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Attacks on Romney and Bain Reflect Gingrich's Economic Ignorance

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In the convoluted world of politics, maybe it is a good thing that some Republican candidates are revealing their ignorance about free market economics by attacking former Massachusetts Gov. Mitt Romney for his role at Bain Capital. If nothing else, it helps clarify what they *don't* understand about value creation in the economy and provides the opportunity for a national debate on this now rather than in, say, October.

I'm not a Romney supporter. But stripped to its core the crime he is accused of is enabling what economist Joseph Schumpeter called "creative destruction." By creative destruction, Schumpeter meant the dynamism and innovation that must constantly occur in order to continually create value in an economy. He called it "the essential fact of capitalism."

[See a collection of political cartoons on the economy.]

Who cares what Schumpeter thought? Virtually every professionally trained economist alive today. Thomas McCraw, the Isidor Straus Professor of Business History, Emeritus at Harvard University calls Schumpeter, "the most penetrating analyst of capitalism who ever lived." His book on Schumpeter—who also trained Paul Samuelson, the first American to ever win the Nobel Prize in Economics—entitled *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* won four prizes, three of them international. Schumpeter is the undisputed father of the concept of creative destruction.

Over time, companies that do not change often die. Life is a dynamic process and our competitors are global. Historically, while there are many companies and even industries that have sought government enforcement of the status quo, competitive forces ultimately win out. Case in point: the candle-makers fought the electricity industry. As the Cato Institute's David Boaz recently wondered, "Should we be keeping the firms that once made horse-drawn buggies, gramophones, and slide rules in business"? Long-term success is determined by a company's ability to provide more value in goods or services than alternatives while using fewer resources. In this way value creation is the fundamental role of business or industry in a market economy.
[See a slide show of Mort Zuckerman's 5 Ways to Create More Jobs.]

So what did Romney do? He ran an investment firm that found small (and some not so small) firms that needed help in value creation. Because consumers and competitors demand innovation, sometimes these companies needed management help, an infusion of cash, or to shut down unprofitable business lines. To be sure, venture capitalists take a lot of risks—most of which don't pay off, but that's balanced by the big rewards all concerned reap when they do succeed.

This stands, by the way, in sharp contrast to government attempts to pick winners and losers in the economy such as they much maligned loans to Solyndra. As Mercatus Center senior scholar Antony Davies put it,

When the venture capitalists and entrepreneurs make bad decisions, it hurts just as when the government makes a bad decision. But when venture capitalists and entrepreneurs make bad decisions, the people who are hurt are the people who knowingly chose to invest, work for or do business with them.

[Read Peter Roff: Mitt Romney Must Sharpen His Defense of Bain Capital]

In other words, the taxpayers don't pay the bill—like they will with Solyndra and other ridiculous and ill-fated government interventions into the market. The fact is that governments acting like venture capitalists using "OPM" (other people's money) to invest have been failures in most countries that have had the arrogance to attempt the task. Spain's record on green jobs is every bit as poor as the Obama administration's, and arguably worse. So the alternative to dynamic capitalism (where risk and return appropriately lives in the private sector) is Euro-statism. This is the path that has led to the higher unemployment and lower quality of life generally found in European countries and has gained an unfortunate foothold here in the United States. So, while former House Speaker Newt Gingrich has shown the depth of his misunderstanding of market economics, on net this*is* an important conversation for the nation to have *now.* For the sake of Gingrich's political career, however, he could have skipped it entirely. After all, Romney gave him plenty to work with when it comes to his legacy as the governor of Massachusetts. Criticism of his approach to the healthcare market in his state, for instance, is something that no one should let him forget. And at least that doesn't involve indicting capitalism.