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Paul Dobrescu*

Wealth of Nations is the Wealth of Ideas. The Social Innovation Imperative

Abstract

Social innovation cannot be a purposeless endeavour. It seeks to set framework conditions for development and to create new paths for growth. That is why, social innovation is to be judged by its results. It is the aim of this article to underline the importance of social innovation and to study its presence in two different temporal and geographical settings: Great Britain in the context of the Industrial Revolution and China in the context of structural reforms initiated around 30 years ago. These two cases indicate that social innovation may provide a possible answer to Adam Smith's inquiry into how wealth is accumulated: the wealth of nations is ultimately the wealth of ideas.

Key words: innovation, social innovation, innovation in government, development mode.

1. Knowledge and Innovation – the New Sources of Economic Growth

Ever since Adam Smith's revolutionary book "The Wealth of Nations" was published, scholars and policy makers have tried to figure out what determines growth and wealth. Adam Smith himself was among the first to provide an answer to this fundamental question and highlighted specialization, the division of labor and institutional prerequisites for growth, while the neoclassical economists emphasized the investment in physical capital and infrastructure. Relatively recently, a new factor was discovered – knowledge. Its contribution to economic growth was first brought to the attention of the academic community in 1956 by Robert Solow, in his famous article „A Contribution to the Theory of Economic Growth". This explicit acknowledgement did not have immediate effects and it took the academic and scientific community about 40 years to introduce knowledge into the mechanisms and tools for assessing factors of economic growth. The milestone marking the new understanding of knowledge as a driver of economic growth is the *1989/999 World Development Report* (done by World Bank). From that moment on, attention has been given to both tangible and intangible sources of growth; among the latter, knowledge accumulation, new organizational designs, new ways of doing business have been prominently featured.

Acting upon the realization that the new sources of economic development are no longer steel, coal mining and heavy industry, and that knowledge and innovation are the drivers of competitiveness and economic growth, many states have developed and exploited knowledge-based activities and services. „The new economy", „the post-industrial society" have become

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magic concepts stimulating the imagination of both scholars, decision-makers and practitioners especially from the developed countries. Benchmark indicators to objectify the existence of the new economy have been proposed by a series of authors: an economy qualifies for this title if the tertiary sector is dominant, accounting for 3/4 of GDP and if it is driven by intellectual capital – knowledge, ideas, talent (Mandel, 2000). This type of economy is stimulated by a synergy between technology and finance: the former is the engine, while the latter is the fuel.

The *2007 World Development Report* even put forth the idea that knowledge creation and human capital development are not merely engines of growth; they are by far the most prominent ones. This view has been extended by other famous indexes and econometric studies holding that the factors influencing economic growth are multi-dimensional and cannot be played one against the other. The *Global Competitiveness Report*, for example, groups the different components of competitiveness into 12 pillars: institutions (both public and private), infrastructure, macroeconomic stability, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market sophistication, technological readiness, market size, business sophistication, innovation (4-7). The latest version of that report (2009) underlines the fact that “although substantial gains can be obtained by improving institutions, building infrastructure, reducing macroeconomic instability, or improving human capital, all these factors eventually seem to run into diminishing returns. The same is true for the efficiency of the labor, financial, and goods markets. In the long run, standards of living can be expanded only with innovation” (p. 7).

2. Innovation Reconsidered in the Context of the Global Economic Crisis

Placing knowledge and innovation at the heart of growth and competitiveness processes has made a lot of sense over time. Yet, the global economic crisis has forced both scholars and practitioners to reconsider fundamental questions about how a country’s wealth is accumulated and preserved. The crisis is “a time for gloom and pessimism”, but it may also “provide the stimulus we need to come up with answers to a question that has defeated policymakers for more than 50 years” (Rose, 2008). The crisis has brought to the fore at least two closely coupled aspects that lost part of their meaning and strength in the midst of the pre-crisis enthusiasm with high-tech revolutions, innovation-powered economies, financial over-sophistication, outsourcing, the privileged task of developed economies to come up with new ideas and the underprivileged tasks of underdeveloped or developing economies to come up with the finished product.

