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STATE AID FOR INNOVATION

CBI'S RESPONSE TO THE COMMISSION'S CONSULTATION

17 November 2005

GENERAL

We appreciate the Commission's wish to make the best use of the tools of state aid to promote innovation. Faced with the challenge of improving EU competitiveness however there is a natural temptation to use state aid in an effort to back winners and to substitute administrative control for the market. The Commission has rightly said that it is through effective competition in the Single Market that the EU will improve its competitiveness on world markets.

Innovation is a complex process which is difficult to define and we agree with the Commission's approach of not introducing a specific Block Exemption. It is far better in our view to build on the existing state aid instruments. These should be suitably updated by increasing for example the exemption limit for small amounts of state aid to €250,000 over three years.

In considering the Commission's specific questions we believe the essential principles are that:

- to justify any state aid there should be a clear market failure on the part of the private sector to invest in a particular technology or innovative venture
- the private sector is inherently more capable of managing risk capital for innovative ventures than government institutions and therefore any state aid should be aimed at leveraging private capital
- the funding of any innovative venture should not significantly distort competition
- the rules must be simple to follow with complexity and bureaucracy reduced to the minimum so that state aid is delivered effectively to deserving applicants

In its State Aid Action Plan the Commission correctly pointed out that there is an opportunity cost in providing state aid. More aid for innovation means less public funding for other projects which could also help innovation, such as improving infrastructure. For this reason we would strongly propose that the Commission's proposals be subject to a regulatory impact assessment so that the cost benefits can be clearly established.

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SPECIFIC QUESTIONS

Appropriate state aid framework (ref. Q1,Q2,Q3 & Q6)

We agree that there should be no separate framework for state aid for innovation. We also strongly endorse the statement that State funding for innovation should not aim at "picking winners".

In reviewing the list of problems affecting innovation in Europe which have been identified by the Commission (Annex A), we consider that the category of "general systemic inefficiencies" is probably the most significant. We would concur with the examples given of a lack of entrepreneurship culture, risk aversion and a negative attitude to failure. Much has been done in the UK in recent years to address the problems in the other categories. For example more than £500m was raised for investment in Venture Capital Trusts during the last tax year, which provides an important source of risk capital.

The Commission's analysis also highlights the question of innovation in the services sector and the fact that it is different in nature from innovation in other sectors. Since manufacturing in advanced economies has been declining as a percentage of GDP for many decades while the percentage of services has been growing, it is important that public funds for innovation are used to invest in ventures that have long-term prospects for growth. If there are going to be more world-class EU companies in services such as software, engineering consulting and healthcare then the best way of delivering any state aid needs to be properly understood. We believe more analysis is needed in this area.

An important point (Question 3) is whether the "ex ante criteria" described provide an adequate approach. In our view they do not. The Commission rightly considers there are significant risks in authorising aid for non-technological innovation on the basis of "ex ante" rules since these could practically cover any routine activity (para.25). However it is then proposed to apply them to technological innovation which the Commission admits cannot be properly defined with a sufficient degree of legal certainty.

We believe it would be consistent with the decision to avoid any special framework for innovation by also avoiding any "ex ante" rules for state aid for technological innovation. It would be much preferable to apply the existing state aid instruments such as the R & D framework and the SME and de minimis Block Exemptions. At the same time it would be useful to provide guidelines on how large companies may be eligible for state aid for innovation projects.

Similarly, we are not in favour of creating any new regime for providing additional regional aid, such as regional bonuses, for innovation projects (Question 6).

Innovative start-ups (Q8 & Q9)

The Commission's analysis suggests that start-ups and innovative SMEs are seriously affected by many market failures; in particular they face very tight funding constraints. This justifies a special form of state aid for "innovative start-ups".

For the UK, we believe this is drawing a too general conclusion from what may be instances of market failures. The new regime proposed is in our view overly complex. More fundamentally it rests on an "innovativeness criterion" which is unworkable and unenforceable. It requires a judgement to be made on the current state of art in the particular industry on which there are likely to be conflicting views given by different consultants employed.

We see a significant risk that aid given under this criterion will simply be used to subsidise routine operating expenses incurred by any SME.

We are also concerned by the proposal to base any exemption on social contributions and other local/regional taxes since these vary widely between Member States and the effect could be to discriminate against a Member State with low social contributions and no local taxes.

The objectives we suggest could be far better met by employing the existing state aid instruments.

Supporting technological experimentation (Q9 & Q10)

We believe that the proposed rules are again overly complex and will be too vague to be enforceable. Defining a specific activity as an "experimental development stage" which could be eligible for new state aid does not appear to us to be realistic. Each industry will develop products in a different way and establishing a single criterion that is universally applicable would seem impossible. There may also be a tendency to define the criterion in a way which fits the older established industries but which will be quite inapplicable to the development of software or a biotechnology product.

Also the requirement that the aid must relate to products or processes that carry a risk of technological or industrial failure could apply to any product being introduced to the market.

We suggest that this proposal be withdrawn.

Innovation intermediaries (Q13)

We broadly support the proposed initiative to provide state aid to SMEs through innovation intermediaries as we consider this could help to address a market failure. The proposed "innovation services voucher" up to a maximum of €200,000 over three years is relatively modest and should be non-distortive. Any aid given directly to innovation intermediaries would be problematic as it could distort competition between them.

It will be important that the rules of eligibility are simple and straightforward. We also suggest that a review of the take-up and cost-effectiveness be carried out after a period of 3 years.

Personnel transfers (Q14 & Q15)

We consider it will be far simpler to provide aid to acquire services through "innovation intermediaries" than for the transfer of personnel. This area is legally very complex with substantial differences in the laws of Member States. The suggested rules, such as that covering the case where a researcher decided not to return to his/her home university, would require the micro-management of state aid in a totally inefficient and inappropriate way.

We recommend that this proposal be withdrawn.

Development of poles of excellence – clustering (Qs 16-20)

There are attractions in using public funding to promote clustering of innovative high-technology companies as a way improving EU competitiveness. However it is not obvious that there are market failures which justify the application of state aid.

The existing successful clusters in Europe appear to have developed organically, often around world-class universities. It would be wrong in our view to attempt to replicate these by modifying the regional state aid rules. This could amount to an attempt to "pick winners" on a grand scale and be a highly risky use of taxpayers' money.

We agree that any state aid given to clusters should be to SMEs. Any state aid to large companies has the potential to be distortive and should be notifed.

There is a proposal that intellectual property rights (IPR) should be allocated between partners on a pro rata basis. While it is understandable that the value of the IPR should be shared, it is likely to be more practical for the ownership of the IPR to vest in one of the parties. This makes licensing and enforceability easier.

It is proposed that state aid should only be granted where it can be shown that the benefits of clustering outweigh its negative impacts on competition. We are not clear how this could be evaluated in practice. For existing clusters, such benefits will already have been achieved and the possible benefits of new clusters may not be measurable for a long time.

It is important in our view to consider the opportunity cost of providing state aid for clusters. Rather than using the route of state aid there could well be a far more effective use of public funds through improvements in planning consents, transport infrastructure, housing and schools. Cambridge, which is one of best-known clusters in the EU, has experienced problems in these areas due to its successful growth.

In summary, we believe that while the proposed special measures to support clustering are well-intentioned they lack sufficient justification and it would be preferable to rely on existing state aid instruments.