The European progressive "Renaissance"
Innovation and Growth in Europe
Past experience and future requirements[1]

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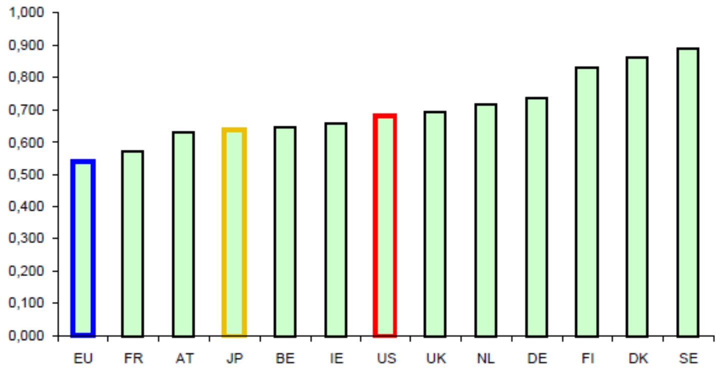
Innovation and growth are not the strong points of the European Union. The USA and Japan have consistently outpaced the EU in terms of research and innovation performance, while China is catching up fast, even though some of the best performing countries in the world are to be found in Europe, as shown below.

Research and innovation performance: best performing European countries compared to world leaders



Note: the index used for comparison in this chart is based on a set of 12 indicators
Source: Innovation Union Scoreboard 2010

Furthermore, the current target for 3% of the EU's GDP to be invested in R&D, which dates back to the Lisbon Agenda of 2000, remains elusive. Needless to say, the financial crisis of 2007/2008, the economic crisis that followed it and the futile austerity policies applied in the EU and especially the Eurozone have placed the issue of innovation further down in the EU policy agenda. Thus, any discussion of the requirements for a progressive European renaissance and the role of innovation and growth in such a process needs to take a macroscopic view, going both back to the period before the crisis and forward to the policies needed to overcome the crisis and the current recession, especially the eurozone's 'perma-recession'[2].

Such an overview also needs to look into the interaction amongst fiscal, monetary and structural policies. More specifically, the Eurozone emphasis on a small number of fiscal indicators and the isolation of the ECB and of monetary policy from developments in the real economy need to be reconsidered. Further, the privatization of almost all public banks that took place in the 1990s and the liberalisation of the EU financial system that was engineered in the 2000s are important pieces of the puzzle. Similarly, the emphasis on wage

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[1] Discussion Note for the Innovation and Growth Session of the "Call to Europe III - Beyond austerity: Building European Solidarity" conference, organized by the Foundation of European Progressive Studies in Brussels, 16-17 September 2013

[2] Term coined by the Economist Intelligence Unit in its July 2013 EIU Global Forecast; http://country.eiu.com

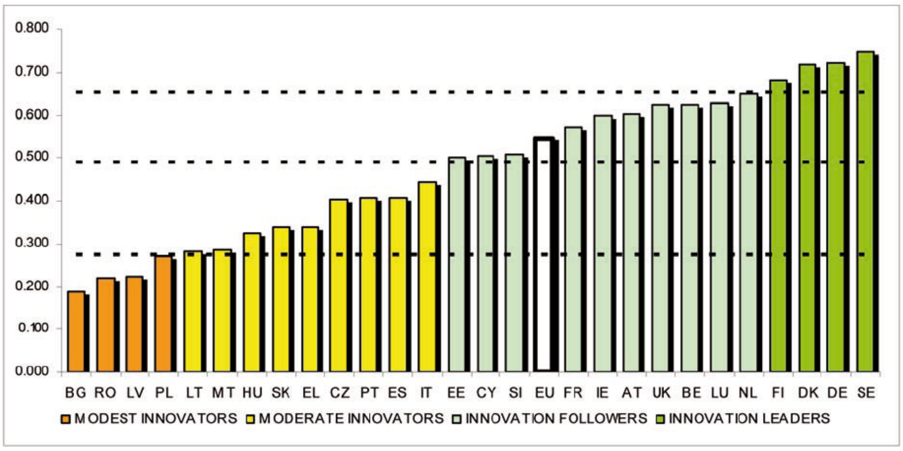
moderation as a means of fiscal convergence has been shown by the crisis to be not only misleading, but also dangerous. Overall, the framework for the analysis of innovation and growth has to take account of the fact that there is an element of indivisibility in relation to economic policy, that can only be ignored at the cost of a lagging performance economically and of increasing inequality and social discontent socially, culminating in a crisis, as we now know with the benefit of hindsight.

The roots of the current crisis are both proximate and fundamental. The financialisation of the global economy and the concomitant rising inequality, whereby the gap between the top 1% of the population and the remaining 99% exceeds the proportions of the 1920s, are fundamental causes closely connected to the workings of contemporary capitalism. At the same time, the excesses of finance and the 'revolving doors' between finance and politics are proximate causes. As such, they have entered the mainstream discourse, albeit to little effect so far.

