How Schumpeter would view the economy today

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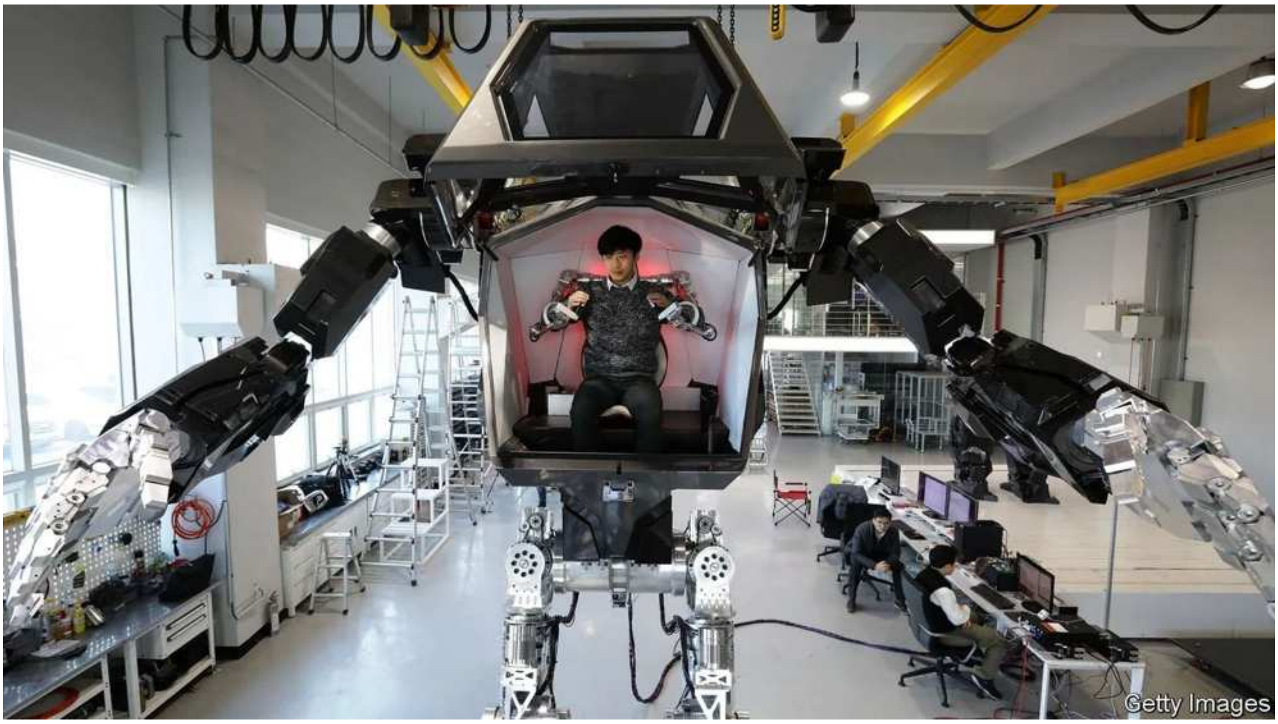

Innovate to accumulate

A new book offers a strikingly upbeat take on modern capitalism

The Power of Creative Destruction. By Philippe Aghion, Céline Antonin and Simon Bunel. Translated by Jodie Cohen-Tanugi. *Belknap Press; 400 pages; $35 and £28.95*

JOSEPH SCHUMPETER thought capitalism was doomed. Incumbent firms would grow too powerful, leading to corruption and, eventually, socialism. His mid-20th-century pessimism has become fashionable today, as societies grapple with inequality, climate change and tech giants. Yet some of Schumpeter's professional heirs are optimists. In "The Power of Creative Destruction" Philippe Aghion, Céline Antonin and Simon Bunel, three economists, apply his most powerful idea to contemporary debates in their discipline. The result is sweeping, authoritative and—for the times—strikingly upbeat.

Elementary models of growth focus on the accumulation of capital, with technological progress and advances in productivity assumed but poorly explained. The Schumpeterian paradigm of creative destruction, of which Mr Aghion is a modern champion, puts innovation at its core. In this view, ideas drive long-term growth. People are motivated to innovate by the prospect of monopoly rents (an aberration in simplistic economics). But innovation also destroys rents by displacing the previous generation of entrepreneurs.

Take development. Critics of free markets like to argue that the fast growth of Asian economies such as South Korea in the late 20th century proves the desirability of state intervention, given that these places often sheltered firms from competition and subsidised their exports. The Schumpeterian paradigm emphasises knowledge. When countries are far from the frontier of innovation, the important thing is to learn how to imitate the best, which the government and businesses might manage arm-in-arm. But economies must later become innovative themselves. In South Korea this was achieved fortuitously. In the late 1990s the Asian financial crisis bankrupted some *chaebols* (industrial conglomerates) and exposed others to competition in part because of policies imposed as a condition of an IMF bail-out. The happy result was an economy that produces ideas.

The authors are not market fundamentalists. They emphasise that innovation is self-perpetuating. Advances in one area, such as internal-combustion engines, will naturally lead to more—and the state can nudge firms down the right path. To tackle climate change, they recommend subsidies for green innovation alongside taxing carbon emissions. They are unafraid of calling for industrial policy in sectors such as aerospace, where the initial costs of entry are high and demand is uncertain (meaning the private sector has an incentive to wait for someone else to innovate first). It is crucial, they urge, that governments always encourage new entrants rather than impeding them.

What about labour markets and inequality? The authors are sceptical about some contemporary doom and gloom. Automation creates more jobs than it eliminates, they reckon. Innovation yields fortunes at the very top but does not seem to boost overall inequality, as measured by the Gini coefficient—a subtle rejoinder to those who think that the success of billionaires is America's biggest problem. Creative destruction is a force for social mobility: California's elites have higher incomes than Alabama's, but its poorest have more opportunities too. Tax cuts on capital income, like Sweden's in the early 1990s, stimulate innovation and growth.

Inequality resulting from lobbying and regulatory capture, however, is cancerous: it brings slower growth and less social mobility. The authors also call for an "insurer state" to redistribute wealth and protect workers against the vicissitudes of a dynamic economy. And they worry about the runaway success of technology giants stifling ingenuity, arguing that competition regulators should be as concerned with the incentive to produce ideas as with companies' market shares.

Schumpeter was an outsider among the Keynesian economists of his day. His ideas were rooted in the real world of business, not the ivory tower. This book, by contrast, is in part a defence of economics (and of third-way liberalism). Its brevity relative to its ambition means that it is not always convincing; sometimes the evidence adduced is thin. But the overall argument is compelling and, with creative destruction falling out of political favour, it carries a trace of Schumpeterian subversion. ■

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