

# INCLUSIVE GROWTH

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## THE ROLE OF THE STATE IN INCLUSIVE GROWTH (IG)

Presentation to: Public Sector Economist Forum (PSEF)  
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# POINTS TO BE MADE IN THE PRESENTATION

- Not yet a generally accepted definition of IG
  - No universally applicable set of policies to promote IG
  - IG policies must be context specific
  - In SA context IG not possible without economic growth
  - In SA economic growth not possible without innovation
  - In SA innovation-led growth requires “entrepreneurial state”
  - Entrepreneurial state invests in innovation for the long run
  - Innovation-led growth is inclusive if reward is aligned with risk
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## INTRODUCTION TO INCLUSIVE GROWTH (IG)

World Economic Forum (WEF) 2015: “While a widespread international consensus now exists on the need for more socially-inclusive models of growth and development, little in the way of concrete policy guidance has emerged. There is a growing need for analytical frameworks and evidence-based solutions suited to this purpose.”

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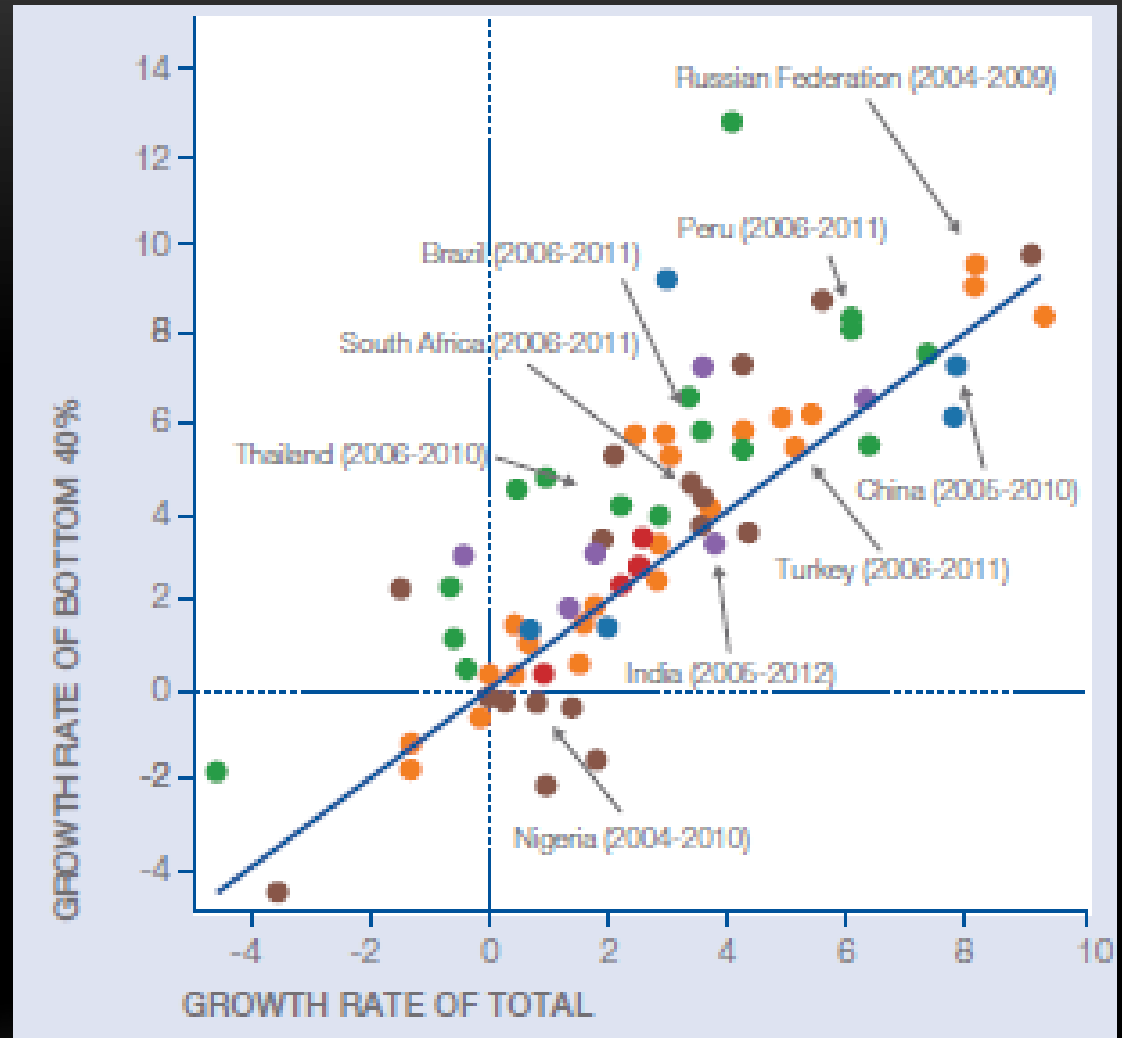
## IG IS NOT ANTI-GROWTH

