Corporate Profits in the GDP Accounts

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_Economic Statistics…from Theory to Practice_
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Profits Get Extensive Media Attention

• But what does this tell us about the economy?
Why BEA Profits?

• There is a need for a measure of corporate profits consistent with other macroeconomic measures in BEA’s “U.S. economic accounts.”

• BEA measure: Profits from Current Production (called “Corporate Profits with IVA and CCAdj”)
  – Measures income earned by corporations from current production, before tax liability
  – Excludes financing flows and capital gains and losses
  – Values inventory withdrawals at current cost (adjustment called the “IVA”)
  – Estimates economic depreciation at current cost (adjustment called the “CCAdj”)
U.S. Economic Accounts

Gross Domestic Income (GDI)

- 57% Employee Compensation
- 7% Taxes on Production
- 28% Corporate Profits
- 8% Gross Operating Surplus (Capital Income)

Gross Domestic Product (GDP)

- 71% Personal Consumption
- 15% Investment
- 14% Gov't and Net Exports

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An Eye on GDP Components

- Personal Consumption: 71%
- Investment: 15%
- Government: 19%
- Exports: 10%
- Imports: -14%
How are Corporate Profits Used?

• *By Wall Street*, to track overall U.S. corporate financial health.

• *By industry analysts*, to track industry financial health.

• *By macro forecasters*, to project investment in plant and equipment.

• *By government policy-makers*, to project tax receipts.
There are Lots of Profits Reports

• Each corporation reports its profits in two different ways:
  – To the public to inform investors, and
  – To the IRS to report income for tax purposes

• BEA uses that information when it creates the U.S. economic accounts. In particular, it creates an economy-wide, consistent-over-time measure of total profits earned by all corporations.
Corporate Profits Reported to the Public

• Annual financial statements follow standards that emphasize consistency over time for each corporation.

• Flexibility allowed on methods and measures.

• Outside audits required to curb exploitation of flexibility.

• Uniformity across corporations is low.
Corporate Profits Reported to the IRS

• Both public and privately-held corporations file tax returns, which are confidential.

• Little-to-no flexibility allowed on methods and measures.

• Tax rates, income definition, and incentive provisions change, diminishing consistency over time.

• Statistical sample provides an economy-wide profits measure with a lag.
• Profits from Current Production are:
  – Unaffected by tax-law and reporting-rule changes.
  – Inclusive of income that escapes tax authorities.
  – Exclusive of dividends, capital gains and losses, and other flows arising from means of financing production.
  – Exclusive of financial adjustments reported for other purposes, such as deduction for “bad debt”.
  – Measured consistently, with data beginning in 1929.
Profits are Cyclically Sensitive

Profits from Current Production

($ in billions)


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## Disposition of Corporate Profits

### In $ Billions, 2003:4

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits from Current Production (\text{&quot;Corporate Profits with IVA and CCAdj&quot;})</td>
<td>1,206</td>
</tr>
<tr>
<td>Less: Taxes</td>
<td>244</td>
</tr>
<tr>
<td>Equals: Profits after tax*</td>
<td>962</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
</tr>
<tr>
<td>Dividends (net)</td>
<td>442</td>
</tr>
<tr>
<td>Undistributed profits*</td>
<td>520</td>
</tr>
<tr>
<td>Internally-generated corporate funds available for investment, or &quot;cash flow&quot;:</td>
<td></td>
</tr>
<tr>
<td>Undistributed profits*</td>
<td>520</td>
</tr>
<tr>
<td>Plus: Consumption of fixed capital (or, depreciation)</td>
<td>757</td>
</tr>
<tr>
<td>Equals: Cash flow</td>
<td>1,277</td>
</tr>
</tbody>
</table>

* Include IVA and CCAdj
Corporate Cash Flow, A Source of Investment

Corporate Cash Flow and Investment (Adjusted for Price Change)

($ in billions)


Cash Flow  Nonresidential private fixed investment

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S&P 500 Index: Broad Measure, but Different

• Purpose: to benchmark performance of corporations in current year
• Composition: large representation of publicly-traded corporations, changing year-to-year as market values, capitalization, and trading activities change.
• Data base: after-tax income reported on financial statements.
Similar Trend with Notable Divergence

BEA Profits (Index) and Standard & Poor’s Earnings Index

(Indexed, 1990:II = 100)

Source: Bureau of Economic Analysis and Standard & Poor’s, Inc.

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Data Sources Used to Estimate Profits

**Financial-Accounting Data:**
- Census Bureau Quarterly Financial Reports (QFR)
  - Available quarterly, within several months of end of quarter
  - Cover manufacturing, mining, and trade - roughly 1/3 of profits
- Data from regulatory agencies, other source used to supplement QFR data

**Tax-Accounting Data:**
- IRS Statistics of Income (SOI) Data:
  - Corporate income-tax return (annual) data
  - Available with a lag of two years
Corporate Profits Release Schedule

• Quarterly estimates are available quickly - two months after end of quarter

• Additional information is incorporated as it becomes available - revised estimates for the most recent three years released every summer.
And, BEA Reports on Profits

• “Business Situation” in the *Survey of Current Business*
Corporate Profits

- Latest news release -- 03/25/04
  Profits from current production (corporate profits with inventory valuation and capital consumption adjustments) increased $81.4 billion in the fourth quarter, compared with an increase of $101.4 billion in the third.
  - Technical note
  - Tables from news release, XLS
- Combined Effects of the Tax Acts of 2002 and 2003 on Selected Measures of Corporate Profits, XLS
- Interactive NIPA tables -- view or download specific tables