

The end of creative destruction?

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Even for those accustomed to reading big numbers, the size of today's stimulus programmes are eye-popping. They come as governments and central banks around the world race to support workers and businesses through the covid-19 economic crisis. In the US, the Fed has lowered interest rates to the zero lower bound and unveiled a raft of credit and liquidity facilities, while Congress has passed trillions of dollars' worth of stimulus. In Europe, the ECB has unveiled a Pandemic Emergency Purchase Plan, and even Germany has suspended its constitutional debt brake. Meanwhile, a number of countries, including the UK and Canada, have announced extensive wage subsidies from the government in order to prevent companies laying off workers.

Yet, while the desire to prevent economic ruin is a noble one, there are rising concerns that the natural process of creative destruction will be unable to work as effectively as it has in the past. If creative destruction is impeded, there are major implications for the path of productivity growth, and hence wages and living standards in the long run. While it is understandable that companies are receiving support through this turbulent period, there are a number of enterprises that would have gone under even without the pandemic. They are being artificially kept alive only thanks to drastic policy support.

This policy support goes beyond the stimulus measures we have seen enacted this year. Indeed, additional central bank support built up over the past few decades has been central to eroding creative destruction. Take the US

for example. In the immediate post-war period, the Fed operated under the Bretton Woods system, and it was then further constrained into the 1980s by the inflationary shock of the previous decade. However, once inflation came under control into the 1990s, the Fed faced far fewer obstacles when it came to supporting the economy. After all, the Fed's mandate from Congress is to promote maximum employment and stable prices. If prices are stable, then that allows it to focus increasingly on the employment goal. In turn, this means that factors such as financial market performance will play an increasing role in their decision-making. Indeed, the Fed's measures under former chairman Alan Greenspan led to the idea of the "Greenspan put", with the Fed stepping in to support financial markets when in turmoil. Simultaneously, the Fed has been forced to shoulder an increasing burden because of the ineffectiveness of fiscal policy, which has regularly worked against, rather than with, monetary policy.

The financial crisis exacerbated this problem as loose monetary policy helped companies that would not have been able to withstand interest rates at higher levels. The term 'zombie companies' even came into usage, originally in the Japanese context but since more broadly, to denote those firms being kept afloat only thanks to intervention.

Yet policy intervention is not the only reason why the rate of creative destruction has slowed in recent years. A number of Western democracies have become more oligopolistic in various ways, which is further stifling the

creative destruction process. Rising wealth inequality has seen the top end of the income distribution accumulate a rising share of the economic pie. In turn, that enables the richest to have much greater lobbying power and influence over government policy. Furthermore, in the US, there has also been increased market concentration, giving incumbent firms greater market power and excess profits.

All these factors suggest we could be heading for a world of lower growth, as companies that should fail in a free market are kept afloat only thanks to a variety of interventions.

Some may argue that, quite apart from policy intervention, lower levels of creative destruction are to be expected relative to the past. Consider that in the decades immediately after the second world war, a period often dubbed the “golden age”, rapid technological progress, coupled with helpful demographics and a relatively low capital stock, contributed to strong and sustained rates of economic growth. Furthermore, because growth was at high levels, society was more tolerant of business cycles, since a slowdown in growth was less likely to cause a full-blown recession.

There were also a number of catalysts that aided growth and disruption in the post-war period that are not easily replicable today. The first is the gain in education. In 1947, just a third of Americans aged over 25 had completed either high school or college. By 2019, that figure had climbed above 90 per cent, enabling major productivity improvements over the period. While this is undoubtedly a good thing, the substantial gains achieved means that this is not an area where the same level of progress can be made today.

Another major catalyst behind the change in many companies and the creative cycle after the war was the entry of women into the workforce. In 1948, women made up less than 30 per cent of the total US workforce. However, by the late 1970s that number had grown to over 40 per cent, and today stands at 47 per cent. This same level of growth is not available over the coming decades. Furthermore, demographics were far more favourable from a growth standpoint in the post-war period, with a much smaller share of elderly citizens in the population compared with today.

So, it seems that the risks for creative destruction are structurally worse now than in the past. Nevertheless, it is worth paying attention to a number of other factors that could give creative destruction a boost without the catalysts of past decades which have frequently involved economic malaise.

One of the most important catalysts is the pace of technological growth. While this has slowed in recent years, it is perfectly plausible that we will see this accelerate in the near term. In particular, the covid-19 crisis has increased the focus on online tools for remote working, shopping, and more. And yet businesses have a long way to go to achieve their online ambitions, and artificial intelligence is still only in its infancy. Furthermore, 5G technologies have the potential to offer transformational change, from autonomous robots to smart cities (See Konzept #16 from July 2019). Put simply, there is tremendous untapped potential.

Contrary to popular opinion, could Europe be better placed to see more competitive markets than the US in the future? The continent has made considerable moves towards open markets over the last 25 years, supported by the relatively apolitical position of EU institutions. Indeed, an ECB working paper found that concentration ratios in the Euro Area over the last decade or so “have remained broadly flat”. Of course, EU member states frequently face disagreement as each looks out for their respective interests, and populism is a growing risk. However, the threat to free and competitive markets appears low for now.

So the risks to the functioning of creative destruction could actually be more relatively skewed towards the US. The question to ask is whether the world’s biggest economy can escape a trap that will result in lower long-term productivity. If the current framework of strong intervention from the state and the central bank continues, and wealth inequality continues to rise alongside that, it is entirely plausible that there will be an increasing drift in an oligarchical direction. In fact, with hindsight we may see that the covid-19 stimulus measures only entrenched the notion that the status quo should be protected at all costs. It’s all relative of course but maybe the US is becoming more European at a time when Europe has moved more in the US’s direction.