Note on Profitability of Domestic Nonfinancial Corporations, 1960–2000

THE profitability of domestic nonfinancial corporations decreased slightly in 2000, as the rate of return on capital slipped to 8.6 percent from 8.8 percent in 1999 (chart 1 and table 1). This rate was the lowest since 1995, but it was still higher than its average for the 1990s, and it was substantially higher than its average for the 1980s. In contrast, it was far below the levels posted in the high-productivity-growth years of the 1960s.

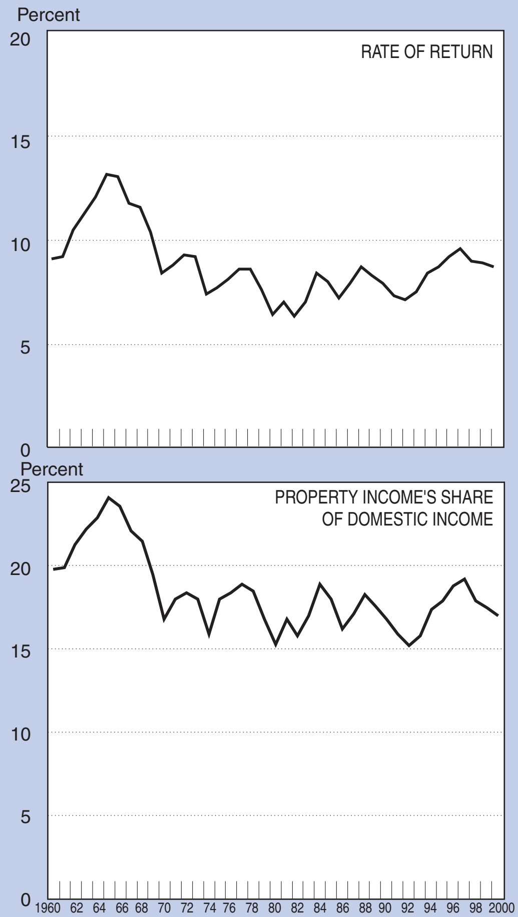
NOTE.—This report was prepared by Daniel Larkins and Ralph W. Morris.

Capital's share of total income dropped to 17.0 percent from 17.5 percent; although this was its lowest level since 1993, it was only a little lower than its average over the last three decades. The share in 2000 was close to the midpoint of the relatively narrow range within which capital's share has fluctuated in during this period.

The rate of return may be calculated in many ways (see the box "Alternative Measures of Rates of Return"). In this note, it is calculated as the ratio of "property income" to "produced assets." Property income is prof-

CHART 1

Rate of Return and Property Income's Share of Domestic Income, Domestic Nonfinancial Corporations, 1960–2000



U.S. Bureau of Economic Analysis

Table 1.—Rate of Return and Income Share, Domestic Nonfinancial Corporations, 1960–2000

[Percent]

