Capitalism Without Capital

The rise of the intangible economy

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There are a host of social and economic problems in the world today...
Secular stagnation

Why is productivity and investment low, even though profits are high and technology is abundant?
Why has the gap between the rich and the poor grown so much?
Why is the financial system doing such a bad job at backing the "real" economy?

Dysfunctional financial system
Why is there a growing gulf between “liberal citadels” and “left-behind” places?
Some people blame capitalism in general...

CAPITALISM IS BAD

AND YOU SHOULD FEEL BAD
...butmaybe it’s because capitalism is changing
...and our book tries to bring together work trying to diagnose these changes...
1. The rise of the intangible economy

2. Why is intangible capital different?

3. What does this mean for business and the economy?
The nature of investment and capital assets is changing.

<table>
<thead>
<tr>
<th>Tangible investments</th>
<th>Intangible investments</th>
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<tbody>
<tr>
<td>Buildings</td>
<td>R&amp;D</td>
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<tr>
<td>Computers</td>
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<td>Plant &amp; machinery</td>
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<td>Vehicles</td>
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<td>Artistic originals</td>
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<td>Software &amp; data</td>
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But this change is hidden...

GDP still doesn’t include most intangibles

...neither do company accounts

Source: Lev and Gu (2016)
Intangibles are everywhere!

1977

2018

Plus: a pure intangible business

Software

Training & processes

Branding & marketing
The rise of intangible investment is a long-term trend

**Tangible** and **intangible** investment share, US+EU11

From SPINTAN database

**Tangible** and **intangible** investment share, US

Predates IT revolution?

From Carol Corrado

Intangible capital is the capital of the 21st Century
1. The rise of the intangible economy

2. Why is intangible capital different?

3. What does this mean for business and the economy?
Four economic properties of intangibles

**Scalable**
Intangible assets can often be used over & over, in multiple places, with little or no reinvestment.

**Sunk**
Once a firm makes an intangible investment, hard to sell it or recover its value.

**Spillovers**
A firm making an intangible investment will not receive all (or perhaps any) of the returns.

**Synergies**
Intangible assets are often especially valuable when combined with other intangibles and human capital.
Property of intangibles 1: SCALABILITY

Minicabs: not scalable

Uber algorithm: highly scalable

Intangible assets can often be used over & over, in multiple places, with little or no reinvestment.
Property of intangibles 2: SUNKENNESS

Phone company goes bust? Sell your HQ. But intangibles are harder to sell off.

Once a firm makes an intangible investment, it tends to be hard to sell it or recover its value.
Often, a firm making an intangible investment will not receive all (or perhaps any) of the returns.
Intangible assets are often especially valuable when combined with other intangibles.
1. The rise of the intangible economy

2. Why is intangible capital different?

3. What does this mean for business and the economy?
   a) Leaders, laggards and secular stagnation
   b) Who wins and who loses?
   c) Financing an intangible economy
   d) What should governments do?
Winners and losers in the business world

Percentage difference in productivity from 2001 values (2001=0)

Why is this happening? Poor tech diffusion? Poor competition policy?

A driver of income inequality (Song & Bloom 2016)

"The Future of Productivity", OECD, 2015, via HBR
The growth of intangibles increases the leader-laggard gap.

**Scalability**

Scalable assets like Uber’s software or Starbucks’ brands are especially valuable for large firms.

**Spillovers**

The ability to capture spillovers is not evenly distributed.

**Synergies**

Firms that already have valuable intangibles get greater benefits from other intangibles.
Cities become more important...

This appears to be a major driver of inequality

Rognlie (and others): housing wealth the majority of the rise in wealth of the richest

Planning restrictions become a costlier luxury
...and more sectorally diverse...

Youngstown, Ohio (1910)

Source: Foreman, Goldfarb, Greenstein (2015)
...but the rise of “liberal citadels” creates tensions

Economic divisions between thriving cities and the rest...

...are underpinned by related cultural differences (openness to experience)
...all contributes to rising inequality

<table>
<thead>
<tr>
<th>Relevant fact</th>
<th>Link to intangibles</th>
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<tbody>
<tr>
<td><strong>Wealth inequality</strong></td>
<td>Significantly driven by property prices (Bonnet et al 2014, Rognlie 2014)</td>
</tr>
<tr>
<td><strong>Income inequality</strong></td>
<td>Driven by gaps between firms (Song &amp; Bloom 2016)</td>
</tr>
<tr>
<td><strong>Status inequality</strong></td>
<td>Are the causes cultural or economic?</td>
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</table>
The difficulty of financing intangible investment: sunk

- Sunk costs of intangible investment makes debt finance harder – fewer assets to salvage in case of default
- Most businesses rely on debt finance

- Some scope to expand IP-based lending (MCAM, UK Intellectual Property Office and Singapore Patent Office experiments)
- But a shift to more equity finance seems necessary. This would require:
  - tax changes
  - significant institution-building
The difficulty of financing intangible investment: spillovers

- Spillovers increase the benefits of diversification – well diversified shareholders can capture the benefits of (eg) R&D even if they spillover

- But some evidence that concentrated ownership (=better info) encourages business investment in intangibles (Edmans)

- Better reporting may help (Lev & Gu) – but it’s a dilemma

- VC can help – but hard to grow
A stronger case for public investment – but how?

Intangible investment share and public R&D, US+EU11

- Spillovers of intangibles increases the case for public investment:
  - Publicly funded research and training
  - Other publicly funded intangibles (procurement, public-run firms)
- But far from clear we know how to do this well...
- ...and is it politically sustainable, given the cultural divides?
And much more...

- The Beatles, Brexit, President Trump, The Domesday book, microwave ovens...
- Intangibles and inequality
- The pros and cons of IP
- Managing intangible businesses
- Five dilemmas for policymakers

One of the best books of 2017 according to: