

TIGER
TRANSFORMATION, INTEGRATION and GLOBALIZATION ECONOMIC
RESEARCH
CENTRUM BADAWCZE TRANSFORMACJI, INTEGRACJI I GLOBALIZACJI
TIGER Working Paper Series

No. 148

A LOOK AT COVID-19 RECESSION THROUGH SCHUMPTERARIAN
“CREATIVE DESTRUCTION” FORCES

Malgorzata Runiewicz-Wardyn

Warsaw, November 2022

Malgorzata Runiewicz-Wardyn

The following interview-based essay presents the author's interview discussion with the economist Peter C. Earle – researcher and writer affiliated with the American Institute for Economic Research (AIER) in Great Barrington, Massachusetts. His research focuses on financial markets, monetary policy, problems in economic measurement. He is also the author and editor of series of articles and books devoted to the effects of the Covid-19 pandemic on the US economy. The author has been a visiting fellow at the AIER in August 2022. Her research subject aimed to explore COVID-19 related "creative destruction" processes in the US and EU economies.

In the words of Joseph A. Schumpeter (1934, p. 16) “depressions are not simply evils, which we might attempt to suppress, but [rather] forms of something which has to be done“ – namely adjustment to change. Change, forced upon us by the process of “creative destruction” occurs through the new innovations and new ways of doing things. Furthermore, creative destruction leads to “the reallocation of factors of production from contracting production unities” to expanding ones, destroying the old economic structures and replacing them with new ones (Schumpeter, 1954, p. 944-1135).

Although Schumpeter's ideas were not expressed in the formal mathematical models of modern economic theory, many leading theorists like Philip Aghion and Peter Howitt (2005; 1992) have included his ideas in models of endogenous growth. The Schumpeterian “creative destruction” growth theory is an attempt to treat the long-term economic growth as an organic, evolutionary and dynamic process.

M.R.W. In his paper “Depressions: Can we learn from past experience?” Joseph A. Schumpeter writes “depressions are not simply evils, which we might attempt to suppress, but (rather) something (that) has to be done, namely, adjustment to ... change” (1934, p. 16). In this sense he also contradicted the classic economic theory assumptions, which largely ignored change, uncertainty and disequilibrium. Instead, he emphasized that “change” builds the conditions for “creative destruction” processes.

We have seen across the globe that recent COVID-19 pandemic became a catalyst for a change in the industries. It also gave unexpected stimulus for innovation development, new wave of entrepreneurship, and radical changes in labor markets. To what extent and in what areas has the pandemic influenced the processes of Schumpeterian “creative destruction”, and where was it a waste of innovative and technological potential?

P.C.E. First, we need to distinguish between two shocks. There was an exogenous shock, which was the pandemic – the spread of the SAR-Cov-2 virus that causes COVID-19. And then there was an endogenous shock, which were the policy measures adopted by governments to mitigate the spread of the virus, largely unsuccessfully.

By far, the more impactful were the government measures – lockdowns, stay-at-home orders, mandatory masking, and the like. Those, to me, were far more influential in creating the conditions for episodes of Schumpeterian “creative destruction”, than the virus alone was.

Most innovations, which arose during the pandemic, and will continue to be productive after the pandemic, may meet the criteria of Schumpeterian “creative destruction”. However, those of them which came about to deal with pandemic policies and will not be necessary, after the pandemic policies were lifted, were probably just a waste. I’ll give two examples. Many businesses learned that zoom meetings and employees working remotely, from home, was not the horror story. They thought it would be employees got their work done, were just as productive (if not more so), and the costs of offices, of subsidizing commutes, and of travel, etc., became lower expenditures and possibly savings. If many of those firms continue to operate on a fully or partially remote basis after the pandemic, one could argue that the savings they generate may finance or fund new and better products. So, one could argue that the paradigm of sitting in an office, and in term the need to hire employees within some physical proximity, or within a particular time zone, and so on was creatively destroyed – to some extent. That’s great for employees, good for consumers,

good for firms, and not good for commercial real estate owners, office furniture makers, etc.

Now consider the plexiglass barriers which were made and ordered for hundreds of thousands of office locations during the early part of the pandemic. Were they necessary? I don't think so, but some people do. An argument could be made that they increased the confidence of consumers who otherwise would not have gone out shopping. But not long after the lockdowns ended, for the most part, they were removed. Sure, some retail locations still have them up, but at this point – now that the vaccine is out there - they're mostly gone. I would say that represents sheer waste.

What would that Plexiglas have been used for otherwise? We don't and can't know, fully, but we do know that at the same time as plastic barriers were being made in 2020 there were plastic shortages which negatively affected the ability to package personal protective gear like gloves and masks. It reminds somewhat of Bastiat's adage regarding the "seen and unseen." Were those plastic shields at check-out counters the best use for that plastic? We can't know, but we do know that there were shortages elsewhere when they were being made. We also know that right now, most of those barriers are stacked in the corners of warehouses gathering dust.

