Lead markets initiative and Pre-commercial procurement

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January 2006: **Aho** report

- create **innovation-friendly markets**: harmonised regulation, use of standards, public procurement drive, competitive IPR regimes
- facilitate **mobility**: finance / venture capital, human resources
- focus use of **research and innovation resources**: clusters, excellence centres, technology platforms

Demand drive for innovation: a new policy dimension

- September 2006:
  - Communication on "A broad-based innovation strategy”
  - Highlights the importance of the demand-driven innovation
    - announced a proposal for a new "lead market initiative“
    - Announced measures on public procurement

- December 2006: Competitiveness Council
  - endorsed proposal, invited Commission
    - to "elaborate a valid approach for fostering the emergence of markets with high economic and societal value“
    - to clarify how public procurement can be used

Commission's response

- By the end of 2007:
  - Commission Communication on "Lead Markets
  - Commission Communication on "pre-commercial procurement
- February 2008
  - Competitiveness Council's KIP
    - Welcomes the two Communication
- Spring 2008
  - Council conclusions on pre-commercial procurements and Lead markets
- EP possible reports on the two initiatives.

Lead market: what is it?

- Lead market = "A **market** where an **innovation** is first **widely used** that later becomes **successful internationally**"

- A market
  - for **innovative** products and services with high **growth** potential
  - R&D & innovation intensive,
  - based on increased public and private customer need/demand
  - where **EU industry** can develop competitive advantage to lead in international markets
  - EU knowledge and industrial basis to capitalise on investments in promising new technologies

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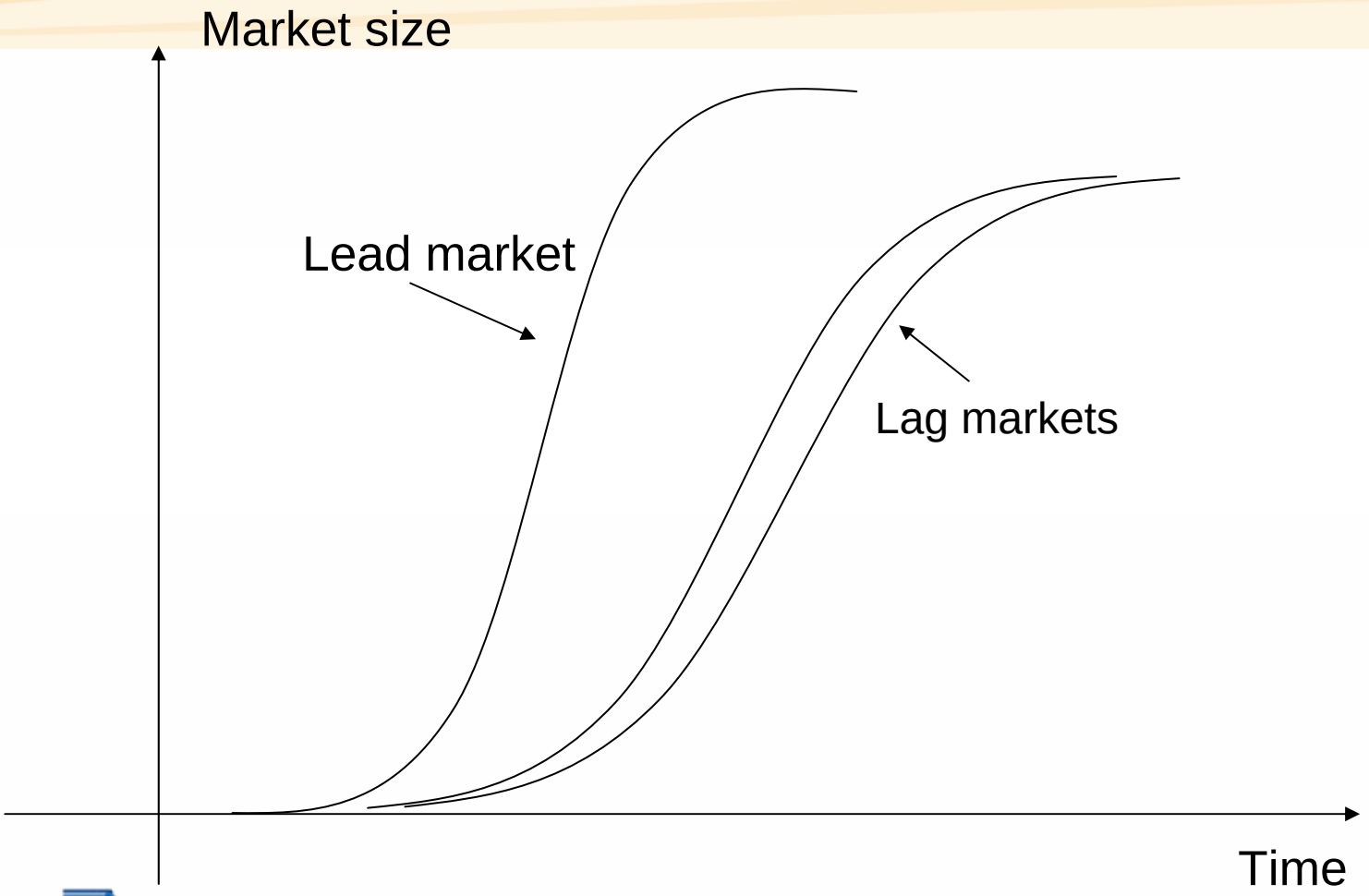
Lead Markets: What is it?

