

18 March 2014

STATE AID FRAMEWORK FOR RESEARCH, DEVELOPMENT AND INNOVATION

KEY MESSAGES

- 1 Innovation is crucial to maintaining and strengthening Europe's global competitiveness. R&D and innovation (RDI) activities are a case where market failures apply and government support is needed.
- 2 We support an economic assessment of state aid in this area, but this should not lead to excessive administrative burden for Member States wanting to stimulate companies to carry out more RDI activities.
- 3 The current requirements in relation to the incentive effect should not put a break on RDI to the detriment of European competitiveness. It is crucial that the new RDI Framework leads to a substantial shortening of the approval process for notified aid.
- 4 The global dimension is not sufficiently considered in the new state aid framework. Ensuring a level playing field for Europe's industry in competing worldwide is crucial. The EU should seek to ensure a global level playing field through the WTO.

WHAT DOES BUSINESSEUROPE AIM FOR?

- The state aid framework for RDI needs to be updated to reflect today's concurrent and interactive industrial innovation process with constant market feedback.
- The criteria regarding collaborations between companies and publicly funded research organisations should be revised to lead to more collaborative RDI projects and avoid industry's hesitation to cooperate with research organisations.
- The role of innovation clusters is essential in drawing closer SMEs and public research. If Europe wants to accelerate transformation through innovation, it has to be ensured that costs of clusters do not deter businesses from joining them.

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INTRODUCTION

BUSINESSEUROPE welcomes the opportunity to provide comments on the draft revised EU framework for state aid for research and development and innovation (**RDI**).

Research, development and innovation are key elements of the EU2020 Strategy. Rules applicable to RDI aid can significantly influence the overall potential R&D activity of European companies, as well as their ability to take risks and bring innovative products to the market while remaining globally competitive. The length of the clearance procedure is, in this respect, important, as it strongly influences the time-to-market of research and innovation efforts.

Improving financing for research, development and innovation and ensuring that innovative ideas can be turned into products and services that create growth and jobs are crucial to maintaining and strengthening Europe's global competitiveness.

In light of the above, BUSINESSEUROPE would like to present the specific comments below on the draft RDI framework under consultation.

BUSINESSEUROPE'S COMMENTS

- **Clarification and legal certainty**

BUSINESSEUROPE appreciates that the RDI draft framework provides a number of welcome and needed clarifications.

Compared to the existing framework, the proposed draft seems to be more precise, and instead of gathering a comprehensive list of different kinds of RDI aid, it focuses on the main types of aid that can be granted, grouping the former categories of RDI aid into more general ones, such as: (i) aid for R&D projects, (ii) for feasibility studies, (iii) for the construction and upgrade of research infrastructures, (iv) for the innovation activities, and (v) for innovation clusters.

We welcome the confirmation in point 9 that Union funding centrally managed by the Commission, either directly or indirectly, does not constitute state aid. The introduction of the "arm's length" notion and the clarifications on pre-commercial procurement, the "arm's length" notion, contract research by and collaboration with research organisations and infrastructures are also to be appreciated. These clarifications seem to reflect the general principle that aid should constitute an economic advantage that the undertaking would not have received in the normal course of business, in accordance with the Market Economy Investor Principle.



At the same time, the new attention to fiscal schemes is surprising, as general fiscal measures have so far been considered non-selective and hence not constituting state aid. It is of vital importance that the existing approach is continued.

- **Common assessment principles**

We endorse the use of economic analysis to determine whether a measure is state aid which can be declared compatible because the positive impact of the aid outbalances possible negative effects (point 36). However, the economic approach should not increase legal uncertainty or administrative burdens in the approval of state aid schemes.

The concrete implementation of the economic approach in the existing framework however appears not to have reduced burdens or to have led to more RDI. On the contrary, it may discourage Member States from devising specific RDI aid schemes given the daunting prospect of having to submit a very detailed assessment for each notification.

Also, it is crucial that the new RDI Framework leads to a substantial shortening of the approval process for notified aid, as the current 9 to 10 months average time is certainly excessive and does not meet business needs.

- **Aid amounts and intensities**

BUSINESSEUROPE opposes the proposal to introduce a new “Net Extra Cost” cap for individual aid. This would amount to the difference between the net present values (NPV) of the aided scenario and the counterfactual scenario, taking into account the probabilities of the two scenarios.

