Valor interview with Professor Mariana Mazzucato

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The public sector plays a crucial role in investment, says expert in innovation at meeting with Dilma

By Vanessa Jurgenfeld

From Sao Paulo

A busy audience attended the panel of the economist Mariana Mazzucato, Professor of Economics of Innovation at the University of Sussex, UK, and author of 'The Entrepreneurial State – Debunking Public vs. Private Sector Myths', during the 6th Brazilian Congress of Industry Innovation held by the National Confederation of Industry (CNI) and SEBRAE[1]. Government representatives and researchers welcomed the Italian author, and so did fans that approached her for pictures and autographs.

Mariana has become increasingly well known in Brazil. On May 15, she met with the President Dilma Rousseff and seven ministers, and has been tipped to be the government consultant in innovation. She has good connections at the Ministry of Science and Technology (MCTI) and The Brazilian Development Bank (BNDES).

Bringing mainly Keynesian ideas to the discussion of innovation, [Mazzucato] is a fierce advocate of the crucial role of the State to direct innovation and the investments in it. She points the finger at what many private sector entrepreneurs would prefer not to reveal - that the State is behind a number of innovations, as it has been recently the case of shale gas in the United States, she cites. In an interview with **Valor**, Mariana highlighted that there should be more emphasis on public policy to strengthen different actors such as the Brazilian Innovation Agency (Finep) in order to build a stronger system of innovation, and amplify the interaction between the public and private sectors. Below, excerpts from the interview:

Valor: You usually extol some aspects of Brazil, such as the role of BNDES in innovation. However, we have in the country a process of deindustrialization, little innovation and weak industrial policy…

Mariana Mazzucato: I really thought things were improving. Now I am worried, because there are real difficulties in regards to what is happening in the government - in the sense of taking the direction that calms the financial market, [thus] becoming very conservative… It is quite interesting to look how previous ministers tried to work. From 2008 to 2011, the State actively invested in innovation, and this resulted in the private sector also investing more. It is important to recognize this, as the changes since then were major. To create a strong system of innovation, strengthening the role of different actors like Finep should have more emphasis. It is important to pay attention to how these organizations interact with the business sector; there should be technology parks to allow exchanges between actors, etc. It is a cumulative and gradual process. In addition, you must have financing for innovation and, in fact, you have it [in Brazil], as there is a bank offering funding that can be the receptor of the future returns to these investments, which [in turn] can be used to finance the future innovation. The system itself creates returns that can be reinvested. There is an

[1] The Brazilian Service of Support for Micro and Small Enterprises.

exaggerated pessimism about Brazil. The country has different actors, [but] you need to understand better how they can work together. The danger now is that, because of the recent scandal involving Petrobras, and due to the narrative told, you blame it all on the large size of the State. [In doing so,] you run the risk of destroying what the reason for success was.

Valor: What do you mean?

Mariana: The situation is very dangerous and delicate in Brazil. People need to calm down in terms of their ideologies and understand that future business profits depend on a serious public policy, but also on the private sector – not on simply cutting the State's role, which is how things seem to be discussed at this time. [Many people see] BNDES and other [public] organizations as a problem instead of part of the solution.

Valor: "Part of the solution?"

Mariana: Of course the problem is that you still have a low GDP per capita and levels of poverty that require a lot of energy from the government, through programs like Bolsa Familia. Instead of this being a 'trade-off' – should I do innovation or poverty alleviation? –, we can think how these two can act together. This is why public banks are interesting. In the last decade, BNDES had a good return and part of it went to the Treasury. The treasury, in turn, can decide what to do with it: to direct resources to education or other programs, etc. What BNDES retains to itself can promote further innovation. This was occurring in Brazil and it is interesting to notice it.

Valor: Brazil adopted some tax exemption in a few industries, and the main critique was that further investments in the economy did not follow from these policies.

"I give an advice to Brazil: make sure you are indeed tackling the source of the problems"

Mariana: I do not like the term 'egalitarian system' because an egalitarian system can be either parasitic, predatory or mutualistic. A mutualistic system would be one in which the government helps to promote and invest in the most difficult areas where the private sector does not invest. Yet, to be mutualistic indeed, it is necessary that the private sector also enters the game and sees the benefits of doing so. And does not use the system as an excuse to do less. That is the problem. We need a confident public sector. There is a crisis of confidence, which in part explains many of the problems of various countries, including Brazil. The current narrative is that the State must get out of the way…[however,] what happens is that the State creates the subsidies, but has no confidence to demand anything in exchange.

Valor: Were there many errors in these policies in Brazil?

