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# New Innovation Policy

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Innovation theory

Market failure (Arrow 1962)  
New knowledge = public good



Innovation policy

Predicts: underinvestment

Targeted spending



Economy



Measure effect here

# Uh-oh! – how do we know?

Meta studies      OECD (Box 2007)

Micro estimates    (Goolsbee, Goldberg)

Control Groups    (Raustalia & Sprigman, Boldrin & Levine,  
von Hippel & everybody)

Panel data          Ratio Sweden

# Maybe policy is wrong

1. Targeting

2. Capture

3. Rent-seeking

yes

# Maybe theory is wrong

1. No market failure
2. perfect competition (Boldrin & Levine 2004)
3. Private provision of public goods
4. Contribution good (Kealey & Ricketts 2014)
5. Discovery problem (Rodrik & Hausman 2004, Potts 2019)
6. Government failure is worse

Also  
yes

# So ... new theory

## The innovation problem is ...

~~Allocation problem~~

~~Solved with spending~~

Coordination problem or  
knowledge problem

Solved with governance institutions

# Innovation problem is discovery of economic opportunity from a new idea

- Entrepreneurs, not scientists
- distributed information from economic environment
- **Information** about costs, factor supply, demand, regulation, competitive & complementary investment, ...
- to calculate (under uncertainty) if an opportunity for profit exists

new theory = new policy

Innovation policy should aim to furnish an institutional environment to **facilitate entrepreneurial discovery** of new economic opportunities

- Predictability (low, stable taxes; institutional environment)
- information, not money
- Permissionless innovation
- Policy learning (regulatory sandboxes, the 'experimentally organised economy')
- Expectation of supply of basic factors (human capital, skilled workforce)
- Deirdre McCloskey's 'Bourgeois deal'

# Friends and enemies of innovation



# benevolent dictator

engage  
enemies

help friends

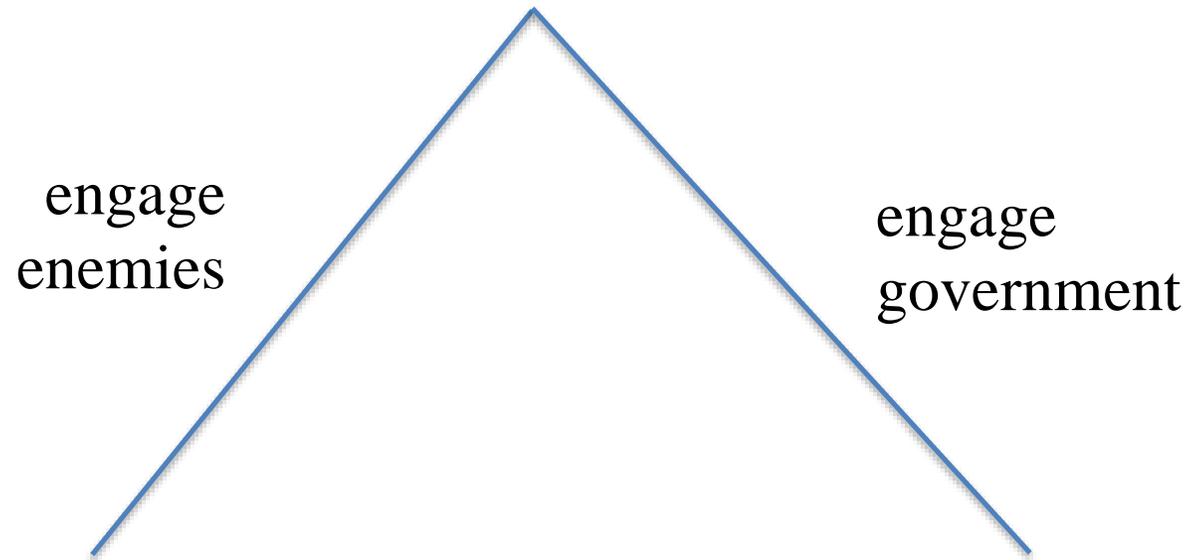
**innovation policy =**  
persuasion,  
Coasian bargaining

