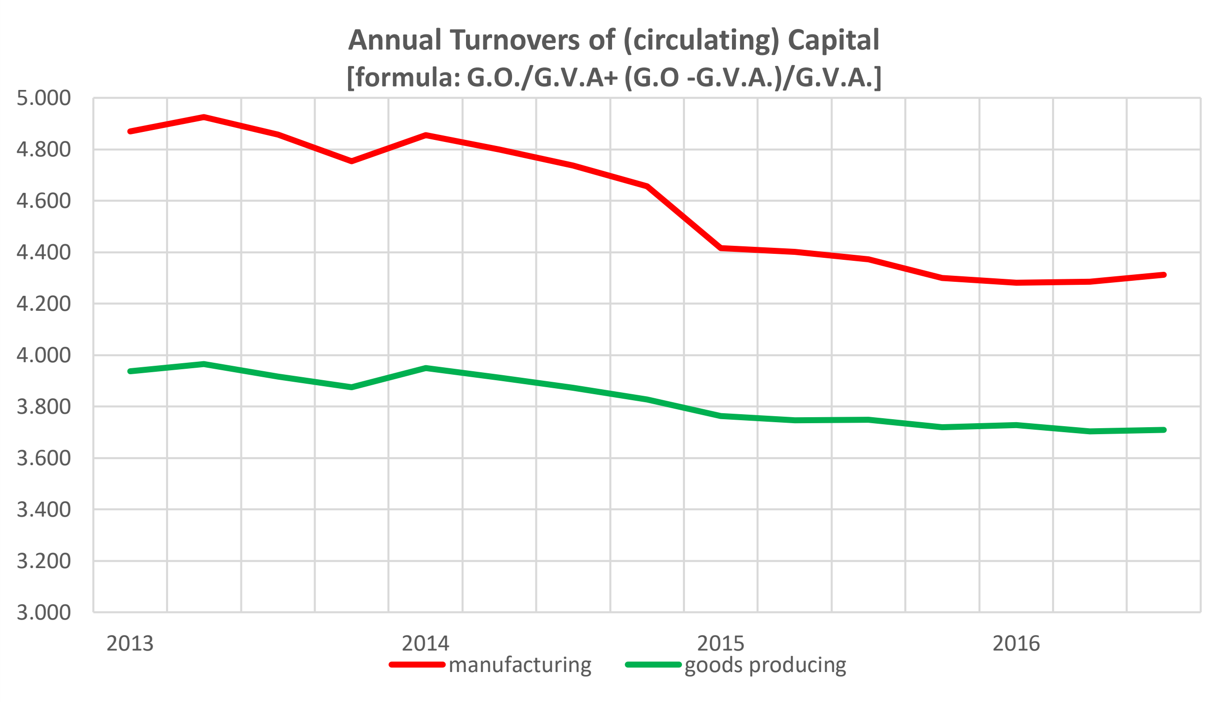
Graph 1.



In both the goods producing and manufacturing industries, the rate of exploitation has fallen. It has fallen by 18% in manufacturing (since 2014) and by 15% in the goods producing sector. There has been no discernible change in the rate of exploitation between the second and third quarters. This is interesting because 2016 was a year of two halves, with an overall deterioration in the first half followed by a slight improvement in the second half. The improvement in the second half which we shall view later was insufficient to reverse all the falls in the first half resulting in annual output adjusted for the extra day in 2016 falling below that of 2015.

If we now turn to turnovers, we note that in Graph 2 below, there is a slight improvement in turnovers for manufacturing but not for the goods producing sector.

Graph 2.

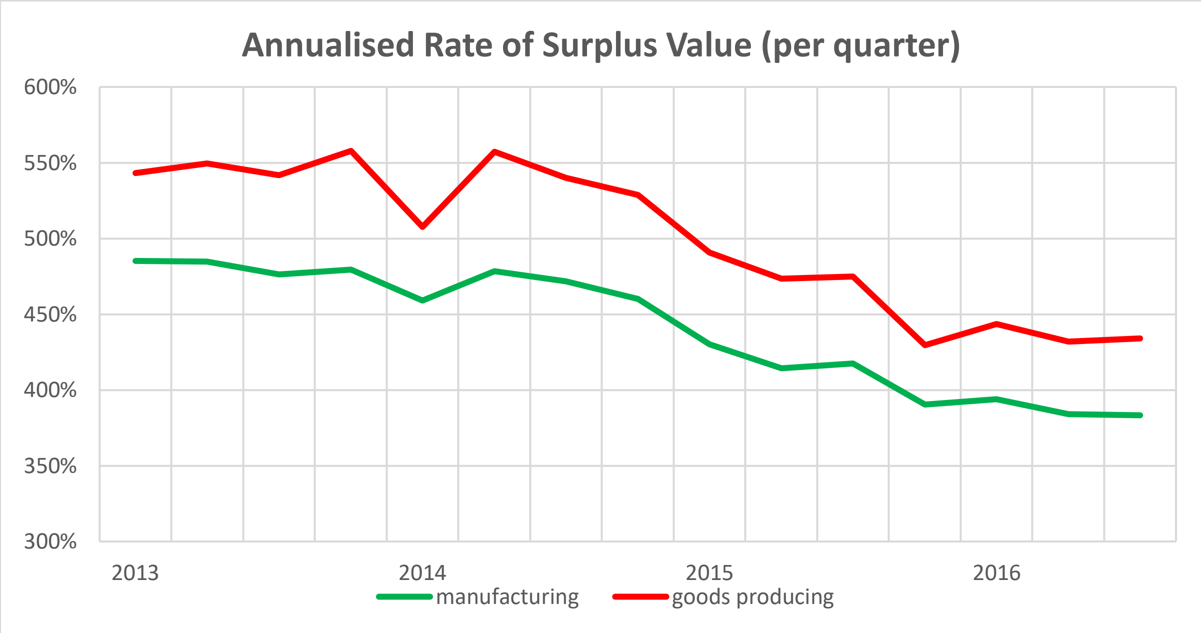


(Sources: BEA Interactive Data, GDP-by-Industry-Accounts Gross Value Added & Gross Output release date 19/01/2016)

The slight improvement in manufacturing from 4.281 turnovers in the first quarter, its current nadir to 4.311 in the third quarter represents a 0.75% improvement. In manufacturing turnovers are currently down 12.5% from their highs in 2013 and 2014 hence the recent 0.75% improvement is marginal. Measured in days, this fall of 12.5% elongated the turnover time from 74 days to 85 days. This means variable capital would have had to increase to finance an additional 11 days of wages. Conversely the same amount of profit, which hitherto was produced in 74 days now takes 85 days. This contributed to the 18.5% fall in manufacturing profits between 2014 and the third quarter of 2016 (Table 6.16D).

