

Seizing Intangibles For the G.D.P.

By Louis Uchitelle, April 9, 2006 – *The New York Times*

THE plain fact is that when it comes to measuring how much the American economy produces and who gets what share of the pie, the federal government's most celebrated statistic -- the gross domestic product -- leaves something to be desired.

The G.D.P. is useful, as far as it goes. It tells us how much value -- often called national income -- is generated each year from the production of goods and services in the United States. The G.D.P. also breaks out how much of that income goes into profits and how much into wages and salaries.

This is where the trouble is. The numbers show that the profit portion of the gross domestic product has risen mildly in recent years, while the wage-and-salary share has shrunk slightly. There is evidence, however, that because of the way the G.D.P. is calculated, the actual shift is much more pronounced.

"We know that income inequality is quite substantial," said Harry J. Holzer, a labor economist at Georgetown University, "and this new evidence suggests that it is worse than we thought."

The Bureau of Economic Analysis, which issues the G.D.P. reports each quarter, is on the case. So are two prominent economists at the Federal Reserve. They all seem to be finding that the current methods for calculating G.D.P. undercount the dollar returns from research and development. What's more, this payoff is not showing up in workers' paychecks.

The approximately \$300 billion spent each year on R & D is a big concern of the bureau's economists. Until now, it has been counted as an expense, reducing the profit total within the G.D.P. Starting in September, however, the bureau will publish an experimental G.D.P. account that parallels the standard quarterly report, except for one change: R & D will be counted as capital investment rather than as an expense.

There is logic in this change. Consider the process of making and selling a dress. The cloth and thread -- the raw materials -- that go into the dress are an expense that must be subtracted from the sales price of the dress, once it is sold, to arrive at a profit. The automated sewing machine that makes the dress, on the other hand, is counted in the G.D.P. accounts as a capital investment because, once installed, it makes dress after dress, generating a stream of revenue. It is an investment drawn from retained earnings to generate more earnings.

Similarly, the research and development that made Prozac possible generates revenue for years, just as the sewing machine does for the dressmaker. Successful research and development yields long-term returns, and the bureau's experimental G.D.P. acknowledges as much, by classifying R & D as capital investment in the satellite account. Capital investment, in turn, counts as a contribution to profit in the G.D.P.

This reclassification leaves no doubt that workers are being left behind as the G.D.P. expands. When R & D is counted as profit, the employee compensation share of national income drops by more than one percentage point. In a \$12.5 trillion economy, that's big money.

Measured in dollars, wages aren't actually falling, but workers are losing ground. "If capital income is going up and wages stay the same, then the share of total national income that goes to labor goes down," said Sumiye Okubo, an associate director of the bureau, who is directing the experimental project.

The two Fed economists -- Carol A. Corrado and Daniel E. Sichel -- along with an outside collaborator, Charles R. Hulten, a University of Maryland economist, go much further than Ms. Okubo and her team in arguing that the G.D.P. data should be revised. They would do more than just reclassify R & D.

In a recent research paper, "Intangible Capital and Economic Growth," they agree with Ms. Okubo's team that formal, scientific research and development should be categorized as capital investment rather than as ordinary expenses. But they say that this treatment should be extended to a host of other investments that generate revenue streams over a period of years.

They would include various intangibles, like advertising when it is used to establish a brand name that permanently lifts sales, and a retail chain's outlays to adapt existing technology to the chain's needs, as Wal-Mart did in designing a superefficient inventory control system.

SUCH intangibles now approach \$250 billion a year, up from only \$11 billion in the 1970's, the three economists calculate. If these intangibles, along with R & D, were incorporated into G.D.P. on the profit side as capital investment, labor's share of national income would decline from a fairly steady 65 percent in the 1950's, 60's and 70's to less than 60 percent today.

The long decline doesn't show up in the standard G.D.P. accounts, which ascribe nearly 65 percent of national income to labor. "The hidden earnings from these knowledge investments have not been shared equally with workers," Mr. Hulten said.

Two reasons seem likely. Some of the profit is probably going to the wealthiest Americans -- the upper 1 percent whose incomes have risen sharply, in part from dividends and other forms of corporate earnings.

Then, too, most of the nation's workers are bereft of bargaining power. Unless that returns, labor's share of national income seems likely to continue its decline.