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NOTE

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Subject: *Preparation of the Council ("Competitiveness") of 20-21 February 2012*
European 2020 Strategy (Research part)
- Annual Growth Survey
- Policy debate

I. INTRODUCTION

1. The December 2011 European Council discussed ongoing efforts to lift Europe out of the crisis, and has called for the new economic governance embedded in the 2012 European Semester to be fully implemented with a view to building confidence in the strength of the European economy. Structural reforms and single market actions, together with fiscal consolidation, must continue to lay the ground for a return to sustainable growth. Science and research have a crucial role to play in identifying where structural reforms are needed and in designing smart, evidence-based public policies drawing on analysis of what works. This must be complemented by increased investments in research and innovation and other growth-enhancing areas.

The 2011 State of the Innovation Union report shows that Member States that traditionally invest more in research and innovation are weathering the current economic turmoil better¹. Assuring adequate access to capital for economic actors by restoring normal lending to the economy is very important in this context.

Innovation and research have been placed at the heart of the Europe 2020 strategy for growth and jobs. One of its headline targets is focusing on R&D: 3% of the EU's GDP should be invested in R&D. To implement this political focus, the Commission proposed the Innovation Union as one of the seven flagship initiatives of the strategy. First evidence on results shows very different patterns across Member States. For the research and development target, based on the national targets, the EU would still fall short of the 3% target. Quick action is needed, not only to protect these targets, but to increase R&D investments. A strong monitoring mechanism for measuring innovation performance and progress towards Europe's shared objectives is needed to identify the growth-enhancing measures that provide the biggest European added value and to steer the process of their implementation.

2. Good progress has been made in launching and implementing the Innovation Union commitments. There is a continuous need to seek additional and strengthened innovation measures to help put the European economy back on track and tackle our societal challenges.

The Innovation Union highlights the importance of partnering in European research and innovation as a means of "pooling forces to achieve breakthroughs". Partnering approaches can help to address major societal challenges and strengthen Europe's competitive position by making the R&I cycle more efficient and shortening the time from research to market. At the same time, an approach of over-coordination and heavy formal processes needs to be avoided. Public intervention aimed at stimulating business investments in new technologies, products and services in Europe is largely dominated by supply side measures, such as research and innovation grants, subsidised loans and tax incentives.

¹ COM (2011) 849

A stronger focus on demand pull and visibility of potential markets could encourage businesses to invest in the development of new products, services and processes. Public authorities could play a stronger role enabling efficient market pull. Public procurement of innovative goods and services is an important example of a demand driven measures. It relies on inducing innovation by specifying levels of performance or functionality that are not achievable with ‘off-the-shelf’ solutions and hence require an innovation to meet the demand.

The capacity of economies to adapt rapidly and to create sustainable new skilled jobs in emerging areas is a precondition for sustaining the European welfare and social model. The relative low capacity of innovative enterprises to grow in Europe, as compared to their competitors, has been identified by the European Council as a handicap for Europe's competitiveness. The benefits from a higher efficiency of the research and innovation system and policies, would be greatly enhanced if the Member States were giving a high priority to identify and remove obstacles to the growth of innovative firms of all sizes and in all areas.

3. As most of the research and innovation funding in Europe is at national level, a key question is which growth-enhancing measures are best undertaken at this level rather than at the European level where there is a need for clear EU-added value in terms of efficiency gains and large scale impact. This concerns in particular such issues as critical mass, simplification and streamlining, pooling and more efficient use of scarce public resources, by aligning research or procurement programmes across Member States, interoperability, and more rapid deployment.

II. QUESTIONS FOR THE EXCHANGE OF VIEWS

In the light of the overall context described above, and the food for thought provided by the Presidency progress report², the Presidency invites the Council ("Competitiveness – Research part") on 21 February 2012 to address the following questions focusing on research and innovation, with a view to contributing to the European Semester exercise. The Council members are invited to provide answer to one of the three questions:

1. Do you agree that research and innovation investments are crucial elements in the formulation of appropriate EU and national strategies to address the current crisis?
2. Given the good progress in implementing the Innovation Union, which additional measures would you prioritise to ensure the greatest chance of immediate economic impacts, e.g. further strengthening the partnering approach, better combining supply and demand side measures, removing obstacles to the growth of innovative firms?
3. Given the principles of subsidiarity, which growth-enhancing measures are best undertaken at the national rather than European level?

