

Estonia's answers to the communication from the Commission “Consultation document on state aid for innovation”

Estonia welcomes the Commission's proposals presented in the 21.09.2005 Consultation document on state aid for innovation.

Already in its position on State aid Action Plan Estonia specially expressed the support *inter alia* to adopt the Communication on state aid and innovation, modifying the Community Framework for Research and Development and reviewing the Communication on risk capital.

Estonia supports the Commission's proposals to facilitate technological innovation for SMEs, but is of the opinion that non-technological innovation and large companies might also need public support.

Answers to the questions asked in the Consultation document on state aid for innovation are presented below.

- 1. Do you think that it is appropriate not to create a separate Framework for Innovation and that the new possibilities for State aid target selected innovation-related activities?*

Estonia is of the position that, for clarity's sake, there could be a separate innovation state aid framework.

Another option would be that the proposed innovation related amendments are incorporated into the R&D framework and general block exemption regulation.

- 2. Do you think that the problems presented in Annex and the market failures identified by the Commission as hampering the innovation process are accurate? If so, why? If not, why not?*

The problems presented and market failures identified in Annex are to a large extent correct and among most pressing ones hampering innovation in EU. Estonia supports the elaboration of common rules and standards e.g. in the field of certification procedures and patent protection procedures, but we do not support harmonization of tax and social security systems as in our opinion the different systems are not obstacle for granting state aid. Tax policy should remain in the domain of Member States.

- 3. The measures described in this Communication provide ex-ante criteria on the basis of which State aid for innovation would be approved. Do you think that such an approach is adequate?*

Estonia supports Commission's efforts to determine ex-ante criteria that would provide clear rules for evaluating various R&D and innovation related public support schemes. It is important to make sure that support schemes are appropriate, have

incentive effect, are proportional to the identified market failure in question and do not distort competition and trade.

However, Estonia does not support Commission's proposal to concentrate only on technological innovation and leave out non-technological innovation. Albeit acknowledging the importance of aid to technological innovation is a big step forward, it is today a widely accepted point of view based on a vast (and growing) amount of research that non-technological innovation (e.g. usage of design, developing new business models etc) is an equally important source of competitiveness for SME-s and also very often their first step in the "innovation game".

4. *Stakeholders are invited to provide empirical evidence about the appropriateness of authorising State aid to large companies, in particular in connection with the objective of developing clusters around poles of excellence in the EU. Do you think that the Commission should develop ex-ante rules allowing State aid for Innovation to the benefit of large companies, or that such type of aid should always be subject to a case-by-case stricter analysis on the basis of a notification to the Commission? As far as support to innovation (or other state aid) is concerned, would it be appropriate to distinguish between different categories of large companies? If so, on the basis of which criteria? And for which purpose?*

Estonian R&D related support schemes have been running for a limited time and therefore no large-scale impact analysis have been conducted yet. However, academic research and impact evaluations carried out elsewhere (such as extensive work on technology programs by TEKES in Finland) have shown that there are great networking spill-overs and that collaboration with large enterprises is one of the most effective ways for SME-s to improve both their technological and marketing skills and capacities, gain access to export markets etc. One typical and illustrative example of this kind of impact is an Estonian ICT company which started as a subcontractor for Ericsson but is now using the knowledge and skills acquired through that collaboration to establish its own trademark and has become one of the strategic R&D partners for Ericsson. Based on these kinds of other examples, Estonia feels that it is important to leave the opportunity to include large companies into support schemes, especially into those directly aiming at creating clusters and networks.

5. *Stakeholders are invited to provide empirical evidence about the appropriateness of authorising State aid to non-technological innovation, notably in services sectors*

As mentioned already above (see point 3), we are in favour of including also non-technical innovation into ex-ante rules. Also, organisations such as OECD have carried out several analyses, which have indicated that knowledge-intensive service sectors are amongst the most innovative ones and also amongst the fastest growing sectors. But such growth is not inevitable as it is equally not inevitable that this sector should grow in EU, as it requires complex supportive environment, developing respective knowledge and skills, risk taking etc, which demand sophisticated

innovation policies. Therefore Estonia considers that state aid could be justified and necessary for promoting the growth of such sectors, but on the basis of clear rules and in restricted amount.