**innovation policy =**  
subsidy, support,  
protection

Goal: reduce transactions costs

Goal: subsidize production costs

# friends of innovation



Goal: reduce transactions costs

## **Risks=**

- free-riding by other friends
- encourages further entry
- becoming a target (e.g. Monsanto)

Goal: subsidize production costs

## **Rewards=**

- can lock in direct support
- don't alienate consumers
- can pay in cash (contributions)

# Innovation Commons

The origin of economic growth

Oxford University Press (2019)

- 1        **We innovate together**
- 2        **The innovation problem**
- 3        **Innovation is a knowledge problem**
- 4        **Four theories of the innovation commons**
- 5        **Origin of the innovation trajectory**
- 6        **Rules of the Innovation commons**
- 7        **Lifecycle of an innovation commons**
- 8        **Theory of Innovation Policy**
- 9        **Inclusive Innovation Policy**
- 10       **Conclusion**

"Everyone agrees that innovation drives the transformation of modern economies. But Jason Potts will ruffle feathers with his fascinating and well-researched account of the origins of innovation itself. Against the statist left he points to the limits of state-led innovation. Against the individualist right, he argues that innovation begins not by heroic individuals alone, but by institutions that govern the cooperative pooling of innovation resources and the coordination of dispersed knowledge. This is a highly innovative account of the sources of innovation, which should be read by everyone working in this field."—**Geoffrey M Hodgson**, Professor in Management at Loughborough University London

"In this beautifully-written and well-argued book, Potts shows how cooperation and networking are essential to innovation and economic growth. He rightly defines technological change as a social process, and demonstrates how collective action problems involving innovation can be overcome by institutions. Relying on both economic history and theory, his book provides a convincing account based on a fusion of the new institutional economics and the economics of innovation. Highly recommended to all social scientists interested in technological change."—**Joel Mokyr**, Northwestern University, Author of *A Culture of Growth* (2016)

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**Swedish Innovation Policy for growth  
- Creating support or removing barriers?**

**Christian Sandström  
Associate Professor, the Ratio Institute  
18 February 2019**

# Financing of Innovations 2013-2018

*Funded by Vinnova*

- 46 Scientific papers
- 19 reports
- 20 arranged conferences
- 76 articles in the media





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# Policies to support innovation

## *Large efforts justified by notions of market failure*

- About 30 Billion SEK in support to industries (innovation, state VC, regional redistribution)(Tillväxtanalys, 2015)
- Billions of SEK in state VC un-invested (Svensson, 2018)
- No significant effect on turnover, jobs or profit (Daunfeldt et al., 2016)
- Positive effects diminish over time (Gustafsson et al., 2016)
- In sparsely populated regions, the effect is significantly negative (Tingvall and Videnord, 2018).
- Subsidy entrepreneurs get higher wages and lowered productivity (Gustafsson et al., 2018).

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# Policies to remove barriers against innovation

