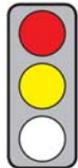


MAIN ISSUES

Objective of the Communication: The Commission would like to improve the framework conditions for research and innovation as well as to coordinate and encourage innovation activities more effectively.

Parties affected: Companies, universities, research institutions, national and regional authorities.



Pros: A “European Research Area” would foster cross-border research activities and thus increase the innovation potential in Europe.

Cons: (1) The instrumentalisation of public procurement for the promotion of innovation leads to a massive distortion of competition and promotes a subtle form of protectionism.

(2) The Commission completely fails to provide an explanation as to why it deems competitive markets incapable of finding efficient solutions to “major societal challenges”.

(3) Planning innovation through “European Innovation Partnerships” that it propagates instead, could be misused for industrial policy purposes and also lead to distortion of competition.

CONTENT

Title

Communication COM(2010) 546 of 6 October 2010: **Europe 2020 Flagship Initiative – Innovation Union**

Brief Summary

► Background and objective of the flagship initiative “Innovation Union”

- According to the Commission, “major societal challenges” (e.g. climate change, energy scarcity and demographic change) can only be overcome through research and innovation.
- Although “Europe starts from a position of strength” (p. 6), the Commission believes it should do much better: if by 2020 the EU spends 3% of its gross domestic product (GDP) on research and development (R&D investment target) (in 2008: 1.9%), its annual GDP could be increased by 800 billion Euros by 2025 and 3.7 million jobs could be created.
- The Commission strongly believes that national and regional research and innovation programmes need “significant” reforms (p. 28). With the flagship initiative it wishes to initiate the establishment of an “Innovation Union”, for which it presents concrete measures (see [CEP Overview](#)).
- In so doing, it employs a “broad” concept of innovation, including not only technical innovations but also “innovation in business models, design, branding and services that add value for users and where Europe has unique talents.” (p. 7)

► Improving the framework conditions for innovations

– Establishing a “European Research Area” to promote academic excellence

- The Commission urges the establishment of a “European Research Area” by 2014. The aim is to create an internal market for research (“fifth freedom”), as to date both universities and research institutions and individual researchers find themselves faced with regulatory obstacles when operating at a cross-border level (e.g. when enforcing pension rights in other Member States).
- The Commission emphasises the important role of a world-class infrastructure for ground-breaking research. Due to increasing complexity and economies of scale, national research efforts should be pooled at European or, if necessary, at global level. The Commission mentions the European Strategic Forum on Research Infrastructure (ESFRI) as a positive example, in which since 2002 the EU has been coordinating projects aimed at establishing a joint research infrastructure.
- Therefore the following measures, amongst others, are proposed:
 - In 2012, the Commission will propose a “common approach” (p. 11) regarding the European Research Area in order to facilitate cross-border research activities.
 - By 2015, Member States and the Commission are to ensure jointly that 60% of the research infrastructure proposed by ESFRI is complete.

– Enhancing access to finance

- Innovative companies should mainly be financed through private capital. According to the Commission, to date the EU invests about 14 billion Euros a year less in venture capital than the US.
- Amongst others, banks are responsible for this situation, for they are “reluctant” to lend to knowledge-based companies that lack collateral (p.13); the situation has been exacerbated by the economic and financial crisis.
- Public means must also be used for the financing of innovative companies. This holds true particularly where “market gaps” exist regarding finance.

