

Reprinted with permission of *The Wall Street Journal* © 2005 Dow Jones & Company, Inc. All rights reserved

Copyright (c) 2005, Dow Jones & Company Inc. Reproduced with permission of copyright owner. Further reproduction or distribution is prohibited without permission.

'Nondestructive Creation'

By R. Glenn Hubbard

7 September 2005

Labor Day parades celebrated a vigorous economy, and Friday's employment report indicated continued job growth. The Katrina tragedy -- whose consequences arouse concern -- will almost surely break the recent pattern of low initial jobless claims, and disrupt employment and growth. But, looking forward, productivity growth continues to be robust, pointing to a healthy resumption of increases in wages and living standards.

The government's monthly figures for job growth mask gross flows for job creation and job destruction many times their size -- a process reflecting the judgments of business owners and managers who assemble the economy's jigsaw in new and valuable ways. These entrepreneurs shape productivity growth, the fount of the living standards we celebrated on Labor Day. The centrality of entrepreneurship for the well-being of labor is not just about jobs. Since 1995, productivity growth has staged a stunning revival, growing at a rate that implies a doubling of living standards each generation.

Progress in IT has contributed to our productivity revival, but that sector is not alone. The rise of U.S. productivity growth has not been mimicked abroad. In Germany and Japan, the second half of the '90s witnessed declines in productivity growth relative to the first. The key point is that growth requires entrepreneurial business practices so that tech-intensive investment has the largest possible effect on productivity.

In retail trade, firms did not become more productive just by buying faster computers. Entrepreneurs and entrepreneurial managers raised productivity by combining investments with changes in business practices. Think about the use of IT to improve links in the supply chain from vendor to retailer. More generally, U.S. markets allow entrepreneurs to create the celebrated "resilience" of our economy, in which labor and capital swiftly respond to shocks from financial market downturns, or disasters such as Katrina, just as they do in response to opportunities for innovation and expansion.

Much of the current policy discussion of the ups and downs of the labor market harkens back to entrepreneurship as "creative destruction." This conception has fueled policy anxiety over job loss and global competition. But so much of productivity-enhancing entrepreneurship is really about "nondestructive creation," in which new products and ideas generate growth.

There are policy lessons, too, in the observation that it is not simply opportunity (e.g., IT) but the seizing of opportunity (e.g., new types of firms or business practices) that enhances productivity. Competition can promote entrepreneurial innovation in a way that raises productivity growth: Foreign competition has long been a source of productivity-enhancing innovation. In the domestic economy, policy can enhance or limit competition by its stance toward new business formation and employment. The U.S. has enviably low regulatory costs of business formation, while, by contrast, entry restrictions limit business formation in a number of other competitor countries. Labor market policy matters, too: Recent OECD research finds a strong negative correlation between a country's technology growth-rate and the strength of its employment protection laws.

Macroeconomic policy also plays a role in entrepreneurs' decisions. A key element of stability is low inflation. Inflation exacerbates distortions in the tax system and confuses relative price signals important to entrepreneurs' decisions. On the fiscal side, spending restraint keeps tax burdens

low, raising returns to work and entrepreneurship, and to saving and investment. Tax reform would do well to emphasize these considerations.

Over the past quarter-century, average U.S. labor productivity has risen by two-thirds. This enormous increase in workers' ability to produce has not come at the expense of jobs. The 40 million new jobs created over the same period reveal the secret of an entrepreneurial economy: Successfully seizing business opportunities can raise living standards and employment. For this reason, entrepreneurship -- the motor that drives the labor market -- must be a focus of study in business education and policy making.

Mr. Hubbard, dean of Columbia Business School, was chairman of the Council of Economic Advisers under President George W. Bush.