

Press Release

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What happened to the “new economy”?

Governor Urban Bäckström spoke on Saturday at the 5th ACI Nordic Congress in Gothenburg on the topic of “What happened to the new economy?”

“Perhaps it is not so surprising that we now hear less and less about the “new economy” than we did a couple of years ago. Considering how rapidly and extensively prices have fallen on the stock market in general and for IT and telecom shares in particular, one could be inclined to the view that all the talk about the third industrial revolution really came to something of a dead end.

However, putting today’s development in an historical perspective, the conclusion that seems to emerge is that the present difficulties are temporary and corrections like this have been at work before in history. The financial and economic conditions of today can, to my mind, be seen as a correction of excessively optimistic expectations that came in the wake of what was labelled a new economy. Three years ago investors were willing to believe anything, now they are prepared to question almost everything. During boom times things do not always turn out as well as people often hope, but neither are they ever as bad in bust times as we human beings sometimes fear. After all, today’s difficulties say very little about the longer-run potential for a major technological breakthrough and its positive implications on our respective economies.

Although the present adjustment process can take time and be painful for many of the new companies and should not be underestimated, it is important that we don’t overlook the broader picture. Over the last fifty years the number of computers in the world has grown from a few thousand to several hundred million today. At the same time, their data processing capacity has increased by almost 60 per cent per year. The price of computers has fallen by around 20 per cent a year over a long period of time. In literal terms, that means that a computer which costs 10,000 kronor today would have cost almost 50 million kronor in the early 1960s.

Gordon Moore, one of the founders of Intel, noted some decades ago that, thanks to advances in the production of semiconductors, the data capacity of a single chip could be doubled every 18 months. This observation, which came to be known as Moore’s law, still holds. What is perhaps even more relevant is that there does not seem to be any reason why Moore’s law should not continue to be valid a good way

SVERIGES RIKSBANK

Telephone
+46 8 787 00 00

Fax
+46 8 21 05 31

E-mail
registratorn@riksbank.se

Internet
<http://www.riksbank.se>

into the future. This means in turn, if it proves true, that computer manufacturers will continue to show a rapid improvement in productivity for a good time to come.

And once the present adjustment period is over and demand for the new technology starts picking up again, production will become successively larger and make a growing contribution to GDP. If an economic sector expands rapidly and also achieves high productivity growth, it will over time generate an acceleration of the total economy's average productivity growth. Put differently, as the expanding sector weighs increasingly heavily in the measurement of total productivity, defined as GDP per hour worked, this will, all else being equal, raise marginal and average productivity. In time, moreover, as the new technology is introduced in various ways in other parts of the economy, productivity growth will also pick up there. So it is not just the production of computers that becomes more efficient; computer applications in other fields heighten the efficiency of processes there as well. The effects spread throughout the economy.

This kind of acceleration of productivity growth has so far only happened in the United States during the 1990s. Many observers have been puzzled over why the same development has not also been seen outside the US. Maybe the most convincing explanation is that the spread of technological breakthroughs takes time. The effects of the new technology will occur gradually in various parts of society as growing incentives to apply them in various economic activities present themselves. Ten years ago, there were very few commentators and analysts in the US who believed in the possibility of large macroeconomic impacts, and yet the acceleration in productivity during the second half of the 1990s has been impressive.

Our Swedish history clearly shows that the combination of major technical breakthroughs and a sizeable relative price fall can lay the foundation for outstanding economic growth, but the road there is often crooked and full of obstacles to be overcome. Few innovations played such a central part in Sweden's industrialisation around the turn of the nineteenth century as electricity and techniques for using it for propulsion. Swedish technicians and companies played a pioneering role here. A fall in relative prices paved the way for the electrification and related expansion of such industries as pulp, paper, mining and basic chemicals. In connection with electrification, trend GDP growth accelerated from approximately 2 per cent a year to between 3 and 4 per cent. Economic growth in Sweden reached one of the highest rates in the world during a number of years.

In the first decade of the twentieth century, however, the optimism over all that the new technology could achieve became rather excessive. The euphoria regarding the huge profits that could be achieved by using hydroelectric power and other forms of electricity to exploit such natural resources as ore and timber became more and more aggressive between 1905 and 1907. There was a correction in the stock market and during the economic downturn in 1907 many companies ran into trouble.

But no two economic downturns or setbacks are the same. What we are now experiencing differs in many respects. The point I want to drive home by drawing parallels with what happened in the early twentieth century is that periods of

"growing pains" have occurred before. Even if new technology has a large potential, the optimism it generates can be excessive for a time and later has to be corrected. That has happened before and it happened again in the late 1990s. But I am fundamentally optimistic about what the new technology can achieve in time for economic growth and prosperity in the world economy. Sooner or later after a correction, activity picks up again and new business opportunities are identified in the wake of the new technology", concluded Urban Bäckström.