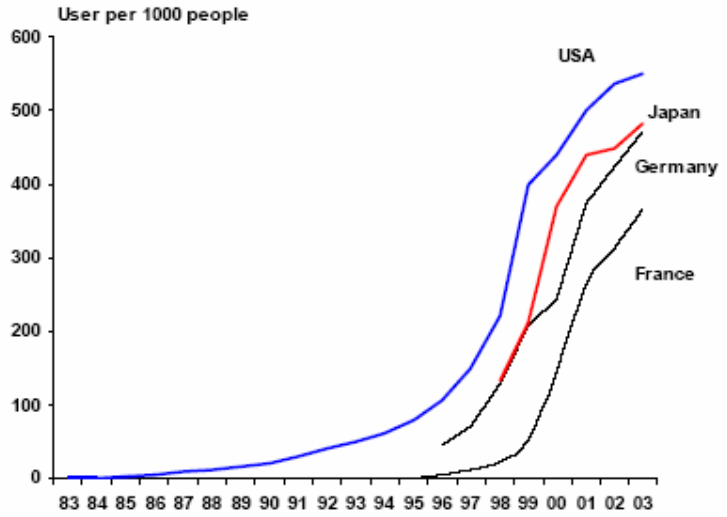


Why Lead Markets?

- Firms in the lead market become global market leaders.
  - Exports are substantial.
- International competitiveness is sustainable
  - successive generations of products are adopted earlier.
- Are often characterised by a high degree of competition
  - and lower prices for users.
- Help keep larger manufacturing capacities at home
  - in order to guarantee superior quality and allow for quick responses to varying local markets trends.
- Lead markets are attractive as an investment location
  - In particular, the influx of marketing and R&D functions ensure a large proportion of high skilled jobs.

