

**Opinion of the European Economic and Social Committee on the 'Communication from the Commission — Consultation document on state aid for innovation'**

(COM(2005) 436 final)

(2006/C 65/16)

On 21 September 2005 the European Commission decided, under Article 262 of the Treaty establishing the European Community, to consult the European Economic and Social Committee on the *Communication from the Commission — Consultation document on state aid for innovation*

The Bureau of the European Economic and Social Committee instructed the Section for the Single Market, Production and Consumption to prepare the work on the subject.

Given the urgency of the work, the European Economic and Social Committee appointed Mr Pezzini as rapporteur-general at its 422nd plenary session of 14 December 2005, and adopted the following opinion by 80 votes in favour with two abstentions.

## 1. Summary and recommendations

1.1 The Committee welcomes the consultation document on state aid for innovation, through which the Commission intends to establish a framework of legal certainty, as well as defining criteria for the granting of more targeted aid and achieving a simplification of the regulatory context.

1.1.1 The EESC is aware that the Commission document opens up for the first time a thorough debate on matters which are now extremely topical:

- what we mean by innovation;
- where the dividing line is between the innovation phase which qualifies for aid and the marketing phase;
- what action is appropriate to allow SMEs to compensate for the well-known limitations on their growth;
- in the present process of globalisation, how our main partners behave in the matter of innovation, and what limits we have imposed on ourselves by adhering to the WTO rules.

1.2 The answers to these questions will influence the new legal framework to be proposed by the Commission; this framework will need to reflect the commitment of the Member States to combine development and progress on the one hand with respect for the rules, especially those of competition, on the other.

1.3 The insufficient competitiveness of Europe is largely due to a modest level of innovation, often resulting from market failures. In these cases state aid can help to stimulate the actors of the market itself to invest more in product and process innovation <sup>(1)</sup>.

<sup>(1)</sup> In 2003 the export of high-technology products as a percentage of total exports was: for the EU-25 17.8 %; for Japan 22.7 %; for the USA 26.9 % (Source: Eurostat, Science and Technology 8/2005).

1.4 The alternative to innovation is the decline of the Union in cultural and economic terms. The EESC is fully aware of this and, through the participation of its members in the various sectors of organised civil society, it is endeavouring to ensure that (partly through proper use of state aid):

- the externalities of the market are overcome or guided;
- entrepreneurial initiative is strengthened;
- suitable measures are identified in the various fields to help micro, small and medium sized enterprises and make them innovative;
- entrepreneurs and operators working in the social sector are helped to understand and use the innovations which are constantly being made in the process of globalisation of the markets;
- forms of private enforcement are developed, facilitating respect for, and full application of, the rules <sup>(2)</sup>;
- practical form is given to the European Research Area (ERA), through the coordinated action of the technological poles and the advanced training schools, so as to disseminate and apply the results of the research <sup>(3)</sup>;
- instruments and means are used to take action on initial and continuing training to adapt professional capacities to the constantly innovating requirements of the market, to help society to understand the constant changes and to disseminate and consolidate the principles of the social responsibility of enterprises <sup>(4)</sup>.

<sup>(2)</sup> INT. 268

<sup>(3)</sup> The objective is to overcome the 'European paradox': we are in the forefront of research, but we are weak in the commercial use of research results.

<sup>(4)</sup> Cf. Green Paper on the social responsibility of enterprises.

1.5 Up to now the Commission has not issued specific rules on state aid for innovation. In accordance with Articles 87 and 88 of the Treaty, it has taken account of innovation in the context of other categories of aid: aid for regional purposes, aid for training, investment capital measures, aid for employment, measures to assist SMEs.

1.5.1 To some extent innovation came under the heading of state aid for research and development <sup>(5)</sup>, which was extended from 30 June 2002 to 31 December 2005 <sup>(6)</sup>.