Six years into the crisis, finance remains dominant in economic and political terms. In fact, the narrative of the crisis has shifted from finance to the 'spendthrift' governments and to the 'lazy' workers, providing the rationale for the austerity policy of the EU, which is the framework of the Fiscal Compact, as well as of the IMF-inspired adjustment programmes imposed on the indebted countries of Southern and Eastern Europe. Such a policy provides no room for innovation and growth. On the contrary, it reduces any possible room for such initiatives. Hence, any discussion of the role of innovation and growth as part of a 'European progressive renaissance' project needs to start from the reversal of austerity policies.

According to the European Commission, member states are divided into four innovation performance categories; the *'innovation leaders'* (Denmark, Finland, Germany and Sweden), whose performance is above that of the EU average; the *'innovation followers'* (Austria, Belgium, Cyprus, Estonia, France, Ireland, Luxembourg, Netherlands, Slovenia and the UK), whose performance is close to or above that of the EU on average; the *'moderate innovators'* (Czech Republic, Greece, Hungary, Italy, Lithuania, Malta, Portugal, Slovakia and Spain), whose performance is below that of the EU on average; and the *'modest innovators'* (Bulgaria, Latvia, Poland and Romania), who perform well below the EU average. This polite terminology (!) cannot hide the fact that there are very wide divergences between the innovation performance of the EU member states, as shown below.

Research and Innovation Performance of EU member states



<u>Note:</u> the index used for comparison in this chart is based on a set of 24 indicators

Source: Innovation Union Scoreboard 2013

Furthermore, these divergences are widening as a result of the crisis and of the austerity policies being pursued by the EU in response to it. For example, between the periods 2006-2010 and 2008-2012 the growth rate of innovation performance on the EU level declined by -0.2% (from 1.8% to 1.6%), while that of the member states with the lowest innovation performance (the so-called 'modest innovators') by -4.5% (from 6.2% to 1.7%). The decline was even more impressive in certain cases, such as that of Portugal, where it amounted to -5.6% (from 7.2% to 1.7%) or that of Greece, amounting to -4.1% (from 2.4% to -1.7%!!). Clearly, such developments undermine the future prospects not only of the countries in question, but also of the EU economy as a whole.

In discussing the question of innovation and growth, the role of the state needs to be emphasized. This is in the classical sense of the state undertaking risky investment, where the private sector is reluctant to do so. Even under neoliberalism, this is the case in certain instances. What needs to be stressed is that in such a case, the state should claim its rightful share from the returns of the products that are thus produced, which unfortunately is not common[3]. Such a return for the state boosts public finances and it thus helps in financing further R&D.

In the case of the EU, the Compact for Growth decided by the European Council in June 2012 introduced no new growth-boosting elements, while the EU obsession with fiscal consolidation at a time of crisis, market liberalisation and wage reductions remains intact. Also, its financing has been aptly described as 'a mere bagatelle' in the sense that it is 'partly illusory and presumably to be spread over some years' (Wolf, 2012: 2).[4]

This is further exacerbated by the fact that the European Council agreement for the multi-annual financial framework (MFF) 2014-2020 limits the maximum possible expenditure for the EU to 1% of the EU's GNI. This means that the overall expenditure ceiling has been reduced by 3.4% in real terms, by comparison to the current MFF (2007-2013). This is the first time that the overall expenditure limit of a MFF has been reduced in relation to the previous one. Therefore, the EU Structural Funds will barely, if at all, substitute missing capital expenditure in national budgets as a result of member states' fiscal tightening.

Overall, the EU appears to be devoid of the necessary tools to boost innovation as a prerequisite for growth. Under such conditions, the following questions appear to be pertinent[5]:

- Why has innovation traditionally been a secondary concern for the EU, in spite of the official rhetoric with regard to growth and competitiveness?
- Is the current Europe2020 Strategy, aiming at a "smart, sustainable and inclusive growth" likely to overcome the shortcomings of the past?
- In view of the large divergences across the EU member states is a common innovation policy feasible/desirable?
- Does the 'fiscal compact' leave any room for innovation enhancing policies?
- The ECB has de facto undertaken a role akin to that of a lender-of-last-resort. Does this help? Is it enough to reduce the uncertainty created by the crisis?

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[3] See Marianna Mazuccato, 2011, The Entrepreneurial State, DEMOS; http://www.demos.co.uk/files/Entrepreneurial_State_-_web.pdf

[4] Wolf, M., 2012, A step in the right direction, Financial Times, 3 July

[5] These were addressed to the members of the panel during the Innovation & Growth session

- The current crisis and the austerity-induced recession in most Eurozone countries are stumping innovation at its roots. How can this be changed? Which growth policies may be compatible with the reduction of the public debt, currently at the centre of EU policy?
- How can finance be redirected to becoming a value creating rather than a value extracting force in the economy? How feasible is a radical restructuring of the financial system, both globally and in the EU?
- Most – if not all - development banks were privatized in the 1990s. What would 'new era' development banks look like?
- What is the role of labour in an innovation creating process? In view of the fact that employment protection has been drastically reduced – if not completely eliminated in many instances – can labour be a force of innovation?
- How can a more equitable distribution of income be an integral element of an innovation promoting policy framework?
- What is the role of the state as an economic actor in the generation of progressive innovation and growth?