Having extracted both the rate of exploitation and turnover times, it is now possible to calculate the decisive rate of surplus value. The rate of profit is contingent on the rate of surplus value. The rate of profit can only rise if there is a rise in the rate of surplus value, or more precisely if there is a rise in the rate of surplus value greater than the increase in the value of the fixed capital invested in its production. This is the normal sequence. The only other condition where the rate of profit can rise without a rise in the rate of surplus value occurs when the value of fixed capital falls which generally occurs in periods of recession where value is depreciated or destroyed, particularly the value of fixed assets.

Graph 3.



The formula for the **annualised** rate of surplus value is the rate of exploitation multiplied by turnover periods. (Sources are found in Graphs 1 and 2.) The result of the reduction in turnover times in manufacturing offsets a stable rate of exploitation. This yields an increase in the manufacturing rate of surplus value of half a percent. Once again, we note the distinction between the rate of exploitation and that of surplus value as they yield different results. If we were to consider the rate of exploitation in isolation, we could not account for the improvement in profitability that occurred in the third quarter. However, when we factor in turnover times to obtain the rate of surplus value, we can.

Manufacturing produces one third of non-financial domestic corporate profits and over half of the profits for the S&P 500 list of companies. Hence it is central to the question of corporate profits in the USA as well as the behaviour of the stock markets that depend on the generation of these profits.

A tale of two halves.

Despite falling from the high point in the third quarter of 2014 the US economy did not enter a recession. This is quite surprising given the production side of the economy. In Graph 4 below, the trend in Total Business Sales is plotted. Total Business Sales (**TBS**) is composed of the sales generated by manufacturing, wholesale and retail. Wholesale has become more important because the BEA has reclassified many manufacturing concerns as wholesalers when they discontinue production at home in order to outsource production from abroad.

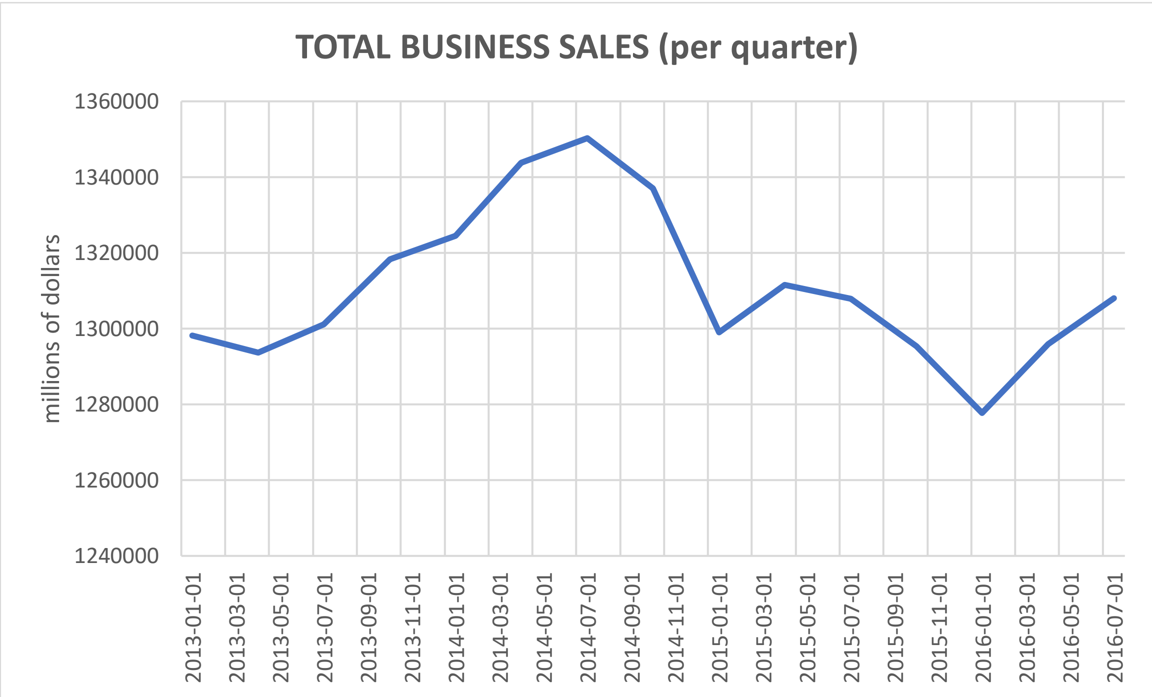
TBS is important to Marxists. We recognise that not all the value produced in production is realised in production. Part of it is realised in circulation (wholesaling and retailing) due to the fact that manufacturers sell their products to distributors below their value allowing the distributors to add back a margin which pays their expenses and leaves them a profit. Whether Leontief instigated this metric or not, he must have been aware of its importance at a time when manufacturing was a much bigger part of the total economy than it is now.

Today we can look at TBS in one of two ways. Firstly, as a share of value added (excluding government) it comprises 27% of the economy. Secondly, as a share of gross output (total sales) this jumps to 55%. Why the discrepancy? One of the central reasons is that part of the value produced in manufacturing is transferred not only to distribution but to outsourcing companies, advertising companies, marketing companies, legal and accounting companies and so on and so forth. For these companies, all located in the service sector, manufacturing is their biggest customer followed by retailers.

Total sales include intermediate sales, hence it includes the purchases of these services logged as value creating by the service sector. If the BEA accounted for intermediate sales correctly, that is they were added back to manufacturing and deducted from the service sector, then the size of manufacturing would swell and that of the service sector would be reduced. But it does not because it treats productive labour and unproductive labour as equal, or what is the same thing, it treats both forms of labour as labour producing value.

Hence the absolute size of TBA resides somewhere between 27% and 55% of the economy. For the purpose of this analysis we need only to be aware that it is bigger than 27%.

Graph 4.