Applying such a calculation method would introduce significant complexity and uncertainty and could lead to a reduction of the available public funding (this new test being aimed at ensuring that the aid is limited to a minimum). Such a calculation method is not adapted to the characteristics of RDI projects, which are characterized by a high level of risk (commercial and technical) and an often very long duration. In such context, counterfactual RDI scenarios are by definition much more difficult to establish, less straightforward and much less certain than in other types of aid. The same comment applies to the draft IPCEI framework, with respect to the calculation of the “funding gap”.

- **Appropriateness of different aid instruments**

Paragraph 60 contains a preference for risk financing over grants and other instruments providing direct pecuniary advantage. While from a strict state aid control perspective risk financing may be less distortive, the Commission must also bear in mind the critical need for the Union’s economy to increase the rate of innovation.

The “valley of death” is a well-documented phenomenon whereby projects fail in the final stages because of the very high costs entailed in bringing innovative products and processes to the point where they are ready for implementation. Loans and other forms



of liquidity support may leverage a limited government budget, making available higher funding amounts when projects are very close to reaching the markets.

However in the R&D phase, that is often preceding these stages, loans would increase the riskiness of a project and are frequently inadequate to incentivise undertakings. The Commission should therefore recognise that grants are the best way of addressing this market failure in the R&D stages, while loans could be a good instrument for later stages closer to the market.

- **Requirements on the incentive effect (point 62)**

The Framework prescribes that State aid for RDI must induce undertakings to pursue research that they would not otherwise have pursued (incentive effect). BUSINESSEUROPE notes that in practice it is very difficult to prove that aid for RDI has a clear incentive effect. The investment decision of an R&D project is based on multiple factors that can hardly be distinguished from each other. In addition, the subsidy alone often does not lead to a decision by itself, but reduces risks, increases speed, stimulates collaboration with for instance SME's etc. The Commission also acknowledges that the counterfactual scenario is, with respect to RDI aid, more complex, sophisticated and debatable than for other types of aid.

At the same time, Member States must provide a substantial amount of quantitative information regarding the changes in RDI spending and other changes related to the aid's recipient. The very specific and detailed quantitative information required does not make it easier to demonstrate that the aid significantly increased RDI activity.

Fulfilling this requirement can be extremely difficult and burdensome for companies and Member States, when, for example, multiple R&D projects run simultaneously or the firm's contribution to a single project is relatively small compared to the firm's overall R&D budget.

We suggest the Framework should indicate less strict criteria on evidence related to the requirement that certain RDI activities are carried out in addition to normal day-to-day operations. This is particularly relevant in view of the fact that a strict interpretation would put European companies at a competitive disadvantage vis-à-vis their competitors located outside the EU, which do not suffer from comparable constraints. However it is essential that the effect on competition and the assurance of a level playing field are and remain a key focus of the application of the framework.

The current requirements in relation to the incentive effect could put a break on RDI to the detriment of European competitiveness. Also, the uncertainty in relation to the outcome of the evaluation process can discourage companies to invest in RDI.

- **Definition of RDI categories**

Nowadays innovation is an interactive, multi-disciplinary and non-linear process. The complexity of (societal) challenges and the enormous speed of technological developments at a global scale strengthen this.



The distinction between fundamental research, industrial research and experimental development reflects the obsolete linear innovation model. This is conceptually incorrect. One of the main reasons for modernising the RDI framework is the scrapping of obsolete categories and the updating of rules to reflect the realities of the modern innovation process. This is not leading to major problems in practice and we appreciate footnote 43 clarifying that these R&D stages do not necessarily have to be followed in chronological order. However, we still believe the framework should reflect today's concurrent and interactive industrial innovation process with constant market feedback. This could avoid the risk that Member States adopt different interpretations with respect to hypothetical categories bearing no relation to reality.

Also, Paragraph 15(bb) defines process innovation as “the implementation of a new or significantly improved production...method”. A lot of research in capital intensive sectors is devoted to advancing production processes to improve cost, product quality or environmental performance. The draft framework proposes to restrict aid intensity for process innovation by large companies to 15%, whereas SMEs would benefit from 50%. So while Member States could provide aid of up to 65% to facilitate research in new processes, only 15% would be available to implement that research. The framework should make a distinction between process innovation from organisational innovation, and increase the allowable aid intensity for the former.

Finally, there is need for more support for innovation and also different forms of innovation (non technological, services and social innovation), as also mentioned by the Innovation Union Flagship Initiative. The range of eligible innovation activities should be consequently extended, provided that these activities are properly defined.

