The New York Times

June 20, 2013

Profits Without Production

By PAUL KRUGMAN

One lesson from recent economic troubles has been the usefulness of history. Just as the crisis was unfolding, the Harvard economists Carmen Reinhart and Kenneth Rogoff — who unfortunately became famous for their worst work — published a brilliant book with the sarcastic title “This Time Is Different.” Their point, of course, was that there is a strong family resemblance among crises. Indeed, historical parallels — not just to the 1930s, but to Japan in the 1990s, Britain in the 1920s, and more — have been vital guides to the present.

Yet economies do change over time, and sometimes in fundamental ways. So what’s really different about America in the 21st century?

The most significant answer, I’d suggest, is the growing importance of monopoly rents: profits that don’t represent returns on investment, but instead reflect the value of market dominance. Sometimes that dominance seems deserved, sometimes not; but, either way, the growing importance of rents is producing a new disconnect between profits and production and may be a factor prolonging the slump.

To see what I’m talking about, consider the differences between the iconic companies of two different eras: General Motors in the 1950s and 1960s, and Apple today.

Obviously, G.M. in its heyday had a lot of market power. Nonetheless, the company’s value came largely from its productive capacity: it owned hundreds of factories and employed around 1 percent of the total nonfarm work force.

Apple, by contrast, seems barely tethered to the material world. Depending on the vagaries of its stock price, it’s either the highest-valued or the second-highest-valued company in America, but it employs less than 0.05 percent of our workers. To some extent, that’s because it has outsourced almost all its production overseas. But the truth is that the Chinese aren’t making that much money from Apple sales either. To a large extent, the price you pay for an iWhatever is disconnected from the cost of producing the gadget. Apple simply charges what the traffic will bear, and given the strength of its market position, the traffic will bear a lot.

Again, I’m not making a moral judgment here. You can argue that Apple earned its special position — although I’m not sure how many would make a similar claim for Microsoft, which made huge profits for many years, let alone for the financial industry, which is also marked by a lot of what look like monopoly rents, and these days accounts for roughly 30 percent of total corporate profits. Anyway, whether corporations deserve their privileged status or not, the economy is affected, and not in a good way, when profits increasingly reflect market power rather than production.

Here's an example. As many economists have lately been pointing out, these days the old story about rising inequality, in which it was driven by a growing premium on skill, has lost whatever relevance it may have had. Since around 2000, the big story has, instead, been one of a sharp shift in the distribution of income away from wages in general, and toward profits. But here's the puzzle: Since profits are high while borrowing costs are low, why aren't we seeing a boom in business investment? And, no, investment isn't depressed because President Obama has hurt the feelings of business leaders or because they're terrified by the prospect of universal health insurance.

Well, there's no puzzle here if rising profits reflect rents, not returns on investment. A monopolist can, after all, be highly profitable yet see no good reason to expand its productive capacity. And Apple again provides a case in point: It is hugely profitable, yet it's sitting on a giant pile of cash, which it evidently sees no need to reinvest in its business.

Or to put it differently, rising monopoly rents can and arguably have had the effect of simultaneously depressing both wages and the perceived return on investment.

You might suspect that this can't be good for the broader economy, and you'd be right. If household income and hence household spending is held down because labor gets an ever-smaller share of national income, while corporations, despite soaring profits, have little incentive to invest, you have a recipe for persistently depressed demand. I don't think this is the only reason our recovery has been so weak — weak recoveries are normal after financial crises — but it's probably a contributory factor.

Just to be clear, nothing I've said here makes the lessons of history irrelevant. In particular, the widening disconnect between profits and production does nothing to weaken the case for expansionary monetary and fiscal policy as long as the economy stays depressed. But the economy is changing, and in future columns I'll try to say something about what that means for policy.