² Doc. 6279/12

ERAC Opinion on the Commission's Annual Growth Survey**INTRODUCTION**

European semester, approved by the Member states in 2010 aims at better coordination of budgetary and economic policies in EU, in line with both the Stability and Growth Pact and the Europe 2020 strategy. Semester starts each year in January after the Commission has published the Annual Growth Survey (hereinafter AGS), which outlines the priority actions at national and EU level for the next twelve months in order to ensure better governance and more coordinated policies. Based on the AGS, the member states identify main challenges at the Spring Council, which are taken up by Member States in their National Reform Programmes (NRP) and Stability or Convergence Programmes (SCP) in April. The Commission assesses these programmes and proposes for each Member State a set of country-specific recommendations, which are then endorsed by the European Council and adopted in the form of Council recommendations or opinions.

On 23rd of November, the Commission published its second AGS 2012³ marking the start of the second “European Semester”, which also emphasises the need for implementation of actions agreed on EU level.

The European semester in research and innovation: Progress one year on

AGS 2012 reviews the implementation of priorities agreed a year ago. In this respect it acknowledges that growth-enhancing structural reforms were initiated in the areas of research, development and innovation.

Among the activities initiated last year, ERAC would like to particularly emphasize the start of ERA framework consultation. Also, following the Conclusions of the European Council⁴, the Commission had proposed a Directive on public procurement⁵, which covers in particular procurement of innovative goods and services and a Regulation on European Venture Capital Funds⁶ aimed at removing bottlenecks to cross-border operation of venture capital. In addition, Council adopted conclusions on the modernisation of higher education⁷ while a number of member states reviewed their national research and/or innovation systems⁸.

Regarding the R&D expenditure, a slight decrease is observed on the EU level in 2010 (2.01 to 2.00% GDP in 2010). However, considering the GDP increase of 2% in 2010, most member states have increased their R&D budgets despite the unfavourable economic and fiscal situation, with total investment exceeding the one of the peak year 2008.

³ European Commission (2011), ‘Annual Growth Survey 2012’, Communication from the Commission, COM(2011) 815 final, and its Annexes.

⁴ Conclusions of the European Council (4 February 2011), EUCO 2/1/11.

⁵ European Commission, Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on public procurement, 2011/0438 (COD).

⁶ European Commission, Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European Venture Capital Funds, 2011/0417 (COD).

⁷ Council conclusions on the modernisation of higher education (28 and 29 November 2011), based on Communication from the Commission: Supporting growth and jobs - an agenda for the modernisation of Europe's higher education systems (20 September 2011).

⁸ Non-exhaustive list of member states with a new R&D and/or I strategies includes AT, NL, PL and SI.

MAIN MESSAGES OF AGS 2012 RELATED TO RESEARCH AND INNOVATION

AGS 2011, which was published roughly a year ago, strongly focused on urgent fiscal consolidation, addressing macro-economic imbalances and structural reforms and proposed actions aimed at strengthening the recovery in the short-term.

AGS 2012 focuses on five priorities: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness; tackling unemployment and the social consequences of the crisis; and modernising public administration.

Research and innovation is covered to various degrees throughout AGS 2012, as indicated in Annex.

A shift towards growth enhancing policies

Compared to AGS 2011, a major shift is observed in AGS 2012, which acknowledges the need for longer-term policies in increasing the EU's future growth. It stresses that with strained public finances, there is very limited room for fiscal policy to boost growth, which has a strong impact on future growth prospects. It also notes that the situation is exacerbated by the increasingly competitive global environment, with emerging economies rapidly “climbing up a technology ladder.” As emphasized in AGS 2012, there is no longer a distinction to be made between the short and the long term measures, as the latter have an immediate impact on the countries' borrowing costs. It urges member states to prioritise growth-friendly expenditure, such as research and innovation, which is an investment in future growth, and places emphasis on growth-enhancing policies.

FOCUS ON THREE GROWTH-ENHANCING POLICY OBJECTIVES

In line with its advising function and consistent with AGS 2012 call for implementation of what has already been agreed, ERAC proposes that Member States and the Commission focus on three specific growth-enhancing research and innovation policy objectives, which are addressed by a number of measures agreed on EU level. In this respect, ERAC particularly welcomes the recent Mutual Learning Seminar, organized by the Commission, which offered high quality information and provided for exchange of experiences on ways in which research and innovation policies can contribute to the enhancement of economic growth.⁹

1. Increase of public sector effectiveness

In times of fiscal consolidation and economic crisis, it is especially important to optimize public investments. As the majority of R&D budgets in Member States are directed at the European science base (universities and research institutions), it is important to carefully examine that the funding is delivered in a way that increases social return and impact economic growth. There is certainly room for improvement. While there are big differences between Member States, EU public research sector in general under-performs in both the quantity of scientific publications per researcher, the quality of output and the exploitation of the knowledge generated when compared to the US.

