



Paradoxes of Prosperity

Why The
New Capitalism
Benefits All

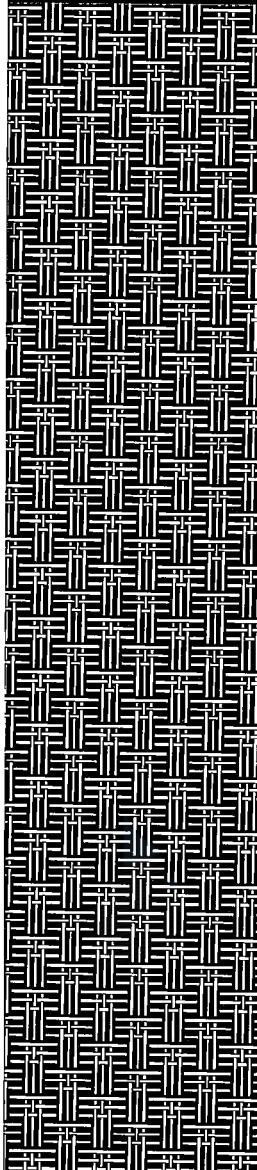
Diane Coyle

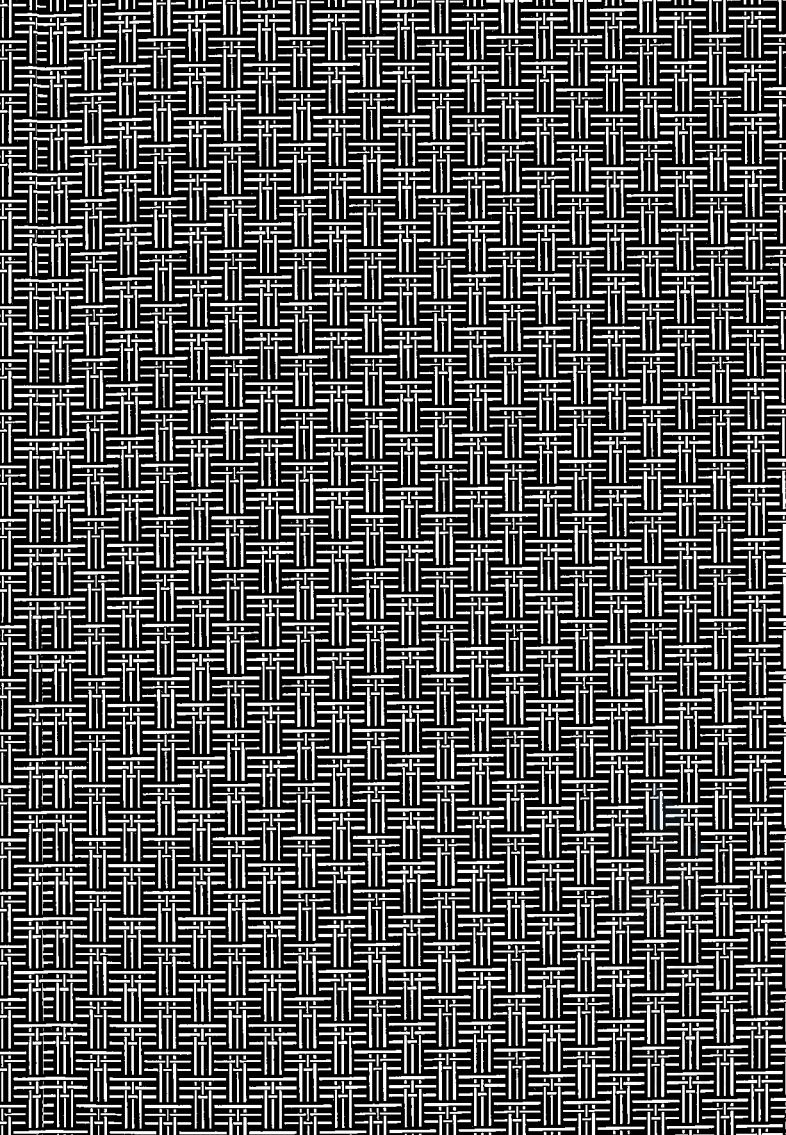
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In the New Capitalism, things aren't always what they seem. We know technology is changing capitalism. We hear about the riches of the information revolution. In theory, there is a greater opportunity for global prosperity now more than ever before.

