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Why is the Stock Market Rising While Unemployment is Soaring?

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Daniel Gross points out that part of the reason that the American stock markets are going up even though unemployment is rising and the real economy suffering is because multinational corporations headquartered in the U.S. are experiencing strong sales abroad:

> Here's a puzzle: The stock markets are doing very well, yet the performance of the underlying economy doesn't seem to justify optimism. The buoyant S&P 500 has risen 53 percent since the March bottom. And while the economy expanded at a 3.5 percent rate in the third quarter, unemployment is high, incomes are stagnant, and consumers are shaky…
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> It could be that the notion the stock market is an accurate gauge of the domestic economy's temperature is outdated.
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> The Dow, the S&P 500, and the NASDAQ are primarily indices of large U.S.-based companies, not main street businesses: more Davos than Chamber of Commerce. These increasingly cosmopolitan firms have been busy globalizing and expanding their operations overseas. In 2006, according to Standard & Poor's, 238 members of the S&P 500 broke out revenues between U.S. and non-U.S. sales. These companies notched about 43.6 percent of sales outside the United States. For large companies that had already saturated the U.S. market, the home market was something of an afterthought. In the second quarter of 2007, 66 percent of Coca-Cola's beverage business came from outside North America.
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> And thanks to the long recession, demand for products and services of all types in the United States has shrunk even since 2006. Yes, the global economy in 2008 experienced its first year of shrinkage since World War II. But growth has resumed, and in some places—Peru, China, India—it never stopped. As a result, the globe's economic geography has continued to change, with the United States accounting for a smaller chunk of global output and demand each year. For much of the past two years, virtually all growth in economic activity has taken place outside America's borders. As a result, U.S.-based companies are becoming even more reliant on non-U.S. customers and operations for sales… in two years, big companies' proportion of sales coming from outside the United States rose 9.8 percent. It's likely the 2009 figure will be something very close to 50 percent.

Don't American Workers Win?

The fact that companies based in America are raking in profits from sales abroad is good for American workers, right?

No.

Gross points out that American workers don't benefit because a lot of the goods sold abroad by American multinationals are made abroad:

> If companies participated in foreign markets primarily by exporting U.S.-made goods, this shift would be good news for the U.S. economy and workers. But that's not how it works. In fact, in the months after the global credit meltdown, U.S. exports plummeted. They bottomed in April, at $120.6 billion, and though they have been rising, the August 2009 total is still 20 percent below the August 2008 total. Globalization is changing the way we do business. It's not a matter of U.S. companies exporting goods—burgers, soda, cars, software—made in the United States to Beijing but rather, making goods overseas and selling them overseas…
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> "Based on a Russian fairy tale and produced in Russia using local talent, the film is the latest step in Disney's broad push into local language production," the FT reports. As Disney CEO Robert Iger put it: "We would not be able to grow the Disney brand … if we just created product in the US and exported it to the rest of the world." If Book of Masters succeeds, it will be good for Disney's American shareholders but won't do a whole lot of good for its U.S.-based employees. Or consider American icon General Motors. GM's sales in China are rocking. In the first nine months, the company sold 1.3 million cars in China, including more than 181,000 in September. By contrast, GM in the United States in the first nine months sold 1.5 million cars in the United States, down 36.4 percent from the year before. And in September, GM sold just 156,673 cars in the United States. That growth in China is good for GM's shareholders and for some of its executives. But since most of the cars sold in China are produced there, with parts produced by suppliers in China, rising sales in the Middle Kingdom won't translate into jobs for unionized workers in the Middle West.
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> The rising U.S. stock market and a weak, slow-growing U.S. consumer sector aren't really in contradiction. Given the large-scale trends transforming the global economy—and the role of large U.S. companies in it—it may be possible to have a sustainable rally in American stocks without a sustainable rally by American consumers.

Don't Multinationals Pay A Lot in Taxes?

Well, at least the multinationals are paying a good chunk of taxes into the American economy, right?

Not exactly.

The Washington Post notes:

> About two-thirds of corporations operating in the United States did not pay taxes annually from 1998 to 2005, according to a new report scheduled to be made public today from the U.S. Government Accountability Office…
>
> In 2005, about 28 percent of large corporations paid no taxes…
>
> Dorgan and Sen. Carl M. Levin (D-Mich.) requested the report out of concern that some corporations were using "transfer pricing" to reduce their tax bills. The practice allows multi-national companies to transfer goods and assets

> between internal divisions so they can record income in a jurisdiction with low tax rates…
>
> [Senator] Levin said: "This report makes clear that too many corporations are using tax trickery to send their profits overseas and avoid paying their fair share in the United States."
> Indeed, as Pulitzer prize winning journalist David Cay Johnston documents, American multinationals pay much less in taxes than they should through a variety of widespread schemes, including:

– Selling valuable assets of the American companies to foreign subsidiaries based in tax havens for next to nothing, so that those valuable assets can be taxed at much lower foreign rates
– Pretending that costs were spent in the United States, so that the companies can count them as costs or deductions in the U.S. and pay less taxes to the American government
– Booking profits as if they occurred in the subsidiary's tax haven countries, so that taxes paid on profits are at the much lower safe haven rate
Working out sweetheart deals with certain foreign governments, so that the companies can pretend they paid more in foreign taxes than they actually did, to obtain higher U.S. tax credits than are warranted
– Pretending they are headquartered in tax havens like Bermuda, the Cayman Islands or Panama, so that they can enjoy all of the benefits of actually being based in America (including the use of American law and the court system, listing on the Dow, etc.), with the tax benefits associated with having a principal address in a sunny tax haven.
– And myriad other scams

As Johnston documents, the American economy is hurt by the massive underpayment of taxes by the huge multinationals.

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