- **Collaboration between research organisations and business**

One of the general criteria for identifying State aid is that it provides an economic advantage that the undertaking would not have received in the normal course of business. This implies that a collaboration benefiting from public funding for its R&D activities can only involve indirect aid if the terms of collaboration for the business are more favourable than in comparable collaborations with other undertakings.

BUSINESSEUROPE notes that the current rules can lead to situations where undertakings partnering with research organisations not only do not get an advantage that is prohibited by the State aid rules, but also have a disadvantage compared to commercial collaborations, and even with respect to undertakings that do not participate in the collaboration with the research organisation, who may get access to e.g. IPRs generated by the research organisation in the collaboration on the same conditions as the collaborating company. This means that such third parties could have the same rights against the same conditions, but without investing in the project that generates the IPRs and bearing the associated risks. In particular:

- Paragraph 28 sets out certain conditions relating to the treatment of any IPR arising from a project to ensure that state aid does not pass through indirectly to undertakings where research projects are pursued collaboratively between undertakings and research organisations. Option (d) in particular applies where ownership of the IPR remains vested in the research organisation. This option may undervalue the contribution made by



the participating companies, as it seems to only allow them to deduct the “absolute value” of their contribution to the costs of the research organisation, from the purchase price of the IPR. As an alternative, we believe that also a deduction proportional to the undertaking’s share of the total costs of the project should be possible, so to take into account any in-kind or cash contributions made by the companies during the research project. Therefore, we very much welcome the new option (c) for avoiding indirect state aid in collaborations with undertakings, which seems to allow for such relative deductions.

- Also On a positive note, the inclusion of the notion of “arm’s length” as definition (f) in point 15 and the reference in point 16 to the draft notice on the notion of aid are useful and welcome. They are in accordance with the Market Economy Investor Principle and imply that a transaction of an undertaking with an organisation benefiting from public funding for its activities only can involve indirect state aid if the terms of the transaction are more favourable than those which would have obtained in comparable transactions between undertakings on a commercial basis.

- **Aid to innovation clusters**

The role of innovation clusters is essential in drawing closer actors who would not otherwise do that sufficiently, and in particular SMEs and public research. If we want to accelerate our transformation through innovation in reaching the EU 2020 criteria – which are essential to competitiveness – we have to ensure that costs of clusters do not deter businesses from joining them.

In this context, it particularly important to:

- Consider duration: clusters mostly generate effects in the long term and therefore require public support for a longer time. This should be matched with objective assessments of the results of the cluster.
- Consider sectors and companies involved: the aid should be adapted to encourage the use of clusters by SMEs in particular, as an effective tool to enable them to adapt and evolve.
- Concerning the aid for innovation clusters, we believe that business associations with capacity and experience in conducting and promoting R&D and innovation activities should be included as a beneficiary regardless the fact that they are classified by the member state as an Innovation Cluster. This approach has to take into account that business associations operating in certain sectors, such as fisheries and aquaculture, for example, cannot be registered as Innovative clusters, according to Community legislation.

As a result of the above, industry could hesitate in cooperating with research organizations, which leads to less collaborative RDI projects, which is certainly not the intended result.



A partly connected issue relates to research organisations established by a group of undertakings to conduct research for those undertakings, which are de facto private collaborative entities. The final sentence of paragraph 15(ee) (“research and knowledge dissemination organisation”) prevents undertakings that are members or shareholders of research organisations from getting preferential access to the organisation’s facilities. This would imply for example that research organisations established by a group of undertakings to conduct research for those undertakings would not be eligible to receive aid. Application of this condition would have very serious implications for a large segment of the Union’s research infrastructure. This sentence should be deleted.

- **Global competitiveness**

The global dimension is hardly getting any attention in the new framework: the state aid rules only arrange for a level playing field within the EU, without ensuring also a level playing field for Europe’s industry in competing worldwide, especially in industrial sectors supported by targeted RDI stimulus measures in other regions.

Also, as mentioned, a strict interpretation of the incentive effective criterion or a too rigid application of the proportionality test (“net extra cost” based upon the counterfactual scenario) would put European companies at a competitive disadvantage vis-à-vis their competitors located outside the EU, which do not suffer from comparable constraints.

The global situation should also be particularly taken into account in the context of cluster policy, and particularly the fact that other regions of the world, like US, India and China have very supportive cluster policies.

Conversely, except for the matching clause in point 92, the global competitiveness of Europe’s industry is not getting sufficient attention in the new framework; the state aid rules only arrange for a level playing field within Europe. In general, other countries don’t have any comparable constraints on RDI support. Therefore the Commission should seek to ensure a global level playing field through the WTO.

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