Yet for the first time in nearly forty years activists have engaged in mass street protests against capitalism. The anti-globalization riots that started in Seattle, Washington, Melbourne, and Prague continue to gain momentum. Riots end in destruction and clouds of tear gas. There is a hunger for change: But is this really the way?

In *Paradoxes of Prosperity*, Diane Coyle, a Harvard-trained economist and award-winning columnist for *The Independent*, examines the need for worldwide change and also the folly of those who think that capitalism and globalization are the problem not the solution. Capitalism, in fact, is the *only* solution for increasing prosperity in both urban neighborhoods and in developing countries. Everything is on the brink of change: A 'new capitalism' is dawning. And there will be a revolution, but it doesn't need tear gas.





Paradoxes of *P*rosperity



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BENEFITS ALL

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Introduction

*You say you want a revolution
Well you know
We all want to change the world.*

JOHN LENNON/PAUL McCARTNEY

*I have ever been of the opinion that revolutions
are not to be evaded.*

BENJAMIN DISRAELI

Revolutionary technologies have revolutionary consequences. That is precisely why the wave of new technologies, the Internet, and genomics that developed commercially from the early 1990s triggered the hope that a New Economy was emerging, one offering the prospect of improved productivity, faster growth, and full employment. However, the dream of an economic nirvana has obscured the fact that such fundamental economic change would go hand in hand with political upheaval, as it always has in the past. The political consequences of a new technological framework, which is undermining existing power bases just as surely as the original Industrial Revolution undermined the traditional landed aristocracy, will nevertheless

become impossible to ignore. There's no halting this revolution midway.

The premise that there is something fundamentally new about the economy is still widely challenged, especially now that it has become clear that the old-fashioned business cycle is not dead after all; so the political consequences have gone pretty much unnoticed. Yet there are already plenty of signs of tension and transformation.

Capitalism and the existing political and corporate structures are under attack. For the first time in nearly forty years young people and workers have been taking part in mass street protests against capitalism, in the anti-globalization riots in Seattle, Washington, Melbourne, and Prague. Local people in countries such as India, Nigeria, and Turkey have slowed or halted projects planned by multinational companies in some of the most effective efforts so far to force executives and governments to consult those most affected by new dams or oil pipelines. Broken windows and clouds of tear gas mean it is impossible to miss the sense that there is some public appetite for change. Less dramatically, teenage computer programmers running Napster have undermined the stranglehold a multimillion-dollar industry has had over the distribution of music. In order to protect online commerce, businesses are able to use methods of encryption that even a decade ago would have been kept secret by government agencies and the military. Voters in Western democracies are quietly turning their backs on conventional party politics, and when they vote are doing so in ways that overturn conventional wisdom about what wins elections.

The desire for a changed political order is partly a result of the late 1990s boom, as affluence brings people the confidence to protest. Thus the first "paradox of prosperity": our very prosperity seems to have brought great anxiety and insecurity with it, and the sense of unease will only increase if there is a short-term economic downturn. These sentiments mean that the good news about the new technologies and the consequent economic change is too often overlooked. And it is good news, big time. Great leaps forward in technology do

translate into faster growth and big improvements in human well-being; who would really want to turn the clock back and live in 1950 or 1900? There is such a thing as economic progress, and most people's lives are getting better, not worse. The time has come to rediscover the unfashionable idea of progress.

The folly of many of the demonstrators and activists today is that they believe in the need for worldwide economic change but reject capitalism as the engine for doing so. Unfortunately, many of the critics of modern capitalism are failing to grab a once-in-a-lifetime opportunity to bring about radical political change, frittering away the chance to build a fairer and better society. They think of the underlying economic transformation now taking place as more of the same, instead of understanding its revolutionary nature. By insisting that the New Capitalism is business as usual except more so—simply more free market, more big business, the same old capitalism gone turbo or manic—they back themselves into conclusions that may well be the exact opposite of the truth and fall victim to their own myths.

