



22 June 2010

Annex to the letter to Ms Máire Geoghegan-Quinn, Commissioner for Research, Innovation and Science – Simplifying the implementation of Research Framework Programmes

1. Introduction

Achieving effective simplification of implementation of Research Framework Programmes (FPs) is vital for Europe as it will increase the participation of businesses in European Framework Programmes, strengthen the European innovation capacity and contribute to meet the objectives set out in the EUROPE 2020 Strategy.

Recent Communications “Simplifying the implementation of the Research Framework Programmes” (29 April 2010) and “More or less controls? Striking the right balance between the administrative costs of control and the risk of error” (26 May 2010) have paved the way for a simpler and more efficient framework.

2. Positive developments

Most of provisions go in the right direction and should be implemented in the Eighth Framework Programme (FP8), and where possible, even before. In particular, BUSINESSEUROPE would like to highlight two positive developments:

2.1. Allowing usual accounting practices for average personnel costs

BUSINESSEUROPE fully supports proposals regarding a uniform application of rules and a broad acceptance of usual accounting practices (average personnel costs).

A broader acceptance of the usual accounting practices of the beneficiaries is very important. Many companies determine their personnel costs charged to projects with the help of cost averaging methodologies that cannot fulfill the criteria for acceptable cost averaging methodologies according to the Commission’s decision of 23 June 2009.

At the moment, these companies would be made to establish a second parallel accounting system calculating unique personnel costs based on individual personnel data for every participating researcher. But such a second parallel accounting system still cannot fulfill the condition that eligible costs of a project have to be determined according to the usual accounting practices of a beneficiary. This gap would be closed by the proposal of an acceptance of any average personnel cost methodologies applied as usual accounting practice by the beneficiary.

The proposed changes regarding average personnel cost in the Communication will probably solve the problems that companies are facing. This is the reason why we cannot wait to have them implemented and urge the Commission to implement urgently temporary simplified rules, which would make the transition until 2014.



2.2. Allowing a higher tolerable risk of error (TRE)

To improve effectiveness of the Framework Programme by increasing speed and reducing transaction costs, trust is a crucial element. Yet, the current institutional system governing the FP seems caught in itself, paralysed by the political necessity of avoiding rather than managing risks. Economically speaking, the transaction costs associated with the FP approach have grown completely out of proportion, with marginal costs of controls, checks and balances exceeding their marginal benefits.

In view of the accountability requirements governing EU research policy implementation, it is unrealistic to expect that simplification will automatically lead to less controls and audits. Nevertheless, allowing a higher tolerable risk of errors in the research domain would certainly help in implementing the more risk-tolerant and trust-based approach that will be needed to achieve a breakthrough in reducing red tape in the Framework Programme and other research-related EU programmes.

BUSINESSEUROPE fully supports proposals presented by the Commission in the Communication "More or less controls? Striking the right balance between the administrative costs of control and the risk of error" (28 May 2010) and calls for implementing them urgently.

3. Issues of concern

Nevertheless, as explained in more details below, a few issues of concern still remain, in particular regarding:

- the structure and timing of calls for proposals
- the limitation of variety of rules
- the introduction of more lump sum elements in the current cost-based approach
- the move towards result-based funding

3.1. Structure and timing of calls for proposals

- Calls with larger topics or even open calls; longer periods for preparing proposals

The proposals to widen the scope of calls and increase the time between call publication and deadline would only increase oversubscription and waste of efforts on weak proposals. Therefore, such measures are bound to lead to disappointment.

- Two-stage submission and evaluation

It is questionable whether the proposed two-stage submission and evaluation of proposals would really curb the problem of oversubscription and avoid excessive effort for proposal preparation. In our opinion, these advantages will only materialize if the first stage entails a very rigorous selection, so that chances for success in the second stage will be substantially higher (e.g. 35-50%) than the average success rate of 16% for FP7 proposals.

With the currently observed success rates of only about 25% in the second stage, two-stage submissions provide insufficient added value over single-stage submissions to

justify the associated longer lead times and additional efforts and thus costs for both the applicants and the Commission.

3.2. Limiting the variety of rules

Limiting the variety of rules in respect of the number of combinations between funding rates, organisation and activity types, is acceptable provided that the usual funding rate for industrial participants of 50% remains applicable for most of the projects. If reimbursement for actual costs (both direct and indirect) were to drop effectively below the level of 50% that currently applies to large industry, we have strong reasons to believe that the industrial FP participation¹ would decrease further.

However, a reduction of the number of methods for determining indirect costs is not acceptable if the use of the usual accounting principles of the beneficiaries would no longer be possible. Companies that have a sophisticated accounting system determining their indirect costs with a full cost calculation should in any case still be able to use their own system.

Same problems may emerge from the proposed single flat rate, which would probably be lower than the actual indirect costs levels that are common in large industry.

A single flat rate compulsory for all beneficiaries would not be acceptable as the real indirect costs of beneficiaries differ significantly depending of many circumstances (technological sector of the department, equipment level, country). A single flat rate would for example be in favor of technologies that do not need special equipment. It would be to the disadvantage projects requiring companies with well equipped research departments.

3.3. Lump sum elements in the current cost-based approach

- Lump sums for personnel per beneficiary

We do not recognise time recording for personnel cost accounting as particularly burdensome and therefore sees no need whatsoever for the wider introduction of lump sums beyond the "People" programme.

