

February 2009

## Innovation Policies in the Current Crisis

### *Points for consideration*

### Introduction

The world is currently facing the most severe financial and economic crisis in decades, which is having important repercussions on OECD economies and in many areas of economic policy. During its annual consultation with OECD Ambassadors in December 2008, BIAC underlined that the OECD, with its proven strength in global economic analysis and its ability to understand long-term trends and policy implications, is a natural forum for contributing to possible solutions. The crisis may have erupted within the OECD's membership, but it has spread to affect the global economy. Policy responses cannot be limited to national actions, but also require broadly-based multi-lateral cooperation. OECD's increased dialogue with major non-member economies is therefore welcomed and should be further reinforced to address the new challenges that member and non-member economies are facing.

In its paper to Ambassadors in December 2008, BIAC recommended the following specific priorities for OECD action in the context of the financial crisis:

- Contributing to discussions on reforming financial markets
- Helping to prevent trade and investment protectionism
- Fostering structural reforms to enhance the potential for economic growth and job creation
- Encouraging macro-economic policies for stability and a swift return to economic growth

While policy action in response to the crisis has rightly focused on dealing with immediate stability concerns, a more comprehensive strategy is needed to put the global economy back on a growth path. The OECD, as a multi-disciplinary organization, can play an important role in facilitating the development of a macro-policy framework that is conducive to putting growth back on track.

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## Securing innovation in the current crisis

In the current situation, it is possible that financially-stretched governments, companies and institutions may become less receptive to pro-innovation arguments, as they deal with other “immediate” challenges. While some tough short-term decisions are clearly required, it is essential to keep sight of longer-term objectives. For at least the past decade, the OECD’s membership has given considerable attention to identifying the conditions that will sustain innovative, knowledge-rich societies, new forms of value creation, enhanced productivity and the capacities and skills to address global as well as local challenges. These efforts, and the accompanying reforms, need to continue, going hand in hand with commitments to keep global flows of trade and investment open and to develop human resources. At the same time, due attention should be given to opportunities that innovation can offer to address some of the consequences of the crisis.

The crisis presents a number of important questions for public policy. To what extent will the financial crisis affect long-term investments in the knowledge economy? Will governments reduce or boost their financial support to research and development, and in which areas? How will private sector budgets be affected and how can pro-cyclical investments be encouraged? Will a tendency to adopt protectionist measures weaken the global connections that have recently been driving innovation? What will be the effect on global challenges, such as health care and climate change, if budgets shrink and actors become more prone to discounting the future?

In BIAC’s view, the OECD, which has carried out ground-breaking work in most of these areas, will play an important role by documenting trends; by exchanging experiences of the policy responses governments have chosen; and by helping to ensure that the arguments for overarching long-term policy objectives such as sustaining innovation remain at the forefront of attention. The business community therefore calls upon the OECD to accelerate its work on the horizontal Innovation Strategy and to reflect in this work the impact of, and possible solutions to, the financial crisis. Similarly, BIAC calls upon governments to refrain from stifling funding for long-term objectives, and to continue to progress reforms that have already been identified as necessary in order to promote these objectives.

## Key business considerations

As the financial situation of many companies and public research organizations is weakening, investors could be tempted to move into a capital preservation mode, thereby forcing companies and institutions to re-assess long-term strategies. This could result in widespread budget cuts for important current and new projects, and an attrition of key human resources within knowledge-intensive institutions. The financial crisis may also deflect public attention away from major challenges that require combined efforts and investments from the public and private sectors, because of the complexities of policy coordination and securing sufficient long-term investment. Nonetheless, BIAC believes that it is crucially important to keep long-term strategies and objectives in mind (even though strict prioritization is required) and to consider how addressing such objectives can contribute towards enabling companies and institutions to address the urgent challenges faced today.

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In light of this, redoubled efforts are required to identify coherent whole-of-government policy packages that take into consideration current constraints and opportunities while maintaining focus on over-arching objectives. As a first step, the OECD could usefully draw upon historical evidence, looking at past recessions and documenting the extent to which targeted-approaches (such as innovation-fuelled growth) formed part of the solution. Such analysis would make an important contribution by complementing current experiences and help demonstrate the case for similar policies today.

BIAC believes that the February 2009 meeting on innovation policies in the current financial crisis is particularly timely, as it allows governments to share information on their policy responses and examine how governments can foster innovation activities by supporting entrepreneurship and institutional reform. In this context, BIAC encourages the OECD not to consider topics such as innovation in isolation, but to take a whole-of-government approach in trying to address current challenges. While the list below is by no means exhaustive, we recommend that particular attention be attached to the following issues.

### **Keeping markets open for trade, investment and knowledge**

In BIAC's view, protectionism will not just be a counterproductive reaction to financial and economic crises, but will also have negative implications for longer-term objectives such as innovation. Open markets for trade and investment are a key driver for economic growth, and these, plus the knowledge flows they sustain, support innovation in its increasingly globalized form. The OECD project on trade, innovation and growth highlighted that trade and investment policies are an essential part of the innovation policy framework. The OECD is ideally placed to communicate effectively the benefits of open markets as well as the costs of protectionism, and address possible implications for innovation.