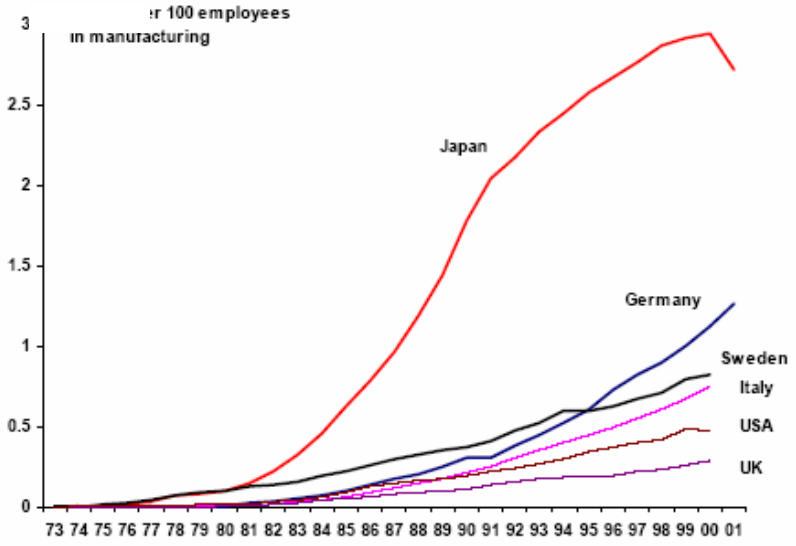
Examples

: Diffusion of Internet in selected countries



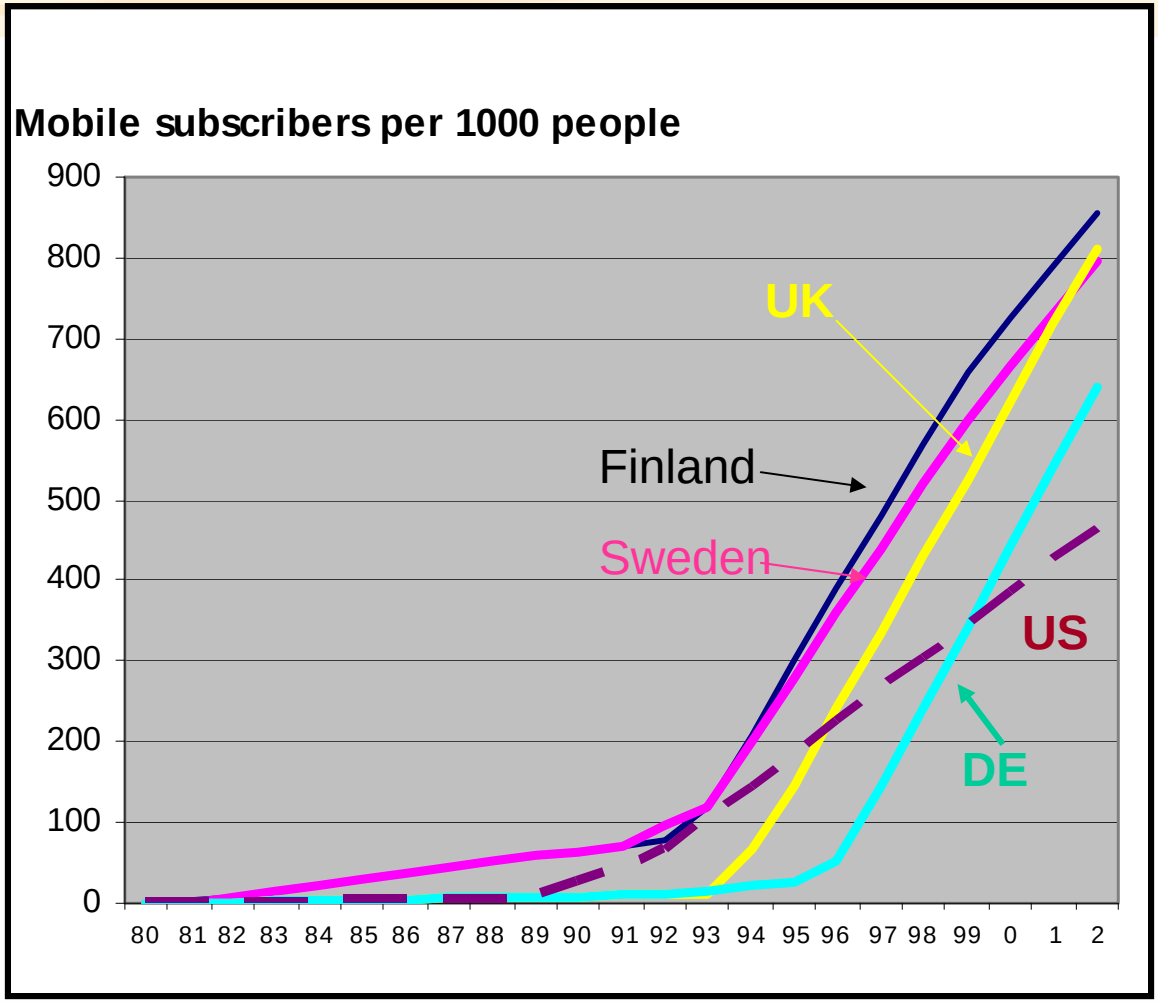
Source: ITU.

