The wealth of nations: Where does it come from?

Clever Collections Conference

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THE WEALTH OF NATIONS: WHERE DOES IT COME FROM?

Original question in economics (moral philosophy)

Adam Smith (1776) asked:

- What causes countries to grow in wealth?
- Why are some wealthier than others?
- What provides value to society?

18th century thought (physiocrats):

- Only physical goods impart value
- Only the agricultural sector creates value
- Manufacturing merely transforms – does not create value
- Assets = land & food for farm labourers

(Asset = something we have today that will provide value in the future – investment good, capital good)

19th century thought:

- Only physical goods impart value
- Agriculture *and* manufacturing create value
- Assets = land & food for farm labourers *and* plant and equipment

Early 20th century thought:

- Value = any increase in well-being (subjective notion)
- The fact of purchase denotes value
- Both goods and services impart value
- Agriculture, manufacturing *and* service sector create value
- STILL …Assets = land, buildings, plant and equipment!

Late 20th century thought:

- Assets = skills, knowledge, know-how, systems, institutions, workplace norms…
- *plus* buildings, plant, equipment and natural resources.
- Formal terms = intangible capital, human capital, intellectual capital, intellectual property, social capital, organisational capital
- Informal term = know-how
- Wealth creation question goes multi-disciplinary (economists, management scientists, marketing people, sociologists …even legal scholars)
- Many terms for same/similar things
- Formal & clear acceptance of terms, definitions, models not yet established

Assets – can be created and owned by:

- Enterprises via
  - R&D,
  - workforce training,
  - development of databases, systems,
  - workplace routines,
  - brand development…

- Households via
  - child rearing,
  - education,
  - voluntary community work,
  - cultural ethos…

- Governments via programs and policies on
  - education,
  - health,
  - infrastructure,
  - laws/regs on workplace culture,
  - laws/regs on community behaviour…

- Community sector via
  - Cultural development
  - Community behaviour…

These assets have always existed.

- Production is not possible without some level of know-how
- Can't even harvest wild berries without knowing which are nutritious or poisonous
- *All* production is just a re-arrangement of matter
- Physical matter in the world is *not* created (its fixed – ask a physicist!)
- Only way to re-arrange matter is to apply know-how to raw labour
- Only way one country or one person can be more productive is use better know-how

Has intangible capital become more important over time?
Is it more important for some countries (Japan versus Saudia Arabia)?

Note :Difference between use value and exchange value (price)

- Use value = how much we pay to have it at all = *total* value to society
- Exchange value = how much we pay for a little bit more = *marginal* value to society

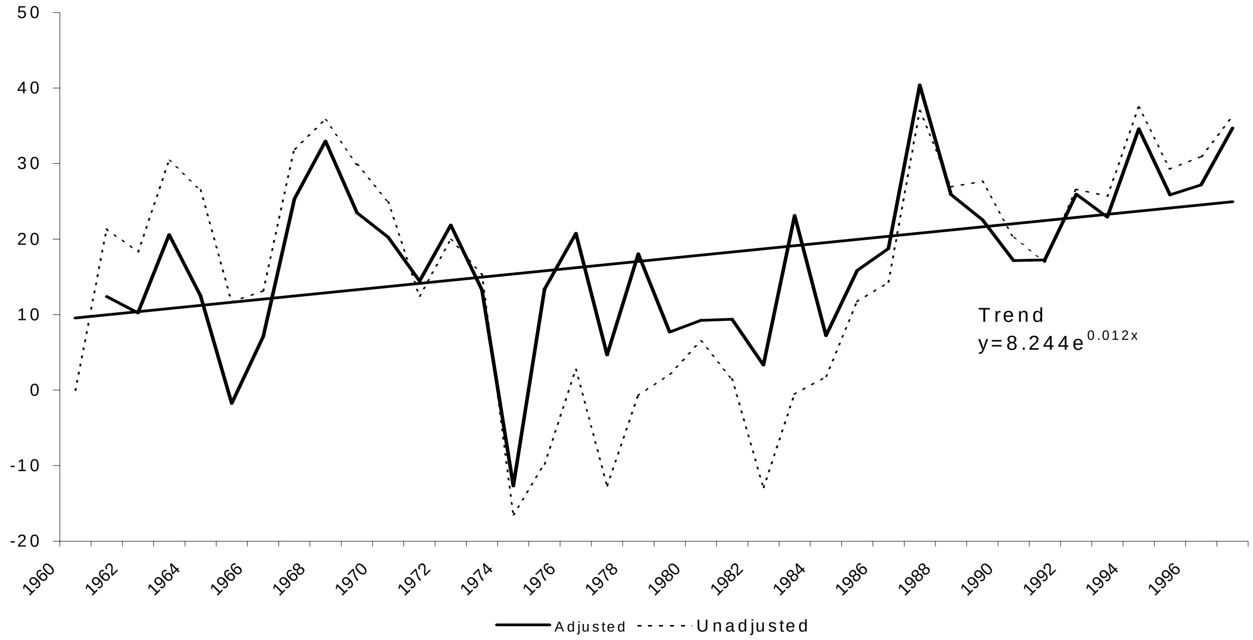
- Water has high use value but a low exchange value
- Diamonds have low use value but high exchange value

