State Aid in Support of Innovation

Report of EIN Working Breakfast 29 January 2014, Brussels

Chair: Maria da Graça Carvalho, MEP

Rapporteurs: Richard L. Hudson and Florin Zubașcu, Science|Business

ABSTRACT:

EU state aid rules have a real impact on how and when innovation happens. Therefore, it is very important that these rules are clear and easy to follow. Different aspects of the design of state aid rules and their impact on innovation were thoroughly discussed at this EIN working breakfast.

INTRODUCTION:

It can be difficult to reconcile policy for state aids and that for research & innovation. But the Commission's process of modernisation of the state aid rules is set to change that, the Chair said. The new rules are intended to close the knowledge gap and to keep stakeholders informed.

The regime for state aid has become more relevant to innovation policy since the Horizon 2020 programme has been put in place. Now, it will be easier to combine state aid with other funding sources such as Horizon 2020. Moreover, there are provisions in the state aid rules that secure the financial coverage of the entire chain of innovation, from research to market.

Different funds have to be put together in in order to support large, innovative research projects, the Chair argued. Horizon 2020 funds, regional funds, EIB funds, and other sources can complement each other to support large-scale projects that can drive innovation in Europe. The keynote of Prof. Pierre Larouche covered the main implications for innovation of the new state aid rules. A debate followed.

EXPERT VIEWS:

- **Keynote**: **Pierre Larouche**, Professor of Competition Law, Tilburg University

Larouche addressed a number of questions that are essential for those who want to know how Europe can have more innovation. The questions were related to the underlying situation of innovation, the market and government failures relating to innovation, and how to reduce the gap between research and market.

Do we have too little or too much innovation in Europe? he asked rhetorically. Of course, the answer is obvious in the European context: we know for a fact that we have too little R&D spending and too little innovation. While the underlying policy concern is the shortage of innovation in Europe, it is surprising to see in certain parts of the state aid framework that the main concern seems to be to prevent excessive spending, Larouche said. In hindsight, from a static perspective, some economists may say that there was excessive spending to get to the point where we are now in terms of innovation, but *ex ante*, this is hard to predict. It might be preferable to generate pressure and incentives to innovate and to invest now, even at the risk of overspending, he added. However, the pressing worry is not how much money is spent on innovation, but rather how that money is spent, i.e. whether that money is spent on increasing the chances of supporting successful projects with an innovative output. From the experience of venture capitalists, we know that most projects are unsuccessful, so managing to support a few successful projects is already quite an achievement). Getting to know how to use resources on the right projects requires a whole different set of solutions.

Innovation is not just another day at the office, he continued. It is a non-linear, unpredictable process; and this is why the Commission cannot expect that innovation will arise only if the necessary money and resources are put at the ready. Indeed, a lot of money can be spent on R&D, but that does not guarantee that there will be innovation at the end of the process. The tricky part is to successfully bring to the market the ideas that come out of R&D. But, one should keep in mind that an idea does not always translate into innovation, and that a product that is successful on the market is not necessarily innovative. Of course, the greater the amount of invested resources, the greater the likelihood of innovation occurrence, but it is also important to ensure that, *ex ante*, all potential innovators feel that they have a chance to get their idea to the market. State aid complements other available funds, and it is unlikely that State aid for innovation will lead to the crowding out of private funding, he added.

State aid is supposed to remedy static market failures such as knowledge spill-overs, asymmetric information, and coordination and network failures. Because of these failures potentially good projects might not get funded, and it is in these particular situations where state aid can help. An important question that arises is whether public authorities can really remedy market failures of this sort, considering that they often do not possess the knowledge required to identify genuine market failures related to innovation. Indeed it is questionable whether there really is a market failure to be remedied, at least for the cases outlined in the draft State aid guidelines draft. Private investors simply might have concluded that this is not the right project for them to fund. Perhaps it would be a good idea to channel state aid for innovation via public-private mixed funds, where you have venture capital involved, and simply rely on the specialisation of venture capitalists in spotting projects that have prospects of succeeding, Larouche said.

Indeed, reliance on the private sector to select investment-worthy projects is vital. "Work in partnerships, work with tax exemptions which free-ride on decisions made by private actors. It's not that private actors are superior, but they spend more time doing this and they have a bit more expertise", Larouche said. Another problem that needs to be solved is clearly the issue of scalability. Ideally people with good ideas should be able to quickly go to the half- billion person European market at least as quickly as the Americans can go to a market of 300 million, he added.

THE DEBATE:

MEP Cristina Gutiérrez-Cortines started the debate, saying that civil servants and the structure of governments are not prepared for innovation, mainly because governments do not know as much about how markets work as private actors do. "Governments are not in the market", she said, and there is a need for a new kind of governance prepared to support innovation. The Chair agreed that despite the fact that it has a good structure for research, industry and energy, Europe indeed lacks a good structure for innovation, and this is why the future of financing innovation is uncertain. The Commission, together with the member states, should put in place an infrastructure for financing innovation – keeping in mind that innovation is a very complex non-linear process, the Chair added.

But the EU has the capacity to solve these issues. Eliana Garces Tolon, a deputy unit head in DG Enterprise, gave the example of EU policy towards renewables. She said that immediately after the EU set a politically binding objective in the field of renewables, more funds were granted with fewer restrictions from the state aid framework to any project that seemed to work towards that political objective. A very specific political commitment towards an objective has immediately had an effect towards a much more flexible state aid implementation. This shows that the European Commission will be sensitive to EU sanctioned political objectives when it regulates on State Aid.

Referring to Larouche's comments on the problem of scalability, Garces Tolon argued that innovation needs much more than increased expenditure; it needs an easy access to the market via more dynamic start-ups. The economic structure in Europe is a lot more rigid than in other parts of the world, and the fact that we do not have an internal market is a big deterrent because the scalability of good ideas is not the same in Europe as in the US or in China, she added.

But ultimately, the most stringent issue is that of governance. Garces Tolon argued that the EU does not have a good governance model for innovation because people do not talk to each other enough. Policymakers, regional governments have to be better connected to industry and research because innovation is a lot more than expenditure - is an entire ecosystem, she added.

MEP Maria do Céu Patrão Neves noted that increasing demands are being placed on researchers to deliver innovation – but many will not be able to do so. She question what the consequences might be for the teams involved in such research projects. Public support might be cut for those projects not able to deliver. So, are we ready to see this kind of consequence?

CONCLUSIONS:

- There is an inherent potential conflict between public funding for innovation and restrictions on state aid. But the overriding policy concern should not focus on the risk of overspending, but rather on how to concentrate the money towards successful projects that can have an innovative output. The investment expertise of the private sector can help guide these decisions.
- State aid complements other available funds and offers an opportunity to all those who feel that they have a chance to get their idea to the market;
- Channel state aid for innovation via public-private mixed funds, where venture capital is involved. Rely on the specialisation of venture capitalists in spotting projects that have prospects of succeeding.
- A problem that needs to be solved is lack of scale in many European markets for innovation. Ideally people with good ideas should be able to quickly go to the entire EU market rather than be stranded in their home country.
- More work is needed to improve the basic framework for innovation in Europe. The Commission, together with the member states, should put in place better infrastructures for financing innovation – keeping in mind that innovation is a very complex non-linear process.