M.R.W. In his best-known work "Capitalism, Socialism and Democracy" Schumpeter stressed "(...) the opening of new markets, foreign or domestic, the organizational development from craft shop to factory incessantly revolutionizes the economic structure from within, incessantly destroying the old one (...) and creating a new one". How did the pandemic affect the processes of globalization, computerization, and networking?

P.C. E. This is too massive a question to answer in a few minutes, but one particular aspect of the pandemic – and to be clear, I mean pandemic policies, not the spread of the virus – is clear. The degree of interconnectedness of the world was driven home by the effects of treating the US economy, and really the economy of the entire world, like a lightbulb. An economy cannot be shut off and turned back on at will like a television or a lawnmower. Part of the decision to enact such policies was rooted in expedience, and part of it was undoubtedly politically motivated. But I would add that the effect of years of heavy econometrics in graduate schools, teaching that economies are like massive machines with fixed moving parts and readily replaceable gears and cogs was revealed. And it is my hope that the realization that economies are more like organic beings than machines or engines will be a lasting one. I'm talking here specifically about the shipping crisis, aspects of

which I covered in two articles: “An Armor Conspired: the Global Shipping Freeze” and “Stuck in Neutral: Trucking and the Pandemic.” Port delays, shortages of resources, unemployment, and a variety of other effects are still with us. Not only are the results of those government initiatives continuing to impact our daily lives, but there are two other factors: those pandemic policies probably didn’t work much to slow the spread of the virus, and they are the opposite of what should happen in an emergency. During disasters, we want goods and services being created and flowing nationally and internationally at speeds that at least equal, if not exceed, normal times. The idea that during a crisis resources, skills, and human knowledge should be suppressed and isolated is so stupid as to border on criminal negligence.

M.R.W. “Creative destruction” occurs through the innovations, which can mean “doing of new things or the doing of things that are already being done in a new way (...)” (Schumpeter, 1947, p. 157) . To which extent the creative technological destruction introduced during the pandemic has evolutionary or revolutionary character? Has the pandemic become a catalyst for new innovations of great importance for long-term economic growth?

Well, the effect of true instances of creative destruction are difficult to predict, so it’s difficult to prepare for them. Additionally, any method of “easing” the disruption caused by creative destruction could easily prevent the arrival of those innovations, which is something we shouldn’t want to do. So again, I hasten to say that the virus resulted in essentially little or no innovations, but the government policies did. Some of those manifest as creative destruction, but many are a simply a policy-driven misallocation of resources. It’s also important at this point to distinguish between Schumpeterian innovations, which is to say the gale of “creative destruction”, and Kirznerian innovations.

They really represent two different types of innovation. The former involves disruption, usually fostered by exogenous forces which have an ultimately disequilibrating effect, whereas the Kirznerian variety tend to be changes which are less innovative, make up for former shortages or errors, and serve to equilibrate. As I mentioned before, I think the improvement, both in terms of quality and competition, that has resulted in the video networking space has resulted in greater productivity and serves as a sort of insurance policy against frankly awful political decisions in the future. We could say the same about telemedicine, which seems to have really taken off over the last two years. You no longer must go to a doctor’s office, sit in a waiting room, and all that. It’s much quicker and easier

now to get medical attention – with exceptions of course. In a few places, robotic and drone deliveries of goods were experimented with, accelerated by the lockdowns. That may indeed pay efficiency and productivity dividends in the future.

Now, some of what are being called innovations are innovative, but they are not emblematic of the Schumpeterian dynamic. Some examples of those are alcohol “to go” cups, the increased availability of food pick-up services, and so on. None of those are particularly groundbreaking, and they make certain services more efficient, but they’re not really earth shattering. They don’t represent a paradigm shift.

In a long-run, COVID-19 pandemic has accelerated the application of certain technologies, which reveal labor market opportunities and risks or possibly can take certain jobs completely out of the market. Think of the automation. It can easily substitute for tasks previously performed by labor, e.g., in food retail. Especially, the low-income jobs, intensive in manual and routine cognitive tasks will be negatively impacted by automation. It is obvious that many organized labor groups advocate for a slower introduction of the machines. Technology tends to shift employment from unskilled to skilled labor. The pandemic has intensified the skill-biased technological change.

M.R.W. For Schumpeter the economy in a depression moves away from equilibrium and opens up the possibility of so called “abnormal liquidation”, or inevitable closures and job losses (1939, p. 149). Who is the winner and loser of the pandemic triggered “creative destruction processes”?