- The Commission has identified the following “market gaps“:
 - “Market gap” 1: Many companies fail immediately after their start-up phase. Particularly critical in terms of finance is the phase when public research grants stop and private capital is not yet available (“valley of death”).
 - “Market gap” 2: Surviving companies often fail to expand into further markets as venture capital funds are too small to operate on a transnational basis.
 - “Market gap” 3: Even well-established companies, irrespective of their size, are unable to obtain higher risk loans, as banks find it difficult to assess knowledge assets exactly, e.g. intellectual property.
- Therefore, the Commission will amongst other things:
 - In 2011, present ideas as to how access to EU funding instruments [e.g. the Competitiveness and Innovation Framework Programme (CIP)] can be “radically” simplified “through a better balance between a control-based and a trust-based system” (p. 12).
 - In 2011, conduct a mid-term review of the state aid research and development and innovation framework ([2006/C323/01](#)) to clarify which forms of innovations can be “properly” supported (p. 15).
 - By 2014, propose new “financial instruments” to attract a “major increase” in private finance (p. 14). In so doing, the Commission will work with the European Investment Bank Group (EIB), national financial intermediaries and private investors.
- **Creating a single innovation market**
 - Public procurement accounts for a volume of 17% of GDP in the EU. Hence, the EU has an “enormous and overlooked opportunity to spur innovation using procurement” (p. 16). Amongst other things, this is due to the public sector’s disinclination to take risks.
 - “Smart” regulation in the form of standards can be a key driver for innovation, e.g. for eco-vehicles [COM(2010) 186; see [CEP Policy Brief](#)]. However, in the EU it takes a long time to agree on standards (see [CEP Policy Brief](#) on harmonisation processes in the EU).
 - The main obstacle to introducing innovation is costly patenting: the registration of a patent is at least 15 times higher in the EU than in the USA. The absence of a cheap and simple EU patent is “a tax on innovation”. (p. 15)
 - According to the Commission, the following measures are therefore required:
 - From 2011, Member States and regions should take special account of innovative products and services in public procurement. This should equally apply to “pre-commercial” procurements to develop new, not yet existing products and services. The Commission demands an EU-wide procurement volume of 10 billion Euros a year.
 - In 2011, the Commission will present a proposal to speed up standard-setting.
 - In 2014, the first EU patent is to be delivered. To this end, the European Parliament and the Council should adopt the legislative proposals on the EU patent, translation rules and the uniform litigation procedure [COM(2010) 412 and 350 as well as Council Document 7928/09; see [CEP Policy Brief](#) and [CEP Monitor](#), in German only].
- ▶ **“Smart Specialisation”**

The European Structural Funds are to provide 82 billion Euros for R&D for the period 2007-2013. The Member States and regions should focus on their relative strengths in order to “become excellent” in these areas (“smart specialisation”) (see also [COM(2010) 553]). The Commission wishes to “help” establish a “smart specialisation platform”. (p. 21)
- ▶ **“European Innovation Partnerships”**
 - In order to tackle “grand challenges” which “clearly” (p. 23) justify government intervention, “European Innovation Partnerships” are to be initiated.
 - In view of the scale of the challenges, it is inappropriate to rely only on competitive markets for finding solutions. As failing to deal “adequately” with these challenges is a “political unacceptability” [see SEC(2010) 1161, p. 68].
 - All “key stakeholders” (p. 24) should be pooled in committees of “European Innovation Partnerships” headed by the Commission. Their aim should be to increase and coordinate investments in R&D and to identify possibly necessary regulation and standardisations as well as to better co-ordinate public procurement to speed up the introduction of innovations into the market.
 - Partnerships should focus on “societal benefits” and a “rapid modernisation of the associated sectors and markets” (p. 23).
 - The Commission proposes launching a pilot project partnership on “active and healthy ageing”. Its aim should be to increase by 2020 the number of “healthy life years” (p. 26) by two and thus to improve the sustainability and efficiency of social and healthcare systems.
- ▶ **Measuring and monitoring innovation progress**
 - The Commission will measure innovation progress in particular by means of a new indicator which takes into account “fast growing innovative firms” (p. 29). This indicator will be developed by the Commission within the next two years.
 - The Commission admits that a “full monitoring” of innovation would require taking into account a number of indicators. Therefore, it will measure the overall progress of innovation using an additional indicator (“Research and Innovation Union scoreboard”). (p. 30)
 - The innovation progress in Member States will be monitored under the framework of the “European semester” – i.e. the planned economic policy coordination [COM(2010) 367; see [CEP Policy Brief](#)].

