

**TechCast Article Series**

**ON CRISIS AND INNOVATION**

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Times of crisis are always a call for reflection on the economic system. And it is natural that this reflection be made under the shadows of our past because history matters. Seventy years ago, the world faced a crisis similar to the current one.

John Maynard Keynes was a great economist of the 20th Century, in good part as a consequence of his central role in explaining the 1930s crisis and applying these lessons to advise governments. Meanwhile, another economist, Joseph Alois Schumpeter, had a completely different explanation for the functioning of capitalism. The key difference between Keynes and Schumpeter is that the first focused on how to achieve economic stability while the second focused on the inevitable role of innovation and change.

Keynes, and most orthodox economic thought, saw the economic system as an equilibrium system, where crises and instability are exceptions to be corrected by governments. For Keynes, the 1930s crisis was a detour in the natural path of the capitalism, caused by a nefarious blend of greed and bad judgment.

Schumpeter, on the other hand, saw change as the keystone of the economy, with competition creating a permanent state of imbalance. He understood that capitalism is inherently unstable, with change as the rule. This dynamic quality is the virtuous essence of capitalism that gives the system its robustness and natural resilience.

What is most important in Schumpeter's vision is that the naturally occurring dynamics of capitalism arise because innovation is the central mechanism that gives capitalism its evolutionary ability for adaptation to change. For Schumpeter the competitive process stimulates

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entrepreneurs to continuously search for new products and improved processes.

But the most important moment occurs not in routine innovation, but in radical innovations that create new markets, followed by a demand that did not exist before. Crises, with the destruction that they bring, is the inevitable reverse side of the same coin.

Schumpeter called this process “Creative Destruction.” The basic dynamics of capitalism continuously destroy the old system and create a new system in its place. The new cannot be reached by the successive improvement of the old - it is necessary to destroy it. And out of the ruins emerges a new, bigger and more prosperous market.

History is full of cases like this. From automobiles to computers to electric energy to the iPod, radical innovations create new markets, change the topography of the economy, transform industries and allow capitalism to rebuild itself from inside out.

Keynes, imprisoned in his static vision of the economic system, took a pessimistic position and underestimated the creative capacity of capitalism. He did not appreciate how innovation creates new economic spaces and extraordinary new market demands.

This analysis shows that crises are inherent in the very nature of the capitalism. Crises do not represent the end of the system but only one process of adjustment, and this deeply transforming process produces great opportunities. Just as the crisis of the 1930s later led to the renewed economic system we have enjoyed since then, today’s crisis will reward those who know how to innovate in the face of profound uncertainty with extraordinary gains.

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