Year	Rate of return: Domestic property income: Total	Rate of return: Domestic property income: Profits from current production	Rate of return: Domestic property income: Net interest	Share of domestic income: Domestic property income: Total	Share of domestic income: Domestic property income: Profits from current production	Share of domestic income: Domestic property income: Net interest
	(1)	(2)	(3)	(4)	(5)	(6)
1960	9.0	8.3	0.7	19.8	18.2	1.5
1961	9.1	8.3	0.8	19.9	18.2	1.7
1962	10.4	9.5	0.9	21.3	19.5	1.8
1963	11.2	10.3	0.9	22.2	20.5	1.8
1964	12.0	11.0	0.9	22.9	21.1	1.8
1965	13.1	12.1	1.0	24.1	22.2	1.9
1966	13.0	11.9	1.1	23.6	21.5	2.1
1967	11.7	10.4	1.2	22.1	19.7	2.3
1968	11.5	10.2	1.3	21.5	19.0	2.5
1969	10.3	8.7	1.6	19.5	16.5	3.0
1970	8.3	6.4	1.8	16.8	13.1	3.8
1971	8.7	6.9	1.8	18.0	14.3	3.7
1972	9.2	7.4	1.8	18.4	14.9	3.5
1973	9.1	7.3	1.9	18.0	14.3	3.7
1974	7.3	5.3	2.0	15.9	11.6	4.3
1975	7.6	5.9	1.7	18.0	14.0	4.1
1976	8.0	6.5	1.5	18.4	14.9	3.4
1977	8.5	7.0	1.5	18.9	15.5	3.4
1978	8.5	6.9	1.6	18.5	15.0	3.5
1979	7.5	5.7	1.7	16.8	12.9	3.9
1980	6.3	4.4	1.9	15.3	10.6	4.7
1981	6.9	4.8	2.1	16.8	11.7	5.1
1982	6.2	4.0	2.2	15.8	10.1	5.7
1983	6.9	4.9	2.0	17.0	12.1	5.0
1984	8.3	6.1	2.2	18.9	13.9	5.0
1985	7.9	5.8	2.1	18.0	13.1	4.9
1986	7.1	4.8	2.3	16.2	11.0	5.1
1987	7.8	5.5	2.3	17.1	12.0	5.1
1988	8.6	6.0	2.6	18.3	12.8	5.5
1989	8.2	5.2	3.0	17.6	11.2	6.4
1990	7.8	4.9	2.9	16.8	10.5	6.3
1991	7.2	4.6	2.6	15.9	10.2	5.8
1992	7.0	5.0	2.0	15.2	10.8	4.4
1993	7.4	5.6	1.8	15.8	12.0	3.9
1994	8.3	6.6	1.8	17.4	13.7	3.7
1995	8.6	6.8	1.8	17.9	14.2	3.7
1996	9.1	7.5	1.6	18.8	15.5	3.3
1997	9.5	7.8	1.7	19.2	15.8	3.4
1998	8.9	7.1	1.8	17.9	14.2	3.7
1999	8.8	6.7	2.1	17.5	13.4	4.1
2000	8.6	6.6	2.1	17.0	12.9	4.0
Average:						
1960–69	11.1	10.1	1.0	21.7	19.6	2.0
1970–79	8.3	6.5	1.7	17.8	14.1	3.7
1980–89	7.4	5.2	2.3	17.1	11.9	5.3
1990–99	8.3	6.3	2.0	17.2	13.0	4.2

Source: Table 2.
NOTE.—Columns 1–2 are percentages of the net stock of produced assets (averages of end-of-year values for adjacent years) valued at current costs. Columns 4-6 are percentages of domestic income.

its of domestic nonfinancial corporations with inventory valuation and capital consumption adjustments plus net interest (table 2).[1] (In the United Nations' System of National Accounts, the sum of profits and net interest is termed "net operating surplus.") "Produced assets" is the current-cost value for domestic nonfinancial corporations of the net stock of equipment and software and of structures and the replacement-cost value of inventories.[2]

Capital's share is calculated as the ratio of domestic property income to domestic income; it is the portion of domestic income that is not labor income.

Q-type ratios

"Tobin's-Q," or simply "Q," is the ratio of the valuation of assets in financial markets to the current-cost value of produced assets. A value of Q above 1 indicates that newly produced physical assets may be purchased more cheaply than (the ownership claims to) existing assets. Such a situation may induce businesses to purchase newly produced physical assets instead of acquiring existing assets; alternatively, it may induce financial investors to reduce the prices they will offer for financial assets. Likewise, a value of Q below 1 indicates that claims to existing physical assets may be acquired more cheaply than newly produced assets.

Table 2—Property Income of Domestic Nonfinancial Corporations and Related Series 1960–2000

[Billions of dollars]

