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FINANCE & INDUSTRIAL POLICY

Beyond Financial Regulation in Europe

Edited by Giovanni Cozzi, Susan Newman, & Jan Toporowski

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Foreword

Massimo D'Alema

Industrial policies are back on the European political agenda. Six years into the deepest economic crisis and recession in the European Union since its inception, it has now become evident that only through a significant increase in public and private investment towards innovative and cutting-edge technologies will Europe succeed in creating more jobs and stimulating growth.

Indeed, as highlighted in this groundbreaking edited volume, future growth will require Europe to become more innovative and to embark on a serious and effective government-led industrial strategy. To this end, Jan Toporowski, in his chapter 'Towards Financially Sustainable Prosperity', clearly emphasizes that the current and almost exclusive focus on the need for more expansionary fiscal policies to spearhead aggregate demand in Europe is clearly not enough. To reignite and sustain economic recovery we need to complement progressive fiscal policies with industrial policies that go well beyond the provision of residual incomes and infrastructure through public works.

Therefore, European governments and European institutions have a central role to play that goes beyond cutting red tape and fixing market failures. Instead, we need strong European states and institutions to invest in areas where the private sector cannot or is not willing to be active. A very good example is given by Mariana Mazzucato who reminds us, in her contribution, 'The Myth of the "Meddling" State', that the US has spent the last few decades using active interventionist policies to drive private sector innovation in the pursuit of broad public policy goals, such as, for example, financing and supporting the development of the algorithm at the heart of the Google search engine! On the other hand, the state in Europe has been put on the back seat of industrial and innovation strategies, thus severely undermining growth potential even before the crisis.

We need Europe to put innovation and industrial development at the core of progressive economic policies. At the same time, we need to call for a different kind of innovation. As highlighted by Riccardo Bellofiore and Francesco Garibaldo in Chapter 2, innovation in Europe should be based on societal needs and demands, be socially responsible, and based on an open cooperation between different actors, cross-cutting sectors and technological domains.

Several contributions in this book also highlight how in recent decades the financial system has been deeply procyclical; it has not sufficiently funded working capital and long-term investment, which is crucial for innovation. Daniela Gabor, for instance (Chapter 6), points out how the European financial system has undergone important changes in size, scope, and complexity during the last thirty years. Their business model has moved away from supporting investment in innovation and technological transformation and has become more reliant on leverage creation and trading of risk funded in wholesale markets. This has had detrimental consequences for growth and has significantly undermined industrial and innovation strategies. Thus, it is crucial, as highlighted by Kollatz-Ahnen, Griffith-Jones, and Bullmann, to fully reconsider the role that the financial system plays in supporting productive investment and within this a clear assessment of the role played by both public development banks, such as the European Investment Bank (EIB), and private banks, in promoting sustainable economic growth.

The current economic crisis and recession have presented us with an opportunity: to bring Europe on a new developmental trajectory where sustainable and equitable growth, innovation, and employment take centre stage. It is, however, essential for progressives to realize that abandoning the excessive and almost exclusive focus on monetary criteria and of balancing budgets is a necessary but not sufficient condition for economic recovery. Instead, we need to make sure that more progressive fiscal and monetary policies are also accompanied by a reconsideration of the role that the state plays in supporting industrial development and innovation. At the same time, we need to make sure that the financial system does not generate excessive risk and that it serves the real economy. The pressure is on and the opportunity has arisen for a responsible, equitable, and sustainable economic strategy. The question remains: do we have the political will to embark on a new economic path?

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Last but not least we thank all the contributing authors of this volume whose chapters reflect their vast experience and research expertise.