6. *Should the rules on State aid for innovation include regional bonuses for cohesion purposes? Should they differ according to the geographical situation of the region, irrespective of cohesion issues?*

The fact that certain regions/Member States are today lagging behind is to a very large extent explained by lower productivity stemming from low knowledge-intensity and low level of innovativeness of economy (including bigger market failures and weaker linkages, networks, overall awareness, etc). Estonia therefore believes that it is important to include regional bonuses in the rules on State aid for innovation. However, the bonuses should not differ according to the geographical situation of the region.

7. *Are some types of aid more suited to specific situations and specific innovation activities (ex: tax rebates, secured loans, repayable advances)?*

Direct grant is usually the most transparent and best-used form of state aid as it allows tailor-made approach. Also state aid in the form of loan guarantees can be important and appropriate for supporting innovation in SMEs.

Nevertheless, the innovation policy should not be confined to direct measures only but should take a more complex approach. For example, it is of utmost importance to have also supportive legal framework for entrepreneurship, investments and innovation in place. Standards (e.g. environmental standards etc) can be used as incentive to innovate; also public procurement can be used as a tool for bringing about innovation.

8. *Do you agree with the proposed criteria to define innovative start-ups, with the approach of not defining eligible costs, with the amounts of aid and cumulation rules? Do you think that different eligibility criteria should be established for high-tech sectors like biotech and pharmaceuticals which have long time-to-market and product development cycles?*

Estonia in general welcomes the idea of introducing the concept of an innovative start-up.

Although Estonia supports the innovativeness and size criterion of defining innovative company, we think that the existence period criterion is not appropriate as this might bring along a pressure to create new firms in order to get state aid.

It is also important that innovativeness should not be confined to R&D intensive technological innovators only. There are market failures and growth obstacles facing non-technological innovators as well. These companies are lacking necessary capital for the investments into knowledge and skills, they too face mismatch on the labour

markets, etc. Therefore, it would be against renewed Lisbon targets – to create growth and jobs – to leave the potential of non-technological innovative companies unused.

9. *Beyond the proposed rules, empirical arguments are welcomed that demonstrate the need for State aid: i) for start-ups independently of the innovativeness criterion, and ii) for innovative SME-s established for more than [5 years].*

Non-innovative start-ups need state aid to improve their capacities and also to become more innovative. Management, marketing, technological skills, etc need to be developed in order to survive, grow and take on projects with higher risks. Both non-innovative and innovative companies need human and financial capital. It is just the type of such capital that is different in terms of sophistication, volume etc.

Market failures for innovative companies do not disappear, they might only get smaller to some extent. Therefore, there is no reason to think that innovative SME-s older than five years might not need support. It might be that a company is still in product development phase and is about to face the challenges involved with marketing, entering into foreign markets, expanding production, etc. Thus, the Commission should allow flexibility for taking into account also the specifics of such companies.

10. *Do you think that other types of State aid apart from those currently granted in respect of risk capital are required in order to help European SME-s grow beyond the start-up phase? If so, which ones?*

In addition to providing seed/risk capital, Member States can also improve companies' access to capital by reducing the information asymmetries for various financing institutions by facilitating dissemination of information, facilitating business angel networks, giving loan guarantees etc. However, experience has shown that in very early stage of development, only state support/or co-financing can bridge the financing gap for innovative companies with high growth potential.

11. *Do you think that these provisions would produce the expected effects in terms of encouraging SME-s to launch innovative products in the market? If not, what changes should be made to these rules?*

Estonia feels positively about the proposals to widen the scope of eligible cost in the R&D framework in order to incorporate also additional elements (like development of commercially usable prototype, technical evaluations and feasibility studies, expenses for adapting technologies to particular production specifications and for optimising the production process, marketing cost relating to technological design) and believes that these changes have the potential to create significantly stronger incentives for SME-s to innovate.

Estonia is reserved about the proposed level of aid intensity – 15%. This might be too low in order to really be effective and have behavioural additionality.

However, regarding management and marketing training we do not see any reason to include this into R&D framework as training aid is already covered by block exemption regulation, which allows much higher level of intensity compared to the suggested 15% in current document.

12. Is there evidence that these provisions should be extended to large companies? Do you think that notification should be required for measures granting substantial amounts of aid to individual firms or individual sectors? If yes, above what amount? What empirical evidence should then be requested by the Commission?

