The Creative Destruction of Labor Policy

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Submitted for presentation at the meetings of the Association of Private Enterprise Education (APEE) in Las Vegas on April 1-3, 2012.

Last revised: November 17, 2011

Abstract

While the consumer benefits from the new products and improved processes due to creative destruction, the major downside to creative destruction is technological unemployment. However, policies adopted by laborers, other institutions, and the government can reduce the downside. Labor can become more resilient in attitude and frugal in spending; and can invest in more diversified and enduring human capital. The family can provide a private safety net. The internet can make job search cheaper and faster. Governments can lessen the barriers to entrepreneurial activity and reduce the volatility of the macro-economy. The final policy considered is a government safety net.

1. Individual Actions, or Government Policies, That Can Reduce the Labor Pains

One response to worries about job loss from creative destruction, might be termed the 'courage and resilience' answer. Yes, losing a job is painful, but the gains are great, and it is noble to display courage, strength, perseverance, and a long-term perspective. (If Shackleton could lead his men across Antarctic in physically horrendous conditions, shouldn't you be ashamed of worrying about a little labor market uncertainty?)[1] And reasonable scholars, such as Deirdre McCloskey (2006), have made reasonable arguments that courage, strength, and perseverance are admirable virtues (though McCloskey does not consider them the most admirable virtues). Todd Buchholz (2004, pp. 177-179) is another who argues persuasively that Americans used to have more backbone, and that we would be better people, and better off, if we had more backbone again.

And sometimes some of us take risks, either because something about the risks thrills us, or because we believe that some important projects or values make the risks worth taking. It is paradoxical that in the spring of 2006, while some young Frenchmen were in the streets protesting the alleged "precariousness" of a labor market under Villepin's proposed mild labor market reforms (Smith 2006), other young Frenchmen were seeking ever-more extreme ways to rapidly descend mountain slopes (Vinton 2006).

So a case could be made for courage and resilience. But most people are not going to be friendly to an argument to toughen themselves up—at least not unless you can convince them that it is in the service of some noble BHAG (Big Hairy Audacious

Goal).[2]

Fortunately, there is a more palatable alternative to the "courage and resilience" argument. It is usually possible for those in the workforce to take actions that can substantially reduce the pain from the destructive side of creative destruction. Stanley and Danko (1996) have argued that most workers have it within their power to achieve significantly higher levels of financial security. The methods are not surprising. Primarily, the "secret" is frugality. This does not mean a life of stoic self-denial. One can live quite comfortably, with many material and psychic pleasures, but do it frugally. But to be frugal, you do need to forego some of the pleasures of conspicuous consumption, and expensive tastes. But isn't it in the end more satisfying and noble to pursue other pleasures anyway, such as the pleasures of pursuing meaningful projects, and of expanding the human capital of oneself and others?

There are a variety of ways to live frugally. You can forego new wardrobes every year or two. You can buy from discount and "club" stores. You can buy big-ticket items (e.g., cars) used rather than new. You can buy a somewhat more modest home, with a mortgage that you could afford to continue to pay during a period of lower earnings. Stanley and Danko provide many examples that those who live below, rather than above, their current means, achieve a level of savings that gives them a peace of mind, even in a changing environment.

They also show, that at given income levels, entrepreneurs are most likely to adopt habits of frugality, and to achieve correspondingly high levels of personal wealth and financial security. This is a significant finding, since entrepreneurs have chosen an occupation that makes them among the most vulnerable to the obsolescence that arises from creative destruction.

2. Human Capital Investment

If parents anticipate that their children will live in an environment where creative destruction is common, they can give advice and make choices that will help their children acquire the human capital that will most help them in a changing environment. Pink (2001) and Peters (2003) each have chapters on education where they point out that the current Dewey-inspired educational systems are designed to turn children into obedient, static, organization men and women. Other forms of education are more likely to aid and abet budding entrepreneurs and free agents. Pink suggests that home-schooling is one constructive alternative. I believe that some versions of Montessori education provide another.[3] Montessori education provides children with the opportunity to constructively make choices, and develop the skills and confidence that will allow them to better function as free agents. Resiliently educated children will as adults be better able to bounce-back from job-loss; and the bounce-back will be faster, and higher.

Other, currently unforeseen, educational innovations may also provide better opportunities for student growth toward resiliency, and the higher Maslovian talents. So, more generally, at the policy level, it would be desirable for government to encourage faster innovation in education by adopting Milton Friedman's voucher plan to expand the range of parental choice in education (1962, pp. 89).