Figure 6.3: International adoption of robots in manufacturing



Source: IfR, OECD.

Examples


Mobile subscribers per 1000 people
900
800
700
600
500
400
300
200
100
0
80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 0 1 2
UK
Finland
Sweden
US
DE

Obstacles for the development of LM

- Fragmented product/service markets:
  - e.g. in eHealth: Large diversity of non-compatible products; None or too many standards; Lack of systems interoperability and scalability …
- Multiple levels of regulations and requirements:
  - e.g. in eHealth: Data protection directive; Reimbursement rules; Liability legislation …
- Risk- / innovation- / reform-averse authorities
  - e.g. in eHealth: Lack of demonstrated evidence; No arrangements for technology assessment, certification and conformity …
- Insufficient availability or access to finance

Public intervention (1)

- Speeding up the business framework conditions for lead markets to emerge
  - Better articulation between demand-side and supply-side
  - Synergies between policy instruments at EU, national, regional,..
- Regulatory measures and IPR issues:
  - regimes necessary for markets to emerge
  - e.g. eHealth: Clarify sharing personal healthcare data;
- Standardisation:
  - help identify emerging needs and speed up their agreements
  - e.g. eHealth standards for authorisation process for access to patient's summary;

Public intervention (2)

- Public sector, acting as a first buyer
  - public sector markets represent >40% of GDP in Europe but in general,
    - these markets make little use of new technologies,
    - they are often fragmented and difficult to access for SMEs
    - Europe spends less than 2 B€ on pre-commercial public procurement; the US 50 B€.

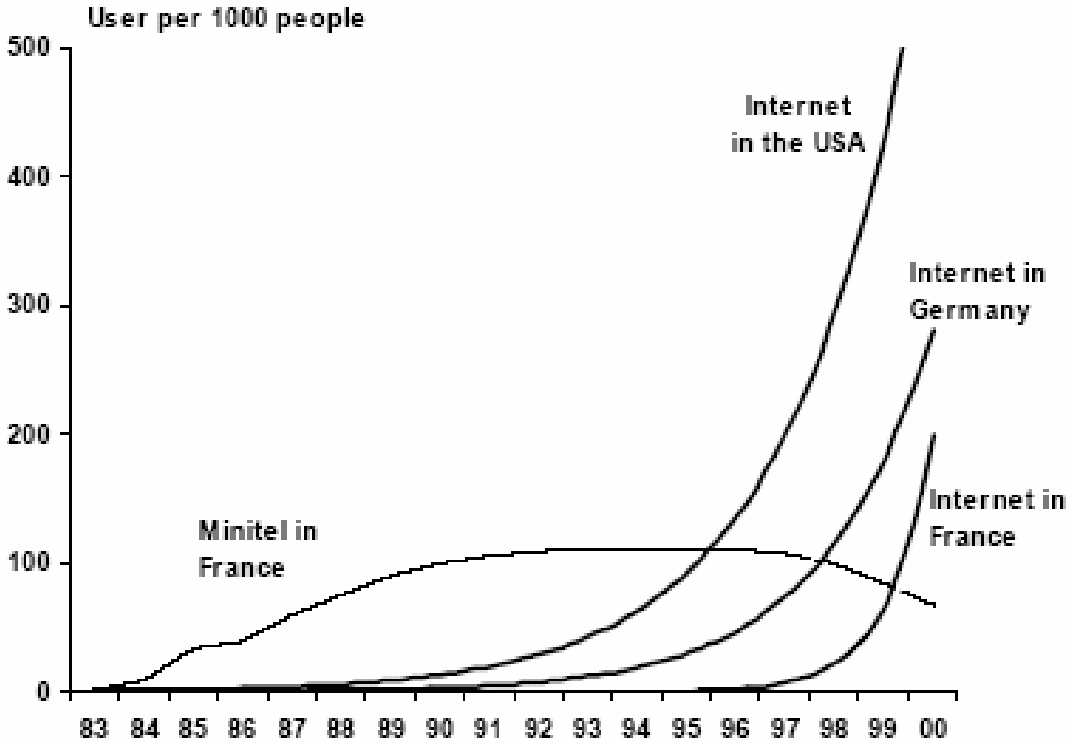
- Alleviate mobilisation of finances
  - banks, EIB Group, Venture Capital …

What to avoid?

