

Knowledge-based capital, innovation and resource allocation (Supporting Investment in Knowledge Capital, Growth and Innovation)

Investment in knowledge-based capital (KBC) -assets that lack physical embodiment, such as computerised information, innovative property and economic competencies- has been rising significantly. This has implications for innovation and productivity growth and requires new thinking on policy. The returns to investing in KBC differ significantly across countries and are partly shaped by structural policies, which influence the ability of economies to reallocate scarce resources to firms that invest in KBC. Well-functioning product, labour and venture capital markets and bankruptcy laws that do not overly penalise failure can raise the expected returns to investing in KBC by improving the efficiency of resource allocation. The same is true for lower barriers to international trade and investment, which also stimulate innovation through greater market size and knowledge diffusion across borders. While structural reforms offer the most cost-effective approach to raising investment in KBC, there is a role for innovation policies to raise private investment in KBC towards the socially optimal level(s). Indeed, R and D tax incentives and, as a finding that contrasts with previous research, direct support measures can be effective, but design features are crucial in order to minimise the fiscal cost and unintended consequences of such policies. Well-defined intellectual property rights (IPR) are also important to provide firms with the incentive to innovate and to promote knowledge diffusion via the public disclosure of ideas. However, such IPR regimes need to be coupled with pro-competition policies to ensure maximum effect while the rising costs of the patent system in emerging KBC sectors may have altered the trade-off inherent to IPR between the incentives to innovate and the broad diffusion of knowledge.

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