Futurity, Intangibles and Crisis

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Futurity

- Futurity is a term coined by John R. Commons to describe the evolution of property rules in the U.S. in late 19th century.
- Businesses were increasingly viewed generally, but crucially by the Courts, as ‘going concerns’
- As going concerns they were valued against estimates of future profit making capacity (typically discounted against current rate of interest).

Tangible and intangible

- Both economy and politics orient themselves towards the future
- ‘men live in the future but acts in the present’
- Assets were initially viewed as consisting of two components: tangible assets, or replacement value or sometimes even liquidation value
- Intangible assets, all the extra that estimate of future earning brought with them

From holding to withholding

- In time the evolution in behaviour was more profound
- Orientation towards future profit making capacity rendered key component of property holding the right to ‘withhold’
- By withholding from markets (or sabotage in Veblen terminology), business kept prices up

The argument

- Futurity exaggerate pro-cyclical tendencies for two reasons:
- First, as assets are largely measured in term of future profit making capacity, so estimation of future are subject to greater volatility than replacement or liquidation value.
- For instance, in the current crisis wealth of about $US 50 trillion have disappeared and re-appeared within a space of five years.
- Economists thought it would take more than a generation to recover 'wealth'

Increased volatility

- Volatility increases because assets in different sectors, shares, real estate, are not only valued against future earning capacity, but also spill between sector.
- Increase volume and share value in late 19th century due to the introduction of futurity in the U.S. led to general re-valuation of shares (Toporowski's theory of capital asset inflation'
- Spilled soon into real-estate asset inflation, and would spill back to capital asset inflation and so on
- The result is pro-cyclical tendencies
- Regulatory measurement never took this aspect into account

Goodwill

- History goes back to 16th century
- The principle that a person's reputation has economic value was established by British courts
- The laws of goodwill were historically linked to libel laws
- Only in late 19th century the principle begins to play an important role in the American economy

First wave of M&A

- Practice in early mergers was to issue two sets of shares, preferential and common shares
- Generally, the former denominated replacement value and would have 7% cumulative interest
- The latter were seen as denominating the entrepreneurial value and were not supposed to be traded in markets
- The ‘promoters’, the banks, were paid in common shares

Laws of excess value

- Companies shares were traded in the market at excess value
- Empirical studies in late 19th century US and Britain sought to find some 'law' in the future profits valuation
- There was no such law – value is subjective
- But the excess value was described as goodwill as well

1881 United Tanners Company

- Established at value of $US 131,000,000
- Of which half in common shares
- It was about 1% U.S GNP at the time
- Generally proved a failure, although by late 1880s for short time common share were traded at high value, rose from 5$ to about $40, the original owners liquidated their holding during those months

U.S. Steel

- 1901 established with $US 1.4 bn value
- Either 6.8% of U.S. GNP or 25% of US GNP
- About half were common shares
- Carnegie got $300 million, while replacement value of his holdings were 75m
- In the books it was found that Carnegie's holding were written at 400m
- His goodwill estimated at 335M

2-4% of US GNP per year

- From 1880 about 2 to 4% US GNP worth of common shares were created annually in mergers
- The figures in the UK were nothing like the U.S but were substantial as well
- Appears that the phenomenon was seriously frowned upon in Germany and France

If I were an economist…

I might have been able to demonstrate empirically that futurity generates pro-cyclical tendencies

I am not: my argument is theoretical and speculative

I might have been able to show that what appears to be a ‘credit crisis’ or even ‘Ponzi crisis’ is at heart exaggerated pro-cyclical crisis.