The *New* Economy?

The New Economy (NE) is one of those expressions people use, sometimes not thinking about its wider meaning. There have been other NEs over the centuries; the NE is not just today's information and communications technology (ICT) and biotech firms, but also yesterday's heavy industrial businesses – that first allowed mass production and made possible changes towards a Social Security system and consumer credit –, plus before yesterday's ventures, representing deep structural changes.
But it is true that nowadays Economy is strongly driven by what computers and communications technologies can deliver, and it is nice to think of our time as a golden age. In fact, for example, the Internet did reduce Planet Earth to pixels in a web browser, and mobile phones do have more computing power than the machines that computed Apollo XI's travel to the Moon... meaning that the current pace of innovation and the processing power available to the end-user are without precedent!

DeLong and Summers' paper on the New Economy, tackles with four questions: (1) in the long run, how important will the ongoing technological revolutions in data processing and communications be?, (2) what does the NASDAQ crash tell us about the future of the NE?, (3) how should the Government handle the NE, in order to maximize public benefits; and (4) what is the real impact of 911's terrorist attack?

While trying to answer these defying questions, one actually faces new interrogations. We have all the reasons to believe that ICT will keep having a key role in the shape of tomorrow's world (1), but I think that the NASDAQ is – unfortunately – far from alone in what comes to crashes (2)... In fact, I think that the few ICT firms that weren't tremendously overrated in the late 1990s, are today's better performers. For example, Amazon and Ebay are now (2003-03-07) worth, respectively, 23 USD and 79 USD per share, comparing to roughly half (!) of that, two years ago. Comparing this to supposedly more safe investments on Coca-Cola and McDonalds, we notice a present stock value of, respectively, 37 USD and 13 USD per share, versus roughly twice of that (!), the same two years ago. So what exactly is the NASDAQ crash?! From these examples, the Dow Jones seems to have crashed harder.
In my opinion, the picture has become clearer in 2003: there is a global crash, not an ICT specific crash. Nevertheless, due to its nature, high technology products give ahead signaling of bumps on the [Economy] road. These products «live fast and die young», meaning that they become obsolete in ever shorter periods of time, when their price collapses from a level where only early adopters would go, to a level where ideally everybody could go.

One of the fundamental characteristics of the NE, is the central role of knowledge. Knowledge builds on knowledge and delivers higher and higher level products that can have, or not, physical expression. For example, music

on CDROM has physical expression, but the same software streamed over the Internet doesn't (unless if completely buffered to some device)... yet it shouldn't be less valuable because of that.
Controlling these ethereal products, with strong public goods attributes, is a challenge to governments (3), since they must balance the incentives to production – such as patents and Copyright – with the public benefits that can, in some cases, happen from diffusion.

What the future holds is a mystery (4), but stagnation on the demand for ICT and biotechnology (BT) sectors, should only happen if uncertainty reigns and no firm steps happen on the war against terrorism. If peace is firmly achieved, business should resume as normal (fast paced innovation driven Economy!); but if war persists, the Government should act as a client for ICT and BT firms, thus keeping demand at a reasonable level.

What the NE is telling the markets is not to expect quasi-rents, but decreasing margins of profit. It happens that technological progress pressures for competition and it is very hard for one firm to hold a profitable position for long.
Considering that knowledge intensive goods have its costs concentrated on the production of the first unit (fixed costs) and near zero (variable) costs for the remaining units, namely if using distribution channels like the Internet, then we can think of viable businesses on the New Economy like monopolies... but not durable ones.

This way, the NE doesn't play the negative feedback game of the «old economy» (OE), where the more the demand, the higher the price, then – by reaction – the lesser the demand, thus being achievable a competitive equilibrium.

The NE depends on economies of scale on the supply side and on economies of scope on the demand side. For example, the Windows XP operating system is such an expensive product that no consumer alone could pay its fair price, so it needs to be sold or installed by the millions, to make it worth the investment. But even that isn't enough anymore, even for a Corporation the size of Microsoft. Microsoft is now spreading the XP platform to several hardware contexts, like PDAs (Pocket PC 2002), Tablet PCs (Tablet XP), and even mobile phones.

For the stockholders, it may get harder to pick the good stocks, but for the consumers, the NE seems very positive. The only gray clouds on the sky seem to be terrorism and remembering that after the 1920s, when the world assisted to a comparable productivity growth, came the 1930s... the great depression of the 1930s. I hope not.