Statement on Subsidiarity by the Commission

The Commission does not address the issue of subsidiarity.

Policy Context

In 2000, the Commission first called for the establishment of a European Research Area [COM(2000) 6]; it is to be completed by 2020 (“Ljubljana Process”; Conclusions by the Council of 2 December 2008). In 2006, the Commission presented a “broad-based innovation strategy for the EU” [COM(2006) 502], in which it demands that public procurement be used for the support of innovation.

The “innovation union” now under proposal is one of seven flagship initiatives of the “Europe 2020” strategy. As a successor of the failed Lisbon Strategy, its aim is to transform the EU into a “smart, sustainable and inclusive” economy [COM(2010) 2020, p. 3; see [CEP Policy Brief](#)].

Options for Influencing the Political Process

Leading Directorate General: DG Research

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The development of innovative business models, products and services is in companies’ own best interests. It is the responsibility of politics to improve the framework conditions for company innovations. On the one hand, to start with the Commission achieves this:

Research results are a basic precondition for the development of innovative products and services. Hence, removing regulatory barriers to cross-border research activities through **the establishment of a “European Research Area” increases the potential for innovation.**

In order to implement basic research projects and when setting up superstructures for experiments, a coordinated approach at European level can be reasonable if the existence of economies of scale and of scope can be verified, e.g. in the case of a particle accelerator. Only to this extent is the Commission to be supported in engaging in the establishment of a common infrastructure as proposed in the framework of ESFRI.

The Commission’s understanding that innovative projects must generally be financed by private economy is correct. The measures announced by the Commission to improve the market for venture capital are therefore to be welcomed. In addition, the “market gaps” described by the Commission actually exist. However, it is all the more important which conclusions are drawn from this. The fact that banks are “reluctant” to lend credits to high-risk projects is understandable. However, this applies to the tax-payer, too. Therefore, somewhat alarming is if access to EU finance programmes is to be “radically” facilitated.

On the other hand, it is quite obvious that beyond an improvement of the framework conditions the Commission wishes to have a direct impact on companies’ innovation activities:

The instrumentalisation of public – in particular of “pre-commercial” – procurement to support innovation leads to massive distortion of competition to the benefit of allegedly innovative companies; it also paves the way for a subtle form of protectionism.

Moreover, the proposed minimum procurement volume of at least 10 billion Euros tempts the responsible parties to take questionable risks. While the Commission criticises public contractors for their unwillingness to take risks, their conduct is actually not only comprehensible but also appropriate: public contractors hold tax money in trust. They would quite rightly be held responsible were they to fall back on allegedly innovative products and services, which later might turn out to be faulty or inferior, rather than proven products and services.

Inevitably, the impression emerges that “European Innovation Partnerships” – through, amongst other things, the instrumentalisation of public procurement – are to be alienated to the benefit of industrial policy motives. Along with the aspired to “rapid modernisation of the associated sectors and markets”, this distorts competition to the benefit of the supported sectors and companies.

The inherent risk of an innovation progress indicator, which takes into account “fast growing innovative firms”, is that Member States specifically promote those companies analysed by the indicator in order to present alleged “successes” resulting from their innovation policy.

On the one hand it is understandable that politics wishes to measure innovation progress, but the Commission should take into consideration the concerns raised by the advisory group for the development of innovation indicators, set up by the Commission itself, according to which a one-dimensional indicator is “hardly” qualified to satisfy the complex demands of the innovation process (see Group [Report](#) of 30 September 2010, p. 4). Therefore, it should forego the development of its innovation indicator and instead focus on multidimensional monitoring.