Prices, wages and profits determined by exchange or marginal values

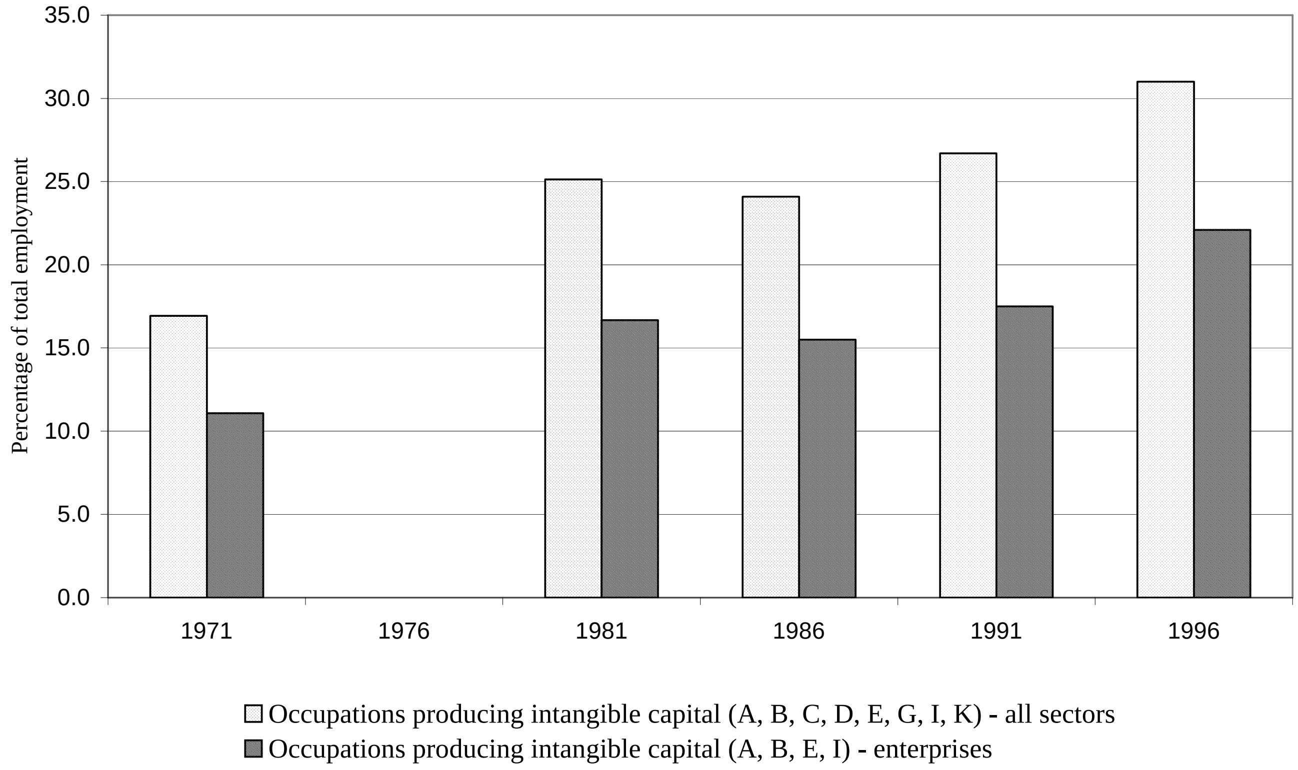
Evidence that

- at the margin the value of intangible capital is rising over time
- marginal profits are made by investing in intangibles

Ratio of intangible capital of all capital, publicly listed companies, Australia, 1960 to 1997.



Proportion of employment in the direct production of intangible capital, Australia, 1971 to 1996



To conclude:

- Intangible investments = expenditure on R&D, increased skill, development of databases, development of knowledge systems, brand development, improved organisation processes…
- Intangible capital probably always been important through history
- But becoming more important as a source of company profits
- Companies are now explicitly investing in intangibles
- Previously done inadvertently or by the voluntary, household sectors
- Most managers recognise this – many have ad hoc systems for measuring and recording
- Financial accounting system is about 50 years behind the time.