First, the crisis revealed the importance of diversification of the economic system, the need to strike a balance between real and virtual economy, between value-added manufacturing and services of all kinds (business, financial, market-related etc.). Talking about the situation in Great Britain, John Rose, chief executive of Rolls-Royce, stressed that “the first priority is to stop treating manufacturing as some kind of relic of the industrial revolution. High value-added manufacturing brings huge benefits. It penetrates the economy of the entire country rather than just London and the south-east; it pays well but avoids bewildering distortions of income; it drives and enables a broad range of skills; it demands and supports a wide

supply chain and it adds value and creates wealth” (*idem*). According to the figures provided by the British top executive, the British industry lost 1 million manufacturing jobs in the past 10 years. More importantly, along with these went brands, designing and engineering capabilities, intellectual property rights and – for researchers – routes to market for their inventions and the direct connection to their customer’s needs. Taking the example of a typical American car, the contribution to its manufacturing is distributed as following: 30% of the added value is accounted by the South Korean providers of subassemblies, 17.5% by Japanese specialized high tech components, 7.5% by German engineering, 4% by manufacturing of minor units done in Taiwan and Singapore, 2% by marketing and advertising performed in Great Britain, 1.5% by data processing done in Ireland and Barbados. The American manufacturer accounts only for 37% of the value-added activities (Rugman, 2009, p. 92). Would it be fair to say that the American manufacturer lost 63% of its value-added manufacturing strength and, along with these, all the strengths mentioned above, such as planning and engineering capability, or the direct contact with the customers’ needs?

Second, the crisis has forced the re-discovery of the meaning of innovation as social innovation, too. The statement according to which innovations (sic!) spur growth and economic transformation had become a mantra of economic growth literature. The problem with that new orthodoxy is the over-reliance on the understanding of innovation as technological innovation, technological breakthroughs, combined with the mistaken belief that this type of (technological) innovation is the exclusive domain of the Western, developed world. The greater prominence of emerging markets multinationals, their connections to the global R&D networks, the changing structure of Chinese (and Asian) exports from low tech to high tech products “challenge the traditional notions regarding the flow of capital, technology and knowledge in the global economy from the developed economies to the emerging ones” (Ramamurty, 2009, p. 8). Exclusive emphasis of technological innovation(s) at the expense of social innovation places countries in a position to miss some of the most important ingredients of the growth and development “recipes”: the quality of policies and the determination of the ruling class to implement those policies. The characteristics of the business environment, the maturity of institutions, the human capital, the technological readiness, financial sophistication, the capacity to come up with technological innovation are all important in spurring development; but they all make sense in a framework conducive to social innovation, driven by development modes that are pragmatic, ideology-free and hence able to adapt to fast-changing realities.

3. Global Landscape – a Ferocious Arms Race with Innovation as the Prime Weapon

As we have already underlined, innovation has a solid reputation in the economic growth literature up to the point where there are authors arguing that “virtually all of the economic growth that has occurred since the 18th century is ultimately attributable to innovation” (Baumol, 2004, p. 13). Joseph Schumpeter was among the first to bring innovation to the fore by postulating that dynamic disequilibrium, the “creative destruction” brought on by the innovating entrepreneur rather than equilibrium is the norm of a healthy, performing economy. He is also credited with clearly establishing the distinction between invention and

innovation. While invention means coming up with good ideas, innovation means making those inventions work technically and commercially. Both invention and innovation has suffered dramatic transformations over time. Before 1800, invention was mysterious and was associated with “the flash of genius”, “bright ideas”, “muses”, “inspiration”, and “Eureka” exclamations. According to P. Drucker, the complexity of the WWI brought about a fundamental change: invention became research, “a systematic, purposeful activity which is planned and organized with high predictability” (Drucker, 1985/2007, p. 30-31).

Today, the even bigger complexity of globalization phenomena has changed the stakes and the structure of innovation, too. Regarding the stakes, competitive pressures are creating a genuine, ferocious arms race, with innovation, and not price, as the prime weapon (Baumol, 2004, p. IX). In structural terms, innovation itself is increasingly becoming a routinized and predictable procedure. “Business firms systematically determine the amounts they will invest in the R&D process, systematically decide on the ways in which they will interact with their rivals in this area, and even systematically determine what it is that the company’s laboratories should invent” (Baumol, 2004, p. 11). Big, global companies have routinized it and broken it into smaller pieces, some of which become the object of outsourcing. As A. Gurría, OECD Secretary-General shows, initially, outsourcing was primarily in manufacturing, taking advantage of the low cost of unskilled labor. In many countries, outsourcing keeps on being about manufacturing only. Regarding China and India, soon a realization came that the salaries of highly skilled knowledge workers in these countries were equally low, 5-10 lower than in the USA. At the same time, those countries invest a lot in higher education and research, which raises the confidence in their scientists and engineers. As a result, outsourcing came to be about R&D and innovation activities, about establishing R&D centres connected to the global R&D network. These international interdependent R&D laboratories “are basic research centres, have close links with international research programmes and their reason for establishment is operation of coordinated world R&D programmes as part of global product strategies” (Dicken, 2004, p. 243).