1.6 On many questions raised here by the Commission the EESC has already given its views unanimously or by a large majority in earlier opinions:

- to grant the appropriate state aid to remedy market failures;
- to take action to compensate for the limits of externalities;
- to agree on shared criteria for drawing up ex-ante assessment criteria, particularly in the field of SMEs;
- to regard innovative processes as important not only in the technological field but also in the field of services, commerce and administration, product and process innovation;
- to provide for increases in aid for innovation in the cohesion regions and in the areas with geographical difficulties (mountain areas, islands and isolated rural areas), partly through the proper use of 'tax advantages' (less burdensome tax treatment) of a regional nature <sup>(7)</sup>;
- to develop and maintain new forms of financial aid for SMEs, such as the development of microcredits and support for operating credit, the securisation of credits, and sureties for micro and small enterprises, which find it difficult to obtain access to forms of risk capital given their company form which is generally personal;
- to support organisations which assist the innovation activities of micro, small and medium-sized enterprises with advice and practical measures;
- to train, partly with public funds, professional experts in the various fields of knowledge capable of assisting micro and small enterprises by guiding them towards innovation

processes;

- to strengthen the centres of excellence with public/private investments and encourage their links with enterprises and with the academic world.

1.7 The Committee has already had occasion to emphasise that state aid intended to encourage investment in innovative projects carried out by SMEs must also take account of the growth of the enterprises and of:

- support for regional and transregional innovation networks;
- promotion of the policy of industrial districts and technology parks;
- the involvement of business angels and service intermediaries such as venture technologists, brokers and patent advisers;
- the setting up of centres for transfer of technology and venture capital;
- the training and hiring of skilled technical staff <sup>(8)</sup>.

## 2. Reasons

### 2.1 Summary of the Communication

2.1.1 The Commission's aim is to open up a debate leading to an improvement in the Community rules on state aid for innovation projects.

2.1.2 The Commission anticipates and clarifies its position on six general sectors:

- support for the creation of innovative enterprises and their growth in the initial phase;
- the use of risk capital;
- ways of integrating in the existing system the innovation which is introduced into research and development projects;
- aid to SMEs to enable them to acquire services provided by specialised bodies acting as innovation intermediaries;
- aid to SMEs to enable them to benefit from the assistance of highly skilled researchers and engineers and to make possible effective exchanges with universities and large enterprises;
- promotion and development of poles of excellence, likely to be useful to all firms and to attract private investors.

<sup>(5)</sup> OJ C 45 of 17 February 1996 as amended by OJ C 48 of 13 February 1998.

<sup>(6)</sup> OJ C 111 of 8 May 2002.

<sup>(7)</sup> Cf. financial engineering and the social function of credit.

<sup>(8)</sup> INT. 268.

2.1.3 Provided that:

- the aid is intended to overcome a well-defined market failure;
- the aid is the most suitable instrument;
- the aid stimulates the beneficiaries to innovate and is proportionate to the problem addressed;
- distortions of competition are limited.

## 2.2 The current situation

2.2.1 In its earlier opinions the EESC always underlined the importance of controlling state aid with a view to bringing about in the EU:

- a competition policy leading to convergence between the various economies of the Member States;
- a business approach based on innovation and entrepreneurship;
- a careful cohesion policy which takes account of the less favoured regions;
- sustainable growth which respects the need to improve labour conditions, enterprises and the environment.

2.2.2 While on the one hand competition policy<sup>(9)</sup> is essential to ensure that the internal market functions and develops properly, without distortions caused by discriminatory rules, on the other hand state intervention can be desirable and necessary to compensate for the limits of the market and market failures.

2.2.2.1 The Lisbon strategy itself, revisited and enriched with new pragmatism in the spring of 2005<sup>(10)</sup>, calls for special attention to be given to:

- market failures;
- economic and social cohesion;
- sustainable development;
- innovation.

2.2.3 The level of state aid has fallen slightly in recent years<sup>(11)</sup>, and above all it has been directed mainly towards horizontal objectives. In 2003 horizontal aid represented 79 % of all aid; within this percentage, 14 % was allocated to research and development<sup>(12)</sup>. This was also noted by the

<sup>(9)</sup> Treaty, Title VI, Section II: Competition, taxation and approximation of laws.

<sup>(10)</sup> COM(2005) 24 final of 2 February 2005. The Member States should reduce and reorientate state aid to overcome market failures in the sectors which have potential for growth and to stimulate innovation.

<sup>(11)</sup> In the period 1999-2001, it represented 0.61 % of the Community GDP, and in the period 2001-2003 0.59 % COM(2005)147 final of 20 April 2005.

<sup>(12)</sup> Source: COM(2005) 147 final, 20 April 2005, Table 7: 23 % to environment and energy saving; 21 % to regional development; 13 % to SMEs; 3 % to training; 3 % to employment; 2 % to culture and protecting the heritage.

European Council of March 2005, which reaffirmed the need to grant suitable derogations where they may be necessary to compensate for market failures.

