

The Economy in Perspective

Plus ça change, plus c'est la même chose. (The more things change, the more they remain the same.)...Last month, the Boise Corporation announced its intention to acquire OfficeMax, an office supply company based in Cleveland. Quite apart from its local significance, the announcement's national significance lies in Boise's acknowledgment that the acquisition is an important step in the company's transformation from a producer of lumber and paper products to a supplier of paper and office solutions products.

Last month, the Kodak Corporation announced its intention to acquire PracticeWorks, a business that provides dental management software and imaging services. Kodak began its corporate life as a manufacturer of photographic film and cameras. Increasingly, however, the company's business model recognizes the growth of digital photography and imaging, so it seeks opportunities to develop services and products that use digital imagery rather than photographic film.

Last year, IBM announced that it had established a new division to sell engineering and technology consulting services to clients seeking to benefit from its IT engineering expertise. Even before this announcement, IBM had transformed itself from a company relying principally on manufacturing and selling computers to one whose revenue comes primarily from selling IT-related consulting services and software. The new engineering and technology services division is intended to help client companies exploit the value of intellectual property in designing new products.

These three corporate news stories are just a small sample of the changes that have been taking place in corporate America as business adapts to changes in technology, competition, and customer requirements. Companies that began as agricultural, mining, or manufacturing firms have found, or are finding, that they must change their business models in order to provide value for customers and shareholders alike. Companies that used to sell commodities or make something are finding that intellectual assets mean as much, if not more, than physical assets. Companies that served one customer segment or one geographic region must now think more broadly about how to exploit scale and scope economies before their rivals take away their customers and markets. And speaking of rivals, some companies are discovering that their competitors in one market can be their partners in another, and that their suppliers or customers in one market can be their competitors in another.

Making a profit in business has never been easy, at least making it consistently. Economic theory teaches that in fully contestable markets—that is, markets in which competitors can enter easily and at low cost—one firm cannot consistently earn profits beyond those of any other firm. Otherwise, of course, new contenders would enter and compete away any excess profits. This makes it easy to see why the evolution of business can be thought of as one long progression from invention to innovation to initial advantage to no advantage at all, unless firms are willing and able to adapt. It is also easy to see why firms seek to erect entry barriers, both domestically and internationally, to thwart competitors who are attempting to enter markets they dominate. Generally, those who stand to lose the most from these changes are concentrated in certain industries and places, while those who stand to benefit are the general public.

The entire world has been opening up to capitalism and trade among nations at a very rapid pace during the last several decades. At the same time, a host of new information, physical, and life sciences technologies have fueled the repeated, rapid development of new products and services. The confluence of these developments has been bringing great opportunities and great upheavals to many businesses, communities, and nations.

Fortunately or unfortunately, these significant developments are not unprecedented in history. Fortunately, because economic history shows that eras characterized by expanding trade and innovation enjoy substantial increases in the living standards of those who participate. Unfortunately, because political history shows that the tensions created by the social changes associated with economic upheaval can cause civil unrest, protectionism, demagoguery, and even war. A long view of history is needed to appreciate that, despite the destruction wreaked along its path, increased trade among nations and technological advancements truly benefit mankind.

Federal Reserve Board Chairman Alan Greenspan was asked at a U.S. House of Representatives hearing last month to explain which high-tech jobs would remain or be created to replace America's disappearing manufacturing jobs. Mr. Greenspan replied that if our labor market is flexible enough and our capital goods market functions properly, jobs will be created. "[T]hat question has been coming up for generations," he observed. "The answer ... is, 'It will happen.'"