Time To Look at the State in a Different Way – Value Creation and Innovation in the 21st Century*

Pál Péter Kolozsi

Mariana Mazzucato:
The Value of Everything: Making and Taking in the Global Economy
Public Affairs, September 2018, p. 384

What can be regarded as real value creation from a social perspective? Which economic operators play a prominent part in this process? Don’t we overvalue the importance of the private sector in the field of innovation and easily forget about the state’s added value? It is questions like these that Mariana Mazzucato, an outstanding representative of economists who are overturning pre-crisis dogmas with increasing success, undertook to answer in her latest work. In the book “The Value of Everything – Making and Taking in the Global Economy”, the Italian-American economist, known as a strong critic of modern capitalism and mainstream economics, concludes that exploring the above issues and dilemmas should not start by performing economic analyses, but by answering a fundamental philosophical question, which was once also a major concern to economists: What does value mean? What makes anything, for example an activity, valuable? What makes this issue particularly relevant is the fact that we have barely overcome the global financial crisis, but the banking sector which ultimately caused the crisis is once again resplendent in its former glory. According to one example, Mazzucato repeatedly uses, a mirror is undoubtedly held up to us by the fact that just a year after a total collapse of the financial markets, Goldman Sachs chief Lloyd Blankfein – who was by no means an independent observer in the outbreak of the crisis – declared that his employees were “the most productive in the world”. The masses of persons who lost their flats, jobs and existence due to the crisis certainly do not share the view of the star banker, and Mazzucato is clearly with them based on what is stated in her book.

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

Pál Péter Kolozsi is a Head of Department at the Magyar Nemzeti Bank. E-mail: kolozsip@mnb.hu
Mazzucato claims nothing less than that most of the economic and social problems of our times and the ever-increasing inequalities can be attributed to a fundamental error of mainstream economics, i.e. the concept that those things and only those things are valuable if market mechanisms show them as valuable. This, however, is not evidence. Determining value on a market basis is a relatively new approach. Before the marginal revolution at the beginning of 19th century, a number of value theories, often rival, were developed by economists who were motivated by a much stronger philosophical interest at that time, and their work revolved primarily around this question of value. Typically, economics started from the concept that activities which create value can be considered as useful, and thus deserve to be promoted from a social perspective, and to that end, the notion of value and value creation had to be defined in some way. If we do not define value in an appropriate way, we might give preference not to value creation, but to value extraction, i.e. to unearned rents without real performance instead of well-deserved profit. This is indeed of critical importance, especially in terms of the redistribution of income and economic development, since economic policy decisionmakers are naturally influenced by the concepts and ideas of value and value creation.

In the first part of the book, Mazzucato presents the development of value theory, describing the resources and activities that economists from mercantilists and physiocrats through classicists to marginal neo-classicists used to regard as productive or unproductive, and how this distinction impacted the social policy and economy policy decisions and strategies of the given era. According to the marginal value theory, which is dominant today, value depends on the utility the consumer gets, and therefore it does not make sense to classify activities as valuable or valueless because the market will make this distinction. Anything that has a price has value, i.e. in contrast to the earlier view, it is not the case that value determines price but, on the contrary, price determines value which thereby depends on the scarcity of the given good. You get what the others think you deserve. Under this concept, basic notions also get a different perspective, for example rent is not an unearned income any longer, but a market imperfection that can be decreased by facilitating competition. The hollowing out of the notion of rent is one of the major theoretical changes in the history of economic thinking, according to Mazzucato. While even the classicists viewed it as an income from unproductive activity and therefore acted against it, neoclassical theory says that in a free market economy, all incomes are by definition productive – we just have to decrease administrative obstacles to market competition, because it is the cure for every problem.

Following this theoretical introduction, the author analyses the current economic order. One of the “negative heroes” of Mazzucato’s book is the financial sphere. The UCL professor believes that financial deepening, deregulation and the huge enlargement of the financial sector is much more of an impediment to progress
than a facilitator. It is not by chance, she argues, that the financial sector was not considered a value creator before the emergence of modern capitalism since interest charged by banks reduced real economy income. Thus, in contrast to today’s view, the banking sector was not seen as a profitable economic sector but as a dead-weight cost. According to Mazzucato’s analysis, most banks are probably the biggest rent-seekers of economy, which do not create value, but extract values from others, the real value creators. Banking income differs anyway in its character from real economy income since it mostly comprises unpriceable elements, and its main source is money creation by commercial banks. For a long time, mainstream thinking practically denied or at least failed to acknowledge that banks create money independently of the state: according to the prevailing narrative, credit institutions are financial intermediaries, i.e. they only pass on savings to investors. For example, the Bank of England only acknowledged a few years ago, under the pressure of the 2008 crisis, that it is not the deposits that create loans but, on the contrary, loans made by banks create deposits. Of course, banks do not have unlimited capacity to create money, since lending has liquidity and capital requirements. However, this does not change the fact that banks mostly “make their living” by providing a monopolistic-oligopolistic service (establishing a bank is subject to authorisation, and the banking market in particular is highly concentrated), and thus they can charge unreasonably high prices. Mazzucato agrees with Keynes and Minsky who claimed that excessive financial dominance is dangerous and harmful, and banks should be subject to strong regulation (“big government, big bank”), as an abandoned financial sector may cause deep crises. Besides, the excessive expansion of fund managers and investment funds is also seen as problematic by the author (“money manager capitalism” and “casino capitalism”, to use the words of Minsky), as in this case the financial sector derives an ever higher income from serving other financial firms or from speculation, and not from serving the real economy, which does not provide real added value from a social perspective.

