Restarting the future: why the intangible economy isn't working and how we can fix it

Written by

Jonathan Haskel

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The failure of financial institutions to keep up with the rise of the intangible economy has led to economic disappointment across the developed world. So, why has this happened, and what do we do now?

At the beginning of the 21st century, it was hoped that new technologies and ways of doing business would mean greater prosperity – but this has not proved to be the case.

Since the turn of the century, businesses have been putting more money into intangible assets, such as software, R&D and design, making them a cornerstone of the economy, rather than tangible assets, such as buildings, plants and vehicles.

Despite this, the pace of intangible investment is slowing and developed countries find themselves in a strange position: the world is richer than it's ever been, yet their economies are suffering from major issues, including stagnation, inequality, and dysfunctional competition.

> Economic institutions need to fit with the technological makeup of an economy

This has been compounded by crises such as the coronavirus (COVID-19) pandemic: countries rightly borrowed to ward off the worst of the effects, but this must be paid back. The problem is, if economies aren't growing fast enough when taxes are raised, everybody must do more with less.

It is essential these issues are addressed so we can progress and create an economy that is faster growing, more sustainable and fairer for everyone. But first, we must understand the reasons we ended up in this situation.

The Great Economic Disappointment

The explanations for the Great Economic Disappointment that developed countries across the world are experiencing fall into two groups: **conduct** and **circumstance**. **Conduct** theories are based on the idea that different behaviour would have resulted in a different outcome. Within this group, left-wing arguments blame neoliberalism and our failure to rein it in with higher corporation taxes or stricter competition laws. Meanwhile, those on the right point the finger at the loss of an entrepreneurial spirit.

Explanations that fall under the umbrella of **circumstance** tend to be more fatalistic, arguing the issues we face today are the manifestation of long-standing failings or the inevitable consequence of progress. At the most pessimistic end of the spectrum, some argue the current situation represents the "new normal". Meanwhile, more optimistic observers consider it more of a teething problem that will be solved as we learn how to make the most of the intangible economy.

In our new book, *Restarting the Future: How to Fix the Intangible Economy*, my co-author Stian Westlake and I put forward a different explanation altogether. We believe the economy is partway through a fundamental change from a tangible economy to an intangible one based on ideas, knowledge and relationships. We argue the problem is not simply with this shift itself but also with our financial institutions, which we depend upon, failing to keep up with it. In other words, the problem we are seeing in the world's major economies is the result of being caught between the past and future.

An unfinished revolution

It is generally accepted that economic activity depends on institutions, or what Arnold Kling and Nick Schulz described as the “operating system” of the economy. Sound institutions enable exchange: trade, investment and specialisation are all essential to making the economy progress. The problem for our institutions today is intangible capital has unusual economic properties; intangible ideas, like designs, can leak out to others who don’t pay for them. Ideas benefit from being shared – traditionally cities have provided an environment where that can happen – and institutions have to adapt to accommodate these changes.

> The status quo suits plenty of people, and change is politically and socially costly

Consider, for example, the increased need for capital markets and banking systems to lend to firms whose intangible assets, such as a new movie script or software design, are difficult to use as security for loans. Compare this to a firm with lots of tangible assets, such as buildings and vehicles, that wants to borrow money. From the bank’s perspective, it makes far more sense to lend to the second type of company. Or consider planning regulation: it keeps density in cities low and house prices high, suiting current residents, but sacrifices the growth of cities, limiting the extent to which they can continue in their role as places where ideas and knowledge are exchanged.

But economic institutions need to fit with the technological makeup of an economy and instead we have the old economic institutions for the new intangible economy. This causes two problems: worthwhile intangible investments are not made, resulting in slower growth, and the potential downsides of an intangibles-rich economy go unchecked.

The solution

If we want to fix institutions, we need to identify and strike political bargains. This will be tricky because the status quo suits plenty of people, and change is politically and socially costly. Rebuilding these institutions is a tough electoral sell and doing the deals necessary to make the new institutions stick requires creativity, cunning, and willingness to challenge vested interests – and these requirements may seem like a tall order, politically.

> The problem we are seeing in the world's major economies is the result of being caught between the past and future

But unlike other explanations for the Great Economic Disappointment, the story we are telling and the solutions we are proposing are grounds for optimism. For, if the issue is that we have failed to update and improve our institutions to keep up with the changing structure of the economy, then there is a solution – even if it is a difficult one to bring about. Institutional renewal has happened before, and it can happen again.

If we are successful, the rewards will be increased growth and prosperity, tackling ecological threats from pandemics to global warming, and finding a way out of the unhappy halfway house in which the economy has been stuck for nearly two decades. These are things worth fighting for.

Restarting the Future: How to Fix the Intangible Economy*, published by Princeton University Press, is available to buy here.*

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About Jonathan Haskel

Chair in Economics
Jonathan Haskel is Professor of Economics at Imperial Business School and, from September 2018 until August 2024, he was a member of the Bank of England's Monetary Policy Committee. His main research interests are productivity, innovation, intangible investment and growth.

He has written two books: "Capitalism without Capital: The Rise of the Intangible Economy" and "Restarting the Future: How to Fix the Intangible Economy".

Read Jonathan's Imperial Profile for more information and publications.

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