

BY JOHN MULLIN

## Cushioning Destruction to Foster Creation

**P**hilippe Aghion is one of the most widely cited economists on record. He has published over 90 papers in refereed academic journals, co-authored 14 books, and received numerous honors. Together with Peter Howitt, he is a pioneer of a research paradigm called Schumpeterian growth theory, which is based on the notion of “creative destruction” popularized by economist Joseph Schumpeter in the 1940s. Schumpeterian growth theory sets itself apart by building and testing economic models specifically designed to explore the implications of creative destruction. The resulting research is featured prominently in Aghion’s latest book, *The Power of Creative Destruction*, which he co-authored with Céline Antonin of Sciences Po and Simon Bunel of the Bank of France.

Aghion and his co-authors define creative destruction as “the process by which new innovations continually emerge and render existing technologies obsolete, new firms continually arrive to compete with existing firms, and new jobs and activities arise and replace existing jobs and activities.” In their view, creative destruction is no less than the “the driving force of capitalism” — the source of both its greatest accomplishments and its failures.

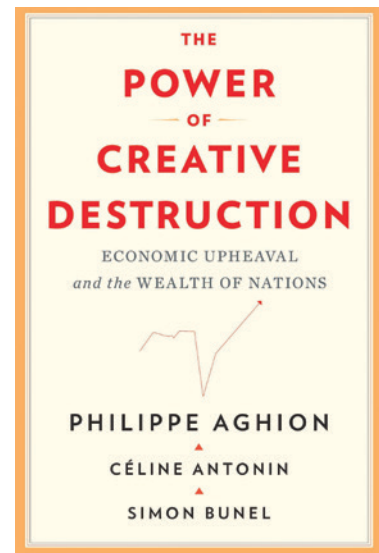
Schumpeterian growth theory is inspired by three ideas: first, that economic growth is primarily driven by innovation and the diffusion of knowledge; second, that decisions to invest in innovation are motivated by the potential returns, and so anything that secures those returns, such as intellectual property rights, will increase the incentive to invest and innovate; and third, that destruction is an inescapable part of creative destruction — a feature of the process that sets the stage for a continuously disruptive

conflict between the old and the new. As Aghion puts it, “creative destruction thus creates a dilemma or a contradiction at the very heart of the growth process.” On one hand, the potential returns to innovation — what Aghion calls “innovation rents” — are necessary to reward innovation; on the other hand, incumbent firms are motivated to block the entry of smaller, more innovative firms into their sectors.

To Aghion, the power of creative destruction is a well-documented reality. It is seen in data showing that startups are a major source of job creation in the United States. It is seen in evidence that the fastest growing U.S. states have been the most intense innovators with the greatest number of patents per capita and the highest rates of job creation and destruction. And it is seen in emerging Europe, where the more rapidly growing economies have been those with higher rates of firm creation and destruction.

*The Power of Creative Destruction* also finds evidence in what it calls historical “growth enigmas.” For instance, why is sustained per capita GDP growth such a recent phenomenon, starting just 200 years ago, and why did it occur in Europe and not in China, where many important technological discoveries had been made since the Middle Ages? A major part of the answer, in Aghion’s view, is that competition in Europe between politically fragmented nations enabled innovation and creative destruction to overcome the opposition of vested interests. In contrast, China enabled incumbent political powers to have the “last word” and block the potentially destabilizing effects of innovation.

According to the authors, government policy should promote



### **THE POWER OF CREATIVE DESTRUCTION: ECONOMIC UPHEAVAL AND THE WEALTH OF NATIONS**

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innovation in several ways. First, the state has a role as an “investor in innovation,” which arises because people undervalue the contributions of their investments to society’s collective knowledge. Second, the state needs to protect intellectual property rights to maximize firms’ incentives to make R&D investments. And third, the state needs to establish policies to lessen the opposition to innovation. At the level of markets, this means the reduction of barriers to competition. For workers, it means providing unemployment insurance and job training assistance to protect against the dislocation caused by job losses.

*The Power of Creative Destruction* ties the need for social insurance to the crucial roles played by social norms and civil society. It holds that an economic system that achieves long-term growth but causes devastating outcomes for many uninsured individuals may not be able to sustain itself by maintaining the consent of civil society. Sustained innovation, therefore, relies on the state as an insurer to cushion the destructive aspects of capitalism. **EF**