Mitt Romney, Hero of Finance by Paul Starr

"Creative destruction" is Mitt Romney's best defense for his career in private equity and the trail of displaced workers some of his ventures left behind. The idea comes from the economist Joseph Schumpeter, who argued that capitalism generates economic growth through "gales of creative destruction" that sweep away obsolete technologies and products. As Romney's advocates have it, that's what his firm, Bain Capital, has advanced—painful economic changes that are essential to a rising standard of living.

If Romney made his fortune that way, he deserves the praise that some conservatives have lavished on him for contributing to American competitiveness. But that isn't the whole story. Much of the work of Bain and other private-equity firms has little to do with the kind of wrenching Schumpeterian change that contributes to growth, still less to the job creation for which Romney claims credit.

Technological innovation was at the heart of Schumpeter's vision, and no one today objects to the role of venture capital in financing tech start-ups or to the re-engineering of businesses to take advantage of new technology. Reorganizing firms to exploit special provisions in tax, securities, and bankruptcy laws is a different proposition. That kind of restructuring can be immensely profitable, transferring wealth to investors while making no positive contribution to growth and employment.

The standard operating procedure for private equity has been to buy firms, take them private, and load them up with debt. By taking them private, the new owners escape from the securities laws, which apply only to publicly traded companies. By loading them with debt, they cut the companies' taxes because the interest is fully deductible from profits, and they use those tax savings to pay themselves generous fees and dividends. If an over-leveraged enterprise then fails, they take it into bankruptcy, firing workers and stiffing creditors even though their own firm has already pocketed large gains. And because private-equity partners can receive those gains as "carried interest" (taxed only at 15 percent), they benefit from special legal advantages in yet one more way.

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This kind of restructuring doesn't just siphon off wealth; it can also interfere with genuine innovation because debt-burdened companies are sometimes starved for capital to invest in new technologies and products. Private equity has generally sought a high return with a quick exit instead of providing patient capital for long-term gains. That's great for those who are in on the deal, but not for the national economy.

Private equity has also contributed to a broader change related to rising economic inequality. Instead of corporations serving a complex of interests—owners, workers, and communities—they have increasingly become wholly dedicated to maximizing returns to owners. This "shareholder-value revolution" has helped to drive the overexpansion of the financial sector and to funnel the gains from economic growth into fewer hands—Romney's, for example.

That Romney served investors well at Bain, no one doubts. That's not a credential, however, for solving the nation's problems. We ought to be reducing the incentives for the maneuvers that enriched Romney—for example, by cutting the deductibility of interest on debt incurred in acquiring companies and raising taxes on "carried interest" so that financiers pay no lower a tax rate than the rest of us. Good luck with that in a Romney presidency.

There is a larger point about Romney's career and good public policy. The turmoil in the private economy, whether generated by creative destruction or financial manipulation, is a reason we need progressive government. Individual firms cannot be counted on to retrain workers for new jobs or to provide them with long-term security; the very instability of private employment is why workers need to be able to count on government when they get displaced to help them obtain the education and skills to adapt. The best "national innovation systems" minimize the harms to workers while advancing technological progress.

Schumpeter's 1942 classic, *Capitalism, Socialism and Democracy*, was a dour book. A true believer in capitalism, Schumpeter nonetheless thought it was doomed because people wouldn't put up with creative destruction, and businessmen lacked the heroic qualities to become effective political leaders. He was wrong on both counts. Instead of resisting innovation, we welcome it, and some business leaders, like Steve Jobs, have become popular heroes.

But Romney is no Jobs, and even his most successful investments—Domino's Pizza, Staples, and Sports Authority—don't quite make him a Schumpeterian hero. There is one good thing about his candidacy, though. It highlights the inequities that have helped make people like Romney so wealthy and powerful. ▣