For example, critics might claim that inequality in America or Britain is as bad now as it was in the late nineteenth century. This is formally true on some measures of the relative gap between rich and poor. But it is also profoundly false, because in no deprived pockets of the Western democracies are living standards as bad as they were in the 1890s. Or they conclude that growth is bad for the vast majority of citizens, that globalization is harming the poor, and that genetic technology will damage people; in fact, economic growth is what reduces mortality rates and improves health, engagement in the global economy is essential for development, and biotechnology holds out the first genuine hope for the treatment and cure of a number of terrible diseases.

The myths embraced by those critical of the current economic and political order in part reflect a long-standing fear of technological change. It's a familiar scene from a grainy old black-and-white movie seen one wet Sunday afternoon: thunder, lightning, torrential

rain, the wrath of all the elements. A glimpse of a vile half-human creature, which turns briefly with a chilling leer at its pursuers before vanishing into the turbulent night. Ever since Mary Shelley created the obsessed scientist Victor Frankenstein and his ghastly, tragic monster in 1818, we have felt uneasy about the power of technology and our potential to create inhuman intelligence. Frankenstein confesses: "It was already one in the morning; the rain pattered dismally against the panes, and my candle was nearly burnt out, when, by the glimmer of the half extinguished light, I saw the dull yellow eye of the creature open. . . . Now that I had finished, the beauty of my dream vanished, and breathless horror and disgust filled my heart." The literary tradition of techno-phobia has continued unbroken, even amongst enthusiasts. Isaac Asimov devised rules that forbade the construction of robots that might harm their creators. Arthur C. Clarke created HAL, the monstrous plotting computer, in his novel *2001*. Robocop gets out of hand. And so on. Such creations crystallize a deep-seated fear that technology teeters on the edge of our control.

The gothic tradition, and its cyberpunk incarnation, is a far cry from the alternative, breathlessly optimistic approach to today's new technologies. Whether it's sequencing the human genome, the latest teeny brushed-silver MP3 player or digital camera, or the remote future prospects for teleportation, technophiles are relentlessly chirpy about the possibilities. And it is this cheery approach that has characterized much comment on the New Capitalism. But the monsters are creeping back out of the shadows. The "tech wreck" on the world's stock markets when share prices in high-tech companies started plummeting from their unprecedented peaks in the spring of 2000, and the subsequent downturn in the economic cycle after a decade-long American boom that had come to feel like normality, would be enough in themselves to raise some doubts about any shiny new high-tech future. But these events have also opened the way to posing deeper questions about the underlying economic trends, just as the 1997-98 financial market crisis gave rise to the anti-globalization protest movement.

When the Internet boom was in full swing, it was hard to dent the dominant mood of euphoria. Frequent warnings about stock market bubbles being bound to burst were swamped by the sheer enthusiasm of investors, of new entrepreneurs, of media commentators and market pundits. For a full twelve months the sun shone perpetually in America, the Millennium Bug stayed away from the New Year 2000 celebrations, share prices rose and rose, sparkling productivity gains were chalked up, jobs were plentiful, and consumers indulged in an orgy of spending.

At the same time, though, a growing number of people started feeling deep unease with the unprecedented prosperity, a sentiment voiced by many commentators. There are dozens of recent books critical of modern capitalism. Richard Sennett wrote: "Our affluence in its present form is becoming an intolerable weight to those who supposedly enjoy it." Marshall Berman argued there was an abundance of critical ideas and added: "Maybe only violent economic collapse will shake Americans out of their narcolepsy. This would put the left in the creepy position (where it has been before) of longing for horrible catastrophe. On the other hand, it may be, as it was forty years ago, that it will create imaginative space where people can begin to think about a better life than this."

He wrote that comment when Internet fever was at its height, the long U.S. economic boom just starting to lose steam. The uneasy transition to more awkward and anxious times does not mean, however, that the New Economy was a brief collective hallucination. This book argues that the economy is indeed changing in a fundamental way, and that society and politics are changing with it. It will, beyond the downs and ups of the business cycle, lay the foundations for huge increases in our future prosperity and transformations of our way of life, like earlier waves of technology-based growth. Just as earlier generations saw electric light, antibiotics, the automobile bring unimaginable changes to their way of life, we and our children will live through an extraordinary transformation.