Year	Domestic property income			Domestic income	Produced assets[1]
	Total	Profits from current production	Net interest		
1960	44.6	41.1	3.5	225.6	499.3
1961	46.1	42.1	4.0	231.3	511.2
1962	54.1	49.6	4.5	254.1	528.6
1963	60.3	55.5	4.8	271.2	546.5
1964	67.2	61.9	5.3	293.7	575.5
1965	78.3	72.2	6.1	324.6	615.6
1966	84.4	77.0	7.4	358.2	681.8
1967	82.7	73.9	8.8	374.9	736.5
1968	88.4	78.3	10.1	411.5	803.1
1969	86.7	73.5	13.2	445.2	885.0
1970	76.5	59.4	17.1	454.6	963.9
1971	87.9	69.8	18.1	489.1	1,047.7
1972	100.3	81.1	19.2	546.2	1,135.6
1973	110.7	88.2	22.5	615.2	1,289.4
1974	105.0	76.7	28.3	660.1	1,591.8
1975	127.2	98.5	28.7	705.8	1,743.2
1976	147.4	119.9	27.5	802.4	1,921.0
1977	172.0	141.3	30.7	912.0	2,133.9
1978	192.8	156.5	36.3	1,043.8	2,425.6
1979	195.1	150.1	45.0	1,161.3	2,807.1
1980	190.8	132.7	58.1	1,247.8	3,212.9
1981	236.2	164.4	71.8	1,406.1	3,600.2
1982	228.8	146.3	82.5	1,444.9	3,788.9
1983	263.0	186.4	76.6	1,542.9	3,884.3
1984	330.6	242.9	87.7	1,752.1	4,124.0
1985	334.2	243.7	90.4	1,856.4	4,301.2
1986	309.1	210.7	98.4	1,912.9	4,429.5
1987	353.3	248.3	105.1	2,069.7	4,645.5
1988	412.2	288.6	123.6	2,256.2	4,931.4
1989	416.1	264.2	151.8	2,362.7	5,190.7
1990	414.6	258.5	156.0	2,467.3	5,440.1
1991	395.7	252.8	143.0	2,482.6	5,515.5
1992	392.2	278.9	113.3	2,586.5	5,687.4
1993	431.2	325.3	105.9	2,721.9	5,961.7
1994	510.4	402.5	107.9	2,940.6	6,308.3
1995	558.3	442.5	115.8	3,111.0	6,652.2
1996	617.8	509.1	108.7	3,284.9	6,956.5
1997	675.6	555.6	120.0	3,510.7	7,325.8
1998	668.5	530.7	137.7	3,726.5	7,636.2
1999	693.9	530.3	163.6	3,966.1	8,095.7
2000	722.2	550.1	172.1	4,257.4	8,664.4

1. Produced assets consist of structures, equipment and software, and inventories; they are valued at current cost at end of year. Through 1997, the estimates for structures and equipment and software are available on the BEA Web site; go to <www.bea.doc.gov/bea/dn2/facd.htm> and choose table 6A. Revised estimates for 1998 and 1999 and new estimates for 2000 are from "Fixed Assets and Consumer Durable Goods for 1925–2000" in this issue. Inventories are from legal-form and industry detail underlying NIPA table 5.12.

NOTE.—Property income is profits from current production plus net interest. Profits from current production is corporate profits with inventory valuation adjustment and capital consumption adjustment. Profits after tax is also shown with inventory valuation adjustment and capital consumption adjustment.

1. Corporate profits and net interest are based on tabulations of "company" data rather than of "establishment" data. As a result, property income for domestic nonfinancial corporations includes income earned by financial establishments of those corporations; similarly, it excludes income earned by nonfinancial units of financial corporations. For a discussion of the industrial distribution of NIPA series, see "A Guide to the NIPA's," (June 2001): M-21 - M-22, available on BEA's Web site at <www.bea.doc.gov/bea/an/nipaguid.htm>. For a discussion of produced assets, see Shelby W. Herman, "Fixed Assets and Consumer Durable Goods," SURVEY OF CURRENT BUSINESS 80 (April 2000): 17-30.

2. In other contexts, different definitions of these terms may be appropriate. For example, for the economy as a whole, some part of proprietors' income might be included in property income.

Alternative Measures of Rates of Return

This box describes several rates of return that differ from the one featured in the note.

The income measure in the numerator of the rate of return ratio could be defined exclusive of net interest or in terms of some measure of profits other than the current production variant. For example, the numerator could be profits after tax (with or without the inventory valuation and capital consumption adjustments), or it could be profits as calculated on the basis of financial-accounting standards.

The denominator could include the stocks of assets valued at historical cost, that is, at the prices at which the assets were purchased. However, comparing current-income streams with historical-cost assets is problematic at best. Moreover, the mix of inventory-accounting methods (such as last-in-first-out and first-in-first-out) would make historical-cost valuation of inventories difficult. (The Census Bureau's *Quarterly Financial Report (QFR)* contains estimates of fixed assets based on historical costs and total inventories based on a mixture of accounting methods; these estimates are available for all manufacturing corporations with assets over $250,000 and for corporations included in the mining and trade areas with assets over $50 million.)

The denominator of the rate of return ratio need not be limited to produced assets. For example, land (including subsoil resources), goodwill, and intellectual property might also be included. Alternatively, stockholders' equity or sales could be used as the denominator, as is done for mining, manufacturing, retail trade, and wholesale trade corporations by the Census Bureau in the *QFR*. (*QFR* measures of profits based on financial-accounting standards, not profits from current production, are used in the numerators.

Three Q-type ratios for domestic nonfinancial corporations are shown in chart 2.