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Introduction

Susan Newman, Giovanni Cozzi, and Jan Toporowski

Since 2008 the North Atlantic Financial crisis has revealed major structural weaknesses in the architecture and operations of (global) finance as it has evolved in the decades since the collapse of the Bretton Woods system. The wave of capital account liberalization, financial deregulation and rapid technological progress that promoted financial innovation and fostered growing interconnectedness across financial markets and banking sectors resulted in a highly fragile global financial system that promoted speculative behaviour and harboured high risks of contagion. Such pathologies of the pre-crisis global financial systems have been prevalent across the spectrum of academic literature and informed a policy debate focused upon curbing the excesses of finance that emerged out of deregulation through re-regulation and re-orientation towards macroprudential regulatory and supervisory frameworks reflected in Basel III, the Dodd-Frank regulatory reform in the US. Thus, the immediate policy responses to the crisis of 2008 focused on banking and finance, beginning with the bank bailouts and followed by regulatory reform aimed at fostering a more stable and less speculative global and European financial architecture.

As the crisis evolved from one of banking into crises of sovereign debt and unemployment in a number of European economies, policy focus turned also to austerity. In the name of fiscal responsibility, highly indebted European countries were urged by the, so-called, Troika (European Commission, European Central Bank, and International Monetary Fund (IMF)) to reduce government spending significantly. According to conventional wisdom, increased economic activity would be brought about by a combination of appropriately paced fiscal consolidation and improved conditions for businesses to create new job opportunities and growth that amounted to greater labour market flexibility (see, for example, Buti and Padoan 2012; European Commission 2012).

However, austerity policies have not had the desired effect. Rather they have had a negative impact on both public and private investment, welfare and employment and it is ultimately setting the conditions for long-term stagnation in Europe. Since 2007, private investment has declined significantly in many European countries and aggregate demand has slowed down. In the South Eurozone (which comprises Italy, Spain, Portugal, and Greece), for instance, investment decreased from 21.7 per cent of gross domestic product (GDP) in 2007 to around 14 per cent in 2014. At the same time investment in the North Eurozone (which comprises Germany, France, Belgium, the Netherlands, Luxembourg, Austria, and Finland) declined from 17.7 per cent to 16 per cent of GDP. Unemployment still remains high in many Eurozone countries. According to International Labour Organization (ILO) forecasts, the unemployment rate will remain, at best, between 8 and 9 per cent over the period 2014–2016, compared with 6.7 per cent in the early 2000s. European Economic growth in the near future is expected to be modest. Recent IMF estimates predict an average annual growth rate of 1.3 per cent for the Eurozone as a whole between 2014 and 2018. This is much lower than the pre-crisis period where GDP growth averaged 2.2 per cent per annum in the period 2002–2006. Even where employment has stabilized, much of this is in low wage, low productivity activities.

In view of the protracted recession in southern countries of the EU, and the less than spectacular recovery of Western European economies, industrial and investment policies are very much back in vogue in EU policy discourse. Industrial policy no longer carries the status of being 'a dirty word' as it did during the heyday of the Washington Consensus when the debate was organized around the legitimacy of the state to intervene in the economy where the role of the state was contrasted with its complete absence, as in the strictest/most extreme reading of neoliberalism. However, despite this welcome opening towards the role of industrial policies in fostering growth and jobs, the dominant political discourse at European level has been confined on the role that public and private investment can play in improving infrastructure such as broadband and energy networks, as well as transport infrastructure and industrial centres, education, research and innovation, and renewable energy and energy efficiency and on the need for further harmonization (see, for example, European Commission 2014b). Indeed, the 'Integrated Industrial Policy for the Globalisation Era Report' of the European Commission (2010) emphasizes how a new innovative industrial strategy for Europe has to be based on better access to finance for business (in particular for Small and Medium Enterprises (SMEs)), better harmonization of the European legal framework, increased protection of property rights, and better coordination of education, research and development and greater coherence in science, technology and innovation cooperation with the rest of the world (European Commission 2010).