Building on those basic foundations will depend on understand-

ing the links between technology, economy, and society; on using them to overturn vested interests in order to redistribute power and wealth; and on recognizing the radical potential today's new technologies contain. For they depend on a resource we are all blessed with: humanity. Economic success in the future will depend not on scarce land, nor on capital, which is now if anything in overabundant supply, but instead on intelligence, creativity, empathy, and other characteristics economists describe as "human capital." What sort of distribution of power this will actually deliver in the societies of tomorrow is still open to question. Industrial revolutions are not revolutionary by chance, but rather only because innovations are put to revolutionary uses, and these are as much political and social as economic.

Left-wing intellectuals are mostly still very hostile to the notion that free-market capitalism can be good. Many prefer the social market variety that can be found in Germany or Japan to the untrammled English and American version. But as Ronald Dore noted in his book exploring the contrasts between the two versions, the latter is certainly driving out the former, the scope of markets is expanding (unfortunately, in his view) at the expense of institutions like the works council or the business combine. He adds, regretfully: "And outcomes are not just in the hands of elite decision makers. People are voting with their feet." This is hardly surprising. The Japanese economy has remained stagnant for a full decade. Germany has an unemployment rate that had barely fallen below double digits after three years of growth. Although it is a commonplace amongst some critics of "turbo-capitalism" that countries like Japan and Germany have a more successful industrial policy toward their traditional manufacturing industries, both the UK and the United States had slightly expanded the number of jobs in manufacturing between 1992 and 1999 despite increasing imports of goods from overseas—whereas Japan and the social market economies in Continental Europe lost 15–20 percent of their workforce in manufacturing.

Conventional rhetoric cannot hide such dismal realities. Nobody

in their right mind would claim any country has yet built the New Jerusalem, but certainly the countries that offer the most extreme examples of bureaucratic management of the economy are in trouble, and their governments and voters know it. Since the dusk of the Cold War and the dawn of the Internet, there has been only one game in town.

It's New, But Is It True?

But to begin at the beginning, the first question that must be addressed is whether the formerly overhyped and currently underplayed New Economy really exists. The vagueness of the term doesn't help. I take the New Economy to mean a lot more than the stock market bubble and the "new paradigm" whereby shares in high-tech companies were believed, for a while anyway, to justify valuations vastly in excess of past levels. This is a contrast to some authors who have concentrated on the stock market phenomenon and, not surprisingly, tend to be skeptics about whether anything fundamental in the world has changed. The lesson of past investment booms is that unusually high profits, which might justify valuations higher than previously experienced, almost always get competed away. The great beauty of competitive markets is that consumers are the ultimate beneficiary of innovation and growth. The share of national output going to profits, and hence company shareholders, has been relatively stable over long periods.

Instead of concentrating on the high-tech bubble, the first chapter of this book looks in detail at the empirical research on patterns of growth and how recent developments compare with very long-term trends. In a nutshell, there is convincing evidence that the long American boom marked a genuine departure from the dismal growth and productivity performance that characterized the mid-1970s to mid-1990s. In the sense that potential output could grow faster than it had in the recent past, the U.S. economy had returned to an earlier golden age. However sharp the current downturn

proves to be, the long boom will remain exceptional. And if this economic slowdown is less severe than past ones, despite the possibility of tumult in financial markets, that will be exceptional too. Outside the United States, there is as yet little evidence of a departure from past patterns in the other developed economies. The American experience has been exceptional, although there is no reason to believe that exceptionalism is inevitable.

The reason for that is spelled out in the second chapter, which looks at the possible causes of the American boom in the “general purpose” nature of technologies like the microprocessor and in the wave of new innovations aside from computers and the Internet. The main impact of this great wave is to make the economy increasingly weightless. As my previous book, *The Weightless World*, showed, the creation of value in modern economies depends on the immaterial qualities of physical goods, such as design, creativity, and marketing, and on the quality of service. While we still want more physical things, we do not value them for the metal or plastic but for weightless characteristics that are embodied in the stuff.

