

December 16th 2005

AmCham EU response to the Commission's consultation on State Aid for Innovation

Executive Summary

<u>Subject</u>	<u>Business Perspective</u>	<u>AmCham EU Position</u>
<i>Beneficiaries</i>	Certain types of innovation involve greater costs and risks than one company can absorb alone	State aid should be allocated exclusively according to a company's innovation potential, rather than size.
<i>Poles of excellence</i>	Poles of excellence can contribute to economic growth and innovation, but need critical mass to become competitive at global level	Aid for poles of excellence should respect a level playing field and avoid duplication at European level. Aid should focus on innovation in products/process rather than on geographical location.
<i>Tools</i>	Aid should be adapted to the specific market failures identified	The tools proposed are: <ul style="list-style-type: none"> - tax rebates or social security reductions for employment or training aid. - repayable advances for R&D investments - refundable tax credits to foster research programme. - support to innovation intermediaries to create a conducive business environment.
<i>Types of innovation</i>	The distinction between industrial and services sectors is no longer relevant	Eligibility should be based on objective criteria (eg, time-to-market) and not sectoral in nature. Innovation in both traditional industries and services should be eligible.

INTRODUCTION

1. The American Chamber of Commerce to the European Union (AmCham EU) is the key organisation in Europe representing the views of companies of American parentage. Its member companies are drawn from a broad cross-section of the European business community and typically are present in most Member States of the European Union. As such, it represents some of the earliest and most committed business supporters of the European ideal and, in particular, of the single market concept.

2. On June 7th 2005, the Commission adopted an Action Plan entitled “Less and better targeted state aid: a roadmap for state aid reform 2005-2009,” stating its intention to launch a “comprehensive reform of state aid policy” over the next five years. AmCham EU has actively participated in the debate and both our previous submissions should be considered as an integral part of these comments¹. The following comments respond to the consultation launched by the Commission on specific improvements in the rules on state aid for innovation. AmCham EU has consolidated the 20 questions posed into five general themes of reflection. Each theme is defined according to the terminology set out in the consultation document. The five themes are the following:

- I. Should distinctions be made amongst types of companies which may be beneficiaries of state aid for innovation?
- II. What criteria should be used to determine the beneficiaries of state aid for innovation?
- III. Should state aid be used in support of poles of excellence and, if so, how?
- IV. What tools should be used to support innovation through state aid?
- V. What types of innovation merit state aid support?

I. Should distinctions be made amongst types of companies which may be beneficiaries of state aid for innovation?

3. Question No. 4 of the consultation states: *“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, should it be appropriate to distinguish between different categories of large companies? If so, on the basis of which criteria? And for which purpose?”*
4. One of the overriding leitmotifs of the consultation on innovation concerns whether big companies should be allowed to receive state aid for innovation at all. In its consultation document, the Commission appears to favour state aid for innovation for start-ups and SMEs, to the detriment of large (non start-ups, non SME) companies. Questions No. 9, 10 and 11, amongst others, revolve implicitly around the analysis of innovation aid being limited to start-ups and SMEs.

¹ Please see: <http://www.amchameu.be/Pops/2005archive/stateaidactionplan09282005.pdf>
<http://www.amchameu.be/Pops/2005archive/stateaidenforcement05282005.pdf>

5. In this regard, AmCham EU would challenge the Commission's approach to public support for innovation, which appears to exclude from consideration large companies which may make large investments in innovation. To the extent that state aid is desirable in support of innovation, it should be extended to all companies, regardless of size. It is granted that start-ups and SMEs are typical victims of market failure as defined by the Commission. Nevertheless, there may be cases where a large company, on the basis of a costs/risks/benefits analysis, would be unable to support the risk of a large innovation project and to find private sector partners willing to share the risks of such a project. This, too, could constitute a type of "market failure" which could be remedied by public intervention. All businesses, whether small or large, must overcome the same additional cost in order to profitably invest and contribute to economic development. In a cost/benefit analysis, the investment of public resources in R&D efforts by a large company with technology leadership could lead to considerable innovation benefits. For example, upscaling a new process to make fuel from biomass is likely to be initiated by a large company (or consortium of large companies). This is a necessary step in the innovation process, with considerable benefits to society in terms of improved environmental performance if successful. Furthermore, a large company (or a consortium of large companies) might work together with smaller companies during the innovative project, thus state aid received by a larger partner could benefit smaller partners later.
6. Additionally, when considering special rules to support innovation intermediaries, which might be the recipients of aid (or pass on aid to the final beneficiaries), the Commission should not discriminate amongst companies benefiting from those innovation-related services. Innovation intermediaries should benefit from a specific and favorable treatment regardless of the size of their clients.