In order to increase the contribution of European science base to socio-economic objectives base ERAC invites:

- Member States to accelerate the implementation of reforms of universities and research institutions. This calls for their structural reorganisation and their diversification, linking of higher education, research and business, as well as promotion of competitive funding models based on performance and results^{4,10}, **according to identified national gaps and priorities.**

⁹ Ken Guy, Lena Tsipouri, Erkko Autio, Report on the 2012 ERAC Mutual Learning Seminar on Research and Innovation Policies http://ec.europa.eu/research/innovation-union/index_en.cfm?pg=keydocs.

¹⁰ ERAC opinion on Modernisation of Universities (ERAC 1211/11).

- the Commission to propose a framework to remove remaining obstacles in order to complete the European research area and to create a genuine single market for knowledge, research and innovation^{4,11}.

2. Design of balanced policy mixes of supply and demand side measures and their governance

A balanced mix of supply and demand side policies as well as a governance system, including public private partnerships is needed to optimize the outputs of public investments, stimulate development of innovative products and contribute to growth of innovative businesses.

Public intervention aimed at stimulating business investments in new technologies in Europe is largely dominated by supply-side measures, such as research and innovation grants, subsidised loans and tax incentives, which constitute over 90% of measures listed in the joint inventory of Erawatch and Trendchart.¹² The imbalance between the supply push and demand pull, along with limited influence on the governance of innovation systems, prevents businesses from maximising their R&D investments and development of new products, services and processes, due to the lack of visibility of potential markets, resulting in sub-optimal efficiency of both, supply and demand-side measures. Despite the overwhelming data demonstrating the positive effect of demand side measures, which aim at creation of markets, either public (through e.g. public procurement) or private (through e.g. standards, regulations), as well as political emphasis¹³, their development in Europe is rather slow. To some extent this could be explained by a lack of experience in some Member States with demand side measures and higher risks associated with them, as compared to the supply side instruments. In fact, development of balanced supply and demand side policy mixes strongly depend on the increased culture of risk taking and tolerance of failure associated with it, equally relevant for the public administration as it is for the businesses and industry.

In order to stimulate the design of balanced policy mixes of supply and demand side measures ERAC proposes that:

¹¹ ERAC Opinion on the development of the ERA Framework (ERAC 1205/11).

¹² Lena Tsipouri, Combining supply- and demand-side measures to stimulate business investments in new technologies and innovative products, Background paper for the mutual learning workshop on high-growth entrepreneurship policies Brussels, January 24, 2012.

¹³ Council conclusions on Europe 2020 Flagship Initiative: "Innovation Union": Accelerating the transformation of Europe through innovation in a fast changing world, as adopted by the Council ("Competitiveness") at its meeting on 25-26 November, 201017165/10.

- Member States and the Commission review their sets of support measures in order to create a balanced policy mix of supply and demand side measures as well as a balanced governance system, including public private partnerships, adapted for specific situations.

The Commission is invited to catalyse the process of policy learning related to the development of innovative solutions to enable efficient market pull;

- Member States make a strategic use of public (including pre-commercial) procurement of innovative goods and services¹¹ in order to improve efficiency and quality of public services, as well as to contribute to future growth. Where appropriate, Member States may consider setting a measurable target, to be used as stimulus to increase the dedicated public efforts, contribute to monitoring of the implementation, as well as to increased tolerance towards failure;
- the Commission provides support to networking and coordination activities which will help public procurers to test common approaches, establish buyers groups and organise joint procurement in an effective way.

3. Removal of bottlenecks to the growth of innovative enterprises

Fast-growing innovative firms are an essential factor in a country's growth and innovation performance. In fact, studies show that only a small proportion of all new firms are responsible for the majority of job creations¹⁴. Yet despite their importance to the economy, the limited data available demonstrates that Europe is falling behind US in terms of fast growing innovative firms. The weakness was also recognized by European Council⁴ which invited the Commission to assess how to best meet the needs of fast growing innovative companies through a market-based approach, as well as Competitiveness Council⁹ which proposed measures such as improved access to finance and the role of competitiveness clusters in order to improve their growth prospects. Yet the bottlenecks are many and varied among Member States and regions, spanning from access to capital, tax systems, single market to IPR policies and cost of patents.

