

Constructing a Price Deflator for R&D: Calculating the Price of Knowledge Investments as a Residual

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Objective of paper

- To construct R&D price index
 - Inform forthcoming capitalisation of R&D
 - Inform European heartsearching about R&D spend (as % of GDP) being flat/falling
- Paper
 - First pass
 - Review existing approaches
 - Implement our approach on UK data
 - Robustness checks
- Basic outline of framework: Edison quote
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Model outline

- Two sectors
 - knowledge-producing: gets knowledge for free, but charges mark-up
 - knowledge-using: rents knowledge
- Three factors of production
 - labor,
 - capital,
 - knowledge.
- Production and income flow relationships, knowledge stock accumulation, rental/asset prices

$$N_t = F^N(L_t^N, K_t^N, R_t^N, t); \quad P_t^N N_t = \mu(P_t^L L_t^N + P_t^K K_t^N)$$

$$R_t = N_t + \quad \quad \quad R_t$$

$$Y_t = F^Y(L_t^Y, K_t^Y, R_t^Y, t) \quad P_t^Y Y_t = P_t^L L_t^Y + P_t^K K_t^Y + P_t^R R_t^Y$$

$$= \quad (! + \delta)$$



Model outline

$$P^N = s_N^K P^K + s_N^L P^L + TFP^N$$

$$\Delta \ln P^Y = s_Y^K \Delta \ln P^K + s_Y^L \Delta \ln P^L + s_Y^R \Delta \ln P^R - \Delta \ln TFP^Y$$



Model outline

Conceptual issues discussed in paper

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UK data set

- Essence of approach: upstream and downstream sectors. So use industry data?
- No. Much R&D is in-house. So, to implement we need to “break” industries into upstream, R&D producing, and downstream, R&D renting
- Data sets
 - BERD: Business Enterprise R&D = surveys own-account R&D spending by firms. Reported for 32 products (~market sector industries).
 - UK EUKLEMS data set (March 2008 release),
 - prices and quantities of output and labor and material input for 72 industries
 - and estimates of capital input and TFP for 23 industries.
 - UK supply-use (IO) tables, for more than 100 industries from 1992 to 2006.
 - allocate own-acc R&D of R&D services industry to other (i.e., downstream) industries using input-output data on sales.
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Summary of shares

- So, shares are

$$s_{Y G}^M = \frac{P^M M^Y}{P^G G^Y} = \frac{P^M M^{KLEMS} - P^M M^{BERD} - P^N N^{IO}}{P^G G^{KLEMS}}$$

$$s_{Y G}^L = \frac{P^L L^Y}{P^G G^Y} = \frac{P^L L^{KLEMS} - P^L L^{BERD}}{P^G G^{KLEMS}}$$

$$s_{Y G}^R = \frac{P_t^R R^Y}{P^G G^Y} = \tau \mu \frac{(P_t^N N^{BERD} + P_t^N N^{IO})}{P^G G^{KLEMS}} \quad \tau = \frac{\rho + \delta_R + \Delta R^{Y OA} / R^{Y OA}}{(\Delta R^{Y OA} / R^{Y OA} + \delta_R)}$$

$$s_{Y G}^K = -s_{Y G}^M$$

TFP in downstream

- TFP in downstream unoa3unoa3un9999 4 strea.2 ()