2.2.3.1 The European Parliament, in its resolution on Strengthening European competitiveness: consequences of industrial changes on the policy and role of SMEs<sup>(13)</sup>, also expresses satisfaction at the reduction in the overall volume of aid and reaffirms the usefulness of aid allocated to research, development, training and advice for small enterprises.

2.2.4 In the context of the process of reforming the aid system<sup>(14)</sup>, on which the EESC has also given its views<sup>(15)</sup>, the European Parliament reaffirms the need to work out a clear line of action on reform of state aid for innovation, understood in its widest sense rather than being restricted to technological aspects<sup>(16)</sup>, and capable of operating horizontally in all sectors which can make a substantial contribution to the Lisbon strategy, including the commercial and services sector.

2.2.5 The EESC emphasises the fact that in 2004 the Commission presented a number of structured proposals for a general reform of aid which take account of market failures. These proposals, also supported by the Committee, are becoming reality through the communications already issued.

2.2.6 Moreover, the EESC is fully aware that the situation in this field is very dynamic, because it is subject to variations in the political, social, economic and legal framework and to the acceleration of the process of globalisation of the markets. Suitable periodic adaptations are therefore necessary<sup>(17)</sup>, while maintaining clarity and transparency of the legal reference framework.

2.2.7 In terms of globalisation of markets special attention should be given on the one hand to the multilateral reference framework of the WTO and on the other to that of Europe's main trading partners.

2.2.8 In the United States of America, the United States Small Business Administration (SBA) grants small and medium-sized enterprises, through a number of federal public programmes, various forms of aid for innovation, to which must be added the aid granted by the individual states as well as the federal initiative known as the Small Business Innovation Research Programme — SBIR.

<sup>(13)</sup> Resolution PE\_6TA (2005) 0230 (EP report A6-0148/2005 of 12 May 2005, Point 36).

<sup>(14)</sup> COM(2005) 107 final 'Action plan on reform of state aid'.

<sup>(15)</sup> INT. 268.

<sup>(16)</sup> Cf. note 5, EP Resolution, Point 50.

<sup>(17)</sup> Cf. SEC(2005) 795 of 7 June 2005.

2.2.8.1 The SBA runs a series of programmes:

- Basic Loan Program, providing guarantees (up to 75 %) for loans which can amount to as much as 2 million dollars per enterprise
- SBA Investment Program, for Angels Capital and Venture Capital investments
- Certified Development Company '504' Loan Program, with aid for innovation and modernization up to 4 million dollars
- Microloan Program, with short term aid up to 35 000 dollars through intermediaries
- Prequalification Loan Program, with aid up to 250 000 dollars, through intermediaries
- Export Working Capital Program, with 90 % guarantee, up to a maximum of 1.5 million dollars
- SBA Express, with aid up to 350 000 dollars and 50 % guarantee
- SBA Community Express, with aid up to 250 000 dollars and 75 % guarantee
- SBA Secondary Market Program and SBA Asset Sales Program, to facilitate access to the shares market
- SBA Women's Network for Entrepreneurial Training Initiative, to train women entrepreneurs.

2.2.8.2 The SBIR initiative, concerned with the granting of public aid to innovation and research in smaller enterprises, provides seed capital assistance for feasibility studies, of amounts up to 100 000 dollars in the first phase and up to 750 000 dollars in the second phase in which prototypes are being developed; for the third phase, no action by the SBIR funds is envisaged, but mechanisms for finding public and private funds come into play for the marketing phase.

2.2.9 Recent **recommendations by the EURAB**, a consultative body set up by the European Commission which brings together the European academic and business worlds, have emphasised the need to adopt a similar mechanism at Community and Member State level to supplement the actions of the RTD&D framework programme, stressing that 'This may require a **revision of EU rules for state aid.**'<sup>(18)</sup>

2.2.10 In Japan, the Agency for Small and Medium-sized Enterprises provides various types of public support for innovation, such as:

- the Start Up programme, which covers part of the costs of practical application of R&D, technological assessment,

acquisition of patents (50 % reduction of registration and renewal costs for 3 years);