- Focus on international markets upfront
  - Focus only on local market leads to negative effects
- No competition: High cost of production
- Choosing a winning technology
  - Neutrality is essential with regard to the choice of technology, i.e. the policy should allow for
    - competition between competing innovations;
- Incompatibility with policies designed to support the innovation process,
  - i.e. policies to protect intellectual property, correct for knowledge spillovers, or combat credit

Example: local markets only are considered

Graph 6.4: Minitel and Internet penetration rates in France, the US and Germany



Source: ITU, Beise (2001).

Lead Markets Initiative

- Communication on LMI: adopted Jan 2008

- Objective:
  - create favourable framework conditions for market developments
  - through public policy measures
    - Legislation / Regulation
    - Standardisation, labelling and certification
    - Public Procurement
    - Complementary Instruments (training, networking)

Lead Markets Initiative

- 6 LMI areas identified with action plans
  - eHealth
  - Protective Textiles
  - Sustainable construction
  - Recycling
  - Bio-based products
  - Renewable energies
- Show by example what could be done in concrete areas

Pre-commercial Procurement: What is it?

- A specific approach for public sector to procure R&D ensuring
  - Benefits and risk sharing between procurers and suppliers
  - Competition and transparency in the procurement process
  - Compliance with the legal framework
    - Internal markets rules, procurement rules, State aid rules

Why is it important?

- Because procurement of R&D is important:
  - to bring essential improvements in quality and effectiveness of public services
  - to strengthen the innovation capacity of the EU and to reinforce industrial competitiveness

Why the Communication is important?

- Because procurement of R&D is under-utilised in the EU
- ..and when it is now done
  - It does not always ensure best value for money for procurers
  - It does not always lead to innovations in the market
- Because a main concern of procurers is how to do it within the legal framework.
- Because there is value in collaboration at EU level
- Because Commission needs to respond to Council's request
  - Role of public procurement in innovation
    - Already issued: handbook on procuring commercially available innovations
  - An important element of demand driven-innovation policies, e.g. Lead Markets,…

A growing demand for innovation in areas of public interest

- Europe's public sector faces major challenges
  - Health, sustainability, ageing, inclusion, security, transport,..
  - Several EU Member States are today world-wide references
    - Quality, inclusiveness and efficiency of public services
  - A position to be strengthened & more widely spread

- Success factors
  - Long term thinking and strategies for public services
  - Embracing innovations at the earliest possible
    - Driving, and benefiting from innovations to fit the needs of our citizens and businesses

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Responding to the demand drive for innovation: more can be done

- Private sector: to be able to compete
  - takes up innovations at the earliest possible
  - procures innovative products and services commercially available, or procures R&D to explore possible new solutions

- Public sector: can do better
  - 45-50% of EU GDP, Public procurement is 17% of EU GDP
  - Why does EU public sector not procure innovative products and R&D with an intensity equal to its weight in economy?
    - e.g. ICT public sector market is only 14% of total ICT market

