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NEW ECONOMY – NO REQUIEM YET

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Until recently the new economy” was reigning supreme: there was the boom—no inflation to speak of, stocks at all time highs and beyond, four years of 4 percent plus growth, full employment, budget surpluses and a benign Federal Reserve. A new world had opened up and even the most cynical septic had to surrender to the new economy. But now everything looks a bit different. There are signs of inflation in product and labor markets and the only question now is whether the economy will slow quickly by itself or whether the Fed has to beat it into the ground, as has been the case in past expansions.

Suddenly the New Economy (NECO) does not look so cool. Hence the question, was it all hype, exaggeration or will it stand up beyond the slowdown? Yes, NECO will live on in the US and it will spread throughout the world; it will become as pervasive as the welfare state and big government did in the 30s. It will shape our economies and our lives for the next decades.

New Economy involves four interacting drivers: technology, competition, and a new economic culture for government, households and business. Investment complements these drivers. Let us review these briefly. Technology is the most obvious part: a revolution in telecommunications that is far more pervasive and more importantly spreading more rapidly than the telegraph or the telephone did in their time. There is also the information revolution with a formidable ability to create software programs that restructure dramatically tasks from accounting to ticketing, from finance to shopping to leisure. All this is far from done: in fact, just the past few years have shown the dramatic step from possibility to reality for a widening range of applications. The explosion of computing capacity introduces opportunities that simply were out of reach even of anyone’s imagination.

The second driver is competition: we have not had as much and as pervasive competition since early in the century or perhaps ever. Moreover, sharply higher competition is even becoming the rule in countries that hate it like the devil—Germany, France, Japan and more. The agents of competition are of course world trade, made more effective by technology, domestic deregulation or dismantling of the welfare state, stockholders that for the first time insist on getting their pound of flesh. Risk capital is available to anyone, not just the establishment, and there is no limit. Suddenly everybody has choice, learns fast about best opportunities and best practice. It is a short step from there to the breakdown of protected markets. It’s a rat race, but everybody, at least as a buyer, is king.

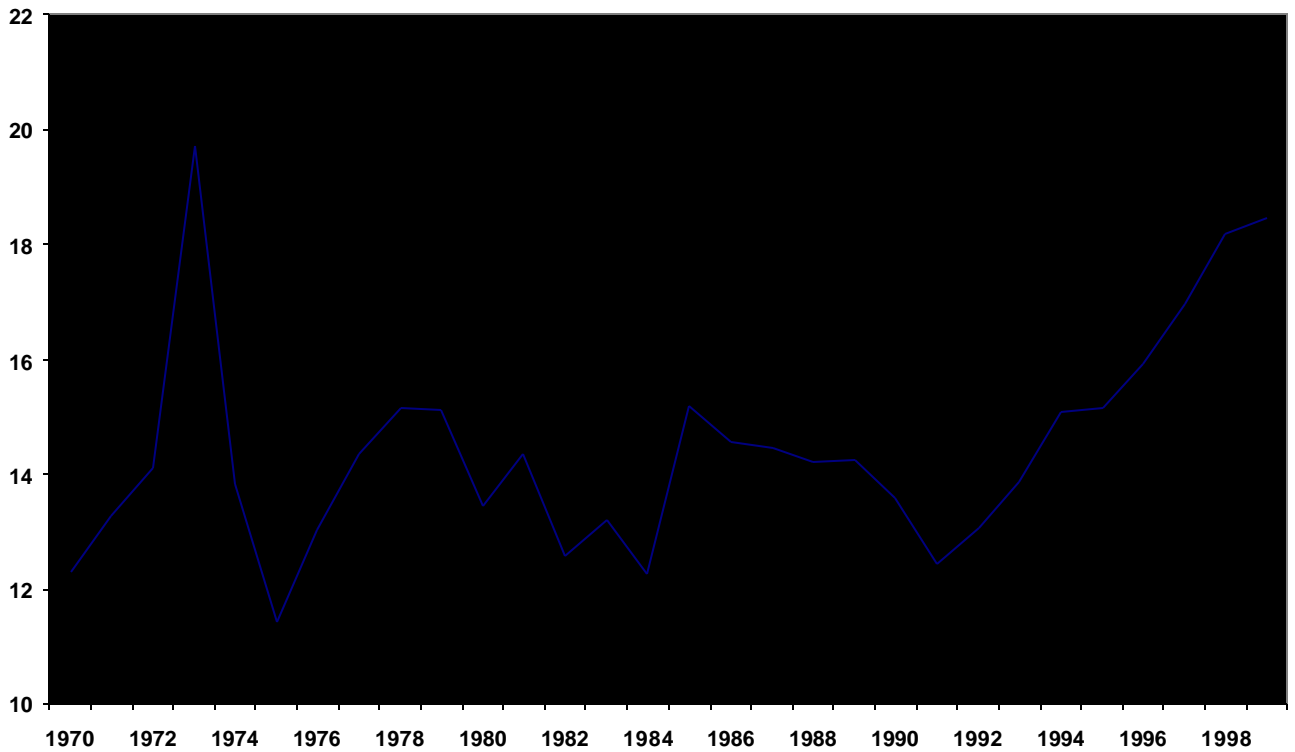
The third driver is a new economic culture. Central banks and treasuries have learnt not that stable prices and sound budgets bring an extraordinarily important contribution to prosperity. At least as important, individuals and businesses have gotten the two key messages of a world where everything is possible: “Don’t take NO for an answer!”

