

# Proposal: An experimental 1 billion productivity fund for Europe<sup>1</sup>

## EXECUTIVE SUMMARY

A recurring challenge in policymaking is how to identify the most promising policy ideas and develop them into impactful programmes. The best policy ideas don't typically come from inside government ministries, but rather from actors across the ecosystem that are closer to businesses and their needs. Unfortunately, governments typically lack the funding instruments to encourage, identify and test novel policy ideas.

We propose the creation of an experimental 1 billion productivity fund. This new fund would identify and test the most promising interventions to accelerate productivity growth and increase competitiveness in Europe.

With its bottom-up approach, this fund would crowdsource the best policy and programme ideas across Europe, and provide funding to test the most promising ones in the "real world", directly benefiting entrepreneurs, innovators and SMEs.

Funding would be conditional on rigorous evaluation, generating actionable insights for decision makers across Europe on the impact of different types of schemes. Better evidence on what works and what doesn't would lead to better decisions on which programmes to scale, which ones to rethink, and which ones to stop.

Lastly, the example it would set (plus the incentives it would provide) would induce national, regional and local governments to become more experimental themselves, seeding a culture of evidence-based policymaking that is open to innovation and constantly seeks to increase value-for-money.

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<sup>1</sup> This proposal was presented to the Eurozone finance ministers at the [Eurogroup meeting](#) held on 7 November 2019.

If implemented well, this fund would spark a transformation in how member states use their own national budgets to improve their competitiveness, leading to more impactful policies across the board.

Experimentation funds are flexible instruments. The fund could be open to pilot schemes that address any of the barriers that hamper Europe’s economic performance, or alternatively target specific areas. For instance, improving SME management practices, accelerating tech diffusion, deepening university-business collaboration, reskilling the workforce in response to AI, improving access to finance for intangible-rich SMEs, or developing innovation skills in educational systems. Alternatively, it could also seek to address societal challenges such as climate change, for instance by testing out interventions that increase adoption of carbon-saving technologies and behaviours.

Over the next 7-year budget period European governments will invest over 1,000 billion euros in policies to support entrepreneurs and businesses to innovate and grow. The proposed productivity fund would represent less than 0.1 per cent of this amount (1 billion). Investing 0.1 per cent to find ways to maximise the impact of the remaining 99.9 per cent represents a very modest investment, with huge upside potential.

## A new experimental €1 billion productivity fund for Europe

Identify, test and support the most promising interventions to accelerate productivity growth and increase competitiveness in Europe

Encourage innovative policy ideas

Fund programmes in exchange for rigorous evaluation

Learn what works best and scale it up

Create a culture of innovation and evidence

### An impactful EU investment

Leverage EU funding to increase the effectiveness and efficiency of member states investment

**€1,000 billion**

European countries' expected expenditure in policies to support businesses to innovate and grow in 2021-2027

**Invest 0.1% (€1 bn) to find ways to maximise the impact of the remaining 99.9%**

## PROPOSAL BACKGROUND

### **Addressing Europe's economic and societal challenges requires new policy ideas and more effective programmes**

The European Union has a long-term productivity weakness. After a long post-war period of convergence with the US, convergence has stalled. Labour productivity is still 33% higher in the US than in the EU, hampering both living standards and long-term financial sustainability. At a time when productivity growth is slowing down across advanced economies, we need to find more effective policies to reverse that trend, while ensuring that the benefits reach EU citizens everywhere

Increasing productivity is not the only challenge. Europe also faces new policy challenges that we have not encountered before (such as tackling climate change), and which will require imaginative solutions. Moreover, the world is constantly changing, so old solutions may not work (if they ever did). Additionally, emerging technologies offer new and unexploited opportunities for policymakers, but it is unclear how best to take advantage of them. In short, we need new policy ideas, but also to learn whether they work.

### **Every year we invest €150 billion without really knowing its impact or maximising value-for-money, hampering productivity growth**

European governments invest around €150 billion every year supporting businesses to innovate and grow<sup>2</sup>, as do many other governments around the world. Are we making the most of this investment? Are there more effective ways of using this funding? How would we ever know?

The What Works Centre for Local Economic Growth at the LSE examined almost 15,000 evaluations and evidence reviews of local economic policies, and concluded that only 2.4 per cent of them provided credible estimates of impact, and of those only one in four demonstrated a positive effect on employment (or 0.6 per cent of the total).<sup>3</sup>

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<sup>2</sup> [Firpo and Beevers, 2016](#).