At higher levels of education, Gary Becker has argued (1975, p. 190) for liberal education as a means to acquire the general human capital that consists of ‘learning how to learn.’ Such general human capital is likely to depreciate through unpredictable changes in the job market. To facilitate the retooling of specific human capital, Alan Greenspan has advocated an expanded role for community colleges. Also aiding worker retooling, are the growing offerings of within-company courses, and also the growing array of online learning tools.

Clayton Christensen has argued that entrepreneurs of disruptive innovations should be patient for growth, but impatient for profits. The improvement in the disruptive innovations that allows them eventually to replace the incumbent products, usually is a gradual one, that can take many years. So, one implication of Christensen (Christensen 2003a; Christensen and Raynor 2003b) is that many episodes of creative destruction, generally will unfold in ‘fullness of time.’ That may seem unfortunate if you are anxious to speed progress. But, it has a positive aspect, in that it increases the time that workers have to adjust their skills, or their career plans, to the emerging new technology. The longer the transition time, the more that it will be possible for the jobs that disappear, to do so through attrition (e.g., retirement) rather than through firings. That is, when we see figures in sources like Cox and Alm (1992 and 2003) on number of jobs lost, it would be wrong to assume that all, or even most, of these jobs lost occurred by the holders of the jobs being laid off or fired.

Another issue that eases the transition, is that it probably is rare for the old technologies to totally disappear. Just as initially there are some niche uses for which the disruptive technology is superior, it may remain true that after the dominance of the disruptive technology, their still may remain niche uses in which the older technology remains superior and in demand. One example might be that vacuum tubes are still in demand in guitar amplifiers where they are thought to deliver a “richer” sound (see: Kramer 2006).

One unexpected form of human capital investment, in the context of creative destruction, may be job hopping. Virginia Postrel (2005) has made the case that in Silicon Valley frequent job changes may benefit both labor and firms.[4] The labor benefits by acquiring a greater diversity of human capital, and possibly achieving a better match between the job and the worker’s preferences. The firm benefits by the infusion of new ideas and skills. Notice that this example refutes the common belief that low unemployment corresponds to long job tenure. When there is frequent job-hopping, there can be both low unemployment, and short job tenure.

3. Private Safety Nets

The family can serve as a form of unemployment insurance (Di Tella and MacCulloch 2002). One member can have a 'safe' standard job, while another can be taking greater risks as a low-level entrepreneur, or as the employee of a fragile start-up. Part time jobs can serve as a safety net, especially during the early start-up period for a love-level entrepreneurial enterprise. A person's own personal savings can also serve as a resource (or safety net) for entrepreneurial activities. Apparently increasing numbers of retirees from standard corporate jobs are ‘following their dreams’ to open entrepreneurial ventures (Pink 2001; Olson 2006). So policies that increase the ability of individuals to save a 'nest egg' would increase their resilience.

4. Internet

One of the main ways that the government can reduce labor pains is to avoid policies that delay or discourage promising new technologies (like the internet). For example, a plausible case has been made that the government's forcing the baby Bells to allow competitors to make use of their infrastructure, at nominal charges, delayed and reduced investment in infrastructure by baby Bells, most notably slowing the roll-out of DSL to homeowners. The widely advocated, "net neutrality" regulation would have a similar effect by reducing company incentives to provide valuable, innovative, but infrastructure intensive, services, such as high quality streaming video.

Recent information technology has reduced the costs of finding new jobs and retooling human capital, and hence reduced the costs to labor of the destructive part of creative destruction (e.g., Pink 2001; Brynjolffson et al 1994). The internet has resulted in faster, and closer matching of workers to jobs, as exemplified, for example, by the online job site, Monster.com (see: Kuhn and Skuterud 2004). The larger the market, the quicker, and better the match between jobs and workers. Monster.com, and other internet job tools, make for quicker and better rebounds, thus reducing the destruction side of creative destruction. The internet may even have enabled a long-term reduction of the steady-state level of unemployment.

More broadly, Pink (2001) has discussed how information technology, enables free agents to provide for themselves office functions, that previously would have required an office staff. Brynjolfsson, et al (1994), also provide argument and evidence that suggests that information technology may have differentially increased the productivity of small work units. And even within large firms, leapfrogging information technology has had the effect of reducing hierarchy within the firm, which would presumably have the effect of moving job characteristics to better locations on the Maslow hierarchy (see: Bresnahan, Brynjolfsson, and Hitt 2002; and Brynjolfsson and Hitt 2000).