- Q1 is calculated as the market value of outstanding equity divided by the net stock of produced assets.
- Q2 differs from Q1 by adding the book value of outstanding corporate bonds to the numerator.[3] The inclusion of bonds makes Q2 a more complete measure of invested capital.
- Q3 differs from Q1 by adding an estimate of the market value of outstanding corporate bonds and net liquid assets to the numerator. In addition, an estimate of the value of land is subtracted from the numerator because land is not included in the denominator.[4]

All three ratios trace similar patterns over time. All three dropped sharply in 2000 after reaching record levels in 1999, but all three still remained considerably above 1 and were higher than in all but 2 years since 1960. (The ratios had moved above 1 in the mid-1990s.) The decreases in 2000 mainly reflected an 18.8-percent drop in the market value of equities as shown in the bottom panel of chart 2.

3. "Outstanding bonds" is a gross estimate; that is, it is not net of financial assets/debt held by nonfinancial corporations.

4. The Bureau of Economic Analysis is grateful to James Tobin for providing an unpublished paper describing a procedure for approximating the market value of bonds outstanding (James Tobin and Dan Sommers, "Explanation of Revised Estimates of Tobin's 'q' Ratio, 1950-1997," (April 20, 1999)). In brief, the *book value* of bonds *issued* in year *t* is estimated as the change in the book value of bonds *outstanding* in year *t* plus the book value of bonds *issued* 10 years earlier (which are assumed to have matured in year *t*). In year *t*, the *market value* of bonds *issued* in earlier years is estimated from the book value of bonds issued in those years by calculating the present value of principal and (semiannual) coupons not yet paid on those bonds (discounted by the interest rate on 10-year Baa bonds in year t). Finally, the *market value* of bonds *outstanding* in year t is the sum of the market values of bonds *issued* in years *t-9* through *t*.

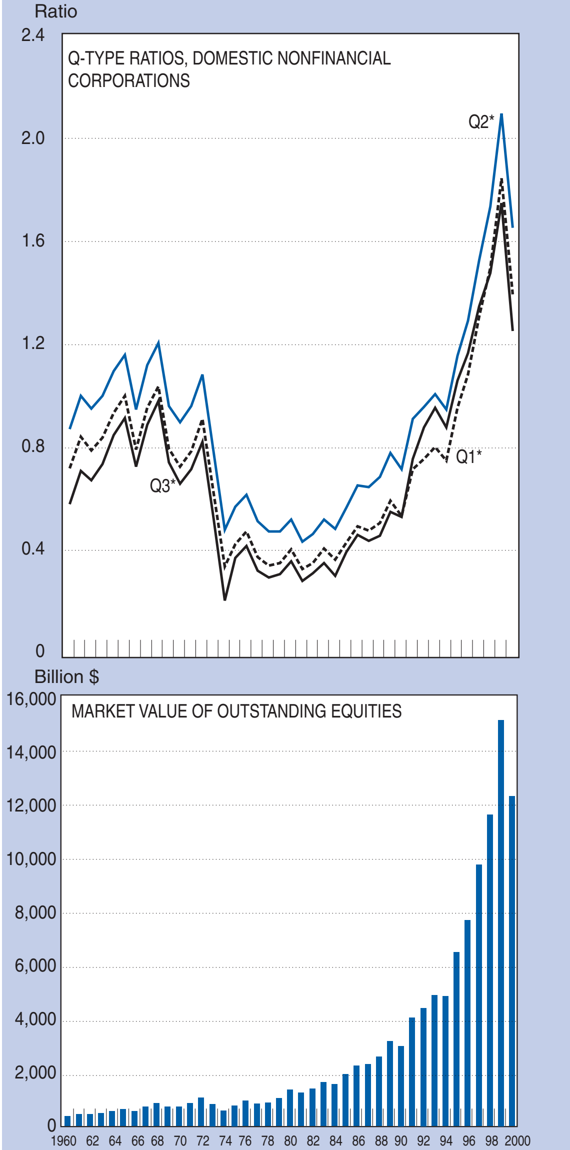
The value of land is estimated as the difference between the value of real estate and the value of structures and of equipment and software.

Net liquid assets is estimated as financial assets less liabilities other than municipal securities, corporate bonds, and mortgages.

The data are from the Federal Reserve Board, *Flow of Funds Accounts of the United States,* Statistical Release Z.1 and "Selected Interest Rates," Statistical Release H.15 (Washington, DC: Board of Governors of the Federal Reserve System).

CHART 2

Selected Measures for Domestic Nonfinancial Corporations,1960–2000



*See text for definitions.

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