BOOK REVIEW

A venture capitalist and theoretician provides a radical reconsideration of the roles of asset bubbles and government investment in technological innovation.

According to the once-dominant perspective of neoclassical economics, efficiently functioning markets and the rational actors who run them justify a minimum of government intervention in the form of either regulation or investment. But in this second edition of his economics book, Janeway (Doing Capitalism in the Innovation Economy, 2012) contends that the most recent market crisis and the existence of bursting financial bubbles in general repudiate that sanguine vision of triumphant human reason. In fact, state action is necessary not only to preserve continuity and confidence during disruptive periods, but also to fund technological innovation. The author conjures a Keynesian model to capture this more nuanced, messier version of progress, one in which the state, the market, and the financial sector simultaneously compete and collaborate—the “Three-Player Game.” Financial bubbles turn out to be necessary: When the timing of the dance between the three players flounders (“coordination failures”), bubbles occur and create the incentive to speculatively invest in risky assets while largely remaining indifferent to their real or future value. Put simply, bubbles generate the conditions for progress, or the “environment in which technological revolutions can reach commercially and economically significant scale.” The propensity to “tolerate unavoidable waste,” for example, to fund research without any expectation that it will generate returns, is the heart of capitalism, not the rational optimization of outcomes, and for this the government is indispensable.

But Janeway deftly shows that the digital revolution’s astonishing success, inconceivable without state sponsorship, has paradoxically contributed to the delegitimizing of government by accelerating the expansion of economic inequality and the social stress that ensues. The worrisome consequence could be that a diminished version of the Three-Player Game is unable to steward the next revolution: the emergence of a green economy. This second edition includes a valuable updated reflection on the ramifications of Donald Trump’s presidency and the angry march of populism. The author’s incisive analysis draws deeply from his dual identity as a venture capitalist with over 40 years of practical experience and a theoretician with a Ph.D. in economics from Cambridge University. As a result, he moves agilely from the microscopic assessment of case studies to the rigorous discussion of academic literature. For those in search of advice on how to “construct defenses against the vagaries of living in this uncertain economic world,” he furnishes creative, sensible lessons. But he also supplies a provocative critique not only of neoclassical economic theory, but also of the behavioral models that presume reliable rationality as a signature characteristic of human decision-making. Janeway employs “two different styles of rhetoric,” one more forbiddingly technical and the other more conversationally informal, the result of the material being sourced from different kinds of presentations he’s given. In either case, unfortunately, the writing can be needlessly turgid and unwieldy. For example, “existential \textit{negative} externality” is the kind of phrase that repudiates itself once said out loud.

A stunning display of insight and erudition and an important contribution to a long-standing debate about the part government plays in technological progress.

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