- Opinions from committees of Member State representatives

The introduction of a written procedure (in addition the existing regular meetings) could limit the time needed to seek opinions from the committees of Member State representatives.

- Lump sums

If due to the introduction of lump sums the reimbursement for actual costs (direct + indirect) were to drop effectively below the level of 50% that currently applies to large industry, industrial FP participation would only decrease further.

¹ Industry participation has declined from 39% in FP4, 34% in FP5, 31 % in FP6 to 25% so far in FP7.

Uniform lump sums will result in a disadvantage for R&D actors in Europe's more developed economies, with higher cost levels than in less developed regions.

In view of the accountability requirements governing EU research policy implementation, we doubt whether it is realistic to expect that the introduction of lump sums will lead to less controls and audits in practice.

Only for very small projects, the introduction of lump sums could be an interesting option, provided that *ex ante* and *ex post* controls remain very limited. The extension of lump sums will not have a major simplifying potential for companies with a full-cost accounting system. In addition, lump sums never really reflect real costs.

3.4. Moving towards result-based instead of cost-based funding

An approach based on outputs/results is likely to favour low-risk R&D projects with predictable outcomes and to have an influence on the projects that are going to be proposed to the Commission. More projects with predictable and secure outcome will probably be presented and less projects with higher risks. This cannot be the intention of EU research policy.

One should not forget that risks are inherent to research. Even an R&D project that produces only negative scientific and technological results may still provide valuable insights. Furthermore, new market developments may necessitate early termination of industrial R&D projects. Such projects should not be punished by paying no (or only part of the) lump sum.

Funding R&D on the basis of delivered outputs/results resembles public procurement processes that may not be compatible with the way of working of the majority of FP participants.

Furthermore, this approach would shift the burden to the experts charged with scientific/technical monitoring. It remains to be seen whether this would be an improvement. There is no evidence that giving up the current input-based approach for a new output-based approach can solve the problem to prove that Commission's money is spent in a proper way with the tolerable error rate (currently 2%). Giving up a complicated but at least measurable figure in favor of a more general approach must not necessarily lead to the conclusion that the taxpayers money is spend in a more acceptable way. Measuring the extent of which certain output/results are achieved may turn out to be at least as complicated as the evaluation of costs determined by established accounting systems.

Regarding the three options suggested for exploring result-based approaches presented by the Commission, BUSINESSEUROPE has some reservations about their efficiency.

- Project-specific lump sums as a contribution to project costs estimated during grant evaluation/negotiation, and paid against agreed output/results.

This approach would *de facto* replace the current *ex post* controls with *ex ante* controls. It is likely that project starts are going to be delayed due to more intense preparatory budget calculations and output definitions. Furthermore, new efforts arise if the

payment of lump sums depends on time-consuming declarations and justification procedures concerning the extent of output/result levels achieved. Each shift in research packages among partners would probably lead to new discussions about the breakdown of the lump sum contribution.

In other words, the existing problems would merely be shifted to the negotiation phase and would not lead to real simplification.

- Calls with pre-defined lump sums

This approach would favour R&D actors in less developed regions because of their lower cost levels.

The additional criterion of the consortium's own investment will lead to a bidding contest between competing consortia and hence to lower subsidy levels. If the reimbursement for actual costs (direct + indirect) were to drop effectively below the level of 50% that currently applies to large industry, industrial FP participation would only decrease further. Actually, the adverse effect would even be that EU funding would go in particular to consortia intending to do their projects anyway, even without EU funding. This way, there would be no incentive effect.

Furthermore, we have doubts whether this model works because it implies that the Commission would consider the resources that the consortium is willing to invest in addition to the lump sum, before the publication of calls. Respondents would be – due to their daily experience - more able to define projects and the justified related costs than the Commission.

Moreover, a kind of competition between the proposals with the smallest contribution rate could arise. This could hinder financially weaker partners to participate as they are more in need of a 50% contribution for example.

Proposals of consortia with partners with lower cost structures could also have an advantage in comparison to consortia with higher costs.

As the predefined lump sum contribution of the EC is paid to the consortium, negotiations among the members of the consortia would have to deal with the breakdown of the lump-sum to ensure adequate contributions for every partner. This extra internal process of the consortium could take away the advantage of the reduced financial administrative tasks towards the Commission after the start of a project.

- A high-trust “award” approach consisting in distributing pre-defined lump sums per project without further control by the Commission

The required maximum transparency on the results achieved makes this approach not appropriate for industrial R&D. This proposal seems to be possible basically only for University researchers where scientific excellence is the major goal and where even the researcher's personal reputation could be at stake. For research in industrial enterprises where also other parameters - such as fulfilling different stakeholders expectations like e.g. bringing new innovative products on the market, safeguard a competitive market position, etc. - are important, this proposal is not adequate.

Instead of such approaches (described in (1)-(3) on pages 10-11 of the Communication), the Dutch approach to High Trust would have been an interesting alternative. Key elements are basic trust in good intentions of applicants, random checks in combination with targeted auditing based on risk analysis, and adequate sanctions (corrections, recovery with interest, and - if needed - criminal prosecution) in case errors are detected. Furthermore, on the basis of its own accounting system, an R&D actor can choose between three different options for charging eligible costs, including actual costs (direct and indirect).