<sup>3</sup> Specifically, the team assessed for each study the methodology used and their results. While not all of these were impact evaluations, they only found 361 studies (or 2.4% of the total) that involved a credible counterfactual and provided strong evidence of causality ("Credible" refers to impact evaluations satisfying the level 3 of the Scientific Maryland Scale, which means that they had a clear justification for why the companies that had not received the intervention would have performed in a similar way as those benefiting from the intervention if the intervention had not happened). Note that not all relevant questions can be addressed with counterfactual evaluation methods, but there is definitely immense scope to use them to increase the quality and quantity of evidence in this policy space.

Ultimately, this lack of evidence leads to policies that are less effective (or potentially even counter-productive), and the risk of wasting limited resources on programs that do not work. As a result, despite substantial public investments, Europe's productivity is lower than it could (and should) be.

### **Policy experimentation can lead to more impactful policies**

Only a few weeks ago, Abhijit Banerjee, Esther Duflo, and Michael Kremer were awarded the Nobel prize in Economics for their experimental approach to alleviating global poverty. Over the last two decades they have set up countless experiments to find out what were the most effective interventions to fight poverty. Over 400 million people have been reached by programmes that were scaled up after being evaluated by them or their colleagues at the MIT Poverty Action Lab (JPAL), the lab that they founded to pursue this research.

With their work, they have demonstrated the value of starting small, testing out different interventions to find out what works best, and then scaling them up. They have tested programs in the same way as we test pharmaceutical drugs, using randomised controlled trials (RCTs) that compare the impact of an intervention relative to the status quo.<sup>4</sup> They have showed how our priors, beliefs, hypotheses or models can be wrong. And therefore that there is no substitute for testing new programmes rigorously in the real world. The knowledge they have generated has improved the lives of millions and radically transformed research in this field.

### **Innovation policy is neither innovative nor experimental**

The contrast with innovation policy is stark. The aim of innovation policy is to support innovation and experimentation with new products, services or business models. Yet, paradoxically, innovation policy itself is neither innovative nor experimental, and the same could be said for the wider range of policies that seek to accelerate productivity growth, such as entrepreneurship, SME, industrial or growth policy.

Becoming experimental means turning the current model of policymaking upside down. Despite all the unknowns, governments often act as if they had all the answers, rather than

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<sup>4</sup> The idea behind randomised controlled trials (RCTs) is a simple one. Participants are randomly placed in a 'treatment' group and a 'control' group (or across multiple 'treatment' groups), and the impact of the intervention is estimated comparing the behaviour and outcomes of the two. Randomised controlled trials can provide an accurate estimate of the impact of an intervention, without suffering the selection biases that hamper many other types of evaluation (although as any other tool, trials can answer some questions but not others).

recognising that they don't. They introduce new policies without prior small-scale testing, assuming they have chosen the best design and hoping it will work.

The alternative is to follow the example of this year's Nobel prize winners: start small, trial different designs systematically, learn what works to increase impact and scale it up.

### **Policy experimentation has unexpected benefits**

Policy experimentation encourages novel solutions to policy challenges and creates a dynamic of continuous improvement. It also makes it easier to discontinue unsuccessful programmes, given that there is a clear expectation upfront that the scheme will be time-limited unless it generates clear evidence of impact (how often are programmes started that won't work and don't have an end date?).

Policy experiments can also help de-risk the process of exploring new policy ideas and changes. By starting small and testing effectiveness early, experiments can in fact make it easier for risk-averse organisations to sample novel approaches and venture into more innovative fields, without having to commit large amounts of resources (and thus reputation) in the process.

Experimentation also lowers overall policy costs, because, despite investing a little more upfront in learning and evaluation, experiments allow policymakers to "weed out" ineffective programmes early on, potentially saving taxpayers from footing the bill. By considering alternative approaches, it also helps identifying options that achieve the same or even better outcomes in a more cost-effective way.

Ultimately, experimental policymaking leads to more learning, better decisions, more impactful policies and higher value-for-money.

For a more complete overview of the different ways that governments can experiment, and examples of how they are doing it in practice, see our [overview paper on experimental innovation policy](#).<sup>5</sup>

### **Some governments are making policy experimentation a priority**

To realise the benefits of policy experimentation, governments need to develop the right incentives, structures, cultures and skillsets. For instance, Finland and Canada have made

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<sup>5</sup> [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3460100](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3460100).

experimentation a key government goal, setting an experimentation unit in the Finnish Prime Minister's office and mandating dedicated budgets for policy experimentation in Canada.

These are two ways to address the misalignment of incentives that often hampers policy experimentation, and change perceptions about what is expected and/or feasible. But there are other levers that could be used, many under the control of finance ministers, for instance as part of the budgeting process or by setting up new funding mechanisms.

