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Animal Spirits Through Creative Destruction

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Abstract

We show how a Schumpeterian process of creative destruction can induce rational, herd behavior by entrepreneurs across diverse sectors as if fueled by "animal spirits." Consequently, a multisector economy, in which productivity improvements are made by independent, profit-seeking entrepreneurs, exhibits regular booms, slowdowns, and downturns as part of the long-run growth process. Our cyclical equilibrium has higher average growth, but lower welfare than the corresponding acyclical one. We show how a negative relationship can emerge between volatility and growth across

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