

What Happens Next – 7.11.2021
Literature, Creative Destruction and Supermarkets
Philippe Aghion QA

Larry Bernstein:

You mentioned Biden's increased steps to encourage competition. He made an executive order yesterday that was unbelievably broad and covered many industries. But in particular, he wanted to throw his hat in the ring to support Lina Khan at the FTC and Wu, also, who's working on pro-competitive behavior. In the last few weeks on the show, we've been focusing on Amazon as an example of an innovative firm, but also that is facing increased scrutiny by the state. Let's take a look at that.

The speaker we had most recently on Amazon was the author, Brad Stone, who wrote the *Everyday Store*, and he also wrote *Amazon Unbound*. And he focused ironically on how innovative Amazon was, and what the FTC, Lina Khan, who runs the FTC now, she's very opposed to Amazon. And one of the things that she wants to do is to prevent Amazon from selling its own products, its own manufactured or its own products on its website. Amazon can only be used to sell third-party, which is different than every other store that also sells its own products. How do you feel about Amazon as an example of our biggest upstart, probably our largest employer? Is it a problem, has it already passed the baton as being yesterday's innovator, trying to undermine future innovation, or is this an example of a firm that's still innovating and the government, if anything, is going to prevent further innovation by its regulation?

Philippe Aghion:

We can see that in the data, is that these firms like Amazon, Google, Facebook, they were big innovators and they contributed a lot to the growth that came from the IQ revolution. So they had a period where they were really boosting growth in the U.S. But then what happened is that they were allowed to do merger and acquisition to acquire a new sector of a new product line freely. And the problem is that then they stifled subsequent innovation and entry. And we know that small firms tend to do more radical innovation than existing firm.

The problem is that you see competition policy needs to be adapted to the digital era. It's very important when you decide whether or not to allow for a new merger, not only to look at market definition and market share, but also to look at whether this merger will encourage subsequent entry and subsequent innovation. And that's what needs to be changed, and that's why competition policy needs to be deployed. We need to rethink and redesign competition policy in the digital era.

Larry Bernstein:

If they were going to limit Amazon's ability to sell, let's say shirts or pants that they manufacturer or produce under the Amazon name on the website. Now let's imagine that Amazon got into pants or shirt business, not by an acquisition of a manufacturer, but they did it

themselves. They got into the shirt business, but they got their own designers, they got their own plants, maybe they got third party deals with these plants, we're going to build this stuff. Are you troubled by that, or is it only in the acquisition of third-party manufacturers that gets you going?

Philippe Aghion:

We see that the acquisition tends to eventually undermine innovation. I think there is also a problem in having a firm, having a span of control, which is too big. I think at some moment it may be counterproductive. So it might be that you are less innovative or creative when you control many lines. So well, that's where it has to be judged in each case, so each acquire or you enter in a new activity, will that stifle entry and innovation. Because you see, you can also cross subsidize, when you have a large firm that gets into a new activity, you actually can cross subsidize the line and practice dumping to discourage other entrants. We don't have this flexibility of the cost of digitization across the various activity, so that's why you have to be careful. I'm not a specialist of competition policy, but I can see the problem of allowing without any limits, large firms to enter any kind of new sector unboundedly. Because then it creates unfair competition vis-a-vis the rest.

Larry Bernstein:

Let me give you a different example, and I don't mean to harp too much on Amazon. But one of the things that Brad Stone had to say was what Amazon does spectacularly well is logistics, both warehouse and distribution. And they went to the post office, they went to UPS and they went to FedEx, and they asked, they said, "Look, we want to do this next day or two day delivery. And we want to work holidays and we want to work weekends." And they went to UPS and FedEx and they said, "Look, we're a union shop, and our people don't work on the weekends and we can't get them to work." And so Amazon said, well, you're forcing us to get into the last mile logistics business with all these Amazon trucks and people. And they use third parties to help them in that process. Then they had to literally develop a logistics system themselves. Now they're offering that logistics system, that new logistics system, out to third parties.

So for example, we had another co speaker on our show who mentioned that the GNC vitamin business, that GNC just called up Amazon and said, will you take care of all of our logistics. How do you feel when Amazon goes into the logistics business and delivers that last mile? Do you think that that also undermines competition, or is this an example of the opposite, where it's innovating logistics?

Philippe Aghion:

It all depends. how it's achieved. To each extent they achieve it by, we know also that in Amazon you have problems of working conditions in Amazon. So that has been an issue raised. We also know that large companies benefited from not paying much taxes, you see from avoiding, from doing a lot of tax optimization. So it all depends how it's done. I don't want to say that Amazon did this, my answer is kind of general. So if it relies on escaping basic labor rules by doing multinational optimization, taking advantage of loopholes in fiscal and social systems abroad. If it's done through that way, then I am against. If it's legal competition, I'm

always going to follow competition. So it has to be seen case by case, but it has, it's very important that the competition be legal. And that's what has to be analyzed, and also to look at this thing, will the takeover of the line or whatever, undermine innovation or not. So there's not easy to do, it's easier said than done, but we have to move in that direction.

