

Innovation, Financial Coordination and the future of the European Union

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- Rapidly emerging countries increasingly competing with established post-industrialized countries
- Transition to a world in which most countries will be developed, realization of promises of industrial revolution, to be welcomed, but
- But, potential threat to welfare and cohesion of EU countries
- Need for EU adjustment

International environment

- Reduce **costs** of EU countries to the level of those of emerging countries, which can be achieved by
 - (i) increased process efficiency (process innovation + organizational changes) which normally entails reduced employment per unit of output,
 - (ii) reduce wage levels to those of emerging countries (disaster)

Possible adjustments

- Make the EU the most knowledge intensive region in the world
- Suitable strategy for the transition
- Gain **temporary monopoly in** fields (e.g. Industrial sectors) which allow EU countries to preserve employment and wage levels compatible with social cohesion

Lisbon strategy

- Differential adaptation of EU countries to international environment
- Some countries preceded the Lisbon strategy (Denmark, Sweden, Finland)
- Germany adapted in a slightly different way
- Mediterranean countries did not adapt at all or moved away from the Lisbon strategy

Present EU difficulties

- Two forces/trajectories contributing to development: (i) increasing **efficiency** and (ii) increasing **variety**, or differentiation (creativity)
- Countries change the composition, or structure, of their economic system during economic development

Innovation, structural change and economic development

- Countries **differentiate** during economic development, with the exception of natural resources rich countries
- Increasing export variety as a strategy for development and catching up

Innovation, structural change and economic development (2)

- Low Tech - low salaries , high tech - high salaries
- Learning economy
- Catching up based on a low cost strategy not enough
- Increasing general competitiveness or of some sectors (e.g. Services)

Innovation, structural change and economic development (3)

- Differential salaries of rich countries based on (i) temporary monopoly in some activities and (ii) wide range of activities and outputs
- But, some old activities are going to be lost due to competition and new ones need to be created (innovation, knowledge intensity)

Innovation, structural change and economic development (4)

- If inadequate competencies are the cause of unemployment then paying people to stay out of the labour market will only worsen the problem (limit of Keynesian policies)
- Need (i) to update competencies and (ii) for the required labour market flexibility (see flexicurity)

Innovation, structural change and economic development (5)

- Strong countries adjust and can preserve employment, competitiveness and social cohesion
- Weak countries gradually become relatively poorer by
 - (i) reducing salary levels at constant composition of their economic system → growingly skewed EU income distribution
 - (ii) awarding themselves higher than deserved (based on performance, productivity) salary levels → indebtedness → bail out

**Increasing differences in
competitiveness**

- Adjust economic system by imposing financial discipline only in the short run to reduce indebtedness
- Consequence: Static (in absolute terms) or falling (in dynamical terms) salary levels & standards of living

Limits of financial discipline

- Financial discipline if not accompanied by proactive structural change cannot solve the problem and is likely to lead in the medium term to
 - (i) falling salary levels & standards of living
 - (ii) unrealistic wage levels → bail out → collapse of EURO → collapse of EU

Limits of financial discipline (2)

- Objective: to increase the competitiveness of **all** EU member countries to avoid the increasing divergence of competitiveness, productivity and GDP per capita
- Low wage competitiveness not enough to catch up
 - Fagerberg Verspagen: need for an NIS
 - Saviotti Nesta Javid 2010 importance of export increasing recently

Coordination of industrial and innovation policies

- Violation of national sovereignty. But see Greece
- If failure:
 - no more EURO in x years
 - no more EU in x+y years
 - worsening position of all EU countries in world economic system

Difficulties

- Introduce policies aiming to making labour markets more *flexible* in the sense of changing the composition of the economic system not only at a given time but in the course of time (see flexicurity)
- Provide carrots and sticks to induce countries to move towards more knowledge intensive activities (not necessarily immediately high tech)
- Adequate temporary exceptions

(Some) Possible solutions

- Adequate temporary exceptions: (i) allow during a **strictly limited** period **barriers** to imports from other EU countries in exchange for binding commitment to reforms increasing competitiveness accompanied by
 - (a) attractive investment conditions for and
 - (b) involvement by the countries which would lose potential exports

(Some) Possible solutions (2)