Making the adjustment from a heavy industrial age economy to a weightless information age one requires a lot more than the invention of some new technologies. These have to be implemented by investment in new equipment, the reorganization of companies and work, and complementary investment in new infrastructure, training, legal frameworks, and so on. In short, it is misleading to think of general-purpose technologies as new gizmos. Rather, they are an entire system. The electrification of the economy involved investment in power stations and power lines, new transmission mechanisms in the factories and in turn new factories, electric lightbulbs and appliances, new technical skills in the workforce, including universal basic literacy, and so on. The economic potential of the internal combustion engine was not realized until there was a road network and logistical system.

It is in fact extremely easy to see why a technology that obviously

has very wide applications does not make any apparent difference to economic growth for a very long time. It might even impose large transitional costs before it starts contributing to the economy. The so-called "productivity paradox," summed up by Robert Solow as "You can see evidence of the computer revolution everywhere apart from the productivity figures," is relatively easily explained. A growing body of economic research focuses on the adjustments being made by individual companies in order to exploit computer and communications technologies. Outside the United States, though, little of the needed complementary investment is yet in place.

The absence of any clear evidence of a changed economy elsewhere makes interpretation of globalization and the New Capitalism seem a question of passing judgment on the American model. Although this will not last, it is a complication. For fear and loathing of the American model is a habit clouding many radicals' judgment. If it is happening in the United States and boosting corporate profits, it must be bad, is the reflex. Even without any real alternatives, since the collapse of Communism in 1989, the long-standing suspicion of capitalism remains. Surely, surely it must carry the seeds of its own destruction?

There are certainly internal contradictions. The middle section of this book looks at a number of paradoxes in the changes now taking place. The paradoxes help explain why well-meaning people are getting into a muddle about what it will take to make the world a better place. For the New Economy contains seeds that could germinate into a fairer and more prosperous society. It will do so by making it possible to usurp established elites, to by-pass corrupt or simply incompetent governments, and to take advantage of new opportunities. Anti-globalization campaigners fail completely to understand the radical possibilities of capitalism. Yet there is no better time to exploit them for the benefit of this world's have-nots than now, a time when capitalism has triumphed. This is the best of times to ensure it delivers what it promises. The most basic promise is that high technology makes people more, not less, important. In an age

of increasingly intelligent machines it is human skills that are in short supply. Moreover, the specifics of history and place matter more than ever in the modern global economy, how we got here and where here is. The high-tech economy is a high-trust economy. It is based on the exchange of ideas, on reputations, on personal qualities. For markets do not exist in a vacuum, and a free-market economy is not some kind of abstract force. On the contrary, the more marketized the economy, the more important the social framework and institutions that support the markets.

There are two compelling reasons why twenty-first-century capitalism, the “New Capitalism,” could be fairer than its twentieth-century beta version, and they stem from the nature of the technologies that are underpinning future prosperity, which depend on the exchange of ideas. That means people engaging with other people.

The first reason is that diversity has a big economic payoff when growth is based on complex problem solving and innovation. People who all think alike, no matter how brilliant and educated they are, will solve problems or generate ideas less easily than people who are different. As established economic elites are self-selecting and all think alike, this opens the door to newcomers—as we have seen over and over again in the computer industry. What happened there first will spread economy-wide.

A second, crucial point is that the more complex the technological basis of the economy, the more complicated and subtle the society needed to operate it. The weightless economy requires a stronger social infrastructure than ever to work well. Countries will need to build their social capital to grow. They will need to be fairer places with an even more highly educated workforce. They will have to have vigorous legal and political institutions. Healthy economies do not exist where social capital has been depleted by war, or bad government or extreme inequality and poverty or widespread corruption.

It used to be possible to imagine that economic growth could occur in authoritarian countries. This was a presumption of the “Asian model,” whereby a number of Southeast Asian countries

achieved economic modernization without a transition to democracy, at least as understood in the West. Some commentators argued economic development was actually easier without having to worry about voters or unions. This is no longer true. It is not going to be possible to build a vigorous modern economy without building a fair society. That poses as great a challenge to the Western democracies as to countries still aspiring to join their club.

The final section of the book looks at some of the implications of this argument, particularly for today's elites. For them, it is not good news. Like the courtiers of the Sun King, officials, politicians, and corporate executives are oblivious to the sound of the tumbrils rattling toward them over the cobbles. The centralized, bureaucratic economy in place since the 1920s is as corrupt as any ancient regime and on its way to the guillotine.