Procurement of R&D is used by our competitors: e.g. the US case

US*

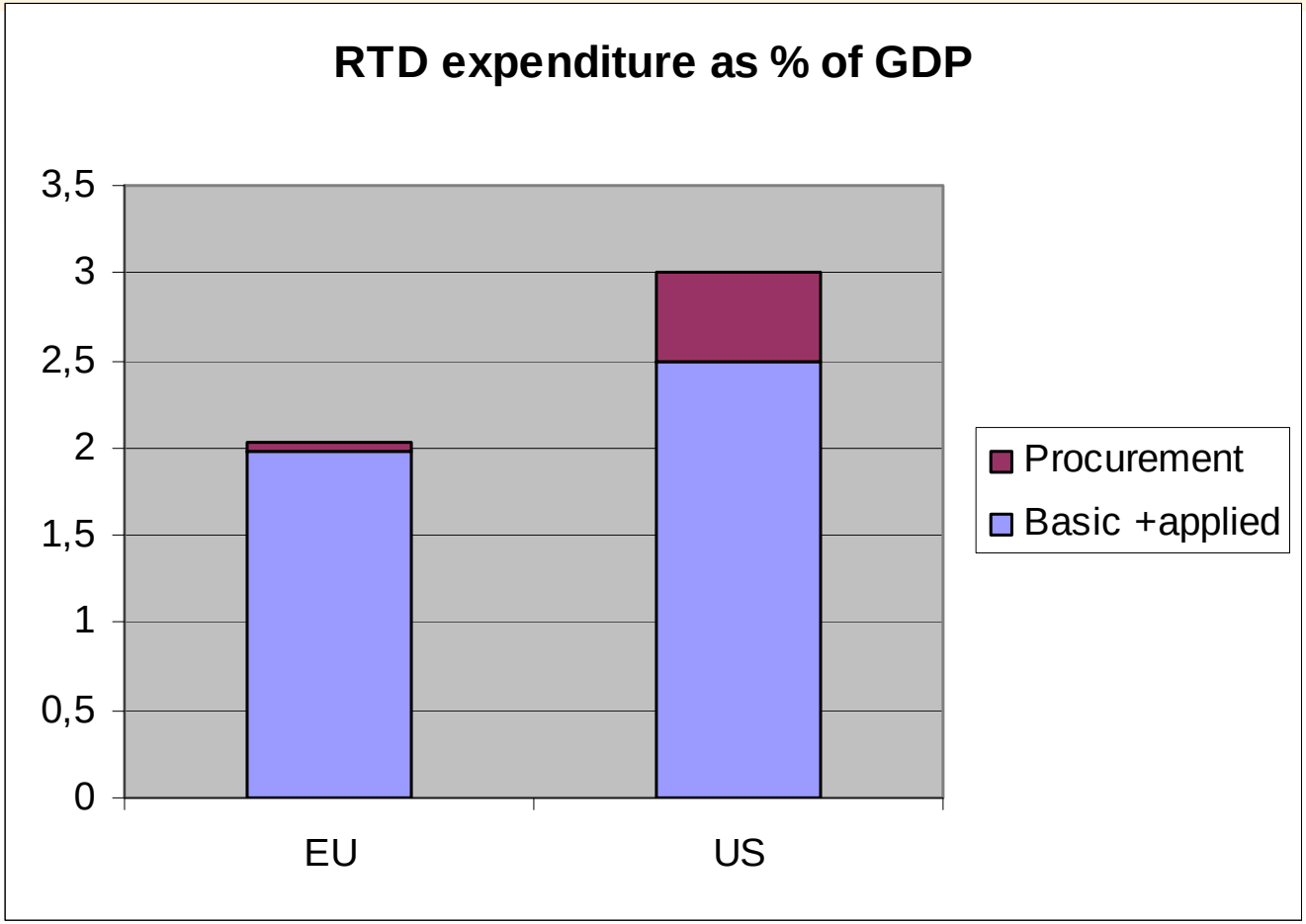
- Similar procurement budget as EU but,…
- 20 times more on R&D procurement than Europe (~50 B€/ year)
- Preferential policies by exception to WTO GPA
- Defence is dominant though (difference 4 instead of 20 times in non-defence areas)

EU*

- So far, procurement marginal role in innovation…
  - ~2.5 B€/year
- Highly fragmented public procurement
- …but growing interest
  - UK, NL, FR,..
- Other areas than defence!!

* 20 times difference in R&D procurement is observed between two markets with comparable total procurement expenditure (EU wide tendered vs US federal government procurement market)

Procurement of R&D can fill half of EU-US R&D gap



Barriers

- Lack of awareness
- Unclear how to do it within the legal framework for R&D procurement
- Fragmentation of demand
- Commission Communication addresses the 3 barriers

The legal framework is no hurdle

- Public Procurement directives 2004/18&17/EC:
  - Procurement of R&D services
  - If benefits only for the procurers than the directives apply
  - If benefits shared by procurers with e.g. suppliers, then directives do not apply, internal market rules only (articles 16f & 24e)