Thus we compute



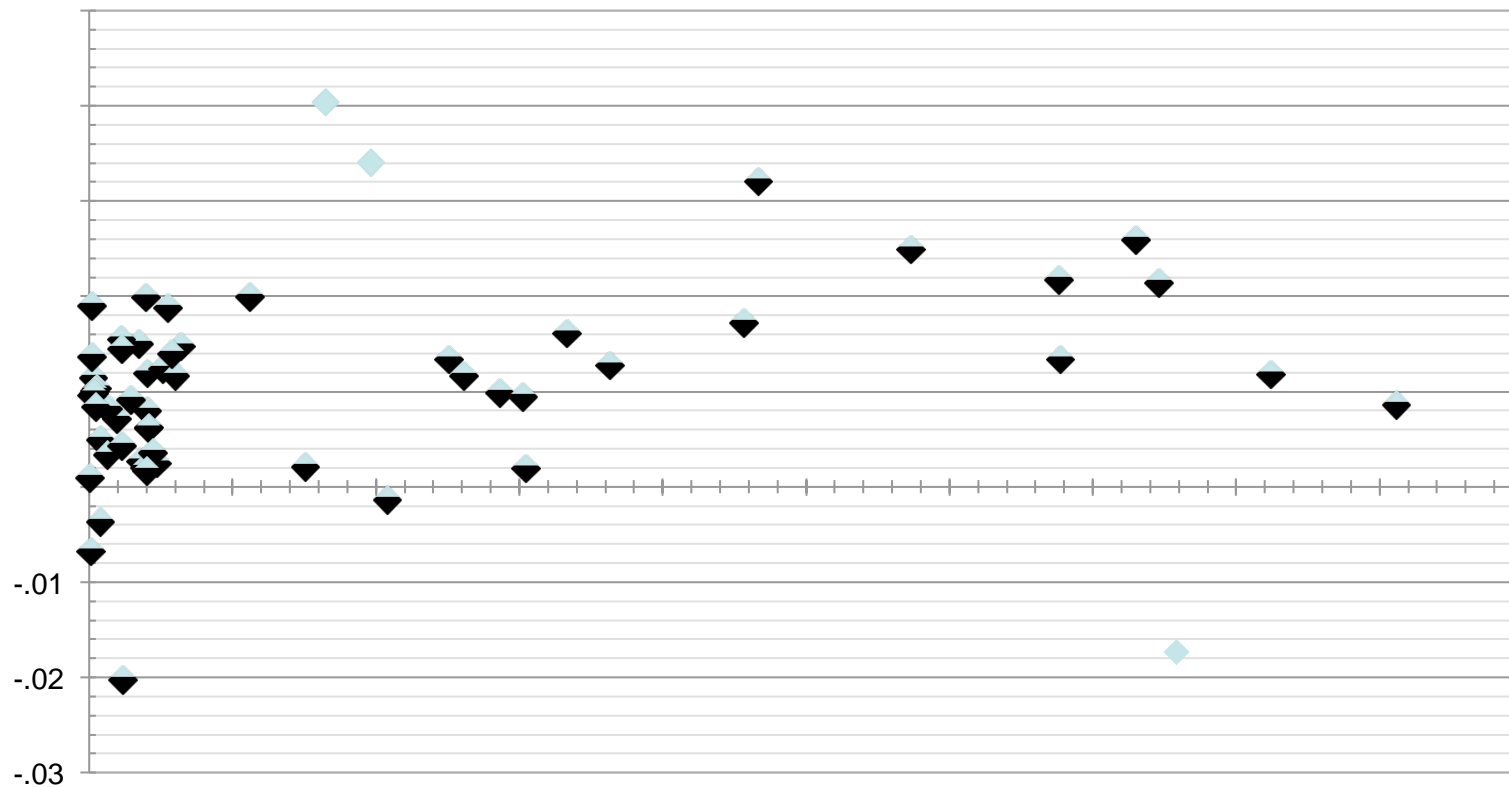
Alternative shares of knowledge spend industry gross output

