UNICE
THE VOICE OF BUSINESS IN EUROPE

COMMENTS

21 November 2005

STATE AID FOR INNOVATION – COMMUNICATION FROM THE COMMISSION

1. INTRODUCTION

Following the State Aid Action Plan, the Commission is considering developing new rules for state aid for innovation to be included in the framework on state aid for R&D, the guidelines on risk capital, the environmental state aid guidelines, and the block exemption regulations. These rules will define the limits within which state aid to innovation may be seen to be compatible with the Common Market. The Commission believes that state aid policy can contribute to a more innovative economy, both by preserving product market competition as a driver of innovation, and by putting forward a framework of rules that facilitates the design of effective state aid for innovation by Member States.

More concretely, the Commission proposes six measures to encourage innovation through state aid. The Commission proposes to support innovative start-ups through tax exemptions and subsidies; it proposes additional flexibility for state aid to risk capital; it proposes to expand the scope of current rules for R&D by authorising state aid for SMEs for activities related to experimentation and commercialisation; it proposes to provide for subsidies for SMEs to buy services or facilities; and, lastly, it proposes to change the current R&D rules to stimulate public-private partnerships in R&D.

As stated in its comments on the State Aid Action Plan, UNICE endorses the principle that Member States should redirect aid towards horizontal objectives of common interest, such as promotion of research and development and innovation, and target it to identified market failures, whilst reducing the overall level of state aid. UNICE considers it essential that new rules will not harm transparent and effective state aid control in the common market. The current lack of effective Community control on the implementation by the Member States of block exemption regulations in the field of state aid is already a matter of concern to UNICE.

Having said this, UNICE welcomes most of the Commission's proposals although it has some reservations and suggestions for further development, which are set out below. Considering that the Communication from the Commission primarily sets out what may be the criteria for designing ex-ante rules for state aid for innovation that could subsequently be included in the existing legal instruments, UNICE's views are preliminary. It will give its final views about the proposed changes when more concrete proposals are decided.

AV. DE CORTENBERGH 168
B-1000 BRUSSELS
VAT BE 863 418 279

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@UNICE.BE
WWW.UNICE.ORG

2. PRINCIPLES GOVERNING CONTROL OF STATE AID FOR INNOVATION

UNICE has consistently held that strict control of state aid, on the basis of clearly defined criteria, is necessary to prevent distortions of competition in the internal market and has repeatedly called on the Commission to define these criteria through guidelines and block exemption regulations, while at the same time urging the Commission to ensure that any new rules do not undermine the efficiency of state aid controls and maintain a level playing field.

As said, UNICE supports the Member States redirecting aid towards horizontal objectives of common interest and targeting it to identified market failures. It is important that state aid is targeted to situations where the market is not itself able to achieve desired objectives of common interest considering that interventions in the market through state aid in situations where there are no clear market failures will distort the proper functioning of that market leading to a situation where uncompetitive companies are assisted at the expense of more competitive companies, which in the longer term will harm European competitiveness. In this context, UNICE would like to stress the importance of an economic analysis of market failures which is done properly and in a fully transparent manner in order to determine appropriate ex-ante criteria and avoid misunderstandings regarding the allocation of state aid.

Although UNICE will provide detailed comments regarding the market failures identified by the Commission and the proposed solutions below, when commenting on the proposed measures, it would like to point out that the Communication unfortunately fails to properly address the global dimension and the existence of international disparities.

The fact that the US, Japan and emerging technology competitors in East Asia, are improving their ability to put together major resources, infra-structure and funding to attract researchers and investments for innovation, whereas the EU is becoming less attractive to the location of R&D and innovation, is not so much due to fragmentation and insufficient policy coordination, as stated in the Communication, but to the very existence of state aid rules and controls in the EU, whereas these do not exist elsewhere. UNICE therefore urges the Commission to ensure that European companies are not suffering from a competitive disadvantage vis-à-vis their competitors located outside the EU who are not (or less) affected by subsidies control. The Commission should seek to establish a global level playing field for subsidies through the WTO, departing from improved Community state aid rules. Similarly, differences regarding the functioning of stock markets in and outside the EU are highly relevant for funding innovation and not properly addressed in the Communication. UNICE suggests that the Commission also explores how state aid can provide for incentives to invest in stocks of young, innovative European companies.

