



Air pocket in innovation

In the late 1970s, at the threshold of the infotech revolution, Gerhard Mensch proposed that the primary impulse to economic growth came, not from quantitative demand, but from product innovation. He also argued that, as a corollary, long periods of economic stagnation were caused by a lack of innovation (see *Stalemate in Technology*, 1979). The life cycle for a new product has a natural, if somewhat unpredictable, profile: it starts slowly with investment in the new idea (personal computers, mobile phones), proceeds through improvements (Wi-Fi, social networking), and ends with artificial enhancements (new look hardware, new software). The impulse can be enhanced at any stage by *process* innovation (new manufacturing technologies, outsourcing, and globalisation). However, once the impulse fades, the economy will transit towards stagnation.

The main thrust of product innovation from the infotech revolution probably finished in 2000. The inevitable slowdown was initially contained by globalisation, but the overall problem was masked by hugely stimulative fiscal and credit policies. The truth became clear in 2008 when the global debt crisis revealed a glut of unmanageable debt on the demand side of the global economy, and a gross misallocation of resources on the supply side. The natural wealth created by new products and processes had been eclipsed by false wealth based on an excessive, government-induced, supply of credit. The global economy fell into an energy gap.

Subsequent policy measures to stave off a banking implosion were (and still are) appropriate. This was the key lesson of the Great Depression. But what has persistently been missed or ignored is the fact that additional fiscal and monetary reflation cannot reverse the natural slowdown in innovation-related capital expenditure. The problem is not one of inadequate demand; it is (as Robin Aspinall of *Rhombus Research* regularly asserts) one of a downward shift in the underlying rate of economic growth. The expansion of dynamic industries will slow, surplus capacity will need to be removed, and unemployment will stay high. By definition, the eventual solution is a 'capitalist' one, involving the search for new products that will generate profit opportunities. But this takes time; and the political environment is already hardening against a free enterprise solution.

The problem here is 'tribal' psychology, reflected in literal and dogmatic thinking within the context of homogenised group beliefs. New ideas are seen, not as providing solutions, but as a threat to the integrity of the group. On the front line there is usually an obvious physical assembly, which may or may not resort to brute force; but behind it is always a much wider community that provides uncritical support. The emotional pay-off for all is one of belonging to a greater whole. The psychological dynamic is one of splitting (not me), projection (it's them), and blame (so destroy them). Behaviour becomes locked into a closed circuit of hostility towards a perceived 'enemy'.

Tribal psychology is seeping into Western politics, impeding an orderly rebalancing of the public sector's claim on private sector resources. Any common ground between the political left and right about the causes of the 2008 collapse is rapidly disappearing, anti-capitalist rhetoric is increasing, and imaginative leadership remains depressingly absent. Southern EU countries that can no longer finance even reasonable levels of government spending are effectively in a depression, while those countries that should be cutting government spending in order to avoid a future funding crisis are instead moving towards punitive taxes and higher inflation. The former countries need to be helped, while the latter countries need to come to terms with reality. Instead, political conflict, based on an abject failure of understanding, has left the global economy sliding towards a longer-term stagflation. It hardly needs to be added that, with an extended period of weak economic growth and rising prices, tribal psychology will burrow deeper into national psyches, reinforcing the potential for conflict, and adding weight to the forces for change. This is both the logical outcome of Professor Mensch's thesis and the forecast from *Helmsman's* economic confidence model.

Tony Plummer

Commentary No. 222: 26th September 2012