

# Foreword to the special issue 'The New Economy: Implications and Viability'

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# Foreword

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This special issue of Louvain Economic Review is devoted to the 'New Economy'. Indeed, a few months after the rapid decline in the stock market for new technologies in most places in the world, it was time to try to draw a balanced synthesis of the economic implications of the so-called New Economy. A few figures are needed to realize why the last decade was indeed an exceptional period, according to historical standards. First of all, the increasing role of information technologies is simply overwhelming. Over the last decade, the real value of business investment in the USA has been multiplied by 22 for computers and peripherals, 3 for communication equipment, and 6 for software. The proportion of total business fixed investment accounted for by, respectively, computers and peripherals, communication equipment and software, increased from, respectively, 2.2%, 6.7%, and 7.2% in 1990, to, respectively, 21.5%, 9.7% and 17% in 2000. At the same time, the US economy (leading in the cycle the European economies) has experienced some exceptionally favorable macroeconomic conditions : high growth rates of output, with a striking average growth rate of GDP around 4.2% from 1995 to 2000, unusual growth in labor and total factor productivity (the former being 1.4% in 1975-95 and 3% in average since 1996 with a peak of 5.2% in the second quarter of 2000), a very low level of unemployment in the US (7.20% in 1993, 4.1% in 2000), one million of jobs created in France. On the other side of the coin, these recent developments were also associated with less desirable features : more wage inequalities and huge reorganizational costs, for both firms and workers; the latter are suffering during the episodes of reorganization from more stress and injuries, while the former have to invest always more in fast-depreciated technologies; rising volatility and financial fragility (The swinging Nasdaq), etc...

From the papers of this special issue, one has the feeling that, if the emergence of the sectors of the New Economy and the diffusion of their technologies to other sectors provide indeed a real set of opportunities, there is

no *free lunch*, and the transformation of these opportunities into economic success and prosperity is unlikely to be at no cost and no effort. Especially in Europe, the road to success is probably jammed with difficulties to implement reforms in the good, labor and credit markets and the possible rise of what has been called the 'numerical divide'. Alain Quinet has already made a very good synthesis of the papers in this issue and has put their conclusions in perspective with the other lessons from the recent literature in the topics. To be complementary with his comments, we want here to focus on the lessons this special issue brings in terms of economic theory. What are the ingredients of all the models, theoretical and empirical, developed by the authors ?

First, the idea that embodiment is fundamental to the recent development of the macroeconomy is a central theme of the first papers. The relative price of capital is declining very quickly and even more quickly during the last decade : The price of personal consumption expenditures in the USA has increased by a little less than 30% over the last decade, while the price of computers and peripherals has been cut by 20%. This means that technological progress is more and more investment specific. As a methodological consequence, there is an urgent need to go beyond the Solow neoclassical one-sector growth model, not only in the research frontier papers, but also in national accounting practices and even in the textbooks.

Second, asymmetries of information are a fundamental ingredient of the relationships between economic agents. If research in microeconomics, notably contract theory and finance, has incorporated these aspects for long now, we still need to improve our macroeconomic models by augmenting them with these informational imperfections. Such attempts have been made in a recent macroeconomic literature dealing with the labor market, but few attempts have been made to introduce financial imperfections and deviate from the Modigliani-Miller paradigm. One of the challenges here is to bring a consensual, simple and precise framework to think about macroeconomic questions under asymmetric information.

Third, the importance of asymmetries of information has several consequences, illustrated in our different papers : the need of a solid contractual environment, of a set of institutional arrangements that is both flexible and stable, the guarantee of property rights, the protection of patents, the existence of specificity but in the present context of fragility in relations between economic agents, all sorts of ingredients that lead us far away from the simplest, the most naïve macroeconomic models that are found in textbooks.

Fourth, the importance of knowledge and the impressive decline in the diffusion costs associated for instance with the development of the internet, and more generally of the information technologies, is not without its own problems. Issues such as inequality, heterogeneity which is another challenge for macroeconomic theory, the existence of sub-optimality of decentralized equilibria due to network externalities, the emergence of segmentation in language or in technology adoption all have to be taken into account for a

correct description of the world and associated policy prescription. Among the inequality issues that have not been directly addressed in this issue, let us only point out the gap between the South and the North that the development of the New Economy is likely to generate. In a world in which new investments have permanently to be made, and in which network externalities require adequacy of technologies between business partners, is Africa going to be able to ever catch up with the North ?

These are some of the questions and lessons we have learnt from this series of papers. Paradoxically, all the techniques described above did not need to be developed to study the development of the New Economy : they clearly pre-existed its take off, since these features were all developed in the late 80's and the 1990's. An optimistic researcher would claim that, for once, economic theory was leading the development of world. Accordingly, we would suggest to use the data and experience of the New Economy in the most possible positive way, i.e. to propagate a new way of modeling macroeconomy, in which the ingredients described above and that are central to it, serve as angular stones of general macroeconomic thinking.

Most of the papers published here have also been presented at a conference at the Université de Metz in April 2001 on the theme of the New Economy, implications and viability. We wish to warmly thank the Faculté de Droit, Économie et Administration and its dean, Françoise Chevalier, for having provided such excellent conditions and Martine Schmidt for having dealt with all the organizational details. We also thank our sponsors, Louvain Economic Review, Conseil Régional de Lorraine and Université de Metz. Our gratitude also goes to the authors, the referees and the editor of Louvain Economic Review, Michel de Vroey, for allowing a double issue on this topic. Special thanks go to Lionel Artige for his excellent editorial assistance.