Regarding the issue of ex-ante criteria on the basis of which state aid for innovation could be approved, UNICE would like to repeat its general position that strict control of state aid on the basis of clearly defined criteria is vital for preventing distortions of competition in the internal market. It therefore deems it appropriate not to create a separate Framework for innovation and to restrict changes to the existing legal instruments to activities related to technological innovation in order to limit the risk of legal uncertainty and abuse. Using a wider definition of innovation also entailing non-technological innovation would make it very difficult to define sufficiently precise and unambiguous state aid rules for innovation that would guarantee a level playing field within the EU.

Regarding the use of block exemption regulations to implement these criteria, UNICE reiterates its concerns regarding decentralisation of state aid control, which, as it relies heavily on self-assessment and monitoring by the Member States and companies themselves, should not detract from the uniform application of EC state aid law. A further reflection will be necessary on the appropriate tools to ensure better transparency, monitoring and control of any decentralised system of state aid management.

3. SUPPORTING RISK-TAKING AND EXPERIMENTATION

Supporting innovative start-ups

The Commission proposes to support the funding of young (less than five years) small (as defined in the SME definition) innovative start-ups which produce products and processes which are technologically new or substantially improved and which carry a risk of technological or industrial failure, or whose R&D expenses represent a minimum of 15% of its overall expenditure, by exempting these companies from 50% of social contributions and other local/regional taxes until five years after founding and for up to five years, provided the benefits are reinvested in the company or repayable advances. In addition, these companies can get aid of up to € 1 million over a three year period provided it is not cumulated with any other state aid, and provided the firm is not in difficulty and the company receives the aid only once.

Although UNICE acknowledges that start-ups and innovative SMEs can be affected by market failures related to their funding, it doubts whether the general definition of innovative start-ups as proposed by the Commission is appropriate to tackle this problem given the widespread differences that exist between different sectors, for example regarding time-to-market and product development cycles. Likewise, the likely incentive and distortive effects of the proposed criteria for granting state aid are likely to differ significantly depending on the sector. UNICE thus suggests that the Commission adopts a more sector-based approach, although it would like to stress that separate rules should not hamper cooperation resulting from converging technologies and markets (*e.g.* ICT-nano-bio-cogno) since this multi- or cross-disciplinary cooperation often leads to very interesting innovations.

Having said this, UNICE notes that often the problem is not so much the creation of start-ups but the lack of growth of these companies. Also, the incentive effect of reductions from social contributions and local and regional taxes can differ greatly depending on the place where the company is located. Furthermore, given the fact that the Commission envisages supporting SMEs only and in this context refers to the SME-definition, UNICE suggest that the Commission clarifies what will be the consequences of an innovative start-up getting larger, for example by growing or merging with another (start-up) company. This equally applies to the other proposed measures addressed below. In fact, UNICE believes that in allowing and granting aid to innovative start-ups, it should make no difference whether these start-ups originate from universities, institutes or (large) firms, or from certain sectors.

4. TACKLING THE EQUITY GAP TO INCREASE THE PROVISION OF RISK CAPITAL IN THE EU

Provide for additional flexibility for state aid to risk capital

The Commission proposes to provide for additional flexibility for assessing state aid provided in the form of risk capital. In this respect the Commission may allow for more flexibility in the safe-harbour investment tranches and the introduction of specific provisions for post-seed stages to facilitate the growth of enterprises by allowing the aid given to SMEs to be added to aid given under the risk capital rules, or through guaranteed loans at less favourable rates than for start-ups, or through repayable advances with shorter repayment terms.

UNICE recognises that market failures may interfere with the efficient funding of firms with equity and that this may justify state aid such as suggested by the Commission. It also acknowledges that state aid too may play a role in post-seed stages. As said above, given the fact that it is especially important that innovative start-ups grow beyond the start-up phase, it supports the Commission focusing on this objective, not only in the context of the risk capital rules but also when looking at other types of state aid (see further below).