Mariana: Of course. There are many mistakes, but the problem is the type of conversation that people are having now in Brazil – and not only in Brazil. After all, it is damaging the very conversation. In fact, it is making things worse, as all the attention is now on government subsidies and the problems of Petrobras. And BNDES is under massive attack too. Altogether, this will diminish the stability of the government [required] to demand something back from the private sector, which makes everything even more distorted. The discussion should be about the ideal ways to organize private and public action in different sectors, so that both the public and the private enter the game.

Valor: You often talk about the role of BNDES. One of the criticisms it faces refers to what some have called 'picking the winners'…

Mariana: The problem is not whether to choose winners or not. Rather, it is how to choose. And how comprehensive this [choice] can be. [Behind] the story of the iPhone and other stories, there were choices, so as in the case of the GPS technology. To go to the Moon was a choice and to achieve so the industry had to do a lot of homework to solve the problems at stake. Missions frame the problems that the interaction of the private and public sectors may help to solve. The idea that somehow the 'Green Revolution' or even nanotechnology would have emerged without the government's choice is historically false. You have to make choices, [you need to] structure government agencies to enable them to make these choices, so that they have expertise in technological areas. These allow innovation processes to take place. When you 'pick', you are not just pushing the technological frontier, but also the frontiers of the market and the discussions about lifestyle. The pharmaceutical industry, for example, should not only think about new medicines, but also new ways of life. When there is not a confident State, the private sector is the one defining the boundaries. Thus, private companies can make complex drugs but do not stir those new areas that are less profitable to the industry, but are a lot more profitable to society as a whole. If the public sector invests in these areas, you can push the boundaries of the market toward new areas, such as lifestyle, diagnosis, other drugs etc. Those choices must be sufficiently brave to move beyond the frontiers defined by the private sector.

Valor: You mention the need for the State to pick a great direction in the field of innovation, like a mission. Do you see such a great direction of innovation [policy] in Brazil?

Mariana: I am not an expert on Brazil, but surely, there is biotechnology linked to agribusiness. The important thing is how to connect different areas. Going to the Moon was interesting because it involved different sectors. It is not for me to say which area Brazil should be pointing at, but what I can tell is that these choices should set the pace [of innovation] and change many sectors. That is what being 'mission-oriented' means. It is different from selecting priority sectors.

Valor: Some economists understand that Brazil has chosen sectors and companies.

Mariana: Part of it needs to be done. Some things need to be made at the sectoral level, vertically. Yet things really change when you have intersectoral problems identified by public policies, which can put pressure on industries to work together. It allows public policy to create 'links' between sectors and generate knowledge. I believe that in Brazil, the areas that can cut across [multiple sectors] such as biotechnology, agribusiness and the green economy would be very interesting in the future, if indeed this interaction occurs.

Valor: There are many ideas of Keynes behind what you advocate. In a high interest rate scenario, as in Brazil, how to persuade the entrepreneur to invest in the real economy?

Mariana: What Keynesian analysis often forgets is the notions of entrepreneur and 'animal spirit'. These are strong notions. You do not awaken the animal spirits of entrepreneurs by simply lowering interest rates. These 'instincts' target where future opportunities are. If you take it seriously, this is a

major issue not just during the downside of the economic cycle. [Joseph] Stiglitz, [Paul] Krugman and others say that we are now under recession, that we must have countercyclical policies and government investments. However, what should we do in the 'boom', just take a step back?
We know that even during the 'boom' there is not animal spirit. Entrepreneurs do not invest in certain areas, which can even be important but considered of too high risk. Keynesian theory shows that under recession, countercyclical policies are necessary, but it does not say much about what to do when we are at the 'boom', other than dealing with regulatory issues. The perception of the future [opportunities] is what guides business investment, not just current profits or the comparison of interest rates. This is the central issue. To think that you will have investors reduce [interest] rates does not work. It may work in the short-run, but it does not help structural change.

Valor: Are you pessimistic about Brazil in the coming years?

Mariana: I was optimistic from Lula up until two years ago. Not so much looking at growth rates, but instead focusing on the kind of discussion going on about development and innovation related to poverty issues. Innovation was part of the process. The trajectory seemed to go in a good direction.
I think that a lot of ideology has led critics, as in regards to BNDES. It is important to understand what the public sector can do and not just to see everything that it does as corruption.

Valor: Some heterodox economists have been saying that Dilma gave way to the market. What do you think?

Mariana: This is not something new for me. If you read Krugman, you may know that this is the wrong way. Part of my job is to support the Keynesian argument and also the idea that contractionary policies will not work. In fact, they never worked. Tell me one country where they did. None. The United States' growth is not due to contractionary policy, nor is China's…Part of my job is also to show that policies must be 'mission-oriented': the public sector needs to be active and daring.