(Source: FRED Total Business Sales **TOTBUSSMSA**)

We note the sharp fall in TBA between third quarter of 2014 and the last quarter of 2015. In inflation adjusted terms, this fall is 8.3%. Price adjustments are based on the Retail Price Index which stood at 100 in 1982-84, (In addition, the last quarter of 2015 sits [an unadjusted] 1.7% below the last peak which was in 2008 before the crash). A fall of 8.3% suggests the US was in recession in and around the turn of 2015 specifically the final quarter of 2015 and the first quarter of 2016. Notwithstanding this fall in sales, real GDP growth was estimated to be 0.9% in the final quarter of 2015 and 0.8% in the first quarter of 2016 or an annualised rate of 0.85%. This anomaly needs to be addressed and it will be interesting to see if in a few years, following revision to the data, whether this anomaly is not reversed.

A year ago, imputed rents added 0.35% on an annualised basis while the annualised increase in the budget deficit was 0.7%. Hence on this basis alone, the economy had to grow by 1.2% in real terms just to overcome the effect of imputed rents and the growth in the budget deficit. It is worth dwelling on imputed rents. Since the mid-1990s when imputed rents first added up to over half of all rents it has risen to stand at 70% of total rents or 4.4% of GDP (Table A2013C1A027NBEA). Between 2014 and 2015 imputed rents rose from $1364.4 billion to $1423.8 billion due to rapid inflation of rents at the time and which is continuing and it was this increase that inflated GDP.

Imputed rents make up only 50% of total imputations so there is scope for further GDP inflation through imputations. One of the real causes for GDP growth and employment growth was Obamacare. According to the January Briefing by the Commonwealth Fund and Milken Institute School of Public Health, scrapping Obamacare without replacing it would cost 2.6 million jobs and lead to a loss in gross output of over $500 billion p.a. after 2019. If we cast these figures backwards it means that since the implementation of Obamacare, 25% of job growth both in and outside of healthcare was attributable to Obamacare. Were it not for this increase unemployment according to the official definition would still be 6.4% rather than 4.7%, or back to where it was in early 2014.

In addition, the loss of business output they estimate to be $500 billion p.a. or nearly or nearly 2% of total gross output. This eclipses the impact on the economy of the infrastructural spending proposed by Trump. The stock market, bless their mohair socks, which has been fixated on infrastructural spending has not yet factored in the damage to the economy caused by the demise of Obamacare with no discernible replacement. From a European perspective, the structural distortions of the US economy are significant. Eurostat in its latest assessment puts total U.S. health spend at 21% of GDP more than double that found in Europe. In terms of personal consumption expenditures which stand at 80% of National Income, only 31% is spent on goods, that is the sum of **net** Total Business Sales. It is smaller than the 33% spend on health care and housing (with utilities excluded). Hence while US workers have hitherto benefited from deflation of goods this has been overwhelmed by health and housing inflation driving the price of labour power above its value and feeding the anger which “won” Mr 46% the election.

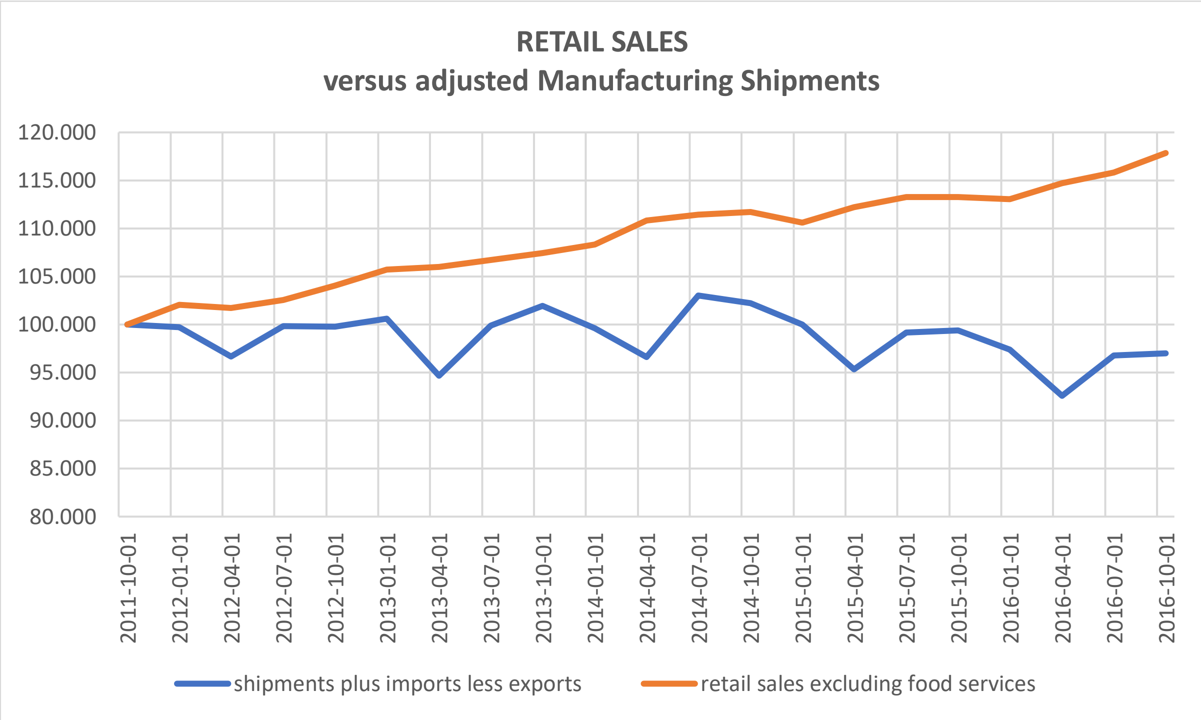
Is the economy improving?

2016 was a year of two halves. Two questions arise. Firstly, and more immediately, did the second half of expansion compensate for the first half of 2016 leaving the year on balance in growth? The answer is no. GDP growth came in at 1.6% for the year or 1.4% if we exclude the one-off contribution made by the stellar export of soya beans in the third quarter. If we assume that the economy must grow at least 1.4% to cover imputations, duplications and the growth in the budget deficit, then we have an economy that has held its own rather than one that has grown organically. This is consistent with the make-up of the economy, where retail, housing and health have grown and where other departments such as industrial production, investment and exports have fallen.

We will begin with retail. Graph 5 below shows the trend over 5 years for retail sales measured against the shipment of these goods sold, adjusted for the import and export of merchandise goods. This is not an exact measure as production together with imports and exports are a blended mixture of intermediate and final goods as well as consumer and capital goods. Only final goods and consumer goods enter into retail sales. Notwithstanding these confounding factors the trends between the two are incongruous because while retail sales have been rising, shipments have been falling. What this incongruity may reflect is a discrepancy between the measure of RPI and PPI or that retail sales are overestimated.