Impact on Efficiency and Individual Freedom of Choice

The Commission completely fails to explain why it deems competitive markets incapable of finding efficient solutions to “major societal challenges” and yet is confident that the “European Innovation Partnerships”, that it plans to head itself, can. Especially in the case of complex problems it is more efficient if, as is common in competitive markets, the parties participating search for – a priori unknown – solutions in a

decentralised manner, than to use solution paths, which are developed during negotiations and are prescribed centrally. Admittedly, the aforementioned option bears the risk of doublings and failure. However, it is only through a variety of possible solution approaches that a solution can be found that later proves to be optimal, whereas **a centralised coordinated approach reduces the potential for solutions.**

Nevertheless, at times, state intervention can be necessary, even in competitive markets, e.g. in the interest of environmental protection. The European emissions trading system (EU ETS) is a good example of how regulatory intervention can be reduced to the necessary minimum and, at the same time, the search for the most efficient solution (here: the most cheaply CO₂ savings) be left deliberately to competitive markets (see [CEP Dossier](#) on EU climate protection, in German only).

However, it is **precisely in the case of the “European Innovation Partnership active and healthy living”**, proposed as the “pilot project”, that **state action is not**, as has been suggested, **“clearly” required**, nor is the confidence in competitive markets a “political unacceptability”. For even without state intervention large financial incentives still exist to develop healthy services and products. Apart from that, the Commission completely fails to explain its claim.

Impact on Growth and Employment

Successful innovations create not only jobs, as the Commission keeps emphasising, but at the same time kill jobs in traditional sectors and companies. This becomes critical where innovations can be implemented only through the help of state aid. To this end, the Commission should use the announced revision of the Community Framework for state aid for research development and innovation to establish stricter state aid rules, as currently Member States may grant large-scale aid for innovations. In fact, state aid is explicitly excluded in cases of “routinely” conducted changes to products and operation processes ([2006/C323/01](#), p. 17). However, the term “routinely” is extremely open to interpretation and therefore creates enormous scope for granting aid that distorts competitions to innovations that are conducted anyway.

Impact on Europe as a Business Location

An improvement of financing conditions would increase the attractiveness of Europe as a business location for research-intensive and innovative companies. Nonetheless, less research-intensive and innovative companies must finance this through increased tax and contribution rates.

Legal Assessment

Legislative Competence

Unproblematic. The EU is empowered to flank measures by Member States regarding research and technological development (Art. 179–187 TFEU). Also in industrial policy terms this is permitted for the purpose of an improved use of industrial potential (Art. 173 (1) TFEU).

Subsidiarity

Measures to complete the European Research Area or to establish a common research infrastructure have cross-border relevance. EU regulatory measures are therefore justified. In the first “European Innovative Partnership” for “active and healthy ageing” this is, however, not the case: the aspired to sustainable organisation of the health system is subject to the Member States’ responsibility.

Proportionality

Currently not assessable.

Compatibility with EU Law

Pursuant to the Directive on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (2004/18/EC) and the Directive coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors (2004/17/EC), it is in line with EU legislation to take into account innovation purposes when awarding public contracts, unless contractors are discriminated against. In practice, however, it is more likely that right from the start only certain companies can offer – alleged – innovations. Therefore, there is always an immanent danger of discriminatory side effects. This is probably also the reason why the Commission wishes to revise the two Directives in 2011: The possible use of public procurement for “other policy targets” is to be facilitated [see Commission Work Programme 2011 COM(2010) 623, Part II, S. 15].

Compatibility with German Law

Currently not foreseeable.

Conclusion

Removing regulatory barriers to cross-border research activities through the establishment of a “European Research Area” increases Europe’s potential for innovation. The instrumentalisation of public procurement for the promotion of innovation leads to massive distortion of competition and encourages a subtle form of protectionism. The Commission completely fails to explain why it deems competitive markets incapable of finding efficient solutions to “grand challenges”. Planning innovation through “European Innovation Partnerships” that it propagates instead, could be misused for industrial policy purposes and also lead to distortion of competition.