- the Creative Technologies R&D programme;
- the Local Revitalisation R&D programme;
- the programme to promote cooperation between industry, the academic world, government and other public officials;
- the Small Business Innovation Research System, the Japanese SBIR, which has the aim of promoting the development of SMEs' technological capacity, granting public aid for their creative activities and financing the marketing of the research results;
- the programme which supports with public funds the introduction and development of information technologies in enterprises;
- the 'Subsidies for SMEs Business Innovation' programme;
- the 'Subsidies for Strengthening SMEs Business Resource' programme;
- the 'Credit Guarantees Exemption' programme;
- measures to reduce interest rates on credits provided by the Japan Finance Corporation for Small and Medium Enterprise (JASME), the National Life Finance Corporation (NLFC) and the Shoko Chukin Bank;
- the tax concessions plan for SMEs;
- the investments plan up to 300 000 Yen, by the 'Small and Medium Business Investment and Consultation Companies';
- the incentives plan set up by the law on 'Promotion of Improvement of Employment Management in Small and Medium-sized Enterprises for Securing Manpower and Creating Quality Jobs'.

2.2.11 With regard to the **Multilateral WTO Agreements**, the concept of 'specific state aid' is defined as a subsidy which may be granted only to an enterprise, an industry or a group of industries in a state granting the subsidy. WTO rules apply only to such aid, with the exception of the agricultural sector, and two categories are envisaged: **prohibited aid and actionable aid.**

2.2.12 **Prohibited aid** is aid intended to favour exports or to favour national goods over imported goods, distorting international trade and thus hampering the trade of other countries: such aid is subject to WTO assessment by accelerated procedure for the abolition of the aid measure or for tariff counter-measures to be adopted by the disadvantaged country or countries.

<sup>(18)</sup> EURAB – European Research Advisory board, 02.053 final 'improving innovation' 2005.

2.2.13 As regards **activable aid**, a country bringing a complaint against an aid measure activated in another country must demonstrate that the aid has had a negative effect on its legitimate interests, on the basis of three types of 'damage' <sup>(19)</sup>. If not the state aid measure is authorised. In the case of damage proved and recognised by the Dispute Settlement Body the country which has activated the aid must abolish it. Otherwise the complainant country has the right to impose compensatory tariffs.

### 2.3 General comments

2.3.1 The Committee welcomes the Commission proposal to identify the relationship which exists, and which can be improved, between state aid and innovation in Europe. It is clear that the insufficient competitiveness of the EU in comparison with other actors in world trade derives to a large extent from a weak innovation process; this weakness is made more acute by globalisation processes.

2.3.1.1 The Committee is also pleased that the issues linking state aid to innovation are the subject of a public consultation capable of enlisting the opinion of those most directly concerned on this delicate subject.

2.3.1.2 The questions included in the communications are wide-ranging, well formulated and cover most of the issues which can arise from market failures and the possibility of simplifying the procedures. The short time available and the lack of study group discussion do not allow the rapporteur to go into the detail of the individual questions or give a fully argued answer to each of them.

2.3.2 The Committee is aware of the fact that state aid for innovation does not on its own constitute a solution to the problem of the EU's competitiveness. Many Community documents and a number of Committee opinions have shown the limits to the European Union's action:

- insufficient level of technological and other innovation;
- insufficiency of common rules and measures;
- weakness of financial markets, which are still too fragmented;
- too low a level of employment;
- malfunctioning of the products market;
- lack of coordination of policies;
- difficulty in access to market services;

<sup>(19)</sup> The agreement defines three types of damage they can cause. One country's subsidies can hurt a domestic industry in an importing country. They can hurt rival exporters from another country when the two compete in third markets. And domestic subsidies in one country can hurt exporters trying to compete in the subsidizing country's domestic market.

— inadequate support for new products or productive combinations which create added value, and of quality jobs capable of guaranteeing the European comparative advantage <sup>(20)</sup>.

2.3.3 This has led to some legal uncertainty, which can be overcome only through careful consideration of the limitations and potential advantages of state aid in this sector.

2.3.4 Product and process innovation, in all its aspects <sup>(21)</sup>, eventually has an effect on the market and is therefore in a position to influence activities which could affect competition and trade in a significant way.

2.3.5 Thus, in order to be able to give authorisation in advance, one must be in a position to work out a transparent and agreed specific reference framework, in a spirit of partnership and proactive cooperation, between the Commission and the Member States.

### 2.3.6 The definition of innovation and the innovative process

2.3.6.1 The EESC is aware that the definition of innovation given in the Green Paper some time ago should be up-dated to take account of the changes which have occurred in the last ten years. It is also necessary to analyse the stages between the processes of innovation and the limit beyond which the marketing stage begins, so that the rules of competition are not unduly distorted.