Proclamations of the return of industrial policy are also evident in the literature, notably in the 2011 special issue of Policy Studies (Bailey, Lenihan, and Arauzo-Carod 2011), the 2009 debate between Ha Joon Chang and Justin Lin (Lin and Chang 2009), and the extensive review by Naudé (2010), and more recently by Warwick (2013). What these historical surveys have revealed is that industrial policy never really went away. Warwick (2013) presents numerous examples of industrial policy from OECD (the Organisation for Economic Co-operation and Development) countries throughout the 1990s and 2000s. Rather, industrial policies over the last three decades or so have taken varied, disparate, ad hoc, isolated and unconnected forms that are in stark contrast to the highly integrated 'vertical' industrial strategies that were typical of post-Second World War industrial development. While industrial policy is increasingly viewed as necessary for industrial upgrading, differences of opinion on both the means and ends of industrial policy persist (see, for example, Lin and Chang 2009). The re-emergence of industrial policy since the crisis reflects the reconceptualization of industrial policy itself from one which saw manufacturing as causally significant in economic growth—as in theories of cumulative causation—to its redefinition, via the (neo-Listian) Developmental State Paradigm, as universal or indiscriminate state support of the private sector. The 'new industrial policy' reflects neoclassical micro economic thinking in that, aside from considerations of factor productivity, all economic sectors look alike and contribute in the same way, albeit not in equal magnitude), to GDP and GDP growth (Tregenna 2011; Fine and van Waeyenberge 2013). This perceived insignificance of manufacturing as an analytical category or strategic sector is evident in the title of Warwick's exposition of the new industrial policy as 'Beyond Industrial Policy'.

The re-orientation of industrial policy reflects both the continued prominence of neoliberal ideology in policy formulation and radical changes over the last three decades in the way in which production is organized from highly vertically integrated structures under Fordism to post-Fordist organization characterized by flexible specialization, vertical disintegration, and geographical dispersion. In this way, industrial policy in the context of advanced industrial economies have been recast so as to focus on innovation as necessary under the heightened imperative to improve competitiveness that has resulted from the globalization of production (Milberg, Jiang, and Gereffi 2014). This thinking is evident in the motion for a European Parliament Resolution on an 'Industrial Policy for the Globalised Era', adopted on 27 January 2011 (European Parliament 2011). It is worth noting that 'finance' appears just five times in the fifty-five-page European Parliament report 'Industrial Policy for the Globalised Era'. Mention of finance was in relation to specialized finance for research and development (R&D) and innovation and sources of long- and short-term finance for SMEs.

Another concern in the current European policy debate is that financial sector regulation and industrial policy have tended to be discussed separately, except in relation to the financing of industrial investment. Whilst the issue of predictable and suitable finance for industry is critical for successful industrial policy that brings about sustained economic growth, and indeed stressed in the contributions from Konzelmann and Fovargue-Davies and Mastroeni and Rosiello in this volume, discussion has largely failed to take account of how finance has intervened in the restructuring of industry over the past three decades. It is our contention that, in order to be successful, European investment, industrial and financial policy formulation needs to be cognizant of the heterogeneous economic structures and growth trajectories of European economies, and the interconnectedness and interdependencies of growth paths that present specific challenges to policy as well as highlight the need for cooperation across the region.

There now exists a large body of literature that invalidates the notion of the financial sector as unproblematic intermediary between savers and firms ranging from methodological individualist approaches that reject the efficient market hypothesis on account of pervasive market imperfections (as in the New Keynesian approach) or the tendency for actors to deviate from 'rationality' owing to the nature of human psychology (as in behavioural economics) at one end of the spectrum and more systemic accounts of unprecedented changes in the structural relations between financial markets, households and firms, and the increasing complexity of these relations, over the last three decades (Froud, Johal, and Williams 2002).

What has also received less attention in mainstream policy and academic discourse has been the structural weaknesses that have appeared out of specific economic development models namely, the precise macroeconomic framework and policy approach and relations with the region and the wider global economy that characterized the growth trajectories of national economies in the lead up to the crisis. Almost a decade on from the watershed moment, the wider economic, political, and social repercussions of the crisis continue to unfurl with little indication of sustained rapid recovery. This is decidedly evident in Europe as austerity ravages countries across the EU with particular voracity in Southern European states, polarizing societies and politics.

In view of the discussion above, the contributions to this volume build upon, and complement, recent contributions to the literature on post-crisis industrial policy, notably the edited volumes by Bianchi and Labory (2011) and Bailey, Cowling, and Tomlinson (2015), and debates around the notion of an appropriate financial architecture that serves the real economy in a number of ways:

1. by assessing the nature of the global financial crisis and its relation with the process of global and industrial restructuring;