### **Experimentation funds are a useful tool to identify and support new policy ideas**

A recurring challenge in policymaking is how to identify the most promising policy ideas and develop them into impactful programmes. Novel ideas for programmes can come from anywhere in the ecosystem, not just from those who are directly involved in policy development inside government ministries. Unfortunately, governments typically lack the funding instruments to encourage, identify and test novel policy ideas.

In the spirit of open innovation, the best programme ideas often come from organisations that are directly working with businesses and have first-hand knowledge on their needs and constraints. However, many of these organisations often lack the resources, skills, incentives and risk appetite to develop their ideas into actual pilot programmes, and then to evaluate them to learn how well they work.

One tool that governments can use is experimentation funds. These funds are a very useful mechanism to identify, test and support the most promising ideas for support programmes tackling a particular policy challenge, learn how to implement them most effectively, and distinguish between those ideas that should be scaled up vs. well-intentioned but ultimately ineffective efforts.

Other policy areas, such as social policy or education, have already shown that this bottom-up approach to crowdsource new programme ideas can be a powerful strategy to tackle complex issues and generate better public outcomes. They have also shown that putting these new ideas to the test through policy experimentation is not only feasible, but also of enormous value when it comes to designing new, more effective programmes.<sup>6</sup>

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<sup>6</sup> The idea of experimentation funds originated in other policy areas. For instance, the UK-based Education Endowment Foundation is conducting over 130 randomised controlled trials involving more than a 1,000 schools and 900,000 pupils in order to test different ways to improve educational outcomes. And the French government runs an experimentation fund for young people, a bottom-up approach to identify innovative interventions to improve youth outcomes (crowdsourced from organisations across the country), implement them at a small scale, and rigorously evaluate them to find out whether they work, before deciding whether they should be

## **Example: The UK Business Basics Fund uses an experimentation fund model to accelerate tech adoption**

To reverse the slowdown in productivity growth is not enough to continue pushing the knowledge frontier forward. We also need to accelerate the diffusion of new technologies across the European economy, something at which Europe underperforms relative to the US. Even more worryingly, recent OECD research shows an increasing divide between the best performing firms and the rest of firms. Reducing the size of this gap could make a substantial contribution to productivity growth and help to reduce inequality.

This is not a new challenge, but past attempts have not been as successful as hoped, so the UK government is trying a different approach to find more effective solutions. Being delivered in partnership with IGL, the UK's Business Basics fund is aiming to test innovative ways of encouraging SMEs to adopt technologies and management practices. It provides funding in exchange for rigorous evaluation, both for small proof of concept pilots and larger scale trials to test ideas at scale. For instance, one of the trials is testing how to get SMEs to adopt AI-based technologies.<sup>7</sup>

## **An experimental 1 billion productivity fund for Europe**

Building on these experiences, we propose the creation of an experimental 1 billion productivity fund for the euro area. This new fund would identify and test the most promising interventions to accelerate productivity growth and increase competitiveness in Europe.

The fund would seek to encourage novel ideas and approaches that tackle these key challenges in an innovative way, but could also be open to testing existing interventions with limited evidence of impact.

With its bottom-up approach, this fund would crowdsource the best policy and programme ideas across Europe, both from traditional organisations but also from newcomers. The funding provided would enable to test the most promising programmes in the “real world”, directly benefiting entrepreneurs, innovators and SMEs.

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scaled up. More recently, both the European Commission and the UK government have taken up this idea and applied it to innovation and growth policy. The European Commission has launched a small-scale pilot call for policy experiments targeted at innovation agencies across Europe, while in the UK the government has set up the Business Basics programme as part of their new industrial strategy.

<sup>7</sup> See this blog for additional information on the Business Basics programme:

<https://www.innovationgrowthlab.org/blog/why-you-should-know-about-business-basics-programme>.

Funding would be conditional on rigorous evaluation, generating actionable insights for decision makers across Europe on the impact of different types of schemes. Better evidence on what works and what doesn't would lead to better decisions on which programmes to scale, which ones to rethink, and which ones to stop. Otherwise, without good evidence, it is impossible to allocate limited public resources to the programmes that have the greatest impact.

Lastly, the example it would set (plus the incentives it would provide) would induce national, regional and local governments to become more experimental themselves, seeding a culture of evidence-based policymaking that is open to innovation and constantly seeks to increase value-for-money.

If implemented well, this fund would spark a transformation in how member states use their own national budgets to improve their competitiveness, leading to more impactful policies across the board.

