



5 WAYS GOVERNMENT POLICIES HELP BUSINESS INNOVATION

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It's gospel among American politicians and business leaders: innovation is key to the success of individual companies and entire industries. And yet, many of these same people contend that to optimize innovation, government needs to stay out of the way.

We disagree and believe there are many opportunities for business and government to work together. Government has played a pivotal role in spurring innovation throughout American history. Think of the national train system in the 1880s, in which federal authorities mediated among a small group of monopolies to establish a standard gauge for all railroads so rolling stock could be shipped anywhere in the US, from one line to another. Or consider the basic research grants that enabled the invention and development of the semiconductor, with the Defense Department serving as the initial risk-taker and customer.

Today, the stakes are high; the health of our planet and our economy depend on innovation occurring on a massive scale. America's international competitiveness is also at stake. As a percentage of total federal spending, R&D [research and development] is at its lowest levels since 1956. In contrast, China doubled its R&D expenditures between 2008 and 2012.

Government support of innovation should be a complement though, not a replacement for private ingenuity and risk-taking. The American experience of public sector involvement, in contrast to many European nations, rarely ends up stifling innovation, capturing the best talent, or otherwise depressing market forces. Successful outcomes require smart policies that recognize and then work to correct market failures (e.g., imperfect information and externalities). The guiding hand of government is a fundamental condition for success. And for effective government support of innovation to occur, responsible business leaders need to advocate for it.

HERE ARE FIVE AREAS WHERE CONCERNED BUSINESS LEADERS SHOULD CONSIDER ENGAGING:

1. RULES AND REGULATIONS

When the Clean Water Act and Clean Air Act passed in the 1970s, polluters complained it would raise their costs. Other companies, however, embraced the challenge and reoriented their entire production processes to “design out” the pollution. Their new products required less raw material to produce (reducing costs), and had a higher degree of quality (thus increasing the price they commanded in the market). In turn, these firms reduced their liability exposure, became more profitable, and captured a greater market share from consumers eager for environmentally superior products.

Regulations can indeed sometimes be challenging to adapt to or burdensome to comply with in the short term. They may require a reallocation of resources and adjustment of business models. Regulations must not be designed to reduce competition or prop up incumbent industries. Instead, they should be crafted to stimulate innovation, break up monopolies, and protect the common good.

2. INCENTIVES AND DISINCENTIVES

Government has a long history of using fiscal policy to encourage certain economic, environmental, and/or social outcomes. Seeking to address climate change by putting a price on carbon is one important example. We think it's time that Congress acknowledges the macro “free rider” problem of climate change by setting a price on carbon, ideally “upstream” on the nation's largest CO₂ emitters. The per-ton price will serve as a clear and efficient market signal to shift consumption patterns and investment decisions. The price needs to be set high enough to encourage a shift in the extraction and production processes of fossil fuels as well as reflect their sunk-costs advantage over renewables.

Taxing carbon would move energy firms and consumers towards using cleaner fuels. And, we believe that a price on carbon, if efficiently designed, could also help to reduce the overall level of federal subsidies for solar, wind, nuclear, etc. What the revenues from a price on carbon are used for is open



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for discussion, but some ideas we favor include infrastructure investment, supporting the economic transition of coal intensive communities, and lowering worker payroll taxes.

Any discussion of federal or state energy incentives needs to appreciate the long-standing support (e.g., tax credits, depreciation allowances, insurance coverage) policymakers have provided the coal, nuclear, and oil and gas industries. The litmus test should be: is this a mature industry? If yes, it should no longer be supported by taxpayers. In time, renewables will achieve parity and government subsidies will not be needed. Until that happens, government has a role to play in helping foster nascent industries.

3. INDIRECT INVESTMENT

Remember when you drove your family down to the beach for a nice relaxing vacation? The government played a pivotal role in enabling that. The Interstate Highway System is a perfect example of what's called “pump priming” - stimulating the economy, mostly through government spending. In this case, the federal government provided funds to build the Interstate system (around \$425 billion in 2006 dollars, by one estimate). It resulted in massive increased economic activity - not just construction and maintenance, but increased commerce and tourism between states. And without government investment, it wouldn't have happened.

Or take basic research. The private sector often shies away from research that has a long lead time before it can be monetized. So, we have government funding of research at the university level. For example, the National Institute of Environmental Health Sciences provides grants to measure and investigate how the environment impacts human health. The science that emerges can be used by the private sector to develop new products and services.

Or look at the Design for the Environment program, a voluntary program run by the US EPA, which helps businesses and institutional buyers identify and choose cleaning and other products that perform well and are safer for human health and the environment.

4. DIRECT INVESTMENT

Anyone who followed the Solyndra debacle knows that any direct investment, in the public or private sector, is risky. Solyndra secured a \$535 million loan from the Department of Energy and ultimately defaulted.

Here's what you may not know: the program responsible for the Solyndra loan also made a great many others - and is now turning a profit. Best of all, that success has legitimized the clean energy market and enabled similar companies to get loans from the private sector more easily. In many cases, when the private sector is unable or unwilling to take investment risks to foster new directions or even new industries, the government can play a vital, direct role.

5. GOVERNMENT AS FIRST MOVER

If you're reading this on a computer, you're benefiting from the government being an early adopter. Our electronic systems have been dependent on semiconductors, especially transistors, for decades now. But when the first transistor was invented in the 1940s, nobody used them - the vacuum tube was still the popular technology.

Then the military became the first major customer for transistors. The federal government essentially provided a market for transistors, making it possible for the private sector to develop its products at a time when a private sector market didn't exist. Without government involvement, it wouldn't have been possible, or at least would not have happened nearly as quickly, to see these products come to market.

Our mixed economy works best when the public and private sectors collaborate. Each has a unique role. The private sector excels at being nimble and responsive. Government ensures a level playing field and corrects market failures. Together, the opportunity to enhance innovation and move it in a direction that benefits society is immense.

The downside risk of government involvement is that the decision-making process may become ossified, captured by special interests, or too bureaucratic. Business leaders must provide guidance for strengthening these processes. In today's political environment, we know that too much of government policy-making has become dominated by legacy business interests that fight to keep the status quo. Forward-thinking business leaders who believe in both a vibrant democracy and economy should engage in the public policy process. Make sure your values and visions are known to policy-makers, lest those who hold a more parochial view dictate the future. 🤖



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