Larry Bernstein:

We have a question from one of our audience members, Tony Calenda. Tony asked this question, how do you plan to retrain middle-aged workers who lose jobs, can we really teach them Python? It sounds good, but does it really work in practice?

Philippe Aghion:

The retraining you're absolutely right. It depends a lot on having a good basic education. I think it's very important to invest in high quality basic education, because it's there that you learn to learn. You see what I mean. We at school, we don't only learn, we don't only acquire particular knowledge about things, we also learn to learn. And we learn not to be afraid of having to learn. And I think that's very important. I think Scandinavia works well, not only because they put a good system for retraining, but because that system hinges on the basic education system, which is inclusive and a very high quality. So I think you need to act on both. If you, with a very bad education system, you could have any system you want on the labor markets, it will not do the job. So you need both that then we know it will be easier to retrain.

but I believe very much in the retraining, but I believe very much also showing what I call good jobs. We have, firms have to be induced to provide good jobs, jobs, where you have on the job training, where you have senior prospects for improving your status. It's very interesting that more innovative firms in fact, tend to provide most new jobs to its non-educated workers.

Larry Bernstein:

Angus. Can you join in this? You, you talked a little bit in your discussion about the role of innovation in education.

Angus Fletcher:

I completely agree. I think first of all, what Philippe is talking about as education as a space in which to encourage openness and bravery towards innovation in general is absolutely true. That's one of the real values of a classroom space is things seem possible in a classroom, which don't seem possible when you go out in the real world.

So in the case of my students, a lot of times my students will go out and they'll have an internship. And in the internship they'll suddenly become scared because they'll be told by a boss, "oh, you can't do that." Or "we don't do that here" or whatever. Where as they come back in the classroom space. We say, why not? Why can't you do that? What do you need to empower you to do those things? So, first of all, just education itself has been a huge engine of innovation, I think is very important.

The other thing I would add as you probably heard from my earlier remarks is I think innovation itself needs to be innovated. And I think, you know, when we hear questions about, you know,

can you teach a middle-aged man to code Python or what, or what have you, the first thing we have to do is, we have to say, how can education meet the needs of that person, not how can education force that person to do what it is that education wants them to do, you know not how can education force you as a middle-aged man to learn Python, but how can education invite you in, empower you, open you up, ask you, what do you want to learn? How can we retrain you?

So there's a kind of dynamic relationship so that instead of people feeling like they are compelled to be retrained like robots or widgets, they're empowered to join this kind of cycle of creative destruction. So they don't fear change the day they themselves open themselves up to change. And I think that's really what we can do more of in our, in our educational institutions and also what we can do more of to our educational institutions.

Philippe Aghion:

I fully agree with that. I think education is a key input to innovation and innovation is a key input to education and that, so that totally intertwines, but education is very important you know, sorry, I thought there was a view that R & D is, would be the main thing to do. If you are in the, without an education, educational basis, your, the effectiveness of your R & D subsidy will be very low. So, you need, you need education for R & D effectiveness. But in education, you need to be innovative.

Larry Bernstein:

You mentioned that the United States is a fantastic ecosystem for innovation and that you were not surprised that the COVID vaccines originated in the US and at an unprecedented rapid pace. The United States paved the way using a combination of government, the NIH, medical institutions, but also private firms. You are a professor at, in multiple different countries. You were just a visiting professor at Harvard, a professor in France, and in London. You are our global guy.

I'm in the finance business, I've been in finance my whole career. I worked at Salomon Brothers and from time to time, I've had the opportunity to work with French banks. And I got to tell you nothing is more unproductive than dealing with them.

It's just extraordinary.

Philippe Aghion:

I know, I know.

Larry Bernstein:

Now I, I don't mean to beat up, but I.

Philippe Aghion:

No! No! No! But you are right.

Larry Bernstein:

I have not dealt with French engineering firms or other French industries. My experience with French banks is terrible. Douglas North talked about the role of institutions in economic growth. What is it about French institutions that undermine innovation and what is it about American institutions that encourage innovation?

Philippe Aghion:

I think it's Institutions and culture, I would say first on institution, for example, in biotech, for basic research in the U.S you have the national science foundation, the national Institute of health. Howard Hughes medical Institute, which is a huge sponsor foundation. There is very little basic research, very little sponsorship in France. That doesn't exist, basic research is underfunded, dramatically in France. All this medical research is underfunded. You have venture capital, very developed, who are the venture capitalist? Most of the time it's successful people who did their own startups, entrepreneurs, who did an IPO and they then became venture capitalists.

In France, venture capitalists are civil servants essentially, they're not at all people who have gone through the experience of working at a startup and growing and becoming successful. You have institutional investors, they play a big role in innovation. They explain all that in the chapter 12 of the book, France has much fewer developed institutional investors.