Estonia supports extending these provisions also to large companies. The reason is that albeit market failures that the state aid is aiming to correct increase progressively as the size of the company gets smaller, they can still be severe also for large enterprises. Allowing innovation aid also for large companies is especially important for Europe's traditional industries, which are becoming less and less competitive as the labour costs increase. This has been obvious for example in textile industry where most of the production has moved out to Asia and thousands of jobs have been lost. Given the likelihood of this pattern to repeat itself in many other traditional industries, EU should on the contrary, pay more attention also to large industries and through creating awareness and giving incentives to help otherwise fading industries to move into innovative and higher value-added activities.

We do not think that there should be differences in treatment depending on the sectoral belonging of the company.

We also consider that large multinational companies, who are already competent in R&D and innovation, may not need such assistance.

Therefore we support flexibility in authorising state aid also to large companies, but only after thorough case-by-case analysis on the basis of prior notification.

13. How would you regard specific support for innovation intermediaries, which merge or develop a joint venture to reach critical mass in a technological field of specialisation? Should investment aid be permitted in this context? If so, on what conditions? What other measures could be envisaged?

Estonia is of the opinion that proposed criteria envisaged in the consultation document could be applied to joint ventures of innovation intermediaries, be they technology specific or not. Gathering the critical mass of competencies and resources would lead to improved service also to their clients, help to become self-sustainable and in the long run, thus also reduce the need for state aid.

14. Is there evidence that the recruitment by SME-s of other types of highly skilled personnel should be also aided?

Based on the most recent Community Innovation Survey results, the lack of qualified personnel was in Estonia identified as the second biggest bottleneck for innovative

companies. On one hand, there might be supply problems from universities, but it seems more likely that there are also demand problems in a sense that innovative activities are regarded as risky and costly by most enterprises (especially in terms of human resources). Thus, innovative activities could be boosted, if to help companies to find and employ necessary specialists. Estonia suggests not to limit the range of highly skilled personnel to only researchers and engineers, as state aid should be allowed also in case of personnel needed for non-technological innovation as well, such as designers, etc.

15. Should the Commission adopt specific rules for cases where a researcher chooses not to return to his/her home university or where the university no longer intends to hire him/her back?

Estonia sees no need for such rules, as it would over-regulate and bring about unnecessary restrictions on the (inter-sectoral) movement of labour.

16. What definition of cluster/clustering activities should be followed and what criteria should be used to distinguish clusters from the broader category of innovation intermediaries?

The proposed definition of cluster is appropriate and captures in our opinion to a large extent the essence of a cluster. Important part of the definition is intensive interactions, which should result in spillovers, both technological and economic ones. Therefore, only those networks that produce learning spillovers and positive feedback loops (above certain thresholds) constitute an effective cluster.

We would also like to point out that in general a regional cluster can act effectively only if companies and scientific and research institutions are situated from each other in the range of not more than 100 km.

17. Do you think that State aid should be allowed to promote European centres of excellence? If so, what type of State aid, for what reasons, and subject to what conditions? What other, possibly better, measures could be envisaged?

We support the idea of allowing state aid also to promote European centres of excellence. Such centres could be supported *inter alia* through grant schemes for the scientists and researchers of Member States.

18. Are additional criteria needed to avoid State aid being fragmented and to encourage the concentration of resources in a limited number of poles of excellence?

There could be extra bonuses for collaborative R&D and innovation, which would give incentives for networking and bringing together critical mass. It would also be useful to favour those who would be able to act in the field of frontier science.

19. What are your views more generally about the need for additional provisions for infrastructure that supports innovation (e.g. in the field of energy, transport etc.)?

In case the Commission means hereby research infrastructure, then it is of great importance to include that into state aid framework, as most of the equipment necessary for technological innovation are by far too expensive for most companies. But also non-research infrastructure could be included for example for shared facilities (such as technology parks and centres), which would serve as a basis for possible clusters.

20. Do you think that large firms should be entitled to State aid, e.g. to establish research facilities in a European pole of excellence? Should the Commission try and develop specific criteria to control such State aid? What type of economic evidence should be requested to analyse the necessity of such State aid?

Estonia is of the opinion that also large firms could be entitled to establish facilities in poles of excellence, but only on the basis of case-by-case analysis. Given the great spill-over effects for SME-s from collaboration with large companies, it would be in Member States' interests to give incentives to large firms to collaborate with SME-s. Allowing big companies to receive state aid for shared infrastructure would be an efficient way for that.

21.11.2005