Public investment and the innovation agenda

By Andrew Jackson
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In response to recent rethinking of economic development policy, the 2017 federal budget announces a more interventionist innovation agenda. However, it marks only a modest shift in direction.

The received wisdom among economists used to be that governments should just set broad "framework" policies such as low taxes, less regulation and fewer barriers to trade. It was up to the private sector to decide what and where to invest. Anything smacking of hands-on "industrial policy" was to be avoided.

Rejecting this dogma, the influential British economist Mariana Mazzucato argues that government leadership and public investments are critical to building innovative economies. She has shown that publicly funded research well in advance of immediate commercial opportunities as well as direct support for strategic corporate investments have been central to the growth of innovative capacity.

Here in Canada, traditional hands-off policies have signally failed to boost our weak record of innovation. In that context, an expert business panel appointed by the Harper government called for more public investment in venture capital, and a shift in emphasis from tax measures to direct government support for strategic private-sector investments.

The previous government invested in venture-capital funds through the Business Development Bank of Canada (BDC), and contributed to strategic funds to support new investments in the aerospace and auto industries.

Tentatively moving in a more interventionist direction as broadly supported by its own business-dominated Advisory Council on Economic Growth, the current government will convene six "Economic Strategy Tables" in areas such as advanced manufacturing, clean technology and digital industries.

They will advise the government on sectoral development strategies, and firms will be encouraged to work co-operatively with each other and with public institutions, supported by funding of $950-million over five years.

The government will set up a Strategic Innovation Fund ($1.3-billion over five years) to directly assist major new private investments, of which just $100-million is new money adding to existing allocations for the auto, aerospace and clean-tech sectors.

The budget also announced a number of measures to assist the clean-technology sector in which the government intends to play a major leadership role; a small ($26-million) increase in funding for late-stage venture capital investments by BDC, bringing it to a total of $400-million over five years; and a small set-aside in public procurement to help innovative Canadian small businesses.

These initiatives will hopefully help Canadian knowledge-intensive firms to access long-term "patient" capital and to invest more in research and development, and thus contribute to the growth of an advanced economy in Canada. They are a step in the right direction.

That said, the total new funding allocated to the innovation agenda is, at best, modest in the context of a $2-trillion economy, and its impact will be incremental rather than transformational. The government has announced a review of existing programs and tax measures, but, like its predecessor, has balked at expert advice to significantly scale back the expensive but inefficient Scientific Research and Experimental Development tax credit so as to provide much greater funding for strategically targeted investments.

There is a major tension between the new strategic approach and the Liberal government's strong commitment to further trade and investment liberalization. The goal of the innovation policy is to build Canadian-based innovative capacity through public and private investments and partnerships, but Canadian workers and taxpayers stand to lose if, as is so often the case, the business is purchased by foreign investors in order to acquire its intellectual capital.

While Canada has the right to regulate foreign takeovers to see if they are of net benefit, the government has raised the asset threshold for review to $1-billion, and to $1.5-billion in the case of United States and European Union investors. This will exclude all but very large corporate mergers and acquisitions.

Provisions with respect to government procurement in international investment agreements also place limits on strategic policies to boost innovative Canadian companies.

The government may have listened to Ms. Mazzucato on the pivotal role of public investment in boosting innovation, but it has not heeded her advice to consider long-term public-equity stakes so as to reward taxpayers when these investments pay off and to anchor footloose investments.

While the federal government is indirectly taking a stake in some new venture-capital investments through the BDC, the intent is very much to exit early in the game once a company goes public rather than to remain for the long haul. So the government shoulders the risk but does not benefit from the long-term payoff.

To conclude, the innovation agenda marks another incremental turn away from "framework" economic development policies. But the shift is unlikely to be transformational unless it is scaled up and accompanied by a greater role for long-term public investment in the knowledge-based economy.