5. SUPPORTING TECHNOLOGICAL EXPERIMENTATION AND THE RISKS OF LAUNCHING INNOVATIVE PRODUCTS

Expanding the scope of R&D state aid rules

The Commission proposes to permit SMEs getting state aid for certain activities which go beyond the first prototype and are closer to the market by including them in the last R&D stage of pre-competitive activities. State aid for activities such as the development of commercially usable prototypes and pilot projects for the purpose of conducting technological and/or marketing experiments, technical evaluations and feasibility studies preparatory to the launch of a new product (including software and laboratory costs), expenses for adapting technologies to particular production specifications, marketing relating to technological design, and management and marketing training, are proposed to be permissible provided the aid intensity does not go beyond 15%, that there is a link to a specific R&D project carried out by the firm itself, and that the aid is related to products and processes that are new or improved and which carry a risk of technological or industrial failure.

UNICE agrees that these activities can be prone to market failure and that state aid could stimulate companies to launch more innovative products in the market. R&D and innovation are widely considered as a general case where market failures (e.g. positive externalities) apply and a role for government intervention exists, not only with respect to SMEs but also with respect to large firms.

The basic economic rationale for state aid for R&D and innovation is exactly the same for large companies and SMEs. As set out in the Communication, and also in the State Aid Action Plan, due to the public good characteristics of R&D and innovation and the positive externalities that do not allow private enterprise to reap the full benefits of its actions, there will be less investment in R&D and innovation than desirable for Europe's economy and society. Large firms increasingly are conglomerates of smaller units that are being held accountable for their financial performance. Therefore, they suffer from the same short-term thinking that leads many SMEs to under-invest in R&D and innovation. UNICE therefore suggests that the Commission also allows state aid for activities related to experimentation and commercialisation granted to large firms.

In addition, UNICE urges the Commission to abolish the distinction between industrial research and pre-competitive development activity and create a single category "industrial RTD". As set out in UNICE's comments to the State Aid Action Plan, the current framework for assessing R&D projects on the basis of the separate sequential R&D stages from the outdated linear innovation model is incompatible with strict time-to-market requirements and should be updated to reflect today's concurrent, iterative and interactive industrial innovation process with constant market feedback.

As a general rule, the gross aid intensity for all "industrial RTD" should not exceed 50% of the eligible costs of the project. The new category "industrial RTD" should also include prototypes (as long as the primary objective is to make further improvements) and computer software (if its completion depends on the development of a scientific and/or technical advance and its aim is the resolution of a scientific and/or technological uncertainty on a systematic basis). Routine or periodic changes made to products, processes and services, on the other hand, should be excluded. This would also be in line with the broader definitions of R&D as provided in the Commission Regulation on the application of Article 81 (3) EC to categories of research and development agreements, and the OECD guidelines for the classification of scientific and technological activities (Frascati Manual). UNICE suggest that the Commission investigates whether these broader definitions could be used for distinguishing industrial RTD and closely related innovation-oriented activities qualifying for R&D aid from business activities disqualifying for such aid.

Considering that decentralisation clearly amplifies the risk of inconsistencies within the system and that R&D aid schemes tend to be very complicated, UNICE believes that the Member States should continue being compelled to notify their R&D aid measures to the Commission. However, the thresholds for notification to the Commission of individual projects under an approved R&D scheme should be increased, so as to allow the Commission to focus on assessing large individual projects.

Lastly, UNICE considers that the Commission should not be too strict when requesting evidence in relation to the requirement that aid for R&D and innovation has a clear incentive effect and leads to activities in addition to a firm's normal day-to-day operations. The Commission's interpretation of this requirement should not put European companies at a competitive disadvantage vis-à-vis their competitors located outside the EU, who are not suffering from comparable constraints. In practice, it is very difficult to prove that certain R&D and innovation activities are carried out in addition to normal day-to-day operations. In any case, the Commission should not *a priori* disqualify aid for R&D and innovation projects that fall within a firm's core business or which have clear market potential.

6. ENCOURAGING INNOVATION INTERMEDIARIES

Support SMEs to buy services and facilities

The Commission proposes to stimulate consumption of services provided by innovation intermediaries by allowing SMEs to receive state aid through a kind of 'innovation services voucher" of a maximum of €200 000 over a three year period with which they can buy a set of well-defined services (such as consultancy) or facilities (such as office space) from clearly defined innovation intermediaries. In addition, it is proposed to stimulate the provision of the services provided by innovation intermediaries by allowing innovation intermediaries who carry out activities that are not market-oriented, that are in the public interest, and that do not create selective advantages for the benefit of individual undertakings, to qualify for 100% state funding.