Mazzucato dedicates a separate chapter to the financialisation of the real economy, the phenomenon that ultimately – due to the distortion of the notion of value – industrial companies and service providers also often generate higher income and profit from financial operations than from their core activity. This in itself would not necessarily pose a problem, but it may have consequences for corporate behaviour that do not serve the interests of society. For example, the author presents share repurchases, a common form of distributing corporate profits to shareholders as a particularly harmful practice. Mazzucato sharply criticises the idea attributed to Milton Friedman that the only job of a company is to maximise shareholder value – this favours short-term thinking (short-termism) over long-term thinking, supports speculation, restrains productive investments and ignores that owners are not the only group that matters for company, but also employees, business partners, the
community as the host of a company, civil society, i.e. all other stakeholders are relevant. According to Friedman, the reason why shareholders are key actors is that they bear the risks deriving from the company’s business activities, and precisely for this reason they are entitled to profit. However, Mazzucato thinks that reality is much more complex than that. Corporate value creation is a collective process, and thus every party involved has its part in the success of the company.

In continuation of this reasoning, along with banks Mazzucato also does not spare the innovational sector. From her perspective, the big innovators and start-ups known today also present rents as profits in most cases. It is a fundamental problem that the mainstream approach ignores that innovation is a collective and cumulative process. In the current system, risks are borne by the community, while profits are distributed to privileged players in the private sector – warns the author, who believes that it is false and misleading to state that big innovations are born in garages in small American towns. In reality, they are rather the result of detailed scientific work carried out over several decades. The situation is further complicated by the fact that basic research is usually carried out by state institutions and not by private companies, as the private sector does not take on the substantial capital requirements and risks involved. This structure is typical for the majority of innovations in the pharmaceutical industry, the Internet industry and bio- and nanotechnology – says Mazzucato, who claims that it is therefore doubtful whether the private profits generated in these industries are proportional to the invested private capital and the risks assumed by the private sector. The author’s answer to this question is clearly no, and out of the harmful practices, she points out patents and trademarks which – in contrast to their original goals – no longer facilitate innovation, but create, almost exclusively, monopolies. According to Mazzucato, the enormous profit of big technology companies are also rents since they are de-facto monopolies, be it social networks or Internet search engines. These monopolies are based on network effects, that is, on the fact that many people use them. There is no real competition on these markets, which is not optimal at the level of society, since it results in overly high prices. In spite of this, state competition authorities do not act against this strong concentration. This observation is not affected either by the fact that these websites are often free for the first sight, because the correct interpretation here is that these companies make their living from the commercial resale of databases received from users for free. If something is free in the online world, users are not consumers but products, the author points out.

The closing part of the book deals with the question of what can be done in this situation, and concludes that we should first of all change our way of thinking. Mainstream thinking treats government as a necessary evil, believing that the state can only remedy market failures (and only to a limited extent, since it might easily
run into one of the government failures), and on the whole, government is not productive, and thus cannot create value. Mazzucato says this reasoning is false and not supported by the facts, but rather has its origin in an ideological position. In fact, the state plays an outstanding role in the operation of the market economy system as a whole, as well as in the development of markets, and in particular in the field of innovation and value creation. The author outlines the extent of the damage caused in public thinking by the spread of the public choice theory. The promotion of the supremacy of the market, the inertia and ineffectiveness of the state significantly reduced the size of the state and eroded the ethos of the public sphere. The latter led to a considerable decline in the self-evaluation of the state, and the government sector virtually began to stop “thinking big”. This is particularly bad because it is precisely the task of the state to launch big projects and solve tasks that the private sector is not able or willing to solve. Just think of space research, the moon landing, the Internet, or basic research applied in the pharmaceutical industry. If we do not believe in the power of the state to create value, it will not be able to do so, but if we acknowledge its results, then it will. A state which decreases its capacity and is uncertain about itself is indeed less able to create social added value. Therefore, the aim should be a state that finds itself again – to that end, it is important to link the results achieved by the state to the state, and possibly not to any private sector players who just ably promote themselves. We need to recognise that the state does not only spend, but also invests and assumes risks, but that it can only benefit from the returns on its investments in an indirect manner at most, through a rise in tax revenues, due to the enrichment of the private sector. If we strive for an economic environment which is based on innovation and grows in a sustainable and inclusive manner, taking social and environmental limitations into account, then the status of the state must be restored both in people’s heads and in actual income accounts.

According to Plato those who tell the stories rule the world, since our behaviour is largely determined by the common experience and common perception of our own jointly shared mental and intellectual frameworks. This view is shared by bestseller historian Yuval Noah Harari, who believes that social changes are shaped by an inter-subjective reality, which is nothing else but a set of stories, a common understanding that exists in the common mind of participants. The novelty of Mazzucato’s book lies precisely in the fact that it questions the stories that modern capitalism is based on. We must rid ourselves of the ideological beliefs that we cannot argue about values. Moreover, we must acknowledge that a major part of innovation comes from the public sphere and not from the private sector, and the state should not be small and stand in the background, but rather be proactive and courageous. First of all, we need to ask ourselves what kind of world we would like to live in, and what kind of economy we would like to have. We have to reward activities and behaviour that facilitate the attainment of the objectives
that we defined, and the creation of real social added value. This is irreconcilable with a socio-economic order that favours unearned incomes, Mazzucato believes. This is because the free market does not mean a market free from the state, not even according to Adam Smith who was widely misconceived and misunderstood, but it means a market free from rent.