

Book Review for 04/06/03 by Robert Mulligan

Title: "The Dynamics of Firm and Industry Growth: the Swedish Computing and Communications Industry"

Author: Dan Johansson

Length: 192 pages

Price: \$22.00

Reading time: 10 hours

Reading rating: 7 (1 = very difficult; 10 = very easy)

Overall rating: 4 (1 = average; 4 = outstanding)

Dan Johansson, a public policy economist at the Ratio Institute in Stockholm, has produced an engaging and very interesting study showing how economic policy can frustrate economic growth. Although the author deals with Sweden, and Sweden's economic policies throughout the nineties have been different from those of the United States, this book should draw special interest from Americans for the light it throws on the high-tech buildup of the nineties and its subsequent collapse.

Although Johansson employs a new and fairly pathbreaking methodology, this book is not so highly technical, formalized, or mathematical that it cannot be easily understood by laypeople. Lay readers will probably want to skim the statistical analysis and focus on the interpretations and policy conclusions. Johansson views firms as business experiments, which may either succeed or fail, but are always essential components of economic growth.

Firms operate in an environment of high risk and extreme uncertainty, a context where not to experiment is automatically to fail. Entrepreneurs take on the challenge of facing the market's risk and uncertainty, in competition with everyone else who accepts the challenge. Not everyone is cut out to succeed at entrepreneurial management, and even some highly-talented entrepreneurs fail, simply because they are unfavored by circumstance, or in other words, unlucky. Now, that's a risky environment.

Firms develop competence blocks to deal with environmental uncertainty. No one can make use of all available information, and successful firms specialize in limited activities in which they can maintain a knowledge advantage over potential competitors. A competence bloc consists of interrelated and competent customers, who can make good use of a firm's products, as well as the inventors, innovators, entrepreneurs, and skilled labor, who are coordinated within the firm, and venture capitalists who provide financing.

Economists have long understood that the entry of new firms into various markets always accompanies economic growth. Some have believed that firm entry causes growth. Johansson points out that an additional requirement for economic growth is the abandonment of certain markets by some firms. In extreme cases, a firm will go out of business completely. Firm exit is necessary to free up resources, including workers, equipment, and money, for new enterprises which are more responsive to, and better

positioned for, market conditions. Valuable resources can be tied up, acting as a brake on growth, if the government intervenes to prop up failing firms in sick industries.

Next, Johannsson turns to government economic policy, and finds few positive features. In Sweden, government regulation discourages entrepreneurs from starting new firms, and the government tries to encourage failing firms to stay in operation. It also subsidizes the least efficient industries, such as shipbuilding. Not only does this waste scarce tax revenue, but it keeps resources tied up producing something the public does not want and will not buy. Poor government policy seems to be the main reason why Swedish economic growth has lagged behind that of nearly every other industrial economy.

Particularly dangerous for economic growth is "incompetent money," investment funds not coupled with market knowledge provided by the government or unskilled venture capitalists, which fund unproductive activities. A notable phenomenon in the U.S. high-tech build-up of the late nineties, was the injection of incompetent money, which enabled the stock values of worthless tech firms to increase astronomically. Especially interesting for the U.S. is that our incompetent capital came mainly from private sources.

This is a penetrating, well-written study of the technology sector. Though the focus is on the Swedish economy, it offers many lessons for the U.S. Investors and policy makers can both benefit from the insights offered by this book.

Robert F. Mulligan is assistant professor of economics in the Department of Business Computer Information Systems and Economics of the College of Business at Western Carolina University. His research interests are monetary economics and constitutional political economy.