WEF 2015: “Strong economic growth is the sine qua non of improved living standards. While a growing national economic pie does not guarantee that the size of every household’s piece will be larger, such an outcome is arithmetically impossible unless the overall pie does indeed expand. Growth creates the possibility of a positive-sum game for society, even if it does not assure it.”

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## Shared prosperity (circa 2006-2011) – World Bank 2015

- Broad correlation between economic growth and reduction of income inequality
- Above diagonal line: reduction in inequality
- Probably not a simple trade-off, but a dynamic interaction between economic growth and policies to share benefits of growth



# WHAT DRIVES ECONOMIC GROWTH?

- Vast literature & comparative research
- Not enough time to go into this in any detail
- Suffice with a simplistic characterisation – growth from:
  - bringing unutilised resources into production e.g. mining
  - imitating innovations made elsewhere to improve productivity of underutilised resources e.g. China
  - innovation that creates new products and/or markets e.g. smart phone

# WHAT IS POSSIBLE FOR SOUTH AFRICA?

- Mature industrial structure – limited scope in primary sector to mobilise unused resources (except communal land)
  - Skill level of labour force & unit labour cost – constraints on further imitation as driver of growth in the secondary sector
  - Only real driver of growth – innovation that increases productivity and competitiveness
  - Innovation-led growth also essential for inclusive growth
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## SA ALSO AFFECTED BY ECONOMIC STAGNATION

- Today SA is in the midst of an economic stagnation that some (like American economist Larry Summers) call 'secular stagnation', which implies that a long-term period of near zero-growth rates is inevitable and persistent.
- Arresting this drift into secular stagnation requires policies that aim at smart, innovation-led growth and inclusive growth at the same time.



# THE ROLE OF GOVERNMENT IN INNOVATION

J M Keynes: “The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do things which at present are not done at all.”

*(The end of Laissez Faire, 1926, 46)*

This requires the public sector to have vision and confidence.

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# THE MYTH OF THE IRRELEVANT GOVERNMENT

The Economist: “As the [information technology] revolution rages, governments should stick to the basics: better schools for a skilled workforce, clear rules and a level playing field for enterprises of all kinds.”

*(The third industrial revolution, 21 April, 2012)*

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# DANGERS OF THE BIASED STORY

This biased story line – the State only a wealth extractor or distributor:

- is hurting the possibility of building dynamic and interesting public-private partnerships;
- undermines innovation; and
- increases inequality.

Lazonick, W & Mazzucato, M ('The risk-reward nexus in the innovation-inequality relationship: Who takes the risks? Who gets the rewards?', *Industrial and Corporate Change*, 2013, 22)

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# THE ENTREPRENEURIAL STATE

Book by Mazzucato:

A very different story: in countries & regions that owe their growth to innovation the State has historically served not just as a regulator of the wealth creation process, but a key actor in it – willing to take the risks that businesses won't – across the entire innovation chain, from basic research to applied research, commercialization and early-stage financing of companies themselves.

Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

## THE ENTREPRENEURIAL STATE (CONT.)

Such investments have proved transformative, creating entirely new markets and sectors, including the internet, nanotechnology, biotechnology and clean energy. In other words, the State has been key to creating and shaping markets not only 'fixing' them.

Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

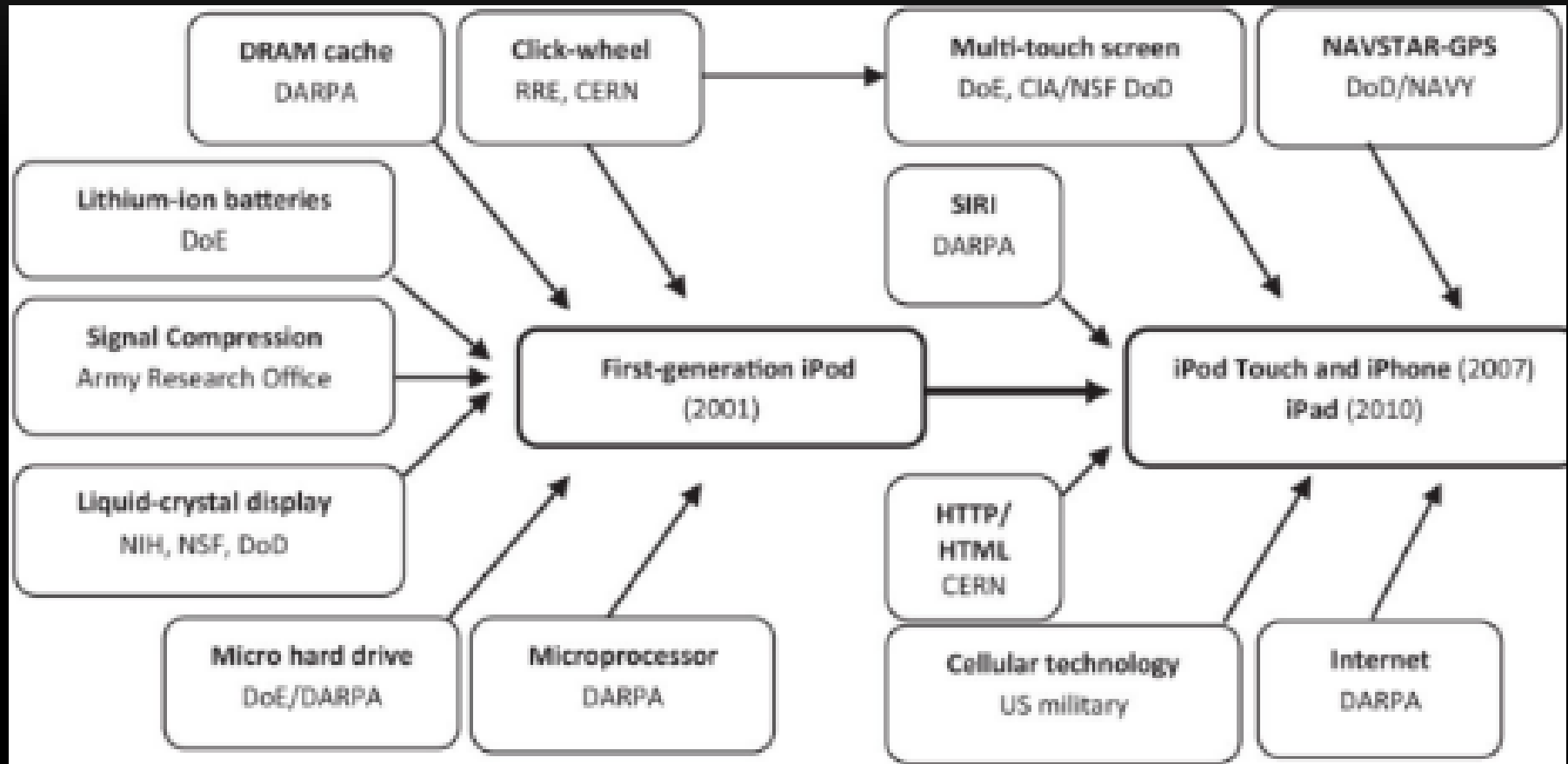
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# STATE ROLE IN DEVELOPMENT OF APPLE

The massive profits and success of Apple were possible largely because Apple was able to ride the wave of massive state investments in the 'revolutionary' technologies that underpinned the iPhone and iPad: the Internet, GPS, touch-screen displays and communication technologies.

- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

# STATE FUNDED R&D BEHIND APPLE SMART PRODUCTS



SOURCE: Author's drawing (with Oner Tulum's research assistance) based on the Office of Science and Technology Policy (OSTP) diagram 'Impact on Basic Research on Innovation' (2006, 8).  
Mazzucato, M (The entrepreneurial state, 2015, Public Affairs)

# STATE ROLE IN GLOBAL COMPETITIVENESS

In addition to fostering innovation in the US, the US government has played a critical role in protecting the intellectual 'property' of companies like Apple.

The federal government has actively fought on behalf of companies like Apple and it is a crucial partner in establishing and maintaining global competitive advantage for these companies

(Prestowitz 2012).