5. What Else Government Can Do (Or Refrain from Doing)

We tend to think of "finding" another job as the only appealing rebound from a job loss. But through entrepreneurship, a person can "create" their own job. So government policies discussed elsewhere in the book that benefit the consumer by encouraging entrepreneurship that creates innovative new products, also benefit the worker by creating appealing alternatives to standard employment for corporations. These policies would include reducing government regulations (Klapper et al 2006), and putting limits on punitive tort damages (Stiglitz et al 2002; Buchholz 2004, pp. 119-154).

A less volatile macro-economic environment reduces job market risks, and the risks of entrepreneurship. Wise monetary policies from the Federal Reserve seem to have been effective in the last couple of decades, at reducing the volatility of unemployment by reducing the frequency and severity of downturns in the business cycle. (Maybe those who grew up in the Great Depression, often over-valued the permanence of a job, as a result of their experience.)

One form of government regulations that reduce job opportunity consists of zoning laws, which often function as a substantial barrier-to-entry. The absence of zoning laws in Houston, for example, has been related to Houston's appeal as a location of opportunity for entry level entrepreneurs.[5] Occupational licensing also creates barriers to entry (Buchholz 2004, pp. 97-117; Kleiner 2000). For one particularly bizarre example, consider the California law saying that hairbraiders need to have a cosmetology license in order to legally braid hair (Postrel 1997).

There is a potential for greater personal financial assets to smooth consumption during periods of unemployment, lowering the downside risks from entrepreneurship and free agency. Bush and Moynihan's personal savings account might be one such policy.[6]

Another would be to have lower personal income tax rates. Schumpeter himself thought the potential for entrepreneurs to achieve high income provided them an incentive to work the hours and bear the risks of being entrepreneurs. (see McCraw 2007, pp. 175-176) So he believed that there was a "cost" to high income tax rates. He also thought the "benefit" of high rates in terms of egalitarian redistribution were over-stated. He suggested the thought experiment in which you would expropriate the high earnings of the rich and distributed it to the proletariat. He concluded that if this were done, it would "hardly raise living standards at all." (see McCraw 2007, p. 176). Other considerations also support low income tax rates that would allow entrepreneurs to retain most of their gains. One of these are Nordhaus' findings (2004) that Schumpeterian monopoly profits are not as large as assumed. Another is that wealthy entrepreneurs often invest a substantial part of their wealth in new ventures. Yet another is that when they consume, wealthy entrepreneurs often end up supporting the initial, high-cost, development stage of new technologies. Yet another final consideration is that wealth obtained through entrepreneurship in an economy open to creative destruction, will usually not be sustained for many generations. McCraw (2007, p. 178) notes that Schumpeter approvingly quotes the saying “Three generations from overalls to overalls.” (For some modest empirical support for Schumpeter’s view, see Nicholas 1999.)

Lower corporate tax rates would reduce the churn, by reducing firm costs, and allowing more firms to stay out of the red (Buchholz 2004, pp. 92-95).

Several different arguments and types of evidence can be adduced to support the proposition that health care in the United States is inefficiently provided. For example, the United States spends a higher percent of GDP for health care than France and Japan, but has lower life expectancy and higher infant mortality than France and Japan. Other explanations should be explored, but one salient hypothesis would be that the United States health care system is inefficient (see Lahart 2007).

One claim sometimes made, is that improvements in health care must come at increasingly higher costs. Christensen et al (2004) provide persuasive arguments and examples to show that this need not be true if we permit the process of disruptive innovation in health care to thrive.

At their worst, they stop the efficient reallocation of labor that is part of the process of creative destruction. One example is the 'featherbedding' that required a coal shoveler be in every engine, even if the engine was a diesel that did not use coal. Another example, from Schmitz (2005), provides strong evidence that reduction in the power of unions would have increased labor market productivity in the Canadian iron ore industry.

6. A Bigger Government Safety Net?

Thomas Friedman (2005) identifies the greatest threat to continued Schumpeterian growth to be obstacles to creative destruction due to workers who fear that their skills will be destroy their skills, and that they will they will end up with a worse job, or no job at all, or too painful a transition. This threat leads Friedman to advocate a larger safety net for workers, in order to earn worker's buy-in to an unimpeded process of creative destruction. Other advocates of creative destruction who also support a larger safety net, include Gene Sperling (2005a; 2005b) and Robert Reich (2007).

