Opinion **US economic recovery**

Covid recovery will stem from digital business

The pandemic has changed the nature of US business and the economy

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Much has been said and written about the pandemic-related rise in business insolvencies — I've written numerous hand-wringing pieces on the topic myself.

But the truth is that many new businesses are being created, too. In fact, recent US data shows that applications for the employer identification numbers needed to start new businesses are up 18.5 per cent this year compared with 2019. Many of these new enterprises will fail, of course — most do. If historical trends hold, this Schumpeterian creative destruction will leave the economic landscape very different after Covid-19.

Start with the new businesses. There's no tally of the type of enterprises being set up, but it's a fair bet that many will be highly digital. They are likely to hold a large chunk of value in intangible assets such as research and development, brands, content, data, patents or human capital, rather than in physical assets such as industrial machinery, factories or office space.

That was certainly the case during the financial crisis. Between 2007 and 2009, the share of intangible assets as a proportion of total fixed investment spending rose by 7.5 per cent, according to an analysis by the Carlyle Group. Its report, which looks at the fallout of Covid-19 on business models, predicts that spending on intangibles may rise by 11 per cent over the next couple of years, as the work from home revolution erodes the importance of physical assets.

So far so good, for knowledge workers, or those starting an asset-light business. But intangible assets are also associated with jobless recoveries. Over the past 20 years, the shift from a tangible to an intangible economy has, to put it quite simply, allowed employers and businesses to do more with fewer workers.

If education levels in the US were higher, workers laid off during this pandemic might be better able to adapt to the new landscape, and use new technologies to enhance their own productivity and employability. But training is not a quick fix.

"Past increases in the intangible share of corporate outlays have been associated with slower recoveries in employment," Carlyle writes. "If that relationship holds this cycle, a return to full employment in the US may be much further off than the late 2021 or 2022 recovery" in gross domestic product.

The continued rise of intangible assets has implications for investors too. Commonly used metrics like "book value", the ratio of share price to a company's productive assets, were often used by "value" seekers to assess which companies might be over- or underpriced. Stocks with the lowest price-to-book ratios were expected to outperform those with the highest ratios.

But current accounting rules do not allow internally generated intangible assets to be recorded on balance sheets as capital. That means this metric has lost much of its meaning. Or the meaning has shifted. Today, a high price-to-book ratio might signal not an overpriced stock, but one that has a lot of the sort of intellectual property and software that have retained their value amid Covid-19.

In a pandemic, it is better to own a company built on customer data than one with bricks and mortar retail outlets. Indeed, it may turn out to be smarter to own companies rich in intangible assets from any sector rather than bet on the Big Tech companies that have been driving the S&P 500. This will be particularly true if regulators begin to pick apart the business models of Facebook, Google and the like.

Finally, coronavirus-related digital shifts may put a lot more downward pressure on pricing power than expected, according to Robert Kaplan, head of the Dallas Federal Reserve Bank. In a recent essay on US economic conditions and monetary policy in the wake of the pandemic, he noted how people's work and shopping habits have changed. They are doing more online, which allows digital platforms to grow bigger, and this in turn has damped business pricing power.

"To respond to this trend, businesses are investing substantially more in technology to replace people, lower their costs and improve their competitiveness," he wrote.

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That in turn may shift how we should think about monetary policy. Mr Kaplan dissented from the Federal Reserve's recent decision to keep the federal funds rate target unchanged at zero to 0.25 per cent. The deflationary effect of the digital revolution, he said, "may well offset the cyclical inflationary impact of a tightening job market".

Translation? Even after we are ultimately out of the Covid-19 woods, the changing nature of our digital economy may mean that we simply do not get as much inflation as we think. Some people believe that's an argument for keeping rates at zero or even lower, for longer — if we aren't at risk of overheating, why worry? Despite his view that acceleration of the digital economy will have some muting effect on inflationary forces, Mr Kaplan worries that a prolonged period of zero rates can encourage excess risk taking.

There are also plenty of academics and policymakers who believe that loose monetary policy has become an economic morphine drip that carries more risk than reward. Indeed, that's a common theme in a new book on the lessons learned about financial fragility between 2008 and today, by the OECD's New Approaches to Economics Challenges initiative.

Bottom line — the cure for the coronavirus economy carries new risks of its own.

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This article has been amended to clarify Robert Kaplan's views on inflation

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