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The Power of Creative Destruction -Economic Upheaval and the Wealth of Nations

Phillippe Aghion, Celine Antonin and Simon Bunel. Harvard University Press 2021.pp389

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Why should a book with only two references to multinational firms in its index be worthy of a review in JIBS? The answer is that the power of creative destruction is an idea that has not been fully exploited in International Business (IB) research. The application of this idea would advance the IB research agenda and would help the integration of IB and innovation studies. The cycle of innovation, prompted, at least in part, by monopoly rents, leading to a new wave of innovation that attacks the incumbents is a key element of IB theory and practice, present since at least Ray Vernon's pioneering "product cycle hypothesis" (Vernon 1966).

Aghion is a much garlanded researcher and the book has five top economists (including two Nobel laureates) lauding the book as a tour de force. It is well written, engaging and provocative. Its approach and data are largely at macro (national economy) level. Critically, it largely abstracts from the agency of the firm – the institution that actually carries out the creation and the destruction. Globalization is generally treated as the interaction of nation states – "managing" exports and imports, unemployment, and education and health policies. Indeed, globalization is largely identified with migration – the movement of people (Chapter 12). Chapter 13 "How to manage globalization" is cast at nation state level, not driven by multinational enterprises or the decisions of their managements. In this model, firms and individuals, including migrants, respond to signals – policy helps to set these market-based signal and later (chapter 15), civil society intervenes in a version (uncredited) of the governance triangle (Abbott and Snidal 2009). There is great scope for the introduction of agency by firms, multinational firms, managers and individuals. Here lies a huge research agenda that IB can fulfil.

The power of creative destruction relies on three ideas from Schumpeter (1950). (1) Innovation and the diffusion of knowledge are at the heart of the growth process. (2) Innovation relies on incentives and on the protection of property rights. (3) New innovations render former innovations obsolete in a process of creative destruction. All of these ideas are compatible with mainstream IB theorising.

Moreover, they apply particularly to multinational enterprises (MNEs) in their innovation and exploration strategies, their intellectual property and exploitation strategies, and their philosophy of continuous improvement in the face of international competition. They fit well with approaches emphasising flexibility and innovation such as the global factory (Buckley and Ghauri 2004, Buckley 2009).

There is a dilemma in the creative destruction approach to global capitalism. Rents are necessary to reward innovation and to motivate innovators (entrepreneurs) but yesterday's innovators must not use their rents to impede new innovations. Incumbent firms can obstruct new innovations. Regulation and the institutional structure of the economy must prevent this use of incumbents' power. The adaptation of institutions over time is crucial –for instance to prevent the “middle income trap”. (See the discussion on Argentina (p22)). Public policies are crucial. The State should preserve competition and the free entry of innovations. The State should also insure against the adverse consequences of job loss from creative destruction as “the insurer state”. Given the path dependence of innovations, the state is necessary to redirect innovation into new areas (an example might be “green” technologies).

However, it is important not to conflate innovation with the birth and creative destruction with the death of firms. This is where IB comes in. The MNE is an institution that, over time, allows both exploration and exploitation of knowledge. MNEs force new innovation and the supersession of outdated ideas within a single, often long-lived institution, creating, absorbing, diffusing and destroying technologies.

The book takes a narrow view of funding, perhaps because its approach to innovation is restricted. After all, innovation can be entirely private sector driven, entirely state driven, or hybrid. It is entirely possible to conceive of a state-funded basic research institute that auctions off innovations to private sector bidders who are better equipped to manufacture, distribute and market the resultant products.

The book argues that the funding innovation is best done by venture and equity capital (p12). This puts entrepreneurship centre stage but fails to proceed to the social and economic conditions that foster entrepreneurship and thus innovation.

The cliché “America innovates, China duplicates, Europe regulates” is illuminated by the concepts in this book. The key argument that Aghion et al. propose is that when the nation is far from the knowledge frontier, then it is effective use the State to imitate but once on, or near, the frontier then a different strategy is need. The treatment of innovation and frontier innovation as presented here needs an IB twist. A full and complete analysis of China and its challenge to Western systems could lead to a fuller treatment of national innovation systems.

Globalization and inequality is the subject of Chapter 5. Unemployment – subnational, declining industries, the “left behind”, IB and inequality (Buckley and Hashai 2021). Industrial policy and continuing dynamism –endogenous growth. Idea of an innovation ecosystem –coming into IB. Value chains are discussed (251,113-4,168) but not seen as major drivers of innovation. The creative destruction of value chains following the pandemic is likely to provoke large-scale innovation in logistics. The focus of the book is on “the firm ”as an autonomous unit, not the firm embedded in its environment, surrounded by markets and institutions, institutional arrangements and government policy, value chains and ecosystems. International Business research can help to round out the complete picture.

Cross-fertilization works both ways. Theory in IB can advance the ideas in this book just as much as the concept of creative destruction an enliven IB. Creative destruction without the multinational enterprise is like Hamlet without the Prince of Denmark.

References:

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ⁱ (The two references are to attracting multinational firms to “pollution havens” (p185) and to multinational firms dealing with tariffs by outsourcing to other countries (p261)).