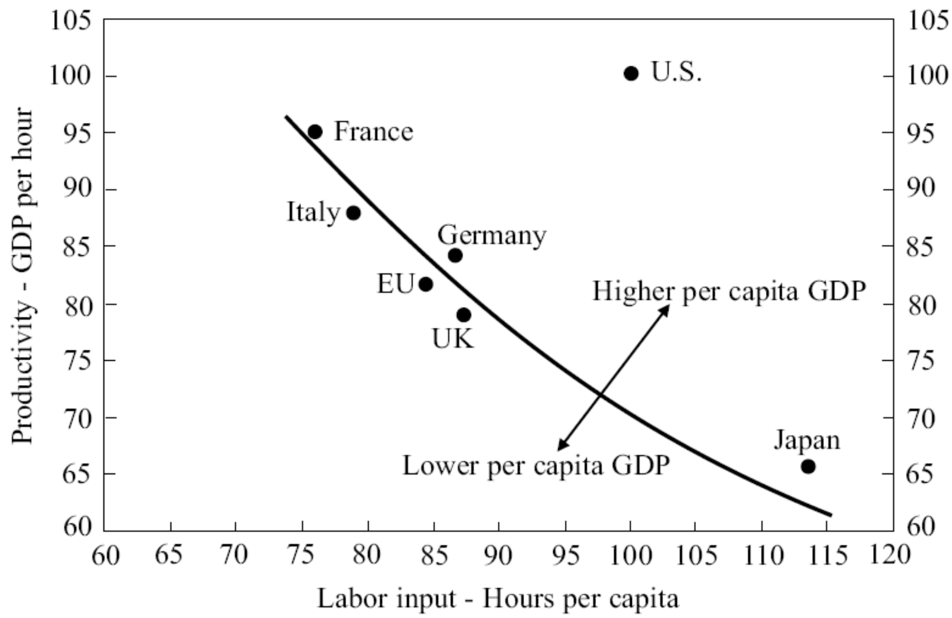
Hayek argued (1976, pp. 122-124; see also pp. 207-208), to the contrary, that the more generous the worker safety net, the more slowly workers will acquire new skills, and move to new jobs, and the more slowly the economy will grow. This is perhaps the main difference between government "safety nets" and the private safety nets that were discussed earlier---the government nets provide workers with incentives to delay taking the steps necessary to transition to new jobs.

Baily (2001) and Feldstein (2003) have argued that countries with bigger safety nets, experience slower economic growth. An informative graph from Baily's study has been reproduced as Figure 8 near the end of this paper. In that graph, the United States appears as an outlier in a graph related worker productivity to average hours of work per week. Baily's explanation was that the United States had a greater openness to creative destruction, which implies that implies that the United States, more than Japan and the nations of "old" Europe, allows jobs to be destroyed. (A related cross-country comparison by Siems (2006) is presented in Figure 9.)

Also supporting the Hayek view is Edward Lazear (2006) who summarized his 1990 paper by saying ". . . I found that job security provisions were instrumental in limiting employment in developed countries." More broadly and recently, other researchers have used cross-country comparisons to reach a similar conclusion (Botero et al 2004; Lafontaine and Sivadasan 2007).