- Treaty Principles / State aid rules
  - If competitive, transparent, non-discriminatory procurement, done at market price, then procurement of R&D services is not considered State aid

- WTO Government Procurement Agreement
  - Procurement of R&D services outside WTO GPA

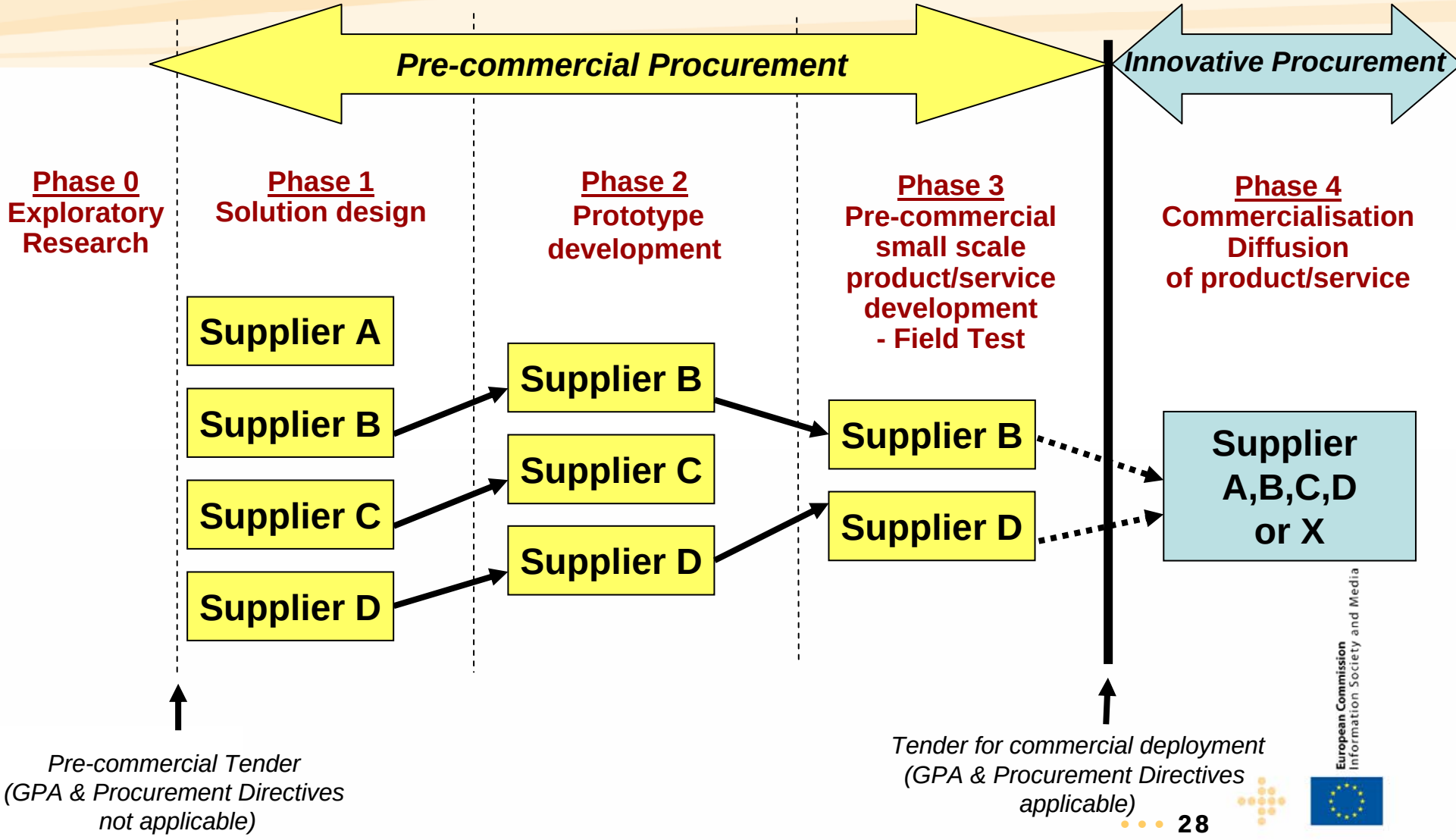
Current practice in EU: often no risk-benefit sharing, no competition