### **Experimentation funds are flexible instruments and can be targeted to specific policy challenges**

Experimentation funds are flexible instruments, so the focus of the fund could be adapted depending on the priorities identified. It could be open to any pilot scheme that addresses any of the barriers that hamper Europe's economic performance, or alternatively target specific areas. Some examples include improving SME management practices, accelerating tech diffusion, deepening university-business collaboration, reskilling the workforce in response to AI, improving access to finance for intangible-rich SMEs, or last but not least, developing innovation skills in educational systems. Alternatively, it could also seek to address societal challenges such as climate change, for instance by testing out interventions that increase adoption of carbon-saving technologies and behaviours.

Experimentation funds can also be adapted to support interventions with different levels of maturity. For totally new programme ideas never implemented before, small amounts of funding could be provided to support a first prototype or proof-of-concept. These small-scale pilots help to demonstrate whether an intervention is feasible, contribute to fix early-stage design issues, and provide an early indication of what might be businesses' demand and reaction to it.

For programmes that have shown some potential, the fund could support randomised trials that test the actual impact of an intervention and provide evidence on its cost-effectiveness.



Finally, for programmes that have already demonstrated their effectiveness, funding could be provided to test tweaks or changes that may further increase their impact or reduce their cost, as well as to replicate programmes in other environments to learn whether they would work in a very different context.

### **This new experimental productivity fund would be an impactful EU investment**

European Union funding can achieve the highest impact when it focuses on investments that unlock wider changes in member states, rather than only replacing investments that member states would have done themselves. Therefore, one way to leverage the EU's limited budget is to seek to increase the effectiveness and efficiency of the substantial investments that members states are already doing in innovation and productivity-enhancing measures, helping to improve the competitiveness of both frontier and laggard regions and firms.

Over the next 7-year budget period European governments will invest over 1,000 billion euros in policies to support entrepreneurs and businesses to innovate and grow.<sup>8</sup> The proposed productivity fund would represent less than 0.1 per cent of this amount (1 billion). Investing 0.1 per cent to find ways to maximise the impact of the remaining 99.9 per cent represents a very modest investment, with huge upside potential.

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### **Annex: About the Innovation Growth Lab**

The Innovation Growth Lab (IGL) was set up by Nesta, the UK's Innovation Foundation, back in 2014 to make innovation and growth policy more impactful through experimentation and evidence. IGL is a global partnership bringing together governments, foundations and researchers to test different approaches to accelerate innovation, entrepreneurship and growth. Ultimately, our ambition is to transform policymaking in this space, embedding a culture of experimentation across economic ministries and innovation agencies around the world.

This is not done overnight. It will take time. It requires raising awareness of the value and feasibility of policy experimentation. Identifying early champions within governments. Helping

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<sup>8</sup> Assuming current expenditure levels continue over the next 7-year period (€150 billion per year, <http://www.innovationgrowthlab.org/blog/much-%E2%82%AC152-billion-spent-across-europe-supporting-businesses-does-it-work>).

them set up their first trials, often small ones, which in turn make it easier for them to build coalitions to undertake larger and more impactful trials. Getting the resulting evidence used and successful programmes scaled-up. And, lastly, sustaining this change until it becomes part of the norm, institutionalised in processes, instruments and budgets.

While it will be a long process until the full impact starts to materialise, we are already starting to see some progress. When IGL was launched, few policymakers across OECD countries had seriously considered setting up policy experiments in this space. When confronted with this idea their response was often quite dismissive: “It can’t (or shouldn’t) be done”.

Today over 15 government agencies in 10 OECD countries have launched or are actively considering policy experiments, with several developing in-house capacity to undertake trials. We’ve supported over 67 trials, have IGL partners or projects in 26 countries, and have worked with more than 25 organisations to help them become more experimental.

We’ve also started to build a global community of policymakers and researchers that share this mission, and our events, capacity building workshops and online resources have reached thousands of policymakers from close to 50 countries. We are also starting to see the first steps towards institutionalising policy experimentation through experimentation funds.

Our portfolio of 67 projects is exploring many relevant questions on how to accelerate innovation and productivity growth. For instance, how can we help people to become more innovative and entrepreneurial? How can we increase university-business collaboration? What is the best way to select which innovation projects to fund? Is money or in-kind support more important for startups and SMEs? How can we accelerate tech diffusion and the adoption of better management practices?

Overcoming the economic challenges we face will require not only new ideas, but also to learn whether they work. At IGL we believe that becoming experimental will help policymakers ask the right questions and get better answers.

If you would like to find out more about IGL and our work, [get in touch](#), visit our website at [www.innovationgrowthlab.org](http://www.innovationgrowthlab.org) or sign up to our [newsletter](#).