The Tangible Impact of Intangible Investments

12/19/2017 08:17 am ET


In 1962, in a book entitled The Production and Distribution of Knowledge in the United States, economist Fritz Machlup suggested that forms of knowledge could be produced, like refrigerators and cars. Machlup urged his fellow economists to begin measuring research and development, marketing, branding, and the training of workers.

Computer software – knowledge written in lines of code – and digital networks have made Machlup’s insight impossible to ignore. By the early 2000s, Jonathan Haskell (a professor of economics at Imperial College, London) and Stian Westlake (a senior fellow at Nesta, the national foundation for innovation in the United Kingdom) point out, academic and non-academic accountants, statisticians and economists recognized that “things that had no visible presence” played a pivotal role in the new economy – and began incorporating intangible investments in the Gross Domestic Product and many other measurements of “national accounts.” In 2006, the “developed” countries were investing more in intangible than tangible assets.

In Capitalism without Capital, Haskell and Westlake examine the key characteristics of intangible investments, including scalability, sunk costs, spillover effects, and synergies. Drawing on the latest research, they assess the implications of the long-term shift to knowledge-based assets on secular stagnation (the “weird mix” of low interest rates, low investment, and low productivity); the public and private financing of business investment; infrastructure; and inequality. Admittedly a work-in-progress, Capitalism without Capital is an essential introduction to an important and often overlooked driver of the modern economy.
Among the authors’ most valuable insights is the identification of factors inhibiting investment in the research and development of intangible assets. The costs of these assets, they point out, tend to be “sunk” (i.e. difficult or impossible to recover), especially if they are uniquely tied to the firm that owns them and/or they are not protected by formal intellectual property rights.

Even more important, Haskell and Westlake suggest, is the impact of “spillover effects.” Even in developed countries, the rules governing ownership and control of “ideas” are contested – and competitors are often able to “invent around them.” And so, companies cannot be at all certain they will reap the benefits of their investments. Electrical & Musical Industries Limited (EMI), the beneficiaries of the success of Beatles’ records, for example, invested in a company that built the first computer tomography (CT) scanner. Although EMI took out patents, General Electric and Siemens licensed some of the technologies from EMI and soon controlled the CT scanner business.

Finally, according to the authors, because intangible assets are scalable and synergistic (able to be combined with other valuable resources), industry giants (Apple, Starbucks, Wal-Mart) are far more likely to invest in them than lagging firms (who are far less able to take financial risks).

For these reasons – as well as reductions in R&D spending by some governments – the pace of intangible capital building has slowed since the Great Recession, slowing total factor productivity and playing a role in secular stagnation.

The authors’ analysis of the role the intangible economy plays in wealth and income equality, urbanization, and rising housing is, it seems to me, far less compelling. And Haskell and Westlake acknowledge that the solutions they propose for the problems generated by the intangible economy are not new, and may be neither practical, politically feasible, nor effective. Their skepticism that venture capitalists, large institutional investors (including sovereign wealth and pensions funds), or government (by taking equity positions in firms) will make up the shortfall in investing in research and development of intangible assets seems justified. They are right as well to doubt that private industry is not likely to fund 21st century Bell Labs or that public institutions will add substantial subsidies to university-based knowledge generators. And we are right to be skeptical about their hope for a cultural shift among corporate managers and shareholders toward longer term investments in R&D and organizational and human capital. Or in a dramatic expansion in adult education programs.

Not surprisingly, then, Haskell and Westlake conclude by underscoring “the deep challenge” we face. For the intangible economy to thrive, we must encourage trust and strong institutions, expand opportunity, reduce inequality and social conflict, and check powerful corporations. “But at the same time, an intangible economy seems to exacerbate all these problems…”

©2017 Oath Inc. All rights reserved.
HuffPost News