P.E. Pandemic disproportionately affected small businesses and exacerbated existing income inequalities in the U.S. Large companies and tech giants have won and are getting more powerful (e.g. Apple, Amazon, etc.). Almost all small business that rely on people being in proximity (hair salons, restaurants, etc.) had closed for some period in the first weeks of the pandemic. Pandemic has exposed deep-rooted labor market structural inequalities, with low-paid workers, young people, women, and above all, what I call “laptop vs. non-laptop” labor. The first group include people who were able to work remotely and maintain their employment with relatively little personal risk to their health, whereas the second one includes those, who could not work remotely, faced financial difficulties and exposure to health risks. This created risk to the increasing social divide. One vulnerable group of labor is single mothers, who were forced to leave active work and shift into either paid or unpaid leave. By 2021, women had the lowest level of workforce

participation since the 1980s. That was destruction and a waste of human and economic potential.

M.R. W. The U.S. government offered extended stimulus package as a part of so called American Rescue Plan, which includes unemployment compensations, small business grants, tax cuts, etc. How do you evaluate the US government policy steps in responding to the pandemic related labor market challenges? Did it and which ways it contribute to ease “creative destruction” processes?

P.C.E. It was disastrous and created a distinction between the “laptop class” and everybody else. Sending the people with the least job security and the lowest pay home indefinitely damaged families, communities, and made their futures less secure. And, as I have mentioned, those policies pushed lots of knowledge out of the workforce via widespread early retirements and smashed women’s representation in the U.S. job market back to levels not seen since the 1980s.

The fiscal stimulus packages paved the way for the terrible labor market we see today, including accelerated retirement (and thus the loss of much workplace knowledge) and the widespread exit of women from the workplace. Perhaps we will find out some years from now that someone who received stimulus payments built a world-changing business that radically changes the business landscape. Other than that, and as of right now, it’s clear that the monetary and fiscal programs of two years ago created huge misallocations of goods, increased poverty, and probably set global growth back a few years.

As the U.S. economy begins to recover from the COVID-19 pandemic one of the potential policy discussions is whether the government should increase the minimum wage, which I think would worsen the effects of inflation, hurt labor, and make the introduction of labor-saving technology more painful in time. Increasing minimum wage will lead to higher prices/ (as it would increase the cost of employing low-wage workers) possibly worsening the effects of inflation and will not mitigate of painful creative destruction process in labor markets. While changes are needed to help incomes keep pace with increasing costs of living, the discussion over increasing the minimum wage should focus on controlling inflation, which damages the purchasing power of consumers. Especially in the last year when general price level has risen more than it has in 40 years. Some other policy measures were equally inadequate and inefficient.

M.R.W. According to the economic philosophy of Joseph A. Schumpeter “creative destruction” is the basis for innovation and inevitable process driving entrepreneurial growth and prosperity. What further policy response is the most necessary to drive and ease the “creative destruction” processes in the U.S. economy?

P.C.E. The government policy response to the COVID-19 virus introduced an existential risk to entrepreneurs that never existed before: the risk that, at some random time in the future, the emergence of a virus or bacteria could be met with a government-imposed, overnight economic depression. Knowing of that possibility, many people who would have started a business never will now, and many existing businesses will not expand as quickly or in the same way as they would have before they knew of this possibility. Small business is the cauldron of new job creation, so this is a serious effect. We’ll never know what the economic growth path might have been without this new precedent, but hopefully entrepreneurial memories are short (or diminish after a generation or two). I think the best policy for ensuring that major changes in employment and the repurposing of capital can be undertaken as swiftly and painlessly as possible is to remove, as much as possible, barriers to employment and regulatory fetters that hinder acquisitions, mergers, and other such major corporate events. Lower or eliminate taxes, fees, licensure requirements, and the like that only serve to make the movement of capital, skills, and prices difficult or “sticky.” Markets, permitted to function as freely as possible, will make the major shifts from one technology or innovation to the next as efficient as possible. It will never be seamless or painless, but by letting prices and markets operate to their fullest extent the process of liquidating the old and building the new can be streamlined and sped up appreciably. The realization of Schumpeter’s gale of creative destruction is often painful in the short term, so best to have it hit all at once and get it over with rather than, by trying to suppress it, making it last longer and become more agonizing than necessary.

M.R.W. Thank you very much for giving me the opportunity to discuss and share your observations, views and research findings.

References:

Aghion P., Howitt, P. (1992). *A Model of Growth through Creative Destruction*

Econometrica, vol. 60, issue 2, 323-51

(ed.) Earle P.C. (2020). Coronavirus and Human Rights, AIER

(ed.) Earle P.C. (2020). Coronavirus and Disease Modelling, AIER

(ed.) Earle P.C. (2020). Coronavirus and Economic Recovery, AIER

(ed.) Earle P.C. (2020). Coronavirus and New Hope, AIER

(ed.) Earle P.C. (2020). Coronavirus and Economic Crisis, AIER

Schumpeter, J.A. (1954). *History of Economic Analysis*. Allen and Unwin, London.

Schumpeter, J. A. (1934). *The theory of economic development*. Cambridge, MA: Harvard University Press.

Schumpeter, J. (1942). *Capitalism, socialism and democracy*. New York, NY: Harper & Row.