### **Fostering sound macro-economic policies**

A stable and enabling macro-economic framework is a fundamental condition for innovation. The recession will undoubtedly put government budgets under pressure due to a simultaneous fall in revenue and rising demands on expenditure. In such a context, structural policies will play a key role in strengthening the resilience to economic shocks. An obvious danger is that the recession might adversely affect necessary reforms, and it will be more critical than ever to strike a balance between short and long-term policy responses. Priority areas, such as innovation, education and others, must be maintained and the accompanying necessary reforms pursued.

### **Encouraging whole-of-government approach**

More than ever, governments need to ensure that investing in the future remains a top priority in both public and private sectors. BIAC has always been supportive of a horizontal approach to innovation, emphasizing the importance of education, human capital, trade, investment and other aspects, and has welcomed the horizontal Innovation Strategy. In view of the crisis, where budget constraints are a reality in a wide range of areas, such an

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integrated approach is particularly important. An immediate priority will be to ensure that there is sufficient capitalization of direct funding instruments and that incentives are in place that increase the use of private resources. However, support to innovation does not always imply granting money. Supporting entrepreneurship and risk-taking, making reforms in the education system, fostering open markets and designing a sound regulatory framework are all areas that need to be pursued. A priority will be to implement and establish effective framework conditions that reflect the understanding of the horizontality of innovation and its requirements.

### **Keeping a strong focus on research and development**

In spite of the current crisis, public and private entities need to be encouraged to sustain their research and development (R&D) activities. Many improvements in effectiveness and efficiency remain available, for example through increased collaboration, better design and use of public-private partnerships. Greater emphasis on international R&D collaboration, in order to minimize unwarranted duplication and maximize opportunities for cooperation, should be sought.

### **Considering the contribution of specific technologies**

The OECD is currently carrying out high-quality work in specific areas of technology, including information and communication technology (ICT), biotechnology and, more recently, nanotechnology. These offer the potential to increase efficiency and productivity across a broad range of current and new applications, including those at the heart of long-term global challenges relating to sustainability and human well-being. It remains vital for governments to understand and encourage innovation in these technologies, including as part of their response to the current economic crisis. For example, investment in high-speed broadband communications, both fixed and wireless, will provide an essential backbone for new applications in education, health, transportation, and research and development. We encourage the OECD to assess how these target technologies can lead to overall efficiency and productivity improvements and what the implications of the crisis might be. Case studies for how investment and innovation in ICT and other technologies can contribute to overall efficiency and productivity improvements throughout the whole economy should be part of the work on the Innovation Strategy.

### **Keeping a strong focus on global challenges**

There is a real risk that the financial crisis will lead to reduced resources and attention for long-term global challenges, such as climate change or health care. We encourage the OECD to help governments understand how to retain their focus on these challenges. Innovation should be seen as essential for economic growth, going hand-in-hand with addressing environmental and social challenges.

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## **Giving particular attention to small and medium-sized enterprises**

Many small and medium-sized enterprises (SMEs) are likely to face particular difficulties in getting liquidity through credits, due to the strict conditions now being demanded by the banks. Yet it remains crucial for these SME's to have access to inexpensive financial sources. Governments should pay particular attention to the constraints that SMEs are facing, and provide guidance to help SME's keep up their innovation activities in the difficult economic climate. This requires better understanding of the different contexts in which different types of SMEs operate.

## **Fostering cooperation and partnerships**

The financial crisis calls for further improvements in efficiency. Partnerships can add value by combining strengths and overcoming individual weaknesses. Opportunities for reaping the benefits of increased global cooperation, open innovation based on increased cooperation and public-private partnerships should be given particular attention in times of a crisis. Likewise, the implications for partnerships in case of severe financial difficulty of one of the partners should be considered.

## **A key role for the OECD**

In times of an economic crisis, international dialogue on keeping innovation high on the agenda of governments and business, sharing best practice and taking an integrated approach to innovation are of key priority. Thanks to its horizontal Innovation Strategy, the OECD is well placed to provide responses, by analyzing past trends and responses to previous crisis, proposing possible remedies and setting priorities with a view to not losing the momentum of action taken so far. Cross-cutting policy goals should remain of high priority in the Innovation Strategy, including the importance of maintaining public commitments, guarding against protectionism, promoting openness, fostering competitiveness, stimulating demand for innovation, and fostering entrepreneurship.

The OECD can play a particularly important role among international organizations in providing a principled approach to the analysis of the crisis, in discussing possible remedies based on past experience and in setting priorities. The experience of member countries provides a rich menu of national responses to the crisis, including monetary and fiscal stimulus, such as expansion of credit to help finance risky projects, investment in infrastructure, training and education, boosting demand, and inspiring business confidence. Now more than ever, the OECD as a multi-disciplinary organization has an important role to play in facilitating the exchange of best practice, in proposing coherent and integrated policy packages to support innovation for growth and in documenting that innovation is a tool that will ultimately make a contribution to helping countries climb out of the crisis. BIAC remains ready to partner with the Organization in contributing to this work.