The increase in retail sales have largely been driven by light motor vehicle sales. In turn light vehicle sales have been driven by credit fuelled by low interest rates. A significant share of car sales are not sales in fact. They only become sales if the borrower pays the final purchase price at the end of the lease. Until they do these cars are borrowed, then returned and a new one borrowed against the payment of a small deposit. This merry go round is dependent interest rate staying low. According to the Federal Reserve's latest table G19, interest rates on car loans were only 0.25% higher in November compared to the 2015 average.

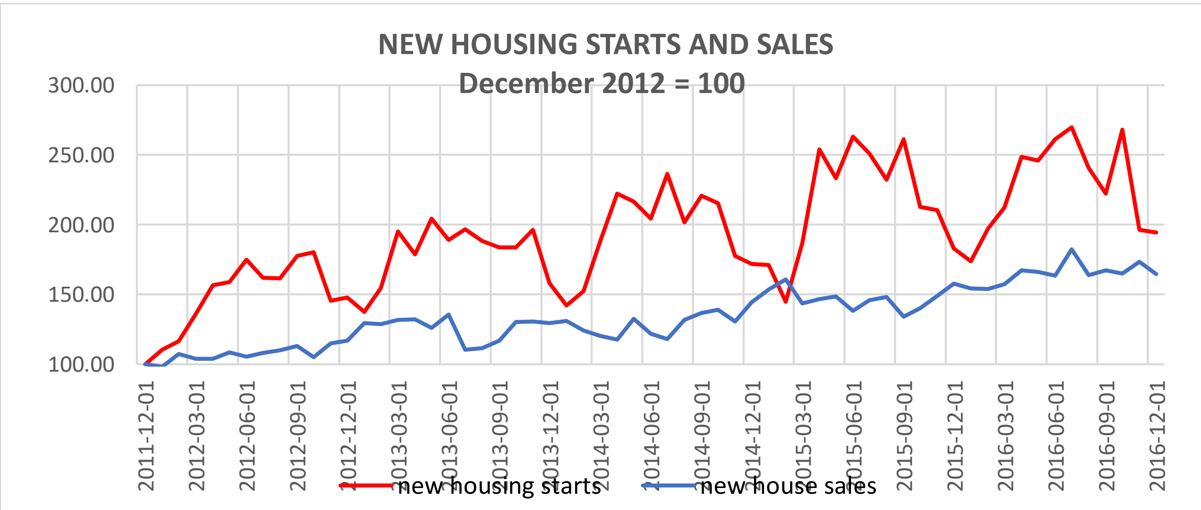
Graph 5.



(Source: FRED RSFXS, IEAXGM, IEAMGM)

The housing market is more interest rate sensitive and as Graph 6 below shows, housing starts and sales are beginning to tail off. (Housing construction which is more volatile is unadjusted while sales are annualised.)

Graph 6.



(Source: FRED HOUSETNSA & HSN1F for sales)

House sales, especially new house sales are more interest rate sensitive than motor car sales. The December release showed new home sales falling 10.4% or ten times the estimate of economists.

December was the first month where 30year fixed mortgage rates averaged over 4% and if the fall was due to the rise in mortgage rates, then as I have said before, the damage done to residential construction will exceed any benefit from Trumps infrastructural plus one wall boast. Any rise to 4.5% in mortgage rates will put an end to any improvement in housing and will most certainly end the flipping of existing house sales which at 6.1% of all sales in 2016 was the highest since 2006.

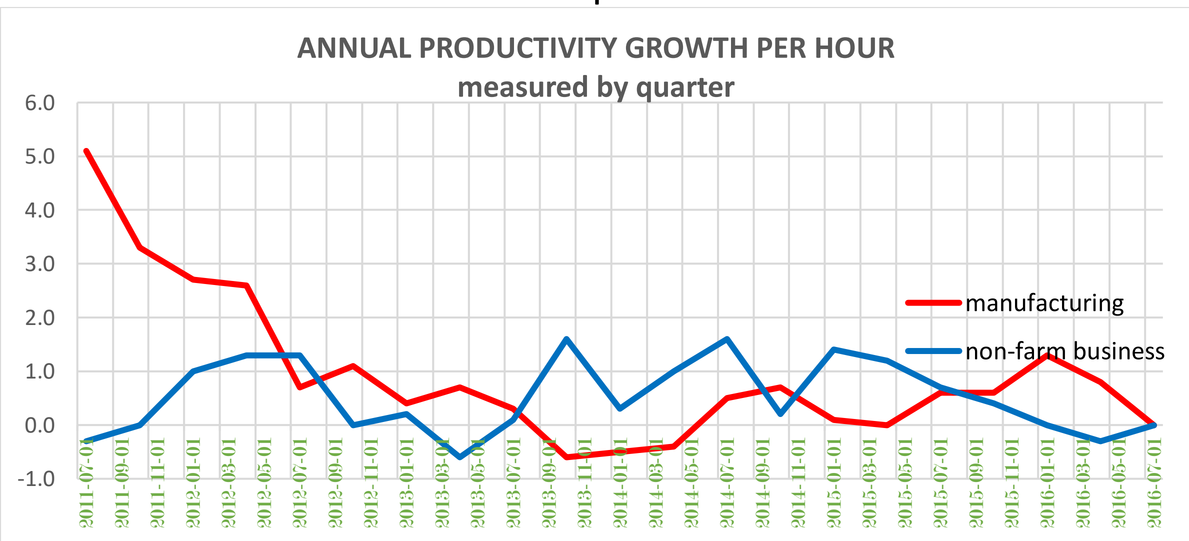
It has been a combination of low interest rates, Obamacare and a growing budget deficit that has fuelled job growth, it has not been investment. However, the job growth figures remain a cautionary tale. According to the latest Congressional Budget Review for December issued on the 9th January covering the first quarter of the new fiscal year (Oct-Dec 2016), income tax receipts rose 2.0% while corporate tax fell 11.7% yielding a fall of 3.1% in tax receipts year on year. Adjusted for inflation (GDP deflator) this yields a real increase in income tax of only 0.7% and a fall in total tax of 4.4%. And this is occurring before Trump introduces his new tax cuts for the rich.

Within income tax which is divided between payroll taxes and non-payroll tax the shift to payroll taxes continues. Either proprietors and richer pensioners are finding new ways to dodge tax, or there is a real movement from proprietorship to being employed, or proprietors are not benefitting from any improvements in the economy. It may well be the case that proprietors would rather give up their independence and become employees thereby substituting a stable income for a precarious one. But even here a change is discernible. The combination of a freeze on hiring by the federal government and the financial freeze on Obamacare has caused initial unemployment claims to spike by 20,000 last week and if this is repeated this coming week, it means jobs growth is over.