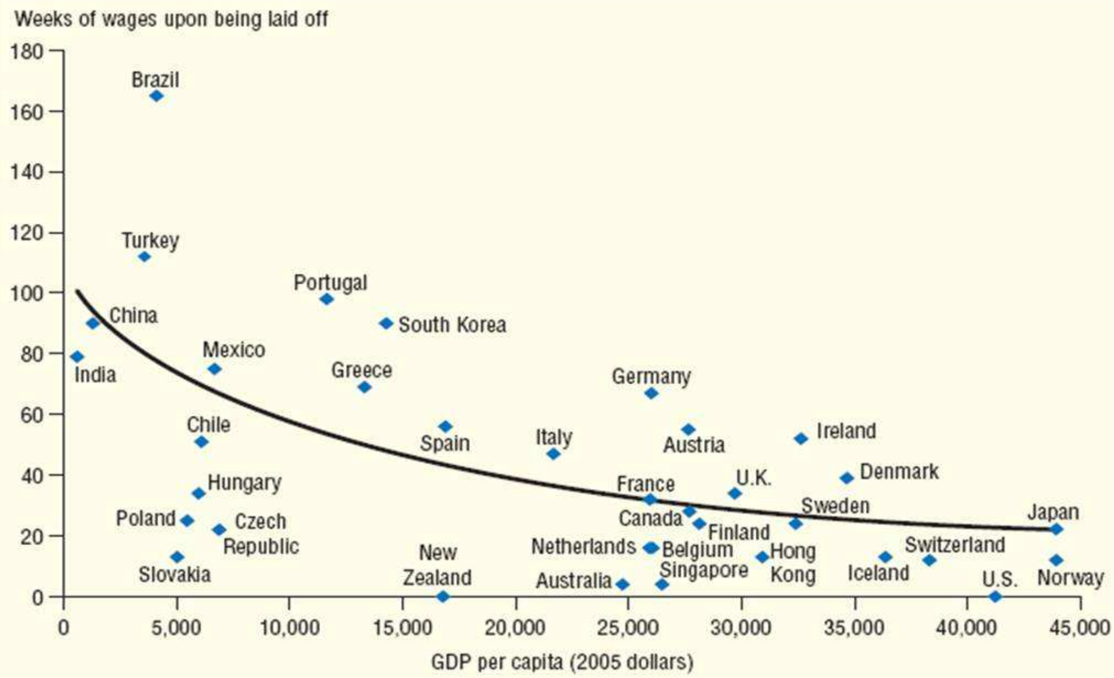
Another consideration that should be mentioned is that increased job security for the less competent requires decreased upward mobility for the more competent.

In the end, a government safety net may be implemented, either out of a belief in its economic desirability, or out of a belief in its politic necessity. It would then be useful to analyze what forms of a safety net would be least costly and most beneficial. The safety net proposal of Thomas Friedman (2005), for example, attempts to preserve the workers' incentive to seek new employment. And Rajan and Zingales (2003, p. 300) note that safety net payments should take the form of lump-sum side payments to workers, rather than the form of subsidies to firms. This would preserve the worker's incentive to seek new jobs; and would not slow the exit of dinosaur firms, and the growth of "sunrise" firms. This would ". . . prevent the victims of creative destruction from being transformed into human shields for special interests, . . . " (p. 300).



Source: The Conference Board.

Figure 1: Explaining the Outlier: Openness to Creative Destruction. Quantities in graph are "indexed to US equals 100." Source: Baily 2001, p. 220.



NOTE: A similar relationship is obtained using purchasing power parity adjustments for GDP per capita. James J. Heckman and Carmen Pagés, in "The Cost of Job Security Regulation: Evidence from Latin American Labor Markets," NBER Working Paper 7773, June 2000, obtain parallel findings using 1995 GDP data for Latin America.

SOURCES: World Bank, World Development Indicators Database; World Bank Group, Doing Business 2006.

Figure 2: Inverse Relationship Between Labor Safety Net and GDP Per Capita. Source: Siems 2006, p. 4.

