

Brussels Economic Forum

Session 2 "Competition and Innovation: Making it happen"

This session, chaired by Mario Monti, was split into 3 sections : 1. "Innovation: What should be the Drivers?" (speakers: Ian Davis, Mc Kinsey & Company and Prof. Philippe Aghion, Harvard University); 2. R&D and Innovation: Ensuring a Competitive Edge" (Speaker: Donald Kalff, former member of the board of KLM); and 3. Competition, Innovation and Growth (Speakers; Jurgen Elmeskov, OECD and Rachel Griffith, Institute of Fiscal Studies). A panel discussion at the end focussed on the key areas of agreement with regard to the issue of competition and innovation and on the additional complementary measures needed to strengthen the link between innovation and growth. Panellists included Ernest Seilliere (Chairman of UNICE), Philip Lowe (DG for Competition, European Commission), Antonio Borges (Vice Chairman, Goldman Sachs) and Gyorgy Jaksity (Chairman, Concorde Securities, Hungary).

On the issue of the drivers of innovation, Ian Davis stressed the importance of "competitive intensity" which according to research by Mc Kinsey is the key driver of innovation. Innovation, he suggested, comes in two main forms, firstly in terms of technology, products and markets and secondly in areas such as processes, systems and methods. He went on to suggest that the impact of innovation on productivity is largely determined by the speed with which it is adopted and diffused throughout the economy. Here he emphasised the need for "scale innovation", taking the example of Wal Mart in the US and stressing the need for "imitators" to "scale-up" the initial innovation. Wal Mart only had an economy-wide effect on productivity when its pioneering uses of ICT and its management / organisational innovations in retailing were widely adopted in the rest of the industry and indeed in other sectors of the US economy. Prof. Aghion added a number of interesting insights regarding the accepted wisdom on innovation and growth theories and pointed to a large number of fallacies associated with the Schumpeterian (i.e. creative destruction) school of thought. He concluded firstly that any policy prescriptions in this area must take account of the many differences in the technological, financial and institutional starting positions of specific countries or sectors; secondly, that the EU should move towards more innovation-enhancing policies and institutions (eg greater market flexibility; increased investment in higher education; and further development of credit and capital markets); and finally that macroeconomic policy has a role to play in innovation by helping to overcome obstacles to the implementation of structural reforms and by reducing macro volatility.

Donald Kalff provided an interesting personalised perspective on the link between R&D and innovation, stressing in particular the importance of an open innovation system and the pivotal role to be played by large companies in stimulating innovation. For Kalff, the patent system should become the cornerstone of an open innovation framework. He concluded by emphasising that policy makers, interested in promoting innovation and growth in their respective economies, needed to focus more clearly on the functioning of the patent system and on stimulating the development of large companies.

Elmeskov and Griffith went on to explore the complex links between competition, innovation and growth, stressing in particular the complementary / flanking policies needed to promote an effective innovation environment in a country or sector. Elmeskov stressed that there was no single European innovation story, with Member State performances varying significantly

based on the degree of business sector innovation and the support provided for the latter from appropriate framework conditions. According to Elmeskov, the fear that competition could become so intense as to have a negative effect on innovation is exaggerated in the literature. Griffith's supported the Elmeskov contention that whilst competition was important for innovation, it wasn't enough – an effective innovation capacity depended also on complementary policies (eg education, flexibility). On the debate on the Lisbon-related 3% target for R&D spending in the EU, Griffiths not only felt that the target was very optimistic but also that it focussed excessively on local R&D spending in the EU (whereas firms and R&D were becoming increasingly global and mobile) and that R&D spending was a very poor indicator of innovation in the services sector. She suggested that innovation policy should focus on flexibility; on entry and exit rules and the need for experimentation; on equipping workers with the generic skills needed to ease sectoral transition costs; on creating links between public and private research organisations; on ensuring a well functioning higher education sector; on understanding innovation in the services sector (where most of the EU-US productivity gap lies); and finally on complementary policies (flexible labour markets and well functioning financial markets).

In the panel and floor discussions, most of the speakers returned to themes which had been raised earlier in the presentations :

- According to Seilliere, the ability to nurture, attract, motivate and retain talent in a country is the key to innovation. He also doubted whether the political will exists to promote innovation at the EU level, with the failure of the recent EU budget negotiations to divert resources from agriculture to R&D and education sending all the wrong signals. For Seilliere Europe can become a great innovation region only if we learn from the US in terms of the changes needed in education, regulation, labour market flexibility and rewards for risk-takers.
- Lowe stressed the need for "smart" regulation and that a "one-size fits all" approach to competition policy was inappropriate.
- Prof. Borges stressed the importance of effective “market exit” rules which are essential in freeing up the resources required by the most innovative firms to expand and prosper. Here, the need for appropriate rewards for the risk-taking involved in innovation needs to be carefully looked at. He also suggested that innovation is essentially a combined public / private effort, with clear roles to be played by both sectors.
- Jaksity focussed on the need to reduce the size of government and to reduce protectionism in order to stimulate entrepreneurship and innovation. Elmeskov underlined however that it is not the size of the public sector which matters for innovation (as evidenced by successful "big" government Nordic innovators), its how the public sector is financed (non-distortive financing) and where the money is spent (is expenditure supportive of growth ?).
- All of the panellists agreed with Borges on the crucial importance for innovation / productivity of having a dynamic market economy which is capable of freeing up resources and channelling them to the most productive firms. In terms of ICT diffusion, the US has shown that it is easier in the retail sector to reap the efficiency gains of ICT by opening new retail stores rather than by investing heavily in existing

outlets. However, this approach is more difficult in Europe due to the planning law restrictions. In addition, it was generally accepted that the higher the degree of product market competition and labour market flexibility, the faster the pace of ICT adoption / diffusion.

- Aghion suggested that “flexicurity” systems were a good example of the complementary policies needed to ensure that increase competition led to better overall outcomes by easing the inevitable trade-off’s between social solidarity and the disruption often provoked by innovation. Such systems have a clear role to play in easing the transfer of workers from “exiting” firms to more successful innovators.
 - The session ended with a discussion on the threat from newly emerging economies to the present innovation dominance of the "old" world. While it was accepted that China, India and Indonesia would in 10 years time be producing three times as many Phd students as the US and Europe combined, the key question is whether this really matters for productivity and growth. In this context it was stressed by Davis that location and innovation should not be confused. Elmeskov added that key ICT innovators, such as Sweden and Finland, have often experienced deteriorating terms of trade (due to the rapidly declining prices of their ICT related products) whereas countries which import ICT and use it effectively (eg Australia) have achieved terms of trade gains over the same time periods. Consequently, policy makers should not concern themselves excessively with innovation itself, the real focus should be on linking innovation to productivity and on generating real income growth for citizens.
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