II. What criteria should be used to determine the beneficiaries of state aid to innovation?

7. Under the current R&D state aid framework, it is impossible to grant aid to activities beyond the first prototype. However the Commission also suggests allowing aid for technological innovation in the "experimental development stage", for SMEs. This development stage would include: (i) development of commercially usable prototypes and pilot projects, (ii) technical evaluations and feasibility studies, (iii) expenses for adapting technologies to particular production specifications, (iv) marketing costs, and (v) management and marketing training. The fundamental issues raised by the Commission are the following:
 - Is there evidence that these provisions should be extended to large companies?
 - Should notification be required for measures granting substantial amounts of aid to individual firms or individual sectors? What empirical evidence should then be requested by the Commission?

8. The Commission's objective in its State Aid Action Plan is to move away from "specific" aid and focus on "horizontal aid". In the opinion of AmCham EU, by singling out start-ups and SMEs only, the Commission proposes action contrary to this objective. We see no reason why large companies be excluded. In many cases, large businesses are better positioned than smaller companies to leverage and deliver on innovation resources as they benefit from the organisational and physical infrastructure, as well as the corporate experience.
9. Certain types of innovation involve greater costs and risks as well as a longer period for potential payback than a company – even a large one – can undertake alone. For example, developing vehicle fuel cell technology will involve the production of a number of generations of prototypes, with attendant work in developing and testing new technologies for fuel storage, cost of material, etc. Each generation is extremely expensive to produce – and again the benefits of success will accrue widely to society. In this circumstance, it may be appropriate for public authorities to share the cost/risk. Irrespective of the size of the company, one of the main criteria should be the contribution to innovation and technology.

III. Should state aid be used in support of poles of excellence and, if so, how?

10. Amongst the objectives of the 7th Research Framework Program is the creation of "poles of excellence". These are regionally-driven clusters able to attract researchers, investors and other leading players in a given sector to collaborate in R&D. The Commission is aware that clusters need critical mass and that market failures prevent some participants (including SMEs, universities and large companies) from contributing fully. Concrete measures to facilitate cluster activity could include (i) a "pro rata allocation" of IP rights between the partners and (ii) aid for infrastructure, provided it is technology neutral and open access is guaranteed.
11. The Commission's formulation of issues concerning poles of excellence seems to revolve around the following points:
 - Should state aid be allowed to promote European centres of excellence? Are traditional criteria needed to avoid state aid being fragmented and to encourage the concentration of resources in a limited number of poles of excellence?
 - Should large firms be entitled to state aid in order 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?
12. In this respect, the Commission seems to acknowledge that large enterprises should constitute an important part of a cluster: indeed, clusters need critical mass and often comprise a balance between SMEs and large firms. Large companies possess the necessary tools and experience which can contribute to the development of competitive clusters. The positive role of large companies has been observed in the

cases of Silicon Valley in the US or “Silicon Saxony” and “Silicon Grenoble”. AmCham EU believes that large companies can make crucial contributions to clusters’ critical mass and should therefore not be excluded from any type of cluster-specific aid. In any event, aid supporting clusters/poles of excellence should take into account the need for (i) a level playing field and (ii) avoiding duplication of poles at a pan-European level. This said, creating a pole of excellence should not be a prerequisite for aid. The only criteria for aid should be based on the effective contribution to innovation in products or processes and not on geographical location.

13. Economic evidence to justify using public resources to create clusters/poles of excellence could include *inter alia*, the following:

- Clearly demonstrable market failures which prevent companies from investing;
- Size and scope of research, risk of success/failure, potential benefits in terms of externalities, number of research professionals, potential for commercialisation, potential for first-mover advantage if research is successful, etc.;
- The value of the investment within the technology cluster at stake;
- The value of the work being localised in the EU and risk of such investment being delocalised outside the EU;
- Pay-back period of the aid based on an objective criteria such as tax income and chain effects;
- Risk that the aid would distort competition in the product market and
- Within sector specific monopolies (eg, the postal sector), additional attention should be given to the transparency of accounts to ensure that state aid or other forms of direct and indirect public funding is not used for the development or acquisition of services falling outside the scope of a clearly defined public service obligation.

IV. What tools should be used to support innovation through state aid?

14. Many existing state aid rules can be used to support regional development (eg, regional investment aid, aid to SMEs for training, R&D). The Commission has committed to supporting regional innovation clusters and poles of excellence. Currently, the Regional Aid Guidelines are the main instrument of regional cohesion through state aid. However, there are horizontal instruments for regional bonuses to increase aid intensity in assisted areas. State aid allowed for innovation may normally be cumulated with regional aid since each has a unique set of eligible costs. To what extent should additional provisions for regional aspects be included in the rules on state aid for innovation? The issues raised by the Commission appear to concern, in particular, the following points:

- Is there a need for additional provisions for infrastructure that support innovation (e.g. in the field of energy, transport, etc.) ?