¹⁴ Erkkko Autio, Background paper for the mutual learning workshop on high-growth entrepreneurship policies.

In view of this discussion ERAC proposes that:

- European Commission and Member States continue the development of a headline innovation indicator for Europe 2020, in line with conclusions of European Council⁴, based on the share of fast-growing innovative enterprises, if feasible.
- Member States identify the bottlenecks preventing the development of fast growing innovative enterprises in their national context and develop comprehensive policies aimed at stimulating their growth. The Commission is invited to provide methodological and ad hoc support;
- the Council adopts the Regulation on European Venture Capital Funds¹⁵ in order to remove the obstacles to cross border operation of venture capital funds.
- Member States submit their input to the consultation on the Review of the EU state aid rules for research, development and innovation.¹⁶ ERAC welcomes the Commission's intention to submit a draft of the reformed EU state aid rules for RD&I for public consultation in 2012.

Finally, ERAC wishes to express its commitment to the implementation of Europe 2020 and will remain actively involved in the follow-up on the Annual Growth Survey and future European Semesters. ERAC will review the progress in relation to the three growth enhancing policies presented in its opinion. Member States will be invited to report on progress in view of the next Mutual Learning Seminars.

¹⁵ European Commission, Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European Venture Capital Funds, 2011/0417 (COD).

¹⁶ Consultation on the Review of the EU state aid rules for research, development and innovation (R&D&I)
http://ec.europa.eu/competition/consultations/2012_stateaid_rdi/index_en.html

Annex
Research and innovation in AGS 2012

The text below contains parts related to research and innovation in the main body of AGS 2012.

Under priority 1: Pursuing differentiated growth-friendly fiscal consolidation

“Prioritising growth-friendly expenditure, such as education, research, innovation and energy which are an investment in future growth, and ensuring the efficiency of such spending.”

Under priority 2: Restoring normal lending to the economy

“Working with the European Investment Bank to maintain and increase its SME loan activity at a sustained pace, while developing synergies with the European Investment Fund through risk-sharing operations, and the establishment of a funds-of-funds to provide capital to funds that targets investments in more than one Member States.”

Under priority 3: Promoting growth and competitiveness for today and tomorrow

(...) “there are two specific obstacles for the EU in comparison to a number of other major competitors: first, the Europe-wide market is still too fragmented and does not allow firms to grow and enjoy the same economies of scale; second, several framework conditions – from access to finance to innovation capacities or regulatory obstacles – are less conducive for firms to create and invest.”

Under priority 4: Tackling unemployment and the social consequences of the crisis

Further adapting education and training systems to reflect labour market conditions and skills demands (...)

“Reviewing the quality and funding of the universities and considering measures such as the introduction of tuition fees for tertiary education, accompanied by student loan and scholarship schemes, or alternative sources of funding, including the use of public funds to leverage private investment.”

Under priority 5: Modernising public administration

“Where absorption rates of EU structural funds is low, building administrative capacity (...) to ensure speedier disbursement of unused funds on growth-enhancing projects (...)”

The list of EU proposals to be accelerated

It includes several key initiatives of Innovation Union, i.e. the unitary European patent, the modernised European standardisation system, the EU VC passport and the revised public procurement framework.

Country-specific recommendations regarding research and innovation in European Semester 2011

(i) Direct relevance for R&I

Italy:

Improve the framework for private sector investment in research and innovation by extending current fiscal incentives, improving conditions for venture capital and supporting innovative procurement schemes.

The Netherlands:

Promote innovation, private R&D investment and closer science-business links by providing suitable incentives in the context of the new enterprise policy (‘Naar de top’).

Poland:

(...) Strengthen links between science and industry by implementing the ‘We build on Knowledge’ programme (‘Budujemy na Wiedzy’). Implement the higher education reform programme ‘Partnership for Knowledge’ (‘Partnerstwo dla Wiedzy’) so as to better align educational provision with labour market needs.

(ii) Indirect relevance for R&I

Slovakia:

Speed up the implementation of planned general education, vocational education and training reforms and take steps to improve the quality of higher education and its relevance to market needs.(...)

The UK:

Implement the planned fiscal consolidation aiming at a deficit of 6.2 % of GDP in 2012-2013, (...). Ensure no slippage from the ambitious spending reduction targets, thereby strengthening long-term sustainability; and, subject to this, prioritise growth-enhancing expenditure.