*Plenty of potential for policy to affect growth and innovation*

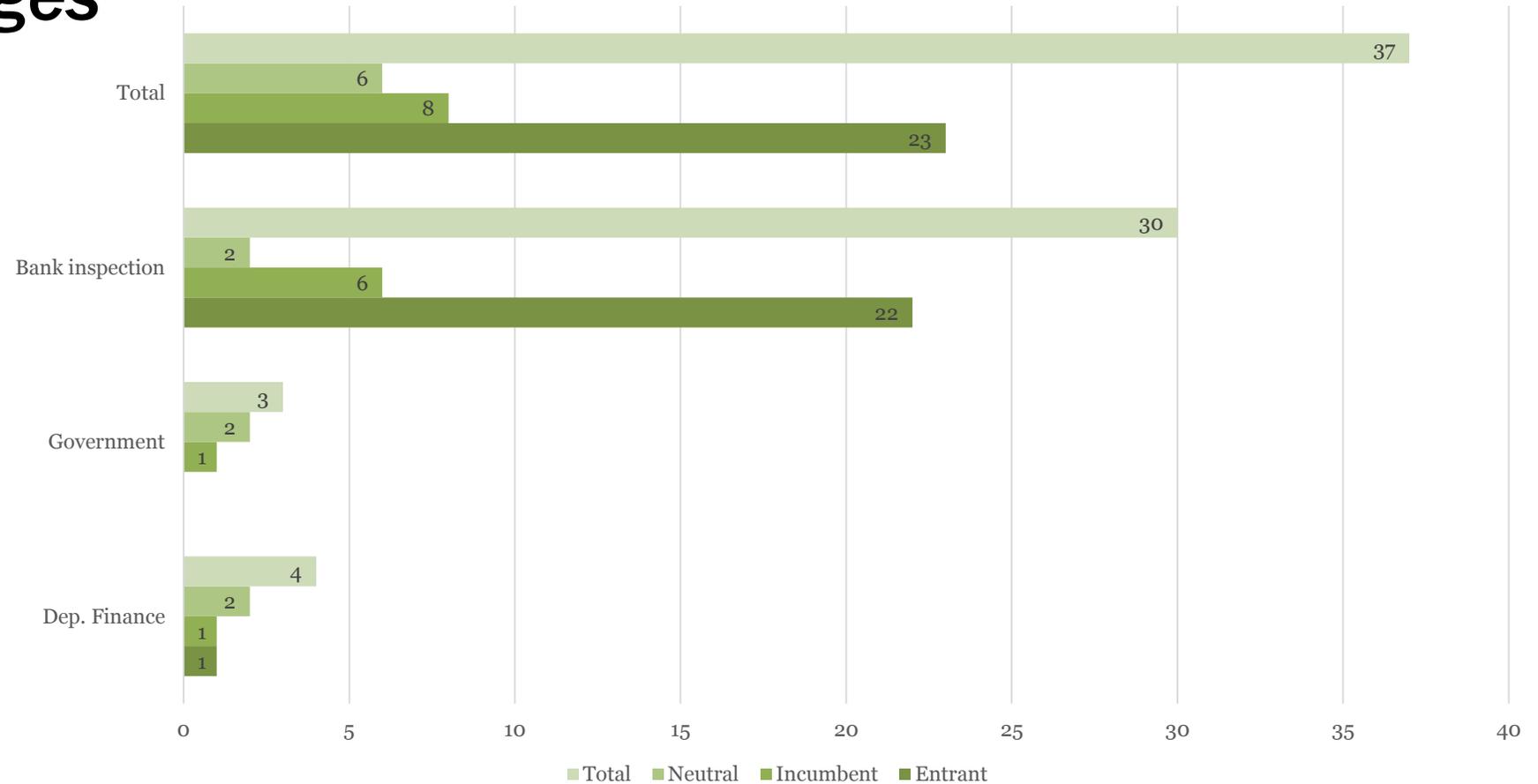
- Established firms need to develop new skill sets to meet technological challenges (Sandström, 2016)
- The greatest obstacle to growth for fast growing firms is access to skilled employees (Demir and Wennberg, 2016).
- An increasing regulatory burden since the GfC hamper firm growth, especially smaller firms (OECD, 2015)
- Other areas with potential include: business law, patent legislation and taxation (Bjuggren et al., 2015)

# Government actions favoring more competition

## Financial Exchanges

**Figure 1:** All decisions made by various government bodies concerning the emergence of entrant firms in the financial exchanges sector who started operating next to the government monopoly of the Stockholm Stock Exchange.

