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ETNO Expert Contribution on Community Framework for State aid for Research and Development and Innovation

Executive Summary:

ETNO generally welcomes the proposed framework but thinks it requires some important adjustments to create legal certainty and be compatible with the Action Plan objectives. Focusing on smaller players may lead to the consequence that whole sectors of the European economy, in particular the most strategic ones such as ICT, could a priori not be allowed to benefit from state aid. The proposal oversees the safeguard that dominant market leaders are subject to stringent ex ante rules, preventing them from enforcing their dominance. The Commission should use the tool of state aid to maximise the specific activity of RD&I and prefer other ex post competition law tools to correct eventual anti-competitive behaviour. Given the application of stringent ex ante rules, we consider that the existence of a general interest and a market failure are necessary and sufficient conditions for granting state aid.

Introduction

After the State Aid Action Plan and the Communication on State Aid for Innovation, the Commission is considering creating a framework for R&D and Innovation, on a more economic-based approach. To this purpose the Commission has recently launched a second phase consultation on the Draft Framework, which will expire on October 13. This document summarises ETNO's views on the matter.

ETNO views on the draft Community Framework

Generally speaking, the proposal is to be welcomed since for the first time the Commission is considering to support state measures in favour of "innovation". Moreover, the Commission considers extending in the future the scope of the block exemptions, currently limited to SMEs.

However, the proposal requires **some important adjustments** in order to create legal certainty and to be compatible with the objectives set in the Action Plan.

According to the Commission's Communication of September 2005, "state aid can in some cases effectively and efficiently contribute to foster innovation, when it addresses market failures that hamper the innovation process without excessively distorting competition". Indeed, the Commission considered that since the level of RD&I spending in the EU is low, in particular by the private sector, the EU could benefit from an increase in the level of RD&I. The current working document eliminates these references, and seems to consider that the main aim of this framework is to facilitate that Member States better target the aid to the relevant market failures. This seems to reveal an approach mainly aimed at limiting state aid rather than at elaborating strategies to boost innovation.

This is confirmed if we consider the provisions related to large companies or companies holding a dominant position. Indeed, according to the proposal it seems that the Commission's main concern in the process of granting state aid for RD&I is that competing companies' dynamic incentives to invest can be distorted and possibly reduced.

Also, where the balancing test is concerned the proposal considers that when the aid beneficiary is a large company, the incentive effect of aid requires a specific demonstration. In this respect, the Commission should realise that the application of this principle may limit too much state aid for innovation since it is difficult to prove in practice that companies (in particular large companies) would not have make the RD&I effort (or to quantify the additionality).

The Commission's proposal gives too much relevance to the size and market power of beneficiaries: indeed, the proposal seems to consider as dominant companies those holding a 25% market share.

This approach is in full contradiction to the current practice in the electronic communications sector, according to which companies might only have a significant market power when holding a market share of around 50%. It is to be underlined, however, that the formal assignment of SMP status to an e-communications operator must be supported by the existence of other deciding factors.

The approach adopted in the present working document does not seem to consider that in innovative markets, market share is just one of the factors influencing market power (more relevant are, for instance, entry barriers) and that in any case market shares can be rapidly challenged by competitors.

The practical application of this approach may lead to the consequence that **whole sectors of the European economy, in particular the most strategic ones such as ICT, could a priori not be allowed to benefit from state aid**, with dramatic impacts in terms of overall lower growth and employment.

Indeed, markets with a high innovative nature are characterised by a high level of uncertainty and risk in terms of return on investment and in many of these, research activity is carried out mainly by dominant companies. In Italy for instance, Telecom Italia's corresponding investments in the telecommunications sector account for 90% of the total enlarged sector (140 mln euro in 2004). Moreover, in the assessment of state aid, the Commission should take into due consideration that in innovative markets, the temporary presence of SMP steered actions is often positive for the overall economic system since the benefits stemming from innovation overcome possible distortion of competition.

Furthermore, the working document does not take into due account that in a regulated industry such as telecommunications, RD&I is carried out mainly by large and dominant companies, which are subject to stringent **ex ante rules** that do not allow dominant company to enforce their dominance. Indeed, ex ante rules requires dominant companies to transfer the benefits of economies of scope and scale to competitors and to consumers.

In applying the balancing test i.e. in the evaluation of the competitive advantages that state aid granted to dominant companies may have which can balance the competition distortions, the Commission should also consider that the use of ICT technologies has important **spill-over effects on the whole economy**. Indeed, large and dominant companies play a pivotal role in innovation by mobilising knowledge and financial and human resources. Therefore, it would be counterproductive to exclude them from aids: this would weaken Europe's global competitiveness.

The Commission should realise that there are other factors that can avoid the risk of dominant companies enforcing market power, in particular the provision of open and transparent selection processes, which can contribute to spreading innovation without leading to the exclusion of efficient competitors. On the contrary, the Commission seems not to give too much relevance to this element.

In conclusion, the Commission should use the tool of state aid for innovation in order to maximise the specific activity of RD&I and prefer other ex post competition law tools to correct eventual anti-competitive behaviour. Given the application of stringent ex ante rules, we consider that **the existence of a general interest and a market failure are necessary and sufficient conditions for granting state aid**.