- 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?
 - Are some types of aid more suited to specific situations and specific innovation activities (ex: tax rebates, secured loans, repayable advances)? How should innovation intermediaries be encouraged to provide infrastructure and services to undertakings involved in innovative activities?
15. In this respect, the Commission should specify under what circumstances financial support for the building of infrastructure following a public tender still constitutes state aid. Indeed, infrastructure will be a critical element in the application of new technologies – and frequently is far beyond the capability of individual firms to undertake. For example, future vehicle safety systems may require vehicles capable of communicating both with each other and with the infrastructures they are using. There is a role for state aid in facilitating the establishment of this infrastructure. Similarly, alternative fuels such as hydrogen may benefit from other distribution mechanisms than existing private “gas stations”. Europe should not close off these potential enablers for innovation.
16. The issue of combining state aid for innovation with regional/cohesion goals is particularly delicate. The question arises whether the differentiated treatment of innovation projects is objectively justified by the EU’s cohesion policy. It may be difficult to develop dependable models in order to obtain both objectives without creating an uneven playing field.
17. As for the types of aid more suited to specific innovation projects, AmCham EU would suggest the following:
- Tax rebates or social security reductions are best suited to employment aid or training aid, as they directly relate to the cost of employment;
 - Repayable advances are an appropriate instrument for R&D, as the successful development of a project may allow the company to repay after having benefited from some “financial breathing space;”
 - Tax credits should be made refundable, to be of immediate value to companies in a net loss position – this can encourage a company to continue or accelerate its research program to facilitate future growth;
 - Specific support for innovation intermediaries which allows them to reach critical mass (for example, through joint ventures or mergers) should be permitted. It is essential to create a business environment supportive of innovative undertakings, which requires (1) adequate and sizeable business advisory services, able to give strategic advice on complex technological issues, (2) the ability to find partners (eventually abroad), and (3) help for companies conducting business in external markets.

V. What types of innovation merit state aid support?

18. The Commission appears to believe that authorising innovation aid for activities, which are not related to technological innovation risks distorting competition and circumventing the rules. Technological innovation is associated with products or processes and thus by definition excludes services. For this reason the Commission invites stakeholders *“to provide empirical evidence about the appropriateness of authorising State aid to non-technological innovation, notably in services sectors.”*
19. The Commission has also identified innovative startups as victims of market failure due to lack of capital or collateral. It proposes two eligibility criteria: (i) start-ups should be small, (less than 50 employees), independent entities under five years old; and (ii) they must either produce products or processes, which are technologically new or a substantial improvement on the state-of-the-art and therefore carry a risk of failure, or have R&D expenses of at least 15% of overall expenditure. Because innovative startups are small and less likely to affect trade and competition, the Commission proposes that aid should not be allocated on the basis of eligible costs but on the basis of the criteria defining innovative start-ups, provided that the amount of aid and timeframe over which it is allocated is limited and that the aid is not cumulated with any other state aid. The Commission requested comments on this specific approach and questions whether different eligibility criteria should be established for high-sectors like biotech and pharmaceuticals which have long time-to-market and product development cycles.
20. In this respect, AmCham EU believes that if eligibility criteria are established, they should not differentiate between industry sectors but should be based on objective criteria (eg, time-to-market). Virtually all sectors today are ‘high tech.’ Creating artificial distinctions between sectors in terms of criteria and benefits would only impede innovation. In addition, as Europe increasingly becomes a service-based economy, innovation in services should also be entitled to receive aid in order to achieve both public policy objectives and competitive advantage on a worldwide scale.

CONCLUSION

21. To reach the Barcelona objective of an average 3% of GDP investment in R&D, AmCham EU believes that state aid in support of innovation should not be limited to start-ups and SMEs. State aid rules should provide a clear and predictable legal framework based on non-discriminatory rules and sound economic analysis in order to ensure a level playing-field for all innovative companies. Representatives of business interests should be consistently consulted on state aid issues. AmCham EU is keen to contribute to a constructive dialogue on this important issue and we hope our proposals will be taken into account by the Commission

* * *

The American Chamber of Commerce to the European Union (AmCham EU) is the voice of companies of American parentage committed to Europe towards the institutions and governments of the European Union. It aims to ensure an optimum business and investment climate in Europe. AmCham EU facilitates the resolution of EU – US issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Total US investment in Europe amounts to \$964 billion, and currently supports over 3.6 million jobs.

* * *