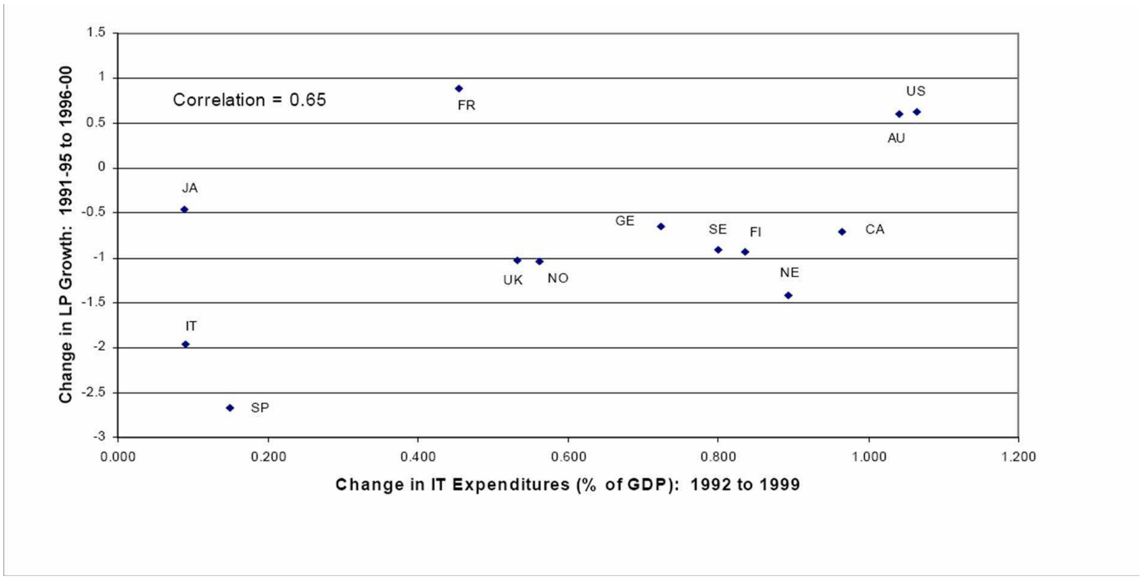


Figure 3: "IT Expenditures and Labor Productivity Growth." Source: Gust and Marquez 2002, p. 34.

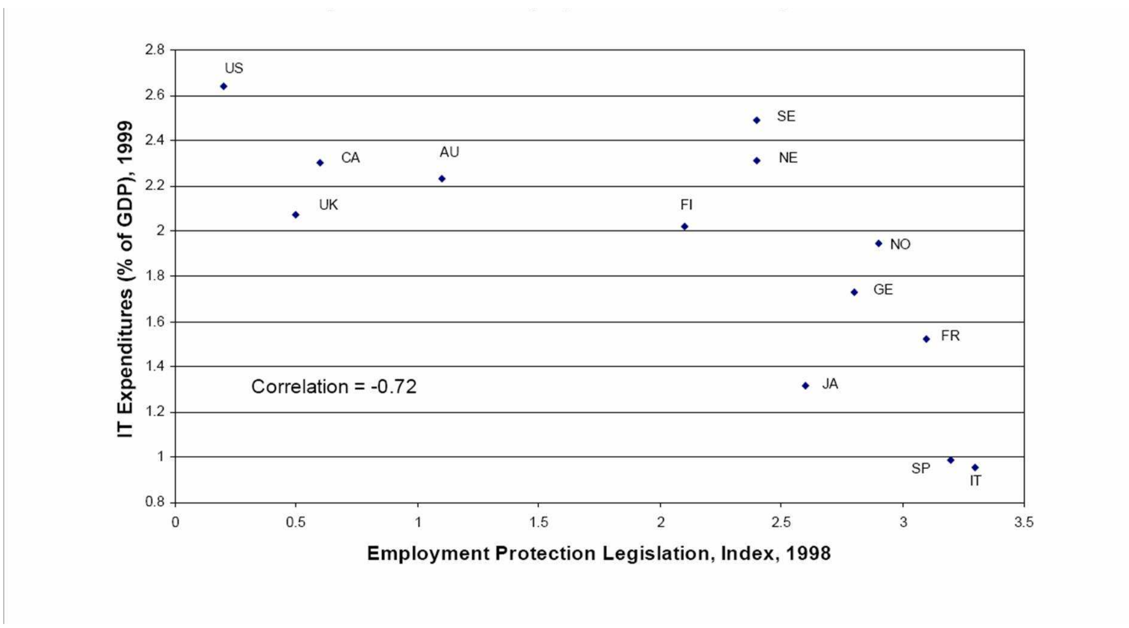


Figure 4: "IT Expenditures and Employment Protection Legislation." Source: Gust and Marquez 2002, p. 34.

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Footnotes

* Prepared for presentation to the 2012 APEE meetings.

[1] See, for example, Morrell and Capparell's *Shackleton's Way: Leadership Lessons from the Great Antarctic Explorer* (2001).

[2] As far as I am aware, the concept of a "BHAG" was first introduced, and elaborated, in Collins and Porras's business classic, *Built to Last* (1994).

[3] Jeffrey Bezos (Amazon) and Sergey Brin (Google) are two prominent information technology entrepreneurs who participated in Montessori education as children. (See: Hof 1998; and Malseed 2007)

[4] Postrel bases her discussion largely on Fallick et al 2006.

[5] "Like other Americans, immigrants often dramatically improve their quality of life and economic prospects by moving out to less dense, faster growing areas. They can also take advantage of more business-friendly government. Perhaps the most extreme case is Houston, a low-cost, low-tax haven where immigrant entrepreneurship has exploded in recent decades. Much of this has taken place in the city itself. Looser regulations and a lack of zoning lower land and rental costs, providing opportunities to build businesses and acquire property." (Kotkin 2005, A16)

[6] "Mr. Moynihan has long advocated the creation of personal investment accounts." (Stevenson 2001).

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