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## ECONOMIC NEWS UPDATE

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General Motors, which like Ford lost \$1.3 billion in the third quarter, will lay off 30,000 workers and close or downsize twelve plants in a desperate effort to avoid bankruptcy. Kodak is frantically attempting to build its digital business as the use of film declines. Knight Ridder shops for a buyer as the collapse of its local newspaper monopolies destroys its viability. Several airlines have declared bankruptcy as their uneconomic cost structures cripple their ability to compete for customers. Telecoms companies watch the value of their wires drop as cell phones, voice-over-internet and cable companies poach their customers. Blockbuster flirts with bankruptcy as new, more convenient ways of delivering films ("content", to use the more modern term) to the screens of couch potatoes make a trip to the rental stores unnecessary.

That destruction of the value of existing assets and businesses is, fortunately, only half the story. The other half was long ago pointed out by Joseph Schumpeter. Schumpeter is said to have remarked, "Early in life I had three

ambitions. I wanted to be the greatest economist in the world, the greatest horseman in Austria, and the best lover in Vienna. Well, I never became the greatest horseman in Austria."

Not having access to the historical records in Vienna, I have no way of knowing whether Schumpeter achieved the final of his three goals. But he has a valid claim to having achieved the first, or at least to ranking right behind Adam Smith. Over 60 years ago, when the American economy was still in the early phase of a war-induced recovery from a decade of stagnation and depression, and the future of capitalism was in doubt, Schumpeter wrote, "Capitalism ... is by nature a form or method of economic change and not only never is but never can be stationary.... The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumer goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates."

This process "incessantly" destroys the old economic structure,

and creates a new one. "This process of Creative Destruction is the essential fact about capitalism... Every piece of business strategy acquires its true significance only against the background of that ... perennial gale of creative destruction..." Schumpeter concluded.

That is the process that is now accelerating in the US economy. The future of newspapers is threatened by new technologies that multiply the methods of delivering news and advertising to consumers. Hardest hit are those, like Knight Ridder, that relied for their profits on monopolies of local advertising. If Google, its share price soaring as media companies' shares languish, succeeds in creating a jobs market that replaces classified advertising, which accounts for over half of the revenue of local newspapers, the old method of spreading ink on dead trees will face an even greater threat. Some newspapers will

Kodak is suffering because the new digital technology is destroying its film producing and processing business. The company is attempting to adapt to the destructive effect of new technology. Its digital revenue in the last quarter rose 47%, to \$10 million, not enough to offset a 20% decline in its much larger but shrinking traditional business.

Traditional telecoms companies are watching the number of residential lines decline, the one-time backbone of their business, decline steadily. Young people prefer the mobility of cell phones; businesses are experimenting with using the Internet to destroy the value of the wires in which telecom companies have invested billions; some consumers are finding the offerings of cable companies more attractive than those of traditional telecom providers. SBC

Communications, which last week changed its name to AT&T after acquiring the long-distance business of the once-mighty monopoly, is planning to adapt to the destruction of its residential landline business by creating a single network to deliver video, data, wireless calls and phone traffic and, according to The Wall Street Journal, making 1,000 or more television channels available to consumers.

As for airlines, deregulation freed innovators to negotiate more reasonable contracts with employees, develop point-to-point service as an alternative to the hub-and-spoke business model of the traditional, legacy carriers, and offer low, load-increasing fares. Whether the old-line carriers, several in or emerging from bankruptcy, can adapt is uncertain, although United says there is black ink in its future. What is certain is that creative and profitable newcomers Southwest and Ryanair know something that busted Delta, US Air and others have to learn if they are not to join Pan Am, Eastern and other once-mighty carriers in the dustbin of history.

And why traipse to a Blockbuster store to rent a video when hundreds of movies are available from multichannel television providers, and on DVDs mailed to your home by companies such as Netflix? Result: Netflix recorded 3.6 million subscribers, up 61% year-over-year, and third quarter revenue of \$174.3 million, up 23%, while much larger Blockbuster saw third quarter revenues drop 1.7% to \$1.39 billion and gross profit fall 8.3% to \$790.5 million, forcing a financial restructuring.

Which brings us to General Motors, in the process of being destroyed by a combination of what Schumpeter called "new consumer goods" (higher-quality and more

attractive imports), “new methods of production” (lower-cost plants of Toyota and others), and “new type[s] of organization” (shorter drawing-board-to-production-line times), not to mention inept management and the cost of benefits lavished on workers when those costs could be passed on to consumers. Investors responded to the company’s survival plan by selling off its shares, already down 42% in the past year. Fortunately, it is not the case that what is bad for General Motors is bad for the country.

Competition of this sort, wrote the man who never succeeded in becoming Austria’s greatest horseman, “strikes not

at the margins of the profits ... of the existing firms but at their foundations and very lives.” Good news for creative destroyers and consumers, bad news for hidebound managers and their shareholders.



## **THE SUNDAY TIMES**

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