Chapter 22
Three Horsemen of the Markets:
On the Perspective of Schumpeterian Revolution in the Nexus of Finance-Innovation-Competition

Gönül Yüce Akıncı
Ordu University, Turkey

ABSTRACT

The purpose of this chapter is to examine the impact of technologic improvement and financial development on competitive power in the 28 member countries of the European Union using panel geographically weighted regression analysis for the period of 2004-2016. The findings of the analysis, which show that increasing technological development accelerates the competitive power, support the Schumpeterian hypothesis, revealing that the impact of technology on competitiveness could accelerate with the contribution of the financial sector. In addition, findings reflecting the fact that the foreign trade which has been strengthened via technical development increases the competitive power show that the level of globalization has a contribution to this process, also. It has been observed that securing the property rights and applying the effective patent regimes leads to competitive advantage, and the economic integration process of the European continent has strengthened the competitive force.

INTRODUCTION

Mankind who made the first breakthrough of world socio-economic history with the Agricultural Revolution, were fed by a continuous social and economic development since the prehistoric times. Countries that left behind the collective movement to increase social prosperity and wealth fenced around their selves and tired to expand this fenced-in area with a competitive structure. In such a period the countries entered into a new social transformation and realized the Industrial Revolution. Capitalism therefore began to feel its influence more strongly since the mercantilist era, in which its bases were implicated. With the Industrial Revolution, the high level of prosperity and competitive advantages capturing for world economies in an unprecedented manner was often linked to an increase in production factors and the influence of the physical capital on the wealth of the countries became more emphasized. Countries

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that were in a subsistence and stable life until the Industrial Revolution left the door of a period in which every economic and financial policy application was regarded as a licit process in order to reach the level of wealth and prosperity and in achieving this goal, the race to gain competitive power became effective. The coordination between the monetary systems of countries were tried to be established to obtain the power. The application of the golden monetary system which operated continuously and relatively efficiently to develop the process of financial system as well as to expand trade flows among countries in the period from 1870 to 1914 has been interrupted by two world wars and the Great Depression. The trade and currency wars that emerged in order to obtain competitive advantage led to the creation of economic blocs and the world economy entered a period when the liberal policies being suspended. In order to reverse the negative socio-economic conjuncture which were manifested in the declining economic, financial and monetary mechanisms the Bretton Woods system was established In 1944, the so-called golden age of capitalism was entered, and economic and financial associations were formed to capture the competitive advantage. The foundations of these associations were strengthened with the help of theories that emphasized the importance of physical capital in increasing the prosperity of the country, but only one piece was needed for the whole picture to be seen: *The measurement of our ignorance.*

The Scientific Revolution helped countries that need a new transformation in order to increase their competition power, which gained great importance to raise the level of welfare and the lost part of the roots of our wealth, or in other words, the dark face of our ignorance is illuminated. Since the 1980s, the importance of technological progress to *rise over the shoulders of the giants* gained momentum and the evolutionary transformation of the Schumpeterian view was achieved economically and financially in order to reach competitive advantages. Schumpeter (1911) asserts that efficient financial markets encourage technology, innovative actions and competition by driving and fund raising entrants with the best opportunities of triumphantly applying innovative goods and manufacture process. Schumpeter and his followers support a liberalized financial mechanism which can mobilize a raised level of financial austerity and allot capital to further prolific uses; both of them increase the level and efficiency of physical capital, strengthen competitiveness and therefore promote the process of economic growth (Luintel & Khan 1999). Consequently, it can be argued that a well-developed financial system has two objectives: to drive economic resources from conventional industries to modern ones and to support and encourage the spirit of enterprise or competitive power in the modern industries. Financial intercessor that drives economic resources from conventional industries to modern ones is similar to the Schumpeterian notion of innovative finance. In this context, technological development enabled countries to rise over the shoulders of the giants on the on hand, and on the other hand it emphasized that the production of information and technology evolved with very difficult processes and that *the fishes were consumed*. In other words, the importance of technical development were mentioned in order to obtain competitive advantages and then some new concepts came to light such as learning by doing, updating the capitalist system to bring up the imperfect competition structure, accumulating knowledge, developing human capital, and the dominance of financial capital and monopoly capital markets.

The globalization process that sets the stage for the transformation of the world into a global village opened the way for the deregulation process by enabling the integration of economic and financial markets and the in order to obtain higher profits international capital, which is regarded as a scarce resource, reached the ability to move freely among countries. At this point, however, a major axis shift raised and the technical development resulting from the contribution of human capital and research and development process substituted for physical capital which was claimed to have a dominant role in achieving competitive power. Therefore, technological innovations which were called as *manna from*

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