(Eriksson et al., 2018)

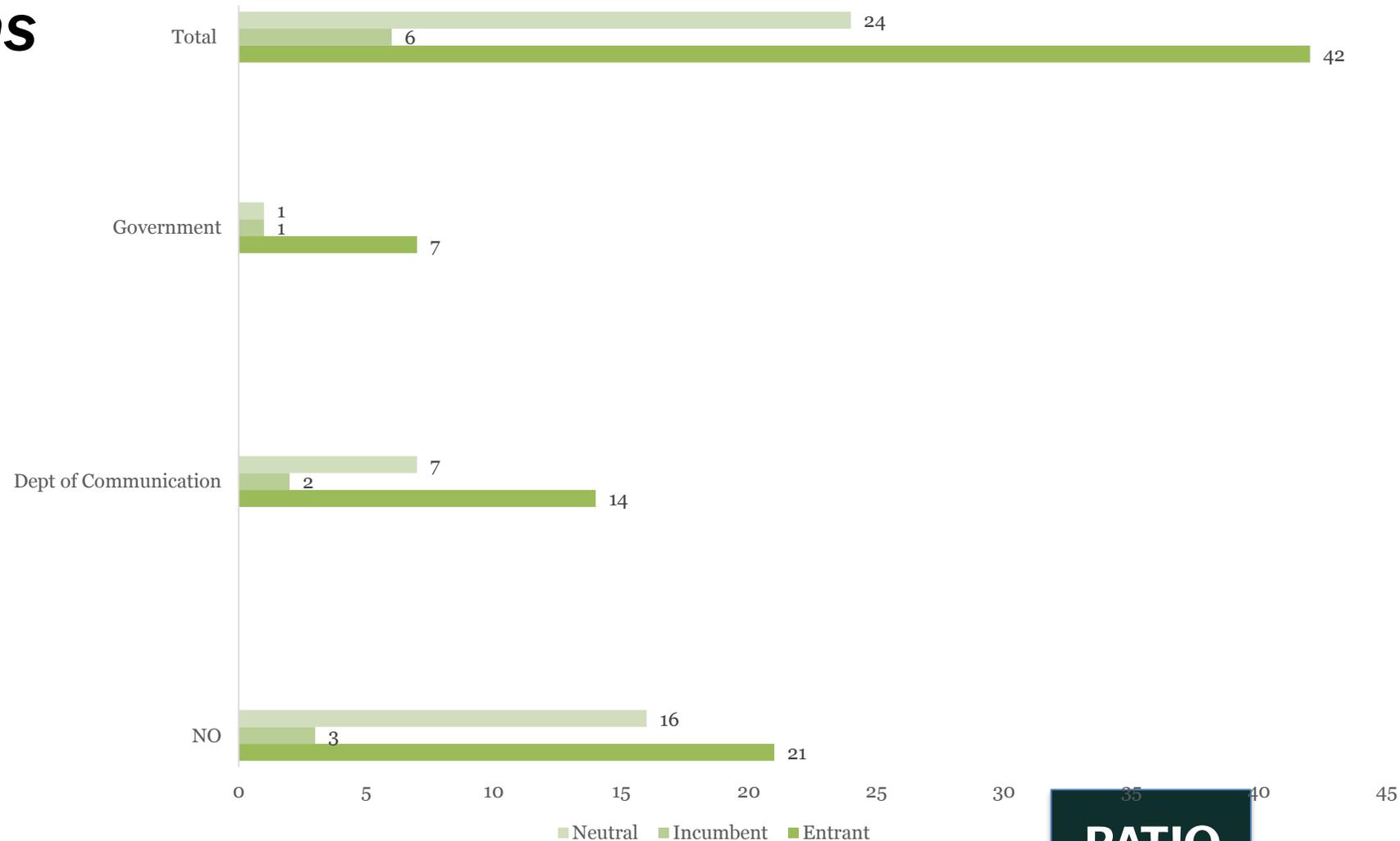


# Government actions favoring more competition

## Telecommunications

**Figure 2:** the decisions made by various government bodies concerning the emergence of new competition in the telecommunications sector. As can be seen, all government bodies were during this time period favoring more competition and the entry of new firms rather than the government monopoly Televerket.

(Eriksson et al., 2018)



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## In conclusion

- **Market failure is hard to quantify and locate**
- **Policies aimed to correct market failure may lead to government failure instead**
- **Over-supply of supporting policies**
- **More policies devoted to removing barriers are needed**

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