own-
account PnN as
share of GO

own-
account plus
allocated from
PnN in R&D
services,, as
share of GO

knowledge
rentals as share

Mean $\Delta \ln TFP(J)$ & Mean $sN(J)$: All market sector industries



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Summary

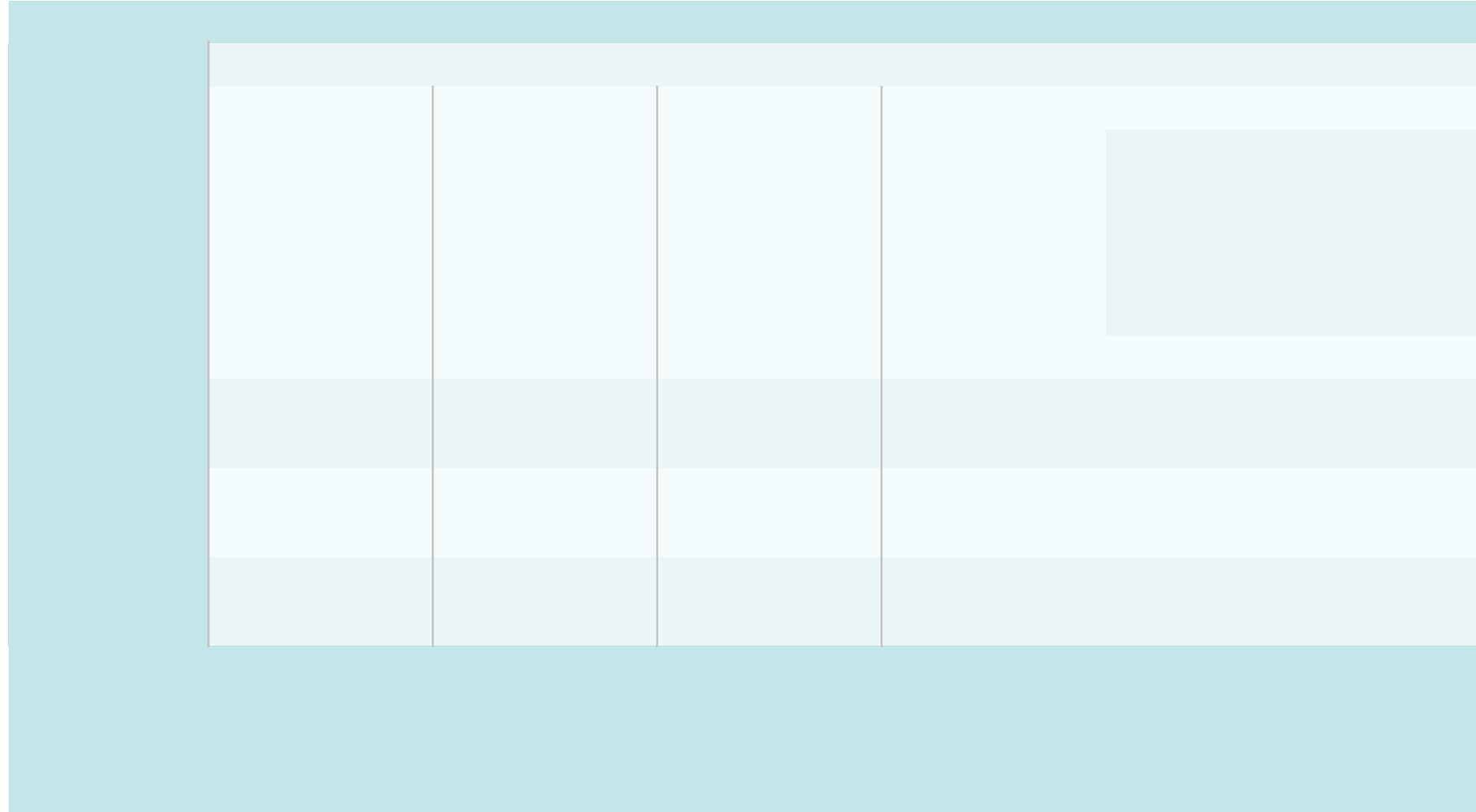
- First pass attempt to measure R&D price from price of downstream R&D users
- Theory suggests needs assumptions on
 - μ = Innovator mark up
 - $\#$ = relation P^N and P^R
 - Downstream $\Delta \ln TFP = \Delta \ln TFP^Y$
- Central estimates:
 - UK R&D prices fall by around 7.5%pa 1985-05.
 - Compare with GDP deflator +3.5%
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spares

