Mission-Oriented Economic Policy

Progressive Economy 31 May 2016

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European economies remain stuck. Growth is expected by the IMF to be just 1.8% across the European Union in 2016, and only 1.5% in the Euro Area[1]. In addition to the weakness of demand, is the weakness of business investment, which remains well below its 2008 trajectory[2]. And given that the objective is not just growth, but growth that is smarter, more inclusive and more sustainable[3] - falling levels of innovation, rising level of inequality, and green policies that remain weak, unequally distributed, and non-systematic is surely not good news for the future of Europe's Horizon 2020 agenda.

The problem is a lack of both public and private investment. EU governments are, in the name of needed 'austerity' to 'balance the books', pursuing pro-cyclical spending policies, while companies continue to cut back, hoarding cash on their balance sheets or returning it to shareholders through dividends or buy-backs[4]. Both hoarding and share buybacks are at record levels.

[1] International Monetary Fund. 2016. World Economic Outlook: Too Slow for Too Long. Washington, April

[2] International Monetary Fund. 2015. World Economic Outlook: Uneven Growth - Short- and Long-Term Factors. Washington (April), p113

[3] EC Horizon 2020 strategy http://ec.europa.eu/europe2020/pdf/europe_2020_explained.pdf (accessed 20/5/2016)

[4] Lazonick, W. (2014). Profits without prosperity. Harvard Business Review, 92(9), 46-–55.

The problem is a lack of expectations on future opportunities: animal spirits. This is a key insight of Keynes[5]. The motivation for firms to enter new markets or make investments in existing ones is driven by expectations of future gains[6].But why are those opportunities not there? When both the public and private sectors are not investing (one due to austerity, and the other due to financialization) - we get secular stagnation. This is not due to exogenous factors, but endogenous to the (lack of) investment.

So the big question is: how can the desire to invest (animal spirits) be induced via policy?

The conventional policy approach, advocated by the IMF and others, is either through incentives (via different types of tax cuts or lightening regulation), or through basic spending on public infrastructure to address market failures in the provision of public goods which can crowd in private investments.

While infrastructure spending is welcome (and a good idea when interest rates are so low), it is limited if not driven by a transformational agenda. The alternative to austerity must be more than tax incentives, and building bridges and roads. What businesses are lacking is a sense of where the future opportunities will lie.

Through mission-oriented policy courageous states can do much more to provide the direction that is needed to unlock investment. Indeed, it is these types of investments

[5] Keynes, J.M., 1936. The general theory of employment, interest and money. New York: Harcourt, Brace and Company.

[6] Dosi, G. and Lovallo, D., 2007. 'Rational entrepreneurs or optimistic martyrs? Some considerations on technological regimes, corporate entries, and the evolutionary role of decision biases', in Garud et al., eds.Technological Innovation: Oversights and Foresights. Cambridge: Cambridge University Press, pp. 41–68.

that got us the IT revolution, the biotech revolution, the nanotech revolution and today are bringing us the greentech revolution (too slow)[7].

Market failure theory assigns only a limited role to the state – to 'fix' markets. Through the influence of public choice theory, it focuses on the downside risks of state action rather the possibilities. This approach can lead to incremental change.

But while innovation has a rate, it also has a direction – and the blind direction chosen by the market's invisible hand is often sub-optimal. It is not the way that major breakthroughs happened in the past, and it is not the way we are likely to address the major challenges of the future. Examples from history show what is possible when governments act in visionary ways to define new futures, solve public problems and create new markets. This is based on a very different 1 understanding of the role of the state and of the relationship between the state and market actors in the wealth creating process.

From Apollo missions that put a man on the moon, to courageous investments that lay behind the creation of the Internet and entire new sectors like biotechnology, nanotechnology, and the emerging green technology revolution, government agencies have done much more than simply address market failures or only 'de-risk' an innovative private sector. They acted boldly, taking risks, to create a future that market actors could not have created alone.

Public organisations in the United States from NASA to DARPA to the National Institutes of Health invested along the entire innovation chain, courageously defining new high-risk directions. Traditional cost-benefit analysis and market failure justifications used by conventional economic theory would have halted these

[7] Mazzucato, M., 2013. The entrepreneurial state: Debunking the public vs. private myth in risk and innovation.London: Anthem Press.

investments from the very start. Furthermore, all these transformational changes required active investments on both the supply and demand side[8].

Where the public sector leads as a bold, market-creating risk-taker, private sector investment will follow. And just as direction provided by mission-oriented policy characterises the innovation process, so the deployment of innovation requires clear direction if it is to unlock investment. Perez and I, for example, have written about how – given the right encouragement – the 'green' direction can provide the direction for investment in the full deployment of ICT[9].

The challenge for states then becomes:

- To create sufficiently credible, stable and enduring commitments in a given direction to channel investment, and provide any necessary complementary assets needed for private sector investment – laying down the tramlines for the deployment of new ideas.
- To ensure the availability of patient committed finance through state investment banks but also from stimulating sources of patient private sector finance; and
- To set rules of the game, which encourage symbiotic interactions between economic actors, reward firms which take a longer-term, broader perspective on the value they create, and offer a fair balance of risk and reward to different actors.

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[8] Mazzucato M. (2016) "From Market Fixing to Market-Creating: A new framework for innovation policy", Special Issue of Industry and Innovation: "Innovation Policy – can it make a difference?" DOI 10.1080/13662716.1146124

[9] Perez, C. 'Capitalism, Technology and a Green Global Golden Age: the role of history in helping shape the future', in Mazzucato, M. and Jacobs, M., eds. Rethinking Capitalism (forthcoming); and Mazzucato, M. and Perez, C. (2015), "Innovation as Growth Policy," in The Triple Challenge: Europe in a New Age. J. Fagerberg, S. Laestadius, and B. Martin (eds.) Oxford University Press: Oxford

I am currently working to develop these ideas further into a systematic framework, and alternative to the dominant market failure theory. My working paper From Market Fixing to Market-Creating: a new framework for economic policy can be found here. The paper considers four key questions that arise from a 'market creating' framework:

1. Decision-making on the direction of change;
2. The nature of (public and private) organizations that can welcome the underlying uncertainty and discovery process;
3. The evaluation of mission-oriented and market-creation policies; and
4. The ways in which both risks and rewards can be shared so that 'smart' innovation-led growth can also result in 'inclusive' growth.