In summation, it is only housing, retail and health that has risen year over year. Total business sales have fallen, industrial production has fallen, exports have fallen, and orders have fallen. It must be also borne in mind that 2016 was a leap year hence comparisons with 2015 require deducting 0.3% from 2015. (The BEA only does monthly and quarterly seasonal adjustment but excludes annual figures.)

Which brings us to the second and more important question: whether or not the improvement in the second half will be enduring. To answer this question a more fundamental analysis is needed beginning with productivity - capitalism's adrenalin. Here the comparison is based on annualised changes (hence q3 2016 versus q3 2015).

Graph 7.



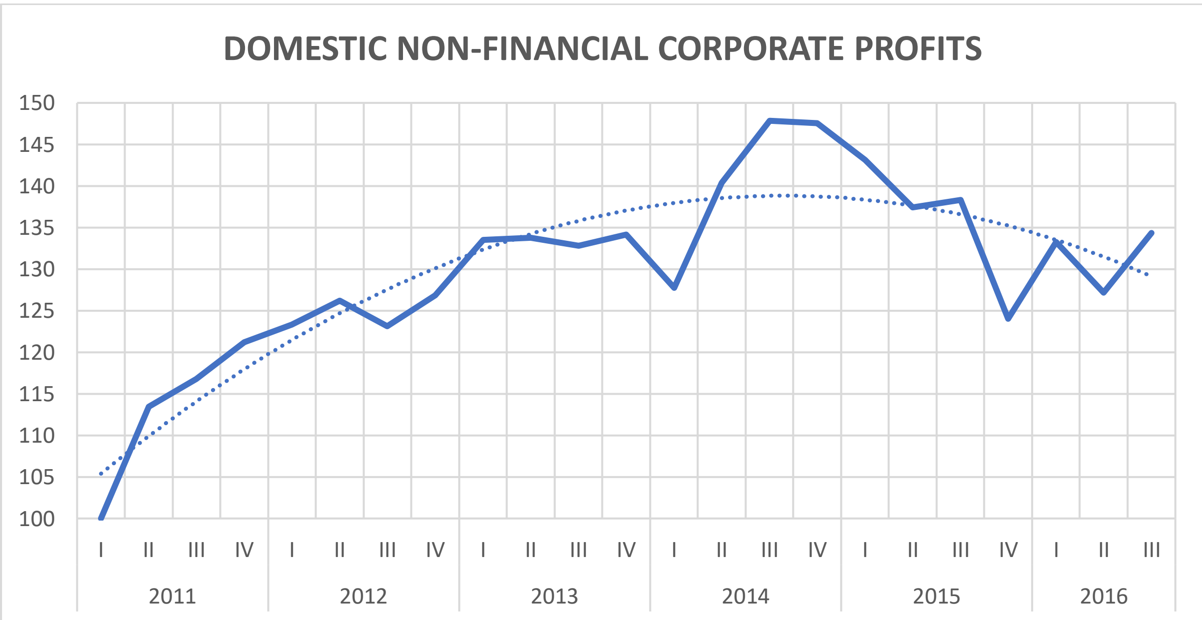
(Sources: FRED PRS30006091 manufacturing, PRS85006091 for non-farm business)

In both cases productivity growth was zero in the third quarter of 2016. Of significance was the fall in manufacturing productivity. The rise in non-farm productivity growth was spurious as it was based on the inflated GDP figures for the third quarter. There is thus no underlying improvement in productivity growth with the medium-term trend at about 0.5% annualised. For there to be a resumption of real economic growth there must be a breakout from an economy dependent on low wages and low interest rates to an economy based on the investment in productivity.

The question of turnover and productivity growth is inextricably linked. Turnover feeds into productivity growth. Falling turnovers are associated with falling productivity and rising turnovers with rising productivity. Without the marginal improvement in turnover in manufacturing, productivity would have fallen further than it did in quarter 3. Michael Roberts has a recent post identifying Zombie companies and the role they play in arresting productivity growth. However, this must be put in perspective. In all industries, less than 5 corporations control at least 75% of turnover and the rest less than 25%. Therefore, the Zombie companies who occupy this 25% slot are insignificant. Moreover, their insignificance has grown with the accelerated international concentration and centralisation of capital which is ongoing. Therefore, stagnating productivity has more to do with the behaviour of the large companies rather than the smaller companies as we will see later in the *Economist* article.

Low productivity makes it more difficult for the capitalists to ratchet up the rate of exploitation which is currently stable. The result is a continuing crisis in profitability. In the graph below which plots non-financial profits, third quarter profits are below those obtaining a year earlier and a full 10% below their peak in 2014 adjusted for inflation. The fall would have been bigger, but the BEA now includes real estate profits in the sphere of non-financial corporate profits which buffered the fall to a degree.

Graph 8.



(Source: BEA Table 6.16D)