Although UNICE acknowledges that the market price for services may be too high for SMEs and that state aid vouchers totalling €200 000 could be an appropriate solution to increase the consumption of services provided by innovation intermediaries, UNICE doubts whether 100% state aid funding for innovation intermediaries who carry out activities that are not market-oriented and in the public interest is proportionate and necessary to stimulate private actors to enter the market. In practice, it will be very difficult to distinguish between those services that are not market-oriented and in the public interest from those that are not.

7. ENCOURAGING TRAINING AND MOBILITY

Support SMEs to recruit and train employees

The Commission proposes to exempt aid to SMEs to cover 35% of the personal costs for highly qualified researchers and engineers on the condition that the personnel recruited is not replacing other personnel. In addition, it is proposed to exempt aid to SME to cover 35% of project related training costs of staff (maximum of three years) to allow for the training of employees in entrepreneurship, creativity, and other subjects related to innovation.

To encourage the temporary loan and exchange of personnel between universities or large companies and SMEs, it is proposed to exempt aid covering the personnel costs incurred in the home university or enterprise in the past two years for highly qualified researchers and engineers, and the costs linked to the loan of personnel, for a maximum of three years, under the condition that large enterprises exchanging personnel with SMEs do not belong to the same group.

UNICE agrees that a high level of training and mobility of researchers, engineers and other employees is necessary to increase innovation in the EU and that there may be problems in matching the supply and demand for personnel. Training of researchers in entrepreneurship and other subjects related to innovation is highly beneficial and, similarly, the recruitment of highly qualified researchers and engineers would help to use research results. In addition, the temporary loan and exchange of personnel between universities and industry should be encouraged, for SMEs and large firms alike. Furthermore, UNICE believes that the permissible aid should be 50%, which is comparable to the typical level of support for similar exchanges through the Marie Curie Fellowships of the Framework Programme.

8. SUPPORTING THE DEVELOPMENT OF POLES OF EXCELLENCE THROUGH COLLABORATION AND CLUSTERING

Change the current R&D rules to stimulate public-private partnerships in R&D

In order to stimulate businesses and universities/research institutions to establish activities and invest in innovation related activities within a cluster, the Commission proposes to amend the current rule that where there is cooperation between industry and public institutes, industry has to pay the full cost of the project or give all intellectual property rights to the public institute so that the payments are not classified as state aid. It proposes to allocate the rights between partners on a pro rata basis according to the contribution of each partner. In addition, the Commission proposes to grant always derogation for important projects of common European interest (Article 87 para 3 under b) when the Commission concludes that the purpose of the aid in question is to promote the execution of such a project. Moreover, it is proposed to allow state aid for the setting-up of a research centre, private university or equivalent to support a cluster and to authorise state aid for infrastructure.

UNICE is pleased that the Commission is proposing that the framework for state aid for R&D should also take account of the growing importance of public private partnerships in the R&D field, however, it is disappointed that new rules authorising state aid for collaboration and clustering would only cover SMEs and entities providing infrastructure generating positive externalities such as universities and research institutions. This is surprising considering that SMEs often flourish in the slipstream of large companies, in particular in regional clusters. It would be counterproductive to exclude large firms from aid schemes promoting collaborative R&D and innovation and the establishment of regional clusters.

With reference to the proposal to require the allocation of the rights between partners on a pro rata basis according to the contribution of each partner, UNICE prefers that the Commission instead makes a clear distinction between collaborative research and contract research. In the case of collaborative research, the same IPR provisions as in the EU Sixth RTD Framework Programme should apply so that no compensation would have to be paid for access and use of IPR where the Sixth Framework Programme rules allow them royalty-free, unless otherwise agreed before the collaboration contract is signed. In the case of contract research where part of the costs is publicly financed, due account should be taken of industry's contributions in the form of financial and non-financial ('in-kind') support or pre-existing know-how when determining the fair compensation for the resulting IPR.

Lastly, UNICE wholeheartedly supports the suggestion to always grant derogation under Article 87 (3) (b) when the Commission concludes that the purpose of the aid in question is to promote the execution of an important project of common European interest. However, as set out above, only if the derogation would also cover large firms. UNICE encourages the Commission to grant such derogation for trans-national R&D projects in the context of European Technology Platforms, intergovernmental programmes, or of national programmes fully open to participation from other Member States. Preferably, such derogations should be granted at the level of such programmes or schemes, rather than at the level of individual projects therein.