# GETTING GOVERNMENTS TO THINK BIG

In all these cases, the State dared to think about the 'impossible':

- creating a new technological opportunity;
  - making the initial large necessary investments;
  - enabling a decentralized network of actors to carry out the risky research; and
  - then allowing the development and commercialization process to occur in a dynamic way.
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- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

# VENTURE CAPITAL NOT THE ANSWER

It is naïve to expect venture capital to lead in the early and most risky stage of any new economic sector today (such as clean technology).

In biotechnology, nanotechnology and the Internet, venture capital arrived 15–20 years after the most important investments were made by public sector funds.

- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

# GETTING GOVERNMENTS TO THINK BIG

This does not mean that the State will always succeed; indeed, the uncertainty inherent in the innovation process means that it will often fail. But it needs to learn from failed investments and continuously improve its structures and practices.

- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

# GETTING GOVERNMENTS TO THINK BIG

This requires a particular type of deal between business and the State that recognizes that since the public sector often undertakes courageous spending during the riskiest parts of the innovation process, it is only fair that it not only pick up the bill during the downside, but also make something on the upside: that is, socialize both risks and rewards.

- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)
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## GETTING GOVERNMENTS TO THINK BIG (CONT.)

- Envision a direction for technological change and invest in that direction
- Public investment should be measured by its courage in pushing markets into new areas
- Allowing public organisations to experiment, learn and even fail.
- Figuring out ways for governments and taxpayers to reap some of the rewards from the upside, rather than just de-risking the downside.

## THINKING BIG IS NOT ANTI-PRIVATE SECTOR

The emphasis on the State as an entrepreneurial agent is not meant to deny the existence of private sector entrepreneurial activity, from the role of young new companies in providing the dynamism behind new sectors (e.g. Google) to the important source of funding from private sources like venture capital for the final commercialisation stage of innovation.

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## PUBLIC SPENDING NOT ENTREPRENEURIAL

Public spending per se is not necessarily an indication of an entrepreneurial state.

The composition of spending is more important than the quantum of it.

# NOT SMALL PER SE, BUT PRODUCTIVITY

Recent evidence has suggested that some economies that have favoured small firms, such as India, have in fact performed worse.

40–60 per cent of the total factor productivity (TFP) difference between India and the United States is due to misallocation of output to too many small and low-productivity SMEs in India. (Hsieh and Klenow (2009))

As most small start-up firms fail, or are incapable of growing beyond the stage of having a sole owner-operator, targeting assistance to them through grants, soft loans or tax breaks will necessarily involve a high degree of waste.



# YOUNG AND GROWING COMPANIES

The policy implication is that rather than giving handouts to small companies in the hope that they will grow, it is better to give contracts to young companies that have already demonstrated the ability to innovate.

It is more effective to commission the technologies that require innovation than to hand out subsidies in the hope that innovation will follow.

(Schmidt 2012)

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# ENTREPRENEURIAL STATE & INNOVATION

The State, through its various agencies and laboratories, has the potential to disseminate new ideas rapidly.

It can also be nimble, using its procurement, commissioning and regulatory functions to shape markets and drive technological advance.

Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

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# ALL RISK SHOULD BE REWARDED

Governments may invest capital into the innovation process without any guarantee of a return commensurate with their investments—and without guarantee that they will be ‘bailed out’ (or not laid off) in case of failures.

For the sake of innovation, we need social institutions that enable all risk bearers to reap the returns from the innovation process, if and when it is successful.

- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

# INNOVATION AND INEQUALITY

When the distribution of financial rewards from the innovation process reflects the distribution of contributions to the innovation process, innovation tends to reduce inequality.

When, however, some actors are able to reap disproportionate shares of financial rewards from the innovation process, innovation increases inequality.

- Mazzucato, M (*The entrepreneurial state*, 2015, Public Affairs)

# INNOVATION AND SUSTAINABLE INCLUSIVENESS

If the state also receives a reward for its investment in innovation:

- it makes the funding of continued innovation sustainable;
  - it contributes to the funding of human capital; and
  - it makes inclusive growth sustainable.
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# SMART, INCLUSIVE AND SUSTAINABLE GROWTH

In summary, 'smart', inclusive and sustainable growth will not happen on its own.

It requires an entrepreneurial state and specific instruments need to be in place to make that happen.

This includes that the risk inevitable in innovation is aligned with the reward in a manner that makes the process inclusive and sustainable.