And for the vaccine, the US has biologic advanced research development agency created on the same model as DARPA, Defense Advanced Research Project agency. This is to turn basic research into mass industrial production very quickly. It worked well with the vaccines. The M-RNA messenger was successfully used. Incredibly, in less than one year into mass production of vaccine that would do the job. There is nothing like BARDA [Biomedical Advanced Research and Development] in France or in Europe, nothing. So you see, so the US has the whole ecosystem. You are much better on all grounds, basic research, venture capital, BARDA, DARPA We don't have any of these.

But on the culture, there is a culture of risk in the U.S. When you fail, early failure is not punished say in France in the school system, people tell you that you are an idiot all the time. And so you're afraid of the teacher. You don't dare and you don't have to ask question. It's very impolite to ask the question to the teacher. Whereas in the U.S, It welcomes to ask questions to the teacher and it's welcome early failure. If it helps you learn, we don't have that at all in our culture. So it's both institutions and culture in France that are detrimental to innovation.

Larry Bernstein:

In my introductory remarks, I commented on the creative destruction caused by COVID. We've had more firms go bust probably in the last 18 months than probably in the history of the United States.

There is this economist who we had on the show who you probably know him Chad Syverson who commented about the very different variance in the return on capital within industries. That's unlike anything we've seen before. Some firms have very low rates of return. Others have very high rates of return in the same industry. And what I suspected happening right now

is those firms that were having zero or very, very low returns on capital pre-COVID experienced negative returns during COVID. They just decided to close up shop and all those workers who had been working for these firms with very low returns on capital got fired because these firms closed and are now being gobbled up by these large established firms who have been historically very productive. Should we be thrilled to death about this creative destruction? Is this the best example of creative destruction in modern times?

Philippe Aghion:

I'm not happy about it, particularly. I'm not, you know, creative destruction is a fact. It's true that COVID boosted bankruptcies? Although in France, during the crisis, France was so protective with firms that the French government that the rate of bankruptcies went down by 30% in France. So during COVID period, in fact, because the government over reacted by protecting firms, the rate of credit destruction went down compared to previous years. Do you see? It will go back to normal. So it depends what the government does. The U.S Government didn't react the way the French government did. So from Germany and other European countries, they reduced creative destruction during Covid, because they over protected firms.

If we go back to normal, they will be something that will resume as before some activities may not resume as before. Medical consultation will go online. I don't know if we fly as much as I used to because maybe now I will do conferences on zoom, some of them at least. So, you know, shopping online might develop. So there are things that we know work, well we know work from home, and the work of Nick Bloom on working from home, it tells you that it will last, that somehow Covid produced a shift in working from home much more. And once that shift is done, you don't go back to where you were before.

So there will be this creative destruction. And it all depends. That's very important why that you have a labor market system that accommodates it. I think there is no drama in having more creative destruction. If whenever people lose their job, they are protected. They receive good unemployment insurance and retraining. I think if that is there, it's less of a drama than I think what we need to protect is more individual. That is the individuals that you need to protect. And that's the way of the Danish model. I find very attractive in that respect because they found a way that making creative destruction more human, more acceptable. They have no problem at all with creative disruption.

Larry Bernstein:

I mentioned in the opening remarks, we had the labor economist from UChicago, Casey Mulligan.

Philippe Aghion:

Yes. I know Casey. I know him.

Larry Bernstein:

And Casey said, when we have these very large federal unemployment benefits that are through September, they're not doing any retraining. These guys are just sitting at home,

depreciating their skillset every day. We are going to allow people to sit home who would otherwise find employment. We have,

Philippe Aghion:

I think there are two ways to answer. Of course, there is a way to say if you want people to get back to work, provide zero insurance and then we'll get back to work. It's true. You get the U.S model where you have low unemployment rates, but very high mortality rates and stress and all that. I look at two indicators. I look at the unemployment rate and the stress as well. And you see that's, what's good with the Danish system. If they found the system to reduce employment and also not have stress and opioids and all that. And how would they do that? If you lose your employment, you get 90% of your salary, but you have to retrain and go to work. And the state helps you find a new job. They propose you two new jobs in your qualification if you refuse more than two you lose your insurance.

So you see the idea is not to get people to stay at home. It's to have a very active labor market policy where you retrain, you help the guy find a job. And when you find a job and the guy doesn't take the job, you say, well, you don't take the job. The, the subsidy is over. And then that works well because they have an insurance, but they also get the job, you understand. And that's what is the genius of the Danish system. They found a competitive system and we explain that in chapter 11 of the book you see. And before there was the view that the only way you will have long unemployment rate is to have people, groups, under enormous amounts of stress. And, I think we can do better. Exactly. If I operate you with or without any anesthetic it is better that I operate with anesthetic.