2.3.6.2 There was a time when the development of society was too slow to be perceived in the space of one lifetime. Today it is so rapid that it is difficult to understand. Societies as a whole, but above all enterprises, administrations and services are today undergoing a formidable series of changes which tend to confuse acquired knowledge.

2.3.6.3 Innovation thus becomes a social process through which the people, bodies and organisations with most knowledge, because they are given the task of exploring it, help the 'others' to draw the appropriate conclusions and transfer them to their professional activities and daily lives.

2.3.6.4 If Utopia is a project for the future, innovation is the verification of all utopias <sup>(22)</sup>.

2.3.6.5 After the Green Paper, the Commission has rightly defined innovation as: 'The successful production, assimilation and exploitation of novelty in the economic and social spheres' <sup>(23)</sup>.

<sup>(20)</sup> EP, Committee for Employment and Social Affairs. Opinion for the ITRE Commission A-6 0148/2005, Point 4.

<sup>(21)</sup> Cf. Green Paper on innovation COM(95) 688 final.

<sup>(22)</sup> Cf. Oscar Wilde.

<sup>(23)</sup> COM(2003) 112 final.

2.3.6.6 Innovation is a complex process. Alongside the development of research activities and a better application of technology, many other factors and conditions, sometimes changeable, help to generate innovation, and among these can be mentioned:

- an enterprise culture orientated towards innovation;
- the system of relationships and interrelationships with other enterprises, organisations and public bodies, essential for the creation and dissemination of knowledge and innovation;
- the legal and regulatory framework of reference, especially on intellectual property;
- access to the capital market, especially with regard to risk capital and the start-up phase;
- education and training services and the relations between the academic and scientific world and the enterprise;
- support structures (such as incubators, district networks, industrial and technological parks) and intermediary structures for innovation.

2.3.6.7 The Committee has already had occasion to state that innovation is a social process<sup>(24)</sup>, which is based on research, takes place in a system of competition and acquires space when it exists in a diffuse way, a positive attitude towards change and risk. The results are an increase in competitiveness, better cohesion and greater socio-economic well-being.

2.3.6.8 In order to have objective criteria to go on, the Committee asks the Commission to specify better, with the help of the representative organisations of civil society, and with coordination by Eurostat, which production and services activities can be included among the activities which it is possible now to define as innovative. It would indeed be extremely useful to have guidelines for this complex and changeable sector.

Brussels, 14 December 2005.

2.3.6.9 **Aid for innovation** (according to the definition in the Green Paper<sup>(25)</sup>). In the view of the Committee, which has already had occasion to give an opinion on it<sup>(26)</sup>, the existing framework should be extended to new types of aid not envisaged by the current guidelines, and further compatibility criteria should be identified, leaving greater room for manoeuvre to the Member States, with no obligation to notify.

2.3.6.10 The Communication emphasises the special needs of the SMEs, repeatedly mentioned by the documents of the European Parliament, the Council, the EESC and the Commission itself. The EESC is also convinced that a real stimulus to competitiveness can come above all from innovative, practical and targeted actions directed towards micro, small and medium-sized enterprises.

2.3.6.11 In small as in large firms, innovation processes need the support of all the staff, with commitment at the various levels. This can happen if there is an environment sensitive to cooperation and if people are able to accept with interest the incentives to try something new. Continuous training is essential to achieving this.

2.3.6.12 In the EESC's view it is necessary for all Member States to increase their efforts to make science more comprehensible and to increase the number of young people taking an interest in it<sup>(27)</sup>. Television programmes could also make a considerable contribution to innovation culture<sup>(28)</sup>. Through training, including by television, the ability to communicate can be strengthened with a view to informing better and hence to innovating and competing. Targeted information expressed in accessible terms helps to make people more aware of science, and to generate innovation.

The President  
of the European Economic and Social Committee  
Anne-Marie SIGMUND

<sup>(24)</sup> Cf. Opinion on the Green Paper on innovation, Sirkeinen, Konitzer, OJEC C 212/1996.

<sup>(25)</sup> COM(1995) 688 final.

<sup>(26)</sup> INT. 268.

<sup>(27)</sup> In 2003 27 % of the active population of the EU-25, about 50 million people, worked in the specialist and technical field, RHSTO (Source: Eurostat, Science and Technology, 11/2004).

<sup>(28)</sup> According to statistical data, 7 people out of 10 glean their information from television channels.