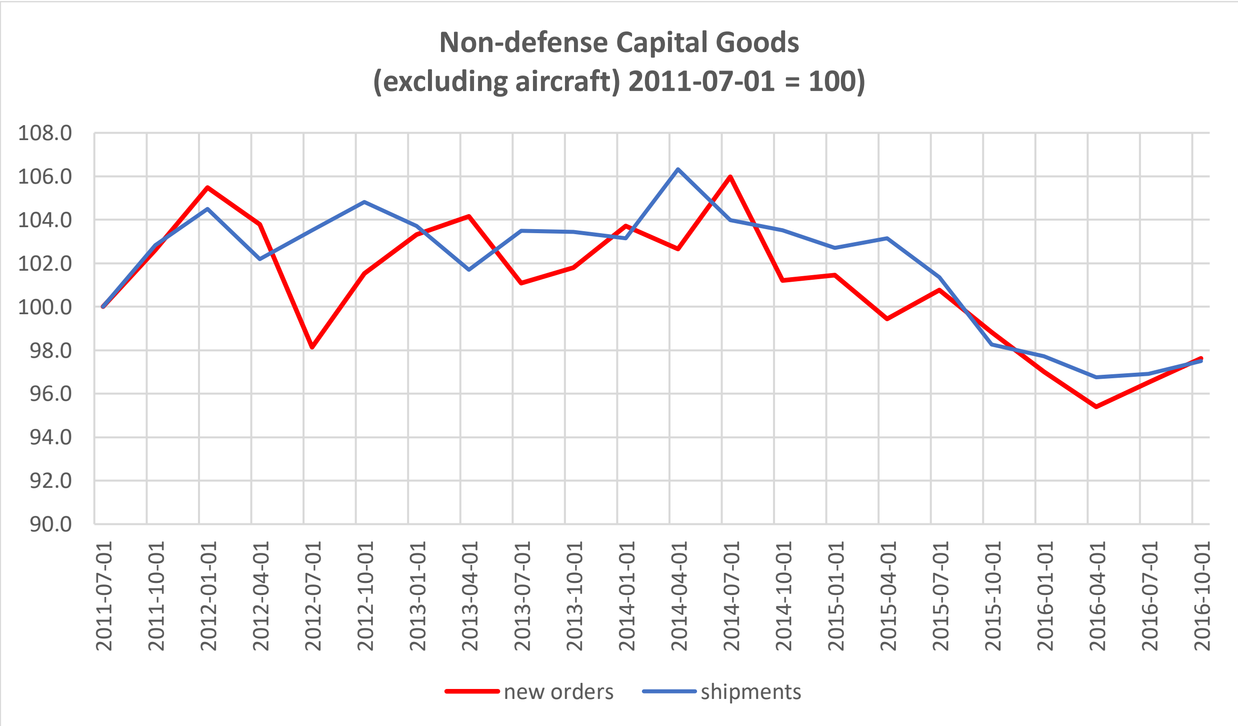
Current profitability was above its short-term trend and this should be the case for the fourth quarter. Once again, we recognise that these profits are GAAP based as the BEA adjusts for exceptionalls. Factset on the other hand does not. Its latest insight into S&P profits for the fourth quarter issued 27th January projects a rise of 4.2% based on 34% of corporations having reported. This is similar to quarter three, and again the profile is much the same with banking profits gaining from the Trump put. However, the comparison for q4 is flattered by comparing it to q4 in 2015 which was the current trough. Furthermore, when we adjust for buy backs of around $540 billion for the year to December 2016 (when the S&P was valued at $20.22 trillion siblisresearch) and we adjust for inflation there is no real increase in E.P.S. at all. It seems that the only reason the stock exchange has woken up and broken out of its trading range is a dose of Trump smelling salts.

For the whole of 2017 Factset suggests profits will rise by 12.0%. If this were to happen, then profits at the end of 2017 would have reversed their fall from 2014. At this point we would have a regular pattern, with a double quarter recession in the fourth quarter of 2015 and the first quarter of 2016 followed by a period of expansion. In other words, the resumption of a period of contraction followed by expansion.

However, there is no underlying support for this profit projection based on the real relations of production that are currently found. With 34% of the S&P 500 having reported, the usual contradictory picture has emerged. Profits are up, but revenue is not. How profits can increase in an environment where labour costs are rising, the dollar is rising and fuel prices have risen goes unanswered. But this is Wall Street. More ominously, downgrades for q1 2017 are exceeding upgrades by a factor above the historical mean.

Profits are of course the mother to investment. It would therefore be expected that the current depressed state of profits has curbed investment. This is shown in Graph 9 below which tracks orders and deliveries of capital goods. For the year as a whole, shipments fell 6.3% and orders by 4.9% versus 2.1% for all non-defence shipments and 1.9% for all orders (these percentages are adjusted for the leap year and inflation). In short, the revival of orders and shipments in the second half has not yet reversed the falls in the first half and as such does not yet constitute an upward trend merely the temporary levelling off of a downward trend.

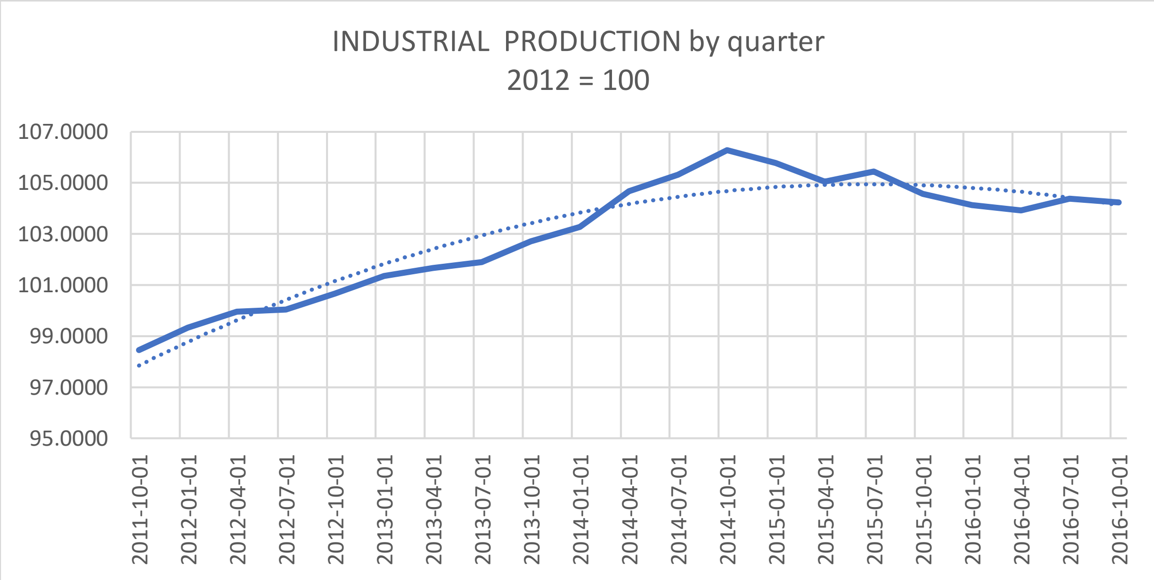
Graph 9.



(Source: FRED Tables ANXAVS & NEWORDER)

A fall in actual investment depresses production in two ways. Firstly, and less significantly it depresses the demand for the products of industry leading to a contraction in Department 1. Secondly and more significantly, it reduces the capacity for increased production. This must be seen in a double sense. A reduction in investment means a reduction in the speed of replacement of existing means of production and therefore the hobbling of productivity, and if it goes far enough, worn out means of production are not being replaced and what takes place is an actual reduction in the number of factories and plants. Hence investment either boosts or depresses industrial production. In 2016 as Graph 10 shows, industrial production fell.

Graph 10.