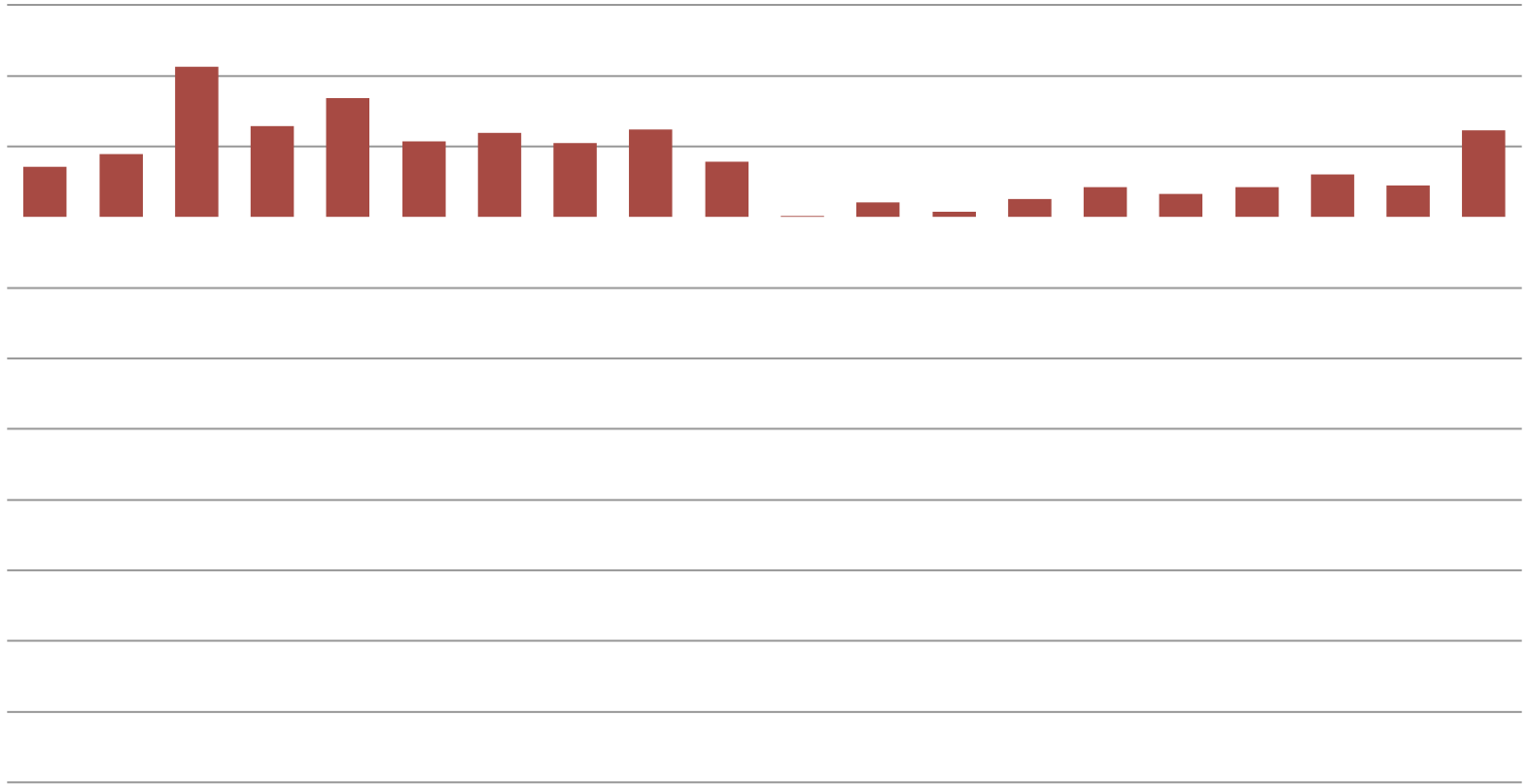
Weights

Memo:

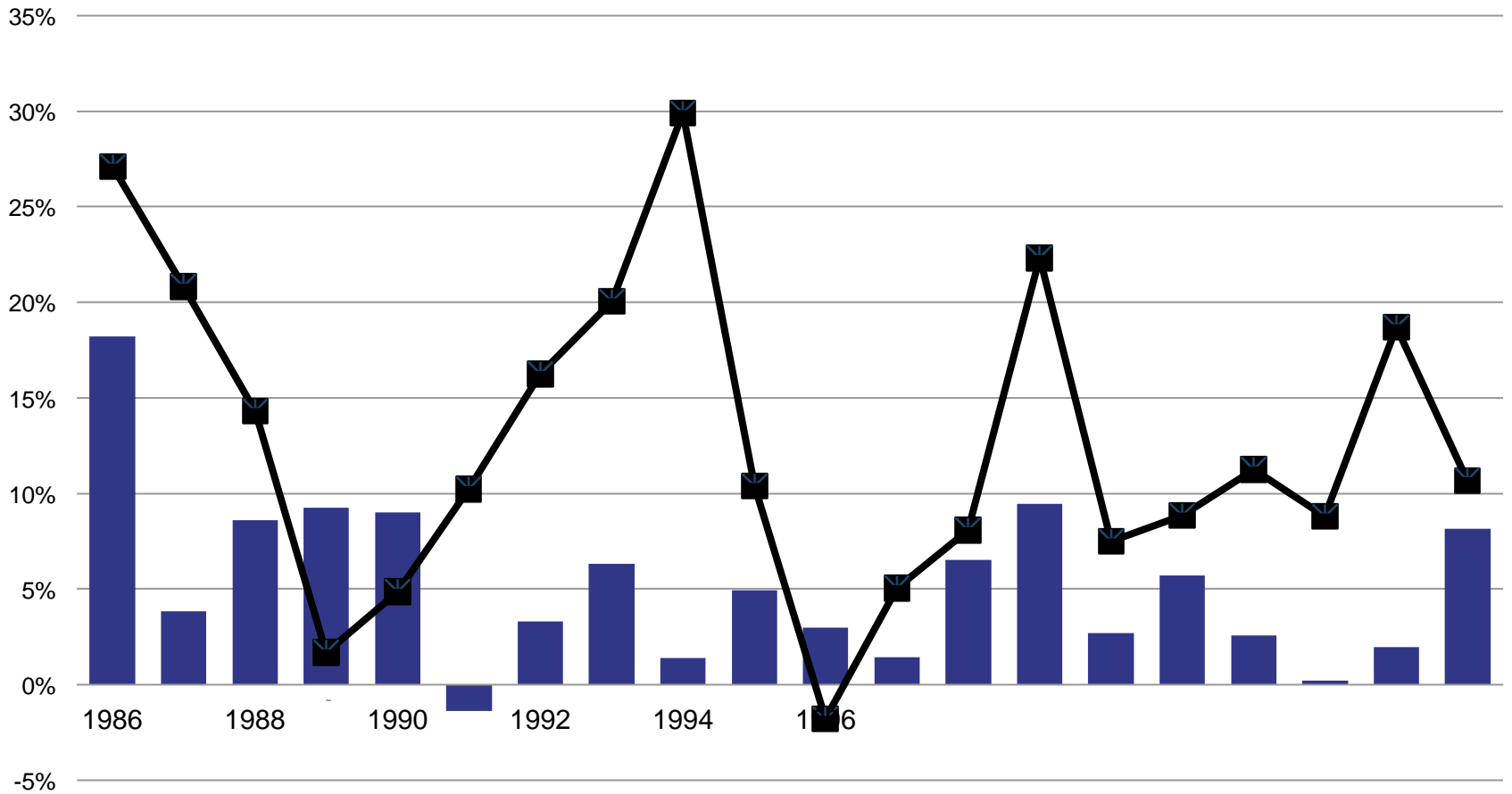
We estimate the contribution of change in R&D rental price to industry GO price:



Results



Results



Robustness: B

&					
	.60!	.70!	.75!	.80!	.90!

Downstream knowledge rental payments, P^{RR}?

- Assume value of new knowledge created in the upstream sector

$$\equiv \mu \left[\left(\quad + \quad + \quad \right) + \quad \right]$$

- To convert P^{NN} to P^{RR}, use rental and PIM

$$\dot{\quad} = (\rho + \delta) \frac{\quad}{\quad}$$

- To give

Mean  $\ln TFP(J)$ & Mean $sN(J)$: Excl. outliers,
nonperformers, and lowest R&D quartile, 2 productivity
episodes

