Intelligence Briefing| Wednesday, 29 June 2016

How does Brexit impact Government R+D Funding for UK based Companies?

Summary

- Access to EU funding for UK companies is unlikely to be affected in the short-term.
- Access to EU funding for UK companies post-EU secession will largely depend on the UK government's ability to negotiate a favorable association deal.
- A potential European R+D investment short-fall may force the UK government to reconsider its intention to replace grant funding instruments with loan schemes.

Last week the United Kingdom held a public referendum on the country's continued membership within the European Union (EU). The final result revealed a small majority of UK voters are in favour of leaving the EU. The decision to leave, if enacted by the UK government, is likely to have significant implications for UK-based companies who strategically leverage government funding instruments, both national and European, to bring innovative technologies and solutions to market. The following report examines how the interests of these companies are likely to be affected in the short and long-term with the caveat that the decision of a Member State to secede from the EU is unprecedented, and that EU Treaty provisions referring to such a withdrawal process are poorly defined, and provide limited guidance. The analysis reflects our understanding of the legal and political situation as it stands today.

Access to EU funding

Today companies operating out of the UK are eligible for a variety of EU grant funding instruments, such as the Horizon 2020 Framework Programme. With more than a 1.000 companies having participated in the programme to date, the UK is currently the fourth largest participant, having received 12% of the available funding for private companies. Withdrawing from the EU means UK companies forego their automatic right to such instruments. UK companies potentially face a funding shortfall, and in future, may need to shoulder more R+D investment costs themselves. Participation in EU projects may also become more complicated, and UK companies will be less well positioned to extract non-financial benefits accrued through pan European R+D collaborations, such as access to latest technologies developed by European researchers or expansion of value chains through work with European industry and SMEs.

Official guidance regarding the future right of access to EU funding for UK companies is still forthcoming. Informally, most experts are confident existing EU projects involving UK companies are unlikely to be affected, nor are pending project proposals or project proposals UK companies intend to submit for EU funding before the end of 2017. For the time being the UK is still full EU member, enjoying full member rights. The UK will continue to hold full EU membership until the date it formally seceded, which is unlikely to be until at least late 2018, if not later. Access to EU funding for UK companies beyond 2018 is less certain, and will largely depend on the exit agreement negotiated by UK and EU decision-makers. Based on a review of various existing agreements between the EU and third countries, the following models for accessing EU funding seem most plausible:

- **Association.** The best case scenario would see the UK be granted the status of an *Associated Country*. This entitles UK organisations, including private companies, to apply for direct EU funding without any restrictions. In return for unrestricted access to EU R+D funds, the UK will most likely need to abide by the majority of existing European laws, including EU laws safeguarding the freedom of movement for European citizens – a law which many UK citizens reject, and cited as a major reason for wanting to leave the EU. The UK will also need to contribute to the EU's research budget, although it will not have a formal channel for influencing how this budget is to be spent – i.e. the definition of research priorities and the implementation innovation funding programmes.

- **Partial Association**. If full *Association* cannot be secured, a second option to be considered is *Partial Association* agreement*.* An agreement of this type is currently in place between the EU and Switzerland. *Partial Association* gives the UK government more leeway as to the EU laws it abides by, and provides UK organisations, most likely academia and research institutes, access to a limited number of EU funding instruments focusing on research infrastructure and basic research. UK companies would not be hindered from participating in projects supported by EU funding, however UK companies would not receive any grant support for their contributions. To make up for this shortfall, the UK government may establish mechanisms for supporting their companies in EU projects. The risk of this approach for UK companies is that the UK government may restrict the amount of funding available (e.g. European funding can cover up to 100% of a company's project costs, whilst UK funding instruments usually cap project reimbursement at 50% of project costs). Under such an arrangement, European partners may be more reluctant to work with UK companies on collaborative projects, because the UK partner's funding will be subject to different conditions which could affect the smooth execution of the project. Finally, whilst the UK may favour such an agreement, the appetite of EU decision makers for it remains to be seen. *Partial Association* could be seen as the UK picking and choosing the EU bits it likes most. Following Brexit, European decision-makers will want to unequivocally demonstrate that a country's interests are best served within the EU club.

- **Third Country.** A *Third Country Association* agreement would see UK organisations hold the same status as organisations operating out of the United States, Canada, and China. These organisations are able to participate in most EU projects but are not eligible for direct EU funding (with few exceptions), and in many cases not supported by national governments. In addition, projects including third country organisations must convincingly argue why the addition of such an organisation is justified, and why their contribution could not be sourced from an EU organisation. For many UK companies these consequences present significant obstacles to their future participating in EU projects. It would be regarded as a diplomatic failure if the UK government could not secure a better deal for UK companies than a *Third Country Status* and we do not expect this to happen unless the UK government takes the decision to fully break off its relationship with the EU, or if the predetermined timeline for concluding withdrawal arrangements is overrun.

<u>National funding</u>

The UK's decision to leave the EU is likely to impact the funding distributed to UK companies via national funding agencies. In the short-term, Brexit induced economic disruption may decrease the total amount of money the UK government is able or willing to invest in innovation support instruments. This may lead to less innovative projects being funded. Furthermore, uncertainty regarding access to EU funding streams, real or imagined, is likely to push UK companies to national funding programmes, hereby increasing the competiveness of programmes and lowering the rates of success. The UK government's innovation funding delivery plan for 2016 and 2017 has already been adopted, and funds earmarked. We therefore do not expect this plan to be significantly impacted by events linked to Brexit.

To maintain the innovation leadership of UK companies, the UK government must act swiftly to fill any investment shortfall left due to restricted access to EU funding programmes. Its willingness to do so will be seen in the following months and years. A less than encouraging sign, in late 2015, the UK government signalled its intention to gradually replace financial grant instruments with loans and other financial products over the next 5 years. Many believe government loans do not provide sufficient incentive for companies to make significant private investments in R+D. In light of the referendum and the country's expected EU exit, the government may well revise its policy direction, though this is yet to be determined.

In the medium to long-term, once the UK's economic situation is stabilised, it is entirely possible that UK funds, which had once been earmarked as contributions to the EU budget, could be redirected to the UK's national funding programme, and to support UK companies participating in EU projects (See *Partial Association* and *Third Country Association* above).

Concluding remarks

The UK's imminent secession from the EU raises countless questions for innovative companies, at least in the medium-term. Many of these questions cannot be definitively answered today and understandably this a cause of uncertainty for business leaders. What was true yesterday, is true today, and will be true tomorrow: innovation does not respect geography, nor does it care much for politics. UK companies will continue to innovate, and there will always be a mutual benefit for these companies to pursue partnerships with their European neighbours. Regardless what form it may eventually take, we are confident the UK and the EU will define a working relationship to enable cross-border R+D collaboration in the future.

About us

LNE Group is an international government funding and government relations consultancy, working with clients in the United States and Europe. We believe governments are technology development partners that can promote innovation and create new market opportunities for ambitious technology leaders. We provide our clients with customised advisory services aimed at securing government support for their research and innovation initiatives.

LNE Group is advising companies on the implications of Brexit for their business. Services being provided include political risk, policy intelligence and government relation advisory services. For more information on how LNE Group can support your organisation, please contact:

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