Average, registered in the four previous expansions. After-tax reported profits in constant dollars also rose at a slower annual rate in the current expansion. After-tax reported profits have been held down by accelerated depreciation allowances and slower price increases, which have enhanced reported expenses and reduced profits generated from holding inventories.

Conclusion
The disparity between reported and economic profits has expanded in recent years. Depreciation charges under the tax code were substantially below the replacement cost of capital during the first half of the 1981 tax changes and disinflation, depreciation allowances have increasingly exceeded the estimated replacement cost of capital. While there was a similar movement between the 1950s and 1960s, the magnitude of that shift was insignificant compared to the one of the past decade.

Recent corporate profits from current production could be viewed as weak or strong, depending on how they are measured. On the one hand, after-tax reported profits of nonfinancial corporations have indeed been sluggish, increasing at a 14 percent annual pace over the current expansion. This is substantially below the 20 percent annual rate of growth, on average, for reported profits in post-Korean War recoveries. On the other hand, numbers can be deceiving, and reported profits are not the most accurate indicator of earnings from current production. Reported profits are simply the difference between total receipts and total expenses, which include "depreciation," as reported for tax purposes. Economic profits, which adjust reported profits for price changes and depreciation allowances, are generally thought to be a better gauge of corporate performance. In contrast to reported profits, after-tax economic profits of nonfinancial corporations have been strong in the current expansion, growing at a 45 percent annual pace, which far exceeds their average annual rate of 19 percent in previous expansions.

An examination of after-tax reported and economic profits of nonfinancial corporations over the last three decades shows that reported profits were not much different from economic profits until the inflationary 1970s, when reported profits surpassed economic profits. That trend has reversed, and economic profits have surged ahead of reported profits. The slowing in the pace of inflation and 1981 changes in tax laws account for much of the reduction in reported profit growth over the last few years. After-tax economic profits have been bolstered by the expansion in economic activity and slower increases in costs and taxes. Modest gains in wages and salaries helped firms keep the lid on operating costs in recent years. Moreover, since taxes are based on reported profits, corporate taxes have not risen in proportion to economic profits. Reported profits have grown more slowly because of the greater use of accelerated depreciation, and because the tax laws account for much of the greater use of accelerated depreciation, and because the tax laws account for some of the faster growth in profits.

Profit Measures
The fundamental difference between reported and economic profits is on the cost side; measuring expenses is problematic when prices are not stable. Reported profits distort business performance during periods of sharp price changes, because conventional accounting procedures record business transactions at original, or historical, costs.

Business operations require that some assets be held for a relatively long time. Due to losses in acquiring raw materials and producing and selling products, goods are held in process, or inventory, for long periods. Inflation increases the final sale prices of these products, but does not alter their cost, which may be measured in prices that prevailed when raw materials, intermediate goods, and finished goods entered inventory. Consequently, reported profits generally are biased upward by inventories being held during periods of inflation—at least under the first-in-first-out (FIFO) method of figuring inventory costs for income taxes.

Another problem with interpreting reported profits stems from depreciation expenses. Production and sales require the service of fixed assets such as buildings, machinery, and equipment that last several years. Business must spread the original cost of these assets over their service lives, but inflation causes the value of depreciation allowances to be less than the replacement cost.

Over the years, tax laws have attempted to deal with this problem by allowing larger depreciation allowances rather than dealing directly with inflation accounting. These periodic changes presumably have been intended to reflect changing economic and technological conditions and to provide a more realistic and accurate measure of depreciation.

Paul R. Watro is an economist at the Federal Reserve Bank of Cleveland. The author is grateful to John Ercog and Martha Scanlon for their comments and to John McElroy for his research assistance. The opinions stated herein are those of the author and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System. The views stated herein are those of the author and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.


2. The other commonly used inventory accounting method is the last-in-first-out (LIFO) method. LIFO attempts to measure the cost of sales in current prices and thereby eliminate inventory profit gains. However, LIFO cannot completely eliminate inventory profits from reported profits, since it does not reallocate inventory when prices change. For a detailed discussion, see Richard W. Kopcke.
Economic profits are reported profits adjusted for capital depreciation on a replacement-cost basis and for the inventory valuation adjustment. The U.S. Department of Commerce estimates replacement costs of inventory and capital used in production for domestic corporations. The adjustment for after-tax economic profits may be calculated under the tax code and the funds available to corporations for research and development. The divergence between reported economic profits and after-tax reported profits in the current recovery is the primary explanation for the current divergence between reported economic profits and after-tax reported profits in the current recovery.

The implicit price deflator for fixed nonresidential investment rose by over 8 percent between 1978 and 1981, compared to an average increase of 8 percent over the last six quarters (ended March 1982). The average annual increase of 8 percent over the last six quarters compared to the last six quarters (ended March 1982) is given that before-tax economic profits

The above-average gains in after-tax economic profits in this expansion have been attributed primarily to gains in the first half of the expansion and to slower increases in both operating costs and taxes throughout the recovery. The charts tell different stories about the health of tax-exempt corporations during the 1975 expansion and the average divergence between reported profits and after-tax economic profits over recent cycles. The charts tell different stories about the health of tax-exempt corporations during the 1975 expansion and the average divergence between reported profits and after-tax economic profits over recent cycles. The charts tell different stories about the health of tax-exempt corporations during the 1975 expansion and the average divergence between reported profits and after-tax economic profits over recent cycles.

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