And “Don’t wait for the government, if you have a problem solve it.” These new attitudes fundamentally change the way the world works: middle management, the great establishment of tradition is being liquidated as is the case in every revolution, protagonists of the status quo are kicked out. Risk talking us valued rather than shunned. Young people want to be in startups, not in investment banks. The man who said it was impossible is interrupted by someone who just did it.

These NECO drivers create a formidable force for change, something Schumpeter (the beginning of the century failed Austrian finance minister at 21, bankrupt banker shortly after, and formidable Harvard economist after that) called creative destruction. He envisaged the result of a major market opening by trade or changed rules of the game, or of an important innovation. The result would be that the existing economic situation—prices, players, rules of the game—would change throughout the economy. In the process a dramatic reshuffling would greatly raise productivity as the established and tired organization of the economy breaks up. Surely there is no better example of Schumpeter’s creative destruction than what has happened in the US over the past decade. Surely too, that cannot stay a US story; indeed, it is the very proposition of creative destruction (reinforced by economic openness and technology) that it now will sweep the whole world.

Skeptics keep arguing that competition and technology wreak havoc for the established harmony in society, that it created inequality and does away with the middle class. True, NECO is tough for those who sit on their backside and live at the expense of stockholders or taxpayers, true it gives a chance to people on the sidelines. Interestingly, in the US it has meant full employment and, most recently, a sharp improvement in the economic status of the poorest. Yes, [people change jobs, yes they have to hustle, but who wants to go back to the 80s? Not the parents who see great mobility and opportunities for their kids, not the kids who have the time of their life. Three cheers for creative destruction. In the meantime, productivity growth is formidable and high rates of investment push out bottlenecks and implement the new economy.

US INVESTMENT
(% of GDP, 1996 Dollars)



All this used to be called neoliberalism and free market economics-- for many that was a derogatory connotation. Now it is "New Economy", everybody's game. It plainly has come of age. Of course, even with NECO the world is still round. It does not offer a quick way to riches, it does not double the growth rate, it does not happen to you by just breathing the air. It is hard work and its miracles are limited but real: Finland as a high tech center of the world, Germany lagging because change is trouble, Japan's slumping economy rescued by formidable technology potential, the US with an extra 5 years by pushing out the bottlenecks that typically translate expansion into inflation. Fresh juice for a world economy that does not have anymore central banks or treasuries to create false prosperity. And most important, perhaps we have even done away with the business cycle. Far too early for a requiem, NECO is just starting.

In the meantime, even with boom growth rates, as boomy growth in productivity holds the Fed on the sidelines. The show keeps going.

US PRODUCTIVITY GROWTH
(% Per Year. Source CEA)