- Procurer pays high dev. price in exchange for all R&D benefits
- High R&D procurement cost
  - little incentive for procurers to share info with other procurers
- No benefit (IPR) sharing
  - suppliers not allowed to exploit innovations to other customers

Best practice: risk-benefit sharing at market price and under maximum competition

- Risk-benefit sharing, a key success factor
  - Financial compensation reflecting benefits shared with suppliers
    - E.g. Procurers leaving IPR ownership with suppliers in return for discount, free usage rights and right to license to 3rd parties
  - Risk-benefit sharing to be done at market price
    - No state aid
- Competition ensuring best value for money
  - Competitive development in phases
  - Separation of R&D phase from contract for large roll-out

Pre-commercial procurement: an example of an open framework ensuring mutual benefits



Based on good practice

- Procure R&D in steps (solutions, prototypes, test series) to reduce risk and give SMEs a chance
  - Grow size of tasks gradually, make bridge from ideas to first test product, procurer = SME first customer reference
- Risk-benefit sharing with suppliers
  - Less risk procurer, commercialisation opportunity suppliers
- Competing development with multiple suppliers
  - Better value for money. US defence report: in-development competition reduces first unit acquisition cost with 20-30%*
- Sharing R&D costs with other procurers
  - Cooperation across borders can help develop a European market and common standard

* 'Competitive Dual Sourcing', Jacques Gansler, 7/10/2007. Based on analysis from Annex G, 'International Armaments Cooperation in a era of coalition security', report US Defence Science Board, August 1996

Actions proposed

- Launch debate with MSs
  - Identify concrete mid-to-long terms public challenges requiring development of new technological solutions
  - Discuss the potential role of pre-commercial procurement in the innovation policy mix in meeting these policy objectives

- Based on outcome debate, Commission will come back with proposals for action (2H 2008)
  - Awareness raising, mobilising stakeholders, etc..
  - Networking / new platforms of cooperation for procurers

Feedback Parliament

- PCP communication presented to some MEPs
- Positive reactions:
  - Link with Structural funds
    - (PCP as tool to reinforce EU cohesion policy)
  - Interest to create debate,
    - plan own intiative report of EU Parl internal market committee on PCP
  - Appreciate IPR risk-benefit sharing
  - Interest for SMEs to participate

Feedback COR – DG Regio - EIB

- Committee of Regions
  - Announced interest to launch own report on PCP
  - Discussions planned on cooperating to reach the European cities and regions (networking)
- DG Regio
  - Discussions planned on link with structural funds
- EIB
  - Discussions ongoing on link with EIB /EIF financing schemes

Feedback Council

- LMI, PCP & VC communication were presented simultaneously to Council
- Joint Council conclusions planned in May
  - Still under current Slovenian presidency
- Member State feedback PCP
  - All MS positive (except Germany sceptical that procurement is right way to stimulate innovation)
  - Asking Commission to come with concrete proposals that provide incentives
    - to facilitating networking between procurers
    - to kick-off first showcase PCP pilot projects

How to move on... Bottom-up and/or Top down?

- Big top down projects
  - In areas of common opportunity to create European lead markets as well as better and more efficient public services
  - E.g. climate change, energy efficiency, health, ageing population, security
  - *Ideas for concrete INFSO pilot projects?*

- Bottom up programme
  - Supporting PCP project proposals from groups of procurers from around EU that are interested to cooperate
  - *Short term (FP7-WP09): could be via ERA-NET+*
  - *Longer term (2013…): could be via new programme*

Who are public procurers?
(List of authorities per country in Annex of PP directives)

- PP Directive 18: public authorities in large sense
  - Not only administrations, also most hospitals etc
- PP Directive 17: utilities in water, energy, transport and postal services sector
  - Bodies established for meeting needs in public interest
    - Governed by public law (state financed, or mgt supervision by state, or 50% mgt appointed by state)
    - Undertakings over which public bodies have influence (shares, votes, appointing mgt by state)
    - Entities which receive special rights from a public body (e.g. regulatory, legislative or administrative provisions which limit competition to other entities)

Networks of procurers across EU MS
How to establish this?

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Three way collaboration
How to establish this?