(Source FRED INDPRO)

It should be noted that industrial production for the final quarter of 2016 was boosted by utilities due to the cold weather compared to the final quarter of last year. Without it the fall would have been steeper. Within this data heavy vehicle production in the final quarter compared to the first quarter was down 25%. As most cargo is carried by trucks in the USA this metric is an important barometer for the health of industry itself. For the year as a whole, industrial production was down 4.7% adjusted for the extra day in 2016.

Discussion: Brexit, Trump and China.

The warm up to Brexit is over and the game is now under way as Theresa (come what) May announced that Britain would leave both the single market and the European customs union in order to free this island from its European moorings allowing its people to boldly sail into global waters. It is clear the smaller capitalists have temporarily won the day against the financial aristocracy.

The course plotted is clear. Britain is to become a tax haven sitting atop a sweatshop. The Tories will shred all the protections - labour, consumer and environmental - Europe enforced and capital will be attracted through reduced corporation tax. May threatened Europe with low taxes to gain their compliance in negotiating the terms of exit. However, low taxes are not a negotiating ploy, they are a necessity if this economy is to survive leaving Europe.

The Tories exemplify the race to the bottom. They are the model for the global corporations. An isolated state, vulnerable in the extreme and dependent on their largesse. Those who voted to take back control are to be taught a salutary lesson. They may have been intoxicated by the fumes of Empire, but in reality Britain is going to become the colony of big business.

Already the losses are beginning to outweigh the gains. A classical scissors effect is emerging. Britain is beginning to lose the City of London without gaining industrial traction as the collapse of BT's share price on the 24th January showed. The loss of at least 20,000 highly paid bankers mainly to New York will not only effect the Treasury's tax base, but more consequentially, it will affect the balance of payments. As the City of London shrinks, the resulting loss of banking revenue and insurance revenue could easily propel the balance of payments deficit to over 10% of GDP, an unbridgeable gap. At this point interest rate policy is ripped out of the hands of the Bank of England and we may as well send Carney back to Canada first class.

Once all this dawns on the backwoods men and women who populate and vote for the Tory party it is by no means certain that Britain will be able to execute Brexit. Time will tell. Trump is of course cheering on the process of European disintegration. The EEC was originally blessed by the USA in the 1950s and 1960s as the means to stand up to the USSR and to provide continental size markets for US continental sized corporations. Now Mr 46% champions its dissolution. He recognises that a disintegrating Europe will be a reduced and divided Europe which will benefit the USA. It will also free the USA to concentrate on its arch enemy, China. His seduction of Russia too is a ploy. His purpose is to prevent Russia with its comparable if not superior military technology allying itself with China at a time when the industrial discrepancy between China and the USA is just as great as the one that existed between the USA and Japan at the time of Pearl Harbour.

Where Trump contradicts the needs of global capitalism is his opposition to existing trade treaties like NAFTA and future trade treaties like TTP and TTIP. In a remarkable body of research published in the *Economist* (28-Jan-2017) entitled *MULTINATIONALS: The retreat of the global company* the magazine examines the top 700 multinationals defined as those with international sales of at least 30%. The *Economist* which last year was cheering global profits, now starkly describes the crisis of profitability besetting these global behemoths. They account for "*50% of world trade; they make up 40% of the world's stock markets and they own most of the world's intellectual property*".

Over the last 5 years the mass of profits generated by these global corporations have fallen 25% dragging down cross border investment in 2016 alone by between 10 and 15%. Of course, some of this fall in profits was due to the ending of the commodity super-cycle and with it the price falls for oil, metals and other industrial commodities. Nevertheless since 2014 there has been a generalised fall in the mass of profits. Where the *Economist* errs is its use of the return on equity (ROE) index. Equity is a moving target, a fictitious sum. The ROE can fall even while profits are rising significantly if share prices are rising even faster. This has been the case in the last two years. All the fall in the ROE shows is that the current rise in share prices is not justified by profitability, and consequently that the rising ROE has had more to do with low interest rates rather than with profits.

I have written previously that the central and overwhelming contradiction facing global capitalism is that while profits have been globalised, investment has not been. It remains hobbled by the nation state. Investment is not globalised because there is no level playing ground (internationally) or better still an excavated playing ground where regulation has been minimised and legal enforcement maximised allowing the global corporations and banks to act extra-nationally. In other words, a single market devoid of jurisdiction.

This is the barrier that capitalism has crashed into. TTP and TTIP are the conscious reflex to the crisis of profitability that has erupted in global capitalism and its resolution. If globalisation is to take the next step, if it is to restore profitability then TTP and TTIP are not optional, they are the precursor to dissolving national markets by creating single markets with a common set of rules constraining national governments.

This is the heart of the problem bedevilling capitalism not the issue of financialisation on which so many Marxists have been fixated. This debate needs to end. The figures and trends provided by the Economist while valuable does not prevent the magazine drawing the wrong conclusion. The *Economist* contends that the multinationals have become lumbering bombers trying to defend themselves from nimbler localised fighter planes. It suggests smaller more locally focused firms are the solution and that the age of the multinational has ended.

This is wrong. The fortunes of the global economy do not depend on the multi-nationals adapting, but rather asserting themselves. If the multinationals shrink from resolving the above described contradiction, if they retreat from globalising investment, from moving from transnational corporations to truly international corporations, then to be sure the world is standing on the edge of a real depression, one which quantitative easing cannot help. This is the strategic imperative.

And it is at this point we turn to Mr 46%. Trump is the product of this unresolved contradiction and a barrier to its resolution. He is the figurehead of the reaction to the results of globalisation, the hollowing out of industry in the USA and the impoverishment of its working class. He proposes plumping up US industry by erecting tariff walls behind which US manufacturing can shelter. But in doing so he is disrupting the international value chain which will raise costs to industry well beyond the gains emanating from his tax cuts. If he succeeds against the wishes of Congress, he will disorganise the global economy at a time when the global economy is unravelling as the *Economist* article has detailed and the results will be convulsive.

Let us take the iPhone. When asked why Apple did not produce any phones or tablets in the USA Tim Cook answered thus. He pointed to the crippling shortage of master die and tool makers in the USA by saying that in China their number would fill three football stadiums, while in the US only one basketball court. While Cook overstated the disparity (The BLS lists 74,500 in May 2015 E51-4111 Tool and Die Makers) a decisive disparity does exist. Even if the USA has the skill and infrastructural base to produce the iPhone in the USA, instead of the $10 it costs to assemble in China, it will cost up to $100 to assemble it in the USA. Either Apple will take a hit to its profits or it will pass that cost on to the consumer.