The distinction between invention and innovation has already become a cliché in the literature. The situation is rather different with another distinction, formalized by P. Drucker, between technical and social innovation. In his view, “innovation does not have to be technical, does not indeed have to be a ‘thing’ altogether. Few technical innovations can compete in terms of impact with such social innovation as the newspaper or the insurance [...] The hospital in its modern form as a social innovation of the Enlightenment of the eighteenth century has had greater impact on health care than many advances in medicine” (Drucker, 1985/2007, p. 29). Money (as tokens that carry value), property rights, the textbook, the modern, Humboldtian university, the nation state, the standardization of production chain at McDonalds’s, the global supply chain practiced by WalMart are all examples of social innovation. Excellence in social innovation may explain, as is the Japanese case, economic success, in spite of the fact that, by and large, the Japanese have not produced outstanding technical or scientific innovations. When the Japanese opened their country to the modern world in 1867, social innovation was “far more critical than steam locomotives or the telegraph. And social innovation, in terms of the development of such institutions as schools and universities, a civil service, banks and labour relations, was far more difficult to achieve than building locomotives and telegraphs. The Japanese made a deliberate decision a hundred years

ago to concentrate their resources on social innovations, and to imitate, import and adapt technical innovations – with startling success” (*idem*).

Social innovation accounts for the differences of performance in development. Otherwise, the recipes of development, including the parts regarding technological readiness and building the capacity for technological innovation would be relatively easy to apply. Yet, companies differ in their capacity to come up with new products and services and, increasingly, in their capacity to design new processes so that the new products and services are deployed more rapidly and at lower costs. In other terms, companies – big and small – must perform in both areas: technological innovation and social innovation (organizational, institutional, process-related etc.). Just like companies, government needs innovation.

Drucker’s severe conclusion that “not to innovate is the single largest reason for the decline of existing organizations” (Drucker, 2001/2007, p. 7) is in line with his distinction between technological and social innovation and it applies to both. In his view, government – not business or nonprofits – and economic theories are going to be the most important area of innovation over the coming years. Let’s remember William Baumol’s depiction of the global *economic* landscape: a ferocious arms race with innovation as the prime weapon. If we agree with the idea that government and economic thinking are the most important objects of (social) innovation, then the adjective “economic” is no longer needed and we have come up with a pretty accurate description of today’s global landscape in general: a ferocious competition between government and economic models, between development ideas or ideas about economic recovery, survival or growth. Perhaps more than anything else, the crisis has raised questions regarding the appropriateness of the existing development model, its capacity to adapt and respond to a fast-changing reality. It has placed under a question mark the prevailing model that has guided the development of capitalist world for the last centuries: the Anglo-Saxon model. In Roger C. Altman’s words, the damage brought about by the crisis “has put the American model of free market capitalism under a cloud” (Altman, 2009).

4. Two Instances of Social Innovation

In order to illustrate the importance of social innovation and its role in boosting development, we have chosen two situations in which the issue appears to be most prominent. The first refers to the situation in Great Britain and the factors that led to the Industrial Revolution and summarizes the answers to the long debated question “Why did the Industrial Revolution happen in Great Britain”. The second refers to China and to its two successive historical experiments during which it has sought to innovate government and economic thinking themselves.

4.1. Why did the Industrial Revolution take place in Great Britain?

A short economic history of the world of the sort written by Gregory Clark would notice that before 1800, the average quality of material life “declined from the Stone Age to 1800” (Clark, 2007, p. 2), the income per person was rather uniform across all societies and there was no upward, no growth trend. The Industrial Revolution changed this dramatically: it inaugurated the growth economy, it increased the incomes per person in a favored group of economies to the point where “the richest modern economies are not ten to twenty times