Valor: In Brazil, there is some discussion about loosening the rules of the labour market as a way of helping economic growth.

Mariana: If you think that you can attack labour costs by cutting wages, it means you did not understand that what determines the cost of labour is productivity and salary costs. When I look at European countries like Portugal, Italy and Greece, salaries are not the problem, but productivity is. Where does the increase in productivity come from? Investment. [Hence], we need to make sure that we are catalyzing investments to key areas, rather than what I see [happening] in Europe, which is to reduce the workers' side, but without dealing with the productivity side. I give an advice to Brazil: make sure you are indeed tackling the source of the problems.

Valor: After the 2008 crisis, is growth more based on innovation than on financial speculation?

"[Many people see] BNDES and other organizations as a problem rather than part of the solution"

Mariana: It depends. There are countries like Spain that are growing because they decided that all their problems come from workers and trade unions. Spain has seen the labour market as a deterrent to growth, so it is cutting these costs, taking actions that go from weakening trade unions to removing some regulations on labour - as Italy did. In the short run, this can cause growth. For example, if a company pays less to its employees, it gets higher profits. However, in the long run growth will retract. First, because this is not where [sustainable, long-term] growth in fact comes from. Higher profits result from greater investments to improve the capabilities of workers and research and development in different sectors, which in the end increase productivity. In Europe, and in different parts of the world, [people] understood the productivity crisis – in 20 years, many countries have had zero productivity gain – as a problem involving one of these different types of deterrents such as labour rights. In the UK, growth has purely been consumption led, and not investment driven. The debt ratios rose sharply. There were different types of policies to incentivize people to buy houses, but they had no income for this. The big question is that, regardless of what the 2008 crisis has showed, we [continue to] have very unbalanced economies. We allowed that only part of the economies managed to have a fast profit recovery – as it is the case for the financial sector, which makes one [financial] operation after the other and is not exactly funding the real economy. There were no reforms to promote economic growth based on long-term investments. We have done nearly nothing, and that only makes things worse.

Valor: After the 2008 crisis, have countries not learned about the need to pay attention to the quality of investments?

Mariana: No [, they have not]. Two significant things should have occurred. First, we should have favored value creation rather than value extraction. Much of what the financial sector does is to transfer existing wealth. It does not create wealth indeed. Second, we do not understand the theory of where wealth comes from. For example, at the [CNI] conference, we heard about the importance of the entrepreneurs and the state, but we heard nothing about the workers. Therefore, we have an incomplete theory. It happens since the 1970s. By hiding where wealth comes from, the prevailing theory also helps to obscure where income distribution comes from. In this way, it allows that only a few [actors] to benefit from growth when it actually occurs. Take the example of clean technologies. Today, we have not enough investments. Whenever we have them, there will be a clean technology bubble, as there will be profits in the energy sector. Right now, it is a choice, but soon it will be something that everyone will have to do. So my point is, OK, we will have investments in clean technology, but who should share the returns when they appear? We saw the 'boom' of dotcom and biotech companies, but the distribution of gains was limited. Now that there is an investment crisis, large corporations are not reinvesting their profits, which affects capabilities and employment. We also have the financial sector appropriating extracted value.

Valor: You have been saying that the raise of innovation policies in the world should come along with 'definancialization'.

Mariana: I find this new attention to innovation and industrial policy very curious. Some of it is welcome, but another part suggests a problematic pathway. [Some people] say that as finance is not going well, and we had the problems of derivatives etc., we now need to invest in the industry; we need to redirect resources from finance to innovation. Nevertheless, this is a troublesome way to present the story, [as] financialization is significantly taking place in industries. Thus, innovation policies must come along with 'definancialization' of the real economy. For instance, how much of the profits of multinational corporations are spent on buying back their own shares? By doing so corporations increase the value of stock options and executives' salaries. 'Top' executives primarily earn 80% of the payments from stock options. When you ask them – and I have done so – why are not they reinvesting profits in the real economy, they say there are not enough opportunities. Yet, the two sectors with highest 'buyback' shares are pharmaceuticals and energy. These are two areas where there are great opportunities and public investments. So why do these companies do not feel compelled to invest? This is a key tragedy in these days.

Valor: How can we achieve 'definancialization'?

Mariana: First, financialization is not the only problem, but there is also a problem of investment. How much of the profits return to the real economy and where do they go to? If there are incentives for companies to invest, they must be conditional on returns for society. For example, one condition imposed to AT & T [in order to allow the company to maintain its monopoly] was to reinvest. This is one example, but in any case, buyback shares should be limited too. Today repurchases and dividends consume 100% or more of net income.