Whatever the case, it is not in the interest of Apple to transfer production. Trump will soon learn that when putting “America First” conflicts with putting “Profits First”, it will be the former that falls not the latter. And this will occur as soon as the economy slips into recession as US industry recoils from higher input costs curtailing future investments.

It was the USA who recreated a world economy after the second world war in order to deprive Britain of its colonies, unite Europe, domesticate Japan and isolate the Soviet Union. The expansion of the world economy after the 1980s took a different form. Instead of the US building new markets for its exports through the dollar it now turned to the world economy for cheaper imports to subsidise its remaining industries and economy. In this manner it revived profitability. It kept its front office, while exporting its back office and factory abroad. This is what Trump seeks to reverse and which formed the core of his inaugural speech attended by “countless millions” wearing *America First* logoed caps made in China.

The only alternative we are told would be to build smart factories in the USA. After all, A.I. does not go on strike or get tired. A.I. reduces wages on the factory floor to the point where international wage differentials become irrelevant. A Chinese A.I. will not undercut a US A.I. In fact, A.I. no longer requires an international division of labour.

This is stating the obvious. What is less obvious is the law of value. Smart factories will destroy value by dramatically reducing labour time. The result will be the necessary substitution of volume for value. To recoup investments and amortise research and development, volume will have to rise inversely to the fall in unit value. These will be mega factories requiring huge economies of scale. This means that they will need to rely on world markets not the national markets to absorb their volume. They will not be factories where computers control 3D printers producing bespoke products or limited production runs. These will be confined to luxury goods production unsuitable for mass markets. Hence not only will these factories not produce jobs they will not provide an alternative to globalisation.

If the debates in Davos are anything to go by the capitalist class is hesitant to introduce smart factories because of their social impact – mass unemployment. However, the capitalists are not free agents, they simply personify the needs of capital and these needs are driven by the development of the forces of production. It is only a matter of time before the storm breaks as the introduction of smart factories in one part of the world economy forces the rest to follow suit or go bankrupt.

In the meantime, Trump's protectionist measures will disrupt the world economy. Growth remains fragile. The EU depends on quantitative easing (responsible for 1.5% of GDP growth there), Japan on a weak Yen and China on the expansion of credit. Hence while production is increasing in the developed world and China, resulting in reflation for the first time in years, its foundations are shallow.

This is particularly true for China. UBS, (quoted on CNBC 26/01/17) projects total debt at the end of 2016 at 277% of GDP up from 254%. At current rates of growth, debt will hit 300% at yearend which is clearly unsustainable. The Bank of International Settlements 2nd December release puts the gap between credit growth and GDP growth at 29.2% for the first half of 2016 which again is unsustainable and which shows no significant improvement. In addition, the shadow banking industry has doubled in size over the last two years to reach 25% of total debt outstanding, Recent losses in this, the riskiest part of the industry, have begun to arrest the surge but it remains precariously exposed to overpriced assets.

In contrast to the Trump smelling salts, the CCP is administering chloroform to the markets. A contrasting picture for the two international economic locomotives where before the USA was running out of steam and China in danger of too much steam. The China 90-day measure of volatility on Chinese stock markets is at its lowest in 24 years. Shanghai remains 39% down from its recent peak despite China being the world's fastest growing major economy. Shanghai would be even lower but as Castor Pang, head of research at Core-Pacific Yamaichi HK says that every time shares drop the national team steps in: *"The national team is buying blue chips, but other investors aren't following suit*," (Quoted on Bloomberg 23/01/2017) The CCP is determined to put a floor under the stock market despite the fact that the state, already the biggest owner of private shares, is increasing its holdings.

The same applies to the export of capital which has been stifled. Chinese foreign exchange holdings, still the world's largest, have been depleted over the last two years and are nearing critical levels forcing the CCP's hand. Private investors have been drowned in paper work and state entities hauled in to explain the reasons for their foreign investments. Tighter capital controls have temporarily ended this haemorrhaging of capital to the detriment of foreign markets and it has already played a contributory role to the fall in new house sales in the USA and elsewhere such as Australia and Canada.

The same chloroform has been applied to house prices as city governments have tried to hold back runaway house prices. However, capital controls have led Chinese investors and speculators to look inwards. If speculators cannot flip overseas houses, then they will turn back to the Chinese housing market. This ball of money will tip over the rules set by city governments trying to slow down price increases. As the Shanghai Daily reported in the two weeks before the Chinese New Year, house prices in Shanghai have begun to pick up again after their pause in the final quarter of 2016. (Shanghai Daily).

Despite a resumption in industrial profits In China the annualised rate of return based on the first 11 months of 2016 has barely budged. In 2015 the rate was 5.5% and in 2016 it was 5.7% based on the 27th January 2017 release by the *National Bureau of Statistics of China* which details industrial profits and in which fixed capital is found. Inventories are provided annually by the National Bureau.

In addition, three additional factors need to be taken into consideration. Firstly, inflation is rising reducing nominal growth. Secondly, variable capital is larger as a percentage of total capital in China and given that wages have been rising strongly this will have reduced the actual rate of enterprise profit. Thirdly, the cost of capital or interest rates have risen 0.6% from historically low levels and will rise further if US interest rates rise again.

Notwithstanding these three factors affecting the rate of enterprise profit, it is difficult to reconcile the National Bureau's figures themselves. The growth in profits of 9.4% does not equate to a 0.2% improvement in profit margins multiplied by a revenue growth of only 4.4%. Such figures translate into a 3.4% growth rate in annual profits not the 9.4% cited. If the lower growth rate figure is correct then the rate of return would have fallen to 5.4% instead of rising. Perhaps this explains the stagnant growth in the inflation adjusted annual rate of investment of 1.1% for private investment and 2.1% for the whole of manufacturing.

Conclusion.

Business conditions are improved compared to the last report but they do not have the weight to constitute a rising trend, let alone a trend sufficient to withstand the political obstacles thrown up by the right wing populist opposition to globalism and immigration. In the USA the rate of turnover of capital and that of surplus value continuous to be depressed, in China the underlying profit trend is anaemic while Europe and the EURO remains dependant on quantitative easing. Above all the strategic obstacles facing capitalism, the need to create single homogenised markets are politically out of reach for the foreseeable future. Therefore, it is likely that far from improving, the longer downward trend will reassert itself once the Trump honey moon is over and economic reality reasserts itself.

Brian Green 29th January 2017.