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**Innovation through knowledge-intensive producer services: progress in EU and  
perspectives of experience transfer to the Baltic States**  
*(revised version June 2001)*

*Objectives.* Research aims to develop concepts and empirical evidence through enquiry into experience of EU countries, and consequently to suggest practical action concerning the role of knowledge-intensive services in the Baltic innovation systems.

*1. Theory / model.* *Producer services* are important in national, regional and sectoral innovation systems. The economics of services generally, and knowledge-intensive services (such as consultancies) especially, the role of service organisations as originators, carriers and users of innovations, are neglected in policy and poorly covered by research.

*Innovations* can be defined as transformations of new scientific and technical possibilities into new products and services. As a rule, these transformation processes are notoriously complex; they do not follow a linear path from research to development to implementation (Van Waveren 2001). Services and service innovation have been largely overlooked in economic, industrial and innovation research, since they were regarded as not fully distinct manufacturing industries. Moreover, innovation has very much been seen as pushed by technology push, but often it is not technological but social (e.g. a new organisation or a new service through a changed behaviour from the service personnel). It is often pull-oriented developed due to market possibilities. Very often innovation consists of small changes, woven together in a complex pattern (which possibly may not even be called incremental innovations). The radical innovations are rare and their effects in form of creating technological trajectories (Dosi 1982) are rare. Technological trajectories may influence the innovation decisions in firms, but they will generally be mixed up with other considerations such as market possibilities, internal resources,

or other types of trajectories such as managerial (new ideas of managing and organising), service professional and social (social movements in society) (Sundbo, Gallouj 1999). A number of mostly qualitative and now increasingly also more statistical studies have been produced and are still underway that show that services innovations are important, have some characteristics of their own, are increasingly intertwined with manufacturing. However it becomes widely accepted that the progress is not sufficient in services research and services policy-making. More research is needed concerning the nature and significance of productivity-enhancing interactions among services, especially producer services, goods production, and the quality of the labour force. A better understanding of the demand for producer services by the public sector would also be valuable. In this sense, research aims to broadly map the knowledge-intensive producer services in terms of innovation-related service functions.

This research does not consider whether, or to what extent, government should tax, subsidise, regulate, or engage in macroeconomic policy, but, instead, large government investments in human resources and infrastructure are necessary to sustain the development of an economy that is increasingly based on innovation, flexible production, knowledge, information, and communications (Larsen 1997).

Policy emphasis, especially in relation to SMEs, has already shifted from manufacturing output and the content of manufactured products at an engineering level, to include manufacturing competitiveness and the sustainability of economic roles and competencies. Competitiveness is now seen as an innovation contest where the bureaucratic, inflexible and non-creative may not survive. Thus a key policy concern is now advanced manufacturing strategy as distinct from advanced manufacturing technology, in a conventional, engineering-oriented sense. Also, competitiveness may now be significantly dependent on the “supply” of strategies or strategic competencies, whatever this may mean, as distinct from (hardware or software) technologies.

The State has a twofold relationship with knowledge-intensive producer services (Hales 1999): firstly, knowledge-intensive business services extend the State policy operations system,

increasingly appearing within the “public” sphere as elements of programme formation and delivery (consultants as managers of innovation programmes, quality control functions, suppliers of specialist knowledge, etc); secondly, the State manages markets for the knowledge-intensive producer services. At one extreme are strategies aimed at modest compensation for market failure (e.g. the partial funding of schemes involving independent research-and-technology institutes in pre-competitive R&D clubs, or subsidised consultancy to diffuse best practice and strategic awareness). At the other there is radical restructuring, market-making, brand management and the creation of national-scale networks of franchise outlets for government-branded service products (e.g. the UK Business Link network of one-stop shops for advice in support of SME innovation and competitiveness).

Neither innovation policy nor technology policy do exist as separate in policy-making. They must be rather regarded as aspects of wider policy areas: from economic and financial policies through industrial and regional policies and targeted to social policies. As Lundvall (1988, 1992) suggests, in the globalising learning economy, innovation policy as *economic industrial policy*, aimed at industrial competitiveness and employment, may be regarded as separate from *technology policy as sector policy* which emphasises the role of technology policy as an instrument to fulfil other policy objectives and technology policy as a general concern in general industrial and economic policies. This research project will be more focused on “policy in technology/innovation” rather than on “innovation/technology in policy”, thus taking into account the “soft function” of innovation in knowledge-intensive producer services.

## **2. Methodology.**

**2.1. Research design.** Method of *comparative analysis* of advanced economies versus transitional economies (the three Baltic countries in this particular case) will be used for the research. From this analysis I expect to deduce the main theoretical principles based on which further modelling of possible, broadly understanding, “experience transfer” from EU to the Baltic States in the field of knowledge-intensive producer services will follow.

The industrialised countries are already advanced service economies. The New Economy has shifted the economic development paradigm from a capital driven economy to knowledge driven economy. Typically the service sector represents more than two-thirds of employment. A substantial fraction of the value-added in any one country originates in the service sectors. Industrialised countries are undergoing significant structural and socio-economic changes, with services playing an important role in these changes. Many sectors of economic activity are running through phases of rapid internationalisation and globalisation, restructuring competitive markets and potentialities for growth.

From another perspective, supply of knowledge-intensive producer services in the CEE countries is diverse and, according to recent research, not evenly distributed in different countries. This reflects different degrees of progress towards the development of market economies in the region. The three Baltic countries have formed a relatively homogenous market conditions for knowledge-intensive producer services, yet there are different levels of organisation of service provision and consumption in these countries. It may be claimed that knowledge-intensive services have not yet reached the desired level of maturity. Several reasons are in the origin of present situation: historical, socio-cultural and political. There is a vast potential that the development of knowledge-intensive producer services may bring to the Baltic economies.

It is expected that the research will also raise wider issues in terms of what might be called “welfare policy” objectives. Depending on the political and social climate in different countries and over time, the importance of the legitimisation and operationalisation of policy objectives may vary. A consequence of this would be the necessity of including learning and its effects on policy formulation into policy-making process. The “demand side” should also be included into policy concerns: this incorporates the role of educated and well-informed customers and consumer and social interest group awareness.

**2.2. Sample.** The geographical scope of the research is Western Europe (with emphasis on cases of Germany and United Kingdom) and the Baltic States (Estonia vs. Lithuania). As it is

stated in this proposal, the Baltic economies have formed a relatively homogenous market conditions, yet there are significant differences; these will be explained in the light of experience in EU countries. The timeframe of the research will include the period from late 70-ies to present: major shifts in the service economy, service and service innovation research took place during the last three decades.

**2.3. Data and data sources.** Main approaches planned for the research are as follows:

- analysis of publicly available data sources (monographs, periodicals, official documentation, European documentation, working papers);
  - macroeconomic data;
  - firm level data (conduct of a questionnaire survey).

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